Banking Stocks: The Ultimate Dirt Cheap Sector

Description

Many value investors have "favourite" sectors. Oil stocks tend to be popular, as do utilities and retailers. Investors can do well with any of them, if they're wise about stock selection. But for my money, one value sector stands out above all the rest:

Banking.

Banking stocks are persistently cheap, yet unlike other value stocks, they're not at risk of disruption. For example, there's always the risk of electric vehicles and renewable energy taking oil down a notch, but with banks, there's nothing on the horizon that will replace the business. And before you say "fintech," I should point out that fintech companies still depend on banks for vital services. **PayPal** for example still depends on **Wells Fargo** for custodial services. There are other examples, too.

So, banking is a proven sector that's not disappearing any time soon. The question, then, is why are bank stocks so cheap?

Why banking stocks are persistently cheap

Bank stocks are persistently cheap for a number of reasons.

One reason is growth. Bank stocks typically don't deliver explosive growth. Over the last five years, the **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) has grown its earnings by 9.5% per year. That's decent growth, but it's nothing compared to the high double digit growth you sometimes see with tech stocks. When **Shopify** reported 16% growth last quarter, it was characterized as a disaster. For TD, that would be a great quarter.

Another possible reason why bank stocks are cheap is fear. In 2008, U.S. banks started seeing a wave of defaults on mortgages, creating a financial crisis that almost caused several banks to go under. Ever since then, bank stocks have had a reputation for being risky. With that being said, regulators responded to the crisis of 2008, and banks today are required to have more assets on hand than they used to.

Dividends galore

One great thing about bank stocks is that they tend to pay high dividends. TD Bank, for example, has a 4% yield. It has been raising its payout consistently over time. From 2003-2008, TD raised its payout each year and more than doubled its payout per share on a quarterly basis. After keeping the dividend steady through the Great Recession, TD resumed dividend raises in 2011. At the end of last year, TD raised its dividend payout by 13%. And it's aiming for more dividend hikes in the future, meaning today's investors will eventually see higher yields.

Is there an upside?

As we've seen, bank stocks are cheap and have high dividend yields. The question is, *"is there any upside"?*

Most likely, the answer is yes. Bank stocks may be out of favour right now, but they tend to do well when times are good. When recessions occur, bank stocks fall, because slow economic activity reduces their lending. Their earnings decline, and their stock prices fall along with earnings. But when the economy recovers, the banks start to turn it around, and their stock prices begin to climb again.

Foolish takeaway

Banks may not be popular, but they're a great investment. Warren Buffett, Li Lu, and many other top investors are heavily invested in banks. If you buy today, there's no guarantee that you'll get rich. But you may end up with a consistent flow of dividend income.

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