3 Reasons to Invest in Bank Stocks Right Now

Description

The Canadian stock market behaved most unpredictably in the last two years. When the pandemic weakened the economy in 2020, tech stocks pushed the market to great highs. **Shopify** overtook the more than 155-year-old **Royal Bank of Canada** (TSX:RY)(NYSE:RY) in stock performance. The stock market did not show the true picture of the economy. Recovery was expected in 2021, especially in airline stocks. But the opposite happened. The market growth was tepid, and energy stocks were the winners.

But one sector that prospered in both years was the banking sector.

Three reasons you should have bank stocks in your portfolio

The Canadian market is heavily weighted toward banks, with the financial sector representing over 28% of the **S&P/TSX Composite** index. The Big Six banks account for most of the Canadian banking sector. These six banks enjoy strong profits from credit lending and fees on daily banking services.

Dividends

The last decade was pretty strong for Canadian banks because of wealth management divisions and mortgage provisioning. Stocks of RBC and **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) surged more than 170% in the last 10 years. This is just the capital appreciation part. Bank stocks are known for dividends.

TD Bank and RBC increased dividends at a compounded annual growth rate (CAGR) of 12% and 4.4%, respectively, between 2017 and 2021. TD Bank announced a quarterly dividend of $0.89 in January, up 12.65% from the previous quarterly dividend in October 2021. RBC announced a quarterly dividend of $1.2 in January, up 11% from the previous quarterly dividend in November 2021.

Bank stocks reduce volatility

Another reason to invest in bank stocks is to mitigate the volatility of your overall portfolio. The above two bank stocks have low beta and they are in a long-term uptrend. The bank stocks underperform in a high-growth market but outperform in a stable or low-growth market. For instance, bank stocks surged in January when tech stock saw a sell-off over fears of the interest rate hike. Moreover, banks stocks surged while Bitcoin prices fell.

If you invest in high-risk growth stocks, you can book profits at regular intervals and park those funds in bank stocks to earn dividends. This way, you can get the best of both growth and dividends.

Exposure to economic growth

Banks are the foundation of a country's financial system. The above two banks have a wealth management arm and a commercial and personal loan arm. During the pandemic, central banks reduced interest rates to a record low. This impacted the retail banks' loan arms. But the weakness in loans was offset by strength in wealth management, which benefitted from the stock market rally. TD and RBC stocks surged over 45% between March 20, 2020, and March 20, 2021.

In 2022, the central banks of Canada and the U.S. hinted at interest rate hikes to control inflation. Even a small change in interest rates has a cascading effect on a country's financial system. Higher interest rates make borrowing expensive and increase returns in the bond market. This proves beneficial to the banking arm that handles loans but adversely impacts the wealth management arm. But overall, banks benefit from higher interest rates.

One Canadian bank ETF to buy now

Now that you know what bank stocks mean to your portfolio, it is time to buy some. If you go to buy even one share of each of the Big Six banks, you will have to shell out close to $800. A cost-effective alternative is a bank ETF. There are many Canadian bank ETFs, but my favourite is the **BMO Equal Weight Banks Index** (TSX:ZEB) ETF.

The ETF has an annualized distribution yield of 2.84%, which is lower than many bank ETFs. But it compensates for the lower yield with a low management expense ratio (MER) of 0.28%. For $43 per unit, you can get exposure to the low price volatility and dividend distribution of the Big Six Banks. The ETF surged 9.37% year to date and 147% in the last 10 years.

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2. NYSE:TD (The Toronto-Dominion Bank)

3. TSX:RY (Royal Bank of Canada)
4. TSX:TD (The Toronto-Dominion Bank)
5. TSX:ZEB (BMO Equal Weight Banks Index ETF)

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Date
2025/06/29
Date Created
2022/02/11
Author
pujatayal