Is Toronto-Dominion Bank the Best Bank in the World?

Description

Tim Regan, managing director of investing firm Kingwest & Co., is pretty bullish on **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD).

He recently sung the bank's praises while being interviewed by Andrew Bell on *Business News Network* : "Really, they are the best global bank in the world."

Regan likes the bank's exposure to the U.S. economy, an area of the world he's bullish on. He says that the U.S. economy's strong job growth, wage increases, and shift to more full-time employees bodes well for the U.S. market as well as for the greenback. This makes results even more impressive once they're converted back to Canadian dollars.

Regan also thinks the U.S. Federal Reserve rate hike will be a nice boost to TD's bottom line. Approximately 25% of its loans come from the U.S., which is by far the highest percentage compared with its peers. Higher interest rates mean higher loan margins, and no corresponding increase in expenses means an increase to the bottom line.

It's obvious that investors share Regan's enthusiasm. The bank trades at a trailing price-to-earnings ratio of 13.1. This is cheap when compared with the rest of the market, but is between 10% and 20% more expensive than its peers. TD's dividend yield is also lower than its peers, coming in at 3.75%, while the rest of the Big Five are all above 4% yields.

The argument is that TD is such a great bank, so it deserves a higher valuation. Should you pay up to get this bank in your portfolio?

The cycles of banking

Over the last five years, TD has been the Canadian bank of choice for investors. The share price is up more than 45%–excluding dividends–easily outperforming its peers. **Royal Bank** was the next best performer, returning 36%. **Bank of Nova Scotia** brought up the rear, only rising 10.5%.

I'm sure it's no coincidence that the two Canadian banks with the largest exposure to the United States have outperformed lately. The U.S. economy has steadily recovered, its housing market is still considered cheap, and, like I mentioned, job growth has been strong.

But perhaps banking, like many other sectors, moves in cycles. Look at it this way. Investors already know the U.S. economy is doing comparatively better than Canada’s. Other investors are concerned that Canada’s housing market will implode and have switched to TD because it offers less exposure to our real estate market. Thus, maybe it’s time to look at one of the underperforming peers.

TD’s position in the U.S. is well known at this point. It’s already built into the price. There’s certainly an argument for buying the highest-quality stock you can find, but there’s also an argument for buying shares of great companies when they’re beaten up. TD is on the opposite side of that cycle, indicating that the stock’s return going forward might be lacklustre. Investors have to either hope for it to continue to grow earnings at a faster pace than its peers or else hope its valuation premium gets even larger.

Still a great business

I don’t want to discount the job TD’s management team has done.

It starts with the retail banking product. TD innovated the market, doing things like extending business hours, and the company has done a nice job positioning itself in a very competitive mortgage market. It also has a top notch wealth management business, and its credit cards are some of Canada’s most popular.

Investors are also excited about TD’s growth potential in the U.S., which is a very fragmented banking market. And financial metrics like return on equity for TD are top notch.

It’s easy to like TD Bank. Growth from the U.S. market looks to be solid going forward, and its dominance in Canadian retail isn’t going away. I’m just concerned about the bank’s valuation. I’d probably look at a cheaper bank for my portfolio, but at the same time, the argument that TD deserves a premium to its peers isn’t outrageous.

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