2 ETFs That Could Eliminate the Need to Choose Bank Stocks

Description

ETFs are everywhere these days. Since the financial crisis of 2008, demand for the funds has exploded. Each of these funds seeks to provide a new exposure to the stock market.

The allure of these funds is that they can eliminate the need for stock picking, providing the return of the particular index or strategy that they are trying to emulate.

Using ETFs can greatly reduce the need for studying and accurately choosing the stocks in an investor's portfolio.

Take one simple example from a favourite sector for many Canadian investors: the Canadian banks. At first glance, it does not seem that challenging. Simply choose any one of the banks and buy shares in that company.

But the truth is that even though these companies have traditionally followed a similar pattern and tend, to a degree, to trade together, the banks do have fairly differentiated business strategies and dividend yields.

For example, **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS) has one of the highest yields of the group at 4.5%. Compare this to **Royal Bank of Canada** (TSX:RY)(NYSE:RY), which has a somewhat lower yield at 3.5%. The difference in price is tied to their operational strategies

At the moment, Bank of Nova Scotia's preferred strategy of investing in emerging markets is seen as a detriment.

Royal Bank, on the other hand, is invested heavily in the United States, which is seen to be much more positive for investors. The various strategies have resulted in additional pressure on Bank of Nova Scotia shares, which would hurt its investors to a greater degree.

An alternative to trying to pick the right stock is to choose an ETF. For the Canadian banks, there are a number of options. The ones I like the best are the **BMO Equal Weight Canadian Banks ETF** (TSX:ZEB) and the **BMO Covered Call Canadian Banks ETF** (TSX:ZWB).

Both of these ETFs are excellent for investors looking for regular income. These ETFs pay their distributions monthly as opposed to the actual banks, which pay out quarterly.

ZEB is appealing if you are looking for capital gains as opposed to income. This ETF provides you with direct exposure to the big six Canadian banks, eliminating the need to buy one over the other. Because the ETF is equal weight, no one bank will end up dominating the portfolio. The distribution for this ETF is currently 3.1%

ZWB is a similar ETF, the difference being that the provider writes covered calls on a percentage of the underlying stock to generate more income. The covered call jacks up the distribution to 4.7%.

While the ETFs provide some diversification, they also come with costs. For one thing, these ETFs each charge a fee to operate the ETF. ZEB charges a fee of 0.62% and ZWB charges 0.72%.

Another potential negative is the fact that the distribution is not terribly different from the dividends the banks offer.

In the case of ZEB it is slightly lower, and for ZWB it is only a little higher than some of the banks, such as Bank of Nova Scotia, which has a yield of 4.5%. Also, ZWB costs you some capital gains because of the covered calls.

But the fact that you do not have to choose any one particular bank is appealing. Another benefit for some investors is the fact that some discount brokers do not charge transaction fees to buy ETFs.

But one of the biggest factors may come down to account size. Smaller accounts may benefit from purchasing ETFs because they can diversify with a smaller amount of capital. Also, if your broker offers free ETF trades, a small account will save an enormous amount of money.

Ultimately it comes down to personal preference, your risk tolerance, and your desire to research individual stocks.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

TICKERS GLOBAL

1. NYSE:BNS (The Bank of Nova Scotia)
2. TSX:BNS (Bank Of Nova Scotia)
3. TSX:ZEB (BMO Equal Weight Banks Index ETF)
4. TSX:ZWB (BMO Covered Call Canadian Banks ETF)

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