Stock Market Genius Warns: Don’t Buy Canadian Bank Stocks!

Description

Stay away from Canadian bank stocks. At least that’s what one famous investor is urging.

Steve Eisman is one of the most successful short sellers in recent history. His bets make money when a company’s value goes *down*. He made billions during the financial crisis of 2008 by betting against U.S. housing prices.

This time, he’s coming for the banks. In 2019, he revealed bets against three companies in particular: **Royal Bank of Canada**, **Laurentian Bank of Canada**, and **Canadian Imperial Bank of Commerce**. He expected at least 20% drops in their share prices.

So far, Eisman has made good money on these short investments. The COVID-19 pandemic certainly didn’t hurt his thesis. Shares of the bank stocks above have fallen by more than his anticipated returns.

There’s just one problem: things are about to get *significantly* worse. While that’s good news for Eisman, it’s terrible news for the aforementioned stocks.

To understand this problem, we need to look back at Eisman’s original thesis. By understanding why he bet against these companies in the first place, we can see how bank stocks will fall even more by the end of 2020.

Here is the thesis

For decades, Canadian bank stocks were a marker of stability and reliability. Just take a look at the historical trading range of RY, LB, and CM stock. All handled the 2008 financial crisis with ease. All traversed the 2014 oil price crash with no long-term impact. Each stock’s dividend has also been consistent over the past decade.

Eisman’s prediction seemed ill-timed given this historical success. But it’s exactly *because* of this success that Eisman took his short position.

“Canada has not had a credit cycle in a few decades, and I don’t think there’s a Canadian bank CEO that knows what a credit cycle really looks like,” Eisman explained. “I just think psychologically they’re extremely ill prepared.”

Eisman is essentially arguing that there’s a sense of complacency similar to what U.S. banks faced just before the housing collapse. The COVID-19 shock, while unique, was exactly the type of even that Eisman was expecting. He knew that the good times could only last so long, and eventually, that Canadian banks would suffer from a down cycle.

Avoid Canadian banks

At the time, Eisman stressed that he didn’t foresee anything calamitous happening.

“I’m not calling for some enormous, massive losses,” he noted. “The Canadian banks are not going to have to be bailed out by the Canadian government. There’s none of that.”

Those hedges may prove unnecessary. Since those statements were made, millions of Canadians have lost their jobs, with thousands of small businesses shutting their doors for good. Many economists believe we’re still at the *beginning* of the economic fallout, especially if we experience a second wave this coming winter.

Canadian banks have largely maintained their dividends to shore-up cash. RBC is still paying $1.5 billion in quarterly dividends. CIBC and Laurentian Bank shares still yield 6% and 8% respectively.

If Eisman is correct and these bank CEOs are truly unprepared for disaster, those dividends will be in peril within 12 months.

CATEGORY

1. Bank Stocks
2. Coronavirus
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TICKERS GLOBAL

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2. NYSE:RY (Royal Bank of Canada)
3. TSX:CM (Canadian Imperial Bank of Commerce)
4. TSX:LB (Laurentian Bank of Canada)
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