Why Toronto-Dominion Bank Is Actually an Incredible Bargain

Description

Bank stocks have had quite the run over the past year, and many investors have been waiting for a pullback before giving the big Canadian banks another look. Canadian banks are terrific long-term wealth builders, and their stocks have finally retreated with **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) leading the way.

Toronto-Dominion Bank usually trades at a premium to its peers in the Big Five, and the reason for this may not be clear. The bank has an excellent risk-management team and a U.S. banking segment that will be a huge tailwind for the company as the U.S. economy strengthens under the Trump administration.

I believe Toronto-Dominion is set to outperform its peers over the next few years and that the stock deserves to trade at a substantial premium over its Big Five peers. Right now, the stock has fallen in line with the valuations of its peers, which leads me to believe that the stock is severely undervalued, because the fundamentals are still solid and deserving of a premium.

The only difference is that bad press from CBC regarding up-selling customers brought the stock down to the level of its peers. The scandal isn't unique to just Toronto-Dominion Bank, so the pullback is nothing more than an opportunity to get a premium bank at a non-premium price.

I think Toronto-Dominion Bank is severely undervalued after pulling back approximately 8% from its high, but Fool contributor Will Ashworth doesn't seem to think so. Mr. Ashworth thinks **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM) is a better deal because the price-to-earnings multiple is a lot lower.

While there are a lot of similarities between the Big Five banks, there are also major differences between them, and coming to conclusions based on a price-to-earnings multiple alone will not get you very far if value is what you're seeking.

The price-to-earnings multiple is a valuable metric, but, unfortunately, it can be abused, especially if you don't dig deeper into the fundamentals of a business and ask yourself questions, such as "why is the price-to-earnings multiple higher or lower than that of the industry?" I think the price-to-earnings multiple can be very misleading to new investors in particular, as some of the time, it could steer investors in the direction of a value trap.

Take price-to-earnings multiples with a grain of salt. They can help supplement your analysis, but if you treat it as gospel, you could potentially hurt your long-term returns.

If finding value was as easy as picking a stock with the lowest price-to-earnings multiple in its industry, then investors could get rich with very little effort or research. Unfortunately, this isn't how it works in the real world; there are a ton of other variables to look at. You've got to determine whether a stock is worth buying or not. If you're a DIY investor, nobody can make this decision for you.

Mr. Ashworth may be correct in assuming Canadian Imperial Bank of Commerce is the "better buy," but keep in mind that the stock is cheaper for a reason. You need to understand that reason before jumping to conclusions based on valuation metrics, like the price-to-earnings multiple, alone.

Canadian Imperial Bank of Commerce has a larger amount of uninsured mortgages in its portfolio, and if there's a housing meltdown, Canadian Imperial Bank of Commerce would get hit much harder than Toronto-Dominion Bank. In addition, Canadian Imperial Bank of Commerce is falling behind with international diversification relative to its peers.

These are just two reasons why Canadian Imperial Bank of Commerce is cheaper based on traditional valuation metrics. Does it mean it's a bad buy? Not necessarily; these two risks are already baked in to the stock. I think it's also a great buy, but I think Toronto-Dominion Bank is an even better buy.

When trying to place a valuation on a stock, it's very important to consider the medium- and long-term catalysts that could drive the stock higher as well assess the amount of risk involved with a particular investment.

Although Canadian Imperial Bank of Commerce is a lot cheaper, I think Toronto-Dominion Bank is trading at a greater discount to its intrinsic value. Warren Buffett once said, "Price is what you pay; value is what you get." You could pay a lower price for a "cheaper" bank stock, but are you actually maximizing the intrinsic value that you'll receive?

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