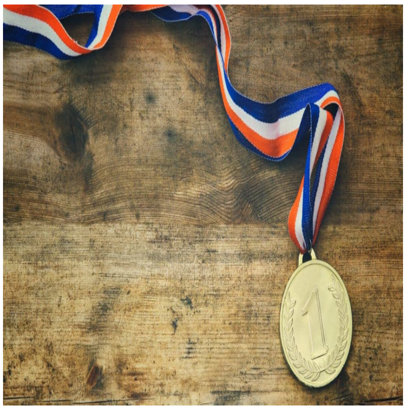

TD Bank (TSX:TD) vs. RBC (TSX:RY): The Best Bank Stock for 2020

Description

Canadian banks have had an eventful year. Short-sellers from across the world turned their attention to our financial institutions, while the housing market and consumer credit quality deteriorated. Yet, most major bank stocks have delivered respectable gains this year, albeit with plenty of stock price volatility along the way.

Now, investors must turn their attention to the new year and pick fresh candidates for their expanded Tax-Free Savings Account (TFSA) contribution room. Here's a direct comparison of Canada's top two bank stocks for your TFSA.

TD

Toronto-Dominion Bank (TSX:TD)(NYSE:TD) had an arguably better year than its rivals. The buyout of its American brokerage subsidiary could add roughly $14.5 billion to the company's cash hoard. Meanwhile, the bank's earnings per share expanded modestly this year as well.

The bank started off as the third most shorted stock on the stock exchange earlier this year, but those betting against it have capitulated as the stock surged 9.5% over the course of the year.

It still seems fairly valued, trading at 12 times trailing 12-month earnings and 1.86 times book value per share. The stock offers a reasonable 3.96% dividend yield at the time of writing.

The bank also has more exposure to the United States than the domestic economy. Over the past year, U.S. retail accounted for 31% of the company's revenue. Along with **TD Ameritrade**, the U.S. accounted for 40% of the company's overall sales in 2019.

Now that TD Ameritrade has been sold, it remains to be seen how the company deploys that cash and whether it can bolster its geographical diversification over time.

RBC

Royal Bank of Canada (TSX:RY)(NYSE:RY) is very similar to TD in terms of size and relative valuation. Just like TD, the bank offers a 4% dividend yield and trades at 12 times earnings and 1.93 times book value. The valuation is marginally higher, but not by much.

However, unlike TD, RBC seems to be a lot more domestic in terms of sales. Last year, 65% of the company's revenue was generated in Canada. U.S. sales accounted for just 23%, while the rest of the world contributed 15% to the company's top line. In other words, RBC operates offices in 36 countries, but it remains a predominantly Canadian bank.

I believe this marginally higher exposure to the Canadian economy makes RBC slightly more vulnerable than TD. It's no secret that the Canadian borrower is pushed to the limit. Canada's household-debt-to-gross domestic product and residential property rent-to-income ratios are the highest in the developed world and much higher than the United States.

A correction in the Canadian credit cycle will impact all banks, but it could have more of an impact on RBC than TD. Coupled with the fact that TD trades at a marginally lower valuation, it seems like the better choice for investors at the moment.

Bottom line

While there is very little difference in the financial strength and valuation of both banks, in terms of geographical diversification, TD stands out as the winner. If you're bearish on the Canadian economy, TD Bank is probably the better bet for 2020.

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