Is RBC Stock a Buy in February 2023?

Description

Royal Bank of Canada (TSX:RY) is a high quality stock in one of 2023's most in-favour sectors.

Interest rates went up all year last year, and banking/lending is the only industry for which rate hikes are practically *ever* a good thing. It isn't guaranteed that high interest rates impact banks in a positive way: if they cause a recession, or if the yield curve inverts, then banks don't prosper from high interest rates. However, there are at least some situations in which banks can benefit from high interest rates (i.e., high rates without a corresponding recession), which is in contrast to other industries, in which higher rates just lead to higher costs.

The above paragraph applies to all financially sound banks, not just RBC. However, RBC stock is a better bet than many bank stocks out there, because it's well-capitalized and has geographic diversification. In this article, I will explore RBC stock and explain why it looks like a good value today.

Why RBC stock is looking like a good value

Apart from macroeconomic conditions that favour banking stocks in general, RBC stock has many specific things going for it.

First things first, it is a very well-capitalized bank. In banking, "capitalization" refers to high quality capital held in relation to assets (where assets are weighted according to how risky they are). The most commonly mentioned bank capital ratio is the CET1 ratio, which is cash and common stock compared to risk-weighted assets. RBC's CET1 ratio is 12.6%. Current regulations require a minimum CET1 ratio of 6%, so RBC is well above the regulatory requirement.

Second, RBC has a solid long-term track record. The bank has been around for 150 years, and it has not faced a serious financial crisis in that entire time. Past history doesn't tell you much on its own, but a record of financial stability lasting hundreds of years does stand out.

Third and finally, RBC is a globally diversified bank. It has investment banking operations in the U.S. and a wealth management business in the Caribbean. Canada's housing market is thought to be a risk factor for Canadian banks right now, so this global diversification benefits Royal Bank compared to more domestic-oriented banks.

Some risks to watch out for

I've so far outlined a case that banks in general are in a good place right now, and that RBC stock is better than the average bank stock. These points make RY look pretty compelling, but there are risks to bear in mind, too.

For one thing, the housing market factor mentioned above, although less of a risk for RY than a purely domestic bank, is still a risk. Canadian houses are about 1.5 times more expensive than U.S. houses, even adjusting for the exchange rate. Many younger Canadians can't afford houses, and rising interest rates are making mortgages more costly for homeowners. So there's some real risk of defaults here.

Also, Royal Bank has a large investment banking division that isn't doing very well this year. Investment banks make money taking companies public. Because stocks fell last year, not many companies are choosing to go public now. They're waiting for better market conditions. As a result, RY's investment banking fees went down last quarter. This is one risk to keep in mind, but RY's overall business (as measured by revenue) is growing this year. On the whole, the stock looks promising.

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