Why Bank of Nova Scotia (TSX:BNS) Stock Fell to Two-Year Lows Last Week

Description

It's not just growth stocks that have taken a hit this year, Canadian bank stocks have also been under severe pressure. **TSX** bank stocks have lost 15%, while **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS) stock has dropped 28% year-to-date. It's currently trading at levels last seen in November 2020.

Why is BNS stock underperforming in 2022?

Bank of Nova Scotia is Canada's fourth-largest bank by market cap. It derives 65% of its consolidated earnings from Canada while the U.S. contributes 6%, and 21% comes from Latin America. Such significant exposure to LatAm countries makes it a relatively risky bet compared to peers. It has been dragging down performance for the last few quarters, which has weighed on BNS stock.

Apart from that, central banks have been aggressively raising rates this year. Such a move generally increases banks' net interest margins. However, it also deters demand for new loans and makes repayment more expensive. BNS has provided total loans of $114 billion in LatAm regions collectively. Higher interest rates could substantially dent repaying capacity, raising the risk of defaults.

As a result, BNS has set aside a relatively large sum in provisions for credit losses. For the quarter that ended on July 31, 2022, the bank reported $412 million in provisions compared to $219 million in the earlier quarter. BNS's provision is higher than peers and recently weighed on its bottom line.

Bank of Nova Scotia in fiscal Q3 2022

For the fiscal third quarter, BNS reported a net income of $2.6 billion, an increase of 2% year-over-year. After its quarterly results, several analysts downgraded the stock due to its higher exposure to Latin American markets. That's put significant downward pressure on the stock in the last few weeks.

Note that BNS has a common equity tier 1 ratio of 11.4%, higher than regulatory requirements butlower than peers' average. The ratio for **Toronto-Dominion Bank** was 14.7% at the end of fiscal Q32022.

This ratio contrasts the bank's core equity capital with its risk-weighted assets. It ultimately indicates the bank's financial strength. It means that BNS could remain relatively weak compared to peers due to its exposure to LatAm markets.

Notably, BNS stock has been a laggard in the long-term as well. In the last five years, the stock delivered a measly 4% return including dividends, while peers, on average, returned 48%. BNS currently yields a decent 6%, higher than peers.

The Foolish takeaway

Almost all Canadian bank stocks have experienced weakness this year. Fears of a severe global economic downturn have spooked investors. BNS could continue to trade subdued if the market remains weak. Peer Toronto-Dominion Bank seems like a stronger bet due to its sound credit portfolio, solid U.S. exposure, and decent dividend yield of 3.95%.

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