Can Toronto-Dominion Bank (TSX:TD) Stock Withstand the Mortgage Growth Slump?

Description

Bank stocks have been among the best long-term performers on the TSX. Boasting steady earnings growth, high dividend income, and consistent (if not high) returns, they've been the closest thing to buy-and-forget plays available. Over five years, the **S&P/TSX Composite Bank Index** has returned 34%, compared to just 10.33% for the broader TSX composite, making banks reliable long-term market beaters.

But now, an alarming trend threatens to change all that.

In December, mortgage growth slowed to 3.1% year-over-year–the lowest rate in 17 years. This came after a cold winter for Canadian Real Estate, which saw home sales slow nationwide and Vancouver prices slide 9.1% over 12 months.

Any decline in real estate presents a problem for the Big Five banks, as mortgage lending makes up a plurality of their earnings. But **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) may be one bank to buck the trend. With 35% of its earnings coming from U.S. retail, TD is far less exposed to the Canadian housing and mortgage markets than any of its peers. But will that fact alone be enough to save it? First, let's look at the bad news.

The bank's bread and butter

Mortgage loans are the largest single segment of TD's loan portfolio, worth around $225 billion. Granted, there are other big segments as well: business and government loans weigh in at a hefty $217 billion. But mortgage lending is the biggest of several big businesses TD has, about 36% of the total lending operation. That's a lot of exposure to mortgages, and by extension, a lot of risk associated with slowing mortgage growth.

Now for the good news: that $235 billion includes TD's U.S. mortgage loans as well as the Canadian ones. TD's Q4 report does not parse mortgages by country, so it's impossible to say exactly how many of their loans originate from America, but since 35% of their total income comes from U.S. retail, it's fair to assume that it's a large percentage. So TD has some geographic diversification to help limit exposure to falling domestic mortgage growth.

Ways to combat a mortgage slowdown

It's one thing to say that geographic diversification protects TD from domestic trends, but quite another to say the company is totally out of the water. Canadian retail is still a larger component of TD's business than U.S. retail, so a slowdown in Canadian mortgages is going to have a big impact. To keep growing at the rate it has seen over the past five years, TD will need a new game plan.

One option is to cut the mortgage rate and stimulate more loans by offering more affordable ones. **Royal Bank** has done exactly that by lowering its five-year fixed mortgage rate from 3.89% to 3.74%. This move could stimulate mortgage growth, but if it doesn't, it just means that TD will earn less on fewer loans.

Alternatives to rate changes

There are of course options available to TD that don't involve raising or lowering mortgage rates. One option is to try to increase business elsewhere. Some banks are responding to the slowdown in mortgages by increasing business lending. However, driving up revenue in any business segment involves increasing marketing expenses, and it's not clear that that would ultimately be profitable.

For now, it looks like the U.S. retail business is TD's best growth bet in the short term.

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