

Update on Canadian Banks



Summary

With European banks and sovereigns in the spotlight again, investors have been wondering about Canadian bank exposures to this troubled region.

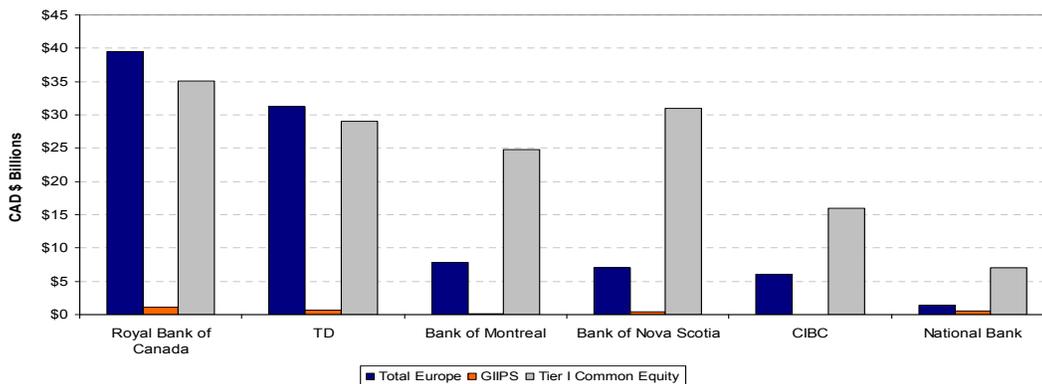
The issues plaguing Europe could be with us for some time, creating the potential for financial market dislocations, elevated counter-party risks, and global bank funding concerns. The most recent bout of risk aversion has contributed to a 10% decline in the S&P/TSX Bank Index from its recent high in March of this year. A stabilization of macro economic conditions and the debt crisis in Europe could lead Canadian banks to be re-rated to higher price-to-earnings multiples. Historically, the banks have traded in the 11-13x P/E range, while the current average is under 10x on 2013 earnings.

In a recessionary scenario for Canada, earnings estimates could fall 10%-15%. Even within the context of this kind of decline, the earnings multiples paid at current prices would be modest when compared to historical averages.

Europe

The graph below compares GIIPS (Greece, Ireland, Italy, Portugal and Spain) exposures and total European exposures to Tier 1 common equity levels for the Big Six Canadian banks.

Canadian Bank Exposures to Europe



Source: RBC Wealth Management, RBC Capital Markets and Company Reports

Notes:

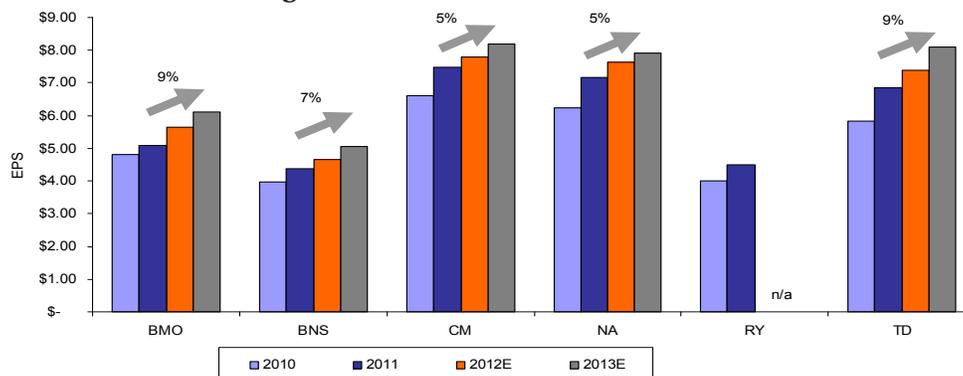
1. Royal Bank, TD and Bank of Montreal figures are net exposures
2. Bank of Nova Scotia figures are total undrawn commitments
3. CIBC figures are total unfunded exposures

Direct exposures to the GIIPS nations are small relative to the capital bases of Canada's major banks. However, exposures to Europe more broadly stand out for Royal Bank and TD. Risk also lies in knock-on effects that could take the form of (i) multiple compression in sympathy with global financial stocks, (ii) counterparty exposures given the inter-connectivity between global banks (liquidity/funding crisis as seen post Lehman Bros 2008), (iii) weaker capital markets and wealth management operations given the impact of challenging equity market conditions on these businesses, and (iv) implications for global economic growth and its repercussions for Canada.

