



1 Top Canadian Stock to Hold for 25 Years

Description

Canadian investors are using TFSA and RRSP accounts to own top Canadian stocks and build retirement portfolios that will complement CPP, OAS, and company pensions.

Let's take a look at **Royal Bank** ([TSX:RY](#))([NYSE:RY](#)) to see why it should be on your buy list for a self-directed [retirement](#) fund.

Profitability

Royal Bank is Canada's largest financial institution and one of the most profitable big banks in the world. The company operates in 29 countries and is among the top 15 on the planet by market capitalization.

Royal Bank reported fiscal [Q2 2021](#) net income of \$4 billion. That's not bad for three months of operations in the middle of a global pandemic. Return on equity (ROE) came in at 19.4%. This is an enviable result for most large international banks. The American banks tend to deliver average ROE of about 12% during normal times and top European banks struggle to deliver ROE above 10%.

Balanced revenue stream

Royal Bank gets 46% of its earnings from personal and commercial banking activities. The capital markets group adds 28% of profits. Wealth management contributes 17%, and the insurance division kicks in 6% of earnings. Royal Bank's investor and treasury services operations provide the remaining 3% of profits.

On a geographic basis, Canada contributes 58% of revenue, while the U.S. adds 26%, and the international operations deliver 16%.

Royal Bank finished fiscal Q2 2021 with a CET1 ratio of 12.8%. This means the bank is sitting on significant excess cash that it will look to deploy once the pandemic is over. Generous dividend hikes

and share buybacks are expected once the Canadian government gives the country's banks the green light to resume these programs. Royal Bank might also look to do a wealth management deal in the U.S. to bulk up its American operations ahead of the anticipated strong economic recovery.

Risks

The feared wave of loan defaults due to massive job losses and business closures didn't materialize last year thanks to substantial government aid and payment deferral programs. Most of the financial assistance is expected to end by the start of next year, so there will likely be a rise in loan losses in 2022, but those should be easily absorbed by Royal Bank and its peers, as long as there isn't another COVID wave caused by variants that break through vaccine protections.

Housing is probably the bigger risk in the next few years. House prices soared in 2020 and 2021, fueled by record-low borrowing costs. Fixed-rate mortgages can be secured at less than 2% right now, and variable-rate loans are even lower.

Inflation threatens to end this party. The Bank of Canada remains convinced that inflation will remain subdued after the transitory spike we are currently experiencing. In the event inflation runs hot for longer than expected, the Bank of Canada will have to start raising interest rates. This would drive up the cost of variable rate loans and likely put upward pressure on Canadian bond yields, which would lead to higher fixed-rate mortgage costs.

A sudden surge in mortgage rates could destabilize the housing market and trigger a crash. Royal Bank finished fiscal Q2 2021 with more than \$300 billion in mortgages on the books, so a meltdown in the housing market would probably cause some pain.

That said, a slow rise in rates is the probable outcome over the next few years. This would avoid a severe housing crash. Royal Bank is capable of riding out a controlled downturn in the property market.

Should you buy the stock now?

Royal Bank isn't as cheap as it was last year, but the stock still deserves to be a core position for a buy-and-hold retirement portfolio. Long-term investors have done well. A \$10,000 investment in Royal Bank 25 years ago would be worth about \$360,000 today with the dividends reinvested.

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aswalker

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