TFSA Investors: Why We Should Still Own Canadian Banks Despite the Scary Headlines

Description

TFSA investors rely on Canadian bank stocks for safe and reliable dividend income and for preservation of capital — a strategy that has worked wonders in the last many years and one that I expect will still be a good one going forward.

It will work as long as TFSA investors adjust their expectations and take down their weighting in Canadian banks accordingly, because it seems we may be in for some weakness.

The Canadian economy is certainly looking like it is in the later stages of the growth cycle, with many indicators pointing to good reasons why we should be cautious going forward.

And while the Canadian banks are famously resilient, that doesn't mean that they will not suffer.

Investors should be prepared for weakness in bank stocks.

Let's take a look.

Toronto-Dominion Bank (TSX:TD)(NYSE:TD)

TFSA investors own TD Bank stock for its dividend yield of 3.93%, its track record of increasing this dividend, and its unparalleled strength.

TD Bank has increased its dividend by a 10-year compound annual growth rate of approximately 10% — the highest among its peer group.

The latest 12% dividend increase and the once-a-year dividend-increase policy is a testament to the bank's strength.

But while the bank’s capital position remains strong, we have seen provisions for credit losses (PCL) rising sharply in the latest quarter — a sign of the times.

PCL increased more than 20% compared to last quarter, and while on the consumer side there is some seasonality due to the holiday shopping season, the heavily indebted consumer is a big risk for the bank and for banks in general.

One thing is for sure: PCL is trending higher and the risk to the estimates is that they are not high enough.

Final thoughts

Rising dividends, high dividend yields, and strong capital positions are the constants with the Canadian banks, but this is being tempered by worrisome trends across the board.

In the latest quarter, we have seen many banks missing estimates and coming in below expectations, as they acknowledge an increasingly difficult environment that is being affected by the economic cycle in its later stages.

While the market strength this year will certainly provide the banks with a nice boost to their second-quarter results, we should remain cognizant of the fact that credit trends are showing signs of weakness, with some calling for a credit doomsday.

Consider reducing your weighting in the Canadian banks, and stick with the best of the Canadian banks, such as TD Bank stock, for continued long-term gains in the form of dividend income and capital appreciation.

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Author
karenjennifer