

PALOS

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Weekly Commentary

Issue No. 49 | December 4th, 2023

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By Charles Marleau CIM[®] and William Mitchell CIM[®]

The Canadian Banks Report

Traditionally, the Canadian Big Six report toward the end of the quarterly earnings season. Last week was no exception as all six reported their Q4 and fiscal year results. Expectations were cautious heading into the week as investors were concerned about macroeconomic uncertainty and the impact of rising interest rates. To put it mildly, 2023 has been tough sledding for our banks.

Bank of Nova Scotia (BNS:TSX/NYSE) reported Q4/2023 results before the opening on Tuesday. Adjusted earnings-per-share (EPS) came in at \$1.26 versus \$1.65 expected and \$2.06 in Q4/2022. Net interest margins (NIMs), which is the difference between what a bank pays for deposits compared to what it earns from loans, softened year-over-year. The capital markets division beat expectations and deposits grew while higher loan loss provisions, increasing costs and a challenged international division hurt performance; results included restructuring charges of \$258 million. While BNS shares were lower by 4.4%, on Tuesday they managed to eke out a 1.2% gain by the end of the week. Shares are down 8.1% in 2023.

CIBC (CM:TSX/NYSE) released strong Q4 results Wednesday morning with Adjusted EPS of \$1.57 versus \$1.53 expected, beating estimates. Canadian personal and business banking (CPBB) and the wealth management segment beat estimates while U.S. commercial and capital markets missed. NIMs for Canadian operations increased 20 basis points (bps) while edging lower by 5 bps in the U.S. Management highlighted a strategy aimed at decreasing exposure to clients with negatively amortizing mortgages. The quarterly dividend was raised by \$0.03 to \$0.90. Investors viewed the quarter positively with CM shares climbing 5.1% during Thursday's session and finishing the week up 6.0%. CM is up 3.3% this year.

RBC (RY:TSX/NYSE) also reported Wednesday with Q4 Adjusted EPS of \$2.78 versus \$2.62 expected. Canadian personal and commercial (P&C) loans and NIMs exceeded estimates while wealth management and capital markets were weaker, partly due to weakness from U.S.-based City National Bank. The dividend was boosted by 2%. Investors liked what they heard with shares up 3.2% on the day and up 3.5% by week's end. Year-to-date RY stock is down 3.4%.

TD (TD:TSX/NYSE) reported Thursday for Q4 with Adjusted EPS of \$1.83 compared to \$1.90 in 2022. The bank took restructuring charges of \$363 million and expects to incur further charges in the first half of 2024. Expenditures on risk management systems in the U.S. followed charges from a Department of Justice investigation related to regulatory violations. Canada-based results came in better than in the U.S. TD shares slid 1.7% by Friday's close and are down by 6.6% for 2023. The dividend was raised by 6%.

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BMO (BMO:TSX/NYSE) and National Bank of Canada (NA:TSX) rounded out the week with results released on Friday morning. BMO Adjusted EPS of \$2.81 (\$2.85 est.) were basically in line and were bolstered by 10% growth in Canadian P&C, 43% growth in U.S. P&C, and 5% in both wealth management and capital markets. The dividend increased by 6%. CEO Darryl White highlighted the addition of two million customers through the acquisition and conversion of the California-based Bank of the West. Shares rose 1.3% on Friday but are down 7.3% this year. Montreal-based National Bank was the “Belle of the Ball” with Q4 Adjusted of \$2.44 versus \$2.26 expected. The bank also announced its authorization to buy back up to 7 million common shares representing 2.1% of shares issued and outstanding. “Buy backs”, like dividends, are commonly used as a tactic for returning value to shareholders. NA also raised the dividend 4%. Shares jumped 4.8% on the news and are up 3.3% for 2023, a relative outperformer.

It's been a tough year for Canadian bank stocks. Year-to-date, CIBC (+3.3%) and National (+3.3%) are the only stocks “in the green” while Scotia (-8.1%) has shown the poorest relative performance. RBC (-3.4%), TD (-6.6%), and BMO (-7.3%) have seen their share prices decline so far in 2023, underperforming a y-t-d gain of 5.3% for the S&P/TSX 60 Index which is regarded as Canada’s “Blue Chip” benchmark. However, we should note that returns including dividends tell a different tale. As of Friday’s close, year-to-date returns including reinvested dividends are positive for CM +8.2%, NA +6.7%, and RY +0.8%. The laggards are BNS -2.0%, TD -2.1%, and BMO -2.7% (source: Bloomberg).

A good benchmark for measuring the performance of Canadian banks is the BMO Equal Weight Bank ETF (ZEB:TSX). The fund is an exchange-traded fund that holds Canada’s “Big Six” banks in equal weights. To exemplify the power of reinvesting dividends we back-studied returns for the 10-year period ending December 1, 2023. Not including reinvested dividends, the ZEB ETF has returned 51.5% (price change) over the past decade. When including reinvested dividends, total return was 113.9% (8.2% annualized). Furthermore, looking at the charts shows us the ZEB put in a “technical bottom” on October 27. Since then, ZEB has rallied by 11.0%. While it would be foolhardy for us to “call the bottom” in the Canadian banks, we recognize that there is a strong probability that bluer skies lay ahead. In our experience, sticking with Canadian banks for the long-term has always proven to be a wise investment.

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) ¹	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	\$8.09	5.41%
Palos Equity Income Fund - RRSP	PAL101	\$6.69	3.88%
Palos WP Growth Fund - RRSP	PAL213	\$9.62	-22.67%
Palos-Mitchell Alpha Fund ³	PAL300	\$9.82	26.82%
S&P TSX Composite (Total Return with dividends reinvested)			8.77%
S&P 500 (Total Return with dividends reinvested)			21.51%
S&P TSX Venture (Total Return with dividends reinvested)			-4.00%
Chart 2: Market Data ¹			Value
US Government 10-Year			4.20%
Canadian Government 10-Year			3.42%
Crude Oil Spot			US \$74.07
Gold Spot			US \$2,071.00
US Gov't10-Year/Moody BAA Corp. Spread			171 bps
USD/CAD Exchange Rate Spot			US \$0.7409

¹ Period ending December 1st, 2023. Data extracted from Bloomberg

² Fund is priced annually

³ Fund is priced weekly on Tuesdays

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