CIBC ASSET MANAGEMENT

CANADIAN BANKS UPDATE

Continued confidence despite recent weakness

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What has happened?

- After a stellar run from their 2020 lows, Canadian banks, as represented by the S&P/TSX Composite Banks Index, fell 10% from February 9, 2022, to April 18, 2022.
- Throughout the same period, the broader S&P/TSX Composite Index rose 1.25%. The Russian invasion of Ukraine shocked markets and triggered a divergence between bank stocks and the broader S&P/TSX Composite Index.
  - The broader S&P/TSX Composite Index has outsized exposure to natural resource and energy stocks, which have benefited from the higher commodity prices caused by the Russia/Ukraine conflict.
- Renewed recession fears, as a result of steeper-than-expected monetary policy tightening by the Bank of Canada and an inversion of the U.S. 2-10yr Yield curve, have also contributed to bank stock weakness.
  - Banks often act as proxies for economic health; therefore, banks underperform when markets fear a recession.

What is our outlook?

- While equities, and specifically bank stocks, may be volatile over the short-term, we continue to have confidence in the sector.
- We think it is too early to worry about the impact of a potential recession on bank profitability. We believe the odds of a recession are still fairly low.
- Strong loan growth and credit conditions, an expanding net interest margin (NIM), excess capital, and a valuation for the sector that is in-line with its historical average, all contribute to an attractive risk-reward profile for the sector.
- We continue to own banks and carefully monitor their trajectory along with the speed of Bank of Canada rate hikes.

What is our rationale?

Net Interest Margin (NIM)

NIMs are watched closely by financial institutions, as they measure the income earned through loans and mortgages and the amount they pay out on deposits. (i.e., Interest generated versus interest paid).

- Typically, NIMs will widen when interest rates are on the rise. In falling-rate environments, the reverse is typically true.
- Interest on deposits typically does not rise as quickly as interest on loans. This is due to the stickiness of the rates of interest paid on deposit accounts and GICs, etc.
- Given that we are in a rising-rate environment, we see Big-Six bank NIMs expanding going forward. Combined with strong loan growth, earnings growth should start to accelerate.

Credit Conditions

This is another important indicator to monitor for the banking sector. Strong credit conditions illustrate the ability of debtors to pay back their outstanding loans. Poor credit conditions may suggest debtors' inability to pay back their debt, and could lead to greater non-performing assets.

- Credit conditions remain healthy. While the credit market averaged around 1.32% to 1.99% of consumers that were delinquent past 30 days from 2013 to 2020, this figure decreased to 0.90% in 2021; it has averaged 0.86% thus far in 2022.

Canadian Mortgage Growth

The Canadian mortgage market has grown significantly over the past few years, aided by historically low interest rates, and has been a large source of revenue for Canadian banks.

- While we expect that mortgage growth has likely peaked, we continue to see positive growth going forward, although at lower levels.
- Mortgage Growth YOY was at 8% in 2020, and 10% in 2021. We expect 10% again in 2022, falling to 6% in 2023. Mortgages should continue to be a source of growth for banks going forward.

Excess Capital

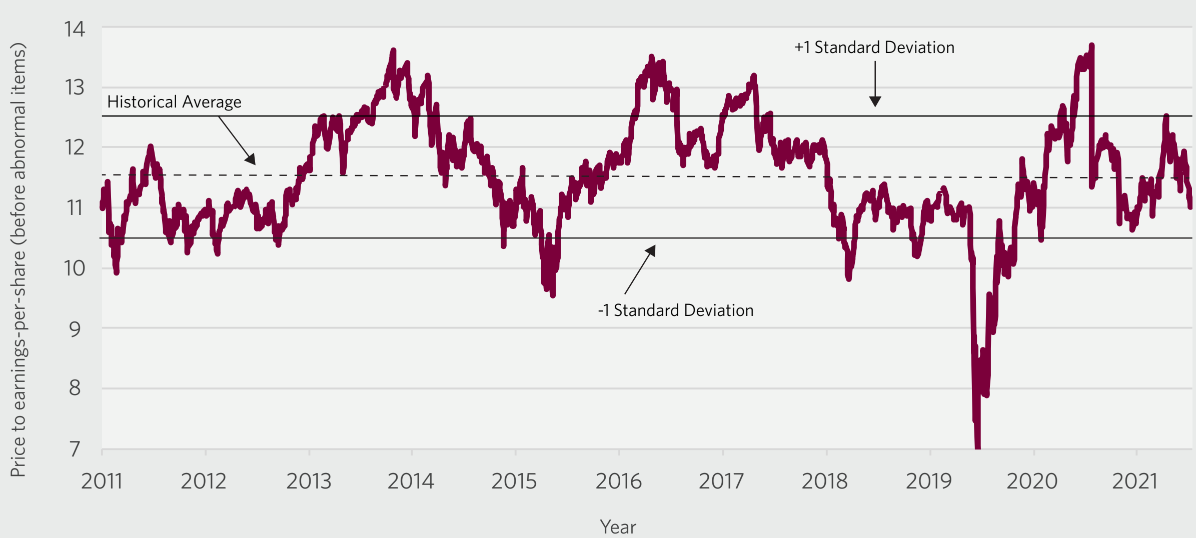
- In March 2020, The Office of the Superintendent of Financial Institutions (OSFI) imposed a ban on dividend increases, share buybacks, and raising executive compensation, in an effort to protect the financial system throughout the pandemic-related economic downturn.
- On November 4, 2021, OFSI announced that it was removing these restrictions.
- Although all Big-Six banks have since increased dividends, most of them still retain excess capital.
- This positions the sector for enhanced shareholder returns, such as increasing dividends and/or share buybacks.

Taxes on Bank Profits

- On April 7, 2022, the Canadian Government proposed a one-time tax of 15% on profits over $1 Billion for the 2021 tax year, and increased the corporate tax rate on banks for profits over $100 million from 15% to 16.5%.
- Banks rallied the day after the budget was announced, as the newly introduced bank taxes were less than the market had been pricing in, and the two taxes only applied to Canadian earnings.
- We believe this will have a nominal impact on bank profitability.

Valuations

- We believe that banks, as a whole, are attractively priced. Valuation for the banking sector is in-line with its historical average.
- This is represented by the ratio of Price to Earnings-per-Share (before abnormal items) of the S&P/TSX Composite Bank Index, which is shown below:



Source: Bloomberg® LP, as at April 19, 2022

Overall, we are confident in the sector going forward and maintain ownership of several banks within our portfolios at CIBC Asset Management.

Let’s connect

Should you have any questions about this report or anything else, please do not hesitate to connect:

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