Worried About Canada’s Housing Market? Then Avoid These 3 Stocks

Description

It’s easy to be worried about Canada’s housing market.

In just about every major city in the country, values have soared while incomes haven’t kept up. The only thing that’s kept real estate even somewhat affordable is low interest rates.

And then there are problems with specific markets. The Vancouver market is almost unaffordable for everybody except the truly wealthy. Both Calgary and Edmonton are suffering because the energy sector is weak. Condos continue to pour onto the market in Toronto, which could prove disastrous if the market there slows down. And both Montreal and the Maritimes are suffering from what could be called the beginning of a new bear market, as listings swell and buyers get nervous.

If you’re bearish on Canada’s housing market at all, there are certain stocks you’ll want to stay away from. Here are three that should be nowhere near your portfolio.

DH Corp

DH Corp (TSX:DH) has come a long way from when it was known as Davis and Henderson, the makers of cheques.

As the cheque business declined, the company moved into technology, acquiring companies that made software for financial institutions. Particularly, the company has done a lot of work designing and creating software for lending purposes, which currently makes up about a third of its revenue.

The correlation to real estate is obvious. As lenders begin to tighten up lending standards, there’s less need for things like mortgage origination software. Fewer Canadians getting mortgages means lower profits for banks, which means less cash available for the next version of the software. It’s a vicious cycle.

Plus, the company has really levered up its balance sheet. It currently has a debt load of more than 2.5x its EBITDA, which could end up being too aggressive in a market where there's less demand for some of the company's products.

Home Capital

If you're bearish on Canadian real estate, you'll want to run far away from **Home Capital Group Inc**. (TSX:HCG).

Home Capital's business is lending to the kind of borrowers who can't get financing through traditional banks. Seeing an opportunity in the market, a couple of years ago it really started to focus its attention on people who don't qualify for mortgage default insurance. That means if the borrower can't make the payments, there's no safety net. Home Capital has assumed all the risk.

The company has approximately $1.3 billion in equity and more than $20 billion worth of mortgages on its balance sheet. A loss of just 5% of the portfolio could all but wipe it out. Even a loss of 2-3% of its portfolio would mean it would have to go to the market looking for a cash infusion, pretty much at the worst time.

Plus, the company is almost entirely concentrated in the Toronto area. This lack of geographical diversification could prove dangerous if that market is weak.

TD Bank

Even though Canada's banks are well capitalized and are in many ways the envy of the rest of the banking world, they will be hurt if there's weakness in housing. And considering its growth in lending over the last few years — to the point where it is now Canada's largest mortgage lender — it's likely **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) would take it on the chin.

The thesis is simple. Yes, the vast majority of TD's mortgages have either large amounts of home equity or mortgage default insurance attached, but the company is sitting on billions worth of home equity lines of credit which could become ticking time bombs.

Plus, the banks have been putting aside almost nothing for loan losses, which has helped them achieve great profits lately. A bank's balance sheet is built on leverage, meaning just a small percentage of uninsured loans will cause those loan loss reserves to soar. TD is much better equipped to handle it compared to Home Capital, but just the sentiment alone will be enough to push down the stock.

Instead of worrying about the housing market, we encourage you to invest in a great business that will continue to perform during think and thin. Check out the details below.

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2. TSX:HCG (Home Capital Group)
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Date
2025/08/25
Date Created
2015/01/23
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