The Top Canadian Banking Stock to Buy and Hold Forever

Description

Canadian banks are once again garnering considerable negative attention, which sees the **Royal Bank of Canada** (TSX:RY)(NYSE:RY) ranked as the most shorted stock on the **TSX**. While the Big Five may be facing some short-term headwinds, these will only be temporary, and it is only a matter of time before they return to growth. It's Canada's largest mortgage lender, Royal Bank, which provides the most opportunity, with its stock gaining a modest 5% over the last year.

Solid results

Royal Bank reported some credible second-quarter 2019 results**,** including a 6% year-over-year increase in net income to $3.2 billion on the back of a 14% expansion in revenue. What really stood out from those results was Royal Bank's return on equity (ROE) of 17.5% which**,** despite being 0.6% lower year over year**,** was quite an impressive number and superior to many of its peers.

It was almost four full percentage points greater than **Bank of Nova Scotia,** at 13.6%, and 1% higher than **Toronto-Dominion**, at 16.5%. This highlights the bank's sterling job of unlocking value for investors, which will likely continue despite being the most shorted stock on the TSX.

Another key measure highlighting Royal Bank's ability to deliver value for shareholders is its return on assets (ROA), which, while four basis points (bps) lower year over year was still a respectable 0.94%.

Credit quality also remains strong, which is important to note as the thesis for shorting Royal Bank is centred on a collapse in credit quality leading to a weaker balance street, lower earnings and a collapse of the bank's market value. At the end of the second quarter, Royal Bank reported a gross impaired loan (GIL) ratio of 0.49%, two basis points higher than a year earlier, but still well within acceptable parameters.

The value of impaired loans was almost 15% higher, although that can be attributed to a decline in the quality of a range of commercial facilities in the oil and gas, real estate and utilities sectors rather than broad-based decline in the quality of Royal Bank's mortgage portfolio.

Now that oil is rebounding and many drillers have learned to survive amid a difficult operating environment, the volume of commercial GILs should decline. In fact, the value of impaired mortgages (excluding HELOCs) fell by around 2% year over year to $753 million.

Royal Bank's earnings are poised to continue growing at a steady clip even if the economic outlook remains soft. The bank has embarked on an ambitious digital transformation program, including improving its information technology infrastructure and bolstering the volume of mobile users. This will further reduce costs and make Royal Bank's operations more efficient.

Royal Bank is investing in its wealth management business, where for the second quarter, net income rose by 9% on the back of solid loan growth and higher client fees. It's also expanding its U.S. footprint with a specific focus on expanding its wealth management and capital markets operations south of the border.

For the second quarter, net income from the U.S. expanded by 11.5% year over year on the back of an improved performance from Royal Bank's capital markets business. The bank is anticipating that the business environment for its capital markets operations will improve, but this may be delayed by a weaker outlook for the global economy caused by Trump's emerging trade war with China.

Foolish takeaway

Royal Bank's steady earnings growth and improving margins has allowed it to hike its dividend for the last eight years straight to see it yielding a juicy 3.9%. The bank offers a dividend reinvestment plan, where they can use the quarterly payments to acquire additional shares, allowing them to cost effectively and easily access the power of compounding.

Had you invested $10,000 in the bank 10 years ago and accepted the dividends as cash, today you would have an investment worth $29,294, a 193% total return or 11.35% annually. If those dividends had been reinvested, that investment would now be worth $34,024, which represents a total return of 40% or 13% annually, highlighting how investors can accelerate wealth creation by reinvesting dividends.

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