Why This Is the Time to Buy Canada's Best Dividend Stocks

Description

There are many solid reasons to avoid buying Canada's banking stocks, which are among the best dividend-paying companies in the world.

The economy is in deep trouble after the outbreak of the COVID-19 pandemic. Businesses are facing a bleak outlook, and borrowers are losing their jobs.

To cope with this unprecedented situation, Canada's best banks are setting aside a large amount to cover their bed debts.

Royal Bank of Canada (TSX:RY)(NYSE:RY) and **Bank of Montreal** (TSX:BMO)(NYSE:BMO
) reported yesterday that their provisions for loan losses hit a record level, as they brace for the economic fallout from the pandemic.

Royal Bank earmarked $2.83 billion in the fiscal second quarter for souring debt, the highest among the Canadian banks that have reported so far. Bank of Montreal put aside $1.12 billion. Both Toronto-based firms reported earnings Wednesday that missed analysts' estimates.

This alarming jump in bad debts could be a valid reason for many investors to avoid banks offer one of the best avenues to earn steadily growing dividends.

Dividends in trouble?

But if your eyes are on the future, and you foresee a quick recovery after this sharp downturn, then this is also the best time this year to buy these stocks at much lower levels. I'm in the camp of those analysts who believe that the dividends of these lenders are safe, despite the falling profitability.

These lenders roughly distribute between 40% and 50% of their income in dividends — a payout ratio that is quite conservative. With profits poised to plunge, as the COVID-19 crisis wreaks havoc on the Canadian economy, those payout ratios, no doubt, could rise sharply.

But for payout ratios to reach a danger zone, let's say 90% or above, we need to see a drastic plunge in profits — a possibility that is quite remote at this point.

According to a recent note by analysts at **JPMorgan**, the western economies are likely to stage a V-shaped recovery as the countries in Europe and North America emerge from lockdowns.

"A steady and uninterrupted lockdown relaxation process points to a V-shaped recovery in Western economies, favoring traditional cyclical and value stocks for the next few months," JPMorgan Global Quantitative & Derivatives Strategy Analyst Nikolaos Panigirtzoglou wrote in a recent note.

In Canada, the current weakness has pushed the dividend yields of the nation's best lenders higher, offering investors a chance to buy these stocks and earn higher returns.

Historically, Canadian banking stocks have offered some of the best returns to long-term investors due to the strength of their businesses, their diversified operations, and the oligopolistic nature of the Canadian market.

"A conservatism, a strength, a diversification and an earnings capability position us well to withstand the uncertainty and turn around and exit this as a stronger bank," Royal Bank CEO Dave McKay told analysts on Wednesday after the earnings report.

Trading at $91.43, RBC now yields about 5%. BMO, after falling 30% this year, now trades at $69.78 with an annual dividend yield of 6%.

Bottom line

For long-term investors, this is one of the best times to buy Canada's top banking stocks and take advantage of their attractive yields.

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