Earnings Outlook

Earnings forecasts for the Canadian banks continue to show mid-to-high single-digit growth rates from 2011 through 2013. With banks touching all sectors of the economy, it is important to consider these forecasts in the context of Canada's economic outlook. RBC Economics' real GDP growth rate forecasts are 2.6% in both 2012 and 2013. Growth is decelerating for the Canadian banks following a decade-long trend of strong mortgage growth. In addition to moderating loan growth, the improving credit conditions seen in 2010 and 2011 no longer provide a tailwind to earnings, having largely stabilized in these prior years.

Canadian Bank Earnings Forecasts



Source: RBC Wealth Management, RBC Capital Markets

Note:

1. Percentages are the implied 2011-2013 compounded annual growth rates.
2. We are restricted on providing forward-looking numbers on Royal Bank.

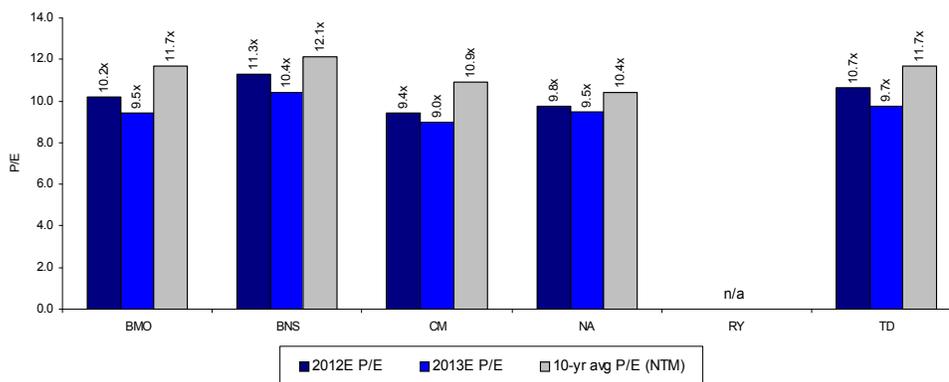
In the short-term, third-quarter results are likely to be weak given lower equity markets, which typically lead to lower trading revenues, investment banking fees, and lower fees in wealth management. A moderating economic outlook may also lead to modestly slower loan growth.

Valuation

Price-to-earnings multiples for the Canadian banks are attractive relative to the historical, forward-looking averages. Compression of these multiples is in part related to concerns over the debt crisis in Europe and challenging global economic conditions. Lower multiples also reflect a moderation in consumer loan growth given the expected slowing of Canada's housing market, which has seen house prices roughly double over the last decade, while Canadian consumer credit has risen to 150% from 110% of disposable income.

Canadian banks are trading at an average 2013 P/E multiple of 9.6x, ranging from 9.0x (CIBC) to 10.4x (Bank of Nova Scotia).

Current P/E Relative to 10-Year Historical Average



Source: RBC Wealth Management, RBC Capital Markets

Note: We are restricted from providing forward-looking numbers on Royal Bank.

Conclusion

While Canadian banks are attractively valued in the historical context, these valuations are predicated on existing earnings forecasts materializing. The most recent bout of risk aversion has been negative for sentiment (multiple) and for the earnings outlook (impact on forecasts for wealth management and capital markets revenues). A stabilization of macro economic conditions and the debt crisis in Europe could lead to a positive re-rating of the Canadian banks. Historically, the banks have traded in the 11-13x P/E range, while the current average is under 10x on 2013 earnings.

In a recessionary scenario for Canada, earnings estimates could be down 10%-15%. Even within the context of this kind of decline, the earnings multiples paid at current prices would be below historical averages.

Required Disclosures

Explanation of RBC Capital Markets Rating System

An analyst's "sector" is the universe of companies for which the analyst provides research coverage. Accordingly, the rating assigned to a particular stock represents solely the analyst's view of how that stock will perform over the next 12 months relative to the analyst's sector.

Ratings:

Top Pick (TP): Represents best in Outperform category; analyst's best ideas; expected to significantly outperform the sector over 12 months; provides best risk-reward ratio; approximately 10% of analyst's recommendations.

Outperform (O): Expected to materially outperform sector average over 12 months.

Sector Perform (SP): Returns expected to be in line with sector average over 12 months.

Underperform (U): Returns expected to be materially below sector average over 12 months.

