Canadian Bank Stocks: Time to Buy the Underdogs

Description

The Canadian bank stocks have been beaten down steadily over the past year. With a recession on the horizon, questions linger as to how much provisions for credit losses (PCLs) will rise, just a few years after pandemic provisions took a bite out of loan growth. Indeed, the Big Six Canadian banks are fine long-term investments that should be picked up any time they're down. Their dividends are safe and sound. And during dips, the yields are that much richer.

As the economy looks to post negative growth, don't expect the bank stocks to act defensively. They may be great long-term investments for a Tax-Free Savings Account (TFSA) or Registered Retirement Savings Plan (RRSP). That said, they tend to experience as much downside in the face of recessions as the market averages. Indeed, 40-50% plunges have become commonplace for the bluest of blue chips on the TSX Index.

Despite the downside risks in the face of worsening economic conditions, I view the bank stocks as worthy pick-ups, primarily for their dividend-growth potential over the course of the long haul.

Now, their dividends are already quite swollen, with dividend yields currently ranging between 4% and 6.2%. However, the magnitude of dividend growth moving forward could continue to enrich income investors over the decades.

In this piece, we'll have a look at two Big Six banking underdogs in **Canadian Imperial Bank of Commerce** (TSX:CM) and **National Bank of Canada** (TSX:NA).

CIBC

CIBC boasts a 5.4% dividend yield after enduring a 25% plunge from peak levels. Undoubtedly, rising interest rates could bring forth pressure on Canadian mortgages. Though surging defaults are always a possibility, I think there's a good chance that inflation and rates could peak at some point over the next few months. Undoubtedly, CIBC has one of the largest mortgage books out there. A Canadian housing market collapse could really weigh down the firm's quarters in a recession year.

Despite the heavy Canadian mortgage book, the stock seems cheap at 8.9 times trailing price to earnings (P/E). Indeed, a cheap stock can become cheaper as sore spots become weak. Regardless, I think CIBC's history of collapsing on recessions is overdone. The company has better risk managers behind the scenes. As a result, past crashes, I believe, are not a good indicator of what to expect from CM stock in 2023.

National Bank of Canada

National Bank of Canada is another smaller-cap bank stock that's well worth considering versus its pricier bigger brothers in the Big Six. The stock is down just 10% but sports a 9.76 times trailing P/E. Over the past five years, shares have returned 53%, not including dividends.

Though the 2020 plunge was a huge road bump, those who held (or bought more shares on the dip) ended up doing just fine. Looking to 2023, I think National Bank will be in for another swift recovery as recession woes come and go.

Though National Bank is more regional than its peers, with a mere 3.9% dividend yield (far smaller than its peers), I think the long-term disruptive potential shouldn't be overlooked.

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