Banking Stocks: The Cure to a Down Market?

Description

This year, Canadian banking stocks are solidly outperforming the markets. For the year, Canadian financials are only down 9%, while the S&P 500 is approaching a bear market. Although TSX banks aren't doing as well as energy stocks, which are positively rallying this year, they are, nevertheless, another value sector that is doing better than the market overall.

The question is, will this continue?

Many economists think that we're entering a recession, and there are credible reasons to think that they're right. A recession is two quarters in a row of negative GDP growth, and we already have one quarter of negative growth behind us. Lately, U.S. tech companies and retailers have been laying people off due to weaker demand, so it seems likely that Q2 will feature negative growth as well.

Recessions are definitely not good news for banks. Although some of the macroeconomic trends this year, such as rising interest rates, are good for banks, the possible recession is bad news. When a recession hits, people cut back on borrowing dramatically, hurting bank revenue. In this article, I will explore whether Canadian banks are still a cure for the market pandemonium we're seeing today.

Why Canadian bank stocks are outperforming

The big reason why bank stocks are outperforming this year is because they are cheap. Prior to this year's crash, some growth stocks were trading at over 50 times sales. When interest rates increase, such extreme valuations start to look questionable. So, when central banks started raising rates this year, investors moved money into value stocks like banks and energy companies.

If you look at a Canadian bank like **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD), you can clearlysee that it is better suited to today's macro climate than an expensive profit-free tech startup is. As alender, it can benefit from rate hikes rather than being harmed by them. As a profitable company, it canafford to pay dividends. And as a cheap defensive stock trading at just 11 times earnings, it is notgoing to spiral into the abyss when speculators get margin called. So, TD has outperformed the U.S.markets this year, because its characteristics make it a logical investment in today's economy.

Will this trend continue?

It's one thing to note that banks have done better than average this year, but quite another to claim that they will keep doing so. Early on, the interest rate hikes looked bullish for banks, but now that the rate hikes are on the verge of causing a recession, that seems less clear. Banks do not profit off higher interest rates all the time. If the higher rates cause a recession, or if they mainly occur on the short end of the yield curve, then banks actually make *less* money. So, it's possible that the bank trade is overextended already.

Foolish takeaway

As a parting thought on bank stocks, I would offer this:

Focus on geographically diversified banks like TD Bank. A domestic-oriented bank like **Canadian Imperial Bank of Commerce** is extremely vulnerable to Canada's housing market. The rate hikes we're seeing this year are taking a bite out of house prices, and the more domestic banks will likely be hit the hardest. According to the Federal Reserve, U.S. house prices are still rising, so Canadian banks with U.S. exposure may give investors a smoother ride.

CATEGORY

1. Bank Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:TD (The Toronto-Dominion Bank)
2. TSX:CM (Canadian Imperial Bank of Commerce)
3. TSX:TD (The Toronto-Dominion Bank)

PARTNER-FEEDS

1. Business Insider
2. Koyfin
3. Msn
4. Newscred
5. Quote Media
6. Sharewise
7. Smart News
8. Yahoo CA

PP NOTIFY USER

1. andrewbutton
2. kduncombe

Category

1. Bank Stocks
2. Investing

Date
2025/08/17
Date Created
2022/05/27
Author
andrewbutton