Canadian Imperial Bank of Commerce vs. Bank of Montreal: Which Is the Best Investment?

Description

The Canadian financial sector has finally pulled back. Banks are a core part of every balanced portfolio and new investors are looking to see which one fits best with their strategy.

Canadian Imperial Bank of Commerce (TSX: CM)(NYSE: CM) and **Bank of Montreal** (TSX: BMO)(NYSE: BMO) are often overlooked by investors, but these two banks have interesting strategies that are worth investigating.

Let's take a look at both banks and see if one is a better investment choice right now.

Canadian Imperial Bank of Commerce

CIBC learned its lesson after $10 billion in write-downs during the financial crisis. The company refocused on Canadian retail and fortified its balance sheet. CIBC finished Q3 2014 with a solid Basel III Common Equity Tier 1 (CET1) capital ratio of 10.1%.

In September, Victor Dodig became the new CEO at CIBC. Shortly before taking the top job, Dodig said the company plans to spend up to $2 billion to grow CIBC's wealth management operations. It's an area he knows well, considering he led the wealth management division before moving to the C-suite.

CIBC's focus on Canadian retail customers has been profitable in recent years but the company is also very exposed to the inflated housing market. As of July 31, 2014, CIBC had $103.8 billion of residential mortgages on its books. About 69% of the portfolio was insured and the loan-to-value (LTV) ratio for the uninsured component was 59%.

CIBC trades at 12.6 times earnings and pays a $4.00 per share dividend that yields about 4%.

Bank of Montreal

Wealth management is a popular way for Canada's banks to drive higher revenues. Bank of Montreal spent $1.3 billion in May 2014 to buy U.K.-based F&C Asset Management. The deal gives BMO a strong foothold in Europe and helps diversify its earnings stream both geographically and by business unit.

BMO's other international focus is its big gamble on the U.S. economy, especially in the Midwest. When the Great Recession hit, BMO had to make a tough decision. Instead of abandoning its operations in the U.S. market, the company decided to double down in the Midwest and bought Wisconsin-based Marshall and Illsey Corp. for $4.1 billion.

In BMO's Q3 2014 earnings statement, the company reported earnings of $147 million from the U.S. operations. The highlight in the report was an 18% increase in loans at the commercial banking unit of BMO Harris Bank. The company sees strong opportunities in the region's mid-cap sector and is executing well despite persistent low interest rates and strong competition in the U.S.

The U.S. manufacturing sector has seen steady growth since the financial crisis but the recent strength in the U.S. dollar is causing some headwinds and the pace of the recovery will likely slow down in the next six months.

Back in Canada, BMO also has a big basket of retail debt sitting on the books. At the end of the third quarter, BMO reported a total of $97.1 billion in residential mortgage holdings. The insured component represented 64% of the portfolio and the LTV on the uninsured housing loans was 58%.

BMO's CET1 ratio was 9.6% at the end of the quarter. The stock trades at 12.7 times earnings and pays a dividend of $3.12 per share. The yield is about 3.8%.

Should you buy?

Despite the high percentage of insured loans, CIBC's mortgage holdings are a bit scary given the fact that the company only has a market cap of $40 billion. If the Canadian housing market has a soft landing, CIBC will be fine. If the correction is ugly, the stock might get hit harder than its peers, given the lopsided reliance on Canadian consumers for earnings.

BMO's U.S. operations and growing global asset management business provide better earnings diversity at the moment. With both stocks trading at the same valuation, BMO is probably a safer bet in the current environment.

CATEGORY

1. Bank Stocks
2. Investing

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1. NYSE:BMO (Bank of Montreal)
2. NYSE:CM (Canadian Imperial Bank of Commerce)
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