Why the Shorts Are Dead Wrong About Canadian Imperial Bank of Commerce (TSX:CM)

Description

It’s been a rough year for Canada’s banks. U.S.-based short-sellers have been spreading fear with their some very negative sentiment in the financial media recently, prompting concerns over the preparedness of Canadian banks for the next credit cycle.

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The second quarter was a big bump in the road, especially for **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM), which nosedived back to its 52-week lows.

As the Canadian bank that’s most exposed to the frail Canadian housing market, it shouldn’t have been a surprise to see a big increase to Q2 PCLs (provisions for credit losses). Although CIBC isn’t the best-prepared of the Big Six for a further crumbling of credit, I’d argue that the single source of failure (CIBC’s domestic mortgage exposure) is already baked into shares in the form of a discount to the peer group that has since widened.

Investors continued to throw in the towel on CIBC shares for many days following the release of the Q2 results, as there’s been a stigma attached to the name ever since the bank got caught with its pants down in the last recession. This stigma, I believe, exacerbates the reaction to bad quarters, as CIBC is arguably the easiest Canadian bank to hate.

To this day, the “CIBC stigma” continues to grow no thanks to short-sellers. Steve Eisman’s widely publicized bearish outlook on the name has been on the minds of most CIBC shareholders. Given the man’s legendary reputation, it’s tough for the average retail investor to justify going long against Mr. Big Short who’s since doubled-down on his bearish bet on Canada’s banks.

CIBC looks to be in a tailspin, but I think most of the damage has already been done.

A further deterioration in credit and muted year-ahead numbers are already a given at this juncture. Although a bounce-back is highly unlikely for the rest of the year (management guided flatter EPS growth for 2019) given the weak macro environment, I do believe that the big purge that the bears are expecting has already played out, thanks to shorts who’ve been “talking up their book” ad nauseum over the last several months.

Investors have had ample opportunity to ditch the stock on Eisman's warnings, and although the man has since doubled-down on his bets against Canada's banks, I wouldn't at all be surprised if his big short suddenly turned into a big squeeze now that the bar has been lowered and the yield is close to the highest it's been in recent memory.

CIBC has been making moves to improve on its operational efficiencies, which have been historically meagre in comparison to its bigger brothers. The bank also looks better equipped to deal with increased PCLs than most folks would give it credit for.

While CIBC is a go-to name to bet against the Canadian housing market, I think the severity of the downturn has been exaggerated. A financial-crisis collapse isn't going to happen. CIBC has been hit with a one-two punch to the chin (Q1 and Q2 results). While the bank may be down (about 18% peak to trough), it's not out.

From a technical standpoint, there's strong support at $100. So, if you want to join the CIBC short club, be ready to cover the dividend, which yields 5.4% at the time of writing. And be wary of what could be the mother of all short squeezes.

Stay hungry. Stay Foolish.

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joefrenette

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