Will Dividend-Paying Top Bank Stocks Drop 20%?

Description

There's an interesting contrarian bet playing out on the Canadian stock market this year. Money manager Steve Eisman, who is most known for accurately predicting the American housing crash in 2007-08 and for being played by Steve Carell in the 2015 blockbuster *the Big Short*, recently announced that he was betting against Canadian banks.

Eisman believes Canada's seemingly robust banking giants are aggressively adjusting their provisions for losses to boost their quarterly earnings. In a recent interview with BNN Bloomberg, he said that even if the market were to normalize over the short-term, bank profits could take a big hit.

Betting against Canada's banks is the definition of a contrarian bet at this stage. The ones on Eisman's hit list: **Royal Bank of Canada** (TSX:RY)(NYSE:RY), **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM) and **Laurentian Bank of Canada** (TSX:LB) are some of the largest and most recognized financial companies in the country.

Royal Bank alone has over $1.2 trillion in assets, offers a 3.9% dividend yield, and has managed to generate 138% in total shareholder return over the past 10 years. Canada's top banks have managed to create a cycle of recurring income and steady growth that's difficult to resist for income-seeking investors.

Most of the articles published on the Motley Fool have also been significantly optimistic about the banking industry. I myself called the industry "robust," and "one of the best places to derive….regular and expanding dividends," in an earlier article.

However, Eisman's short bet has prompted me to take another look. Concerns over Canada's economy and the housing sector have been mounting for years, and the downturn in Vancouver's premium real estate market could be indicative of more pain to come.

A significant amount of Royal Bank and CIBC's core operations are exposed to the Canadian economy, specifically mortgages. Laurentian is mostly exposed to the province of Quebec. Eisman may be right that a minor correction in the housing market and a normalization of the credit cycle would impact profits, but I don't think that's a bad thing.

For investors who already hold the stocks, the thesis predicts a plunge in profits and market value of the stock, but the dividend is covered with more than enough cash. Royal Bank, for example, has $556 billion in cash and is expected to pay out $5.7 billion in dividends this year, which means that the dividend is covered 10 times over.

Similarly, CIBC and Laurentian hold 74 and 36.4 times their annual dividend in cash, respectively. For dividend investors, the steady income seems secure and the banks have enough of time to recover even if a crisis hits them in the near-term.

For investors who haven't yet bought these stocks and are monitoring it closely, a near-term correction could provide the perfect opportunity. In my opinion, Royal Bank is the clear winner among the three banks mentioned here.

Bottom line

There seems to be a legitimate risk of a near-term correction in the stock prices of Canada's top banks. But the good news is that dividend seekers are secure and the potential downturn could prove to be an opportunity for new buyers.

CATEGORY

1. Bank Stocks
2. Investing

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2. NYSE:RY (Royal Bank of Canada)
3. TSX:CM (Canadian Imperial Bank of Commerce)
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