



Ignore the Short Sellers and Buy Toronto-Dominion Bank (TSX:TD)

Description

Canada's second-largest bank by assets, **Toronto-Dominion Bank** ([TSX:TD](#))([NYSE:TD](#)), [continues to attract](#) substantial negative attention, becoming the most shorted stock on the TSX. Much of that negative view is being driven by fears of a Canadian housing correction, reduced growth opportunities, financially stretched Canadian households, and weaker than expected earnings over previous quarters.

Normally, such a significant degree of short selling would indicate that there are grave problems with a company and act as a red flag for investors, but in the case of Toronto-Dominion, this sentiment is overbaked.

Now what?

For a bank that short sellers are betting will fall into distress, Toronto-Dominion delivered some exceptional second-quarter 2018 results. Earnings per share shot up by an impressive 18% year over year, driven by a solid performance from Toronto-Dominion's Canadian and U.S. retail banking business, where net income expanded by 17% and 16%, respectively.

There is some truth to the claim that there is a lack of growth opportunities in Canada's saturated mortgage market. Toronto-Dominion's large U.S. franchise endows it with [considerable potential](#). The bank's U.S. banking business is ranked as the ninth-largest by assets, and for the first quarter it reported a remarkable 24% increase in net income compared to same period in 2017. Toronto-Dominion's U.S. business was responsible for generating 34% of its total net income. Those strong earnings gave the bank's overall bottom line a healthy lift, causing adjusted net income to rise by an impressive 20%.

There is every sign that this strong growth will continue because of Trump's tax reform and a stronger U.S. economy, where gross domestic product (GDP) is forecast to expand by 2.7% in 2018, which is 0.4% greater than 2017. Even Toronto-Dominion's Canadian operations will grow at a decent clip, despite the outlook for Canada's economy not being as positive as that for the U.S. because the International Monetary Fund (IMF) has estimated that it will expand by 2.1%.

More importantly, Toronto-Dominion continues to maintain a solid balance sheet, possessing a

Common Equity Tier 1 Capital ratio of 11.8%, which is a full percentage point higher than the equivalent quarter for 2017. Credit quality also remains high. For the second quarter, it fell by 13% in value year over year, while net impaired loans as a ratio of total loans was a very low 0.36%, which was seven basis points lower than a year earlier. Allowances for loan losses also dipped, declining by almost 1% in value when compared to 2017.

When this is considered in conjunction with over 40% of Canadian mortgages being insured and an average loan-to-value ratio of 52% for uninsured mortgages, even a catastrophic collapse in Canada's housing market would have very little long-term impact on the bank.

Toronto-Dominion's focus on boosting efficiencies, expanding its distribution network, and enhancing its technology capabilities will drive stronger growth, which should translate into a firmer bottom line and higher share price over the long term.

So what?

It is difficult to understand the large volume of short selling related to Toronto-Dominion. There are signs that Canada's housing market won't collapse, and the bank maintains a strong balance sheet, including more than adequate levels of capital and credit quality. This — along with the risk-mitigation strategies that Toronto-Dominion has employed — will markedly reduce the impact of any financial crisis in Canada, while enhancing its growth potential. For these reasons, it remains a top pick for every portfolio, especially when its sustainable and regular dividend, which yields just over 3%, is accounted for.

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