Increasing Interest Rates Make Toronto-Dominion Bank Even More Appealing

Description

For those of us with variable loans, increasing interest rates are definitely frustrating. Our payments increase, and we know that the extra money is going one place: into the bank's pocket. But for the banks, such as **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD), interest rates increasing presents greater opportunity to generate profits — and profits mean dividends.

Unlike the other Canadian banks, Toronto-Dominion is best suited to benefit from increasing interest rates because both the United States and Canada are starting to move higher. About a third of its income comes from the United States, so as the Fed continues to increase interest rates — now at 1.25% — net income will follow.

But Canada is also boosting its interest rates. For the first time in years, the Bank of Canada increased the rate by a quarter percent to 0.75%. Although it's not a serious increase, it demonstrates that the Bank of Canada is willing to do it, especially if the economy remains strong.

We can see this played out in Toronto-Dominion's retail banking margins. In Q2, its Canadian business had a margin of 2.81%. In the United States, its margin was 3.05%. That's to be expected since interest rates are higher in the United States. Analysts expect the Fed to increase interest rates more in 2017, so these margins should continue to increase.

Increasing interest rates also means Toronto-Dominion can offer more money on savings accounts. This, in turn, provides even more money for the bank to lend out, creating a snowball where more money comes in so the bank can lend more out, thus earning more in profit.

Nevertheless, it hasn't been the greatest six months for the bank. And despite interest rates increasing, Toronto-Dominion's stock has struggled.

Over the past six months, the bank has lost nearly 9% of its value primarily because of an article released by CBC which argued that Toronto-Dominion was pressuring employees to meet unrealistically high sales revenue targets. The only way to achieve that was to push aggressive sales tactics and, in some cases, break the law.

I view this drop strictly as a buying opportunity. Toronto-Dominion may inevitably be forced to pay a fine for its wrongdoing, but in the long run, it simply won't matter. And the quarterly results show that. In Q2, Toronto-Dominion earned $1.34 per share, which was $0.10 greater than what analysts had expected and absolutely destroyed last year's earnings. As was to be expected, the bank's U.S. division saw an 18% boost in earnings.

Increasing interest rates should lead to greater profits and, ultimately, greater dividends. In the beginning of the year, Toronto-Dominion boosted the dividend by 5% to $0.60 per quarter. Thanks to the bank's strong earnings, its payout ratio is only 46%. And thanks to the recent drop in stock price, the yield is getting closer to 4%.

Here's where I stand on Toronto-Dominion: it's the second-largest bank in Canada and the 10th-largest in the United States. It did some things wrong that were reported, but this creates a buying opportunity for you. And, ultimately, with interest rates increasing, profits are only going to follow. I'm bullish on Canada and Toronto-Dominion, so I believe you should buy.

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