Better Buy: Bank of Montreal Stock or TD Bank Stock

Description

Bank stocks look oversold after heavy selling over the past several months. Investors seeking Tax-Free Savings Account (TFSA) passive income or Registered Retirement Savings Plan (RRSP) total returns are now wondering which Canadian banks are undervalued and good to buy for a self-directed portfolio. Let's take a look at two banks that are betting big on U.S. economic growth.

Bank of Montreal

Bank of Montreal (TSX:BMO) trades near $122 per share at the time of writing. This is down from more than $153 in March. BMO stock currently offers investors a 4.5% dividend yield with dividend increases likely on the way for 2023 and the coming years. Bank of Montreal ranks as Canada's third-largest bank with a market capitalization of $82 billion.

Bank of Montreal paid its first dividend in 1829. The board raised the payout by 25% late in 2021 and by another 4.5% when the company reported fiscal second-quarter (Q2) 2022 results. Based on the size of the increases, it would appear the board isn't too concerned about the revenue and profits outlook over the medium term.

Bank of Montreal is buying **Bank of West** for US$16.3 billion. The deal will add more than 500 branches to BMO Harris Bank, Bank of Montreal's American businesses, and will position the bank for growth in the California market. Bank of the West gets 70% of its deposits from clients based in the state.

TD Bank

TD (TSX:TD) is Canada's second-largest bank with a market capitalization of $154 billion. The stock trades for close to $86 per share at the time of writing. TD hit a high of $109 in the early part of this year but has steadily declined amid the broader pullback in the banking sector.

TD raised its dividend by 13% late last year. Investors should see another generous increase for fiscal

2023, as the company looks to close a couple of strategic acquisitions south of the border. TD's current dividend provides a yield of 4%.

The bank is buying **First Horizon**, a retail bank based in the southeastern part of the United States, for US$13.4 billion. The purchase will expand TD's branch network in the U.S. by more than 400 locations and will make TD a top-six bank in the American market. TD is also spending US$1.3 billion to buy Cowen, an investment bank. This will beef up TD's capital markets operations.

The stock looks attractive at less than 11 times trailing 12-month earnings.

Is one a better buy?

Economic headwinds are on the way. Banks will likely see revenue growth slow down in 2023 and 2024, and loan losses could increase, as rising interest rates put some businesses and households in a difficult position.

However, both Bank of Montreal and TD have strong capital positions to ride out the downturn and will remain very profitable, even during some challenging quarters. At this point, the anticipated bad news is likely already reflected in the share prices.

Bank of Montreal offers a better dividend yield, so investors seeking passive income might want to make BMO stock the first pick. I would probably split a new investment between the two banks today.

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