Better Buy: Toronto-Dominion Bank vs. Canadian Imperial Bank of Commerce

Description

The Canadian banks have enjoyed a very impressive run up over the past year. Many Canadian banks have become fully valued, but, make no mistake, the Canadian banks are still terrific additions to the core of any investor's portfolio, even at these levels.

The banks pay attractive dividends that will grow by leaps and bounds over the next decade. You can sleep peacefully at night knowing that the dividends will be paid out even during the worst of recessions.

Let's compare two banks in the Big Five that have the highest and lowest yields to see which one is the better buy today.

Toronto-Dominion Bank (TSX:TD)(NYSE:TD) offers a juicy 3.2% dividend yield, but it's considered the lowest of its peers in the Big Five. The stock is the most expensive based on traditional valuation metrics, but this is the way it has always been. The company has a fantastic risk-management team, so the company will likely fair well if there's a Canadian housing crash or another rout in oil prices. The company is hedged against the decreasing Canadian dollar too thanks to its large exposure to the U.S.

The American economy is expected to strengthen over the next few years thanks to President Trump's corporate tax cuts and deregulation. The U.S. Federal Reserve is also expected to raise interest rates at a faster pace, and it's quite possible that Janet Yellen will bring forth as many as three rate hikes this year, which will be a huge tailwind for Toronto-Dominion Bank.

I believe the U.S. dollar will continue to strengthen versus the loonie, and this is yet another tailwind for Toronto-Dominion Bank over the medium to long term.

Sure, the bank looks expensive with a 14.76 price-to-earnings multiple, but as Warren Buffett once said, "It's better to buy a wonderful business at a fair price, than a fair business at a wonderful price."

Canadian Imperial Bank of Commerce (TSX:CM)(NYSE:CM) offers a bountiful 4.27% dividend yield. The stock appears to be much cheaper than Toronto-Dominion Bank with a minuscule 10.12 price-to-earnings multiple. Based on traditional valuation metrics, the stock is the cheapest of the Big Five, and many investors believe the stock would be the best buy. I believe this is the wrong way to think, especially considering that the company is overexposed to the domestic market.

The Canadian economy is not as stable as our neighbours are south of the border, and many believe that Canada's housing market is in a bubble. Canadian Imperial Bank of Commerce will feel a substantial amount of pain if the housing market collapses.

The lack of U.S. exposure compared to its Big Five peers is also concerning. Canadian Imperial Bank of Commerce could miss out on the tailwinds coming from a strengthening American economy. There's a lot of catching up to do in this regard.

And the winner is…

Toronto-Dominion Bank looks like the better buy today. The stock has always traded at a premium to its peers in the Big Five, and given the huge tailwinds, I believe this valuation gap could increase going forward.

Sure, Canadian Imperial Bank of Commerce is cheaper, but it's cheaper for a reason. The dividend yield may be higher than that of Toronto-Dominion Bank, but I believe Toronto-Dominion Bank is better positioned to increase its dividend by a larger amount over the next five years.

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