Investors: Don’t Let Canada’s Housing Bubble Crush Your Portfolio

Description

It seems that every day Canadians are getting another warning about our overvalued real estate market.

The latest comes from a very reputable source. Canada Mortgage and Housing Corporation (CMHC) released a report on Wednesday once again warning about certain markets being overvalued.

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Toronto and Vancouver were named as specific examples, echoing sentiment that’s been present for years now. With detached houses in both markets regularly changing hands for more than $1 million, it’s obvious that prices aren’t supported by traditional metrics.

British Columbia took an interesting step towards trying to soften Vancouver’s real estate market this week, passing a 15% land transfer tax for non-residents. Frustrated wannabe buyers and bubble watchers applauded the move, happy to see something done about what they see as a potentially devastating bubble.

Critics, meanwhile, wondered whether such a tax would discourage foreign investment in Canada. Additionally, they slammed the province’s move to make such a tax effective retroactively, affecting people who already have homes under contract.

Getting back to the CMHC report, many observers were surprised top brass didn’t just single out Vancouver and Toronto as overvalued. Other potentially dangerous markets included Calgary, Saskatoon, and Regina.

Meanwhile, the report identified Montreal, Edmonton, Winnipeg, Montreal, Quebec, and Hamilton as being more moderately overvalued. Between the two different categories is almost every major Canadian city.

What can the average Canadian do to protect themselves from a housing market that looks to be becoming a national bubble? Here are a few ideas.

Move into international stocks

Although I'm hardly predicting a U.S.-style crash will happen here in Canada, it's still likely a real estate crash will affect our underlying economy. So much consumer spending has been linked to housing.

This will ultimately show up in Canadian stocks, especially the consumer discretionary sector. When the value of real estate is collapsing around them, the last thing most folks want to do is go out and spend money.

The easy solution to this is to move portfolio exposure internationally. This can be done either by investing in foreign stocks directly or moving into Canadian stocks with substantial overseas operations.

Definitely avoid these two stocks

If real estate starts to come down in a big way in Canada, two stocks in particular will feel the market's wrath.

The first is **Home Capital Group Inc.** (TSX:HCG), Canada's largest subprime lender. Home Capital has lent more than $20 billion to homeowners across the country, although most of its portfolio is located in the Toronto area. As goes the Toronto market, so goes Home Capital.

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Home Capital is also dealing with some borrower fraud. The company disclosed approximately $1.9 billion worth of loans on its balance sheet were possibly obtained using falsified income documents. Although, in the company's defence, these loans have performed well.

The other dangerous stock is **Genworth MI Canada Inc.** (TSX:MIC), CMHC's competition in mortgage default insurance. Genworth has more than $300 billion worth of potential mortgage insurance exposure, yet only has $3.5 billion in equity. If things really collapse and foreclosures start popping up everywhere, Genworth could be in rough shape.

Just don't buy

While I'd argue the advice of selling your house and renting is sound, I'm the first to admit it's impractical. Especially if you've lived in the same house for a long time.

Many younger people are anxious to buy, wanting to get into the market before it becomes too expensive. For these people, I'd argue waiting on the sidelines for a while longer.

Firstly, renting has never been cheaper. Landlords are willing to accept very anemic returns on their property in exchange for what are increasingly viewed as guaranteed capital gains.

Secondly, a young person is taking on more risk by buying than someone older Say you struggle and put down $50,000 on a $500,000 house. If that house goes down by 10%, you've lost your whole net worth. Somebody with a paid-off house suffers far less.

It isn't time to panic about Canadian housing, but investors do need to keep an eye on the market. Eventually, the bubble will burst. It's only a matter of time.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:HCG (Home Capital Group)

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