Bay Street Week Ahead: Oddly calm sailing for banks

Lynne Olver, Reuters

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TORONTO (Reuters) - Canadian consumers will probably feel the pinch of the global credit crisis for some time as loans become more expensive, but for Canadian bank shareholders, the worst may already be over.

Shares of Royal Bank of Canada , Canadian Imperial Bank of Commerce and their peers were relatively calm this week even as swooning commodity prices buffeted the Toronto Stock Exchange's benchmark index and mounting anxiety over the future of Lehman Brothers and other U.S. financial companies kept the U.S. sector on edge.

Indeed, the slide in commodity prices probably benefited Canadian bank shares, while the concerns about capital and toxic assets that have rocked Wall Street had little impact.

Toronto-listed bank stocks gained 3 percent this week as of Thursday's close, and were up 20 percent since July 15, when the S&P/TSX Banks index hit its lowest point since February 2005.

"There may be some internal market flows coming out of the commodity space into the banks, because frankly if you're moving away from commodities within the Canadian market, there's not a heck of a lot to buy other than banks," said David Wolf, an economist at Merrill Lynch in Toronto.

It is "abundantly clear" that Canadian banks generally steered clear of the severe writedowns that tripped up other global players, Wolf said, but their relative outperformance has still been remarkable.

"It is one of the reasons why the overall TSX, as weak as it has been of late, has outperformed just about every other global market."

The S&P/TSX Composite Index lost 0.4 percent this week to end at 12,769.58, and is down 7.7 percent year to date.

To be sure, there's no shortage of analysts flashing yellow caution lights about Canadian bank stocks. Many feel that it is too early to jump in and buy, with growth and valuation catalysts lacking. The Canadian economy, joined at the hip with its southern neighbor, is expected to generate anemic growth at best in the coming months.

"Right now I'd say we're very cautious, because we haven't seen any signs out of the U.S. that things are getting better," said ***Ohad Lederer***, a financial services analyst at ***Veritas Investment Research***.

Dundee Securities analyst John Aiken said the "relief rally" inspired by quarterly results posted by Canadian banks in August would probably last another month, but then he expects negative news from the U.S. financial sector to push global stocks lower again.

Yet some wary strategists are starting to change their tune.

Nick Majendie at Canaccord Adams figures that more problems will emerge from the world's financial institutions, but said in a quarterly report this week that much of the bad news is already priced in.

Majendie's portfolio remains overweight in energy and precious metal stocks, and significantly underweight banks. He still has concerns about credit derivatives, off-balance sheet transactions and a slowdown in capital-markets businesses. Still, he said bank shares already reflect a fair degree of this risk.

Scotiabank analyst Kevin Choquette takes the point a step further, describing the drop in Canada's banking shares as "extreme." The sector has been "grinding it out," posting modest earnings declines in recent quarters while keeping strong capital positions.

"The banking siege has presented one of the best buying opportunities in decades," Choquette said in a research report this week.

That's not to say that profitability will soon bounce back to 2007's record levels, when the country's eight publicly traded banks earned C$19.7 billion.

Several factors will constrain growth: a slowing Canadian economy, the U.S. housing slump and a possible recession, and higher financing costs, among others.

Toronto-Dominion Bank Chief Executive Ed Clark even said this week he was nervous about potential "accidents" in the broader financial system as the industry restructures.

As for higher funding costs, the yield spread between senior bank debt and Government of Canada bonds has roughly tripled in the past year, and preferred shares have become more costly for banks to issue -- in turn spelling higher rates for Canadian borrowers.

"There will be some pass-through of this, I don't think it's all being passed through at this time," CIBC CEO Gerry McCaughey said at a conference.

($1=$1.06 Canadian)

(Reporting by Lynne Olver; Editing by Frank McGurty)

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