Why Royal Bank (TSX:RY) Is Still a Top RRSP Stock

Description

Royal Bank (TSX:RY)(NYSE:RY) rallied significantly off the 2020 low to a new all-time high this year. Investors who missed the surge wonder if RY stock is still a good buy for a self-directed RRSP portfolio.

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Royal Bank earnings

Royal Bank is a profit machine, even during a global pandemic. Canada's largest bank by market capitalization reported a net income of $4.3 billion in fiscal Q3 2021, representing a 34% increase over the same period last year. Once you strip out the impact of provisions for credit losses and taxes, earnings rose 6%.

Royal Bank set aside billions of dollars for potential losses on bad loans last year due to the pandemic. Government aid and payment deferrals helped avoid the worst-case scenario as businesses and homeowners have avoided filing for bankruptcy.

An uptick in defaults should be expected once the assistance programs end, but Royal Bank is able to absorb the hit and has started to reverse some of the provisions. In fact, Royal Bank released $638 million of PCL on performing loans in the quarter due to the bank's macroeconomic outlook and improved credit quality of borrowers.

All of Royal Bank's divisions reported strong year-over-year results. Net income in the personal and commercial banking operations rose by $746 million, or 55%. Wealth management earnings increased by $176 million, or 31%. Capital markets net income jumped $180 million, or 19%. Insurance income increased $18 million, or 8%. Investor and treasury services saw earnings jump $12 million, or 16%.

Return on equity was 19.6% in the quarter and Royal Bank finished fiscal Q3 with a CET1 ratio of 13.6%. This makes Royal Bank the most profitable of the large Canadian banks and it has one of the strongest capital positions.

The diversified revenue stream is important for investors to consider when evaluating bank stocks for their portfolios.

Risks

The Delta variant is spreading quickly across Canada and the United States, hitting unvaccinated people particularly hard. Health experts warn that hospitals could fill up again with COVID-19 cases and potentially force regional governments to implement new restrictions. That could slow down the economic recovery and put borrowers at further risk of default just as support programs at the federal level are ending.

Rising inflation is another risk to watch. The Bank of Canada is of the opinion that a surge in inflation above its target range is transitory. That might turn out to be the case and the bank will have the flexibility to keep interest rates low for a longer period of time. If, however, high inflation persists through the end of next year, the Bank of Canada might be forced to boost interest rates sooner than expected and by larger amounts.

This could potentially trigger a wave of defaults on business loans and mortgages. If the housing market plunges, Royal Bank could take a hit. The company finished fiscal Q3 with $349 billion in Canadian residential real estate loans. This is a big number, although Royal Banks's exposure to the housing market relative to its size is smaller than some of the other banks.

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Dividends

The government forced the Canadian banks to halt dividend increases last year. Now that the economy appears to be rebounding, the banks will likely get the green light to restart distribution hikes in late 2021 or early 2022. RBC investors should then receive a generous increase.

The distribution provides an annualized yield of 3.3% at the time of writing.

Why Royal Bank is a buy

Royal Bank trades near $130 per share, which is just under the 2021 highs. Despite the big rally, the stock still deserves to be an anchor holding in a Tax-Free Savings Account (TFSA) or RRSP portfolio. Royal Bank is very profitable and is large enough to make strategic acquisitions to boost growth. Long-term owners of the shares have enjoyed great returns and that trend should continue.

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