Should You Buy Canadian Bank Stocks in the Face of a Potential Recession?

Description

Canadian bank stocks do not fare too well when the broader economy falls into a recession and markets tilt into a bear market. Undoubtedly, when loan growth slows, earnings fall off a cliff, and shares of the big blue chips tend to get crushed. During the Great Financial Crisis, the bank stocks took one straight on the chin.

The 2020 stock market crash was no better, with the big bank stocks, once again, leading the charge lower. There's no denying the economic sensitivity of the banks. With bank stocks recently slipped over fears that central banks will hike rates until we fall into a potentially disastrous economic downturn, it's not a mystery as to why many banking giants have more than corrected off their peak levels.

Canadian banks are built differently, though. You can doubt their resilience, but their capital ratios are among the world's best. They've been stress-tested, and they always make it out of recessions without sustaining severe, long-lasting damage. Indeed, the big banks have done a great job of steering out of trouble, and that's a significant reason why shares of the Big Six tend to experience the biggest gains once the markets bottom and the worst of the recession fears pass.

Undoubtedly, Canadian banks are owned by many long-term investors who seek appreciation and sizeable dividends. Though it may make sense to sell them with the intent of getting back in after the broader basket of Big Six Canadian bank stocks suffers from a 30-50% crash, doing so is market timing. Further, we don't know for sure that we're going to fall into a recession due to rate hikes.

Higher rates without a recession?

In the U.S., the Fed has been relatively hawkish. Though Fed chair Powell shot down the chances of a 75-bps hike, I think that the Fed's inflation focus could weigh heavily on the roughness of the "landing." There's some chance of a recession in the states by 2023, depending on which pundit you check in with. A soft landing may still be possible if inflation can back off sooner rather than later. It doesn't seem very certain at this juncture, but anything is possible.

Here in Canada, the recession risks seem lower, with the profound strength in commodity prices and a

Bank of Canada that doesn't sound nearly as hawkish. Indeed, the Bank of Canada has fallen behind the curve, perhaps farther behind than the Fed. That could mean more persistent inflation but a more robust stock market on this side of the border.

Undoubtedly, rates will still rise, but perhaps at a slower pace. Higher rates without jeopardizing economic growth could spell great things for the big Canadian bank stocks.

Royal Bank of Canada: A top pick to bank on

Royal Bank of Canada (TSX:RY)(NYSE:RY), with its strong domestic exposure, seems way too cheap to ignore, given things may not be nearly as ugly as they appear for the Canadian banks. Royal Bank is the best in its breed, yet shares are down around 15% from their all-time highs. At 11.3 times trailing earnings, with a 3.8% dividend yield, RY stock seems like a bargain that's been unfairly dragged down alongside almost everything else.

Indeed, the economy is in questionable shape. Still, even if we are to fall into a recession, RY stock is among the first stocks to recover in the years following a substantial drawdown.

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