

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

Description

As of 15 September 2018, Canada's second largest bank by assets, **Toronto-Dominion Bank (TSX:TD)(NYSE:TD)** was the second most-shorted stock on the TSX. It appears that institutional investors, traders and speculators believe that the bank will pull back sharply in the coming months despite it having reported some solid 2018 results and gaining almost 12% for the year to date. While there is evidence that Canada's banks are facing a challenging operating environment, it is difficult to see Toronto-Dominion's stock experiencing a substantial decline in value anytime soon.

Now what?

Canadian banks have attracted considerable negative attention in recent years despite pulling through the 2008 financial crisis in good shape and reporting solid results for nearly a decade. Much of the attraction for short sellers is focused on what they believe is the considerable risk of a Canadian housing correction and the marked impact this would have on Canada's banks.

They believe that rising housing prices, extreme levels of household debt and questionable mortgage underwriting practices would cause the crisis to ripple out across Canada's banks triggering significant losses among their mortgage portfolios. This would cause their stock to collapse.

Toronto-Dominion is a favoured target because of scathing reports regarding its sales practices in 2017, the concentration of uninsured domestic mortgages and concerns over its mortgage underwriting practices. There is also the widely held belief that growth opportunities for Canada's banks are severely limited because of a saturated domestic financial services market and faltering loan growth.

Nonetheless, it appears that the short sellers are wrong. A recent report from economic and financial research agency Moody's Analytics indicates that Canada's housing market [is stable](#) and that there won't be any short-term correction over the next five years.

Furthermore, mortgage underwriting practices in Canada, especially among the big banks, have tightened significantly in recent years. The prudential regulator, Office of the Superintendent of Financial Institutions (OSFI), introduced new underwriting standards during the first quarter 2018 aimed at reducing the systemic risks associated with mortgage lending. Those tighter rules caused household lending during the quarter to tighten and mortgage originations at Canada's largest lenders to slow.

The strong health of the credit portfolios of Canada's banks is reflected in data from the World Bank, which shows that the value of bank non-performing loans are a mere 0.5% of total gross loans. This is well below the level required to precipitate a crisis even if there was a sharp correction in the housing market or if the economy slowed significantly.

While Toronto-Dominion's ratio is 0.7% or 20 basis points above the national average, it is still well below the level that indicates that there are issues within the bank's loan portfolio.

It should also be noted that 37% of the residential Canadian residential mortgages underwritten by Toronto-Dominion are insured and those that aren't insured have a conservative average loan-to-value ratio (LVR) of 52%. Such a low LVR indicates that there is considerable room to maneuver should housing prices fall before a crisis would erupt in Toronto-Dominion's mortgage portfolio.

The bank also remains well-capitalized, ending the third quarter 2018 with a common equity tier one capital ratio of almost 12%, indicating that it is capable of absorbing any losses triggered by a collapse in the quality of its loan book.

It shouldn't be forgotten that Toronto-Dominion's earnings will continue to grow at a [healthy clip](#). The bank is rated as the ninth largest by assets in the U.S. and derives roughly 37% of its net earnings from south of the border. Because of the ongoing U.S. economic upswing and President Trump slashing the U.S. corporate tax rate to 21%, Toronto-Dominion's U.S. earnings will continue to grow. This will offset any weakness in Canada and enhances the bank's growth profile.

So what?

It is difficult to see any credit crisis emerging that will significantly impact Canada's banks. And that, coupled with Toronto-Dominion's quality credit portfolio, healthy balance sheet and solid growth prospects indicates that the short sellers are wrong about the bank's outlook. For the aforementioned reasons, Toronto-Dominion should form a core holding in any investors portfolio.

CATEGORY

1. Bank Stocks
2. Investing

TICKERS GLOBAL

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

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise
4. Yahoo CA

Category

1. Bank Stocks
2. Investing

Date

2025/09/29

Date Created

2018/10/04

Author
mattdsmith

default watermark

default watermark