Dividend Investors: Buy Zones for the Small Banks

Description

With the dramatic dips that have been happening in the market in the last week, investors might be at a loss on when they should buy shares. Now, let's think about why you would own shares in the smaller Canadian banks in the first place.

They are solid businesses that pay a growing dividend. Because they're smaller, they should have higher growth than the Big Five banks.

The question is, what price (or what yield) is a good entry point for these banks?

Setting buy zones

Okay, the sixth-largest Canadian bank isn't *that* small. **National Bank of Canada** (TSX:NA) has a market capitalization of over $13.2 billion. National Bank of Canada is the leading bank in Quebec, with 46% of its revenue coming from personal and commercial banking, 25% coming from wealth management, and 26% coming from financial markets.

It last increased its quarterly dividend in June at an annualized rate of 8.3%. Its payout ratio of 42% is within its dividend payout ratio target of 40-50%. So, you can expect more increases in the future.

Its yield reached 5.5% during the Financial Crisis; however, at other times, it rarely hit over 4.5%. Today at $41.6 per share, it yields 5% with a quarterly dividend of $0.52 per share, which is a pretty rare opportunity.

It's much harder to set a buy zone for **Canadian Western Bank** (TSX:CWB) because its stock price is affected by the oil price. After all, 49% of its loans are located in resource provinces. For example, during the Financial Crisis, it reached a yield of over 5%. In the dramatic dip on Monday, shares dropped to as low as $21 per share, or a yield of close to 4.2%.

No matter which facet investors look at Canadian Western Bank, it is priced at a historically high yield. Because its stock price is affected by the oil price, investors planning to buy it should be prepared for higher-than-average volatility compared with other banks.

However, Canadian Western Bank is a well-run business. This can be seen in its ability to continue increasing its dividend during the Financial Crisis, while the Big Six banks froze their dividends for at least a couple years. In fact, Canadian Western Bank has increased dividends for 23 years in a row. The last increase was in June at an annual rate of 10%.

In conclusion

Both National Bank of Canada and Canadian Western Bank are priced at attractive yields. The former has a strong presence in Quebec, while the latter is interconnected with the oil price. If you believe the oil price will eventually stride to higher levels, investors can average into Canadian Western Bank at selectively high yields of 4% or higher.

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TICKERS GLOBAL

1. TSX:CWB (Canadian Western Bank)
2. TSX:NA (National Bank of Canada)

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