The Stock Picker's Guide to Royal Bank of Canada for 2015

Description

The year 2014 will surely be remembered very fondly at **Royal Bank of Canada** (TSX: RY)(NYSE: RY). Throughout the year, the bank continued to exceed expectations, and finished with record earnings of $8.9 billion, or $6.00 per share. Along the way, shareholders have enjoyed a 12.5% share price increase as of this writin), as well as the dividend, which was hiked twice this year.

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So what does 2015 hold for RBC? And should you hold the stock? Well, below we take a look.

Growth fueled by volatile businesses

Of all the big five banks, RBC is most exposed to volatile businesses like Capital Markets and Wealth Management – together, they accounted for 35% of the bank's earnings in 2014. And this year, that exposure was a blessing. The two divisions each posted earnings growth of more than 20%.

But the good times cannot last forever. Remember, 2014 has generally been a strong year for the markets, which has boosted earnings in both divisions. And this has also been a strong year for mergers and acquisitions, providing a big boost to Capital Markets.

Stormy waters lie ahead

The Canadian banking environment has been great for a long time – no one can deny that. But there are a couple of negative trends to watch out for in 2015.

First of all, most observers agree that Canada's housing market is overvalued. In fact, Bank of Canada governor Stephen Poloz recently estimated Canadian house prices to be 10-30% too high. The good news is that a housing correction shouldn't have a big impact on the bank's mortgage portfolio, which is rock solid. The bad news is that a housing correction would stunt loan growth, and could have ripple effects on the Canadian economy. Either way, RBC's earnings growth would take a hit.

Secondly, the decline in oil prices may spell bad news for RBC. It could hurt most in Capital Markets, which will likely see declining revenues from mergers and initial public offerings. It could also hurt the Wealth Management business, where sinking stock prices mean less revenues. Furthermore, low oil prices are very bad for parts of Canada – especially Alberta – and RBC's business in these regions could suffer as a result.

The most expensive bank

RBC should certainly be congratulated for a great year. But thanks to its strong winning streak, investors have been buying up the bank's shares. And as a result, RBC is now Canada's most expensive bank, trading at 13.5 times earnings and 2.4 times book value.

I'm not saying you have to avoid RBC – after all, the bank has performed extremely well, and its management team deserves much credit. But there are some serious risks with the bank's shares, and they are trading at lofty levels. You'll probably find better options among the big five banks.

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