When the Next Recession Hits, You Want to Be Invested in TD Bank (TSX:TD)

Description

I don't often write rebuttal articles, but this past week there was an article from fellow Fool contributor Chien Liu. In his article, Chien made the argument against **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD). Liu argued that investors should avoid TD Bank because of two factors: the bank's exposure to the U.S. market and declining cash from operations.

Liu also argued against the bank because it lost 49% of its value in 2008-09 at the peak of the financial crisis. Fair enough, but it's important to note that no stock was immune to one of the largest corrections in history. The author doesn't speak to the exact dates used to get to the 49%, but it's an arbitrary number.

I will use the yearly returns to counter the notion that TD made for a bad investment. In 2008, the **TSX Composite Index** lost 35.03% of its value, the worst yearly performance on record. Over that same period, TD Bank lost 35.34% of its value. In essence, TD Bank tracked the market and its performance was in line with its peers.

If the argument was to be made against banks in general, than I would concur that in a recession, they would struggle. To pick on Toronto-Dominion as the bank to avoid based on a 49% drop doesn't hold up. Likewise, in the ensuing years, TD crushed the market and has been the best-performing bank on the index, with gains of 270%.

Exposure to the U.S. is a good thing

Most of Canada's banks have struggled this past year, as bears have called for a mortgage crash. When the bottom fell out of the U.S. housing market, it sparked the financial crisis. There's little doubt that Canada's housing market has been frothy. This is especially true in key markets such as Toronto and Vancouver.

Let's assume for a minute that the bears will eventually be right. In such a case, TD Bank's exposure to the U.S. is a good thing, as it isn't as exposed to Canada's mortgage system.

Second, the Canadian market is essentially flat, and those most exposed such as **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM) are expected to grow at a snail's pace. Thanks to its U.S. exposure, TD Bank has the highest expected growth rates among Canada's Big Five.

Once again, having a diversified operation outside of Canada is a good thing, and is one of the reason's Toronto-Dominion is one of the best banks for growth.

Declining operational cash flow

The author also zeros in on the bank's declining operational cash flow (OCF). As per Chien, OCF declined from "$37.4 billion in fiscal 2016 to $5.7 billion in fiscal 2018." It is a true, albeit flawed statement. Factually, it is correct: TD's operational cash flow has declined. So, why is it a flawed statement?

Banks are lenders, and operational cash flow is largely dependent on how banks classify loans. A bank's financial statement is unlike most industries and can be challenging to interpret. Statement cash flow is one of the least reliable methods to evaluate the performance of banks, as they are highly volatile. Earnings and book value are far more reliable.

Don't believe me? In an interview back in 2013, Warren Buffet asked about valuing banks and he went on to explain:

"Earnings are key to valuing banks. Now, it translates to book value to some extent because you're required to hold a certain amount of tangible equity compared to the assets you have."

Over the past five years, TD Bank has grown earnings at a rate of 11.23% annually, which is tops in the industry. Looking forward, the bank is expected to post an industry-leading annual growth rate of 6% over the next five years. It is also trading at a discount to its five-year historical price-to-book value of 1.79.

Foolish bottom line

Are banks in trouble if a recession hits? Likely so — as are a good number of **TSX**-listed equities. However, it should not prevent you from investing in Toronto-Dominion bank, which is among the most reliable in the industry. In my opinion, TD Bank is still Canada's best. If anything, it's one of the safest stocks to hold if a recession hits.

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mlitalien