Riches vs. Risk in America’s Favourite Canadian Bank Stock

Description

A dividend darling at a fair price, offering diversification across North American borders. What’s not to like? Today, let’s take a moment to understand what U.S. investors see in one of our top banks, and why the banker could be a route to riches or a potential source of risk in a long-term dividend portfolio.

A top stock to stack or a potential heart attack?

Looking through the Canadian stocks regarded by American pundits as being top-tier dividend darlings, a domestic investor will recognize the usual fistful of utilities tickers, along with the odd REIT and a bank or two. Today we’re going to drill down on one of the latter investments and see what’s so hot about **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD), as well as what’s not so hot about the home of the big green armchair.

Selling for $76.91 a share and yielding a moderate and protected 3.84%, TD Bank is seen as defensive, though not entirely protected from risk. Banks have a tendency to be fair-weather friends during a recession, with some analysts eyeing their semi-cyclical nature as inherently dangerous. What dividend investors, both American and Canadian, like about TD Bank, however, is its combination of growth and stability.

Let’s unpack that: TD Bank has seen its U.S. operations leap forwards of late, generating the kind of growth that isn’t usually seen in a major banking stock. TD Bank is also an outperforming stock, a metric often used by performance-focused investors to ascertain whether a stock is worth buying. Americans see TD Bank as safe, offering diversification away from their own financials sector, and growth in markets hitherto untapped by their own banks.

Why this stock may be a risky play, no matter who likes it

Systemic risk exists in Canadian banking, however, and sometimes it’s easier to categorize those risks when viewing the sector from the outside. Pundits have seized on rising rates of delinquency, underlining the threat to dividends that this brings with it. This is why TD Bank gets singled out for investment. Its greater allowance for bad loans, coupled with high growth in the U.S., positions TD Bank ahead of its Big Five peers.

A rising Canadian dollar means a slowdown in TD Bank's American growth due to the currency differential. Add to this the less-regulated nature of the U.S. banking industry relative to the Canadian financial environment, and you have a two-pronged threat to TD Bank's growth — and therefore its dividend. While investors bullish on the U.S. economy have little to worry about, the fact is that TD Bank stock is not a risk-free play.

The bottom line

We mentioned the "r-word" a moment ago. Recession has moved away from being an abstract worry to a legitimate eventuality in recent months, with both the U.S. and Canadian yield curves inverting, and a range of economic stressors weighing on global markets leading some pundits to predict a U.S.-led market correction. In summary, what makes TD Bank so attractive — its U.S.-sourced growth — could potentially be its greatest source of risk.

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Date
2025/06/29
Date Created
2019/07/21
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