Canadian Banks: Quality at a Premium Price

Key Takeaways:

- **Canadian banks are benefiting from more than bank fundamentals.** As heavyweights in the Canadian equity index, the Big Six are getting a side benefit from global flows into Canada as investors seek exposure to hard assets, commodities, oil, gold, and non-U.S.-dollar markets.
- **The quality premium is defensible.** Valuations are not cheap relative to history, but high profitability and supportive thematic tailwinds justify higher multiples in a market that continues to re-rate quality earnings.

The Hard-Asset Flow Supports the Rerating

Canadian banks are often treated as boring stocks. That is partly why they have become more interesting for global investors lately.

As we discussed in our earlier piece on this topic (***Canadian Banks: The Quiet Quality Trade***), the big Canadian bank stocks offer quality-focused diversification for global equity portfolios increasingly driven by the Tech momentum and geopolitical uncertainty. The quality bank stocks remain premium choices for investors seeking exposure to Financials with stable dividend income.

We maintain a positive view on the Canadian banks, while remaining mindful of their historically elevated valuations. We have not held the bank stocks in our model portfolio, but that reflects our portfolio construction process rather than a negative view. Financials have not ranked among our top sectors or secular themes in a market shaped by shifting policy, geopolitical fragmentation, and the chaotic actions of the U.S. administration.

In retrospect, however, the Canadian banks may have served as useful diversifiers in our portfolio. They have been second-order beneficiaries of a geopolitical landscape that has favored resource-rich economies. **The S&P/TSX Composite Banks Index has outperformed the S&P 500 by roughly +25 percentage points over the past twelve months, reinforcing the role Canadian banks can play as quality diversifiers in the current equity market context.**

Canadian Banks Index Outperforming Especially When Tech Momentum Fades

Global: *S&P/TSX Banks index relative to S&P 500*
(index)

Note: Indexed to May 5th, 2025 = 1.0
Source: Bloomberg, Rosenberg Research

The Big Six offers dependable dividends, strong domestic franchises, high profitability, and relatively low volatility. In a market still dominated by the debate over U.S. Tech valuations, AI capital spending, and policy uncertainty out of Washington, those characteristics have become more valuable.

The sector is not a value trade at all. P/E multiples have already re-rated to historical highs, and the easy part of the move may be behind us. The macro conditions in Canada do not suggest a great growth story either. The investment case rests on quality, income, macro diversification, and their role inside a Canadian equity market that is increasingly attractive to global allocators looking for hard-asset exposure. Energy and raw-material scarcity is likely to remain a powerful secular theme in the years ahead. Canadian assets can enjoy higher valuations than their historical norm as this secular theme translates into expanding investment opportunities in the country, supported by a more favorable policy backdrop.

That last point is important. The Big Six are not just banks; they are also index heavyweights. They account for a large share of the S&P/TSX 60, which means they benefit when global investors increase allocations to Canadian equities. Those flows are often driven by a broader view on commodities, energy, metals, gold, and the Canadian dollar. When the outlook for oil and hard assets improves, Canada tends to appear on the global asset-allocation screen. Banks then become a secondary beneficiary of that rotation, even when the original allocation impulse is not explicitly about financials.

Since the second half of last year, we have been in a market phase that favors the quality premium in the market. Investors are looking for ways to diversify away from U.S. dollar assets and AI-heavy U.S. stock market dynamics. The search has been increasingly moving toward hard assets, metals, oil, gold, and markets that offer a more tangible link to resources. Canada has plenty of that. The Canadian equity market is widely understood as a commodity-linked market, and when sentiment toward oil, mining, and gold improves, passive and active flows into Canada tend to strengthen. The banks are carried along with that tide.

That does not necessarily make the Big Six a commodity trade in disguise, however. Their earnings are not driven by the commodity prices. Unlike the economies with a Dutch Disease, Canadian banks' earnings are diversified across sectors in the economy while being rather exposed to the housing-market-related risks. They are major index constituents, deeply tied to domestic financial conditions, and exposed to the broader health of Canadian capital markets. When Canada gets reweighted higher in global portfolios, the banks receive the flow. That flow-driven rerating seems to be an important part of the recent story.

