One Must-Know Trick When Investing in Canada's Banks

Description

When investing in Canada's banks, trying to decide which one to go with is often a fool's game. Each of the big five is so thoroughly combed over by analysts and portfolio managers that it's hard to imagine any of the banks being seriously mispriced.

However, there is one trick that has worked well for years: Simply buy the worst-performing bank stock over the past 12 months. Why does this work so consistently? Well, Canadian banking is a sector where each company will experience up years and down years, but always bounce back to the mean. Meanwhile, bank investors tend to overreact to short-term results.

All you have to do is buy the bank that's most out of favour, and wait for things to return to normal.

The stock to avoid

Along the same lines, you'll probably want to avoid the bank whose shares have performed the best over the past 12 months, which right now is **Toronto Dominion Bank** (TSX: TD)(NYSE: TD). The bank that prides itself on convenience and customer service has returned an astounding 37.72%, including dividends, over the past 12 months.

This shows up in TD Bank's valuation multiples. At 14.6 times earnings, its shares are certainly expensive by historical standards, and because of its high share price, its dividend yield of 3.4% is the lowest among its large peers.

TD Bank is one of the most popular names to start with when building a portfolio, but that's part of the reason why its shares have done so well. At this point you're likely better off going against the crowd.

The stock to buy

You would think that a return of 28.16% over the past 12 months is pretty good, and by almost any standard, it is. However, in the context of Canada's banks, where seemingly everything has gone right recently, this number puts **Royal Bank of Canada** (TSX: RY)(NYSE: RY) in last place.

As a result, Royal is cheaper than TD Bank, trading at 12.6 times earnings. In my opinion, Royal should trade at a more expensive multiple, given its opportunities to grow earnings from wealth management and capital markets. Meanwhile, TD Bank is focusing on retail banking in the United States, which is much less profitable.

Of course, with these kinds of returns over the past year, there's a strong argument for avoiding the banks altogether. However, if you're looking for a big bank to anchor your portfolio, at this point you're better off choosing Royal Bank of Canada.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:RY (Royal Bank of Canada)
2. NYSE:TD (The Toronto-Dominion Bank)
3. TSX:RY (Royal Bank of Canada)
4. TSX:TD (The Toronto-Dominion Bank)

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