2 Canadian Bank Stocks That Provide the Best Value

Description

Canada's Big Five banks have been arguably the most consistent performers on the TSX. They post reliable growth and are praised by income investors everywhere. Each of the Big Five have their time in the sun. By the same token, there are a few that always underperform the group.

Historically, Canada's big banks have always returned to the norm, which is why when a bank underperforms and its valuation drops below historical averages, it's time to buy.

As of today, two Canadian banks that are trading at a discount to historical averages: **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS) and **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM).

Weak share performance

It's not surprising to see both of these banks trading at discount to historical valuations. Year to date, the Bank of Nova Scotia has lost 6.9% of its value. Canadian Imperial Bank of Commerce hasn't fared much better, with its share price dropping 5.8%.

Over the past year, Bank of Nova Scotia's stock is the only one in negative territory with a 2.75% loss. Although CIBC's stock has fared much better, its 6.5% gain still trails the others in the group.

Historical averages

I have some homework for you. Take a look at the historical price-to-earnings (P/E) chart for all Canada's big five banks. Notice a pattern? Like clockwork, every time the company's valuation dips below its normal P/E ratio, it always reverts to the mean. Likewise, every time its P/E ratio gets ahead of historical averages, it retreats to the norm.

There is no easier way to identify buy signals. As of today, Bank of Nova Scotia's current P/E ratio of 11.1 is below its normalized P/E ratio of 12.2. Likewise, CIBC's current P/E ratio of 10.3 is below its normalized P/E ratio of 11.4. Their peers are trading in line with historical averages. What does this mean? It means that Bank of Nova Scotia and CIBC provide the best value.

Investors can expect that both of these banks will eventually trade in line with their historical P/E ratios. For Bank of Nova Scotia, a P/E of 12.2 would result in a share price of $86.37; this implies 10% upside. Once CIBC's stock trades in line with its P/E of 11.4, it's price would be valued at $128.02. Once again, that's a 10% upside from today's share price.

It is also worth noting that both banks are trading at a discount to their historical price-to-book values.

Higher dividend

A happy unintended consequence of a lower share price and undervaluation is a higher yield. These two banks are reliable dividend payers and are Canadian Dividend Aristocrats, having raised dividends for eight consecutive years. As a result of recent share price weakness, they are both offering a dividend yield that's higher than historical averages.

Not only do you get a big bank at a discount, but you also get to enjoy higher income!

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

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2. NYSE:CM (Canadian Imperial Bank of Commerce)
3. TSX:BNS (Bank Of Nova Scotia)
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Date
2025/07/22
Date Created
2018/07/20
Author
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