Will Canadian Banks Spoil the TSX Rally Next Week?

Description

The Santa Claus rally has arrived a tad early this year. Driven by the vaccine news, the otherwise muted November has brought more than 11% gains for the **TSX Index.** However, broader markets face the moment of truth as Big Six Canadian banks plan to release their fiscal fourth-quarter earnings next week.

Canadian bank stocks are the biggest constituents of the TSX Index. One can expect a strong dominance of these stocks on the index movement for the next few weeks. The TSX Index has soared more than 55%, while Canadian bank stocks at large have surged 45% since the respective pandemic lows in March.

Canadian banks to report earnings next week

The biggest among them, **Royal Bank of Canada** (TSX:RY)(NYSE:RY) will report its quarterly earnings next Wednesday. The sequential growth both on revenues as well as on the earnings front might see some lift.

However, it might take years to reach 2019 profitability levels. The strong performance of the capital market segment will likely remain the bright spot once again. Surging markets added record profits for almost all banks in the fiscal third quarter, and the trend could continue in Q4 as well.

Royal Bank has already set aside $3.5 billion in provisions for bad loans in the last two quarters. Its cautious provisioning will likely curtail the dent in the upcoming quarterly earnings.

No increase in dividends

Canadian regulators have barred banks and financial institutions from increasing dividends or buying back shares due to the economic fallout. Although that might hurt investors in the near term, cash retention is more vital for banks to weather the crisis. Royal Bank will pay a dividend of $4.32 per share in 2020, implying an annualized yield of 4%.

Toronto-Dominion Bank (TSX:TD)(NYSE:TD), the second-biggest bank by market cap, will report its quarterly earnings next Thursday. While a resilient housing market and increasing repayments from borrowers could underpin banks' earnings, higher deposits and lower interest rates could impact their margins.

TD stock has soared 45% since its record lows in March. It yields 4.4%, higher than TSX stocks at large.

I don't see any substantial movement in Canadian bank stocks driven by their upcoming earnings. While quarterly earnings growth could remain subdued, their strong balance sheets and attractive dividend profiles might continue to attract long-term investors.

Bank of Nova Scotia (TSX:BNS)(NYSE:BNS), the country's third-biggest bank, will report earnings on Tuesday. Apart from its earnings, how Scotiabank's management looks forward to 2021 will be a key driver for its stock. Notably, it is the cheapest stock from the valuation standpoint among the Big-Six Canadian banks.

Broader economic recovery in 2021

A sooner than expected vaccine launch could remarkably alleviate uncertainty and could restart corporate investments, which will once again boost employment and help the economy get back on track.

Certainly, it will take time. But I'm expecting a strong comeback in the second half of next year, assuming the vaccine reaches a large population by then. Limited restrictions and promising changes on the vaccine front should drive the economic recovery.

If you are not looking for substantial gains in the short term, but stability and dividends are your priority, then Canadian bank stocks should be your bet.

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vinitkularni20