Even a Recession Won't Stop This Bank From Delivering Value

Description

The likelihood of a recession and ensuing bear market is growing, despite the outlook for stocks improving, which saw gold plunge to below US$1,500 per ounce. Nevertheless, an economic downturn and market correction is certainly due at some time during the foreseeable future. The ongoing trade war between the world's two largest economies, the U.S. and China, weak manufacturing data, slowing economic growth in the Eurozone, notably its largest economy Germany, and an inverted yield curve have all alarmed financial markets.

While this has made many investors nervous, it is important to remember that the secret to creating wealth is to invest for the long term in quality stocks and ignore market noise. One quality stock destined to continue delivering considerable value for investors is Canada's sixth-largest lender **National Bank of Canada** (TSX:NA).

Strong performance

The bank, which is the most domestically focused of the Big Six, has been one of the strongest performers, despite the considerable headwinds facing Canada's banks. National Bank has gained 18% for the year to date but still appears attractively valued with a price that is a mere 10 times forecast earnings and less than two times its book value.

The bank reported some solid third-quarter 2019 numbers, despite the headwinds impacting Canada's banks over the last year. These include a healthy 7% year-over-year increase in net income on the back of higher net interest income and non-interest income.

In fact, for the latest reported quarter, National Bank reported a return on equity (ROE) of 18.6%, which was 0.2% greater than the same period in 2018 and the best ROE of the Big Six. That indicates National Bank is delivering considerable value for shareholders, despite the headwinds that are impacting Canada's banks.

There is every indication that the bank will continue to deliver further value for investors, regardless of the poor economic outlook. This is because National Bank is focused on reducing costs and boosting the efficiency of its operations, as evident from its second-quarter efficiency ratio of 53.5% which was a full percentage point lower than the same period in 2018. The lower a bank's efficiency ratio, the more effectively it is generating revenue from its assets.

National Bank's efficiency ratio will fall further because of its focus on controlling costs and leveraging off improved technology. This is particularly important to note in the current operating environment where growth is being stymied by a softer housing market and a weaker-than-anticipated economy because it will boost profitability.

Another notable aspect of National Bank's operations is its solid balance sheet and high-quality credit portfolio. It finished the second quarter with a gross impaired loan ratio of 0.44%, which is one of the lowest among the Big Six banks. Such a low ratio indicates that National Bank takes a conservative approach to underwriting its mortgages and managing risk. It also demonstrates that it would take a significant economic meltdown to have a material impact on the quality of the bank's credit portfolio and balance sheet.

This, when coupled with National Bank's growing assets, which expanded by 7% year over year to $276 billion by the end of the second quarter, and common equity tier one capital ratio of 11.7%, highlights its financial strength.

National Bank also pays one of the highest-yielding dividends among the Big Six, having hiked its dividend for the last nine years straight to yield a juicy 4%. With a dividend payout ratio of 42%, the dividend is sustainable, making National Bank an attractive investment for income-hungry investors.

Foolish takeaway

Regardless of its domestic focus, National Bank remains a top play on the Canadian economy and housing market, which will pick up once trade war jitters die down and oil recovers. The bank's financial strength, quality loan portfolio, and moves to boost profitability by controlling costs as well as implementing efficiencies will bolster earnings even if there is an economic downturn. For these reasons, National Bank is one of the best of the Big Six banks to buy and hold for the long term.

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