



Why “Boring” Bank Stocks Are Beating Cryptocurrency

Description

Canadian bank stocks are beating cryptocurrency in 2022.

As of Tuesday, the S&P/TSX Capped Financials Index was up 2.73%. **Bitcoin**, in the same period, was down 18.76%. It has been a period of strong performance for Canada’s banks. Not only did they outperform Bitcoin in January, they also beat tech stocks—the NASDAQ, much like Bitcoin, fell in January. In this article I will explore some possible reasons why Canadian banks outperformed last month.

Interest rates rising

One big thing that bank stocks have going for them right now is interest rate hikes. The U.S. Federal Reserve is rumoured to be doing “six or seven” rate hikes in 2022. The Bank of Canada, meanwhile, has signalled that a 50 basis point increase is coming. These are material developments. When interest rates rise, both deposit and loan interest rates go up, but loan interest typically goes up more. So, the “spread” between loan interest and deposit costs increases, leading to higher profit margins for big banks.

In theory, that’s how it works anyway. Things have not always played out that way in practice. As the Federal Reserve of St. Louis points out, there have been times when interest rates and bank margins moved in opposite directions. However, they have been positively correlated more recently.

Canadian banks like **The Toronto-Dominion Bank** ([TSX:TD](#))([NYSE:TD](#)) should be able to make good money in 2022. TD’s ex-CEO recently said that he [didn’t expect](#) Canada’s interest rate hikes to cool the housing market. Citing investor psychology, he claimed that buyers would still find the interest rates “accommodating.” If that’s the case, then TD Bank and other Canadian banks should be OK in the year ahead. If people keep buying houses even with higher interest rates in the picture, then TD will simply make money off the rate hikes. The same goes for the other big banks.

Tech stocks taking a beating

As for why [cryptocurrency is falling](#), it may have to do with the exact same phenomenon that is benefitting bank stocks. Interest rate hikes hurt growth stocks just as much as they help bank stocks, and Bitcoin is highly correlated with the biggest growth industry in the world: tech.

In December, Bitcoin had a 0.58 correlation with the NASDAQ. That's a fairly strong positive correlation, implying that Bitcoin and tech stocks move in the same direction. As for why it holds: one possible explanation is that many tech companies are invested in Bitcoin. For example, **Block** makes money off Bitcoin transactions, and many other tech companies have Bitcoin on their balance sheets. It would make sense, then, for the NASDAQ and Bitcoin to be correlated.

As I noted above, rate hikes can increase banks' profit margins, but they also reduce growth companies' value. The higher the growth rate, the higher the percentage impact of a rate hike. So bank stocks look more attractive than tech stocks when interest rates rise. They also look more attractive than crypto, which at this point, is deeply embedded in the tech scene.

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