Canada's Big Banks: Are They Buys in This Market Rally?

Description

The markets are doing their best to bounce back from the steepest bear market in history. Last week, the S&P/TSX Composite Index eked out a 0.42% gain, and it is now up 12% since the start of April. Increasingly, the market rally looks sustainable, and investors are looking to once again buy into the markets. Canada's big banks should be at the top of your list.

The market is rallying on the backs of only a few sectors — tech in particular. While technology stocks are hitting 52-week highs, financials continue to struggle. The S&P/TSX Financial Index is only up 1.2% in April, far below the Index average.

Year to date, financials are trailing the index by approximately 10 percentage points. Canada's big banks are usually strong performers. This is not so in 2020, as all the Big Five are trailing the Index.

Since they have yet to find their footing, it remains a good time to pick up Canada's big banks at discounted valuations. Here are two of the cheapest.

Canada's worst-performing big bank

Let's start with the worst performing of the Big Five, **Bank of Montreal** (TSX:BMO)(NYSE:BMO). In 2020, Bank of Montreal stock is down by 32.91%, far outpacing its peers.

Why the underperformance? On the surface, the bank is one of the most exposed to the Canadian oil and gas industry. With oil prices trading at prices not seen in decades, the entire industry is at risk of insolvency. This means that banks with high exposure could potentially experience high loan losses.

Unfortunately, Canada's big banks don't report quarterly results until the end of May. As such, investors won't get clarity on the magnitude of impact until such time. That being said, I believe Bank of Montreal is trading at levels that are tough to ignore.

Let’s put BMO’s exposure to oil and gas into perspective. First, oil and gas only account for approximately 2.5% of outstanding loans. Second, when you take into account the undrawn credit facilities, Bank of Montreal is actually one of the least exposed to the industry.

The bank is trading at only 7.01 times earnings, 1.01 times book value, and at a 37.2% discount to historical averages. There is none cheaper among Canada’s big banks.

A top performer

Speaking of cheap, another Big Five bank that is currently trading at a big discount to historical averages is **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD). As of writing, TD Bank is trading at a 32.3% discount to historical averages. In fact, it has only been this cheap once before, and that was during the Financial Crisis.

Over the past decade, TD Bank has been the best-performing Canadian big bank. In 2020, its 24.66% loss is second only to **Royal Bank of Canada**. Why does it consistently outperform? It has the highest exposure to the U.S. markets. Since the U.S. has far outpaced the Canadian economy, it is therefore not surprising that TD Bank has outperformed the Big Five.

Across the board, earnings growth is expected to turn negative in 2020. In 2021, TD Bank is expected to post earnings-growth rates of 5.71%. Although below the company’s five-year double-digit average, it is the second-highest growth rate among Canada’s big banks.

Finally, TD Bank’s dividend is among the safest in the world. At 43%, it has the lowest payout ratio of its peers and has averaged higher dividend growth. Earlier this year, the company raised the quarterly dividend by 6.76%.

As the U.S. looks to re-open, TD Bank will surely be among the first of Canada’s big banks to rebound in a broader market rally.

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