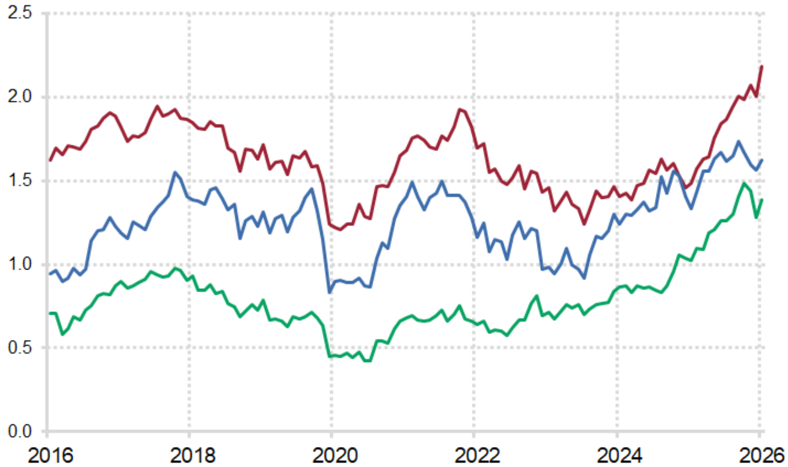
Quality Income at a Premium Price

The Big Six is not a value trade. The sector’s fundamentals help explain why the re-rating has been defensible. Canadian banks have generated stronger and steadier returns on equity than many U.S. and European peers, while doing so with lower and more stable leverage. Profit growth was better than expected in 2025, and consensus expectations point to continued earnings growth in 2026, supported by capital returns, dividend increases, and improving funding conditions.

Canadian banks are not high-beta growth stocks either. They are not designed to win a speculative melt-up led by the likes of AI beneficiaries and retail momentum flows. They are more useful when investors want some insulation from the excesses elsewhere in the market. That is why the sector can work as a stabilizer if U.S. Tech or related EM assets de-rate, or if the U.S. dollar weakens further as investors diversify toward non-U.S. assets.

Canadian Bank Valuations Are Consistently Higher Than the U.S. and EU Peers

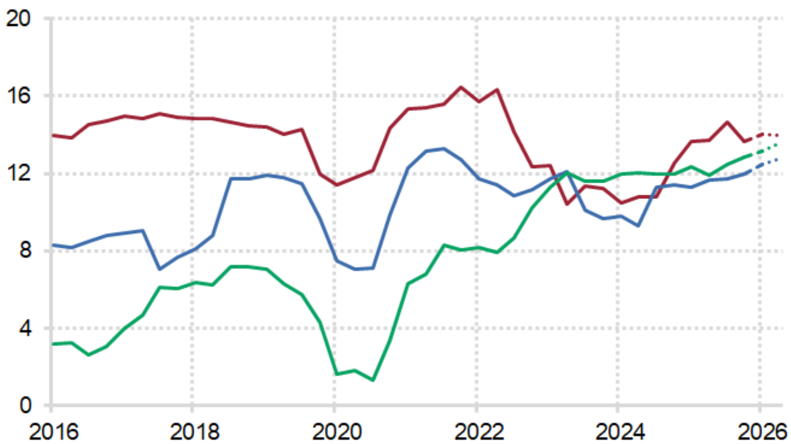
Global: *Price to Book Ratio*
(red line; TSX Banks index; ratio)
(blue line; S&P 500 Banks index; ratio)
(green line; Stoxx 600 Europe Banks index; ratio)



