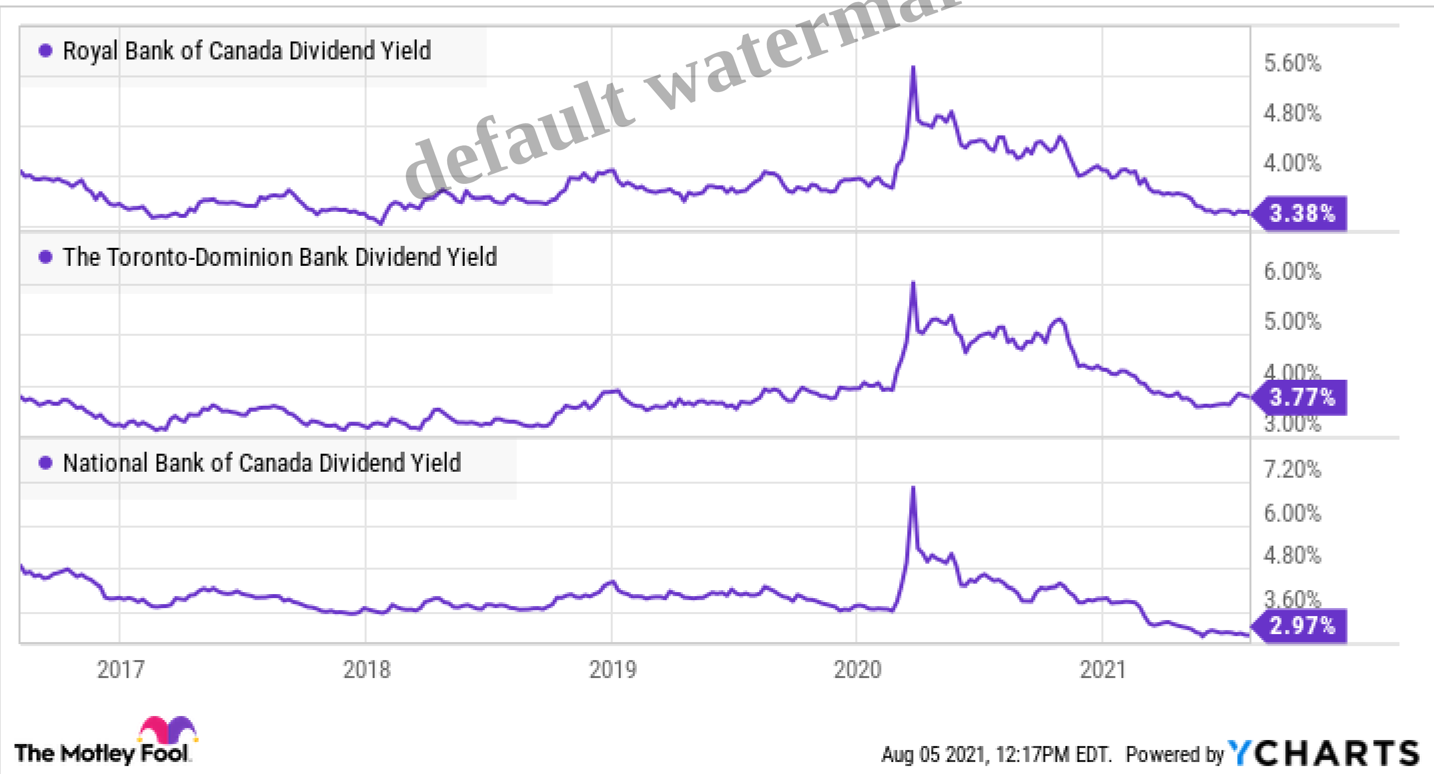
Canadian Bank Stocks: Should You Buy, Hold, or Sell?

Description

The Canadian bank stock yields are relatively low to their historic levels, which has made it lacklustre for some investors to hold. The five-year dividend yield graphs illustrate this.



RY Dividend Yield data by YCharts.

There are two reasons for this low yield phenomenon. First, the Canadian bank stocks have made a tremendous run from the pandemic market crash last year. In fact, they have exceeded their pre-pandemic highs.

Second, regulators have cautiously prevented the banks from increasing their dividends. For example, **Royal Bank of Canada**

(TSX:RY)(NYSE:RY) and **Toronto-Dominion Bank** have maintained the same quarterly dividend for six consecutive quarters. **National Bank of Canada** has frozen its quarterly dividend for seven quarters.

The banks' earnings drop in fiscal 2020 were primarily due to higher provision for credit losses as the banks anticipated high levels of bad loans from the pandemic.

However, net impaired loans turned out to be much lower than expected. Specifically for Royal Bank, its net impaired loans in fiscal 2020 only rose 5% to $2.2 billion versus fiscal 2019, equating to only 0.3% of total loans and acceptances.

As a result, we are witnessing a strong rebound in bank earnings this year, as they reduce their provision for credit losses from an improving economic outlook as we navigate the pandemic situation.

Should you buy Canadian bank stocks today?

Ideally, you would have bought the solid Canadian bank stocks during the pandemic market crash when they were cheap. However, if you're just looking at the banks today, they're not bad buys. Overall, they're reasonably valued, and you can expect dividend increases to resume once the bans from regulators are lifted.

For example, Royal Bank's payout ratio is only estimated to be about 40% this fiscal year versus its five-year average of roughly 48%. So, it could very well make a bigger hike in its next dividend increase.

If you have no Canadian bank exposure, it could make sense to buy some at today's fairly valued prices.

Who should hold Canadian bank stocks?

The Canadian bank stocks have long since been a part of diversified long-term investment portfolios. As they have demonstrated by maintaining their dividends through economic distress (the 2020 pandemic, the 2007/2008 global financial crisis, etc.), the banks are solid dividend payers. So, there's a place for them, particularly in dividend stock portfolios.

The Canadian bank stocks aren't trading at outrageous valuations. So, from a valuation perspective, it doesn't warrant selling. They also pay safe dividends that are expected to grow steadily over time. Safe dividends provide more predictable returns for investors. Therefore, conservative long-term investors should continue holding Canadian bank stocks as a part of their diversified investment portfolios.

Why might some investors sell Canadian bank stocks now?

Some investors would have loaded up on the big Canadian bank stocks during the pandemic market crash because they saw them as sure-win investments at those basement prices. They would besitting on awesome price gains by now.

Their positions could be much bigger than they're comfortable with. For example, for risk management purposes, investors could ensure not to allocate more than 25% to a sector.

If you have more than 25% of your stock portfolio in Canadian bank stocks, it's a good idea to sell some to diversify elsewhere in better opportunities for income or growth.

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