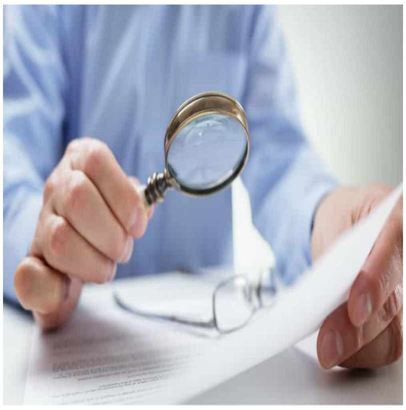

Warning: 3 Stocks That Could Plunge If Either of These 2 Canadian Bubbles Burst in 2019

Description

While still up for debate, many folks would agree that both Canada's housing market and consumer debt levels are in bubble territory. As you may have heard, Canada's housing market is starting to develop an alarming amount of froth, and with a huge portion of Canadians one interest rate hike away from a potential bankruptcy, there's no question that there will be severe repercussions should either of Canadians bubbles burst in the new year.

Consider **Home Capital Group** (TSX:HCG), **Equitable Group** (TSX:EQB), and **goeasy** (TSX:GSY). The former two companies are vulnerable to a housing meltdown, and the latter could face a dire situation should consumer debt levels face a recession or rate-driven correction.

All three firms, as you may have guessed, are alternative lenders that charge customers higher interest rates for the riskier loans that they provide. When economic conditions are good, it's a party for the alternative lenders, and the ROEs are head and shoulders above other credit-worthy lenders who are getting less bang for their buck. When the tides turn, things could start getting ugly for the alternative lenders, and should liquidity become a problem, investors who hold on the way down could stand to get hurt pretty badly.

The alternative mortgage lenders could get clobbered in a housing flop

Home Capital Group had a liquidity crisis of its own not too long ago, before Warren Buffett came to the rescue. Although the alternative lender has since regained investor confidence with a repaired balance sheet, investors would be wise to limit their exposure to the alternative lending behemoth unless they see a mild cool down of Canadian housing hotspots, and not "big one" that many bank short-sellers have been calling for over the past few years.

Less than a quarter of Home Capital's loan book is insured against default, but in spite of this seemingly alarming number, fellow Fool Nelson Smith thinks that management has received a wake-up call with regard to the high degree of risk that's involved with alternative mortgage lending. Smith still believes that investors will "sell first and ask questions later" at the first signs of smoke, however, so those drawn in by the seemingly attractive ROEs should remember that they come with strings attached.

Equitable Group, another alternative lender, is in the same boat as Home Capital, but unlike its bigger brother, the company lacks a connection like Warren Buffett.

And if the consumer debt bubble bursts?

Goeasy is a market-crusher that's a must-own in an up market, but when things sour, a substantial amount of wealth could be wiped out with no recovery in sight. During the financial crisis, the alternative financial firm took a whopping seven years to get back to pre-recession highs, dropping as low as 70% peak to trough.

Late last year, I warned investors that goeasy was a high-risk stock to own due to the possibility of a consumer debt bubble bursting.

"Goeasy is one of those companies that are fantastic to own until it's not," I said. "As goeasy's loan book continues to grow, I'd monitor uncollectables closely."

Given that we're witnessing a slow-and-steady withering away of the economy that's apparently being held hostage, I'd hit the brakes on goeasy, as defaults could surge and investors may not have a chance to head for the exits before the major downside.

Foolish takeaway

Will a housing or consumer debt bubble finally burst in 2019? Nobody knows, but most folks think the probability of either event occurring is relatively low. Given that the Bank of Canada appears to be dovish due to a combination of factors, including the global economic slowdown and the ridiculously high amount of consumer debt, investors probably shouldn't bet on either bubble bursting this year.

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