1 Top Canadian Bank Stock to Buy in April

Description

Like stock markets around the world, Canadian stocks have been hit hard by the coronavirus pandemic. The **S&P/TSX Composite Index** has shed 18% since the start of 2020, and there are fears of further losses ahead. One sector that has been hit by the stock market crash is banks.

Canada's Big Six banks have declined sharply since the start of March 2020, losing anywhere between 11% and 24%. The biggest loss was recorded by **National Bank of Canada**, which shed 24%. **Royal Bank of Canada** (TSX:RY)(NYS:RY) and **Toronto-Dominion** (TSX:TD)(NYSE:TD) were the least affected, only losing 13%.

Poor short-term outlook

There are fears of worse ahead for the big banks. Many economists are declaring that the global recession triggered by the coronavirus pandemic will be worse than the 2008 financial crisis. This is because it will be driven by the consumer, with consumer spending responsible for up to 70% of gross domestic product in developed economies. That means there will be a sharp dip in demand for credit and business activity, as consumption declines significantly.

There will be additional shocks for the banks because of a marked decline in the domestic housing market, which has been a key driver of earnings growth over the last decade. The vulnerability of heavily indebted Canadian financial households to external economic shocks and rising unemployment will apply further pressure to earnings.

Worsening U.S. economy

For Toronto-Dominion, **Bank of Montreal** and **Canadian Imperial Bank of Commerce**, which have a significant U.S. presences, the impact will be worse. Analysts at **Goldman Sachs** forecast that U.S. GDP will contract by a whopping 34% during the second quarter 2020. U.S. unemployment recently surged to a record high of 6.6 million people. Analysts are tipping that the Fed's recent economic stimulus will trigger another U.S. housing crash. That certainly doesn't bode well for U.S. bank earnings and will trigger a spike in impaired loan and credit losses.

Toronto-Dominion is among the most vulnerable Canadian banks to a deep U.S. recession. It is rated as a top-10 bank south of the border, with considerable loan exposure. For the fiscal first quarter 2020, Toronto-Dominion reported that U.S. credit facilities were worth $234 billion, which was a 7% higher than a year earlier. That represents 33% of all loans underwritten by the bank. Most of those loans, 57% by value, were made to U.S. businesses, magnifying their vulnerability to a U.S. recession.

This will have a sharp impact on Toronto-Dominion's earnings over the remainder of 2020.

Buy Canada's largest lender

Even the measures taken by banks to mitigate the impact of a coronavirus recession in Canada won't offset the impact. Canada's largest lender, Royal Bank, has employed similar measures to its Big Six peers to reduce the negative effect of a deep economic slump in Canada.

While the bank has focused on expanding its U.S. business, it doesn't appear as vulnerable as Toronto-Dominion. Royal Bank's U.S. loans only amount to $82 billion or roughly a third of Toronto-Dominion's.

The focus of the lender's U.S. expansion has been into wealth management. Royal Bank's global asset management and U.S. wealth businesses are important earnings growth drivers. By the end of the bank's fiscal first quarter, U.S. assets under management had expanded 23% year over year to $173 million. That saw quarterly revenue from U.S. wealth management expand by 10% year over year to year to $1.6 billion.

Importantly, impaired loans within that business are exceptionally low. Typically, investment assets aren't as heavily impacted by economic slumps. Invested capital is quite sticky and is generally a cash cow for the investment manager. Royal Bank's focus on wealth management in the U.S. and significantly lower credit exposure bode well for its earnings.

Foolish takeaway

Royal Bank is trading at a mere nine times forecast 2020 earnings per share and 1.6 times book value, illustrating that it is very attractively valued. The lender pays a sustainable dividend, which it has hiked for the last eight years straight to yield a juicy 5%. Those characteristics underscore why now is the time to buy Royal Bank.

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2. NYSE:TD (The Toronto-Dominion Bank)
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