CAN WE BANK ON BANKS??

For Canadian investors, **last week was pivotal** as our major banks reported 2nd quarter earnings (N.B. their qtr. runs Feb. to end of April) and we got our first insight of the effect of the economic shutdown.

The Big Five are major holdings of many portfolios, both individual and institutional, and so there was **much to ponder over**. Naturally, earnings were dramatically lower and, while the banks did better in their **PCL's** (provision for credit losses) than most of the (very pessimistic) analysts expected, the provisions were all in the billions of dollars. A sample illustration of some of the numbers:

1. **TD** had a $3.2 billion build-up of provisions for credit losses for the quarter - the highest among the Big Five.
2. **CIBC's** capital ratios fared better than peers in Q2-F20 but still recorded $1.1 billion of PCL.
3. **Bank of Montreal** PCLs were $1,118MM, below the consensus of $1,323MM.
4. **RBC** reported adjusted cash EPS of $1.03, below consensus of $1.54. Q2 net income, down 54% year over year.
5. **BNS**' total provisions for credit losses (PCLs) were $1.85 billion, compared to RBC's estimate of $2.79 billion.

Overall the results were **not pretty**, and there is concern amongst Bank analysts that the loss provisions are not adequate. The major impact of rent deferrals, mortgage non-payments or credit card losses may well lie ahead, and so the question of the next quarter results, ending July, must be on top of every bank investor's mind. **Every piece of research does indicate the Banks' capital ratios are well above minimums and the dividends are secure**. However, it is obvious Canada's economic woes coupled with close to zero interest rates are weighing heavily on their future profit expectations. Perhaps this explains the dismal price performance of financial shares after the earnings announcements.

It was another **very strong week for equity markets** as the Dow Jones rose 3.75% and the S&P500 had it best two-month performance since 2009. Our TSX managed a weekly gain of 1.87%, but was far outclassed by many global indices, especially Europe, as more and more of the Euro zone countries began to 'reopen'. Spain led the way rising almost 6%, and France and Italy were not far behind with over 5% gains. **Japan, however, was the stellar leader with a weekly gain of over 7.31%.** What was interesting was that a very recent Merrill Lynch survey of major institutional money managers found a high level of skepticism and thus high corresponding cash levels in their portfolios.

Barring an upswing in Covid cases as more countries open up, not only business, but borders, I believe many of these sceptics will be drawn into the market under the old FOMO (fear of missing out) strategy.

While stock markets continue their long standing party trick of fooling and confusing the masses, I think it is prudent to be cognizant that there is indeed much uncertainty out there. First and foremost is the possibility of a second wave as social distancing ends, post pandemic practices in many industries remains a work in progress and the full economic cost is still to be tallied. Last but not least, US-China relations seem to be on a down swing again, especially with the new restrictions in Hong Kong and the city's potential loss of its special economic status.

Thus, keeping an appropriate **cash balance** on hand, perhaps **"pruning" positions** in companies whose share prices have had large increases because of Covid-19 related enterprises may be a timely move. At the same time, it is also an opportunity to **reposition** out of companies whose fortunes may be severely challenged in the years ahead.