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Take Advantage of Historically High Yields From the World's Soundest Banks

-- By Carla Pasternak

Wayne Gretzky once described the key to his hockey success: "I skate to where the puck is going to be, not to where it has been." This is great advice for investors -- especially if they're looking at Canadian banks. Canada's banks have taken a hit with the broader market, but it's where these stocks are going next that makes them well worth considering.

Canada's six major banks command 90% of the industry's assets. Five trade on the NYSE. They aren't household names for U.S. income investors, but they should be. For one thing, they carry dividend yields of up to 8.5%. They also boast an average 3-year dividend growth record of +16.8%, and in the past year alone they've raised their dividends an average of +18.8%. *(Full Story Below)*

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Take Advantage of Historically High Yields From the World's Soundest Banks

It may come as a surprise to some, but Canada's banks were rated as the world's strongest by the World Economic Forum late last year. Canadian lenders scored top marks as the most solvent among 134 countries. The banks also rated fifth for investor protection and sixth for financial market sophistication.

Standard & Poor's recently came to the same conclusion. The rating agency wrote in a mid-October client note that Canadian banks are well positioned to weather the downturn. Despite some challenges, S&P analyst Lidia Pareniuk said Canada's banks have "substantially more robust balance sheets and capital positions and lower risk profiles" than their peers in either the U.S. or Europe.

Canada's banks have escaped the U.S. subprime mess relatively unscathed:

Income Notes

Two-year Treasury bonds yield less than 1%; the 30-year bond is less than 3%. Ten-year Treasury yields have averaged just over 4.5% since 1798. Today they offer just 2.5%.

Corporate-bond yields are not that high in historical terms, but the spread they offer relative to government bonds is extraordinary. And at 3.3%, the dividend yield on the U.S. market hardly seems mouthwatering, but it's higher than the long-term Treasury-bond yield for the first time since the 1950s.

-- *The Economist*

Although Treasury rates have begun to rise, few could argue that their still-anemic yields have much to offer long-term investors.

That isn't the case in the corporate sector. In October and November, some investment-grade corporate bonds offered yields as high as 8% or 9%, representing an additional 5 to 6 percentage points over Treasuries. The average junk-bond yield recently climbed higher than 20%.

Although corporate bonds have recovered some ground in recent weeks -- as of Jan. 8, the yield on the

They've taken combined write-downs of about C\$16.2 billion -- a tiny portion of the \$1 trillion of write-downs and losses suffered by banks around the world since the third quarter of 2007.

The tightly regulated Canadian banking system assures the strong financial condition. The conservative capital ratios of Canadian banks are the envy of the world. According to Bank of Canada Governor Mark Carney, Canadian lenders maintain an average asset-to-capital ratio -- a measure of loans issued to cash on hand -- of 18. He compared that to an average of 25 for U.S. investment banks, 30 for European banks, and more than 40 for some major global banks.

Major Entry Opportunity

Despite this, Canadian banks are being punished along with their peers around the world. Canadian bank stocks, as measured by the iShares Canadian S&P/TSX Capped Financial Index, are down more -30% during the past six months.

That spells opportunity. Since price and yield move in opposite directions, yields on Canadian bank stocks have risen to unprecedented levels.

For example, shares of one Canadian bank have lost just over -40% since August 1st, pushing the yield to 8.5%, which amounts to more than 2.5 times its average yield of 3.2% during the past decade.

For another Canadian bank, it's the second verse of the same song. Its low stock price has catapulted its yield from a 10-year average of 3.3% to 7.1%.

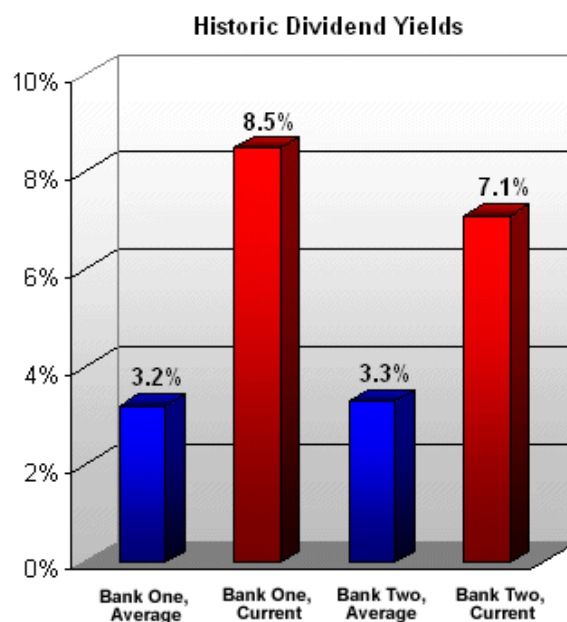
Of course, an elevated dividend yield sometimes signals a dividend at risk. While we can never rule out a dividend cut down the road, recent actions suggest that Canadian banks are generally confident in their future and that their dividends are secure.

Two Canadian banks, for instance, raised their dividend during the past 12 months; three others increased their dividend in 2007 and have maintained the new payout.

Tasty Yields and Capital Gains

Though Canada's banks aren't asking for any sort of bailout and certainly don't need one, tight credit markets and slowing demand for Canadian exports are weighing on the economy and dampening the outlook for the country's banks. But that caveat notwithstanding, Canada's economy is projected to fare better than the United States, Japan and most of Europe. Its growth rate will still be positive in 2009. Analysts expect to see an expansion of about +1% this year and a far stronger +2.4% in 2010.

There's some additional good news. In addition to tasty yields, Canadian bank shares carry substantial long-term capital gains potential. The two banks featured above -- trading with more than twice their average dividend yield --



Barclays Capital U.S. Corporate Investment Grade Index had dropped to 7.3%, down from 9.1% at the end of October -- many argue that there's still plenty of value to be had in the corporate sector.

-- Morningstar

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By Andy Obermueller
January 7, 2009

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would have to gain more than +100% for their yields to revert to historical levels. Meanwhile, investors can collect a nice revenue stream while they wait.

[Follow this link](#) to learn more about my two favorite Canadian bank picks featured in today's issue.

Thanks for joining me on my search for today's highest-yielding securities!



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-- Carla Pasternak

Co-Editor

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