



Is Royal Bank (TSX:RY) a Good Stock to Buy Now?

Description

Royal Bank ([TSX:RY](#))([NYSE:RY](#)) is Canada's largest financial institution and ranks among the top 15 in the world. The share price has rallied significantly off the lows of the 2020 [market crash](#), and investors wonder if Royal Bank stock is still a good buy.

Earnings

Royal Bank reported strong [fiscal Q2 2021](#) earnings. The robust results suggest that the feared losses from the pandemic won't occur, and the bank could be getting ready to make some big moves.

The bank generated net income of \$4 billion in the quarter. That's not bad for just three months of operations. Royal Bank said it released provisions on performing loans to the tune of \$260 million. That means it reversed provisions for credit losses (PCL) compared to a \$2.1 billion increase of PCL in the same quarter last year when all the banks prepared for widespread loan losses. Comprehensive government aid for businesses and households over the past year helped avoid a worst-case scenario of loan and mortgage defaults. In fact, bankruptcy filing rates are at multi-year lows.

Royal Bank gets revenue from a variety of banking segments. The personal and commercial banking operations delivered solid results in fiscal Q2, and the capital markets division had a record quarter.

Strong stock markets, a booming housing sector, and the reopening of the economy should continue to benefit Royal Bank's operations.

Dividends

Royal Bank had to put dividend hikes and share buybacks on hold as a result of pandemic restrictions implemented by the government for financial institutions. With the improvement in vaccination rates and an economic rebound underway, the government is expected to give Royal Bank and its peers the green light to restart dividend increases.

Royal Bank has a CET1 ratio of 12.8%. This means it is sitting on significant excess cash it can deploy in a number of ways. Part of the funds will go to shareholders in the form of dividend hikes. It wouldn't be a surprise to see Royal Bank boost the payout by more than 10% in the next two or three years.

At the time of writing, the stock provides a 3.4% yield.

Growth

Royal Bank has the financial firepower to make large strategic acquisitions. The bank bought City National in the United States for US\$5 billion in 2015. Another deal focused on wealth management, private banking, and commercial banking south of the border wouldn't be a surprise, given the large cash hoard.

Royal Bank might also look to boost its Canadian wealth management operations, although there are few independent players of meaningful size left in the domestic market after a flurry of deals before the pandemic.

Risks?

The end of government aid programs is expected to result in a surge in business and personal loan defaults, as companies and homeowners who managed to hold on due to the financial assistance are forced to shut down or sell their homes. The banks have a pretty good idea of how much the hit will be in the near term. The greater risk could be a spike in interest and mortgage rates in the next few years.

Why?

Inflation could force the Bank of Canada to increase interest rates sooner than expected and by larger than anticipated amounts. This would drive up the costs on variable-rate loans. At the same time, rising bond yields might trigger a jump in fixed-rate mortgages costs.

In the event rates rise too quickly too soon, the housing market could tank. In that scenario, Royal Bank and its peers with large mortgage portfolios could be in for a rough ride.

On the positive side, rising interest rates also boost net interest margins for the banks, and this tends to offset the negative impact of higher defaults.

The bottom line on Royal Bank stock

Royal Bank isn't a cheap stock today, but the bank deserves to be a core holding for a buy-and-hold TFSA or RRSP portfolio. Investors should see generous dividend increases in the next few years, so I would probably buy a half position now and look to add on a market pullback.

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