2 Top Canadian Stocks to Buy Before Poloz Raises Interest Rates

Description

A consensus is emerging in the financial markets that the Bank of Canada is going to rate interest rates in July.

In a remarkable turnaround for the economy, which has been hurt by a sustained bearish trend in commodity prices, like oil and copper, policy makers have become more bullish in recent weeks as the economy shows strength and job creation picks up.

Traders in the futures market are now pricing in a ~50% chance that the Bank of Canada governor Stephen Poloz will raise the benchmark interest rates in the next rate-setting meeting on July 12.

In surveys, before Poloz adopted a more hawkish tone, most economists were not expecting an interest rate increase until 2018.

This environment presents an interesting opportunity for income investors who were scared to take long positions in Canadian banking stocks.

Rising rates generally mean a strengthening economy in which banks face less loan losses. Banks usually earn more from the spread between what they pay to savers on their saving accounts and what they earn from investing in government bonds.

Top Canadian banking stocks underperformed the broader market on fears that the country's sizzling real estate market may hurt their loan portfolios, especially after the funding crisis that an alternative mortgage lender **Home Capital Group Inc.** faced in April.

Now that the economy shows signs of strength and the Bank of Canada readies its first interest rate hike in seven years, I see a good value for dividend investors in the country's top banking stocks. Here are my two favourite picks:

Royal Bank of Canada

Royal Bank of Canada (TSX:RY)(NYSE:RY) is Canada's largest bank by assets with exposure to almost all sectors of the economy. If you like Canada and its sound banking regulation, RBC is one top stock you should consider adding in your portfolio.

Buying RBC also fits well in a strategy where you want to diversify away from a much riskier U.S. banking sector, which has seen many banking failures in the past decade.

Trading at $94.74, RBC shares offer a 3.58% dividend yield. This yield is much higher when you compare it with some top U.S. banking shares, like **Wells Fargo & Co.**, **JPMorgan Chase & Co.**, and **Citigroup Inc.**

In the last quarter, RBC reported an 11% increase in the second-quarter earnings, beating analysts' forecasts, due to a robust performance in its capital markets and wealth management businesses.

The bank has been rewarding its investors with higher dividend payments over the past 10 years, offering on average 8.45% dividend growth.

Currently, it pays a quarterly dividend of $0.87 per share. With a dividend-payout ratio of 40-50%, RBC is in a comfortable position to continue with its history of increasing dividends each year.

Bank of Montreal

My other pick among Canadian financial stocks is **Bank of Montreal** (TSX:BMO) (NYSE:BMO).

Though BMO shares have underperformed this year as the bank reported higher loan losses from its U.S. business, the bank is still one of the best-managed institutions when it comes to capital ratios and future growth prospects.

BMO has a long dividend-paying history with a solid business mix in Canada and overseas. Offering ~3.8% yield, BMO is one of the top dividend-paying stocks in the Canadian financial space. As BMO celebrates its 200th anniversary year, it has mailed a dividend cheque to its shareholders every year since 1829.

BMO is trading at 12 times forward earnings, well in line with its peers, suggesting that it's not expensive and can easily reach the 52-week high of $82.30.

Conclusion

In short, both RBC and BMO are well positioned to benefit from a rate-driven rally in the Canadian market, and dividend investors should take advantage of this opportunity.

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