These American Banks Are Better Buys Than Royal Bank of Canada and Toronto-Dominion Bank

Description

The Big Five banks have long been staples in so many Canadians' portfolios, and for good reason. Our banks face limited competition, and are protected by high barriers to entry, helping them to make big profits. They have also—by most standards—acted responsibly throughout many business cycles, and they are extremely well capitalized.

Meanwhile, U.S. banks have not made such great investments. The banking industry in the U.S.A is far more competitive, and profits are much harder to come by. And, of course, we all know how irresponsible they were leading up to the financial crisis.

Yet today there are some big concerns about Canadian banks, mainly because of the state of our economy. And down in the United States, the mood is much more hopeful. On that note, we explore two trades you should make today, each involving a Canadian bank and a similar one from the United States.

1. Sell RBC and buy JPMorgan

Royal Bank of Canada (TSX:RY)(NYSE:RY) and **JPMorgan Chase & Co** (NYSE:JPM) have a lot in common. Both are big players in capital markets and wealth management in addition to being leading retail banks. Both acted very responsibly during the financial crisis. And both are market leaders.

Of course, their biggest difference is where they operate. And this is where JPMorgan has the advantage. The bank is benefiting from the U.S. economic recovery, and will get a further boost when interest rates rise. Meanwhile, RBC will see its earnings come under significant pressure, with the Canadian economy likely in recession and the Bank of Canada cutting interest rates.

So logically, JPMorgan should be far more expensive than RBC, at least relative to its earnings. But that's not the case at all. Both companies trade for roughly 12 times earnings.

There are some possible explanations for this. Canadian banks make up such a large part of the TSX that portfolio managers are forced to buy them. Meanwhile, portfolio managers in the United States have more options. Furthermore, banks are simply more popular here than in the U.S.A thanks to Canadian banks' strong history. So, as a result, American banks are a far better deal than their Canadian counterparts, and this is a perfect example.

2. Sell TD and buy Wells Fargo

Like RBC and JPMorgan, **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) and **Wells Fargo & Co** (NYSE:WFC) have a lot in common. Both are leading retail banks, and have a fantastic track record of making the most out of their branches. Each bank made it through the crisis relatively unscathed. And the two banks have seen their shares do very well for a long time.

Also, like the first example, Wells trades at only a slight premium to TD at about 14 times earnings. This isn't because Wells is a lower-quality bank—of note, **Berkshire Hathaway** has been a shareholder of Wells since 1989. Instead, Wells is likely a bargain for the same reasons as JPMorgan.

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