FOYSTON, GORDON & PAYNE INC.
INVESTMENT COUNSEL

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Canada's Banks Doing Well, As We Expected

As you know, Foyston, Gordon & Payne (FGP) has been taking a contrarian view on Canada's banks, and this strategy has been working positively for clients:

- The S&P/TSX Banks Index has risen over 20% since its low in early February.
- The share prices of all but one of Canada's Big Six* banks recently reached 52-week highs, and some bank stocks are approaching their all-time highs of late 2014.
- The Big Six are trading at 10.7 times our estimate of their 2017 earnings. The average of the last 20 years has been 11.5 times earnings.
- Dividend yields are averaging about 4% for the Big Six, compared with 3% for the S&P/TSX Composite Index.

What's going on?

The banks released their second-quarter results in the past two weeks and reported accelerating loan losses in their oil and gas portfolios. The spillover effect to consumer credit in the oil-producing regions has been minor and largely offset by good performance in the rest of the country.

While the increase in energy-related loan losses reduced the quarter's earnings per share (EPS) by about 3%, the banks' solid fundamentals in retail banking and their increased focus on cost management resulted in an average EPS growth of 2% compared with the same quarter last year.

What this means for our clients' portfolios

We buy quality companies at attractive prices. The Canadian banks represent quality and are attractively priced even at their current valuations.

Based on our outlook for the banking sector, our Canadian equity portfolios continue to hold an overweight position in this sector.

* The Big Six banks are: Royal Bank of Canada, Toronto-Dominion Bank, Bank of Nova Scotia, Bank of Montreal, Canadian Imperial Bank of Commerce, and National Bank of Canada.

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