These 3 Banks Should Outperform Now That the Bank of Canada Has Raised Interest Rates

Description

When the Bank of Canada announced an increase in the policy rate from 0.50% to 0.75%, it marked a change for Canadian investors.

When central bankers like the Bank of Canada embark on a "hawkish" policy of higher interest rates, it usually entails dampened consumer spending and lower economic growth, to name just two of the more common side-effects.

But while higher interest rates don't normally bode well for the broader economy, it is good for lenders, who can effectively charge higher rates on the loans they originate.

Canada's lending landscape is dominated by the "Big Five" Canadian banks: **Royal Bank of Canada** (TSX:RY)(NYSE:RY), **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD), **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS), **Bank of Montreal** (TSX:BMO)(NYSE:BMO), **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM). They are all expected to benefit from the recent rate hike.

So, while the news is somewhat bearish for the broader market, there are opportunities to profit.

The big question is, which banks stand to benefit most?

At the end of the day, banks make their money from two sources: interest and fees.

With rates now higher and most expecting that trend to continue, banks that make up the bulk of their revenue from interest should be expected to outperform those that make the bulk of their revenue from fees, which will be unaffected by the recent rate hike.

In that regard, TD leads the way with 58% of revenues being comprised of interest income compared to 42% coming from fees.

While TD will see higher interest income from its loan book, it should be noted that a large part of TD's operations is based south of the border, which will remain unaffected by the Bank of Canada's policy change.

CIBC is next in line with interest making up 54% of revenues.

CIBC has a loan balance which sits north of $320 billion, meaning even a small increase in rates can lead to millions in new-found profits. Not to mention that CIBC currently has the highest dividend payout of the major banks, offering a yield of 4.67%.

BNS rounds out the list of Canadian banks that make up more than half of its sales from interest, matching CIBC at 54%.

BNS’s loan book, which is valued at $500 billion, is considerably larger than CIBC’s, but, like TD, a material portion of the company’s business is generated outside Canada’s borders.

Time to re-evaluate

In light of the recent announcement, many Canadians will benefit from rebalancing their current portfolios to reflect those companies that stand to benefit from an increase in rates.

While an investment in the Canadian banks may not be the most original idea of all time, it may turn out to be a profitable one if the market flocks to “safer” assets.

Meanwhile, those looking for income may opt for a company like **Altagas Ltd.** (TSX:ALA). It pays a 7.63% yield, which compares well to the banks making this list, none of which pay a yield above 5%.

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2. NYSE:BNS (The Bank of Nova Scotia)
3. NYSE:CM (Canadian Imperial Bank of Commerce)
4. NYSE:RY (Royal Bank of Canada)
5. NYSE:TD (The Toronto-Dominion Bank)
6. TSX:ALA (AltaGas Ltd.)
7. TSX:BMO (Bank Of Montreal)
8. TSX:BNS (Bank Of Nova Scotia)
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