1 of These 2 Banks Is Perfect for a Trade

Description

Both **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS) and **Canadian Western Bank** (TSX:CWB) have exposure to commodity markets, which affect the bank stocks to have a bigger downside when commodity prices are low.

Bank of Nova Scotia, or Scotiabank, has exposure to emerging markets that are often tied to the ups and downs of commodity prices. Canadian Western Bank has 32% and 5%, respectively, of its loans in Alberta and Saskatchewan, which are resource-rich provinces.

The Albertan economic health is mostly tied to the health of the energy sector, which is largely dependent on oil and gas prices. So, that's why Canadian Western Bank's stock has corrected more than 35% in the past 12 months. Notably, it's a positive that Canadian Western Bank has negligible direct exposure (i.e., less than 0.4% of total loans) to oil and gas production loans.

Bank of Nova Scotia is a great buy for a 5% yield

At about $68.30 per share as of writing, Scotiabank trades at a price-to-earnings ratio (P/E) of about 9.7, which is quite cheap for Canada's most international bank; it normally trades at a P/E of about 11.8. This multiple implies a fair price of about $84.60 per share. In other words, Scotiabank is undervalued by about 19%, which is quite a discount for a blue-chip dividend stock.

Scotiabank will be a more stable holding than Canadian Western Bank due to its larger scale and increased diversification. If commodity prices improve, it'll be positive for Scotiabank.

Currently, Scotiabank offers a safe yield of about 5%, which is fabulous. Its dividend is supported by a sustainable payout ratio of about 49%, which aligns with the payout ratios of the other Big Five banks.

Scotiabank will benefit from the higher growth of the Pacific Alliance countries from which it generates about 21% of its earnings. This is a long-term growth strategy that investors need to be patient with. The meaningful correction of about 16% from a year ago is a great opportunity for conservative investors to accumulate shares in the stable bank for an elevated starting yield.

Canadian Western Bank is a great trade right now

At about $25.20 per share as of writing, Canadian Western Bank trades at a dirt-cheap P/E of about 8.3. Normally, it can trade at a P/E of 12.6, which implies a fair price of about $38 per share. Of course, trading at such a price requires the cooperation of commodity prices. If you think commodity prices will improve, now's a great time to scale into Canadian Western Bank and accumulate shares in the stock for a trade.

Investors will be reassured to know that the bank has increased its dividend per share for 26 consecutive years. That's right! Even when the Big Five Canadian banks froze their dividends in the aftermath after the last financial crisis, Canadian Western Bank actually *increased* its dividend. Its quarterly dividend per share is 13% higher than it was three years ago.

Based on the fair price of about $38 per share, Canadian Western Bank is undervalued by about 33%. So, now is a fabulous price to buy the stock for an upside potential of 50%. However, it might take two to three years to play out. So, patience needs to be exercised.

Meanwhile, Canadian Western Bank offers a safe 4.13% yield. Its dividend is supported by a very sustainable payout ratio of about 35%.

Investor takeaway

If you're aiming for total returns in a safe stock or want to trade the ups and downs of energy in a safer way, Canadian Western Bank is a great way to do so. It offers a safe 4.1% yield and 50% upside potential using a base case.

If you're looking to add a safe bank to your portfolio as a long-term holding, consider buying Scotiabank now at a discounted price and an elevated and sustainable yield of 5%.

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kayng