Investors: Canadian Bank Stocks Are Still Ridiculously Cheap

Description

One of the biggest takeaways from 2020 was to never count out the Canadian banks. Even if the macro environment is weak, and the situation seems hopeless, betting against the banks can be harmful to your wealth. Going against the grain, while painful, can literally pay huge dividends for those with the stomachs and a long enough time horizon.

Even though you'd run the risk of looking like a fool (lower-case *f*, folks!), sometimes you've just got to hold your nose and do some buying when the stock market is collapsing under its own weight. The Canadian banks are Dividend Kings with unmatched track records, not only for paying out some of the oldest dividends but also recovering rather abruptly from crises.

Never count out the Canadian banks!

In prior pieces, I've strongly urged investors to load up on the Canadian banks while they were priced at steep discounts to their intrinsic values. Many analysts turned their backs on the banks, and they had a plethora of reasons to do so. But for those seeking yield and a shot at outsized capital gains, the banks were among the best of bets in town. And although baked-in headwinds gave the impression of extreme risk, the banks were actually the least risky they've ever been with their wide margins of safety back in the ominous depths of March.

Well, hindsight is 20/20. But if you sided with history and bet on the banks in spite of the circumstances, you were rewarded with a quick gain, as you "locked in" your enhanced dividend yield. Today, the steals are all but gone, and the swollen yields have mostly reverted towards their historical mean levels. That said, the banks still look cheap, given their profitability prospects beyond 2021.

The worst is now in the rear-view mirror

This pandemic caused a provisioning storm like no other for most-affected banks like **Bank of Montreal** (TSX:BMO)(NYSE:BMO), which came into the crisis with a big chunk of oil and gas (O&G) loans. The O&G field was probably the ugliest place to be in when the markets tanked in early 2020.

But as it turned out, fears, panic and excess pessimism were overblown beyond proportion, leaving calm, calculated investors with an opportunity of a lifetime.

With the COVID-19 pandemic likely to end in late 2021 or early 2022 thanks to a handful of safe and effective vaccines, the banks suddenly look investible again. In prior pieces, I've warned that investors would have to buy before the coast was cleared by a vaccine breakthrough if they wanted to get the biggest yield and the most upside. With many big banks just a few percentage points away from their all-time highs, the banks may be viewed as a missed opportunity by many who didn't buy earlier last year.

The Canadian banks aren't done yet

With valuations on bank stocks still at the lower end, though, and the potential for rising interest rates over the next decade, I think the banks are just getting started. If all goes well with the economy's recovery in 2021, I wouldn't at all be surprised to see names like BMO soaring to new heights.

While it would have been nicer to buy BMO stock at a 20% discount to its book value rather than the 20% premium that now exists (shares trade at 1.2 times book today), I'd argue that BMO stock is still ridiculously undervalued, given the 1.5 times book industry average and the potential for longer-term earnings growth prospects that may still be discounted by investors and analysts.

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