Warren Buffett: 2 Stocks to Avoid This Year

Description

The year 2020 is a classic example of the unpredictable nature of the stock market. The factors that influenced the stock price movement have changed. Hence, the **TSX Composite Index** surged 16%, even when the gross domestic product (GDP) contracted 38.7% in the second quarter. The factors driving the stock market rally was the government stimulus package that increased household disposable income by 10.8% in the second quarter. Canadians invested this money in tech stocks and gold stocks.

What is Warren Buffett up to?

However, traditional businesses continued to perform in tandem with economic growth. This year, the market saw some unusual moves by the Oracle of Omaha, Warren Buffett. Instead of buying at the dip, he is selling at the dip. He exited his entire position of $6 billion in airline stocks and has, so far, sold another $6.9 billion worth of stocks in nine U.S. banks and financial stocks. However, he is buying more stocks of **Bank of America**.

You may question Buffett's investments in tech and gold stocks, but you don't question him on bank stocks. He is the one who made money from the 2009 financial crisis by investing in bank and financial stocks. Then why is he selling them now?

The central bank reduced the interest rate to nearly zero and offered loan deferrals as part of the stimulus package. These deferrals will end in October and November, thereby exposing banks to a large number of defaults. Moreover, many capital-intensive companies like airlines and energy have withdrawn their revolving credit facilities and taken short-term loans to maintain liquidity to withstand the crisis.

The rating agencies have already downgraded airline debt to high risk "BB-" ratings. If these companies file for bankruptcy, it could lead to more bad debts for banks. He probably expects bank stocks to hit rock bottom once the default figures are out. Then he might invest in distressed banks.

The fact that Buffett stays invested in Bank of America is because it has a lower risk of default than other banks.

How to play the Buffett card with TSX stocks

The Toronto Stock Exchange is dominated by the Big Five banks. All the banks have sufficient liquidity to withstand the crisis. They have also set aside provisions for credit losses. The credit defaults would significantly impact the profitability of these banks this year and probably the first half of next year. That is when some of these stocks might hit the bottom.

Among the top five banks, **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) and **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS) reported some of the steepest dips in net income and return on equity (ROE) in the third quarter of fiscal 2020.

- TD Bank's net income fell 30% year over year (YoY), while its adjusted ROE fell 580 basis points to 10.4%.
- Bank of Nova Scotia's net income fell 47% YoY, while its adjusted ROE fell 600 basis points to 8.3%.

Hence, their stock prices did not recover significantly from the March sell-off and are still down 16% and 26%, respectively. They are trading below their 50-day moving average and are unlikely to recover this year. They might fall further if the reported defaults are greater than expected.

You might buy these bank stocks now for their high dividend yields. TD Bank stock has a dividend yield of 5.18%, and Bank of Nova Scotia has a yield of 6.6%. But note that they have paused their dividend growth until further notice. It might take at least two years for the banks to return to increasing their dividends.

Investor corner

If you want to walk Buffett's path, wait for the above two bank stocks to fall in the second market crash and then buy them at the dip. If you are in it for dividends, there are stocks like **Enbridge** and **RioCan**, which have dividend yields as high as 8% and 10%. They offer a better risk-to-reward ratio.

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