



Should You Buy Bank Stocks Now?

Description

Canadian bank stocks are down considerably from the 2022 highs. Investors who missed the big rally off the pandemic lows are wondering if the banks are now [undervalued](#).

Let's take a look at the market outlook for the banks and see if one deserves to be on your TFSA or RRSP buy list.

Market outlook

Canadian banks are very profitable in most economic conditions. That being said, certain times are more lucrative than others and there might be headwinds on the way in the next couple of years.

Why?

Bank stocks sold off significantly in the past few weeks as part of the broader market pullback. There is a concern that anticipated profits might not materialize and that is why stock prices and multiples are coming down.

The Bank of Canada and the U.S. Federal Reserve have started their process of raising interest rates to try to tame inflation. Economists are concerned the central banks are too late to the table and will have to increase rates by more and for longer than anticipated to get inflation under control.

Central banks think they can achieve the goal while navigating a soft landing for a hot economy. Critics think a recession is inevitable and predictions of stagflation are becoming more common. This refers to a situation where inflation remains persistently high even through a weakening economy.

Inflation for April hit a 31-year high of 6.8% in Canada. The rate south of the border is even worse at 8.3%, although that is down a bit from the March high.

A steep economic downturn would force businesses to scale back investments and could lead to a jump in job losses. That seems unlikely right now with unemployment at the lowest levels in decades

and companies across a wide swath of industries struggling to fill positions.

Higher mortgage rates caused by soaring bond yields and rising interest rates will cool off the hot housing market. This will have an impact on bank revenues, but it might not be the big hit investors fear. That being said, a meltdown in house prices caused by a wave of listings could trigger defaults and leave the banks stuck trying to offload homes and condos that are worth less than the value of the mortgages.

Volatility should be expected in the coming months and more downside could be on the way for bank stocks, but the pullback is starting to look overdone, especially if it turns out that the fears are overblown.

Best bank stocks to buy now?

Bank of Montreal ([TSX:BMO](#))([NYSE:BMO](#)) and **TD** ([TSX:TD](#))([NYSE:TD](#)) might be the way to go in the medium term. The two banks announced large acquisitions in the United States in recent months that will significantly expand their existing American operations and position the two banks to benefit from long-term U.S. economic expansion, while adding more revenue coming from outside Canada to diversify the earnings stream.

Bank of Montreal raised its dividend by 25% for fiscal 2022 and TD increased its payout by 13%. These were the largest dividend increases announced by the big Canadian banks last fall when the sector received the green light to restart payout growth.

I wouldn't back up the truck just yet, but buy-and-hold investors might want to start nibbling at the current share prices.

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Author

aswalker

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