Should You Buy Royal Bank of Canada (TSX:RY) Stock for Its 4.5% Dividend Yield?

Description

It looks like market volatility will be the norm rather than the exception for the rest of 2020. In the last week, investors witnessed a massive sell-off in tech stocks and the broader market. Does this mean it is time to bet on large-cap Canadian companies such as the **Royal Bank of Canada** (TSX:RY)(NYSE:RY) that offer a semblance of certainty given its 4.5% dividend yield?

Banking stocks are not the best bet in a low interest rate environment

Earlier this week, the **Bank of Canada** revealed it will keep the overnight rate unchanged at 0.25%. It also kept the bank rate at 0.5% and the deposit rate at 0.25%. It was the fourth consecutive time when the country's central bank kept these rates unchanged since March.

The COVID-19 pandemic wreaked havoc in early 2020 that resulted in business shutdowns. The Bank of Canada then made an unprecedented decision to cut interest rates to 0.25% from 1.75% in a month.

While lower interest rates are attractive for a few sectors (read "real estate"), it puts massive pressure on the bottom line of financial lenders. Banking companies are in fact hurt by high unemployment rates, which might increase the risk of defaults as well as by low-interest rates which will impact profit margins.

In the June quarter, the Royal Bank of Canada attributed its fall in earnings to lower interest rates. Company CEO Dave McKay said, "We reported earnings of $3.2 billion, our strong pre-provision pre-tax earnings of over $4.7 billion added to our capital buffer this quarter, while absorbing the impact of higher PCL and lower interest rates."

Analysts tracking Royal Bank of Canada expect earnings to fall by 14.2% year-over-year in fiscal 2020, despite a 3.2% increase in sales.

Royal Bank of Canada remains a long-term buy

While the ongoing pandemic will continue to impact several industries, it is likely to be a near-term headwind. Banking stocks such as the Royal Bank of Canada will gain momentum when the market rebounds and consumer demand increases.

Royal Bank of Canada is the largest Canadian bank and one that has generated significant profits and cash flows over the years. Given its massive size, RY is well poised to absorb a hit to its financials and has also survived multiple economic recessions.

The stock is trading 12% below its 52-week high with a price to sales multiple of 2.9 and a price-to-earnings multiple of 12.6, which is attractive for value investors, especially given its tasty dividend yield.

The Foolish takeaway

Royal Bank of Canada has lowered its provision for credit losses in Q3, which means its earnings should improve going forward. If you invest $10,000 in this stock, you can generate $450 in annual dividend income and help you generate a passive income stream.

RY stock remains a solid long-term buy given its huge market presence and dividend-paying history. The stock has returned 33% in the last five years despite the recent pullback and should outperform broader markets in the upcoming decade as well.

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