Nervous About Housing? Then Avoid Canadian Imperial Bank of Commerce

Description

Many investors are losing sleep over a possible correction in Canadian housing.

According to many analysts, Canada's housing market could very well be more overvalued than the United States's market was back in 2006-07. These folks point to things like sky-high price-to-income and price-to-rent ratios, which are both making investors nervous. Additionally, many think that low interest rates are helping to artificially keep the market propped up. Even the hint of increasing rates could be enough to do serious damage.

Even Canada's bank CEOs have started publicly voicing their concerns about the housing market. **Bank of Nova Scotia** CEO Brian Porter said the company is looking to slow lending–especially in Vancouver and Toronto–because of concerns about an overheated market. **Royal Bank** CEO David McKay says the company is "closely monitoring" the same markets.

Canadian Imperial Bank of Commerce (TSX:CM)(NYSE:CM) is also somewhat worried, but management is doing their best to help alleviate potential investor concern. A few weeks ago the company put out a report saying it had crunched the numbers, and a drop in home prices of 30% combined with 11% employment would only cost it about $100 million in mortgage losses.

Additionally, Chief Risk Officer Laura Dottori-Attanasio applauded the job done by front-line employees in underwriting loans, especially those in Toronto and Vancouver. Compared to the national average of the bank's portfolio, these loans had a lower loan-to-value ratio with a higher overall credit score. Arrear rates are also much lower than the overall portfolio.

CIBC has gone to considerable effort to assure nervous investors about its exposure to housing. While it has swayed some investors, many more aren't buying a word of it. Here's why.

Most exposed to housing

One of the knocks against CIBC for years has been its Canadian-centric operations. Aside from a few small forays into the wealth management field in the United States, the company has been pretty much singularly focused on Canada.

That changed a few months ago. CIBC finally went shopping for assets across the border, agreeing to buy Chicago's PrivateBankcorp for $4.9 billion. The deal is expected to close in the first part of 2017.

Although CIBC paid the steep price of some 18 times earnings and 2.2 times tangible book value for its prize, many investors–including myself–applauded the move. It helps to diversify a bank that was too exposed to one economy.

But it might not be enough. Thanks to the new foreign buyers' tax passed by the province of British Columbia on real estate purchased in the province, Vancouver's real estate market is starting to experience some major weakness. Both Calgary and Edmonton have been rocked by the troubles in the energy sector, and markets like Winnipeg, Montreal, and Halifax are tepid at best.

If these issues are just temporary, it won't be a big deal for CIBC. But if things get even worse, investors will start to get concerned about real estate again. And when they do, the company with no current U.S. exposure will suffer.

Already priced in

With a price-to-earnings ratio of just 10.3 times projected 2017 earnings and a dividend of 4.8%, CIBC looks to be a pretty solid value compared to its peers. Investors have priced in many of the risks already in CIBC shares.

Compared to its peers, CIBC trades at a discount of between 10% and 20%. If we get the proverbial soft landing in the real estate market, there's a good chance CIBC shares will bridge that valuation gap. And if we don't, at least CIBC is relatively cheap today.

The thesis is pretty simple. If you're concerned about Canada's housing market, CIBC probably isn't where you want to be. If you think the market still has a few strong years left in it, that should give the company the chance to solidify its new U.S. operations and lessen its exposure to Canada. And in the meantime, investors are getting nearly 5% annually as a nice consolation prize.

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