The Big Bank Short: Taking Stock After Q2 Earnings

Description

In April, Steve Eisman of *The Big Short* fame gave more insight into his purported short of Canada's top banks. He identified three targets, which I discussed in a mid-April article. In an early June interview with Bloomberg, Eisman reaffirmed his short call and said that he had added to his positions.

Investors have now been granted a look at Canada's top banks after a second quarter earnings season. To add to the intrigue, volatility has returned to North American and global markets in a big way amid concerns surrounding trade tensions and a slowdown in global growth. After viewing second-quarter earnings, Eisman has said that his conviction level on the short moved from a "7 out of 10" to a "9 out of 10."

How do Eisman's short targets measure up in early June? Let's dive in.

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

Royal Bank is the largest financial institution in Canada and was identified by Steve Eisman as a short target this spring. The bank released its second-quarter 2019 results on May 23. Shares of Royal Bank had dropped 3.5% over the past month as of close on June 4.

Royal Bank posted solid 6% year-over-year growth in net income to $3.23 billion and reported diluted earnings per share growth of 7% to $2.20. Net income in Personal and Commercial banking rose 6% from the prior year to $1.55 billion. As expected, Royal Bank and its peers reported a marked improvement in Capital Markets segments due to improved market conditions in early 2019.

All things considered Royal Bank put together a strong quarter in comparison to its peers. It cannot be considered a value play at its current price, but showed consistent growth across its major segments.

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

CIBC was the second bank listed by Steve Eisman. It's the fifth largest of the Big Six Canadian banks.

Shares had plunged 7% month-over-month as of close on June 4. The stock dropped sharply after its second quarter earnings release, and I advised investors to ignore the buy signal that followed.

Adjusted net income in Canadian Personal and Small Business Banking fell 3% year-over-year to $571 million. Eisman pointed to a 30% increase in commercial impaired loans over the past three months. While he reiterated that this was not “calamitous,” he argued that this strengthen his point that Canada’s top banks were not prepared for the “normalization of credit” conditions.

The slowdown in Canadian housing is a growing concern for CIBC. Its real estate lending portfolio, once the strongest among its peers, declined 0.9% year-over-year to $223 billion as at April 30. CIBC has said that its focus on urban centres has led to challenges over the past two years.

Laurentian Bank (TSX:LB)

Laurentian Bank was the third bank identified by Eisman. Unlike the previous two, Laurentian is a regional bank based in Quebec. It released its second-quarter 2019 results on May 30. The stock had climbed 4.5% week-over-week as of close on June 4. Shares were up 15% in 2019 as of this writing.

A mortgage underwriting crisis at Laurentian caused major turbulence in its stock price from late 2017 to the end of 2018. The bank managed to resolve this crisis in 2018, but has also been forced to contend with labour issues in its home province of Quebec. In the second quarter, it announced a new collective agreement with its unionized employees, which was a strong point for investors.

Net income at Laurentian slid primarily due to a sharp drop in loan volumes. Laurentian anticipates that margins will improve as it reorients its portfolio going forward. The bank also hiked its quarterly dividend by $0.01 to $0.66 per share, representing a strong 6% yield.

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