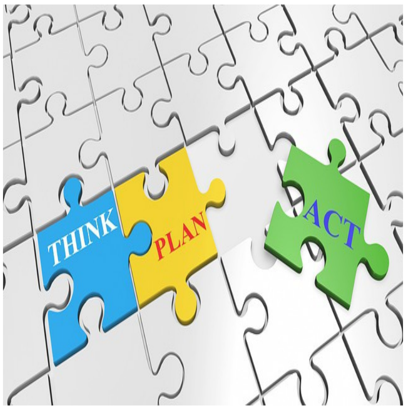

3 Risk Factors Every Canadian Investor Must Consider With Canada's Big Banks

Description

The large-cap Canadian financials sector has experienced a very interesting amalgamation of both tailwinds and headwinds of late, making picking a "Big Six" Canadian bank a tricky task. While I believe the largest Canadian banks will continue to outperform in terms of long-run risk-adjusted returns compared to their smaller regional peers in the long term due to better risk profiles and pricing power overall, it is also clear that picking the right name in this current environment can be tricky, given the changing landscape for financials.

Here are the top three areas I would suggest investors focus on for banks such as **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM):

U.S. tax reform

Lower U.S. tax rates are undoubtedly going to be one of the major stories of 2018 for most firms in most industries in Canada, given the level of exposure most firms have to the U.S. market. While this is true for most large Canadian banks, CIBC has trailed its counterparts for some time now in developing a strong U.S. presence. Over the past year or so, CIBC has ventured into the U.S. market; however, the percentage of revenues attributed to the U.S. market vs. Canada is very small, and as such, CIBC remains as close to a Canadian pure-play bank as we can find today.

In contrast, peer **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) has, for a number of years, been building up a very well-integrated and diversified portfolio of assets in the U.S., which are poised to take advantage of new tax regulations south of the border. When looking at big Canadian banks from a U.S. perspective or tax rates, I expect CIBC to lag its peers.

Interest rates and dividend yields

One of the most attractive selling points of owning shares in a company like CIBC with a dividend yield in excess of 4% is the fact that investors are able to receive the potential capital appreciation of a stock like CIBC along with a meaningful dividend yield, which was much higher than bond yields previously. With U.S. 10-year yields now creeping up toward 3%, a 4% yield on a Canadian bank suddenly doesn't look so hot, and investors may look elsewhere in the fixed-income world to make up such income with little to no risk.

Canadian housing market

Perhaps an unintended consequence of rising interest rates is the fact that owning a mortgage becomes more expensive. The underlying reality that Canada has not seen a meaningful correction in housing prices in a very long time, unlike its U.S. counterparts, is concerning to many investors, including myself. CIBC remains overexposed to the Canadian housing sector, and, in my opinion, the valuation discount CIBC gets relative to its peers is warranted.

Stay Foolish, my friends.

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