Bank of Nova Scotia (TSX:BNS): Should You Buy the Stock for the 7% Dividend Yield?

### Description

**Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS) now offers a juicy dividend yield, but economic risks in the Canadian and international markets have investors wondering if this is a safe time to buy the stock.



## Market outlook

The global economic downturn continues to evolve. Lockdowns to slow the spread of the coronavirus have plunged countries into a recession. Job losses are the worst since the Great Depression, and analysts have widespread views on when the rebound might occur.

Optimistic types anticipate a V-shaped recovery, as countries move to re-open their economies. Massive monetary and fiscal stimulus measures could launch the global economy into overdrive next year. The IMF even predicts strong economic growth in 2021 after a rough ride in 2020.

Pundits with a more conservative outlook suggest we could be in for a U-shaped rebound. The extent of the job losses and the ongoing uncertainty regarding a potential second wave of the pandemic could mean the recession will drag on longer than expected. In this scenario, unemployment might remain elevated through the first half of 2021 until a vaccine emerges and life starts to get back to normal.

Bears warn that we might be headed for an L-shaped economic trajectory. The theory suggests government efforts to save companies and citizens from bankruptcy might be too small or arrive too late.

## Bank stocks

Unemployment levels in Canada and the United States now top 13%. The U.S. treasury secretary recently said the American unemployment rate could push as high as 25% before things start to improve.

The longer people are without income, the higher the risk of defaults on loans. Banks put their loan portfolios through stringent risk analysis and structure their lending according to their abilities to ride out the worst-case scenarios. Pundits worry we might be beyond the limit any bank considered possible.

Time will tell.

## Bank of Nova Scotia

Bank of Nova Scotia trades at $50.50 per share at the time of writing. The stock sat at $74 in February and hit a March bottom below $47.

Canada’s third-largest bank entered the crisis with a strong capital position, and most analysts believe all the top Canadian banks will maintain their dividends through the downturn.

## International operations

Bank of Nova Scotia gets about 30% of its adjusted net income from the international division. The exposure to emerging markets is both a risk and an opportunity. The bank’s foreign assets primarily operate in Mexico, Peru, Chile, and Colombia. These four members of the Pacific Alliance trade bloc rely heavily on strong commodity markets for economic growth. Pain in the oil and copper sectors could put near-term pressure on these countries.



On the upside, a global rebound fuelled by fiscal programs targeted at infrastructure developments might reverse fortunes quickly.

## Canadian business

In Canada, people are taking advantage of mortgage deferrals. Government assistance should also help many consumers and businesses ride out the lockdown phase. As long as Canadians can get back to work by the end of the year the level of loan defaults should be manageable. If not, the banks might be in for a rough ride for longer than a few months.

Provisions for credit losses in the fiscal Q2 report will be key. The market is pricing in bad news right now and anything better than a worst-case outlook might trigger a rally in Bank of Nova Scotia’s share price.

That said, Bank of Nova Scotia could retest the March low regardless of the bank’s guidance, so I wouldn’t back up the truck. However, investors who buy now get paid well to ride out additional volatility and the dividend should be safe.

Five years from now, the stock should be higher than it is today.

Risks remain, but if you have some cash available for a buy-and-hold dividend portfolio, it might be worthwhile to start a small position near $50 per share.

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