



Should You Buy Bank of Nova Scotia Stock or CIBC Stock on the Dip?

Description

[Bank stocks](#) are down considerably from the 2022 highs. Investors who missed the big rally off the 2020 crash are wondering which Canadian banks are now oversold and good to buy for a [Tax-Free Savings Account \(TFSA\)](#) or [Registered Retirement Savings Plan \(RRSP\)](#) focused on dividends and total returns.

Recession risks

The Bank of Canada and the U.S. Federal Reserve are raising interest rates aggressively to cool off the economy in an attempt to get inflation under control and back down to the 2% target. Inflation was 7% in Canada in August.

Households are already diverting discretionary spending to cover rising food and fuel costs. Many are dipping into savings. The jump in interest rates is now pushing up mortgages rates, putting additional pressure on household budgets. Property owners with variable-rate loans immediately face much higher payments each time rates rise. Homeowners with fixed-rate mortgages will see a delay in the impact, but most will have to renew at more expensive rates when the current loan term expires. The longer rates remain high, the greater the risk for a deep recession.

At the moment, economists broadly expect a downturn to be short and mild due to a strong labour market and historically high savings built up during the pandemic. These factors should help ease the short-term double hit from soaring rates and ongoing high inflation.

Bank of Nova Scotia

Bank of Nova Scotia ([TSX:BNS](#)) trades near \$65 per share at the time of writing compared to \$95 at the peak in February this year. The huge pullback has shocked long-term investors, but the drop is more due to recession fears than as a result of the bank's fundamentals.

Bank of Nova Scotia raised its dividend by 11% near the end of 2021 and increased the payout by

another 3% when the company released the fiscal second-quarter (Q2) 2022 results. Bank of Nova Scotia also raised its share-buyback target by 50% earlier this year from 24 million to 36 million shares.

The company finished fiscal Q3 2022 with a common equity tier-one (CET1) ratio of 11.4%. This is a measure of the bank's capital position and its ability to ride out a downturn. The government requires the Canadian banks to maintain a CET1 ratio of 10.5%, so Bank of Nova Scotia is sitting on excess cash.

Net income for the first nine months of fiscal Q3 2022 came in at \$8.1 billion compared to \$7.4 billion in 2021.

Investors who buy BNS stock at the current price can get a 6.3% dividend yield. The stock currently trades for 7.8 times trailing 12-month earnings.

CIBC

CIBC ([TSX:CM](#)) trades for less than \$60 per share at the time of writing compared to \$83 at the 2022 high.

Investors often overlook CM stock in favour of the four larger Canadian banks. Part of this is due to CIBC's track record of making big blunders. The other reason is concerns about the company's exposure to the Canadian residential housing market. Aggressive lending to home buyers over the past decade drove strong profits for CIBC, but the mortgage book is large relative to the bank's size when compared to its peers. In the event there is a crash in property prices to the point where mortgages owed are higher than market values for the properties, CIBC would likely take a bigger hit than the other banks.

Supply shortages and strong demand should prevent the housing market from capitulating, even as mortgage rates rise, but the risk needs to be considered.

CIBC raised its dividend late last year and increased the payout again this spring. The stock currently offers a 5.6% yield. CIBC finished fiscal Q3 with a CET1 ratio of 11.8%. The stock currently trades for 8.6 times trailing 12-month earnings.

Is one a better buy?

Both stocks look oversold and attractive at the current prices. However, Bank of Nova Scotia trades at a cheaper multiple and offers a higher yield. As such, I would probably make BNS stock the first pick right now.

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Author

aswalker

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