Why These 3 Stocks Are Still My Top 3 Short Plays

Description

Making bold bearish calls on stocks can be something of a dangerous thing to do.

In an article I wrote just over two weeks ago, I highlighted three of my top short ideas for investors who may want to consider hedging existing positions or going against the grain and providing market efficiencies by shorting **Home Capital Group Inc.** (TSX:HCG), **Equitable Group Inc.** (TSX:EQB), and **Canopy Growth Corp.** (TSX:WEED). At the time of writing, these companies were down 73.8%, 12.4%, and 10.3%, respectively, over the past two weeks alone.

The reality is that financial markets are built on a foundation of bullish, forward-looking investors; most are looking to capitalize on the average 7-8% annual yield the major stock indices provide. Investors would not invest if the market did not predictably increase every year (on average) over a long period of time.

That said, stock corrections and re-valuations of existing stocks are necessary for the stock market to operate efficiently. Many studies have proven that stock markets tend to overreact — on the upside as well on the downside.

Here's why I believe more downside exists in Home Capital and Equitable Group after their massive declines on Wednesday, and why I would hold on to any hedge or short positions on these companies (though I don't own any shares or options on these names).

I believe the marijuana industry is still evolving and that the growth prospects of other companies such as **Aurora Cannabis Inc.** (TSX:ACB) and **Aphria Inc.** (TSXV:APH) are superior to those of Canopy, and would recommend a long-short strategy for these cannabis companies (long ACB or APH and short WEED) to mitigate any large industry moves one way or the other.

The bull case

Other analysts and pundits have continued to propose that Home Capital and Equitable Group are simply too cheap to ignore. I can't disagree with the numbers: Home Capital now has a whopping 15.25% dividend yield (at the time of writing), and Equitable Group's yield has also increased substantially to 2.5% from a relatively insignificant yield just a few days ago.

ROE numbers remain high due to the higher levels of risk taken on by these firms, and these companies are now what many bullish investors consider to be “cigarette butts” with the market capitalizations for Home Capital and Equitable Group dropping from approximately $2 billion and $1.5 billion, respectively, to $420 million and $650 million, respectively, since the beginning of the year (at the time of writing).

The bear case

Having written over a dozen pieces analyzing the downside on Home Capital and a few on Equitable Group, I have seen the bull case firsthand from investors who have attacked my position and repeatedly called out my analysis on these stocks, which I have remained bearish on since the beginning of the year.

Some have claimed these stocks are cheap and therefore have value, while others have challenged my analysis of these companies’ business fundamentals and scandals of late.

Bottom line

The market has spoken and seems to have taken a completely bearish sentiment with respect to these alternative Canadian mortgage lenders. I would recommend extreme caution with these three names and suggest anyone interested in taking a long or short position do their homework on the associated risks with each play.

Stay Foolish, my friends.

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2. TSX:HCG (Home Capital Group)
3. TSX:WEED (Canopy Growth)

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