



3 Reasons Why the Short Interest in Bank of Nova Scotia Is Unjustified

Description

Investors continue to make big bets against Canada's banks. **Bank of Nova Scotia** ([TSX:BNS](#))(NYSE:BS) is one of the most shorted Canadian banks on the New York Stock Exchange. It is also the fourth most-shorted stock on the TSX with **Toronto Dominion Bank** being the only bank to attract greater short interest.

This shorting activity, where investors are essentially betting on the price of Bank of Nova Scotia falling, is being driven by concerns about an impending Canadian housing meltdown, its volume of loans to the oil industry, and considerable exposure to vulnerable emerging markets.

Nonetheless, while these are all headwinds that will impact the bank's performance over the short term, it appears that the headwinds faced by the bank are being overcooked.

Now what?

Firstly, despite the risks posed to Canada's economy by oil's protracted weakness, rising household debt, an overheated housing market that ends up like the U.S. housing meltdown is highly unlikely. This is because there are a range of key differences between Canada's housing market compared to that of the U.S. in the run up to housing meltdown.

Key among these are stricter regulation, a substantially lower volume of subprime mortgages, and far more rigorous lending standards among Canada's banks.

There are signs, however, that the housing market is overheated, and it will have to cool sometime soon. Even when this occurs, it will have, at worst, a moderate impact on Bank of Nova Scotia.

You see, while mortgages make up 45% of the value of Bank of Nova Scotia's total loan portfolio, 48% of its mortgage portfolio is insured, and the remaining uninsured component has a very conservative average loan-to-valuation ratio of 53%. This means that a housing crash would have very little impact on the health of its balance sheet or loan portfolio.

Secondly, there is considerable concern among investors about Bank of Nova Scotia's exposure to the

oil industry. While the total drawn loan exposure of \$18 billion appears to be a worrying number, it should be remembered that it only amounts to 3.6% of the Bank of Nova Scotia's total loan book. Furthermore, of those loans, 60% are still rated as investment grade, which means the chance of those companies defaulting remains low when coupled with the recent rally in crude.

Finally, while markets such as Colombia, Peru, Chile, and Mexico are vulnerable to the protracted slump in oil and other commodities, the overall impact on Bank of Nova Scotia has been minimal.

For the first quarter 2016, Bank of Nova Scotia's net income from international banking shot up by a very impressive 21% compared with the same period in the previous year. And this can be attributed to strong loan, deposit, and fee income growth in Latin America. Not to mention that its overall loan exposure to South America remains low with loans in the region only making up 3% of the value of its total loan portfolio.

Those countries are also primed for further strong economic growth over the long term, and that will drive demand for credit ever higher, giving Bank of Nova Scotia's bottom line a healthy bump.

So what?

It is difficult to understand the rationale for Bank of Nova Scotia being so heavily shorted. Clearly, any further falls in the oil price, along with slower economic growth in Canada, will hurt earnings over the short term, but the bank won't experience a catastrophic event that could cause its price to crash. In fact, it is the only Canadian bank with an internationally diversified business, giving it the best long-term growth prospects of the major banks.

CATEGORY

1. Bank Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:BNS (The Bank of Nova Scotia)
2. TSX:BNS (Bank Of Nova Scotia)

Category

1. Bank Stocks
2. Investing

Date

2025/10/01

Date Created

2016/05/09

Author

mattdsmith

default watermark