Better Buy: TD Bank or Bank of America?

Description

The **Toronto-Dominion Bank** (TSX:TD) and **Bank of America** (NYSE:BAC) are two of my favourite bank stocks. The first is the bank stock that I have held the longest, while the second is a relatively new addition to my portfolio. I started buying TD stock back in 2018 when I observed that the bank was rapidly expanding its presence in the United States, while I bought BAC after noticing that a lot of investors I respect own it.

There is a decent possibility that bank stocks will do well in 2023. Interest rates are going up, and banks collect higher interest income when rates are higher. That's one bullish sign. On the other hand, we have an inverted yield curve (that is, a yield curve that slopes downward), which means that interest on term deposits is rising, too. So the gains from rising interest rates could be muted. Nevertheless, I think the overall strength of banks will become apparent when they start releasing their earnings tomorrow.

In this article, I will explore the two bank stocks I own, and attempt to determine which is the better buy.

The case for TD Bank

The case for TD Bank rests on the fact that TD has obvious catalysts on the horizon. TD is in the process of buying out two U.S. banks: **First Horizon** and **Cowen.** First Horizon does US$861 million a year in earnings, Cowen about US$128 million. Between the two of them, they could add nearly US$1 billion to TD's bottom line. So far, it looks like there are some issues with the First Horizon deal. The deal was criticized by the U.S. Senate Financial Services Committee on the grounds that TD had engaged in exploitative practices. Getting that worked out might take some time. The Cowen deal involves an investment bank, making it harder to oppose on consumer protection grounds. I expect that one to close fairly swiftly.

The case for Bank of America

The case for Bank of America over TD Bank rests on the fact that its mortgage loan portfolio is somewhat less risky than TD’s is.

The average U.S. house costs US$358,000, the average Canadian house costs $628,000. The price of a Canadian home translates to US$464,000, after factoring in the exchange rate. Canadians and Americans earn similar median salaries. Therefore, Canadians are paying more for housing than Americans are.

Why does this make BAC’s mortgage loan portfolio less risky?

Because a big part of the default risk on a mortgage is the borrower’s ability to afford the interest. When a person’s mortgage is 10 times their annual income, they are much more likely to default, compared to if it were 5 times their annual income. Bank of America is operating in a region where houses are cheaper, so its mortgage portfolio should be safer than TD’s.

My final verdict

Taking all the relevant factors into account, Bank of America seems like a slightly better bet this year than TD Bank. I personally own more TD shares than BAC shares, but if I were to make a one-year bet on one of these stocks only, it would be Bank of America. TD’s big advantages are long-term growth catalysts; if you’re in it for the long haul, it could outperform Bank of America. But the latter stock looks a little bit safer this year.

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