



Buy Bank Stocks Like Warren Buffett

Description

When it comes to investing in value companies, Warren Buffett knows best. He is the king of finding companies that are undervalued and then buying them up. And one sector that he invests in heavily is the banking sector.

While the price to book value is an important ratio, when looking at banking stocks, Buffett argues that it's the return on assets that matters to him most. But he goes on to say, "It [return on assets] translates to book value, because ... you're required to hold a certain amount of tangible equity, compared to the assets you have."

What that means is that banks that are pulling in more money from their assets are worth more in Buffett's eyes compared to companies that don't pull in as much. In the chart below, I've laid out the average return on assets in comparison to the average price to book value.

five banks or type unknown

In the chart, we see that **Bank of Montreal** ([TSX: BMO](#))([NYSE: BMO](#)) has the lowest P/B. But it also doesn't return a lot on its assets. On the other hand, **Royal Bank of Canada** ([TSX: RY](#))([NYSE: RY](#)) has a P/B of 2.28 times, but it also returns 0.96%. If you take a deeper dive into it, you'll see that the quarterly return on assets has been rising since the beginning of the year. Finally, looking at **Canadian Imperial Bank of Commerce** ([TSX: CM](#))([NYSE: CM](#)), we see that it returns 0.88%, but also has a higher price to book value of 2.23 times.

Based on the data in the chart, none of the stocks jump out at me as definite buys. But there's another way to decide which stock is best and that's by looking at what Buffett has bought. His favourite bank stock is **Wells Fargo & Co.** ([NYSE: WFC](#)). Its price/book is 1.65 times, but its return on assets is right around 1.5%. That's an amazing return.

It's the type of bank Wells Fargo runs that makes it appealing. It is your typical neighborhood bank that makes its money from deposits, fees, and loans rather than investment banking. If you take that information into consideration as well, my eyes hone in on two companies: Royal Bank of Canada and **The Bank of Nova Scotia** ([TSX: BNS](#))([NYSE: BNS](#)).

I choose the former because it has growing returns and because it resembles Wells Fargo. A lot of its revenue comes from old-school banking tactics. Furthermore, the return on assets heading toward 1% is really attractive, and when it crosses that threshold, I think the stock will rise even more.

The Bank of Nova Scotia, though, is a bit cheaper and is pushing toward the 0.9% mark for return on assets. What I also like about it is that it has diversified its revenue into Latin America.

In my opinion, both of these stocks would be great buys. If you're looking for a stock based on the P/B, pick up Nova Scotia. But if you're looking to follow in Buffett's shoes and get a stock that is returning more on its assets, check out Royal Bank.

But remember, you don't want to base your research only on the P/B ratio and return on average assets. Therefore, check out this report on the Big 5 banks for more in-depth information to help you make your decision.

CATEGORY

1. Bank Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:BMO (Bank of Montreal)
2. NYSE:BNS (The Bank of Nova Scotia)
3. NYSE:CM (Canadian Imperial Bank of Commerce)
4. NYSE:RY (Royal Bank of Canada)
5. NYSE:TD (The Toronto-Dominion Bank)
6. TSX:BMO (Bank Of Montreal)
7. TSX:BNS (Bank Of Nova Scotia)
8. TSX:CM (Canadian Imperial Bank of Commerce)
9. TSX:RY (Royal Bank of Canada)
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Date

2025/09/14

Date Created

2014/10/09

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