Why History Suggests You Should Buy Bank of Nova Scotia Today

Description

Over the past 15 years a very simple strategy would have drastically boosted your returns from Canadian banks. All you had to do was buy the worst performing stock over the previous 12 months and hold it for a year. If you had repeated these two simple steps every year, your returns would have easily eclipsed an equal-weighted portfolio of the Big Five banks.

This kind of strategy doesn't work in all sectors. In the energy sector, your best bet is usually to buy the *best* performing stocks. This is probably because energy price trends (both upwards and downwards) tend to last multiple years. So, the companies that benefit most from rising energy prices keep on outperforming. The opposite is true in a bear market.

But in banking, investors often overreact to short-term events. Thus, if a bank struggles, its shares go down by more than they should. This provides us with a perfect opportunity to scoop up some undervalued shares. And over the following 12 months, this discount tends to disappear, allowing us to pocket some nice profits.

Which bank should you buy today?

Based on this trend, **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS) is easily your best option. Over the past 12 months, its shares have fallen by nearly 6%, by far the worst among the Big Five.

There are legitimate reasons for this. The bank has struggled mightily in the past year, particularly in the Caribbean. This reached a climax in early November when the bank announced a series of job cuts, along with $450 million in write-downs.

But the bank's stock price has overreacted. As a result, nearly $5 billion has been wiped off the bank's valuation. Its shares trade for only 11.6 times earnings, a very low number for a company with depressed net income. At this time last year, the company traded for over 13 times earnings.

Which bank should you sell?

Over the past 12 months, **Royal Bank of Canada** (TSX:RY)(NYSE:RY) has had the best performing shares. And why not? It is aggressively expanding in the U.S.A and Europe. It remains a leader in Canada. And the Capital Markets business has been very strong.

Yet beneath the surface, trouble could be ahead. The bank paid full price for City National, a big private bank in the United States. Europe is always topsy-turvy, especially today. The same could be said for Canada. If commodity sectors continue to struggle, then Capital Markets revenue could eventually dry up. And RBC trades at a premium to most of its peers.

Here at The Motley Fool, we rarely advocate for short-term trading strategies. But at the very least, you should remember not to overreact to recent headlines. It seems that a lot of people make that mistake with Canadian banks. And there’s no shame in taking advantage.

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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)
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