Source: Bloomberg, Rosenberg Research

Higher Valuations Are Driven By Consistently Higher Profitability

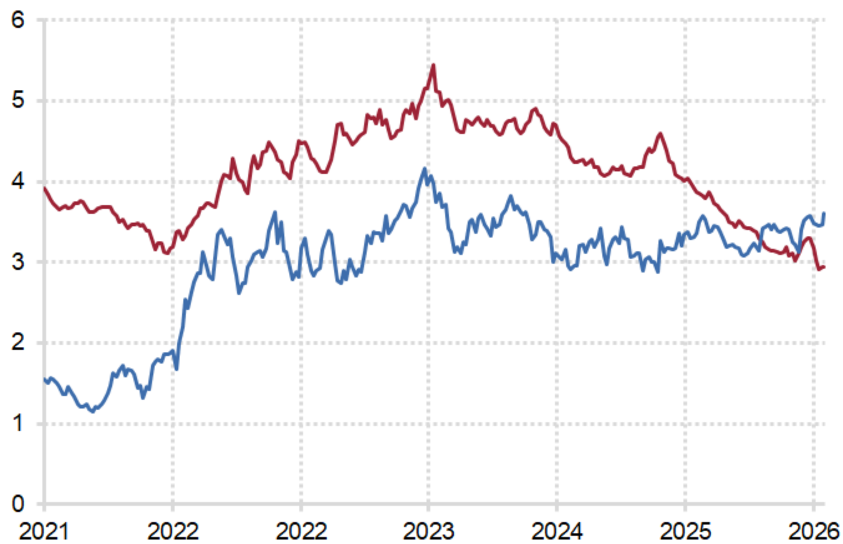
Global: *Return On Equity*
(red line; TSX Banks index; percent)
(blue line; S&P 500 Banks index; percent)
(green line; Stoxx 600 Europe Banks index; percent)



Source: Bloomberg, Rosenberg Research

TSX Banks Index Dividend Yield and Canadian 10-Year Yield

United States
(red line; TSX Banks index dividend yield; percent)
(blue line; Canadian 10-year bond yield; percent)



Source: Bloomberg, Rosenberg Research

Since the valuations are currently at premium levels, a granular and comparative approach to the bank stocks can become more useful than usual. The Big Six share many common features, and stocks are highly correlated, but they are not necessarily the same trade. Their business mix, mortgage exposure, U.S. footprint, credit sensitivity, and idiosyncratic risks might differ. We present a brief outline of those differences below.

A Brief Overview of the Big Six

RBC remains the broadest franchise in the group. It has the scale, diversification, and earnings power that investors usually associate with the highest-quality Canadian bank. Its fiscal 2026Q1 performance was strong, helped by Capital Markets, Wealth Management, and Personal Banking. It also has meaningful capital flexibility, supporting dividends and buybacks. The risk is that RBC is not immune to Canada's housing cycle. It has a large domestic mortgage and HELOC (Home Equity Line of Credit) book, including a meaningful wave of uninsured mortgages renewing through 2030. The likely offset is quality: low loan-to-value ratios, high borrower credit scores, and a limited share of high-risk mortgages. In short, RBC is a profitable compounder, but still with housing-cycle exposure.

TD is the capital-rich recovery story with a regulatory overhang. The bank has strong fundamentals, a large North American franchise, and one of the strongest capital buffers in the group. There does not seem to be any issue with basic financial strength. The relative overhang on valuations and growth expectations is the U.S. anti-money-laundering remediation process, which remains the major idiosyncratic drag on the stock. The bank paid more than $3 billion in penalties in 2025. There are asset caps imposed on the bank's subsidiaries in the U.S., and the caps are hard constraints on growth prospects. TD also has meaningful Canadian housing exposure and is more sensitive than some peers to interest-rate movements. The opportunity is that the market already understands much of the TD-specific problem. The risk is that the regulatory process in the U.S. takes longer than investors expect.

Scotiabank (BNS) offers some additional geographic diversification in Latam. BNS stands out because of its Pacific Alliance exposure across Mexico, Peru, Chile, and Colombia. That gives the bank a more distinctive profile than its domestic peers, and it can be useful if investors want exposure beyond Canada and the United States. Latin American markets are a source of growth, socially in the current macro landscape, but they can also become an additional risk if economic risks rise in the region, of course.

