Brompton Insights

Canadian Banks – Stability in Good Times, Bad Times

March 28, 2023

Fund in focus: Brompton North American Financials Dividend ETF (BFIN), Life & Banc Split Corp. (LBS, LBS.PR.A), Brompton Split Banc Corp. (SBC, SBC.PR.A)

The global banking industry has once again been thrown into turmoil with the recent regional bank failures of Silicon Valley Bank, Silvergate Capital, and Signature Bank in the U.S., as well as the takeover of Credit Suisse by UBS Group at the behest of regulators in Switzerland. While there were specific issues impacting each of these entities, these recent failures have highlighted the risks associated with the rapid increase in overnight interest rates over the past year as central banks around the world have moved swiftly to tighten policy in response to high inflation. These risks include declining asset values (i.e. bond investments) as a result of higher rates across the yield curve, particularly for banks that run a duration mismatch on their balance sheets, as well as the potential for banks to quickly lose deposits as depositors search for higher yields in investment products and/or flee in the face of a real or perceived banking crisis.

While Canadian banks are not completely immune from these issues, we thought this was a good opportunity to remind investors of the strength of our banks and our banking system in Canada. There are several reasons why we think Canadian banks are well positioned to handle the uncertainty facing certain U.S. regional banks and European banks:

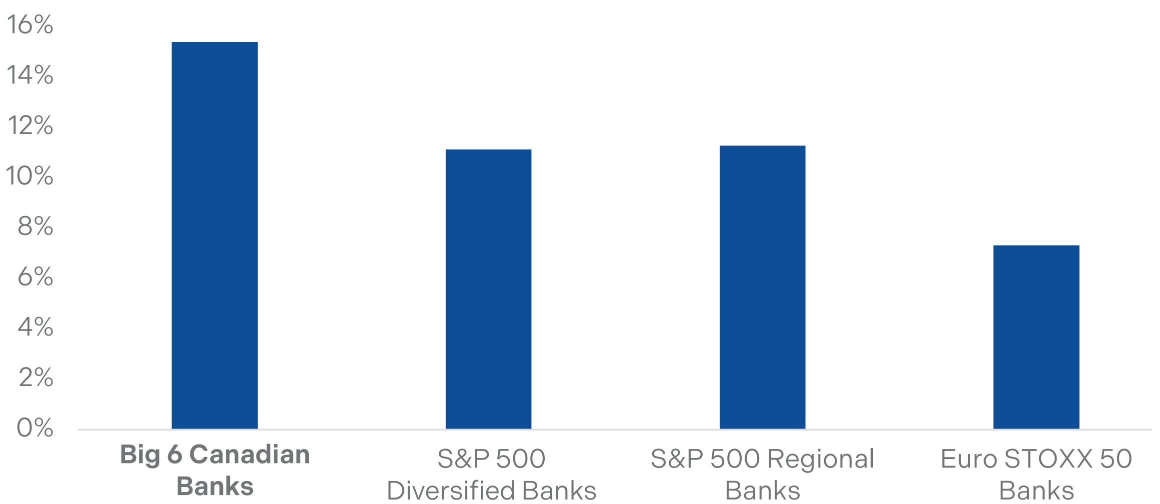
1. Canada has an excellent track record when it comes to banking regulation, supervision and governance, and Brompton believes our banking system is among the most disciplined (ie. conservative) in the world. In fact, the Office of the Superintendent of Financial Insitutions proactively increased the required CET1 (Tier 1 capital) ratio by 0.5% in 2022.

2. The Big 6 Canadian Banks are well capitalized with an average CET1 ratio of 13.7% as of the latest fiscal quarter (quarter ended January 31, 2023). This compares to 11.3% for the S&P 500 Diversified Banks and 9.5% for the S&P 500 Regional Banks (Source: Bloomberg).

3. The Big 6 Canadian Banks run more diversified business models and have better deposit franchises than the U.S. Regional Banks. As such, they are better prepared to deal with challenges as they arise, and deposits tend to be stickier.

4. Canadian Banks are more profitable than their U.S. and European peers (Figure 1). We believe that high profitability is the first line of defense in a crisis, as core profits can be used to absorb losses and/or rebuild capital in times of stress. In our view, this is the key differentiating factor for Canadian Banks and a key reason for why they have been able to weather past crises so well.

Figure 1: Bank Return on Equity (2018-2022 Average)



Source: Bloomberg as of March 23, 2023

With the turmoil over the past few weeks, global bank stocks have sold off. This includes the Canadian Banks, despite being better positioned to handle the challenges facing the global banking industry. After this selloff, Canadian Banks now trade at 9.1x forward EPS (as of March 23, 2023), which is near the low end of the range experienced over the past decade excluding the early days of the COVID pandemic (Figure 2). As such, we believe Canadian Banks present an excellent buying opportunity for investors with a long-term view.

Figure 2: TSX Diversified Banks – Forward P/E Multiple

Source: Bloomberg as of March 23, 2023

Brompton's Approach

At Brompton, we have experience investing in Financials and have several products that investors can use to get exposure to banks, including in our split share funds and ETFs. The following Brompton funds all trade on the TSX and focus specifically on Financials:

Fund Name	Preferred Share Ticker	Class A Ticker	ETF Ticker
Brompton Split Banc Corp.	SBC.PR.A	SBC	
Life & Banc Split Corp.	LBS.PR.A	LBS	
Brompton North American Financials Dividend ETF			BFIN

BROMPTON FUNDS

VALUE

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