Many Investors Are Overlooking The Bank of Montreal — Should You?

Description

When building stock portfolios, many investors like to start with one or more of the big five banks. But one of these banks in particular often gets overlooked: **Bank of Montreal** (TSX: BMO)(NYSE: BMO). Very often that is exactly the kind of company you should be looking for.

So should you add Bank of Montreal to your portfolio? Below we take a closer look.

A cheap price

Despite a strong run over the past year, in which Bank of Montreal shares gained 25%, the company still trades quite cheaply relative to its peers. According to Morningstar, the company trades for less than 12 times earnings and only 1.7 times book value. By comparison, **Royal Bank of Canada** (TSX: RY)(NYSE: RY) trades at 13.4 times earnings and 2.5 times book value.

Growth opportunities

Better yet, Bank of Montreal has plenty of opportunities to grow, particularly in the United States. The key has been commercial and industrial (C&I) lending, which has grown 8% year-over-year. In a note to clients two weeks ago, CIBC analyst Rob Sedran said that Bank of Montreal is "most exposed to a better outlook for C&I lending in the United States." This has helped offset weakness in personal lending.

Weakness in Canada

That being said, Bank of Montreal is not as strong domestically as some of its competitors. To illustrate, Royal Bank has about twice as many loans, deposits, and employees than Bank of Montreal in Canada. And this larger scale allows RBC to more easily absorb its fixed costs. As a result, RBC is much more profitable than Bank of Montreal – in 2013, RBC's profit per employee was 18% higher than Bank of Montreal's and its profit per branch was 80% higher.

With such profitable operations in Canada, RBC is able to more aggressively target new banking customers. To illustrate, you can get an iPad mini just for opening up an RBC bank account. **Toronto-Dominion Bank** has a similar promotion except TD is offering Samsung Galaxy tablets instead.

But Bank of Montreal has no comparable offer. So as can be seen, it is simply not as well-positioned to compete in Canada relative to some of its peers. And that should be concerning to investors.

A poor track record

Unfortunately, Bank of Montreal does not have a very good track record, and this is what should concern investors the most. For example, the company ran into trouble during the financial crisis, and had to raise equity in late 2008 (after the stock had already plummeted). More recently, Bank of Montreal has pursued short-term growth at the expense of long-term profitability, most notably by introducing 2.99% mortgages with five-year terms.

This track record has had an effect on the stock price. Over the past 10 years, Bank of Montreal's shares have increased by only 6.8% per year, the worst number among the big five banks. By comparison, RBC shares have returned 12.4% per year over this time frame.

No need to hold Bank of Montreal

All in all, Bank of Montreal is a lower-quality bank that is trading relatively cheaply. And by buying the shares, you can make a bet on the United States' continued economic recovery.

But if that's the kind of investment you are looking for, you're better off buying one of the big American banks. They have stronger franchises, have cheaper valuations, and are more of a pure-play bet. As for the Canadian banks, you should likely opt for one with a better track record.

CATEGORY

1. Investing

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2. NYSE:RY (Royal Bank of Canada)
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