

## Why Short-Sellers Are Wrong About Toronto-Dominion Bank

### Description

Canada's banks continue to attract considerable negative attention, particularly from south of the border due to fears of a major housing correction emerging. This scenario sees Canada's second-largest lender **Toronto-Dominion Bank** ([TSX:TD](#))([NYSE:TD](#)) as being the most shorted stock on the TSX. The lenders' recent earnings miss has also attracted considerable attention from short-sellers.

While pundits have been claiming that a meltdown is due for quite some time, it has yet to occur — and likely will never occur. And this, combined with the strength of its business, means that the short-sellers are entirely wrong about Toronto-Dominion.

### Now what?

Claims that Canada's housing market is overheated and due for a massive correction have been circling for years. These claims triggered considerable short-selling of Canada's major banks and alternate mortgage lenders including **Bank of Nova Scotia** and **Home Capital Group Inc.** ([TSX:HCG](#)). When Home Capital Group went [into meltdown](#) mode in mid-2017, many pundits, notably those from the U.S., claimed that it was the top of the iceberg and that Canada's financial system would soon follow.

Nonetheless, Home Capital Group's brush with the corporate undertake was solely the result of its own internal problems and not evidence of systemic failure among Canada's lenders.

Fears of a housing meltdown and the impact it would have on the economy led to Canada's prudential regulator, the Office of the Superintendent of Financial Institutions, or OSFI, move to gradually tighten mortgage regulations.

This, in conjunction with moves by British Columbia and other provinces as well as Ottawa to curb speculative investments in housing, has caused the frothy market of mid-2016 to cool. After peaking in May 2017, the growth of the national average house price slowed, rising by 5.7% year over year in December 2017, with much of that growth stemming from the overly heated housing markets of Vancouver and Toronto.

Even if housing prices are sharply corrected, the fallout for Canada's major banks such as Toronto-Dominion would prove minimal. A larger number of mortgages are insured, and those that aren't have conservative loan-to-value ratios. Toronto-Dominion's fourth quarter 2017 came in at 42% and 50%, respectively. The bank's credit quality also remains solid, as is evidenced by the net impaired loan ratio of 38 basis points at the end of the fourth quarter 2017, an eight-basis point improvement over a year earlier.

Toronto-Dominion is also well capitalized, having a common equity Tier 1 capital ratio of just under 11%, thereby underscoring the bank's financial strength.

What many short-sellers are forgetting is that Toronto-Dominion will benefit from higher interest rates in the U.S. and Canada. These have already boosted the net-interest-margin, or NIM, for its Canadian retail business by eight basis points year over year to 2.86%, while its U.S. retail bank expanded to 3.18%, or five basis points higher than a year earlier.

Trump's tax reforms will serve as a powerful tailwind for earnings, as the U.S. economy benefits from his planned fiscal stimulus.

These factors will give Toronto-Dominion's earnings a healthy boost, particularly as the U.S. economic recovery gains greater steam, which, along with rising business as well as consumer confidence and employment, will give demand for credit a solid boost.

### **So what?**

Regardless of what the short-sellers believe, a major housing correction is unlikely. When combined with the strength of Toronto-Dominion's financial position, its high-quality loan portfolio and the [increasingly positive](#) economic outlook, this will ultimately be a costly trade for short-sellers.

In fact, there are signs that Toronto-Dominion is well positioned to benefit from greater economic growth in Canada and the U.S., which along with higher interest rates, will give earnings — and ultimately its stock — a healthy boost.

### **CATEGORY**

1. Bank Stocks
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### **TICKERS GLOBAL**

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2. TSX:HCG (Home Capital Group)
3. TSX:TD (The Toronto-Dominion Bank)

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mattdsmith

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