Risk Qualifiers (any of the following criteria may be present):

Average Risk (Avg): Volatility and risk expected to be comparable to sector; average revenue and earnings predictability; no significant cash flow/financing concerns over coming 12-24 months; fairly liquid.

Above Average Risk (AA): Volatility and risk expected to be above sector; below average revenue and earnings predictability; may not be suitable for a significant class of individual equity investors; may have negative cash flow; low market cap or float.

Speculative (Spec): Risk consistent with venture capital; low public float; potential balance sheet concerns; risk of being delisted.

Distribution of Ratings, Firmwide

Rating	RBC Capital Markets		Investment Banking Serv./Past 12 Mos.	
	Count	Percent	Count	Percent
BUY [TP/O]	776	52.05	230	29.64
HOLD [SP]	648	43.46	156	24.07
SELL [U]	67	4.49	2	2.99

For purposes of disclosing ratings distributions, regulatory rules require member firms to assign all rated stocks to one of three rating categories Buy, Hold/Neutral, or Sell regardless of a firm's own rating categories. Although RBC Capital Markets' stock ratings of Top Pick/Outperform, Sector Perform and Underperform most closely correspond to Buy, Hold/Neutral and Sell, respectively, the meanings are not the same because our ratings are determined on a relative basis (as described above).

In the event that this is a compendium report (covers six or more subject companies), RBC Dominion Securities may choose to provide specific disclosures for the subject companies by reference. To access current disclosures, clients should send a request to RBC Dominion Securities, Attention: Manager, Portfolio Advisory Group, 155 Wellington Street West, 17th Floor, Toronto, ON M5V 3K7.

Dissemination of Research

RBC Capital Markets endeavours to make all reasonable efforts to provide research simultaneously to all eligible clients. RBC Capital Markets' equity research is posted to our proprietary websites to ensure eligible clients receive coverage initiations and changes in rating, targets and opinions in a timely manner. Additional distribution may be done by the sales personnel via email, fax or regular mail. Clients may also receive our research via third party vendors. Please contact your investment advisor or institutional salesperson for more information regarding RBC Capital Markets research.

Important Disclosures

The author(s) of this report are employed by RBC Dominion Securities Inc., a securities broker-dealer with principal offices located in Toronto, Canada.

RBC Dominion Securities Inc.* and Royal Bank of Canada are separate corporate entities which are affiliated. "Member CIPF. ®Registered trademark of Royal Bank of Canada. Used under licence. ©Copyright 2012. All rights reserved.

Bank of Montreal

Royal Bank of Canada, together with its affiliates, beneficially owns 1 percent or more of a class of common equity securities of Bank of Montreal.

A member company of RBC Capital Markets or one of its affiliates received compensation for investment banking services from Bank of Montreal in the past 12 months.

A member company of RBC Capital Markets or one of its affiliates managed or co-managed a public offering of securities for Bank of Montreal in the past 12 months.

RBC Capital Markets, LLC makes a market in the securities of Bank of Montreal and may act as principal with regard to sales or purchases of this security.

RBC Dominion Securities Inc. makes a market in the securities of Bank of Montreal and may act as principal with regard to sales or purchases of this security.

RBC Capital Markets is currently providing Bank of Montreal with non-securities services.

RBC Capital Markets has provided Bank of Montreal with investment banking services in the past 12 months.

RBC Capital Markets has provided Bank of Montreal with non-investment banking securities-related services in the past 12 months.

RBC Capital Markets has provided Bank of Montreal with non-securities services in the past 12 months.

A member company of RBC Capital Markets or one of its affiliates received compensation for products or services other than investment banking services from Bank of Montreal during the past 12 months. During this time, a member company of RBC Capital Markets or one of its affiliates provided non-investment banking securities-related services to Bank of Montreal.

Portfolio Advisory Group personnel, including the portfolio advisor or any individuals directly involved in the preparation of the report, including their supervisors, hold(s) or exercise(s) investment discretion over a long position in the common shares of Bank of Montreal.

The portfolio advisor responsible for this report or a member of his/her team hold(s) or exercise(s) investment discretion

or control over a long position in the non-convertible fixed income securities of Bank of Montreal.

TD Bank

Royal Bank of Canada, together with its affiliates, beneficially owns 1 percent or more of a class of common equity securities of TD Bank Financial Group.

