In the Midst of a Housing Market Slowdown, Investors Should Watch Out for This

Description

A year after the government tightened mortgage lending practices to include more stringent stress tests and qualifying rules, the housing market has shown weakness and vulnerability across the board, albeit none as much as Vancouver's.

As investors, we should care about this for many reasons. This slowdown in housing prices can be expected to trickle down and be felt by many different groups.

First is the most obvious: the banks.

Toronto-Dominion Bank (TSX:TD)(NYSE:TD) has big skin in the game of mortgages, as residential mortgages accounts for almost 47% of the bank's Canadian retail lending portfolio.

So, the bank is vulnerable to a slowdown in new mortgages, and although it is pretty sheltered from credit issues, it is vulnerable with regard to home equity lines of credit.

As we know, these are based on the value of your house and are generally carried at higher interest rates than your mortgage.

If borrowers perceive themselves to be less "rich" as a result of home prices falling, they would be less inclined to borrow, driving down home equity lines and ultimately interest paid to the bank. This is the opposite of what has happened in the last 10 or more years, which has driven the banks to record profits and record stock prices.

Another corner of the market that would be affected by a housing market slowdown is consumer spending. Again, it relates to the feeling, real or perceived, of being less "rich," which would cause consumers to rein in their spending.

Canada Goose Holding (TSX:GOOS)(NYSE:GOOS) has been performing exceptionally well since its IPO in March 2017. Its stock price has reflected this, with a 262% return.

But going forward, macro-economic risks are real, and you may therefore want to rethink owning stocks such as Canada Goose.

Consumer debt loads are high, economic growth is slowing, housing prices are falling, and the stock market is increasingly volatile. The effect of all of these factors is that consumers will cut spending. And what spending goes first? That would be spending on luxury, higher-priced items, such as Canada Goose apparel.

On a company-specific level, Canada Goose is pretty highly concentrated in its product offering, with over 90% of it coming from outerwear. Although this has been a highly profitable strategy, this lack of diversification may cause problems going forward in a more difficult environment.

Trading at almost 60 times this year’s consensus earnings estimates and over 40 times next year’s, Canada Goose stock is vulnerable to any setback, big or small, because expectations baked into the stock are so high.

If you are a momentum investor, you are likely comfortable with these types of multiples. And up until now, you have clearly made a handsome gain on your investment.

Watch closely, as the market may be turning, with weaker housing prices driving weaker consumer spending.

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Author
karenjennifer