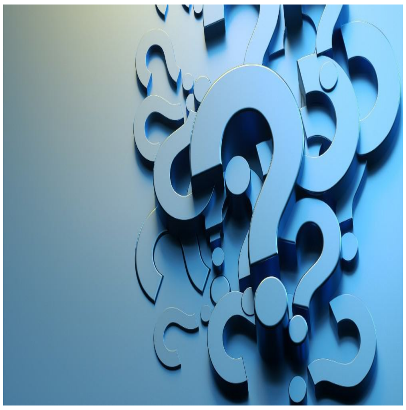

Billionaire Diaries: What's With Warren Buffett Selling Bank Stocks?

Description

Many things have been changing lately. They aren't going as they are supposed to. Going by the textbook, the stock market should fall when the economy contracts. But that is not happening. The government distributed cash to Canadians to spur spending, but they are instead saving. Billionaire investor Warren Buffett should be buying in the market crash, but he is selling. What is leading to this change?

Warren Buffett: The change in how money works

It's time to change the textbook, because the way the money works has changed. Buffett is changing with time. In an ideal world, you put money in the bank and earn a compounding interest rate. But the fiscal stimulus package has changed everything. How did the U.S. and Canadian government manage to release US$2.2 trillion and over $150 billion in the fiscal stimulus in the pandemic?

Governments are printing money and reducing interest rates to nearly zero and, in some cases, even negative. This means you will pay to keep your money in the bank. The way the money works has changed. The governments have pulled off this arrangement for over a decade since the 2009 financial crisis.

The government's fiscal stimulus package put money in the hands of Canadians, and they saved it. Because of the near-zero interest rates, investors are putting money in the stock market, driving it to new highs, while the gross domestic product (GDP) contracts.

Warren Buffett sells bank and finance stocks

This free money individuals are getting from the government is reducing Buffett's confidence in the financial sector. Hence, his company **Berkshire Hathaway** has sold more than US$6 billion worth of stake in not one, not two, but nine U.S. bank and finance stocks, including **JPMorgan Chase** and **Wells Fargo**. He completely exited his **Goldman Sachs** position. However, he increased his stake in **Bank of America** to 11.9% by adding US$2 billion worth of shares.

What made Buffett anti-finance? He said that banks are good businesses, as long as they don't make major mistakes. What mistakes did banks do to be abandoned by one of their top shareholders?

If you see carefully, bank stocks have failed to recover from the March sell-off, while the overall stock market recovered significantly. The **BMO Equal Weight Canadian Banks Index ETF** is down 14%, while the **TSX Composite Index** is down less than 2%. Bank stocks are underperforming the market, as they face a looming default wave.

Banks' profitability is at stake

As part of the fiscal stimulus package, the government offered loans and mortgage deferrals. As this deferral period ends and unemployment remains high at 10.2% (in August), there are fears of credit losses. The top six Canadian banks have set aside $6 billion in provision for credit losses in the third quarter of fiscal 2020.

Although Canadian banks are well capitalized to bear the losses, the magnitude of default is unknown. Once the defaults start coming in, it would take a long time to recover the payments, and this would impact their profitability.

Among the top six Canadian banks, **Scotiabank** and **TD Bank** (TSX:TD)(NYSE:TD) have the highest provision for credit losses (PCL).

TD Bank has PCL of $6.3 billion in the first nine months of fiscal 2020. It's fiscal 2020 third-quarter earnings per share fell by 23% year over year. Its return on equity fell to 10% from 15.8% in the same quarter last year. Its profits are falling, even though the defaults have not yet begun. The bank is preparing for the worst. Hence, its stock is down 17% year to date.

Investor corner

Warren Buffett saw the profit hits coming for a longer term. He cashed most of his bank stocks, as he doesn't see them recovering in the near term. In these already uncertain times, it is better to avoid bank stocks, as they are doomed to see profit cuts in the near term.

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