YIELD HOG
As long-term investments, the Big 5 banks are hard to beat

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Bank shareholders, rejoice.

With Bank of Montreal raising its dividend by 2.9 per cent on Tuesday – its first increase in five years – all of the Big Five are back in dividend growth mode following the financial crisis. Bank of Nova Scotia also boosted its dividend, by 3.6 per cent, and we'll likely see more increases as other banks report this week.

For BMO shareholders, in particular, it's been a long wait. But bank investors have endured these sorts of dry spells before, and those who didn't panic were ultimately rewarded. Royal Bank of Canada, for instance, went for more than five years without a dividend increase in the early 1990s, when its balance sheet was hammered by a recession and a nasty real estate bust.

But as the economy improved, Royal Bank's dividend more than doubled over the next five years, and doubled again in the five years after that. The message for investors? The banks hit their share of potholes, but as long-term investments they're hard to beat.

That leads us to today's question: Which of the Big Five has delivered the highest return over the past 20 years? This is a period that encompassed economic slumps, market meltdowns, financial collapses, energy shocks, wars and – as mentioned – long periods with zilch in the way of dividend increases. In other words, we're not looking at the banks through rose-coloured glasses here.

This is rear-view mirror analysis, of course, and our goal isn't to identify the bank you should buy now. Rather, we want to show how an average investor would have made out using a simple buy-and-hold strategy. We also want to demonstrate the importance of dividends – specifically, reinvested dividends – to a shareholder's total return.

We'll assume the investor started on July 31, 1992, and held until July 31, 2012. The first number for each bank is the simple annual price appreciation, excluding dividends. The second is annual total return, assuming all dividends were reinvested in more shares. The third is what an initial $10,000 investment would have grown to over the 20-year period, including dividends (but before inflation, taxes or commissions).

The banks are listed in ascending order of total return, from worst to best. But as you'll see, even the "laggards" of the group put up some solid numbers.

Bank of Montreal (BMO)
Annual price return: 8.14 per cent
Including dividends: 12.58 per cent
$10,000 would be worth: $107,100

Canadian Imperial Bank of Commerce (CM)
Annual price return: 8.51 per cent
Including dividends: 12.85 per cent
$10,000 would be worth: $112,380

Toronto-Dominion Bank (TD)
Annual price return: 11.05 per cent
Including dividends: 14.78 per cent
$10,000 would be worth: $157,926

Royal Bank of Canada (RY)
Annual price return: 10.96 per cent
Including dividends: 14.84 per cent
$10,000 would be worth: $159,381

Bank of Nova Scotia (BNS)
Annual price return: 11.52 per cent
Including dividends: 15.49 per cent
$10,000 would be worth: $178,619

How did the banks stack up versus the index? Glad you asked.

All of them handily beat the S&P/TSX composite, which had an annualized price return of 6.29 per cent over the same period.

We were unable to obtain an S&P/TSX total return figure from Bloomberg that went back as far as 1992, but if you add a dividend yield of 3 per cent – roughly what the index is yielding now – you get a total return of 9.29 per cent for the S&P/TSX. That's well below the total return of the banks.

It's worth repeating that the bank with the highest return over the past 20 years won't necessarily be the best performer over the next 20 years.

Indeed, there are no guarantees that the banks as a group will continue to generate such strong returns in the future.

That said, this exercise shows that holding the banks through thick and thin, and reinvesting dividends along the way, has been a profitable strategy.