How Investors Just Had the Last Laugh Over Traders

Description

Last week we saw a very interesting phenomenon as the first of Canada's biggest banks reported earnings that beat expectations. Instead of being rewarded, however, investors saw a decline in their fortunes. A few days later, when two additional banks (of the Big Five) announced their results, the market did nothing special. In spite of increasing corporate profits (and share buybacks), the market is not allowing the bulls to run any farther.

As is sometimes the case when corporate profits increase year-over-year and investors expect this to be the new norm, there is a willingness to pay an increasingly higher multiple for shares of quality companies. In the past quarter, shares of **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM) beat expectations, as the company reported a net profit of $2.89 per share. In spite of a 12% increase from the same quarter one year ago, investors did not become wealthier on the news.

Although higher revenues from wealth management operations drove profits higher, the focus remained on Canadian housing and the decline in originations of new mortgages. As many investors are aware, when a bank increases the amount of new lending (in the current quarter), the amount of revenues that are expected to be taken in should be higher in future quarters. Essentially, a new loan becomes an account receivable over time. Barring the borrower defaulting on the loan, the bank will increase revenues and profits due to higher lending.

What the share price decline may be telling investors is that there is an increased worry about the Canadian economy, as fewer Canadians qualify for a mortgage under the new rules. Essentially, revenues are expected to decline over time as old mortgages get paid down and there may be a lack of new mortgages to replace what is being paid down.

Where investors have clearly beaten the traders over the past week is in the holding period return of their investments. For long-term investors, the decline of the share price is actually a positive sign, as the company has announced the initiation of a share buyback that will retire close to 2% of the current outstanding float.

In spite of many investors wanting bigger and bigger dividend payments, the past two years saw CIBC increase the number of shares outstanding (due to the wealth management acquisition); thus, it only makes sense that management would want to begin returning cash to shareholders through a share buyback rather than an even higher dividend (based on a greater amount of shares).

For traders, however, the decline in share price (from the earnings release) poses a major problem, as their holding periods are typically much shorter than investors, and after experiencing a loss of close to $2 per share, they have a deep hole to crawl heir way out of. Only time will tell how things work out for them.

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