



Home Capital Group Inc. Bears Beware of a “Short Squeeze”

Description

If you believe, as I do, that **Home Capital Group Inc.** ([TSX:HCG](#)) has a long way to fall yet, and have not yet committed to a short position in the company, here’s some food for thought: consider the risks associated with a short position this late in the game.

The dynamics have changed with respect to this stock

Home Capital is not a stock with a highly diversified investor base any more; rather, the company has seen massive consolidation in its investor base due to the selling (and short-selling) of late.

The sheer number of scandals that has led to the massive decline of nearly 40% year-to-date can be read about in many of my previous pieces on Home Capital – what I want to look at in this article is how this has affected HCG’s investor base.

As holders of the company’s stock have fled, short-sellers have largely filled the void, with short interest now breaching record levels for Home Capital’s stock. At the same time, the investor base for Home Capital has become largely concentrated, with two firms holding more than 26% of the company’s stock as of April 22:

Name	Shares Held	% Total	Shares Held
QV Investors Inc.	8,443,711	12.81%	
Turtle Creek Asset Management Inc.	8,767,037	13.47%	

This change in the company’s investor make-up has some investors talking about the newfound possibility of a short squeeze.

What is a “short squeeze?”

A [short squeeze](#) is a rare phenomena in finance, however it is one which is very interesting and exciting for outsiders watching a stock (perhaps less so for those involved).

The basic idea is that, as a company begins to see its market price decline due to a rapid rise in the short interest in the stock, one or two firms can begin buying up large amounts of shares at lower and lower prices. When effectively the entire market is short a given stock, and one or two firms own the majority of the outstanding shares of the company (or a significant enough chunk), these firms may have an opportunity to essentially corner or “squeeze” the short-sellers because they are effectively the only places short-sellers with large positions can go to replace the shares they borrowed.

Remember that a short position is one in which a share is borrowed and is subsequently sold with the hope that it can be replaced at a lower market price – the key here is that the share must be replaced. If one or two firms own effectively all the outstanding shares, these companies can demand the shares back, and demand that the short-sellers pay them exorbitant prices to replace the borrowed shares.

It is clear that the market dynamics are changing quickly for Home Capital, and it is unclear whether QV or Turtle Creek will be able to acquire enough shares to make a short squeeze a possibility, however if they play together, anything is possible.

Bottom line

While Home Capital may still have significant room to move downward, at this level it is important for any investor considering a new short position to be extremely careful, as much of the “froth” has already been skimmed off the top of Home Capital since the beginning of the year.

Stay Foolish, my friends.

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