



Why Royal Bank of Canada and Bank of Nova Scotia Are a Buy Today

Description

Over the years, there's been a pretty simple way to be a successful investor. All you needed to do was buy shares of Canada's banks.

There has been plenty said about the quality of Canada's banks, and for good reason. Unlike their U.S. counterparts, Canada's lenders survived the financial crisis intact, taking the opportunity to raise capital and be stronger than ever. Even though there are now some pretty serious doubts about the viability of our inflated housing market, the banks have made some prudent moves, like tightening lending restrictions and focusing primarily on loans that require default insurance from CMHC.

For the most part, having success investing in the banks has been pretty simple. It doesn't really matter when an investor purchased shares, all it took was a little patience and the investment would be profitable.

As investors worry about the overall health of the Canadian economy, Canada's banks have taken it on the chin, with both **Bank of Nova Scotia** ([TSX:BNS](#))([NYSE:BNS](#)) and **Royal Bank of Canada** ([TSX:RY](#))([NYSE:RY](#)) falling 10% from highs set in the summer and the fall, respectively.

What if, over the last five years, an investor would have made the simple move of buying shares in each of these banks each time they fell 10%? Would that lead to outsized returns? Let's take a closer look.

Royal Bank

The rules of this test are simple. Each time the stock falls 10%, an investor buys more. We'll compare the result to blindly buying on the first trading day of the year.

The investor would have purchased Royal Bank six times. Here's a summary of the purchases showing the date and share price of each.

- May 2010: \$55.56
- August 2010: \$50.00

- June 2011: \$54.00
- September 2011: \$48.60
- November 2011: \$43.74
- May 2012: \$52.20

Compare that to an investor who just purchased their shares on the first trading day of each year.

- January 4, 2010: \$56.62
- January 3, 2011: \$52.14
- January 2, 2012: \$52.78
- January 2, 2013: \$60.50
- January 2, 2014: \$71.59

The result looks to be pretty obvious without even crunching the numbers further, but let's complete the exercise. The buyer who waited for a 10% dip in Royal Bank shares had an average purchase price of \$50.68, while the buyer who bought each year on the first trading day of the year didn't do as well, having an average purchase price of \$58.73. Both investors would be comfortably in positive territory at this point, but the "buy on the dips" investor is looking at a total return that's about 15% higher. Over five years, that's notable.

Bank of Nova Scotia

For Bank of Nova Scotia, the exercise ended a little differently. Here's a summary of the purchases an investor would have made buying each time the stock fell 10% from recent highs.

- July 2011: \$54.54
- November 2011: \$49.49
- May 2012: \$50.58
- July 2013: \$55.02
- December 2014: \$66.18

Meanwhile, here's a summary of the investor who blindly bought on the first trading day of each year, using the closing price.

- January 4, 2010: \$48.93
- January 3, 2011: \$56.29
- January 2, 2012: \$51.70
- January 2, 2013: \$57.50
- January 2, 2014: \$66.01

This backtest was much closer. The investor buying Bank of Nova Scotia each time the stock went down 10% has an average purchase price of \$55.16. Meanwhile, the investor who bought on the first trading day of the year picked up their shares for an average of \$56.09.

What does this test tell us? Ultimately, it reinforces the fact that buying during dips is a good thing over the long term. The main reason why the Bank of Nova Scotia experiment didn't do as well is because the stock has already had its 10% downturn, which inflates our average purchase price. The other four purchases would have ended up leading to better profits, just like with Royal Bank.

Buying high quality companies during dips is a good thing. As Royal Bank approaches 10% off its most recent highs, history would dictate it's a good entry point. Bank of Nova Scotia, meanwhile, is already there. I think investors who follow this strategy with any of Canada's banks are likely to be pretty successful.

CATEGORY

1. Bank Stocks
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TICKERS GLOBAL

1. NYSE:BNS (The Bank of Nova Scotia)
2. NYSE:RY (Royal Bank of Canada)
3. TSX:BNS (Bank Of Nova Scotia)
4. TSX:RY (Royal Bank of Canada)

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