Should Royal Bank of Canada (TSX:RY) Stock Be in Your RRSP in 2020?

Description

Canadian bank stocks often come up as top picks to anchor a balanced RRSP portfolio.

The group has performed well over the long haul and bounced back to new record highs in the wake of the Great Recession. A surge in home prices over the past decade has driven much of the profit growth, and investors are wondering how long that party can last.

In addition, the trade war between China and the United States is putting pressure on the global economy. If the tariffs are extended and economic activity slows in a meaningful way, the Canadian economy could be in for a rough ride.

This would put pressure on the banks.

Let's take a look at **Royal Bank of Canada** (TSX:RY)(NYSE:RY) to see if it deserves to be on your buy list for a self-directed RRSP heading into 2020.

Earnings

Royal Bank just reported fiscal Q4 and full-year 2019 results. Adjusted earnings for the 12-month period rose 4% to $12.9 billion. Revenue was a record $46 billion in the year, up 8%. The strong revenue growth was led by a gain of 11% in wealth management and a 6% increase in the personal and commercial banking segment.

Return on equity was a solid 16.8%. Royal Bank finished the fiscal year with a high CET1 ratio of 12.1%. This is important, as it indicates the bank's ability to ride out tough times.

Overall, Royal Bank had a good year, but the Q4 numbers came in weaker than consensus estimates by analysts who cover the bank. Royal Bank reported net income of $3.2 billion in the fiscal fourth quarter, or an adjusted diluted $2.22 per share. The market thought that number would be closer to $2.28 per share.

Provisions for credit losses on impaired loans increased across the three main business segments. This could be an indication that consumers and companies are starting to feel the pinch of high debt levels and economic uncertainty.

Dividends

Royal Bank raised the dividend twice in 2019. The payout ratio for the year came in at 46%, putting it well within the 40-50% target.

The bank normally increases the payout in line with its earnings-per-share (EPS) growth. In the Q4 earnings release, Royal Bank indicated it is still targeting medium-term annual EPS growth of at least 7%.

Risks

A deep economic downturn is the biggest risk to all the Canadian banks. On the personal and commercial banking side, there is a threat that businesses could reduce spending and investment. In the event that things get really bad, unemployment could rise, which would put debt-heavy households in a difficult situation.

Royal Bank’s Canadian residential mortgage portfolio finished fiscal Q4 at $302 billion. The uninsured portion is $226 billion, and the loan-to-value ratio on the uninsured housing loans is 51%. A meltdown in house prices caused by a wave of defaults would be bad, but the situation would have to get quite nasty before Royal Bank incurs meaningful losses.

Housing has picked up a new tailwind in the back half of 2019, supported by lower mortgage rates. As long as employment rates hold up, the odds of a housing crash remain slim.

Should you buy Royal Bank stock?

The shares are trading down slightly on the Q4 numbers, and the dip could continue if the broader market gives up some of its big gains in the coming weeks. As such, I wouldn’t back up the truck today.

However, at the current price of $105 per share, Royal Bank trades at a reasonable 12 times trailing earnings. Investors might want to start nibbling on any further weakness. Pullbacks have historically proven to be good buying opportunities in this stock.

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