BMO Stock Rose 6% in November: Is it a Buy Today?

Description

Canadian bank stocks showed some recovery last month on the hopes of slowing interest rate hikes. The Big Six TSX bank stocks, on average, increased 6% in November, offering some respite to investors. Canada's third-biggest by market cap, **Bank of Montreal** (TSX:BMO), also surged 6% last month, reaching its four-month high.

Should you buy BMO stock?

Banks generally play well in rising interest rate regimes. So, this year was supposed to be dominated by banks amid the policy-tightening cycle. However, record-high inflation and accelerated rate hikes created a rather gloomy picture for the broader economy. Recession fears heavily weighed on bank names since April, precisely when investors got clarity about the pace of the rate hikes.

As inflation data came in milder-than-expected last month, that made way for expectations about the slowing rate hikes. As a result, bank stocks, including BMO, rallied last month.

Bank of Montreal released its fiscal fourth-quarter earnings last week. It posted a net income of $4.48 billion for the quarter that ended on October 31, 2022. This marked a massive 107% increase year over year. Provisions for credit losses increased to $226 million for the quarter from $126 million in the year-ago quarter.

BMO dons superior credit quality

Banks have been setting aside a higher amount in provisions recently due to an expected increase in the loans that could go bad. However, BMO is much more well positioned in terms of credit quality.

It reported a common equity tier-one (CET1) ratio of 16.7% in the recent quarter, the highest amongthe Big Six Canadian banks. This ratio compares a bank's equity capital to its risk-weighted assets and indicates its capacity to withstand economic shocks. In the same quarter last year, BMO had this ratio at 13.7%, showing a better financial shape than last year.

Even if bank names recently witnessed some upturn, macro challenges do not seem over yet. Inflation could continue to be a big obstacle next year as well, considering higher energy prices and supply chain challenges, given the unrest in China. Moreover, the targeted inflation range is still a distant dream for central bankers, hinting at continued interest rate hikes in 2023. So, a potential economic downturn can't be ruled out just yet.

Valuation and dividends

Despite the gloomy picture, some bank names look attractive at current levels. And BMO is one of them. It is still trading 13% lower than its March 2022 highs. On the valuation front, BMO stock is trading nine times its earnings and 1.4 times its book value. Both measures highlight discounts compared to peers, as the industry-average trades around 10 and 1.8, respectively.

Moreover, BMO looks particularly strong on the dividend front. It currently yields 4.2%, which is in line with its peers. It has paid dividends for the last 194 straight years, the longest dividend-paying streak for any Canadian company. Notably, it has increased shareholder payouts by 5% compounded annually in the last 15 years.

BMO's undervaluation might not drive the stock higher immediately. Given the recession fears and ensuing uncertainties, bank and financial stocks could continue to trade subdued. However, BMO could outperform in the long term due to its superior credit profile and discounted valuation.

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