Today's Top Pick: Bank of Montreal

Description

Investing in Canadian banks has historically served investors well. These stocks share a few key traits I think investors would do well to consider. Among these, extremely low competition due to high entry barriers in an oligopoly is key. This allows for increased pricing power and a nice defensive moat for long-term investors.

Banks in general had been trading below their historical multiple in the last year. However, the trend in financial stocks has turned around dramatically, and in the right direction. Banks thrive during times of recovery, as loan-loss provisions are removed and interest rates rise.

Accordingly, **Bank of Montreal** (TSX:BMO)(NYSE:BMO) looks like a great pick to me in this environment. Here's why.

BMO: A decent dividend yield provides a steady income source

The global economic turmoil that the pandemic brought was not a favourable scenario for bank stocks. Banks haven't been able to increase their dividend and buy back their shares. But this should change soon, with BMO leading the charge.

In its recent earnings, this bank has shown a strong recovery across all divisions. In fact, it delivered adjusted net income just above $2 billion, which was a solid contributor to its stellar 9.8% stock price increase over the last quarter.

With dividend yields rising, investors are set to benefit, as these dividends earned can serve as an alternative yet steady income source. Meanwhile, passive earnings through Bank of Montreal's dividends open up the opportunity to reinvest them in the market for greater capital appreciation.

An ideal business mix translates to excellent performance across divisions

Comparing the net earnings for November 2020 to January 2021, this bank earned $2.02 billion — a staggering 27% year-over-year increase. Even the net adjusted earnings per share surprised analysts; this bank posted $3.06 earnings per share vs. expected EPS of $2.15.

While much of this revenue growth can be credited to a drop in loan-loss provisions, various operational improvements must be praised. This bank's U.S. operations posted a 67% year-over-year increase to $459 million. This sort of revenue growth is bullish for the investors, who remain optimistic about its long-term sustainability.

Apart from its core banking division, the capital markets also delivered a strong performance in the same period, clocking a 36% year-over-year increase to adjusted earnings of $489 million. Compared to the previous quarter, its Tier-I capital ratio also increased by 0.5%.

Bottom line

The post-pandemic recovery trend is encouraging for investors. Indeed, I believe this stock has the potential to continue to grow and provide decent returns over time.

In the near future, investors will likely continue to benefit from additional loan-loss provision reductions. Meanwhile, in the long run, improved credit quality is likely to factor into meaningful revenue growth.

With all these catalysts in mind, investors should definitely consider BMO as a core portfolio holding right now.

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1. Bank Stocks
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