TD Stock: Has it Bottomed Out?

Description

TD (TSX:TD) had a rough ride through the market correction last year, as investors dumped Canadian bank stocks after a spectacular recovery from the pandemic crash.

Contrarian investors with a buy-and-hold investing style are wondering if TD is now oversold and a good stock to buy for passive income and total returns.

TD Bank overview

TD is Canada's second-largest stock with a current market capitalization near $156 billion. The bank is known for its retail banking operations across Canada, but the company actually operates more branches south of the border and the American business is going to get a lot bigger this year. TD is in the process of buying **First Horizon** for US$13.4 billion. The deal will add more than 400 branches and 1.1 million customers primarily located in the southeastern states. TD's existing operations in the United States stretches from Maine down the east coast to Florida. When TD announced the deal, it expected the purchase to add US$55 billion in loans and US$75 billion in deposits.

TD is also using excess cash it built up during the pandemic to expand its capital markets capabilities with the US$1.3 billion purchase of **Cowen**, an investment bank.

The U.S. deals should help drive future revenue and profit growth and will further diversify TD's operations.

Risks

TD trades near $86 per share at the time of writing. This is up from the 2022 low around $78 it hit in the summer but down from the 12-month high around $109.

The stock fell as investors became increasingly concerned that aggressive interest rate hikes by the Bank of Canada and the United States Federal Reserve will trigger a deep and prolonged recession.

The central banks are trying to get inflation back down to 2% by cooling off a hot economy. Rate increases, however, take time to work through the system. Even with the hikes already implemented, inflation remains stubbornly elevated, and labour shortages continue to drive up wages. If the central banks raise rates even higher, they could tip the economy into a steep downturn rather than navigate a soft landing.

In the worst-case scenario the jobs market would reverse course, causing a surge in unemployment. The loss of income combined with higher living costs and soaring mortgage payments could force thousands of property owners to default.

Recent reports from the Canadian banks indicate they think only a small single-digit percentage of their mortgage loans are at risk of default, but that will still equate to tens of thousands of properties.

TD has a large Canadian residential mortgage portfolio, so it would likely feel some pain if the economy enters a severe downturn.

Opportunity

TD generated adjusted net income of $15.4 billion in fiscal 2022, up from $14.6 billion in fiscal 2021. In the fiscal Q4 report the bank said it expects to deliver adjusted earnings per share growth of 7-10% in fiscal 2023, despite the economic headwinds.

Assuming that pans out to be the case, TD stock probably bottomed last summer and still appears undervalued at the current multiple of 9.1 times trailing 12-month earnings. Investors who buy TD stock at the current price can pick up a 4.5% yield and could see a double-digit dividend increase at some point this year.

If you have some cash to put to work, this stock deserves to be on your radar.

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