2 Undervalued Bank Stocks Yielding Over 5%

Description

The Canadian banks are core holdings in many dividend income portfolios. There's a good reason for that. They have a long track record of paying solid dividends.

The banks are offering above-average dividend yields now due to a global recession from COVID-19 disruptions to the economy. Here are two banks that are providing yields of more than 5%. This is an attractive income for long-term investment, seeing as the best five-year GIC rate is going for 2.1%.

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BNS stock

Bank of Nova Scotia (TSX:BNS)(NYSE:BNS) currently offers one of the best dividend yields among the Canadian banks. Its exposure to global markets outside of North America is weighing on its performance, as those economies are expected to experience a slower recovery than the North American markets.

In a normal market, investors would be lucky to buy the bank stock for a 5% yield. Today, it provides a yield of 6.2%, which is 24% more income than that attractive level!

BNS Dividend Yield data by YCharts.

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BNS stock has paid dividends continuously since its first payment in July 1833. That's 187 years of consecutive dividend payments!

The bank maintained its dividend throughout the last recession triggered by a global financial crisis. There's hope that it can maintain its dividend throughout this stressful period as well. It could take two to three years before it would resume dividend growth. However, shareholders are compensated with a juicy yield.

BMO stock

Bank of Montreal (TSX:BMO)(NYSE:BMO) generates about 59% and 32%, respectively, of its earnings from Canada and the United States. Approximately 68% of its earnings come from its North American personal and commercial banking operations.

In a normal market, getting a yield of 4.8% from BMO stock would be quite compelling. Today, it provides a yield of 5.4%, 12% more in income.

BMO Dividend Yield data by YCharts.

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Similar to the other big Canadian banks, BMO's near-term performance is weighed down by a global recession. Specifically, in the first half of the fiscal year, its revenue declined by close to 6% to $12 billion.

Its provision of credit losses more than quadrupled, as the bank anticipated a rise in bad loans. This, in turn, dragged down its net income by 24% to about $2.3 billion for the first half of the year. Adjusted earnings per share fell 25% to $3.45.

With a quarterly dividend of $1.06 per share at writing, that implies a recent payout ratio of 61%. Therefore, it should be able to maintain its dividend this year.

Just like BNS stock, it could take up to three years before BMO stock would resume dividend hikes.

The Foolish takeaway

Due to the reduction in earnings this year, the bank stocks provide juicy dividends and are fairly-valued for near-term investment. However, based on normalized earnings, BNS and BMO stocks are undervalued by about 31% and 28%, respectively.

It could take up to three years for their earnings to recover to normal levels. Consequently, it's best to view the big Canadian bank stocks as above-average income investment vehicles that can deliver annualized returns of 11-15% over the next three to five years.

An investment of $5,000 in the banks today can grow to about $9,200 over the next five years with a combination of dividend income and valuation expansion to the mean.

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