Should You Add Toronto-Dominion Bank (TSX:TD) to Your TFSA?

Description

Here's a good role of thumb for your TFSA: avoid stocks that carry a considerable amount of risk. Of course, that's (almost) always good advice, but it is even more important when trying to build a nest egg for the future, as many TFSA investors are doing. The wrong investment can lead to significant losses and can set you back on your way to financial independence.

You may have also heard that the Big Five Canadian banks are excellent picks for your TFSA, but what to make of allegations that these banks risk suffering from a financial collapse? Should you avoid them after all?

The case against the Big Five banks

For years, some critics have been ringing alarm bells to warn investors against the risks of a financial collapse in the Canadian banking industry. These pundits argue that the big five banks are dangerously exposed to the Canadian housing market. In case you don't recall, one of the factors that precipitated many of the largest U.S. banks into some serious trouble in 2007 and 2008 was their subpar mortgage lending quality which had been brewing for many years.

So prominent has become the case for a similar financial collapse among Canadian banks that there is a name given to the strategy aimed at profiting from it: "The Great White Short." **Toronto–Dominion Bank** (TSX:TD) (NYSE:TD) happens to be one of Canada's largest mortgage lenders, usually grabbing one of the top three spots in this category. If the detractors are right, TD will be among the most affected by the collapse.

Will the collapse happen?

To be clear, there are some reasons to think there might be troubles up ahead for TD and other banks in the mortgage sector. For instance, home prices have been falling, and credit growth has been stalling. But it is doubtful whether the short-bet against the Canadian banks will pay off. The financial collapse and ensuing recession that happened in 2008 had a silver lining: banks are now far more stringent when it comes to their credit standards.

The relevant authorities have also imposed some additional criteria on banks as far as financial health goes. Also, the economy has been cruising in all of North America.

Economic growth tends to go hand in hand with higher revenues and earnings for banks, since consumers and businesses are more likely to borrow money in those times, which leads to higher proceeds for the banks (all else remaining equal). TD bank in particular benefits from the financial health in both Canada and the US arguably more than any of its competitors.

The firm possesses more branches and more customers south of the border than any of its peers. Investors can also count on steady and growing dividends with TD. Over the past five years, the firm has grown its dividend payouts at a compound annual growth rate of about 10%. The company currently offers a dividend yield of 3.82%.

Should you buy?

There will undoubtedly be an economic downturn at some point. In fact, equity markets suffered quite a bit at the end of last year. But there seems to be little solid evidence that the Great White Short will eventually pay off the way detractors of the big five banks have been predicting. TFSA investors who have TD bank in their portfolio can sleep peacefully, and those who don’t yet should strongly consider jumping aboard.

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