



## Could Canada's Banks Cause U.S. Hedge Funds to Go Broke?

### Description

According to Hedge Fund Research's global index, hedge funds have lost 1.8% this year already, and there are signs of worse to come. The industry has been engulfed by catastrophic results that have caused net outflows over the last two quarters to rise to their highest level since 2009, placing an already beleaguered industry under even further pressure.

In fact, one money manager claims that hedge funds will lose up to a quarter of their assets over the next year; they face a painful washout that has its origins in the global financial crisis that commenced in 2007.

The irony is that despite their so-called expertise and financial savvy, many hedge funds missed the *Big Short* of book and movie fame, suffering considerably under the weight of the U.S. housing meltdown that caused the U.S. financial system to unravel and ignited the global financial crisis.

Many now think they can make up for lost ground by shorting Canada's banks. After all, housing prices have disregarded recent economic weakness to soar to new heights in recent months just like they did in the U.S. before the global financial crisis began.

So what could go wrong?

### Now what?

The biggest problem is that despite their massive pay packets, U.S. hedge fund managers, traders, and analysts, believe that Canada's mortgage market is the same as the one that existed in the run up to the U.S. housing meltdown in 2006.

They're accustomed to the "jingle mail" of people walking away from non-recourse mortgages as well as the massive volumes of subprime loans and contagion associated with securitized substandard mortgage instruments that came to dominate the U.S. mortgage market.

They aren't accustomed to a system dominated by secured recourse mortgages and compulsory mortgage insurance, where lending standards are quite conservative. Nor do they understand the

quality of Canada's banking supervision or the propensity of Canadians to possess a high degree of equity in their homes and pay their mortgages off as quickly as possible.

It now appears that after having bet on this apocalyptic meltdown for some time with little to show for it, the hedge funds are now trying to talk up the collapse they are betting on. While this may have garnered some impressive local headlines and the support of fellow hedge funds, it doesn't appear to be working.

Not only were Canada's banks described as the world's best managed banks by the 2015 World Economic Forum, but there is a growing chorus of voices among asset managers that the sell-off of Canada's banks is overdone.

Even after all the nay saying of U.S. hedge funds, Canada's banks continue to perform strongly; neither the protracted slump in crude nor slower economic growth has had any real impact on earnings.

This has, in fact, created an opportunity for investors seeking to increase their exposure to Canadian banks because many are now attractively valued.

The most-shorted bank on the TSX, **Toronto-Dominion Bank** ([TSX:TD](#))([NYSE:TD](#)) has seen its share price—like that of **Royal Bank of Canada**—remain relatively flat over the last year.

Canada's most international bank, **Bank of Nova Scotia** ([TSX:BNS](#))([NYSE:BNS](#)), has seen its share price fall by 4% over that period. This coupled with their attractive valuation metrics, such as Toronto-Dominion's price-to-book ratio of 1.6 and Bank of Nova Scotia's ratio of 1.5, along with juicy but sustainable dividends yielding 3.5% and 4%, respectively, makes now the time for investors to add them to their portfolios.

## So what?

I am certain there will be no tears shed by Canadian banks and bankers, or their investors should U.S. hedge funds be hit hard by their short-sighted bet against Canada's banks. It is becoming more and more apparent that their greed, shallow research, and herd mentality could eventually lead to their undoing.

## CATEGORY

1. Bank Stocks
2. Investing

## TICKERS GLOBAL

1. NYSE:BNS (The Bank of Nova Scotia)
2. NYSE:TD (The Toronto-Dominion Bank)
3. TSX:BNS (Bank Of Nova Scotia)
4. TSX:TD (The Toronto-Dominion Bank)

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**Date**

2025/08/03

**Date Created**

2016/05/28

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