Canadian Banks Could Surge Amid Inflation Fears

Description

That was quicker than expected. Inflation expectations are growing, with bond yields continuing their ascent above the 1.5% mark. In numerous prior pieces, I urged investors to load up on Canadian bank stocks before stimulus-induced inflation jitters, and interest rate hike woes had a chance to grip the markets.

"The post-pandemic world is up ahead, and with talks of rate hikes that could start coming in over the next few years, it's not too far-fetched to think that top financials could be ready to enter the early innings of a multi-year rally." I wrote back in February.

"Canadian banks have been depressed for far too long. And they may be ready to make up for lost time, as they endure another several years' worth of thin net interest margins (NIMs) en route to what could be a rising rate environment that could be in the cards in as little as four years."

Rate hikes: Just a matter of time?

I thought it would just be a matter of time before U.S. Federal Reserve chair Jerome Powell would be forced to hit the rate hike button again. There was always the possibility that the Canadian and American economies (and inflation) would run the risk of overheating in its climb out of the coronavirus recession, sparking the need for quicker-than-expected rate hikes. The possibility of overheating may be turning into a probability, given the latest action in the bond market.

While there's no telling whether inflation jitters will pressure Powell to make a move sooner than he said he would, I do think it would be wise to punch your ticket to a Canadian bank stock before we even have a chance to be thrown into a rising-rate environment, especially if you followed the recommendation of certain sell-side analysts who turned their back against the Canadian banks prior to the 2020 U.S. presidential election.

The Canadian banks are still screaming buys

Sometimes it pays dividends to be a contrarian, even if there are few, if any, catalysts on the horizon, and seemingly insurmountable headwinds that would make you look like a fool (that's a lower-case "f") for going against the popular opinion. I recommended buying the battered banks like **TD Bank** when analysts slapped shares with a downgrade. And just a few months later, after an epic run, I'm still a raging bull on the Canadian bank stocks, even though traditional valuation metrics suggest they're fully valued.

The biggest bargains and steals in the Canadian banking scene may have vanished in recent months. But if you think we're in for quicker-than-expected rate hikes, TD Bank and its Big Six peers still seem too cheap for their own good at this juncture.

Rate hikes could turn the tides in the favour of the big banks, as the weight is gradually lifted off of their ridiculously-thin net interest margins (NIMs). For now, the Fed maintains its dovish stance. They want employment to recover first. However, the bond market action, I believe, suggests that Chairman Powell may have no choice but to hike rates sooner than expected, perhaps far sooner.

So much for the "lower for longer" environment?

Even if rates stay depressed for longer and U.S. bond yields pullback below 1% sometime soon, I'm still an advocate for buying Canadian banks here if you're a long-term investor. Whether rates start rising next year or in four years from now, the banks will eventually see headwinds replaced with tailwinds and their price of admission will likely rise, perhaps way up. In the meantime, the big banks will find many other ways to make money while rates are low.

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