



Why the Short Sellers Are Wrong About This Top Canadian Bank

Description

After disappointing the market by reporting earnings that fell short of expectations, Canada's second largest mortgage provider **Toronto-Dominion Bank** ([TSX:TD](#))([NYSE:TD](#)) has found itself to be the second most short stock on the TSX.

The bank is attracting considerable adverse attention with hedge funds and other traders convinced that its stock is poised to collapse for a variety of reasons. Key among them is the view that Canada's housing market is overheated, which combined with heavily indebted households and the bank's reliance upon mortgage lending to drive growth, leaves it exceptionally vulnerable to a [housing correction](#).

While these and other potential external macro-economic shocks arising from a slowing China, a U.S. China trade war, Brexit and poor economic growth in the Eurozone could impact Canada it shouldn't prevent investors from buying Toronto-Dominion.

Disappointing results

A key driver of the bank's less than satisfactory first quarter 2019 performance was Toronto-Dominion's wholesale banking business, which reported a \$17 million loss compared to a \$278 million profit for the equivalent period during 2017. That can be blamed on higher expenses, lower trading activity and increased market volatility.

Earnings from Toronto-Dominion's Canadian banking business also declined sharply with net income plunging by 22% year over year to just under \$1.4 billion because of a \$31 million charge related to the Greystone acquisition and an after-tax \$446 million charge associated with Air Canada's loyalty program.

On a very positive note, Toronto-Dominion's U.S. retail banking operations reported that net income shot up by a notable 30% to \$1.2 billion, which can be attributed to loan and deposit growth, higher margins and improved systems.

It is Toronto-Dominion's solid U.S. retail banking franchise, where it is ranked as a top 10 bank, which along with its investment in stockbroker TD Ameritrade will be a primary driver of growth. The U.S. economy continues to gain momentum, boding well for further credit demand while a growing net interest margin will boost profitability for a business that is responsible for generating roughly half of Toronto-Dominion's reported net income.

Credit risk is low

Despite a sharp uptick in its gross impaired loans ratio (GILs), which shot up by six basis points (bps) year over to 0.26%, credit risk is well within manageable levels.

Furthermore, there are signs that Canada's housing market is far from collapse. While prices have cooled, and mortgage demand has slowed there are signs that the worst may be over for the domestic housing market.

According to the Canadian Real Estate Association, housing sales during 2019 will fall to their lowest level since 2010, but this should be the bottom of the market with the industry body expecting sales to expand at a higher clip and the national average price to expand in 2020.

Many of the toxic characteristics that triggered the U.S. housing market meltdown over a decade ago are missing from the domestic marketplace. These include a substantial pool of subprime mortgages, the contagion sparked by collateralized debt obligations (CDOs) and other mortgage backed derivatives and an ever-growing supply which caused housing prices to cascade downward.

Aside from Canada's stricter prudential regulations compared to the U.S. in the lead-up to the housing crisis, mortgage insurance also acts as an important backstop that prevents any housing correction from having a marked impact on domestic banks.

Over a third of all of Toronto-Dominion's Canadian residential mortgages are insured, while the domestic mortgage portfolio has a very conservative average loan to value ratio of 53%. This provides ample protection from any economic shocks that could trigger a sharp uptick in loan defaults.

While the outlook for the Canadian mortgage market remains subdued for 2019, which will likely crimp Toronto-Dominion's growth that should be offset by a strong performance from its U.S. operations and a recovery in its wholesale banking business.

Despite the somewhat disappointing first quarter 2019 results Toronto-Dominion hiked its quarterly dividend by 10% or \$0.07 per share, seeing it pay an annualized dividend of \$2.96 per share which represents a yield of 4%.

Why buy Toronto-Dominion?

The strength of the bank's [U.S. business](#) is its ongoing commitment to rewarding investors through regular dividend increases and the improved outlook for its Canadian and wholesale operations bodes well for a stronger performance. For these reasons, now is the time for investors to acquire Toronto-Dominion, should be a core holding in every portfolio.

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