A Stock to Avoid if Canada's Housing Bubble Bursts

Description

With all the talks of a potential Canadian housing bubble, investors ought to brace themselves for what could be an implosion for the record books.

Some pundits are calling for a violent bubble burst, whereas others see a gradual flatlining of real estate values over a prolonged period of time. If and when the Canadian housing market does correct, it'll likely be somewhere in between the two extremes.

Regardless, Canadian investors shouldn't overexpose themselves to a specific class of investments, especially if they already have a mortgage on a property within the bubbliest of markets like Vancouver or Toronto.

So, without further ado, consider trimming **Home Capital Group** (TSX:HCG) from your portfolio if you're of the belief that the recent bout of cooling in the housing market is a precursor to a more sinister downturn.

Just a few years ago, the popular alternative mortgage lender found itself in hot water when it fell into a liquidity crisis. GIC rates got slashed, and it wasn't long until Warren Buffett answered the call, making a sweetheart deal with the firm that ultimately helped it get back on its feet again.

Today, Home Capital Group stock is red hot with shares more than doubling over the past year. Like investing with leverage, the high-ROE business of alternative mortgage lending can lead to incredible results over time until a black swan event finally comes to be.

While it is comforting that Buffett is cheering on the firm from the sidelines (perhaps waiting for another opportunity to provide his emergency services), investors ought to be tread cautiously with the name if they think the frothy housing market will suffer more than just a run-of-the-mill cooldown.

At the time of writing, at least part of the risk of such a housing meltdown is baked into Home Capital Group stock, as shares are much cheaper than they ought to be given all the massive profitability and net interest margin improvements that have been made of late.

Earnings are now ridiculously strong, margins are improving, operations are becoming more efficient, and, most importantly, credit is on stable footing — at least for now.

With shares trading at 11 times next year's expected earnings and 1.2 times book, the stock looks undervalued, and it'll likely continue to outperform if anything short of a housing bubble burst ends up happening.

For now, all is well at Home Capital Group. But things could go wrong without a moment's notice, so make sure you have a full understanding of the risks involved with the name.

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