TD Bank Stock Is a Top Dividend Pick for August

Description

TD Bank (TSX:TD)(NYSE:TD) stock's rally has been running out of steam in recent weeks. The broader basket of Big Six Canadian bank stocks have all seen their rallies stall (many have flatlined for the summer), but TD Bank stock is now pulling back. And at this rate, shares of the top bank could be flirting with a correction, which is defined as a 10% peak-to-trough drawdown.

Today, TD stock is down 7% from its peak and for no really good reason. Undoubtedly, TD Bank has dragged relative to its peers in the ascent out of the depths of 2020. The reasons remain unclear, especially given that TD is arguably one of Canada's more premier banks with some of the highest quality of earnings out there. Not to mention the bank's prudent managers who are well-versed in risk management and unlocking long-term value for shareholders, regardless of the market "weather" at any given moment in time.

TD Bank stock leads the downward charge, but why?

Indeed, inflation is showing some signs of cooling off. It seems as though central banks were right about their views of inflation being transitory. For June, inflation pulled back to 3.1%, down slightly from the number posted in May. As of right now, the prospect of runaway inflation seems unlikely, and the pressure on central banks to raise interest rates is starting to ease.

The banks could use higher interest rates after moving through an environment that's made it tough to expand upon margins, most notably net interest margins (NIMs) on deposits. With lower inflation and a continued dovish stance by the Bank of Canada (BoC), TD stock has really sagged relative to its peers.

While higher interest rates can act as the tide that lifts all boats in the banking waters, so to speak, TD Bank arguably has most to gain from a higher-rate environment, both at home and south of the border.

Interest rates will rise again, but before they do, TD stock could surge

In due time, TD's Canadian and American retail banking businesses will get a huge boost, as interest rates ascend again. Until the world can eliminate COVID-19, though, central banks will probably hold off on the fast-and-furious rate hikes that would propel bank stocks much higher.

With delta and various other new variants spreading rapidly, we may not be dealt a rate hike until 2023. That's a whole year and a half away. But if you're a long-term investor who's looking for a huge discount in a high-quality name that will eventually enjoy the windfall of higher rates and associated margin expansion, TD Bank strikes me as a must-buy at these levels.

The stock is being overly punished of late. Shares are trailing the pack, with a mere 10.7 times trailing earnings multiple. For the type of quality U.S./Canadian exposure you're getting, I find the depressed valuation to be borderline absurd, even though the catalyst of higher rates now appears to be pushed back.

Bottom line

Given that higher interest rates are a foe of many higher-growth common stocks, I'd argue that TD is a wonderful rate hedge and dividend-growth stock to own for once the tides turn and central banks kick off the process of tightening. So, if those Fed minutes and the thought of rate hikes scare you, now is as good a time as any to punch your ticket to a banking behemoth like TD.

Over the next three years, as we inch closer to the pandemic's end and the first of what could be many rate hikes, don't expect the relative discount on a name like TD to last.

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