Is Bank of Nova Scotia (TSX:BNS) a Safe Dividend Stock in a Recession?

Description

During times of extreme uncertainty, as we are facing now, it's important for investors to review their portfolios and try to reduce risks.

Morgan Stanley has warned in a recent note that it sees a global recession within nine months if President Donald Trump imposes 25% tariffs on an additional $300 billion of Chinese exports and Beijing retaliates.

With this backdrop in mind, let's try to find out if **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS) is a dividend stock that you should keep in your portfolio.

Generally speaking, banks' fates are closely tied with the health of the economy. When the economy is growing, companies are expanding and consumers are borrowing, banks make more money. In contrast, when the economy shrinks, banks become stricter with their lending practices, as their balance sheets take a hit from defaults and loan restructurings.

This generality, however, doesn't apply as much for the top Canadian lenders, including Bank of Nova Scotia, as it does for banks south of the border. The reason is that Canadian banks operate in an oligopoly where the competitive pressures are limited. This, combined with their strong balance sheets and a sound regulatory environment, makes Canadian banks a much safer bet during times of economic distress.

Weakest recovery

Bank of Nova Scotia, the third-largest lender by market size, has had the weakest recovery among the top five lenders this year, gaining just under 2% so far. That rebound comes after a more than 15% plunge in its share price last year.

That pullback was largely driven by investors' concerns that the lender's aggressive acquisition drive will erode profitability in the short run. That concern proved right, as evident from Scotiabank's latest earnings report.

The lender missed on analysts' estimates for the second quarter due to higher provisions for loan losses tied mainly to takeovers, leading to a 63% jump in provisions across the bank. Provisions for credit losses were higher than analysts' estimates of $873 million, including $151 million tied to takeovers in Peru and the Dominican Republic.

Scotiabank spent more than $7 billion on acquisitions last year to bolster its businesses in Chile and in wealth management in Canada, while selling a number of international operations in the Caribbean and El Salvador.

But despite this weakness in the short run, Scotiabank's underlying performance remains quite strong, and I don't think investors should sell its stock, even if the risk of recession grows.

Ultimately, the lender's recent acquisitions will start to improve its bottom line, providing more depth to its earnings. After the latest acquisitions, Latin America now accounts for 34% of the bank's overall net income.

According to CEO Brian Porter, the bank's financial performance will improve in the second half, helped by a greater contribution from the emerging markets, along with a better expense management and improving capital ratios.

Bottom line

Trading at $69.39 at the time of writing, BNS stock yields 4.7% and pays a $0.87-a-share quarterly dividend. The payout is attractive enough to hold on to this stock even if the Canadian economy hits a recession. The lender has the firepower to emerge stronger from any potential economic shock.

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