Will the 3% Surtax Hurt Bank and Insurance Stocks?

Description

Will the Liberal Party make good on its promise to levy banks and insurance companies with a 3% surtax in post-election? The prime minister himself vowed to impose the said tax when re-elected. The hike will apply to financial institutions whose profits exceed $1 billion (US$793 million).

If the plan pushes through, banks and insurance companies' corporate income tax rate will be 18%, not 15%. Also, the financial institutions must contribute to the Canada Dividend Fund. The question now is whether the tax will hurt bank and insurance stocks.

New tax proposal

While the move is populist, some investment strategists believe it will have a minimal to slightly negative effect. Daniel Gonzalez, a wealth analyst at Javelin Strategy & Research, views the tax proposal as minor. He added that affected corporations in the financial sector will find ways to minimize the impact.

Gonzalez estimates the big banks to pay $1 billion in extra taxes annually. However, the financial sector can mitigate or lessen the damage by raising customers' fees or reducing costs. For Kurt Reiman, the chief investment strategist for North America with **BlackRock**, people should watch how banks emerge from the pandemic.

James Black, director of equities research with Beutel Goodman Investment Counsel, said banks and insurance companies fared well during the pandemic. He added that Canadian banks in particular have strong track records of managing through challenging times.

The steady performances of **National Bank of Canada** (TSX:NA) and **Manulife Financial** (TSX:MFC)(NYSE:MFC) in the stock market somehow indicate confidence in the institutions. Investors can buy shares of the companies or add to positions if they already own the stocks.

Superb business performance

Canada's sixth-largest bank continues to impress with its superb business performance in 2021. For the nine months ended July 31, 2021, National Bank reported $2.4 billion in net income. It was a 51% growth versus the same period last year. In Q3 fiscal 2021, net income grew 39% to $839 million, or 39% than in Q3 fiscal 2020.

President and CEO Louis Vachon said, "The bank's strong performance since the beginning of the fiscal year has continued in the third quarter of 2021." He also said the sustained increase in revenues reflects the improving economic environment. Besides becoming a strong brand name in the banking industry, National Bank is a Dividend Aristocrat.

Investors are content with the 38.13% year-to-date gain. At $96.69 per share, the dividend yield is a decent 2.95%.

Ambitious goal

Like National Bank, Manulife has earned Dividend Aristocrat status. Regarding dividends, the insurance stock pays a generous 4.52% dividend. Market analysts recommend a buy rating and forecast a 19.82% upside potential from $24.75 to $29.66 in the next 12 months.

The $48.07 billion company reported 70% and 28% growth in net income and core earnings in the first half of 2021 versus the same period in 2020. According to Roy Gori, Manulife's president and CEO, the $1.72 billion core earnings in Q2 2021 was a record. Apart from expense discipline, management's ongoing concern is to make Manulife the most digital, customer-centric, global company in the insurance industry.

Slightly negative impact

Scott Chan, managing director of **Canaccord Genuity**, said the 3% surtax would slightly negatively impact the earnings of banks and insurance companies. With Chan's assessment, I would say its impact on the stocks would be negligible.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

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2. TSX:MFC (Manulife Financial Corporation)
3. TSX:NA (National Bank of Canada)

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Date
2025/08/23
Date Created
2021/10/01
Author
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