Here's Why I'd Avoid Bank Stocks After the Bank of Canada's Latest Rate Decision

Description

The **Bank of Canada** — on Wednesday — announced its decision to keep the overnight rate unchanged at 0.25%. It also kept the bank rate of 0.5% and a deposit rate of 0.25% intact. It was the fourth time in a row when the Canadian central bank has kept its key policy rate unchanged since March 2020.

Fears of recession

Earlier in March, when the COVID-19 started spreading at a fast pace across North America, Bank of Canada took the unprecedented move of cutting the key interest rates thrice within a month from 1.75% to 0.25%. Rising fears about one of the worst recessions ever and weakening investors' confidence were two of the main reasons that led to Bank of Canada's swift actions earlier this year.

The central bank avoided using words like *recession* and *downturn* its latest statement. However, the statement gives multiple warnings to bank investors if you carefully read between the lines.

Low interest rates are taking a toll on the banking industry

While the low interest rates lead to higher housing demand by encouraging consumers to borrow from the banks, they're not necessarily good for the banking industry, as they directly affect banks' margins.

For example, **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) highlighted the low interest rate environment as one of the key factors pressurizing its margin in its latest quarter. **Royal Bank of Canada** (TSX:RY)(NYSE:RY) — the largest Canadian bank — attributed its lower earnings from personal and commercial banking as well as from wealth management and treasury services to lower interest rates.

Similarly, low interest rates (along with the pandemic) have been affecting the core banking operations of the **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM) for the last couple of quarters.

Weakness in core banking operations

Notably, all three banks — RBC, CIBC, and TD Bank — managed to beat earnings estimates in the third quarter. On the one hand, their capital market volume rose significantly; but their core banking operations suffered heavily due to the ongoing pandemic and low interest rates on the other. This is one of the reasons I've been arguing against buying bank stocks since these banks reported their Q3 earnings in August.

More reasons to worry

Apart from the risk of lower interest rates affecting the banking industry, the Bank of Canada also admitted that "the pace of the recovery remains highly dependent on the path of the COVID-19 pandemic and the evolution of social distancing measures required to contain its spread."

Of course, everything the central bank said in this statement makes sense, and the pandemic-related uncertainties make the economic condition very predictable. But I wouldn't want to block my money by investing in bank stocks when even the central bank is unsure about the prospects of economic recovery.

Bank stocks could fall

The shares of RBC, CIBC, and TD Bank are down by 5.1%, 3.9%, and 12.6%, respectively, on a year-to-date basis. However, CIBC stock has inched up by nearly 10% over the last month. During the same period, TD Bank stock and RBC stock rose by 4.1% and 2.2%, respectively.

I don't find many supporting reasons for the bank stocks' recent gains except that their higher capital market segments gave a boost to their recent quarterly earnings. But I consider this positive trend in the capital market segment volume to be temporary.

Foolish takeaway

Till the time I don't find a concrete factor to drive a sustainable recovery in their personal as well as commercial banking operations, I'd definitely want to avoid buying bank stocks. And you probably should, too — unless you have a huge risk appetite and are up for a bumpy ride in the short to medium term.

Instead of adding risky stock to your stock portfolio, you should focus on diversifying your portfolio at the moment. Doing so with a sense of urgency is important as the market volatile as significantly risen lately. The volatility could continue to be high in the next few months due to multiple factors, including the prolonged pandemic, emerging U.S.-China tensions, and the U.S. election.

CATEGORY

1. Bank Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:CM (Canadian Imperial Bank of Commerce)
2. NYSE:RY (Royal Bank of Canada)
3. NYSE:TD (The Toronto-Dominion Bank)
4. TSX:CM (Canadian Imperial Bank of Commerce)
5. TSX:RY (Royal Bank of Canada)
6. TSX:TD (The Toronto-Dominion Bank)

PARTNER-FEEDS

1. Business Insider
2. Koyfin
3. Msn
4. Newscred
5. Sharewise
6. Yahoo CA

Category

1. Bank Stocks
2. Investing

Date
2025/07/20
Date Created
2020/09/10
Author
jparashar