



Stop Worrying About the Canadian Economy and Buy Toronto-Dominion Bank

Description

These aren't the brightest of days for the Canadian economy. With oil prices dropping over 50% since June 2014, the Bank of Canada has had to revise Canada's GDP growth rate to 1.5% for 2015, down from the 2.4% forecasted in October.

This is due to the fact that oil-producing regions will see lower incomes from the oil patch—and along the supply chain—as investment is reduced and discouraged by low oil prices. This will in turn influence spending.

With Canadian banks being perhaps the purest play on the Canadian economy as a whole, you may be wondering about their safety as an investment going forward. Over the past five years, **Toronto-Dominion Bank**([TSX:TD](#))([NYSE:TD](#)) has outperformed its peers according to Bloomberg's risk-adjusted return. This metric measures returns relative to share-price volatility, and is a solid measure of a stock's safety and stability.

Looking deeper into this statistic, it's clear that TD Bank has some major advantages that will enable it to continue earning solid, stable returns, even in a weak economic environment. Let's take a look at them.

TD is actually set to gain from Canadian weakness thanks to U.S. exposure

While economic conditions in Canada are not ideal, the United States is currently experiencing a broad-based recovery after the recession. Unemployment rates are currently at 5.8%— a six-year low— and in the third quarter GDP growth came in at a staggering 5%. Consumer spending is growing at the fastest rate since 2006, and this is all great news for American-based banks, as these metrics all imply greater demand for loans.

This is where TD's enormous advantages lies. TD is in many ways just as American of a bank as it is Canadian, with 1,300 branches in the U.S., compared to 1,150 in Canada. Overall, 26% of TD's revenue is American-based.

Not only will TD benefit from a broad-based American recovery, but the recent oil price plunge—while

mainly negative for Canada—is actually a boon for the U.S., especially in the states where TD operates. **Royal Bank of Canada** estimates that every 10% decline in oil prices boosts U.S. GDP by 0.2%. The U.S. is largely a net importer of oil, and lower energy costs combined with increased consumer spending driven by low gasoline prices should enhance loan demand.

Since TD is operating mainly in the eastern states, far from any states with oil-production assets, TD's American assets can be seen as an effective hedge against any oil price weakness incurred from the Canadian economy.

TD is also poised to benefit from the weak Canadian dollar—thanks again to its American exposure. About 26% of TD's net income is earned in American dollars, and those dollars need to be converted back into Canadian dollars. Thanks to the strength of the U.S. dollar, this effectively provides TD with an earnings boost at no additional cost.

TD has the lowest exposure to the oil sector

The oil sector has been largely responsible for Canada's recent economic pessimism, but TD Bank is well insulated from any negative effects due to its small direct exposure to the sector, compared to its peers.

For example, a major means of determining a bank's exposure to the energy sector is by looking at its commercial energy loans as a percentage of total loans. TD has by far the lowest exposure out of its peers, with only 0.75% of its total loans being to the oil and gas sector. This is compared to 2.25% for Royal Bank of Canada and 3% for **The Bank of Nova Scotia**.

In addition, TD only has about 14% exposure to Alberta, compared to 23% for Royal Bank. With TD having low exposure to both oil and gas loans, and low exposure to Alberta, TD shareholders have limited reason to worry about both weakness from oil producers, and resulting weakness from Alberta consumers.

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