Toronto-Dominion Bank (TSX:TD) – Should You Buy the 4% Yield?

Description

The **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) stock is well known for its high dividend yield. At 4.1%, the yield is much higher than average for Canadian stocks (which collectively yield approximately 2.5%). If you invest $100,000 at a 4.1% yield, you get $4,100 in cash back every year. That's a decent bit of cash flow. On top of that, TD Bank has an excellent dividend growth track record, having raised its payout by about 9% per year over the last five years.

So, TD Bank stock has a lot of potential. However, there are real risk factors as well. The Bank of Canada is raising interest rates this year, which has mixed effects on banks. On one hand, when central banks raise interest rates, they collect more income on every dollar lent out. But on the other hand, they tend to issue fewer loans. Basically, if the interest rates go up by the same amount on both short and long-term bonds, it's a good thing for banks. But if the yield curve inverts (i.e. short-term bonds start yielding more than long-term bonds), it's not good for the banks.

Banks like TD are unique in that higher interest rates can *sometimes* be good for them (they're unambiguously bad for almost every other industry). However, if Canada goes into a recession, high interest rates might not be enough for TD to make up for what's lost in new lending.

Why TD Bank has a 4% yield

TD Bank has a 4.1% dividend yield because of two factors:

1. It has raised its dividend continuously over the last 10 years.
2. Its stock price has fallen this year.

When a company significantly raises its dividend while the stock falls, it tends to end up with a high yield. TD Bank actually delivered big price appreciation in 2021, but it's falling this year, so the yield is rising.

This doesn't mean that TD is some "dividend only" stock where the capital gains are inadequate. It has outperformed the whole **TSX** by 10% over the last 12 months. However, the stock's returns haven't been so great this year, which has pushed the yield higher.

Why is TD falling this year? Mainly because of perceived risk factors. Housing in Canada is very expensive, and many people think that homeowners will begin to go broke when high interest rates become too much for them. If that happens, then TD will probably lose some money, but there are also reasons to be optimistic.

Expert says First Horizon deal likely to close

Although Canada's housing market is a risk factor for TD Bank, the bank has other investments in the works that could make up for it. For example, it's in the process of buying **First Horizon Bank** (NYSE:FHN) in the Southeast U.S., a market where houses are much cheaper than in big Canadian cities.

If TD closes the First Horizon deal, it will gain access to $89 billion worth of assets, making it the sixth biggest bank in the United States. For much of this year, the FHN deal was thought to be at risk of cancellation, but just recently, fund manager Roy Behren said that the deal will likely close. If Behren's information is accurate, then it should be smooth sailing ahead for TD, with big dividends for shareholders.

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