The Big Six Risks in a Nutshell

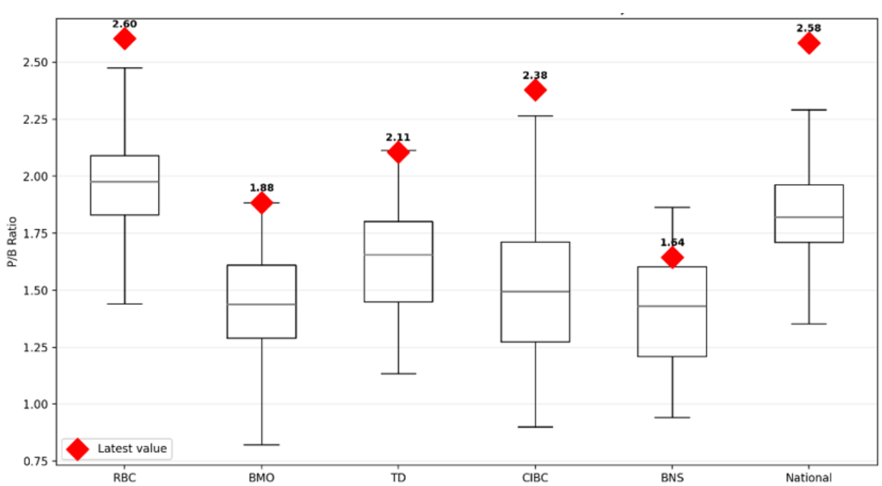
Canada

Bank	Character of the Trade	Profit/Capital Snapshot	Main Upside	Key Risks
RBC	Broadest quality franchise; scale, diversification, and earnings power	Strong fiscal 2026Q1, with pre-provision, pre-tax earnings up +14% YoY; CET1 ratio at 13.7%; surplus capital supporting dividends and buybacks	High-quality franchise, strong Wealth Management and Capital Markets exposure, improved ROE target	Large Canadian mortgage and HELOC exposure; mortgage renewals; housing-cycle risk; some CRE exposure
TD	Capital-rich recovery story with a regulatory overhang	CET1 ratio at 14.5%; large capital surplus; targeting 13% adjusted ROE in fiscal 2026 and roughly 16% by 2029	Discount could narrow if U.S. remediation progresses; strong North American retail franchise	U.S. AML remediation through 2027 or beyond; high rate sensitivity; meaningful Canadian housing and credit-card exposure
Scotiabank	International diversification story	CET1 ratio at 13.3%; management targeting 14%+ medium-term ROE by 2027	Exposure beyond Canada and the U.S.; potential upside from Pacific Alliance recovery	Latin American macro volatility; higher unsecured-lending risk; mortgage renewals and rising delinquencies in Ontario/GTA
BMO	North American commercial-credit and U.S.-cycle trade	CET1 ratio at 13.1%; targeting ROE of 15%+ by fiscal 2028	Less exposed to Canadian housing than peers; U.S. franchise can benefit from stronger commercial activity	Highest commercial lending exposure among peers; U.S. macro and trade risk; Bank of the West integration/rate sensitivity
CIBC	Cleanest expression of Canadian housing risk	CET1 ratio at 13.4%; aiming for cycle ROE of 15%+	Domestic franchise leverage if housing and employment remain resilient	Highest mortgage concentration; payment-shock sensitivity; elevated credit costs; higher relative U.S. CRE risk
National Bank	High-quality domestic franchise with Quebec anchor	CET1 ratio around 13.7%; 2026 ROE target raised to 16%	Lower housing risk due to Quebec concentration; strong profitability; low credit-card exposure	Integration risk from Canadian Western Bank and Laurentian syndicated-loan purchase

Source: Company Reports, Bloomberg, Rosenberg Research

Big Six Valuations Look High Relative to Their Own History

Canada
(price-to-book ratio)