A member company of RBC Capital Markets or one of its affiliates received compensation for investment banking services from TD Bank Financial Group in the past 12 months.

A member company of RBC Capital Markets or one of its affiliates managed or co-managed a public offering of securities for TD Bank Financial Group in the past 12 months.

RBC Capital Markets, LLC makes a market in the securities of TD Bank Financial Group and may act as principal with regard to sales or purchases of this security.

RBC Dominion Securities Inc. makes a market in the securities of TD Bank Financial Group and may act as principal with regard to sales or purchases of this security.

RBC Capital Markets has provided TD Bank Financial Group with investment banking services in the past 12 months.

RBC Capital Markets has provided TD Bank Financial Group with non-investment banking securities-related services in the past 12 months.

RBC Capital Markets has provided TD Bank Financial Group with non-securities services in the past 12 months.

A member company of RBC Capital Markets or one of its affiliates received compensation for products or services other than investment banking services from TD Bank Financial Group during the past 12 months. During this time, a member company of RBC Capital Markets or one of its affiliates provided non-investment banking securities-related services to TD Bank Financial Group.

A member company of RBC Capital Markets or one of its affiliates received compensation for products or services other than investment banking services from TD Bank Financial Group during the past 12 months. During this time, a member company of RBC Capital Markets or one of its affiliates provided non-securities services to TD Bank Financial Group.

National Bank

Royal Bank of Canada, together with its affiliates, beneficially owns 1 percent or more of a class of common equity securities of National Bank of Canada.

A member company of RBC Capital Markets or one of its affiliates received compensation for investment banking services from National Bank of Canada in the past 12 months.

A member company of RBC Capital Markets or one of its affiliates managed or co-managed a public offering of securities for National Bank of Canada in the past 12 months.

RBC Dominion Securities Inc. makes a market in the securities of National Bank of Canada and may act as principal with regard to sales or purchases of this security.

RBC Capital Markets has provided National Bank of Canada with investment banking services in the past 12 months.

RBC Capital Markets has provided National Bank of Canada with non-investment banking securities-related services in

the past 12 months.

RBC Capital Markets has provided National Bank of Canada with non-securities services in the past 12 months.

A member company of RBC Capital Markets or one of its affiliates received compensation for products or services other than investment banking services from National Bank of Canada during the past 12 months. During this time, a member company of RBC Capital Markets or one of its affiliates provided non-investment banking securities-related services to National Bank of Canada.

A member company of RBC Capital Markets or one of its affiliates received compensation for products or services other than investment banking services from National Bank of Canada during the past 12 months. During this time, a member company of RBC Capital Markets or one of its affiliates provided non-securities services to National Bank of Canada.

Bank of Nova Scotia

Royal Bank of Canada, together with its affiliates, beneficially owns 1 percent or more of a class of common equity securities of The Bank of Nova Scotia.

A member company of RBC Capital Markets or one of its affiliates received compensation for investment banking services from The Bank of Nova Scotia in the past 12 months.

A member company of RBC Capital Markets or one of its affiliates managed or co-managed a public offering of securities for The Bank of Nova Scotia in the past 12 months.

RBC Capital Markets, LLC makes a market in the securities of The Bank of Nova Scotia and may act as principal with regard to sales or purchases of this security.

RBC Dominion Securities Inc. makes a market in the securities of The Bank of Nova Scotia and may act as principal with regard to sales or purchases of this security.

RBC Capital Markets is currently providing The Bank of Nova Scotia with non-securities services.

RBC Capital Markets has provided The Bank of Nova Scotia with investment banking services in the past 12 months.

RBC Capital Markets has provided The Bank of Nova Scotia with non-investment banking securities-related services in the past 12 months.

RBC Capital Markets has provided The Bank of Nova Scotia with non-securities services in the past 12 months.

A member company of RBC Capital Markets or one of its affiliates received compensation for products or services other than investment banking services from The Bank of Nova Scotia during the past 12 months. During this time, a member company of RBC Capital Markets or one of its affiliates provided non-investment banking securities-related services to The Bank of Nova Scotia.

A member company of RBC Capital Markets or one of its affiliates received compensation for products or services other than investment banking services from The Bank of Nova Scotia during the past 12 months. During this time, a member company of RBC Capital Markets or one of its affiliates provided non-securities services to The Bank of Nova Scotia.

