Why Bank Stocks Should Be a Key Component of Dividend Portfolios

Description

Bank of Nova Scotia (TSX:BNS)(NYSE:BNS) was the first to report its fiscal Q4 and full-year results among the Big Six Canadian banks. The others, **Royal Bank of Canada**, **Toronto-Dominion Bank**, **Bank of Montreal**, **Canadian Imperial Bank of Commerce**, and **National Bank of Canada** will report their results next week.

Scotiabank did fine given that it recently made a number of acquisitions and divestitures with acquisitions requiring integration costs and its divestitures booking a net loss.

Overall, Scotiabank increased revenue by 8.3% to $31 billion with adjusted earnings per share rising marginally by 0.4% to $7.14 for the fiscal year.

Over the longer term, the bank thinks it can achieve +7% earnings-per-share growth with its stable and very profitable Canadian Banking business, its higher-growth International Banking business, a growing Global Wealth Management business, and by reducing operating expenses across its businesses.

Over the last year or so, the bank has closed six acquisitions. Since there are integration costs, once integration completes, its earnings should improve meaningfully.

Bank stocks should be a key part of dividend portfolios

The big Canadian banks have a long history of paying safe dividends. The Big Six Canadian banks' returns on equity in the last decade have all been at least in the teens, indicating that they are consistently profitable and are therefore excellent core holdings, especially since they pay secure yields of 3.8-5% with payout ratios of roughly 50%, if not lower.

Scotiabank in particular pays a nice dividend yield of 4.8%, which is supported by a payout ratio of about 49%. Canada's most international bank has long-term growth potential from its international markets, which saw double-digit earnings growth in fiscal 2019. As it builds scale in the high-growth Pacific Alliance countries, it will have opportunities to reduce operating costs.

In any case, the quality Big Six Canadian banks offer passive income that is about 58-108% greater than the current interest rate offered by one-year GICs.

Additionally, the banks' eligible dividends are more favourably taxed in non-registered accounts. Most importantly, the stocks offer long-term price appreciation, which is not available from GICs. So, long-term investors should certainly consider the big Canadian banks as a key component of their portfolios for growing income and higher total returns.

Portfolio building

Dividend investors should consider the financial sector, including the Canadian big banks, some of the safest banks in the world, for 10-25% of their long-term dividend portfolios.

Utilities, REITs, telecoms, consumer staples, healthcare, and technology are other sectors to consider for safe dividend income and growth. Remember to diversify outside of Canada, which has a limited offering of stocks in consumer staples, healthcare, and technology.

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