



Are Canadian Housing Prices Set to Plunge 50%?

Description

These days, it's a pretty popular opinion for pundits to predict a correction in the Canadian real estate market.

There are plenty of reasons the market appears overvalued. Low interest rates have pushed values up significantly over the last 15 years. Traditional valuation metrics like price-to-income and price to rent ratios are very expensive, at least compared to historical averages. Plus, we've all read the stories about how folks in major cities just can't afford homes.

But one author has taken it a step further, predicting Canadian houses are set for the kind of fall that even eclipses what the United States saw a few years ago.

The author is Hillard MacBeth, who is a portfolio manager from Edmonton, and the book is called *When the Bubble Bursts: Surviving the Canadian Real Estate Crash*. The book isn't due out until March, yet MacBeth is already attracting headlines for his overly pessimistic call.

Essentially, MacBeth looked at the real estate market's outperformance since the year 2000, and determined prices would have to fall 50% to go back to the trend set where we were back in 1975.

Add in other factors like the massive numbers of baby boomers with a large percentage of their net worth tied up in real estate, and perhaps MacBeth could be on to something. Whether his numbers end up being right or wrong, the fact remains that Canadian housing is a pretty dangerous place to be.

How to play this as an investor

A prolonged slowdown in housing will affect just about every sector in the Canadian economy — from banking to consumer goods. If folks aren't confident in the value of their house, chances are they'll avoid spending money on other things.

The most obvious thing is to avoid any private mortgage lender. **Home Capital Group Inc.** (TSX: HGC) is the biggest, with more than \$21 billion in loans, mostly in the Toronto area.

Unlike other Canadian lenders, Home Capital has been actively moving away from loans insured by the Canadian government. The company has more than \$13 billion worth of uninsured mortgages, yet only has about \$1.7 billion in liquid assets. If the market tanks, Home Capital will be a terrible stock to hold.

More stocks to avoid

Even though the Canadian banks have done a much better job of keeping their mortgage portfolios insured, there's still a ton of risk in owning any of the Big 5.

Perhaps the riskiest of the group are **Canadian Imperial Bank of Commerce** ([TSX: CM](#))([NYSE: CM](#)) and **Bank of Montreal** ([TSX: BMO](#))([NYSE: BMO](#)). It's not that there's anything specifically wrong with these two banks. They're both solid institutions that have a solid history of overperformance and ever-increasing dividends. As long as Canadian housing doesn't fall significantly, they'll do fine, just like the rest of the banks.

The issue with Bank of Montreal and CIBC is their size. CIBC has a market cap of \$40 billion, while BMO checks in at \$53 billion. Each is considerably smaller than the leader of the group, **Royal Bank**, which has a market cap of \$116 billion.

Get out now?

If investors think a crash is coming, should they sell all their bank stocks and wait things out?

They could. But I wouldn't.

Certain observers have been calling for a crash since the Great Recession. And yet, Canada's banks are all up handsomely from their lows, and have resumed their annual dividend increases. They performed remarkably well as the housing market continued marching upward.

Instead, I'd recommend investors take a wait-and-see approach before selling any financials. If prices nationwide start to fall, then maybe take another look at your bank holdings. But until then, there's little reason to panic. Even in the unlikely scenario that the market collapses by 50%, there will still be plenty of time to get out.

CATEGORY

1. Bank Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:BMO (Bank of Montreal)
2. NYSE:CM (Canadian Imperial Bank of Commerce)
3. TSX:BMO (Bank Of Montreal)
4. TSX:CM (Canadian Imperial Bank of Commerce)
5. TSX:HCG (Home Capital Group)

Category

1. Bank Stocks
2. Investing

Date

2025/08/18

Date Created

2014/10/07

Author

nelsonpsmith

default watermark

default watermark