Was Warren Buffett's Bet Against Canadian Housing Market Crash Right?

Description

It's been close to three months since Warren Buffett rescued troubled mortgage provider **Home Capital Group Inc**. (TSX:HCG), betting against the general perception that the Canadian housing market is about to crash.

Buffett's **Berkshire Hathaway Inc.** bought a 38% stake in Home Capital, the nation's largest non-bank mortgage provider, at a time when the lender was about to collapse after a run on its deposits amid revelations of mortgage fraud from its brokers.

The troubles at Home Capital escalated as soaring housing prices triggered warnings of a severe correction from rating agencies this spring. But the latest signs suggest that the widely speculated correction in the Canadian housing market isn't turning into a crash, validating Buffett's view that problems at Home Capital won't spill over to the broader banking sector and won't replicate the U.S.-type Financial Crisis of 2008, triggered by the collapse of its housing market.

The latest earning reports from the country's largest lenders show that Canadian banks are managing their huge mortgage portfolios quite well with no sign of distress, despite the fact that Toronto home prices are down nearly 19% from the April peak and resales were about 40% down in July than they were a year earlier, according to the Toronto Real Estate Board data.

Bank earnings

Canadian Imperial Bank of Commerce (TSX:CM)(NYSE:CM), the most exposed lender to the housing market among the "Big Six" banks, is prepared to increase its market share in mortgages, even after its residential mortgage book swelled 13% to $197 billion at the end of June when compared to the same period a year earlier.

For the third quarter, CIBC reported a 9% increase its earnings per share (EPS) to $2.77 from $2.67 a year ago. Analysts had, on average, forecast EPS of $2.66, according to **Thomson Reuters**.

Showing his confidence that the Canadian housing market won’t see a doomsday scenario, the Chief Financial Officer Kevin Glass told journalists he is “very comfortable” with the bank’s mortgage growth.

Royal Bank of Canada (TSX:RY)(NYSE:RY), Canada’s largest lender, had a similar positive story for its investors when it announced its third-quarter earnings.

The lender didn’t show any sign of distress from its mortgage portfolio in the third-quarter earnings; instead, it surprised investors by a better-than-expected profit and an increase in its dividend payout.

RBC increased its quarterly dividend by 5% to $0.91 a share — more than the average analyst forecast of $0.89.

Investor takeaway

Shares of Canadian banks have been under pressure this year mainly on concerns about a severe correction in the Canadian housing market. Those worries have stopped investors getting excited about these solid dividend payers, despite the rising interest rates, which should boost their earning potential.

Now that housing crash scenario isn’t playing out the way many shortsellers were hoping to see, I think it’s a good time for investors to follow Buffett’s instinct and grab some attractive yields offered by Canadian banking stocks.

I particularly like CIBC stock with a dividend yield of 4.9% after a recent pullback in its prices. There is no doubt that some home buyers and sellers are going to feel some pain as the market corrects itself after a long and steep upward journey, but I don’t see a collapse of our housing market coming.

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