

## Ignore the Short-Sellers and Buy Toronto-Dominion Bank

### Description

Canada's second largest bank by assets **Toronto-Dominion Bank** ([TSX:TD](#))([NYSE:TD](#)) continues to attract the ire of investors, dropping by 3% since the start of 2018. It is also garnering considerable scrutiny from short-sellers given that it's the [second most shorted](#) stock on the TSX at the time of writing. The reasons for this are difficult to fathom, particularly when no other Canadian bank is attracting that level of negative attention.

### Now what?

Short-sellers make money when stocks decline in value. It appears that they are betting on TD being exceptionally vulnerable to a downturn in the economy and the potential for a banking crisis to emerge because of Canada's heavily indebted households. That interest was magnified after a scathing report from the Canadian Broadcasting Corporation (CBC) earlier this year about poor sales practices at the bank. There are fears that this could lead to regulatory intervention, including fines, a loss of reputation that would curtail TD's growth prospects or worse, a sharp decline in the quality of its loan portfolio.

It was these types of high-pressure sales practices that ultimately led to the U.S. housing crisis and near meltdown of its financial system a decade ago.

Another concern is that lower-than-expected economic growth in Canada will further curtail the bank's growth prospects in an already saturated mortgage market.

Nevertheless, there are signs that the short-sellers are wrong when it comes to TD.

Like its Canadian peers, the bank has very little exposure to subprime loans, while it has maintained tight control of its underwriting standards. This is readily apparent when you consider that the bank has an extremely low gross impaired loans ratio of 0.49%. The value of impaired loans for the first quarter 2018 was 10% lower than it had been a year earlier. TD has also adequately provisioned for those impaired loans with total credit loss provisions

Then there is the conservative nature of the bank's loan portfolio.

While Canadian mortgages may be among the most vulnerable segments of TD's loan portfolio and make up 30% of its total loan book, the risks they pose are mitigated through a range of strategies. Key among them is that 41% of Canadian mortgages are insured, and those that aren't insured have a low loan-to-valuation ratio of 51%.

TD is also well capitalized with significant liquidity, as is evidenced by its common equity tier 1 ratio of 10.6% and liquidity coverage ratio of 122%.

One of the most important aspects of the bank's operations is that it has a significant operational footprint in the U.S., which means it will benefit from Trump's [recent tax reforms](#) and fiscal stimulus. The bank's U.S. retail banking franchise is responsible for almost a third of its net earnings, and the

reduction of the U.S. corporate tax rate from 35% to 21% will give those earnings healthy lift.

Tax reforms are expected to drive higher growth south of the border. In 2018, U.S. gross domestic product (GDP) is forecast to expand by between 2.5% and 3% compared to the 2.3% recorded for 2017. That significant uptick in growth will drive greater business activity and consumption, which bodes well for further loan growth.

In 2017, U.S. credit card debt expanded at its greatest rate since 2007. Faster economic growth will also compel the Federal Reserves to hike official interest rates over the course of the year. That will boost the net interest margin for TD's U.S. business, making it more profitable.

This will make up for the anemic rate of economic growth expected in Canada, where GDP is forecast to expand by less than 2% during 2018.

### **So what?**

Regardless of the negative perception of the bank, TD is positioned to grow strongly in coming months, particularly as the U.S. economic upswing gains further momentum. While patient investors wait for this to translate into a higher stock price, they will be rewarded by the bank's sustainable and steadily growing dividend yielding just over 3%.

### **CATEGORY**

1. Bank Stocks
2. Investing

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2. TSX:TD (The Toronto-Dominion Bank)

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### **Date**

2025/08/27

### **Date Created**

2018/04/09

### **Author**

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