Why BMO Stock Lost 10% Last Year – Should You Buy?

### Description

Some investors began aggressively building positions in banking stocks early last year. The move then made sense as rates were about to increase, and bank names outperform during rising rate environments. However, TSX bank stocks notably disappointed investors. They lost 10% last year, largely in line with the broader markets. Canada's third-largest **Bank of Montreal** (TSX:BMO) also lost 10% of its value in 2022.



## Why TSX banks disappointed investors last year?

Re-openings after the COVID-19 pandemic and war in Europe sent inflation to record-high levels last year. Global central banks, though late to react, started rapidly raising benchmark interest rates to tame the adamant inflation.

Generally, banks see higher net interest margins and, ultimately, superior earnings growth as interest rates increase. However, this time, the rate hikes were coupled with roaring inflation. So, even when interest margins were higher, the bottom line could not grow proportionately. Some Canadian banking bigwigs rather witnessed earnings decline in the fiscal year 2022.

Bank of Montreal, on the other hand, showed handsome financial growth. For the fiscal year 2022, it reported earnings of $13.5 billion, an increase of 74% year over year.

Peer Canadian banks saw earnings drop mainly due to their higher provisions in the latest quarter. Banks set aside an amount as a provision for loans that could go bad in the future. As many fear, higher inflation and rate hikes might result in a recession in 2023. This could impact borrowers' repayment capacity and increase bad loans. So, banks create provisions to withstand such shocks. As provisions increased, banks' net income fell in recent quarters.

## BMO posted industry-leading financial growth in 2022

Bank of Montreal reported provisions of $226 million in the recent quarter that ended on October 31,

2022. In the earlier quarter, its provisions were $136 million. The rising amounts of provisions indicate that banks are turning increasingly cautious.

However, it's still too soon to tell. Even if banks are setting aside millions in provisions, there are a few indicators that show positive economic developments. Canadian banks have strong balance sheets and have seen decent loan and deposit growth in recent quarters. Plus, the job market is still quite robust, which might keep bad loans in check.

Moreover, Bank of Montreal has some of the best credit quality among Canadian banking giants. At the end of fiscal Q4 2022, it had a common equity tier 1 ratio of 16.7%, higher than peers. The ratio indicates the bank's core equity capital against its risk-weighted assets.

It could be an opportune time to enter BMO stock amid its ongoing weakness. The shares are trading at a price-to-book value of 1.2x, much lower than the industry average. Note that although BMO stock looks attractive, it may not see a significant recovery soon. As the macroeconomic picture is still dominated by rate hikes and recession fears, TSX bank stocks could continue to trade subdued.

Meanwhile, BMO offers handsome dividends that yield 4.7% at the moment. It has paid dividends for the last 194 straight years, the longest dividend-paying streak for Canadian banks.

## Bottom line



So, if your investment horizon is long enough, BMO stock looks attractive due to its stable earnings growth and dividends. Its superior balance sheet and relative undervaluation might create shareholder value in 2023 and beyond.

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