



Could Bank of Montreal Be a Top-Performing Bank Stock Going Forward?

Description

Investors often hear less of **Bank of Montreal** ([TSX:BMO](#))([NYSE:BMO](#)) than its peers, and its below average returns may have something to do with this. Over the past 10 years BMO has had the lowest returns of the Big Four, returning about 20% (without dividends) compared with **TD Bank**, for example, which returned 76%.

If you look over shorter time frames, however, things at BMO are improving. Over the three-year time frame, and including dividends, BMO was more or less tied with TD Bank as the second-place bank with a compound annual growth rate of about 16%.

This is thanks to some recent moves by BMO; the bank has focused on the U.S. and wealth management, and its strong position in these areas may help it become a top-tier bank stock in the coming years.

BMO has strong and growing U.S. exposure

In 2011 BMO made a major push into the U.S. with the \$4 billion purchase of Marshall & Illsley, and the bank's U.S. personal and commercial segment has since become a large portion of the business and a key source of growth.

BMO currently obtains about 19% of adjusted net income from its U.S. operations (which include U.S. personal and commercial, wealth management, and capital markets). The majority of this income comes from the personal and commercial segment, and the commercial portion has been a particular source of strength.

The business has had 13 consecutive quarters of double-digit commercial loan growth, with commercial deposits climbing 9% year over year in Q3 2015. The bank recently capitalized on this strength by purchasing **General Electric's** transportation finance unit for \$11.5 billion.

About 90% of the assets from this acquisition are located in the U.S., and the acquisition would grow BMO's total U.S. loans from 29% to 32% of the portfolio. This would give BMO the largest portfolio of U.S. loans (as a percentage of total loans) of any Canadian bank.

General Electric's transportation finance business is the largest U.S. commercial truck and trailer financier in North America, and the business has loans diversified across the entire U.S.

While the deal is expected to boost earnings by 3% immediately as well as improve margins, the real strength is that it further exposes BMO to the U.S. economy. The transportation business reflects the overall economy well, and the overall U.S. economy is expected to grow by 2.6% in 2016 compared to 1.7% for the Canadian economy.

The U.S. is also expected to see consumer-spending growth of 3.1%, business-investment growth of 4.4%, and residential-investment growth of 7.7% in 2016. This compares to 2.1%, -0.7%, and 0.5%, respectively, for Canada.

Stronger consumer spending, residential investments, and business investments will all be strong tailwinds for the transportation sector, which moves consumer goods, business goods, and residential construction supplies, and this strong exposure will give BMO a major edge.

BMO's focus on wealth management also provides an edge

Another key difference between BMO and its peers is its focus on wealth management, which includes asset management, full-service brokerage, as well as online investing.

Wealth management contributes 22% to BMO's overall revenues, which is well ahead of any of its peers, and this has also represented the bank's fastest-growing operating segment over the past five years.

Having a strong wealth-management business offers several advantages to the bank. Firstly, unlike traditional lending activity, banks do not need to hold plenty of capital to expand their wealth-management business. Due to regulatory requirements, whenever a bank grows its loans, it must also grow its capital, and this is expensive for banks since they need to either retain earnings (which means not paying them out to shareholders), or issue shares (which dilutes shareholders) to do so.

Wealth management is more profitable than traditional lending due to these lower capital requirements, and revenues are also more stable since they come from fees. A growing baby-boomer demographic should lead to BMO's wealth-management business seeing better growth than the lending portion of its business.

CATEGORY

1. Bank Stocks
2. Investing

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Author

amancini

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