Revealed: A Canadian Bank to Buy (and 1 to Sell) for 2020

Description

Macro headwinds that have been plaguing the Canadian bank stocks finally seem to be fading away after a year of immense pain (rising provisions, surging expenses, thin NIMs) and short attacks.

Steve Eisman, the man made famous from *The Big Short*, was incredibly bearish on Canadian banks just a few months ago. He went as far as noting that he has short conviction in nine out of 10 banks on national television. That's ridiculously bearish and alarming for Canadian investors, many of whom own a sizable chunk of Canada's banking behemoths either directly or through funds.

Eisman has an impeccable track record, but I warned investors to take his words with a grain of salt because the banks weren't at risk of imploding as they did during 2007-08. Yes, many Canadian banks weren't well equipped to deal with the normalization of the credit cycle, but that doesn't necessarily mean they're the second coming of *The Big Short*.

The worst-prepared banks, like **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM), took a hit to the chin, with shares plunging around 20% from peak to trough. A garden-variety sell-off, it was, and not even close to the magnitude of fallout during the financial disaster that sparked the Great Recession.

As the banks slowly but steadily pick themselves up off the ground, the shorts are bound to go quiet, and I see a scenario where the basket of Canadians banks could make up for lost time in 2020.

While most sell-side analysts still have "hold" ratings pinned on many of the Big Six names, I think it's a good idea to do some buying with some of the cheaper names in the space before another round of better-than-feared earnings results queues.

CIBC is at the top of my list at this juncture, with shares trading at just 9.3 times next year's expected earnings, which is lower than both the stock's five-year historical average and the banking industry average.

In a prior piece, I'd noted the silly reasons for why CIBC was trading at such a massive discount to its peer group, also highlighting the fact that the stock was now cheaper than the more regionally weighted **National Bank of Canada** (TSX:NA).

While CIBC does have a reputation for ill-preparedness for dealing with crises and one of the worst series of earnings results over the past year and a half, I think the negativity is overblown such that those willing to jump in now will be able to lock in a 5.1% yield with capital appreciation potential for a nice margin of safety relative to most other bank stocks out there.

National Bank of Canada, however, looks like a stock you may want to ditch. Does the Quebec-based bank deserve to trade at a higher multiple to CIBC? I don't think so.

Not to discount National Bank's performance this year (solid Q3 earnings beat that saw incredible 18% ROEs), but the stock is way too frothy while it sits at all-time highs. I believe nothing has fundamentally changed to warrant an 11.5 times trailing earnings multiple, which is more expensive than a lot of its bigger brothers in the Big Six.

Moreover, National Bank is even more domestically undiversified than CIBC, with its substantial weighting in the province of Quebec. As such, I'd take profits in National Bank and put it in CIBC if you're looking for optimal results moving forward.

In any case, you'll get 1.3% more yield by making the switch to CIBC!

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joefrenette