



3 Big Advantages to Owning Bank of Montreal Instead of its Peers

Description

There's no question about it—investing in Canada's banks and financial services sector has been an effective wealth creator over nearly all time frames. Over the past five years, the S&P/TSX Financial Services Index posted an average annual total shareholder return (which factors in dividends) of 13.5%, exceeding the TSX by 4.4%. For over three years the index exceeded the TSX by 8.3%

When narrowing the financial services index down to just Canada's banks and looking at a longer 10-year time horizon, the returns become even more profound. Canada's banks produced a total shareholder return of over 170% since 2005, which greatly exceeds both the TSX, and the American S&P 500, which typically outperforms the TSX and the financial services index.

Therefore, is the wisest choice simply to invest in a bank ETF? Not necessarily. While the banks seem fairly homogenous, there are significant differences in risks and returns. Although investors typically gravitate towards the Big Three Banks, **Bank of Montreal** ([TSX:BMO](#))([NYSE:BMO](#)) deserves a second look as it offers excellent returns, with a much lower risk profile than its peers, making it a solid choice for conservative investors who want exposure to the banking sector.

Here are three key advantages to owning BMO.

1. BMO is near the top of its peer group in terms of capital adequacy

While investors often look past something like capital adequacy when making an investment in a bank, often looking to earnings or dividend-growth potential—especially during periods of economic recovery and bull markets—it's important to remember that economic crises inevitably do happen, and strong capitalization is the only thing standing between a bank and insolvency.

There is also regulatory risk—by 2016 Canadian banks will be required to have 8% common equity tier 1 capital (CET1), up from 7% currently. Meeting these requirements is essential, or else banks will have limits put on how they can spend their earnings. In this regard, BMO leads the way. Its current CET1 ratio is 10.2% compared with 10% for **RBC**, 9.9% for **TD Bank**, and 10.6% for **Bank of Nova Scotia**.

2. BMO is one of the less volatile Canadian Banks with top-tier returns

Although there are multiple ways to measure risk, one of the most predominant is by looking at something called volatility. Volatility refers more or less to the degree in which a stock's returns vary over time. Stocks with high volatility often exhibit wilder swings and are considered high risk.

One way to measure volatility is by using a measure called *beta*, which measures the degree to which a stock responds to movements in the index. A stock with a beta of one will typically move in tandem with the market, whereas a stock with a beta of 0.5 will be 50% less volatile than the market. If the market drops 10%, a stock with a beta of 0.5 will only drop 5%.

When looking at Canada's banks, RBC has a beta of 0.73, making it the most volatile of Canada's Big Four bank stocks. Bank of Nova Scotia has a beta of 0.57, and BMO and TD Bank have betas of 0.56 and 0.52, respectively. This puts BMO near the bottom in terms of volatility, making the stock less risky than the overall market and most of its peers.

Does this mean that BMO also has a lower return than its peers, since low risk typically equates to low returns? On the contrary. In fact, recent research has found that low-volatility stocks significantly outperform their peers over longer time frames, and this is true for BMO.

Over the past five years, BMO has produced a total shareholder return of 15.5%. This is compared with 12% for RBC, 13% for the Bank of Nova Scotia, and 16.5% for TD Bank. The end result? BMO offers more returns for less risk.

3. Solid dividend yield

Not only is BMO a low-risk stock, but it also offers the highest yield of its peers, further reducing its risk and making it a smart choice for income investors. With a yield over 4% (currently at 4.18%) and a low payout ratio of 49%, BMO's dividend is another reason to buy.

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1. Editor's Choice

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1. NYSE:BMO (Bank of Montreal)
2. TSX:BMO (Bank Of Montreal)

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