Short-Sellers Betting Against Toronto-Dominion Bank (TSX:TD) Will Lose

Description

Canada's Banks are attracting renewed interest from short-sellers. The Big Five make up the five most shorted stocks on the TSX, as U.S. hedge funds bet on a housing meltdown and sharp uptick in mortgage defaults. **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) is ranked as the third most shorted.

Canadian banks are attracting negative attention

Market pundits appeared convinced that Canada's cooling housing market will enter a sharp correction, which will not only choke off the key growth driver for domestic banks but cause a sharp decline in the quality of their assets. Short-sellers anticipate that this will cause their market value to decline substantially. While there may be some merits to their argument, they have been shorting Canadian banks since the end of the global financial crisis roughly a decade ago and it has been a costly trade for them over that period.

There are signs that Canada's banks are some of the healthiest globally. Not only did they pull through the last financial crisis in solid shape, but significantly tighter prudential regulation, stricter underwriting standards, compulsory insurance for mortgages with high loan-to-value ratios, and a lack of mortgage derivatives mean that a U.S.-style housing meltdown is improbable.

Positioned for growth

Toronto-Dominion is uniquely positioned to keep growing at a rapid clip, despite the lack of growth opportunities in Canada's mature and highly saturated financial services market. This is because, early on, management realized that to guarantee future growth, it needed to expand beyond Canada's domestic market.

The bank did this by investing heavily in expanding its U.S. presence, which now sees it ranked as a top 10 U.S. bank in what is arguably the world's largest financial services market. That endowsToronto-Dominion with considerable growth potential, especially with the U.S. economy, havingperformed strongly since 2016.

By the end of the fiscal first quarter 2019, its U.S. retail banking business was responsible for earning over 40% of Toronto-Dominion's adjusted net income. For that quarter net interest income from its U.S. business shot up by 15% year over year to $2.2 billion on the back of strong loan growth. Personal loans expanded by 8% year over year, while Toronto-Dominion's U.S. business credit portfolio grew by 9% in value.

This combined with a higher net interest margin was responsible for giving earnings a solid lift with U.S. retail banking's adjusted net income rising by 16% year over year. That solid growth should continue for the foreseeable future, despite fears of a U.S. recession. The likelihood of an economic slump, despite the yield curve recently inverting, is low, especially after the Fed adopted a softer stance on monetary policy, signalling earlier this year that there would be no further interest rate hikes during 2019.

Toronto-Dominion's wholesale banking business experienced a difficult quarter because of challenging market conditions, which caused revenue to plunge by 35% year over year. It is expecting a better performance from wholesale banking over the remainder of 2019 because of an improving economic outlook.

Quality lending portfolio

While the bank's gross impaired loans ratio expanded by six basis points (bps) year over year to 0.26%, that can be attributed to higher defaults in Toronto-Dominion's U.S. commercial credit portfolio rather than an overall decline in the quality of residential mortgages. In fact, the gross impaired loan ratio for its Canadian retail banking business fell by two bps quarter over quarter and was only one bps higher compared to a year earlier. This indicates that credit quality remains high and defaults are well within manageable levels.

The quality of Toronto-Dominion's Canadian residential mortgage portfolio remains high. The proportion of that portfolio which is uninsured has an average loan-to-value ratio of 53%, providing plenty of room to move should economic difficulties impact households while 31% of all Canadian residential mortgages underwritten are insured.

Why buy Toronto-Dominion?

Toronto-Dominion has the best short-term growth prospects of Canada's major banks. The ongoing success of its U.S. operations in a fickle market in which to operate will act as a powerful growth engine. That attractiveness is enhanced by the high quality of its credit portfolio and the fact that the bank is well capitalized.

For these reasons, the short-sellers have got it wrong in the case of Toronto-Dominion. While investors wait for the strength of Toronto-Dominion's operations to translate into a higher market value, they will be rewarded by its regular and sustainable dividend yielding 4%.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. 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. Dividend Stocks
3. Investing

Date
2025/08/27
Date Created
2019/04/08
Author
mattdsmith