

Why You Should Buy These 2 Stocks Instead of Canadian Banks

Description

It seems like things just keep getting better for Canadian bank shareholders. The S&P TSX Bank Index just closed at a record high, exceeding the previous record set in 2014. Some Canadian Banks—despite being some of the largest and most conservative names in the country—have posted year-to-date returns of nearly 30%. This is incredible for such low levels of risk and volatility.

This could lead investors, however, to making the mistake of assuming that the past will repeat itself going forward. Since recently reaching record highs, most Canadian bank stocks look extremely expensive. **Toronto-Dominion Bank** ([TSX:TD](#))([NYSE:TD](#)) is trading at 12.57 times its estimated 2017 earnings per share of \$5.03. **Royal Bank of Canada** ([TSX:RY](#))([NYSE:RY](#)) is trading at 12.12, and **Bank of Nova Scotia** ([TSX:BNS](#))([NYSE:BNS](#)) is trading at 11.35.

How does this compare with the past? Valuations of over 12 times forward earnings are rare for Canadian Banks. TD, for example, has traded at an average of 11.2 times forward earnings for the past 10 years compared to 12.57 times currently. The sector as a whole has only traded above 12 for very brief periods (with the exception of the mid-2000s before the financial crash).

It seems unlikely that banks can support these valuations going forward. Growth in the Canadian Personal and Commercial segments (comprising about 45% of earnings for most banks) is slowing to a crawl thanks to tightened rules on mortgages from the government combined with an overheated housing market (that is vulnerable to a slowdown from rising interest rates) as well as record debt levels from Canadians.

With Canadian GDP growth expected to remain slow, it is difficult to see how Canadian banks can maintain their currently expensive valuations. In fact, according to analysts at **National Bank** the Canadian banking sector has the second-lowest earnings-growth expectations in 2017. It is for this reason that Canadians should look to these two stocks instead.

Brookfield Asset Management ([TSX:BAM.A](#))([NYSE:BAM](#))

Brookfield is a global asset management firm that invests in real assets. Real assets refer to things like infrastructure, real estate, pipelines, airports, utilities. Real assets generally have stable, long-term cash flows that are usually subject to little competition and typically see revenues that grow with inflation and economic growth.

Brookfield has over \$250 billion in real assets under management, and Brookfield's most attractive quality is its strong expected growth rate. With bond yields fairly low, institutional investors are looking for low-risk, long-term ways to earn good returns. As a result, institutional investor allocations to real assets have been growing (from 10% in 2000 to 15% currently), and Brookfield has seen its assets under management grow from \$158 billion in 2012 to \$250 billion currently.

Analysts at Bank of Nova Scotia see Brookfield growing its cash flow by 16% annually through to 2018,

which is far ahead of what is expected for Canadian banks.

TransCanada Corporation ([TSX:TRP](#))([NYSE:TRP](#))

While Canadian banks as a whole are expected to grow earnings by only 4.7% in 2017, pipeline and infrastructure company TransCanada has a much more robust growth profile, while offering a similar low-risk profile to banks.

TransCanada expects dividend growth of close to 10% annually through to 2020 (which exceeds what can be expected from bank stocks) and this growth will be underpinned by a growing free cash flow profile. TransCanada has ample potential to both extend this growth outlook (to 2025 potentially), as well as to boost to it to 12% annually (in line with **Enbridge**). A conservative payout ratio and strong growth platforms will enable it to do so.

While the growth outlook for banks may be uncertain, TransCanada has \$26.5 billion in secured growth projects ready to roll out by 2020. TransCanada has even more upside potential through its uncertain large-scale projects (like Keystone XL) which could provide even more upside should they gain approval.

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TICKERS GLOBAL

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2. NYSE:BNS (The Bank of Nova Scotia)
3. NYSE:RY (Royal Bank of Canada)
4. NYSE:TD (The Toronto-Dominion Bank)
5. NYSE:TRP (Tc Energy)
6. TSX:BN (Brookfield)
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