Why Royal Bank of Canada (TSX:RY) Is a Top Stock for 2020!

Description

The outlook for Canadian banks continues to be bleak heading into the new year. Investors are hoping for the best, but expecting the worst, as the credit downturn continues to take its toll on the growth of the Big Five behemoths.

Net interest margins (NIMs) are looking thin, and with credit not yet normalized, provisions for credit losses (PCLs) are still to be expected, as the banks ramp up efforts to better weather the next part of the storm.

For many Canadians, it was a forgettable 2019, but there was much to learn about the banking scene as all six top institutions (the Big Five plus **National Bank of Canada**) were put to the test. There were unforeseen winners like National Bank, major losers like **CIBC**, and everything in between.

Royal Bank of Canada (TSX:RY)(NYSE:RY) was in the upper end of the range as the industry waters became rough. With shares now down a modest 6% from late-November all-time highs, I think investors may want to look to the name as a safer way to play the banks in the new year.

Analysts have already set the bar low for all the Canadian banks. Growth is going to be small and scarce as high provisions, thinning NIMs, and rising expenses continue to be the dominant theme for the pack.

Best in class

While Royal Bank missed the mark in the fourth quarter ($2.22 earnings per share versus the $2.28 consensus estimate), with revenue and expense growth of 4% and 7%, respectively, I see Royal Bank as a “C” student in a class that averaged a “D”.

Royal Bank is succumbing to the same industry pressures as its peers, but at the very least, the bank is not as “ill-prepared” as some of its smaller brothers in the Big Five. Growth will continue to be modest, but Royal Bank’s management team did guide to a steadying PCL ratio in the new year, as credit normalization may be attained more quickly for Royal Bank than some of its inferior peers (I’m looking at you, CIBC).

While the fourth quarter was nothing to write home about, the wealth management and Canadian banking segments were encouraging bright spots. The wealth management business, in particular, I see as a significant source of strength as management looks to grab share in the rapidly evolving industry.

Royal Bank may have stumbled like many of its peers, but it's still a king among men. And at today's valuations, I'd say there's overlooked upside to be had from a bank that appears to well-poised to dodge and weave through the punches that the industry will be throwing its way.

King among banks

At the time of writing, RY stock trades at 11.1 times next year's expected earnings and 1.9 times book, both slightly lower than the stock's five-year historical average multiples of 11.5, and 2.1, respectively. While many Canadians have written off the banks as a top opportunity to create wealth in 2020, I do think many have forgotten that Royal Bank is still a premier name that's deserving of a premium multiple. As far as Canadian banks are concerned, Royal Bank is royalty.

With the name, you'll also get a 4.1% yield, as provisioning grinds to a halt and the bank gets ready to expand in the next phase of the credit cycle.

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