What a Federal Reserve Hike Means for Toronto-Dominion Bank

Description

It's finally happened. The United States Federal Reserve has analyzed the U.S. economy and decided that the time has come to finally increase interest rates. The unanimous vote set the new target range between 0.25% and 0.5%, which is up from 0-0.25%.

But it doesn't appear that the Fed is going to stop there. According to some policy makers, there is an expectation that interest rates will continue to rise slowly through 2016 before ending at approximately 1.375%.

But what does this mean for an organization like **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD)?

The lower interest rates are, the tighter the margin is for banks like TD. By increasing interest rates, banks now have a greater range in which they can offer loans to individuals, allowing them to increase their profits per loan. Naturally, a 0.25% increase in interest rates is not going to make a significant difference, but if interest rates do increase to 1.375% by the end of 2016, that will be a big step for the bank.

The other reason that this helps TD Bank is because it further strengthens the U.S. dollar. Consider that a decade ago there wasn't a single TD Bank in the United States. After investing $17 billion in buying out small banks, TD now has 1,300 locations, which makes it one of the top 10 banks in the U.S. That means that it is generating a significant percentage of its revenue from the U.S.

This is big because when it brings that money back to Canada, it results in a positive conversion. According to the company, its U.S. dollar adjusted earnings saw an increase of 6% in the fourth quarter, which is pretty solid. Convert that to loonies, and suddenly the U.S. profits are increased by 27%.

Should you buy?

But the question is, Should you buy TD because the Fed has finally started to increase interest rates? While I believe that this is mostly a psychological move, the fact that interest rates have finally increased should result in rates becoming easier to increase in the future. If interest rates rise over 1%, that will open up the margins in which TD is able to generate profit.

Even in a 0% interest world, TD was doing well. In 2015, TD's net income was $8.02 billion and revenue was $31.4 billion. In fiscal 2014, the bank saw $7.88 billion in profit on $29.96 billion in revenue. With the dollar continuing to gain strength and interest rates providing more margin, I expect that the bank will make even more profit in 2016.

Investors should expect the 3.71% yield to continue, which comes out to a quarterly dividend of $0.51 per share. Further, if profits increase significantly in 2016, don't be surprised if the dividend increases. TD has raised dividend payments for five years in a row, so it is in the habit of rewarding investors.

All of this leads me to say that you should buy this bank.

CATEGORY

1. Bank Stocks
2. Investing

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