Is Now the Time to Be Ramping Up Mortgage Growth? Canadian Imperial Bank of Commerce Thinks So

Description

Investors pondering why Canada's smallest of the Big Five banks, **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM), is continuously undervalued compared to its peers have often pointed to the attractiveness of fundamental valuation metrics. Indeed, the smaller Canadian bank appears more attractive than ever at current levels; however, the market has continued to price in a much higher risk premium for the Canadian lender, focusing on a number of potential headwinds for the bank.

I'm going to discuss one of the more prevalent headwinds for CIBC, one which corresponds to the bank's current competitive situation in the Canadian mortgage market.

CIBC continuing to focus on Canadian market and growth

One of the key differences between CIBC and its larger Canadian peers is the amount of exposure CIBC has to the Canadian market and, in particular, the Canadian housing market in a time when interest rates are on the rise and talks of a Canadian housing bubble deflating are all the rage these days.

Rising interest rates are generally considered to be a positive for lenders, as top- and bottom-line margins and profitability tend to improve as rates rise. In general, rising interest rates also indicate an improving economy, which is good for both the Canadian consumer and CIBC overall. Canada continues to make up a much higher percentage of CIBC's overall banking revenue when compared to its peers, despite recently announced acquisitions in the U.S. market of PrivateBancorp and Geneva Advisors.

The issue with rising interest rates is mainly centred on the discussion of how such interest rate hikes will affect the ability of mortgage holders to service their underlying debt. With some of the lowest mortgage rates in the developed world, with a very high percentage of such loans at adjustable rates (reset every five years, give or take), any meaningful increase in interest rates has the potential to affect a very high percentage of Canadians, affecting how much they can borrow and therefore cap housing prices, which have been increasing year over year in the double-digit range for some time now.

In the last quarter, CIBC reported residential mortgage growth of 13% year over year, noting that the lender has grown its Canadian mortgage book much faster than its peers in recent quarters, expecting the trend to continue. CIBC noted in its quarterly financial statement release that it does not expect a “hard landing” for the Canadian housing market, but rather a potential cooling off as interest rates rise and housing price increases slow.

Bottom line

The discount investors are able to get on CIBC shares comes with a price. For deep-value investors, now may be the time to jump in. In the long term, should CIBC continue to move in the right direction strategically and diversify a bit more, I believe the lender can be a great long-term holding. That said, medium-term risks relating to the company’s current lending strategy make this bank a difficult name to assess; I therefore remain on the sidelines.

Stay Foolish, my friends.

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