Income Investors: With a 5.5% Yield, TD Bank (TSX:TD) Is a Buy Today

Description

Pretty much every economist out there today is in agreement that they'll more economic pain ahead, which means the entire global economy will enter a very difficult period. If this is the case, then economy-dependent stocks like the Canadian banks are certainly going to feel some pain.

The real question is not whether we are going to feel economic pain, but rather how deep and how long that pain is going to be. It is this question that plagues would-be investors in Canadian banks.

If the economic downturn was long enough, it stands to reason that governments won't be able to pay for everyone's wages forever. Eventually, debt will be called and downgraded. Governments would lose control of their books, and a period of forced austerity could ensue. If you think this can't happen, just ask Greece.

The fallout on banks

Forced austerity could put pressure on banks if it leads to a period of massive defaults. Credit could collapse, forcing banks to reign in their lending practices even further. The tightening would constrict credit growth. Banks will lay people off to protect their earnings, leading to more people joining the unemployment lines.

A diversified bank

The biggest problem, at least in my mind, is a prolonged recession or even recession. Canadians in the aggregate are already woefully over-indebted without a safety net to withstand a prolonged economic downturn, which means it is important to choose a bank with a business model diversified by region and business model.

One of my favourite banks that meets these criteria is the **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD).

TD is a diversified bank with almost as large a presence in the United States as it has in Canada. Almost half of its earnings come from south of the border, allowing the bank to benefit from the strong

American dollar.

The year-end results shed some light on the nature of its diversified income generation between the two countries. Canadian and U.S. retail banking contributed a relatively similar amount to net income, with Canada contributing $1.7 billion and U.S. retail giving $1.91 billion when converted from U.S. dollars.

Dividend strength

Dividends are also important to Canadian investors, and TD has one of the strongest in the group. Currently, TD pays a quarterly dividend of about 5.5%. The yield is quite high, although not as high as others in the group.

Nevertheless, I would argue that the lower yield indicates that investors likely consider this company to be relatively safer than other banks due to its diversification.

The downside

A bank's earnings are a function of economic strength, so even TD will not be immune to a general economic downturn. As the weak economic numbers are affecting both Canada and the United States, there will still be negative effects from both sides of the border.

That said, being diversified away from the commodity-dependent, overleveraged Canadian economy should help earnings to a degree.

The bottom line

I believe that you could begin entering a position in Canadian banks today, TD in particular. Eventually, this too will pass after which the banks should benefit from renewed economic activity. Right now is a great time to start buying the banks, as long as you do so with a very long-term time horizon and the ability to ride out what could be a very challenging period.

Fortunately, Canadian banks like TD Bank are historically very strong institutions with great management and a diversified footprint.

Even if things get worse, these companies should be able to weather an economic storm. While they aren't risk-free by any means, they are very good companies that should be in practically every investor's portfolio.

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