Ranking Canada’s Bank Shares: Which One Should You Buy First?

Description

I’m a firm believer in one simple investing axiom.

If Canadian investors want to get rich, they should have at least one of our largest banks in their portfolio. There’s no need to stop at one, either. Investors should feel free to add a new bank to their holdings any time the sector becomes a little undervalued.

Canada’s banks simply have too many advantages to ignore. They’ve become so big that they’ve scared away potential competition. Government regulations restrict new entrants from entering the market. Most of their mortgage portfolios are guaranteed against default. This protection is paid for by borrowers and is backstopped by the federal government.

Thus, the only question investors need to answer is which Canadian bank is the most attractive long-term hold right now. There’s no clear cut winner, but I think there are a couple that stand out above the competition.

The runners-up

I’m probably the least bullish on **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM). CIBC silenced its long-term critics last year by finalizing a deal that saw it expand into the United States. But the company was forced to keep raising the price paid for these U.S. assets, which makes it less likely they will really impact the bottom line in 2018 or 2019.

Shares trade at just 9.2 times forward earnings expectations, which is the lowest ratio of the big five. The market has long been a little more bearish on CIBC than its competitors, and it shows.

I’m also a little more bearish on both **Bank of Montreal** (TSX:BMO)(NYSE:BMO) and **Royal Bank of Canada** (TSX:RY)(NYSE:RY), which have both followed a similar path in recent years. Both are focusing on bulking up their U.S. businesses while maintaining a strong focus on capital markets. There’s nothing wrong with this strategy, but I just don’t think the middle of a bull market is the time to invest in it. Investors should wait until we’re in the next bear market to consider these two banks.

Second place

The second-place finisher, **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD), has long been considered the best managed bank in Canada. The company has done a terrific job gaining market share in both Canada and the United States. It recently surpassed Royal Bank as Canada's largest by total assets and is now the 10th largest in North America. The company also has a sound balance sheet as evidenced by its best in class Tier 1 Capital Ratio. Finally, TD is making a big push into digital banking, a move that figures to pad the bottom line.

It's obvious TD has a lot going for it. At times investors have been willing to push up the company's valuation in response, making it the most expensive bank in Canada from a price-to-earnings perspective. These days the valuation is downright reasonable. Shares trade at just 11 times forward earnings and at 1.9 times book value.

In short, TD investors are getting a world-class bank at a great price. Now is a great entry point.

The winner

Despite TD's many favourable qualities, I still like **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS) the most today.

My reasoning is simple. I love what management is doing in Latin America. The region is responsible for about a third of the company's profits today, with great growth potential. The population is expanding in these regions much faster than in Canada, and millions are entering the middle class. Interest rates in the region are higher too, meaning the company enjoys much better margins on loans.

Scotiabank shares are trading at less than 10 times forward earnings and just 1.5 times book value. They're currently flirting with a 52-week low as well. It's obvious the overall emerging markets sell-off is impacting Scotiabank shares. This issue will undoubtedly sort itself out over the next year or two. Emerging markets always come back.

The bottom line

Just because I like Bank of Nova Scotia shares the best doesn't mean the other banks will struggle. They'll continue to perform, though perhaps not quite as well. I don't think investors will regret a purchase of any of the big five a few years from now.

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TICKERS GLOBAL

1. NYSE:BMO (Bank of Montreal)
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:BMO (Bank Of Montreal)
7. TSX:BNS (Bank Of Nova Scotia)
8. TSX:CM (Canadian Imperial Bank of Commerce)
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