



A Warren Buffett Stock That May Bring More Upside in 2018

Description

When Warren Buffett bought a stake in the troubled Canadian mortgage lender **Home Capital Group Inc.** ([TSX:HCG](#)), his decision surprised many of us.

The timing of his investment was quite bizarre. Short sellers were after Canadian lenders, betting that Canada's largest alternative provider would collapse, taking with it the whole banking system, which is highly exposed to the [red-hot housing market](#).

But that doomsday scenario didn't materialize. During the past seven months since Warren Buffett's **Berkshire Hathaway Inc.** bought 16 million shares of Toronto-based Home Capital, its price has jumped about three-fold. For short-term players, these gains are stunning, and it's probably time for them to book the profit and move on. Let's determine if this is the right strategy.

Canada's housing market

[Home Capital's fortunes](#) are very much tied to Canada's housing market. After a tumultuous start to the year, housing data is still showing a mixed picture.

In Toronto, the benchmark home price index fell for the sixth consecutive month in November. The index has fallen 8.8% since May — the largest six-month decline in the history of data since 2000.

In contrast, residential home sales in Greater Vancouver jumped ~26% last month compared with the same month a year ago. The Real Estate Board of Greater Vancouver says the number of sales is 17% above the 10-year average for the region in November. Many analysts are citing the new, harsher mortgage rules as one of the greatest risks in 2018.

The mortgage rules are coming at a time when the new listings are up 37% in Toronto from a year earlier, and, according to one study, tougher mortgage stress testing could make it impossible for up to 50,000 Canadians to buy a home each year.

What does that mean for Home Capital?

A cooling housing market and dwindling mortgage underwriting mean that Home Capital will find it tough to regain its market share, which it lost after the liquidity crisis it faced this spring.

In its latest update to shareholders, the management has indicated that the new loan sales were well below historical levels and were “not adequate to replace loan assets reduced through sales.”

Trading at \$17.07, the company’s shares have gained 24% in the past three months, showing that investors have the confidence in the turnaround plan to revive the profitability. The plan includes improving service levels, introducing competitive product offerings, and increasing outreach in the broker community.

After achieving stability in its funding and getting the backing of the world’s most renowned value investor, I think Home Capital is a short-term play no more. It might prove a good investment if you have a long-term investment horizon.

Going forward, the stock will trade on its business performance rather than news flow. So, if you want to be on Warren Buffett’s side when it comes to investing in this Canadian stock, I think you have a good chance to make some money.

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Date

2025/08/16

Date Created

2017/12/20

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