2 Shorted Bank Stocks to Watch Ahead of Earnings

Description

This spring, investors learned that businessman and investor Steve Eisman, made famous in the book and film *The Big Short*, was targeting Canadian banks. Eisman said that the normalization of credit would result in significant turbulence in the Canadian financial sector. This “normalization” appears to have been put on pause in the United States and Canada, as both central banks have eased up on rate tightening in response to fundamental economic pressures.

Today, we are going to look at two bank stocks that Eisman specifically identified. Should investors steer clear as we await another batch of bank earnings for the second quarter? Let’s dive in and find out.

Royal Bank of Canada (TSX:RY)(NYSE:RY)

Royal Bank is the largest financial institution in Canada. It was also one of three bank stocks identified by Steve Eisman as short targets. Shares of Royal Bank have climbed 12.7% in 2019 as of close on April 25. The stock has dropped 1% over the past week.

Royal Bank is expected to release its second-quarter results for fiscal 2019 before markets open on May 23. In the first quarter, the bank reported 7% year-over-year growth in diluted earnings per share to $2.15. Royal Bank and its peers suffered from market turbulence and net income in its Capital Markets segment dropped 13% year over year to $95 million.

Analysts expect an uptick from Q2 2018. Indeed, Royal Bank should see a boost from improved market conditions. Canadian growth is expected to pick up in the final three quarters of the year, which is another positive sign for the big banks.

Royal Bank stock is a pricey option in late April. The stock is trading at the high end of its 52-week range.

Canadian Imperial Bank of Commerce (TSX:CM)(NYSE:CM)

CIBC is the fifth-largest bank of the Big Five. It was the second bank identified by Steve Eisman. On April 1, I suggested that investors buy CIBC on the dip after it fell into technically oversold territory. Shares have climbed 5% since then.

CIBC is expected to release its second-quarter results in late May. In the first quarter, CIBC saw adjusted net income fall 5% from the prior year to $1.36 billion. It was flat from the previous quarter, but the first quarter of the fiscal year is historically the most robust. Adjusted net income in Canadian banking fell 4% from the prior year largely due to higher provision for credit losses and lower fees. Net income in Capital Markets plunged 38% year over year to $201 million.

CIBC boasted one of the strongest mortgage portfolios of the big banks over the past decade, but this has not been the case in recent quarters. There is evidence that the Canadian housing market has stabilized following turbulence in 2017 and 2018, but CIBC has failed to recapture its old momentum. On the bright side, the bank is actively preparing for future headwinds. Provisions for credit losses shot up 121% from the prior year to $338 million.

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