Why The Bank of Nova Scotia Is Set to Outperform Toronto-Dominion Bank

Description

Over the past year, shares of **The Bank of Nova Scotia** (TSX: BNS)(NYSE: BNS) have not performed particularly well. During that time, they are up not quite 6.5%, easily the worst of any big five bank. Leading the pack is **Toronto-Dominion Bank** (TSX: TD)(NYSE: TD), whose shares are up over 18% in the past year.

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But there are reasons to believe that next year will be a different story. Below are three reasons why.

1. The worst performing bank

Over the past 15 years, you could have employed a very simple strategy, and make outsized returns by doing so. All you needed to do was buy the bank stock that had performed worst the previous year. If you had done this, you would have handily beat the **S&P/TSX Capped Financials Index**.

The reason is very simple – in the Canadian banking sector, investors tend to overreact to short-term trends. And in the longer term, the banks usually revert to the mean. For example, perhaps the best time to buy TD was after a disastrous year in 2002. Since then, the shares have outperformed handsomely.

So if history is repeating itself, then now might be a perfect time to buy Bank of Nova Scotia.

2. Emerging markets vs. USA

This year has not been a kind one to emerging markets stocks. As a result, Bank of Nova Scotia's emerging markets exposure has not helped its share price. In fact the shares were down 8% in January alone.

But the bank's exposure to emerging markets is limited to strong, growing economies like Mexico, Colombia, Peru, and Chile. So it's quite unfair that the shares were punished by an emerging markets sell-off. Meanwhile, TD is heavily exposed to the U.S. market, which is far more competitive and less profitable.

So arguably, Bank of Nova Scotia's greatest strength is perceived as its greatest weakness.

3. Price

Thanks to Bank of Nova Scotia's lagging stock price, you can now pick up the shares for a nice bargain.

To illustrate, the shares trade at only 11.6 times earnings. Remember, this is a company that earns almost half of its income in high-growth international markets. You'll have a tough time finding other stocks with such growth prospects trading so cheaply.

Meanwhile, TD trades at 14 times earnings. Granted, there are reasons to like TD – it has a fantastic track record, is arguably the lowest-risk bank, and should benefit from an eventual recovery in the United States.

But given where each of these companies are, Bank of Nova Scotia should probably be more expensive than TD. Until that's the case, you're better off buying Bank of Nova Scotia.

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1. Investing

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