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Weekly Commentary

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Canadian Banks: The Report Cards are Out

Contrary to in the United States, where banks release their earnings around the front end of earnings season, the Canadian banks traditionally report towards the back end. **Canadian Imperial Bank of Commerce (CM:TSX/NYSE)** was first out of the gate on February 24. For Q1/2023, which ended on January 31, CIBC delivered a “strong start to the year” according to President and CEO Victor Dodig. Adjusted net earnings of $1.8 billion and earnings per share (EPS) of $1.94 were a result of having grown revenue and pre-provision pre-tax (PPPT) earnings to record levels. Investors reacted positively with CM shares up 2.7% on the day and as of Friday’s close, CM shares are higher by 15.2% in 2023.

Bank of Montreal (BMO:TSX/NYSE) and **Bank of Nova Scotia (BNS:TSX/NYSE)** reported last Tuesday, March 2. For the first quarter, BMO earned record revenue of $2.3 billion and EPS of $3.22. In his opening remarks on the earnings call, CEO Darryl White credited “our balanced and well diversified business model” for the record revenue in personal and commercial banking. As part of its North American strategy, BMO completed its acquisition of U.S. based **Bank of the West** on February 1, essentially “doubling” its U.S. footprint. This moves BMO to “Top 10” status among banks south of the border. Despite the impact of lower markets on the wealth management side of the business, BMO’s exchange traded funds (EFTs) were once again ranked number one for a 12th straight year. The market’s reaction was somewhat muted with traders driving shares lower by 1.1% for the day. However, shares moved higher through Friday and year-to-date (YTD), BMO is up by 6.6%.

Also on Tuesday, BNS reported quarterly adjusted earnings of $2.4 billion and diluted EPS of $1.85, This was interpreted by “the street” as a miss. Lower year-over-year (YOY) revenues were attributed to higher costs, lower net interest income, and lower revenues from wealth management, underwriting and advisory. Canadian banking operations fell 10% YOY resulting from higher provisions for credit losses although deposits grew by 10%. BNS, distinguished by its international operations including Latin America, saw shares tumble 5.7% on the day. However, investors pushed the stock higher over the following three sessions and as of Friday’s close, BNS is up 5.4 % YTD.

Royal Bank of Canada (RY:TSX/NYSE), Canada’s largest bank by market capitalization, reported Wednesday. For Q1, net income of $3.2 billion was lower by 22% YOY while diluted EPS was $2.29, down by 19% YOY.

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Earnings were impacted by the Canada Recovery Dividend (CRD), certain tax related adjustments, and higher provisions for credit losses. PPPT earnings of $5.9 billion were up 7% YOY. Growth in Canadian bank lending and record revenues in capital markets and wealth management contributed to the strong performance. Higher expenses of +17% YOY were attributed to client-facing technologies, infrastructure and artificial intelligence (AI); macro challenges remain. Deterioration in home ownership affordability slowed mortgages while investment banking fell 11% YOY. Credit card balances (+13% YOY) and business lending (+15% YOY) offered tailwinds. The initial reaction drove RY shares lower by 3.6% but by Friday, shares had fully recovered. RY is up 7.4% since the end of 2022.

National Bank of Canada (NA:TSX) also released numbers on Wednesday. On the earnings call with analysts, President and CEO Laurent Ferreira National stated "the bank has had a good start to the year" with "strong results" and "robust margin performance" generating superior return on equity (ROE) above 18%. Revenues from Personal and Commercial banking rose 17% YOY despite higher rates impacting retail and commercial demand. Net income from wealth management grew 16% YOY, Corporate and Investment Banking delivered its second best performance on record, and the Financial Markets business remained strong. Shares marked a 16-month high on the open and closed the week 2.5% higher. NA shares are up 12.6% this year.

Last to report was **Toronto-Dominion Bank (TD:TSX/NYSE)** on Thursday. For Q1/2023 TD delivered strong results. Earnings increased 8% to 4.2 billion while EPS rose 7% to $2.23. Revenue grew 16% YOY. Canadian Personal and Commercial banking, credit cards, and U.S. Retail Banking operations delivered record quarters while TD Asset Management remained the top manager for Canadian pension assets. Revenues from Wholesale Banking were flat. Due to delays in the regulatory approval process, closing of the acquisition of U.S. based First Horizon Bank has been extended to May 27 from February 9. TD shares were lower by 2.4% on the day but closed out the week up 1.6 % for the year.

In our assessment, the much-anticipated earnings reports from the Canadian banks delivered a "mixed bag". Evidently, increasing costs from wage inflation, higher operating expenses and weaker financial markets were headwinds. Consumers and businesses continue to borrow despite a challenging environment that includes housing affordability, which is being impacted as mortgage rates rise. While only two of the "Big Six" saw positive price action following their results, all six joined in the late week rally and were higher by Friday's close. The average gain in 2023 is 8.1%, beating the 6.2% return for the S&P/TSX Composite.

Canada's banks are recognized globally for stability, relative safety, dividend reliability and we view them as truly the "best-in-class". The **Palos Equity Income Fund** and **The Palos Income Fund LP** hold core positions in BMO, BNS, NA, RY and TD. The **Palos-Mitchell Alpha Fund** holds shares and call options in BMO, RY and TD.

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) [1]	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	$8.93	8.24%
Palos Equity Income Fund - RRSP	PAL101	$6.96	6.89%
Palos WP Growth Fund - RRSP	PAL213	$13.92	11.50%
Palos-Mitchell Alpha Fund [3]	PAL300	$8.89	11.52%
S&P TSX Composite (Total Return with dividends reinvested)			6.69%
S&P 500 (Total Return with dividends reinvested)			5.68%
S&P TSX Venture (Total Return with dividends reinvested)			12.77%
Chart 2: Market Data [1]			**Value**
US Government 10-Year			3.95%
Canadian Government 10-Year			3.34%
Crude Oil Spot			US $79.68
Gold Spot			US $1,854.60
US Gov't10-Year/Moody BAA Corp. Spread			184 bps
USD/CAD Exchange Rate Spot			US $0.7354

[1] *Period ending March 3rd, 2023. Data extracted from Bloomberg*
[2] *Fund is priced annually*
[3] *Fund is priced weekly on Tuesdays*

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