Royal Bank of Canada (TSX:RY): The Only Bank to Own in 2020

### Description

Canada's bank stocks, fairly or not, are still attracting considerable negative attention to be among some of the most heavily shorted stocks on the TSX. Canada's largest lender, **Royal Bank of Canada** (TSX:RY)(NYSE:RY), is the second most shorted stock on the bourse, followed by **Toronto-Dominion Bank**. During 2019, the big banks failed to perform, with Royal Bank rising only 11%, which was well below the 19% rally experienced by the **S&P/TSX Composite Index**.



Renowned short-seller Steve Eisman of *Big Short* fame, who predicted that the U.S. housing bubble would burst in 2007, has spoken widely about the headwinds facing Canada's banks and why he is shorting them.

The reasons for this are quite simple: short-sellers are anticipating that a combination of a softer housing market, high levels of household debt, and subdued economic growth will lead to a decline in credit quality, weighing on their profitability and balance sheets.

## Improved outlook

While the big banks remain a favoured target among U.S. short-sellers, there are signs that their performance, particularly that of Royal Bank, will improve substantially over the course of 2020.

Royal Bank is poised to deliver a solid performance after a flat 2019 with a range of signs that bode well for its ability to deliver value. Key is the increasingly optimistic outlook for stocks now that geopolitical tensions in the Middle East have started to subside, and the likelihood of a full-blown trade war between the U.S. and China appears to have been avoided.

Canadian stocks are expected to perform solidly over the course of 2020. Some pundits are predicting that the bourse will hit new record highs, and that the S&P/TSX Composite Index will finish the year at well above 18,100 points. That bodes well for the Big Five banks and should lift their market value.

There is also a growing expectation that Canada's economy will pick up during 2020, because of an improving global outlook, which should trigger greater demand for credit, as consumer and business confidence improves. This, however, is dependent on the trade war jitters coming to an end. Lower oil prices because of easing tensions in the Middle East bode well for renewed global growth, bolstering Canada's economy.

There are fears that after a weak 2019, Canada's housing market will soften further, and a correction could sharply impact the banks.

Nonetheless, many analysts and real estate agents are expecting the housing market to improve over the course of 2020 with higher sales activity and up to a 4% increase in the national average house price. That will be primarily driven by a more positive economic outlook and improved consumer confidence. A firmer housing market will bolster the performance of the big banks, particularly those like Royal Bank, which are focused on the domestic mortgage market. That will give Royal Bank's earnings a solid boost, as it expands its lending activities.

The bank reported record 2019 revenue of $46 billion on the back of a healthy 10% year-over-year increase in net interest income and 7% increase in non-interest income. This was primarily driven by a solid performance from Royal Bank's personal and commercial banking as well as wealth management business, which should see Royal Bank report another year of record revenue for 2020.

The increasingly positive outlook for the economy and housing market will boost earnings from the bank's insurance business, which reported a whopping 33% year-over-year increase in revenue and a 4% bump in its bottom line.



The two worst-performing divisions in 2019, Investors and Treasury Services and Capital Markets, should also experience improved earnings because of a firmer global outlook and greater demand for their services. Royal Bank's ongoing focus on digitizing its operations, along with implementing other efficiencies and controlling costs, will boost profitability and its bottom line.

## Foolish takeaway

Royal Bank is positioned to experience solid revenue growth during 2020, as the economy improves and the housing market warms, giving its earnings a solid lift. While investors wait for that to boost the bank's share price, they will enjoy its regular sustainable dividend yielding a juicy 4%. For these reasons, now is the time to buy Royal Bank and lock in higher returns for 2020.

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mattdsmith