



Will Toronto-Dominion Bank Continue To Outperform Royal Bank of Canada?

Description

The conventional wisdom about Canadian bank stocks has always been that they are fairly similar. That is to say, if one bank does well, chances are very good the others will do the same.

However, Canada's large banks do show quite different performance over longer time frames, and this is especially true for Canada's two dominant bankers, **Toronto-Dominion Bank** ([TSX: TD](#))([NYSE:TD](#)) and **Royal Bank of Canada** ([TSX:RY](#))([NYSE:RY](#)).

As you will see, TD Bank has outperformed over several time frames, and according to several measures. The question is: Will this continue?

How much has TD Bank outperformed RBC?

Year to date, TD Bank has outperformed RBC by a fairly small 1.3%. Over time, however, the differences grow. If you bought TD Bank shares exactly five years ago, you'd have realized a very healthy 78% return from share price. If you factor reinvested dividends into this return, it rises to an astounding 112%. An investment in RBC at the same time would have yielded a smaller 43.62%.

According to Bloomberg's risk-adjusted return, which measures returns relative to share-price volatility or risk, TD once again outperforms over five years with a 9% gain to RBC's 6%. In other words, TD is showing better returns with less risk.

Why TD Bank has an edge

The big question is, why? I believe the answer stems directly from TD Bank's strategy, and approach to banking. This strategy can be simply summed up in the fact that TD Bank chooses to call its branches stores.

TD separates itself from RBC in the fact that it is almost entirely focused on what seems now like old-fashioned retail banking. In Q3 2014, 90% of TD Bank's earnings came from its Canadian and U.S. retail operations combined, and only 10% came from its Wholesale division, which provides trading and investment banking services. RBC, on the other hand, receives about 25% of earnings from its

capital markets division. Unlike retail banking, capital markets activities are far more volatile and connected to the performance of equity markets.

TD is extremely focused on building a large, loyal customer base, and offering a superior range of products combined with world-class customer service. This approach offers, low volatility, high profitability returns, and can explain why TD Bank has the highest risk-adjusted return.

TD Bank currently has a customer base of approximately 22 million, more than Royal Bank's 16 million, despite having a smaller market cap. These customers are also incredibly loyal, thanks to excellent customer service and long service hours, which includes Sunday banking. This excellent customer service is reflected in the fact that TD Bank won the J.D. Power best customer service award for the ninth year in a row.

This approach of simple, old-fashioned banking also gives TD Bank the highest proportion of demand-and-notice deposits (low- to no-cost funds like checking accounts) to loans amongst all the big banks, which in turn allows TD Bank to earn better net interest margins than RBC.

Warren Buffett, in an interview on how he selects bank stocks, stated "what you make money off of is customers". It should come as no surprise to investors then, that his favorite bank stock, **Wells Fargo**, also calls its branches "retail stores" and pursues an old-fashioned banking strategy based around building a loyal customer base, looking for low-cost deposits, and being dedicated to risk management. Sound familiar?

TD's outperformance should continue

TD Bank has been aggressively expanding into the U.S. market, which differentiates it from RBC. It currently has more U.S. branches than Canadian branches, and is located in seven of the 10 wealthiest states, with a huge market of 70 million people to tap into.

With the Canadian housing market showing signs of overheating, and Canadians hitting record levels of debt, TD is well diversified compared to RBC. RBC also has considerable exposure to Canadian real estate market through mortgages compared to TD, adding to its risk, and reducing its potential gains.

CATEGORY

1. Bank Stocks
2. 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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Date

2025/08/26

Date Created

2014/11/24

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