Investors: Shorting Toronto-Dominion Bank Is a Ridiculous Idea

Description

Toronto-Dominion Bank (TSX:TD)(NYSE:TD) continues to be one of the most shorted stocks on the Toronto Stock Exchange.

According to the latest TSX short report, which is effective February 28, there are more than 85.5 million TD shares currently sold short, meaning investors have collectively bet against $6 billion worth of TD shares.

TD has a market cap of $131.7 billion as I write this. It is Canada's largest bank by assets, recently surpassing **Royal Bank of Canada.** It is Canada's biggest mortgage lender and owns more than 1,300 branches in the United States. This diversification throughout North America is one of the biggest reasons why investors are bullish on the stock.

Then why are so many investors short TD? Let's take a closer look.

Why short?

Many hedge funds will use large and liquid stocks to short the market as a form of hedging. This minimizes the impact to investors if the market goes down.

TD is the perfect stock to use as a hedging tool. It's incredibly liquid with more than three million shares trading hands on an average day in Canada alone. Since it has a large presence in both Canada and the United States, hedge funds on both sides of the border can use it to bet against their respective banking sectors.

Then there's the Canadian housing bubble. Although TD is a diversified lender with operations across Canada, it will certainly be impacted if the average house price crashes in Toronto or Vancouver. It's hard to avoid two of Canada's largest metros.

Besides, it's called Toronto-Dominion Bank. It clearly has some exposure to Toronto.

There's also been some more recent controversy surrounding TD. A recent CBC story outlined some of the aggressive sales tactics forced upon front-line employees, which includes pushing clients to sign up for overdraft protection or to upgrade to bank accounts with large monthly fees.

Why shorting TD is a terrible idea

There's one simple reason why shorting any of the Canadian banks is a bad idea.

They've been some of the best performers in the entire market for more than a century now.

According to a recent RBC report, Canada's banks are the only major North American sector to outperform **Berkshire Hathaway** over the last 25 years. It's not easy to beat Warren Buffett, but Canada's banks have accomplished that.

Think about all the advantages a Canadian bank has. Five companies control more than 80% of the market. They all offer similar products at close to the same price. It's a pain to change banks, meaning customers are incredibly sticky. And banks are masters at charging fees for everything.

Oh, and these banks regularly loan money out knowing 100% of it is guaranteed by mortgage default insurance, which is paid for by the customer.

What a great business.

Even the recent controversy about TD's sales practices is much ado about nothing. Every bank does similar things. Even my friendly credit union tries to upsell me to various products, like wealth management or a better bank account.

The bottom line

No business is perfect. I'm the first to admit that.

TD does have some weaknesses. It will be impacted when Toronto's real estate bubble pops, although it should easily be contained. New mortgage lending will slow, which will impact overall growth.

Ultimately, however, TD is still an incredibly strong company with a number of very real competitive advantages. If you're looking to short, look somewhere else. It's just too dangerous to short TD.

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