



Home Capital Group Inc.: Where Have All the Bulls Run?

Description

Home Capital Group Inc. ([TSX:HCG](#)) has officially turned sour, and investors are exiting positions in this once-promising lender in Canada's high interest rate non-prime category.

I am a believer that one of the most valuable traits any investor can have is the ability to change one's mind about an investment on evidence contrary to one's viewpoint. The ability to reverse course and cut losses before an investment turns into a complete disaster can mean the difference between making money and losing money in a given year.

Long-term investors often have no choice but to hold steadfast on an industry or a group of stocks during a prolonged downturn with the confidence that the investment will turn around based on solid underlying fundamentals. When the fundamentals of an industry change, however, the best investors are often the fleetest of foot, getting out when others are adding to value-trap positions.

Case in point: Warren Buffett's exit of **Wal-Mart Stores Inc.** along with a surprising 180-degree shift toward the U.S. airline industry have investors talking. Here is a world-class investor with an iconic long-term investment strategy that has completely shifted his views on bricks-and-mortar retailing and the aerospace industry.

Other iconic investors, such as Bill Ackman, who have stuck to their guns with investments in clunkers such as **Valeant Pharmaceuticals Intl Inc.**, have paid a hefty price for this lack of strategic agility. Ackman's loss on Valeant has been calculated at more than \$4 billion, according to sources.

Bottom line

The investors bullish on Home Capital's prospects have seemingly dissipated. Repeatedly shouting "value" and "low price-to-earnings ratio" won't make value appear. Sometimes a company has cracks in its foundation, and when a business's fundamentals are failing, even the most bullish investors should take inventory of the issues and carefully analyze the causes and potential future impact of the adjusted fundamentals.

The market has taken its time in adjusting to the reality that Home Capital is in hot water, and while

some Home Capital supporters have claimed that the decline in the company's stock price is due to unfair speculation, short sellers from south of the border, or just plain "bad news," the reality is that each of the scandals that have plagued the company of late cumulatively add up to the following:

- High probability of increased costs for the company via increased deposit rates;
- High probability of material decreases in loan origination due to reputation-related issues;
- Significant likelihood that increased scrutiny and an OSC investigation into the company's lending practices will uncover additional regulatory issues; and
- Increased likelihood of a downgrade to non-investment-grade status, increasing borrowing costs and reducing or eliminating institutional investor interest.

All things being equal, Home Capital is a company that has a long and difficult road ahead. It appears that a key driver behind the recent plunge in the company's stock price is that investors have just started to notice.

Stay Foolish, my friends.

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