Royal Bank of Canada (TSX:RY) Just Soared 12% — Time to Back up the Truck?

Description

Don't look now, but **Royal Bank of Canada** (TSX:RY)(NYSE:RY) surged over 12% in just around two trading sessions around the bank's second-quarter earnings results.

The Q2 results themselves were really nothing to write home about. Royal Bank's results weren't exceptional by any means. Profits were cut in half (EPS was down 54% YoY), while provisions for credit losses rose substantially.

However, it seems investors thought Royal Bank 's crummy quarter was a lot better than the prediction of many bears. A lack of significant surprises was all that was needed to move the needle. The oversold name has arguably exhibited the most resilience relative to its peers over the past year.

Peak provisions may be in the rear-view mirror (as well as unsurprising second-quarter results for many of Royal Bank's peers). As such, most of the pessimism about Canadian banks may already be past. The stage could be set for a substantial relief rally toward mean valuations.

Royal Bank stock still a top "catch-up" trade

I have often pounded the table on the Canadian banks, urging investors to "lock in" their higher yields. I've also had a strong preference for quality names, like Royal Bank, that are best-equipped to deal with the recession. I also urged investors who missed out on the April-May market rebound to consider the banks as a "catch-up" trade that I thought would mirror the market bounce with a few month's worth of lag.

Banks are now looking to get back on the EPS growth track. This follows significant damage control amid the perfect storm of challenges created by COVID-19 and the Canadian credit downturn. I think there is compelling upside, especially with Royal Bank stock, heading into year-end.

Royal Bank of Canada rips the Q2 band-aid off

Royal Bank saw weakness across the board in Q2, with PCLs up 564% YoY, Canadian P&C earnings down 56% YoY, capital markets earnings down 86% YoY, and wealth management earnings down 28% YoY.

The latter two segments, I believe, will keep Royal Bank stock afloat through the duration of this recession. As such, investors who want to bet on banks but limit their downside if this recession proves to be more severe, ought to put Royal Bank at the top of their list.

At the time of writing, RY stock trades at a modest 1.6 times book, which is considerably lower than the stock's five-year historical average price-to-book (P/B) multiple of 2. Other traditional valuation metrics are also depressed, but given the profound disruption caused by COVID-19, my preferred metric of choice is the P/B ratio.

Royal Bank stock has led the latest upward charge for the banks. After an unremarkable quarter, I think fear about Canada's banks could quickly turn to optimism. They could be on a sustained rally much higher in spite of the COVID-19-related uncertainties that are still out there.

Foolish takeaway

The second quarter was nasty, but it wasn't as unpleasant as some of the biggest bears on the Street had feared. The Q2 band-aid has been ripped off for Royal Bank, and I think the road to recovery may be coming a lot sooner than most think.

So, if you're a long-term investor looking to get more yield (shares currently sport a 4.7% yield) for less, it makes sense to buy Royal Bank stock, or any of its peers, at today's depressed valuations.

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