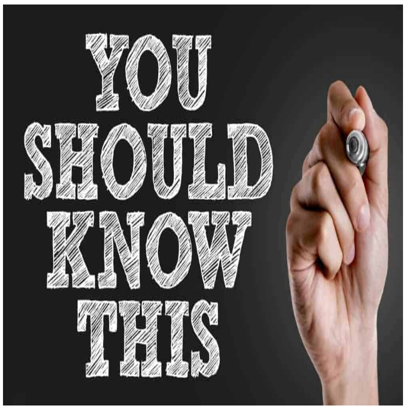

Why I’m Betting Against This Legendary “Big Short” Investor

Description

I recently re-watched *The Big Short*, the 2015 movie chronicling the journey of several brave investors who bet against the U.S. housing market in 2005-07.

The excesses in the financial system at the time now all seem so obvious, so we forget how contrarian the call was. These people were convinced the economy would do something that had never been witnessed before. No wonder everyone thought they were nuts.

One of the prominent investors in the film, Steve Eisman (he was played by Steve Carrell and went by the name Mark Baum), has continued his career betting against overvalued companies. For instance, Eisman was a big advocate of shorting U.S. for-profit colleges, a trade that worked out handsomely over the long term.

As much as I respect Eisman and others who made a fortune betting against the U.S. housing market, that doesn’t mean these folks are infallible. One very successful trade does not turn someone into Warren Buffett.

Here’s why I not only think Eisman is wrong about his latest short position but how I’m actively betting against him for my own portfolio.

He’s betting against what?

Eisman sees many of the same issues that plagued the U.S. banking system back in 2006-07 happening right here in Canada.

He points to things like our sky-high housing prices in major cities, deteriorating mortgage underwriting standards for our banks, and, more recently, a rise in loan-loss reserves from the largest Canadian banks. If the Canadian economy enters a recession, it could be very bad news for our banks.

Eisman is particularly bearish on **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM), recently stating his confidence level shorting that particular banks (and two others in Canada) as a “nine out of 10.” Key points of his thesis include a recent increase in loan-loss reserves, tepid results from the Canadian mortgage division, and a need to hoard capital for an inevitable recession.

Meanwhile, I have recently taken advantage of the weakness in CIBC shares to add to my position. Perhaps surprisingly, I agree with some of Eisman’s criticisms of Canada’s fifth-largest bank. I think loan losses will get worse before they get better. And I’m concerned about the Canadian economy.

The big difference is between our predictions of what will transpire from these issues. Eisman thinks the bank’s shares will fall as bad news continues to come out, while I think expectations are so bad that there isn’t much that can push the stock down further.

In other words, I believe the stock is so unloved right now that it’s poised to go up, even without a obvious catalyst. With shares up some 5% over the last month alone with no obvious news to push them higher, I think I’m onto something.

Strengths of Canadian banking

The five largest Canadian banks are just too strong for me to have much confidence in shorting them.

These banks have a dominant position in the sector, effectively controlling the market. They have numerous advantages like a strong mortgage default insurance system to protect them against the riskiest loans, diverse operations that ensure a regional downturn will be a blip on the radar, and expansion into other markets like the United States. Although CIBC was a little late on that last front, the company has successfully joined its peers in the U.S.

Investors who get in today get to buy at a low price-to-earnings ratio (which currently sits comfortably below 10 times) and a succulent dividend yield of 5.5%.

The bottom line

As much as I respect Eisman and the others who predicted the demise of the U.S. housing market, I disagree with his thesis here. If anything, this is a long-term buying opportunity for investors to buy Canadian banks. Take advantage of this gift; I know I sure am.

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nelsonpsmith