The 3 Hidden Risks of an Investment in Royal Bank of Canada

Description

Royal Bank of Canada (TSX:RY)(NYSE:RY) is one of the most popular stocks to hold in Canada, and for good reason. It faces limited competition, generates consistent profits, and is very well capitalized.

That said, there are still some big risks associated with an investment in RBC, and because of the bank's success these risks can be easily forgotten.

1. Energy

No matter which way you look at it, RBC has a greater exposure to the energy sector than its peers do. When looking at October 31st numbers, the bank has lent nearly $10 billion to energy firms, representing 8.4% of its commercial loans—only **Bank of Nova Scotia** has a higher proportion of loans to the energy sector. Furthermore, RBC has another $22 billion of "undrawn commitments" to energy companies (i.e. lines of credit that can be accessed at any time).

It doesn't stop there. RBC has a big Capital Markets business, one that has a specialty in the energy sector. So, if oil prices remain depressed for a long time, then merger and IPOs in the sector will likely die down. And declining stock prices wouldn't be good for the wealth management business.

2. Disruption

Back in March RBC CEO Dave McKay said the bank is on a "collision course" with technology companies, like **Apple Inc.** and **Google Inc.** The Silicon Valley giants, along with numerous other tech firms, are wading deeper into the financial services space, hoping to disrupt the sector. If they are successful, this would take a big bite out of RBC's profits.

The most notable threat is Apple Pay, which should be coming to Canada later this year. But it doesn't stop there. Small companies like Wealthsimple hope to disrupt wealth management. Peer-to-peer lending networks are also gaining traction.

Granted, there are barriers to these tech disruptors—such as trust and regulation—that buy RBC some time. But banks are notoriously slow to innovate, while technology companies are very nimble. We should expect this to be a threat for a long time.

3. That feeling of invincibility

RBC deserves some serious credit. It hasn’t had any disastrous experiences since the early 1990s, when real estate-related loans led to billions in write-downs. For this reason, the bank could easily get complacent.

Contrast that with a bank like **Canadian Imperial Bank of Commerce**, which still has its subprime loan disaster fresh in its mind. CIBC has hunkered down, gone back to basics, and made risk management a top priority. In other words, it is determined not to repeat its recent mistakes. It’s no coincidence that CIBC today is better capitalized than RBC.

Like the other two risks, we’ve yet to see this become a problem at RBC. It’s still something investors should watch out for, especially with Canada’s economy on such shaky ground.

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2. Investing

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