3 Reasons to Buy Toronto-Dominion Bank Instead of Royal Bank of Canada

Description

Royal Bank of Canada (TSX:RY)(NYSE:RY) and **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) are not only Canada's two largest banks, but they are also the country's two largest companies. Thus, it is no surprise that so many Canadians make these firms' stocks a staple in their portfolios.

Today these banks are trading at about the same level — RBC and TD trade at 12.7 and 13.0 times earnings respectively. But that doesn't mean they're equally attractive investments. So, which one should you buy?

Well, there's a strong case to be made for TD. We show three reasons why below.

1. The right kind of U.S. exposure

These days, the United States is firing on all cylinders. Economic growth numbers are strong, unemployment is falling, and low oil prices are giving the average consumer a nice boost. As a result, the outlook for banks in the United States is bright. And if the Federal Reserve raises rates this year, banks will perform even better.

This is very good news for TD, which has a big retail presence in the United States. In fact, the bank has more branches in the United States than it does in Canada. The American branches stretch along the East Coast, all the way from Maine to Florida.

RBC should be less excited, even though it derives 18% of income from the United States (compared to 16% at TD). This is because RBC's U.S. income does not come from retail banking. Rather, it comes from services, such as capital markets and private wealth management. To illustrate this, fewer than 6% of RBC's loans are in the United States (compared to 27% at TD). So, there's less to gain from falling unemployment and (potentially) higher interest rates.

2. Less dependence on oil

Of course, energy exposure is a big point of concern for all Canadian banks, but at TD there are reasons not to be worried.

For one, TD is concentrated in geographies that benefit from low oil prices, such as Ontario and the U.S. East Coast. Second, energy accounts for only 2.6% of commercial loans. So you probably won't see loan losses increase too much if the oil rout continues.

There is a lot more to be worried about at RBC, where energy accounts for about 8.5% of corporate loans. RBC's Capital Markets business also identifies energy as a "key sector of expertise." So, if the oil rout continues, and there is less activity in the sector, then RBC's bottom line will take a hit.

3. A lower-risk bank

Finally, RBC undeniably has a riskier business model than TD. Some of the reasons have already been discussed. RBC has more exposure to the oil market. RBC also has more exposure to Capital Markets, which is a volatile and opaque business.

But there's another big reason to choose TD over RBC: risk management. To be specific, TD has always put a big emphasis on risk management, ever since posting its disastrous results in 2002. To be fair, RBC has been quite prudent as well, but TD places that extra emphasis on managing the downside, something that investors should be looking for in today's environment.

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