Buy This Overlooked Canadian Bank Yielding 4% in November

Description

Canadian banks are attracting considerable attention lately, much of it negative, with the big five banks being among the top-10 most shorted stocks on the TSX.

However, one bank continues to report solid results and is poised to benefit from a strong economy after the U.S. Federal Reserve's latest interest rate cut and growing optimism that the trade war between the U.S. and China will come to an end.

National Bank of Canada (TSX:NA) has gained 23% since the start of 2019 and reported some solid results for the nine months to the end of September. There are signs of further growth ahead making now the time to buy.

Delivering value

Despite being the most domestically focused of Canada's major banks, National Bank reported some strong third-quarter 2019 results, regardless of the doom and gloom surrounding the global economic outlook at the time.

These included a 9% year-over-year increase in diluted earnings to $1.66 per share on the back of healthy revenue growth driven by solid lending growth where loans and acceptances expanded by 6%.

The quality of National Bank's loan portfolio remains high with a gross impaired loans ratio of 0.44%, which was unchanged from the same period in 2018. That, along with 40% of the bank's Canadian mortgages being insured, will reduce the impact of an economic downturn on National Bank.

Uninsured mortgages and HELOCs have loan-to-valuation ratios of 60% and 58% respectively, indicating that a sharp downturn in housing prices would be required to have an impact on National Bank's loan portfolio.

National Bank is also focused on driving greater efficiencies across its business, which was responsible for its efficiency ratio falling by 1% year over year to 53.5%. A bank's efficiency ratio is a key metric that demonstrates how effectively it is using its assets to generate revenue. The lower the ratio the better, with a ratio of around 50% recognized as being optimal.

National Bank has one of the highest returns on equity (ROE) of the major banks. It report a ROE of 18.6% for the third quarter, highlighting that it is delivering considerable value for shareholders. This will continue to improve with the bank focused on controlling costs and improving technology to maximize the return it generates on its assets.

National Bank also finished the third quarter well-capitalized, with a common equity tier one capital ratio of 11.7%, which was 0.1% higher than a year earlier, and a liquidity coverage ratio of 154%.

The economy of Quebec, which is National Bank's core market, continues to perform solidly. Gross domestic product (GDP) for 2019 is forecast to grow by 1.8% and then by 1.5% in 2020. Unemployment is expected to fall from 5.4% in 2019 to 5.3% during 2020, which bodes well for improved consumer confidence and demand for credit.

Quebec has also avoided the overheated housing market that has emerged in other parts of Canada, notably Toronto and Vancouver, thereby reducing the potential impact of external economic shocks on National Bank's mortgage book.

Foolish takeaway

The increased optimism surrounding the economic outlook triggered by the Fed's latest interest rate cut and growing speculation that the trade war between the U.S. and China could be resolved should give the economy a healthy boost.

This all bodes well for National Bank's earnings to keep growing and for it to continue delivering value for shareholders. While investors wait for that to lift its share price, they will be rewarded by National Bank's sustainable dividend yield of 4%, which is one of the highest among the big six banks.

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Date
2025/07/01
Date Created
2019/11/18
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