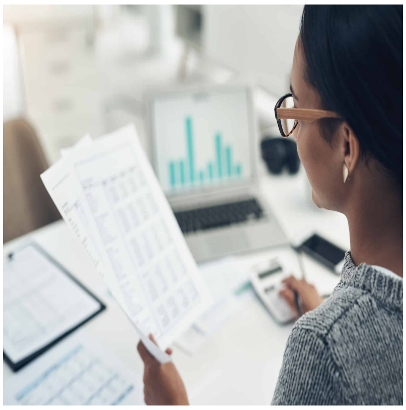

Better TFSA Buy: Royal Bank Stock or a GIC?

Description

Dividend stocks are the cornerstones of many investors' portfolios. Offering both yield and potential capital gains, they can deliver high returns. Not all dividend stocks are great investments, but diversified portfolios of dividend stocks tend to perform well over the long term.

For much of the last decade, the conversation pretty much ended there. With low interest rates, dividend stocks were the best income investments out there, no questions asked.

Today, things are a little different. Thanks to the Bank of Canada raising interest rates, many bonds have pretty high yields. Guaranteed Investment Certificates (GICs), which previously paid next to nothing, are now yielding up to 5%! That's a higher yield than **Royal Bank of Canada** (TSX:RY) can boast, and RY is usually considered a high-yield stock.

In this article, I will compare RY stock and GICs side by side, so you can decide which is a better investment.

The case for Royal Bank stock

The case for Royal Bank stock rests on dividend-growth potential. Today, RY stock has a 4% dividend yield, which is already pretty good. The yield could go higher in the future, too. Over the last five years, RY's dividend-growth rate has been 6.6% per year. At that rate of growth, it would take 10.9 years for a company's dividend payout to double. There are no guarantees that RY's dividend *will* continue growing at that rate, but there are reasons to think that it could happen.

For one thing, the current macroeconomic environment is pretty good for banks. Interest rates are rising, and banks make money off of interest rates. The higher they go, the more revenue they collect. This is simplifying a little, because high interest rates also discourage spending, which slows down the growth in loans. But in the near term, banks can make money off of rising interest rates.

In its most recent quarter, Royal Bank delivered modest 2% growth in earnings per share in the same period when many other stocks were seeing their earnings decline. Interest income increased, as expected.

The case for a GIC

The case for investing in a GIC instead of RY stock is very simple: the GIC is less risky.

Royal Bank stock has a very high yield, but it is subject to a variety of risk factors, ranging from recessions to defaults to yield curve inversion. Yield curve inversion is when short-term interest rates go higher than long-term interest rates; it's usually not considered good for banks. With GICs, you aren't subject to many of these risks. The bank that sells you a GIC could default, but if your savings are less than $100,000, you're insured by the FDIC, a government-backed agency.

Another thing GICs have going for them is high yield. Not all GICs can beat RY's 4% dividend yield, but a few can. For example, there's a GIC offered by **EQB** that yields 5.15%. That's higher than Royal Bank's current yield, but remember that RY or any other dividend stock can raise its payout.

The winner is…

Taking all possible factors into consideration, Royal Bank stock looks like a better bet than GICs. Its yield is a little lower, and its risk is a little higher, but with that extra risk comes the potential for dividend growth. For this reason, it could provide a higher total return than GICs. However, for the best mix of risk and return, you might want to consider owning both assets.

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Date
2025/07/21
Date Created
2022/12/11
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