Source: Bloomberg, Rosenberg Research

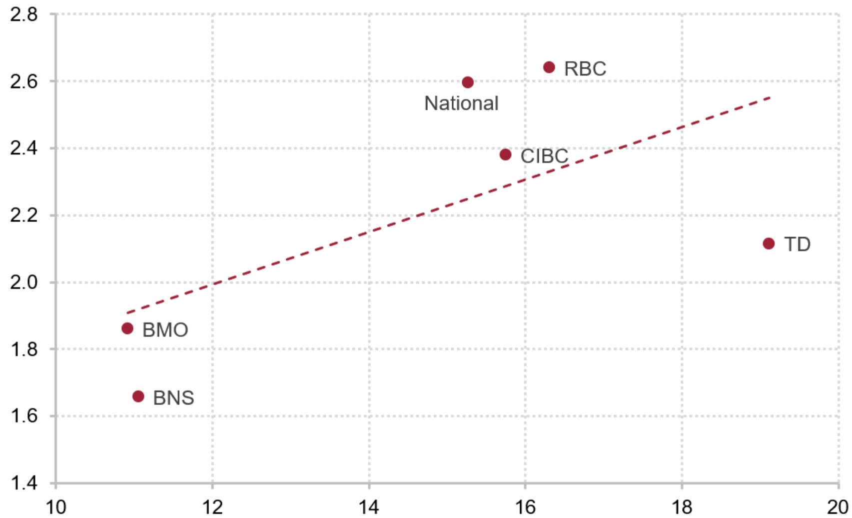
BMO is more exposed to commercial credit and the U.S. cycle. The bank has a strong franchise and remains well-capitalized. It has the largest U.S. commercial loan presence among peers, leaving it a bit more exposed to U.S. macro conditions, trade uncertainty, and USMCA-related risk. The Bank of the West acquisition also increased its sensitivity to U.S. interest rates. On the positive side, BMO is less exposed to Canadian housing than the rest of the group. It is therefore not the housing-risk trade. It is more of a North American commercial-credit and U.S.-cycle trade.

CIBC is probably the cleanest expression of Canadian housing risk. The bank has strong capital and an attractive domestic franchise, but it is the most concentrated in Canadian housing. Mortgages represent roughly half of total loans, and upcoming renewals leave the bank highly sensitive to employment trends, payment shocks, and any housing correction. Its U.S. commercial real estate exposure might also be a concern relative to the size of its balance sheet. That does not mean CIBC is structurally weak. It does mean that investors buying CIBC need to be comfortable underwriting the Canadian household and housing cycle more directly than with the other banks.

National Bank is a domestically focused quality story. It is smaller than the other five, but it has been one of the most profitable and best-regarded franchises in the group. Its Quebec concentration gives it some insulation from the more stretched housing markets in Ontario and British Columbia. It also has relatively low credit-card exposure and a balanced interest-rate sensitivity profile. The main growth risk is the financial outcome of the recent acquisition of The Canadian Western Bank. The investment case rests on whether management can realize the targeted synergies without diluting the bank’s historically strong profitability profile.

Price to Book vs. ROE of the Big Six

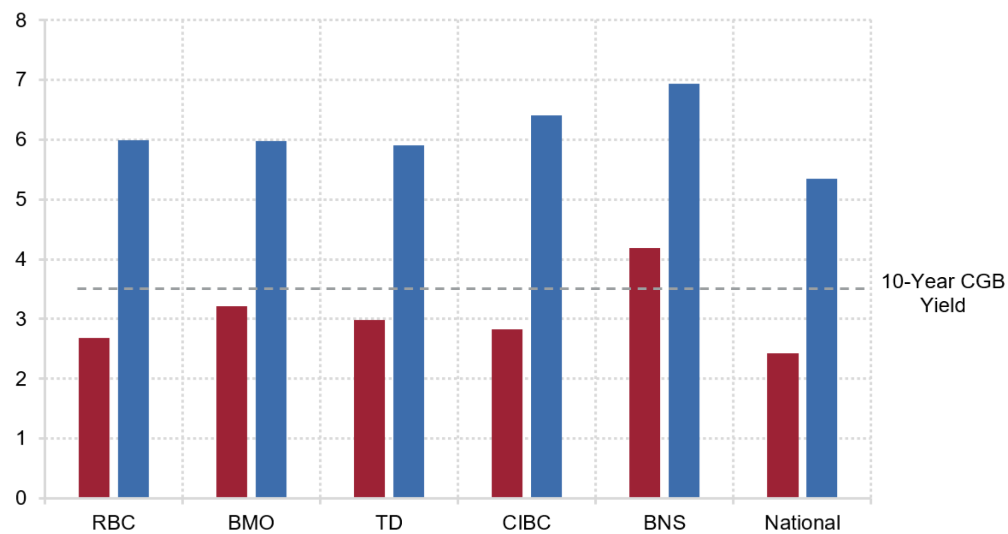
United States
(x-axis; return on equity; percent)
(y-axis; price-to-book ratio)



Source: Bloomberg, Rosenberg Research

Indicated Net Dividend Yields vs. the Canadian Government Bond Yield

Canada
(red bars; dividend yield; percent)
(blue bars; earnings yield; percent)



Source: Bloomberg, Rosenberg Research

Canadian Rates Outlook: No Clear Signal

BoC policy has been on hold for a while, and the direction of the next action remains uncertain according to the bank's latest communication. We have held the view that the weakness in the housing market and the growth dynamics warrant further cuts. The BoC keeps referring to a high level of uncertainty and unnecessarily waiting for better visibility, an extremely rare condition in economics.

