This Cringe-Worthy Canadian Stock Is My Best Short Idea for 2018

Description

Shorting a stock is not recommended for the average investor since your losses are theoretically limitless. Unless you're risk-averse, I wouldn't recommend shorting any stock even if you're convinced that a business is on the secular decline.

Getting in too early in a short can be just as bad as being wrong with your bearish thesis, especially for stocks with high dividends, as you'll be on the hook for regular distributions. In time, such distributions can really add up; if the shorter-term movements in the stock price don't head in the red, you'll likely be squeezed from your short position as you throw in the towel and question your original bear thesis.

In summary, short positions should come with a warning label. But if you've got experience with shorting stocks and some mad money to take risks with, I think **IGM Financial Corp.** (TSX:IGM) is shaping up to be one of the best short plays for 2018 and beyond.

In many previous pieces, I've discussed my distaste for IGM's deteriorating business — and the recent run-up in the stock that makes me cringe. Desjardins Securities recently named IGM as one of their top stocks for 2018, but I'm not buying what they're selling.

Many longer-term headwinds that I've emphasized in the past may begin to produce a dent in IGM's top-line numbers over the short- to medium-term. This, in turn, may be exacerbated by a tougher regulatory environment that looks to protect the average Canadian investor from being ripped off when it comes to obscure fees behind mutual funds.

An income value trap that you shouldn't set foot in

In addition, after IGM's recent 2017 rally, there are plenty of gains that are likely to be surrendered as we head into 2018. The stock currently trades at a 13.4 trailing price-to-earnings multiple, a 2.2 price-to-book multiple, a 3.5 price-to-sales multiple, and a 15.7 price-to-cash flow multiple. All of which are in line with the company's five-year historical average; this concerns me, as there are many major headwinds that will inevitably eat into both top-line and bottom-line numbers, both of which I suspect will be on a steady and gradual year-over-year decline.

To rub more salt in the wound, IGM's operating margin is likely to fall off a cliff as the company is forced to lower its mutual fund fees as Canadians begin to realize how much they're really paying with mutual funds with near 3% MERs. If Canadians knew how much they were actually paying, I think every Canadian should consider a financial advisor who doesn't have a conflict of interest.

Bottom line

IGM currently yields 5.12%; thus, such a short is a risky proposition, especially as nobody really knows when the average Canadian will rise out of the dark when it comes to mutual funds and their associated fees. Canadian mutual fund fees are among the highest in the world, and given the ample investment instruments available today, I think IGM's underlying assets will deteriorate over the next five years and beyond. Even with IGM's recent cost-containment efforts, I think the longer-term headwinds are insurmountable.

If you don't understand shorting or the associated risks, I'd recommend just avoiding the stock of IGM, which I believe is a dangerous income value trap.

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