A partner, director or officer of a member company of RBC Capital Markets or one of its affiliates, or an analyst involved

in the preparation of a report on The Bank of Nova Scotia has, during the preceding 12 months, provided services for The Bank of Nova Scotia for remuneration other than normal course investment advisory or trade execution services.

The portfolio advisor responsible for this report or a member of his/her team hold(s) or exercise(s) investment discretion or control over a long position in the non-convertible fixed income securities of The Bank of Nova Scotia.

Canadian Imperial Bank of Commerce

Royal Bank of Canada, together with its affiliates, beneficially owns 1 percent or more of a class of common equity securities of Canadian Imperial Bank of Commerce.

A member company of RBC Capital Markets or one of its affiliates received compensation for investment banking services from Canadian Imperial Bank of Commerce in the past 12 months.

A member company of RBC Capital Markets or one of its affiliates managed or co-managed a public offering of securities for Canadian Imperial Bank of Commerce in the past 12 months.

RBC Capital Markets, LLC makes a market in the securities of Canadian Imperial Bank of Commerce and may act as principal with regard to sales or purchases of this security.

RBC Dominion Securities Inc. makes a market in the securities of Canadian Imperial Bank of Commerce and may act as principal with regard to sales or purchases of this security.

RBC Capital Markets has provided Canadian Imperial Bank of Commerce with investment banking services in the past 12 months.

RBC Capital Markets has provided Canadian Imperial Bank of Commerce with non-securities services in the past 12 months.

A member company of RBC Capital Markets or one of its affiliates received compensation for products or services other than investment banking services from Canadian Imperial Bank of Commerce during the past 12 months. During this time, a member company of RBC Capital Markets or one of its affiliates provided non-securities services to Canadian Imperial Bank of Commerce.

The portfolio advisor responsible for this report or a member of his/her team hold(s) or exercise(s) investment discretion or control over a long position in the non-convertible fixed income securities of Canadian Imperial Bank of Commerce.

Royal Bank

Portfolio Advisory Group personnel, including the portfolio advisor or any individuals directly involved in the preparation of the report, including their supervisors, hold(s) or exercise(s) investment discretion over a long position in the common shares of Royal Bank of Canada.

Portfolio Advisory Group personnel, including the portfolio or any individuals directly involved in the preparation of the report, including their supervisors, hold(s) or exercise(s) investment discretion over a long position in warrants, rights or securities convertible into the common shares of Royal Bank of Canada.

The portfolio advisor responsible for this report or a member of his/her team hold(s) or exercise(s) investment discretion or control over a long position in the non-convertible fixed income securities of Royal Bank of Canada.

To access the company disclosures mentioned in this report, clients should refer to <http://www7.rbcm.com/GLDisclosure/PublicWeb/DisclosureLookup.aspx?EntityID=1>



The information contained in this report has been compiled by RBC Dominion Securities Inc. ("RBC DS") from sources believed by it to be reliable, but no representations or warranty, express or implied, are made by RBC DS or any other person as to its accuracy, completeness or correctness. All opinions and estimates contained in this report constitute RBC DS's judgment as of the date of this report, are subject to change without notice and are provided in good faith but without legal responsibility. This report is not an offer to sell or a solicitation of an offer to buy any securities. Additionally, this report is not, and under no circumstances should be construed as, a solicitation to act as securities broker or dealer in any jurisdiction by any person or company that is not legally permitted to carry on the business of a securities broker or dealer in that jurisdiction. This material is prepared for general circulation to Investment Advisors and does not have regard to the particular circumstances or needs of any specific person who may read it. RBC DS and its affiliates may have an investment banking or other relationship with some or all of the issuers mentioned herein and may trade in any of the securities mentioned herein either for their own account or the accounts of their customers. RBC DS and its

affiliates may also issue options on securities mentioned herein and may trade in options issued by others. Accordingly, RBC DS or its affiliates may at any time have a long or short position in any such security or option thereon. Neither RBC DS nor any of its affiliates, nor any other person, accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or the information contained herein. This report may not be reproduced, distributed or published by any recipient hereof for any purpose. RBC Dominion Securities Inc.* and Royal Bank of Canada are separate corporate entities which are affiliated. *Member-Canadian Investor Protection Fund. ©Registered trademark of Royal Bank of Canada. Used under licence. RBC Dominion Securities is a registered trademark of Royal Bank of Canada. Used under licence. ©Copyright 2011. All rights reserved.