

Comparing Bank of Montreal and Bank of Nova Scotia

Description

For investors looking for the best opportunity in the financial sector, shares of **Bank of Montreal** ([TSX:BMO](#))([NYSE:BMO](#)) and **Bank of Nova Scotia** ([TSX:BNS](#))([NYSE:BNS](#)) currently offer a significant amount of upside for long-term holders. As the entire sector has performed very well since coming out of the Great Recession of 2008/2009, investors who were previously in a position to “throw darts at a board” may no longer have it so easy.

With comparable dividend yields and five-year returns, shareholders have to dig a little deeper before choosing the best bank.

When evaluating the financial statements of Bank of Montreal over the past four fiscal years, net income has risen at a rate of only 3.8%, signalling a potential slowdown. The bank, which has been very diligent and built a significant amount of retained earnings over the past few years, has experienced a decline in returns on equity (ROE). The number, which totaled 13.7% in 2013, has dropped to 11% for the 2016 fiscal year in spite of higher earnings.

Furthermore, as the company has engaged in minimal share buybacks, there could be a large share buyback waiting to happen should the economy slow down modestly. Barring a complete meltdown, as was the case in 2008, investors need not worry.

For those selecting Bank of Nova Scotia, the security may be significantly more attractive given the amount of risk investors are taking on. With a bottom line which has increased at a rate of 3.7% over the past four fiscal years, the company has done much more for investors than Bank of Montreal. The ROE of Bank of Nova Scotia declined from 14.4% in 2013 to 12.6% for the 2016 fiscal year. Although the bank maintains a dividend-payout ratio which is a few percentage points higher than its nearest competitor, the bank has done much more for shareholders by engaging in share buybacks and reducing the denominator to measure earnings per share, which become higher on a per-share basis. Investors are getting a bigger piece of the pie as time moves forward.

When considering the source of earnings from each institution, the better diversification of Bank of Nova Scotia (geographically speaking) has failed to translate to a less volatile share price. Instead, investors must accept this security with a beta of 0.88 in comparison to 0.67 for the Bank of Montreal. What could potentially account for this discrepancy may be the recent appreciation of the Canadian dollar. As the dollar has increased in value, the earnings generated from the business segments outside Canada will translate to lower profits for the bank. With this now priced in, the potential for higher returns may just be found with Bank of Nova Scotia over the next few years.

For income investors, the dividend yield of each of these companies are approximately 3.9% for Bank of Montreal and 3.95% for Bank of Nova Scotia. Given the risk and reward for each security, Bank of Nova Scotia seems to be the better investment.

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