



Should You Buy TSX Bank Stocks or This 1 ETF?

Description

While the markets are relatively calm at the moment, that situation may be untenable. Today let's revisit the case for buying the **BMO S&P TSX Equal Weight Banks Index ETF** ([TSX:ZEB](#)). Is this a better play than buying single **TSX** bank stocks?

I sounded a note of caution last week, writing that investors should be mindful of "**Scotiabank's** exposure to the Pacific Alliance, **TD Bank's** exposure to the U.S. economy, or **BMO's** oil exposure. The sudden souring of any one of these areas could drag down an equally weighted bank index."

Should investors buy a bank ETF?

ZEB's 4.7% dividend yield is lower than some individual banks' yields. Consider, for example, CIBC's rich 6% yield. However, the risk from emerging markets and the U.S. economy is mitigated by indexing. So too – with regard to CIBC – is the risk that a bank with a smaller market capitalization faces in an economic landscape rife with debt-laden households and uncertain investor sentiment.

There are two sides to indexing, though, posing something of a conundrum to the low-risk investor. Funds lower the impact of a single bank's operations going awry. This is the [great strength of an ETF](#). However, an index's homogenized nature nevertheless *ensures* that such risk is passed on to investors, albeit in a watered down state.

For instance, a pure-play TD shareholder is exposed to the U.S. economy, but only tangentially to the risk from a pandemic stricken Pacific Alliance. Similarly, a Scotiabank investor will have a lot of exposure to the Pacific Alliance, but less so to the dangers of an American slowdown. However, investors holding ZEB in a portfolio are exposed to *both* such uncertainties.

Weighing up the benefits of bank stocks

Investors have to weigh the pros and cons of holding an index. Whether ZEB is a suitable replacement for individual bank stocks depends on various factors. For instance, busy investors with less time to

spend of portfolio maintenance may wish to go with the ETF option. Conversely, the hands-on investor with more time to spare may wish to pick stocks that outperform the financials sector.

At the end of the day, indexes are for low-risk investors looking for [slow and steady wealth creation](#). The choice between ZEB and a single bank stock comes down to strategy, financial ambitions, and time frames. On the one hand, active investors with a bigger appetite for risk may wish to cleave to the adage: “You don’t make money by running with the herd.” The index investor, conversely, may prefer the mantra: “There’s safety in numbers.”

Investors may wonder whether holding a top bank ETF such as ZEB alongside individual bank stocks makes sense. Arguably, though, this would lead to overexposure in the banking space.

It also rather defeats the purpose of holding a fund that covers Canada’s Big Six banks. Investors who favour a particular bank might therefore want to think about simply building up a larger position in their chosen moneylender.

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