Canadian Investors: How to Prepare for Canada's Housing Bubble Crash

Description

Check out any list of cities in the world in danger of experiencing a housing crash and two Canadian cities almost always make the cut. Homes in Toronto and Vancouver have seen tremendous appreciation during the past decade. Indeed, these cities are often listed as two of the most unaffordable cities in the world based on their median housing costs and the median income of their residents.

Ten years ago, the average house in Toronto cost $450,000, compared to $810,000 today. Similarly, the average price of homes in Vancouver has jumped to almost $1,000,000 from $600,000 just 10 years ago.

Despite weaknesses in the housing markets of Edmonton and Calgary, the average home price across the country has increased 50% over the past decade. Ten years ago, it cost an estimated $350,000 to buy a home in Canada. Right now, the same property costs approximately $525,000.

Many experts believe that this growth is not only unsustainable, but also due for a correction, while other real estate experts believe that Toronto's housing market is no longer in a bubble and that the properties are at their fair values.

Regardless of which side of the fence you're on, investors would be wise to make defensive moves to protect their portfolios.

Rising debt levels

We all know that the debt levels carried by Canadians continues to rise.

According to Statistics Canada, the household credit market debt-to-disposable income rose to 175.9% in the quarter ended in September 2019. That number grew slightly from a revised 175.4% in the previous quarter. The annualized rate of growing debt of 1.2% in the quarter outpaced the 0.9% gain in incomes.

The bottom line: Canadians are taking on debt faster than their incomes are growing. Stephen Poloz, Bank of Canada Governor, has repeatedly warned that elevated household debt levels are the economy's biggest vulnerability.

The fear is that any weakness in Canada's economy would cause rising unemployment, placing even greater pressure on heavily indebted households.

This could create a rise in mortgage defaults, as financially stretched households find it increasingly difficult to meet their debt obligations. This scenario would create a vicious cycle as more and more mortgage defaults lead to an increase in housing supply, creating fewer home sales resulting in lower home prices.

In a worst-case scenario, as experienced by the U.S. during the Great Recession, the banking sector would be among the first casualties. The deterioration of the banks' credit quality would deteriorate, weighing on their balance sheets and earnings.

Defensive move

Currently, Canada's Big Six banks are among the 10 most shorted stocks on the **TSX**. **Toronto-Dominion Bank** is the most shorted, followed by **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM) and **Royal Bank of Canada**.

If you are a long-term investor in these banks, you may consider reducing your exposure if you believe the housing bubble will pop.

Looking at CIBC, the stock is currently trading at $108.77 as of this writing. The bank, like many of its peers, pays a fantastic dividend of 5.3%. While the stock is slightly down from its 52-week high of $115.96, it is well off its low of the year at $97.55.

The banking sector is a large part of the composition of the TSX and a well-diversified portfolio will certainly include bank stocks. However, if you've been enjoying the CIBC dividends for several years, it may be time to take some profits off the table if you believe the tides are turning for the housing industry.

Remember, many U.S. investors got burned when the housing bubble popped. Hindsight is 20/20, but when it comes to investing, it's better to be safe than sorry.

CATEGORY

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