The rate backdrop cuts both ways for Canadian banks. Higher oil and materials prices have lifted inflation concerns, but the larger risk is that this global supply shock turns into a growth shock. If higher input costs squeeze households, margins, and trade volumes. How much further slowdown from the current anemic growth it would take for the Bank of Canada to act remains a puzzle.

For the banks, the effect of a rate cut, if ever, would be mixed but broadly stabilizing. Lower rates can pressure asset yields and variable-rate loan income, but they also reduce funding costs, ease mortgage-renewal stress, and lower the risk of sharper credit deterioration. That matters for a banking system with meaningful household exposure.

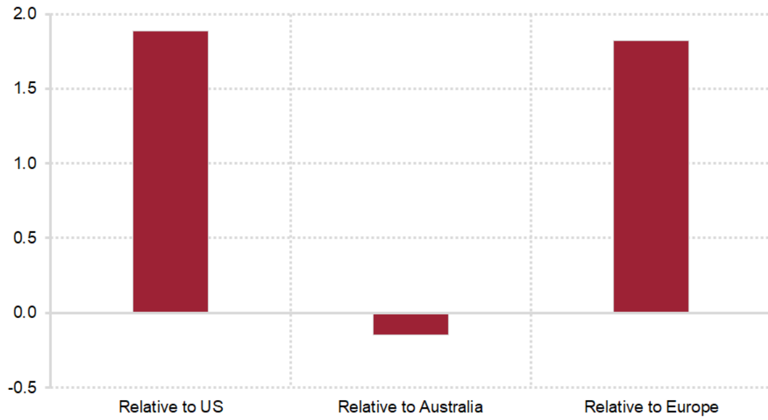
Conclusion: Premium Valuations With Thematic Tail Winds

In a market where investors are trying to balance exposure to Tech-driven growth and U.S. dollar concentration in portfolios, the Big Six may still offer a credible "quiet quality" allocation. But that quality now comes with a premium valuation. Whether that premium is justified by Canada's renewed appeal as a hard-asset market, or whether it is too expensive relative to historical levels, is a harder debate to settle.

To have a better comparison, one needs to look at relative valuations through time, not just nominal levels. We looked at the Canadian banks' P/E ratio premium or discount relative to other regions to see whether today's valuation premium is unusually high compared with other bank indexes.

Big Six Valuations Relative to U.S., European, and Australian Banks

Canada
(number of standard deviations)



Source: Bloomberg, Rosenberg Research

When we compare the P/E ratio of the MSCI Canada Banks Index relative to the U.S., Europe, and Australia, we see that Canadian banks are trading not only in the upper range of their own historical P/E ratios, but also at elevated valuations relative to U.S. and European banks. That is not true versus Australia, another commodity-based economy with a Commonwealth regulatory touch and a relatively conservative banking model. This points to a broader stock-market pattern that favors hard-asset exposure and high-quality earnings.

Yes, the Big Six are not cheap. But the market seems willing to pay a premium for quality and for exposure to a hard-asset economy in a fragmenting world marked by chaotic U.S. policy.

We maintain our HOLD/BUY rating, as we see the thematic premium drifting higher. For portfolio construction, the sector still makes sense as part of a lower-volatility equity allocation to a highly profitable industry. Canadian banks also offer an indirect way to participate in renewed global interest in hard-asset-driven economies. When allocators want Canada exposure for oil, metals, gold, and commodity-linked diversification, the Big Six are likely to receive part of the flow simply because they dominate the index.

The rerating of the Big Six has been helped by fundamentals, but also by macro flows. If commodity sentiment remains constructive, the Canadian dollar stabilizes or strengthens, and global portfolios continue to diversify away from the U.S., the stocks can continue to drift higher. But if the hard-asset rotation fades, housing stress rises, or unemployment weakens the consumer-credit picture, the sector's quality premium could be tested.