



Canadian Imperial Bank of Commerce Was Downgraded: Is This a Signal to Sell?

Description

What: The impact of the oil rout is not only being felt in the energy patch, but across Canada's economy. One of the most exposed industries is Canada's banks. The oil rout has now triggered a round of analyst downgrades for Canada's banks, with one of the latest being the **Canadian Imperial Bank of Commerce** ([TSX:CM](#))([NYSE:CM](#)).

So what: It is easy to see why CIBC has attracted such a negative outlook for analysts, and for some time I have believed it is the one bank among the big six banks that investors would do best to avoid.

CIBC is the most reliant upon Canada's housing market and mortgage lending as a means of generating growth. This is because unlike **Toronto Dominion Bank**, which has established a sizable presence in the U.S., and the **Bank of Nova Scotia**, it has no sizable offshore exposure to speak of. As a result, any meltdown in Canada's already very frothy housing market will have a far greater impact on CIBC's bottom line.

We are already seeing the impact of the oil rout with housing markets at the heart of the energy patch; they have experienced softer prices and higher inventories. Since the oil rout began approximately six months ago, Alberta's average house price has fallen by 4%, while rental vacancies continue to rise, especially in key oil hubs, such as Fort McMurray and Edmonton.

In January 2015, housing inventories in parts of Alberta shot up by about 30% when compared to the equivalent period in 2014. This is expected to continue, with industry insiders expecting even more layoffs across the energy patch as the oil rout bites deeper.

These events do not bode well for Canada's housing market, which saw prices hit record levels when it became one of the most expensive housing markets globally. Clearly, Canada's housing market is ripe for a broad-based decline in prices, and recent events in the patch may just be the trigger required for this to occur. For CIBC, any decline will be bad news, with over three quarters of its loan portfolio made up of residential mortgages.

The **Royal Bank of Canada** also cut interest rates and this will have an impact on the profitability of the big six by applying greater pressure to their net-interest-margin.

Another concern regarding CIBC is its troubled Caribbean operations, with the region labouring under a sustained economic slump. In fact, the majority of its impaired loans and allowances for credit losses are for loans in its Caribbean business.

CIBC is also one of the least efficient of the big six, with an efficiency ratio of almost 65% at the end of last quarter, while its return on assets—a critical measure of a bank's performance—was disappointingly low at less than 1%.

Now what?

The oil rout and its potential impact on Canada's housing market, along with lower interest rates, couldn't come at a worse time for CIBC.

The bank is still battling to minimize the impact of its poorly performing Caribbean operations on its bottom line, while being heavily dependent on the domestic credit market as a key growth lever. For these reasons, I believe that CIBC is best avoided by investors, with both Toronto Dominion Bank and the Bank of Nova Scotia being superior investment opportunities.

CATEGORY

1. Bank Stocks
2. Investing

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1. Editor's Choice

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

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