



A Recent Acquisition May Mean a New Defensive Stock With Huge Upside

Description

Late last week, **Bank of Nova Scotia** ([TSX:BNS](#))([NYSE:BNS](#)) announced the acquisition of MD Financial Management, a major wealth management firm specializing in serving the needs of professionals in the medical field. With a purchase price of \$2.6 billion, the company is undertaking a major acquisition in the hopes of diversifying their [business](#) even further.

Investors typically identify with major banks as the “go to” investments during good times, yet the easing of regulations over the past two decades has made it much easier for investors to be insulated from market downturns. While a downturn in the economic cycle traditionally meant large losses for banks, leading to a decline in the share price, today’s banks are very different, as their businesses go far beyond banking.

The latest move by Bank of Nova Scotia will likely provide much more consistent earnings. As the costs of running an investment management business are almost fixed, shareholders stand to benefit in two significant ways. The first way is by enjoying the economies of scale of the existing operation (after the acquisition), while the second is the consistency of revenues throughout bad times.

When we delve into this, it’s important to realize that if the stock markets declines by 20%, the revenues of the wealth management businesses will not decline by nearly as much. If we take an investor with an asset allocation of 50% fixed-income and 50% equity as an example, half the portfolio will decline in value by 20%, while the other half will remain even or potentially increase in value (as interest rates are often cut during recessions). Investors in Bank of Nova Scotia will therefore be able to benefit from the interest rate cut, as assets invested in fixed income will increase.

Is Bank of Nova Scotia the most defensive of all the banks?

Given that this wealth management acquisition follows a major acquisition by competitor CIBC, this transaction should come as no surprise to Canadians. The main difference however, is that the exposure from the acquisition of MD Financial Management will provide more exposure to the Canadian equity markets, while CIBC’s acquisition offered exposure to the U.S. market.

In the case of Bank of Nova Scotia, the bank is one of the most internationally diversified, with a

substantial bricks and mortar presence in South America.

Currently, shares of the well-diversified Canadian based bank trade at a price of \$77 at the time of writing and offer a dividend yield of no less than 4.25% with an opportunity to move higher. Although this bank has a substantial amount of revenues denominated in foreign currency, it's important to realize that this headwind may soon become an advantage with a lower Canadian dollar.

Investors who are prepared to be patient while collecting a [generous dividend yield](#) may have found a new defensive stock with massive potential!

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