All Big Bank Stocks Could Go Downhill Fast

Description

The surprisingly rapid recovery in stock markets after the March low has left investors and analysts astounded. With markets looking like they will be back on track to pre-pandemic levels soon, it feels like investors can take a breather.

However, there are signs of major trouble ahead that you cannot ignore. As the real estate bubble keeps getting ripe to burst, financial institutions that rely heavily on mortgage income could face problems.

The real estate market

Despite the challenging situation, the real estate market has stood out as being quite odd. While it faced an initial decline, the average selling price of residential properties has continued to soar. The low interest rate environment in Canada is encouraging an increasing number of people to pump more money than they might be able to afford into real estate.

Additionally, the lower interest rates are taking a toll on financial institutions. With lower interest rates, more people are buying houses. To get the upfront capital, Canadians are borrowing money from banks, and the low interest rate is affecting the banks' margins.

The **Bank of Canada** announced that it would retain the overnight rate of 0.25% with a 0.25% deposit rate and a 0.5% bank rate. The bank took the unprecedented move of cutting key interest rates thrice in a month from 1.75% to 0.25%. With fears rising about one of the worst recessions ever, banking investors might see significant short-term trouble.

Strong recent run

Royal Bank of Canada (TSX:RY)(NYSE:RY) has recently reported a healthy income in its latest quarter. Like some of its peers, RBC managed to beat earnings estimates. After the initial outbreak, RBC's earnings fell by almost 60% in one quarter. Most of the loss was due to the need to increase provisions for credit losses (PCLs).

Banks need to estimate defaults and set aside funds to cover them. When the PCLs go up, earnings decrease. RBC managed to lower its PCLs in the third quarter of 2020. Despite its increase in earnings, the low interest rates continue to take a toll on its margins.

The danger of a housing market crash or a second wave of infections still loom overhead. In case any of the two events happen, banking stocks like Royal Bank of Canada could take a serious tumble. It is even possible that the next market crash could be worse than the one we saw in March.

Foolish takeaway

Top financial institutions like RBC still look like safe long-term bets for investors. However, if you are an older investor with a shorter investment horizon, you might want to reconsider your position in banking stocks. A housing market crash could send your portfolio reeling from double-digit losses.

If you have a long investment horizon, you might hold on to your shares and wait for banking stocks to recover. I would advise re-evaluating your position in Canadian banks and look towards safer investments if you want to protect your capital.

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adamothman