Royal Bank of Canada: Here's Why I'd Avoid its Stock Despite its Q3 Earnings Beat

**Description**

**Royal Bank of Canada** (TSX:RY)(NYSE:RY) released its third quarter of fiscal 2020 results on August 26 before the market opening bell. The largest Canadian bank reported a 1.3% year-over-year (YoY) decline in its Q3 earnings to $2.23 per share. However, it was significantly better as compared to Bay Street analysts' estimate of $1.77 per share.



RBC's third-quarter earnings were primarily driven by solid YoY growth in its capital markets, insurance, and wealth management segments.

The earnings event seemingly boosted investors' confidence, as its stock rose by 1.3% on Wednesday morning. At the same time, the **S&P/TSX Composite Index** was up 0.5% for the day.

## RBC's Q3 revenue rose amid the pandemic

In the quarter ended July 31, 2020, Royal Bank of Canada reported $12.9 billion in revenue — up 11.9% YoY. It was also better than analysts' expectation of $11.5 billion.

While lower interest rates caused a decline in client activity, the bank's net interest income rose by 2% in Q3 2020 as compared to the same quarter of the previous fiscal year. Also, its trading revenue from capital markets segment registered solid gains.

Its Canadian banking arm, as well as City National Bank — a subsidiary of Royal Bank of Canada — saw positive volume growth during the last quarter.

## COVID-19 headwinds in the banking sector

The COVID-19 crisis has increased the challenges for the Canadian banking sector. In the third quarter, Royal Bank of Canada's insurance segment was hit, as the pandemic led to a rise in insurance claims. Nonetheless, lower claims costs and a strong 51% YoY rise in its insurance segment revenue helped the Toronto-based bank negate these COVID-19-related headwinds.

In the last quarter, COVID-19-related measures also increased RBC's overall expenses. Its management considers the extent and duration of the pandemic's impact on the economy to be uncertain.

## Uncertainties about the economic recovery

In its Q3 earnings report, Royal Bank of Canada confirmed a rise in economic activity across North America due to easing COVID-19 restrictions. But the bank predicts labour market weakness to continue in the near term and considers the trajectory of the economic recovery to remain uncertain.

Despite the recent rise in economic activities, Royal Bank of Canada expects the U.S. and Canada GDP to remain well below 2019 levels in the second half of 2020. Weak business and consumer confidence, along with higher unemployment rates, are likely to hurt the GDP.

## How low interest rates are also hurting RBC

Unlike in capital markets and insurance segments, Royal Bank of Canada's revenue from its investor & treasury services fell by 14% YoY and 32% sequentially to $484 million. It was primarily due to lower funding and liquidity revenue as a result of lower interest rates and a rise in enterprise liquidity.



## Is Royal Bank of Canada stock a buy after Q3 results?

Royal Bank of Canada's third-quarter results showcased strength due to a sharp rise in capital markets revenues and trading activity. I expect these factors and its strong Q3 results to accelerate the recovery in its stock in the coming weeks.

In contrast, low interest rates, higher insurance claims, and low business confidence could continue to hurt banking sector investors' sentiments. That's the reason why I wouldn't recommend conservative investors to buy its stock, as these factors — along with a weak economic outlook — could keep RBC's stock highly volatile in the short term.

But if you're looking to invest your money in stocks for long-term wealth creation, then you can consider buying its stock on any dip towards the support level between $95 to $98 per share.

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