Canada’s Real Estate Bubble Is Ready to Burst; Rent and Buy Metro Inc. Stock Instead

Description

Major developments occurred this week that point toward the possibility that Canada’s red hot real estate market could be in store for a major slowdown. The major development was that oil prices have officially plunged past the price point where they are good for the economy to the point that they may have negative consequences on Canada’s oil-based economy. West Texas Intermediate futures are now trading around US$78 a barrel, very close to the estimated cost of oil production in North America.

Other data released this week showed that Vancouver’s housing prices are approaching yet another record high. According to Canada Mortgage and Housing Corp. the price for detached houses, condos and townhouses sold in Greater Vancouver is on track to average $811,000 this year, up 5.6% from 2013. Many other housing markets in Canada are also overpriced, but Vancouver leads the charge. The average price for a detached house in the Vancouver area is forecast to climb by 4.8% to $1.51-million in 2015. This housing price growth is based on one major thing — projected economic growth — and low oil prices may derail this.

Oil and Canada’s economy go hand-in-hand

If low oil prices persist for a long enough period of time, it will wreak havoc on Canada’s economy. Businesses will slow down, hiring will freeze and in many cases lay-offs will result. This in turn will cause hardships on homeowners (current and future) and in turn some may lose their homes while others will stay away from the market completely.

Right now, given the high cost of real estate and oil’s potential to hurt Canada’s economy, it is probably better to rent and invest in certain equities. The key is to find a proven performer that will either not be impacted by oil prices, or even better could experience some upside on lower energy costs. There is one company that fits this bill perfectly: **Metro Inc.** (TSX: MRU).

Why Metro Inc.?

Metro Inc. is in the grocery business. The east coast food distribution company owns over 600 grocery stores. If the price of oil stays low enough for a long enough period of time that it impacts the Canadian economy, people will have to cut back on expenditures. While they may have to cut back on grocery purchases, demand for groceries will never completely go away because people need to eat. Also, demand may be balanced by people eating out less and buying more groceries to save money. Another fact to consider — if low oil prices drive this change, Metro Inc.'s profits will likely be positively impacted by declining transportation costs.

Stock vs. real estate returns

Over the past 10 years, Metro Inc.'s stock has advanced 306.89%. This makes the average annual return about 31%. Data compiled by RBC Economics covering 1980-2013 shows that the average annual increase in Vancouver's housing prices per year has been 6.8%.

There are expenses and taxes associated with both purchasing and holding stocks and real estate, but real estate costs (especially if you hold a mortgage) are considerably higher. When you consider the higher costs of owning real estate and the fact that Vancouver' s real estate has historically appreciated at a much lower rate than Metro Inc.'s stock, a purchase in Metro Inc. would make more sense right now, and that is not even considering what a crash in Canada's real estate market would do to home prices.

CATEGORY

1. Investing

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1. TSX:MRU (Metro Inc.)

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