Is Toronto-Dominion Bank a Buy at All-Time Highs?

Description

One thing is certain: those who have bet against **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) at any point in the past several years have lost. All through 2015 (and to this very day), TD was one of the top most-shorted stocks on the TSX as U.S. investors bet heavily that a housing crash in Canada and oil-patch weakness would take down the shares.

They were wrong. TD has returned 20% year-to-date, hitting all-time highs just yesterday. The bank has returned 76% over the past five years. Given the bank's strong past performance, is it wise to jump in now while the stock still has momentum?

Investors may be wise to wait for a correction. By most measures, TD is currently very expensive. Currently, TD trades at 11.73 times its 2018 consensus earnings per share estimate of $5.53. This makes TD the second most expensive Canadian bank on a forward price-to-earnings ratio basis.

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Royal Bank is slightly more expensive at 11.8 times its 2018 earnings, but the Canadian bank group as a whole trades at 11.3 times its 2018 earnings. This means that TD trades at a premium of 4% to its peer group. Looking at long-term averages, TD has typically traded at an only 3% premium to its peer group over the past five years (and only a 1% premium over the past 10).

In fact, looking all the way back to 2001, there were only a few brief periods where this premium to the group spiked above 5%, and it usually quickly reversed after. What does all of this mean? If investors want to make more money on TD shares, the bank's earnings for 2018 either need to be revised upwards, or the bank needs to trade at a higher multiple (the multiple needs to grow from 11.73 times).

TD's Canadian segment is lagging

In order for TD to either beat earnings estimates or see its earnings multiple grow to an even greater premium to its peer group, it will likely need to see more strength from its Canadian Personal & Commercial (P&C) Banking segment. This segment comprised 50% of the bank's operating earnings in Q4 2016, and its performance is important to the bank's performance.

Unfortunately, TD's Canadian P&C segment has been constantly lagging its peers. TD's P&C segment earnings declined by 0.8% in Q4 2016 year over year. This compares to **Bank of Nova Scotia**, which saw a 13.4% growth in earnings, and Royal, which saw a 1.5% growth in earnings. TD was the only bank to see a year-over-year decline.

The bank was also the only bank to post negative operating leverage in this segment (which means essentially that expenses grew faster than revenue). The bank also saw a fairly large decline in its margins compared to its peers and loan growth that was merely in line with its peer group.

Going forward into 2017, it is difficult to see how TD will begin to outperform its peer group in this segment. The bank is very sensitive to interest rates, because it has a large amount of deposits, which it invests in low-yielding bonds. These bonds mature and then get reset at a lower interest rate as rates fall (and they have), which is bad news for TD's margins.

If interest rates in Canada rise in 2016, TD can be expected to outperform, but it is difficult to say if this will happen.

TD still has a very strong U.S. segment

Fortunately, TD has a strong U.S. segment; the segment grew 14% year over year. This segment is expected to see double-digit growth again in 2017, and because it is very sensitive to interest rates, the growth could outperform TD's peer group as interest rates rise in the U.S. (which they certain to in 2017).

Overall, this means that investors should probably wait for a pullback in TD shares to reduce risk and maximize returns.

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