Worried About a Housing Correction? Be Cautious With This Stock Today

Description

Lately, the Canadian housing market has gone from red hot to white hot. Investors are piling into mortgages as if they're going out of style.

However, there's a high-risk and a low-risk way to play this space. I'll discuss why **Home Capital Group** (TSX:HCG) is certainly on the higher end of the risk spectrum.

Home Capital: The face of Canada's mortgage tantrum in 2017

Home Capital is an Ontario-based sub-prime lender that provides mortgages to individuals who find it challenging to get a mortgage through a conventional bank. In 2017, this company became the face of Canada's housing market crash. It was on the brink of a run on its deposits and faced various allegations relating to its underwriting practices. During that period, HCG's stock price plummeted below the $10 mark.

At that time, I was bearish on Home Capital stock. After all, this is a sub-prime lender, and the outlook for Home Capital was, well, less than rosy at the time. Back then, the Canadian housing market looked overheated. Today, the Canadian housing market looks like an inferno.

Home Capital's clientele base is built upon those borrowers banks won't touch. Yes, there are indeed some higher-quality borrowers in the mix who don't qualify for various reasons. (Not all junk bonds are the same).

However, generally speaking, for investors concerned about any overheated sector, gravitating toward a company like Home Capital over one of the Canadian banks right now is not a decision I would make.

The housing market is potentially entering the bubble territory

The Canadian housing market has continued to make headlines of late. The recent year-over-year property price surge of 14.9% in the average selling price in the Greater Toronto region is insane. The average cost of a home in Toronto? It's now well more than a million dollars. What's crazier is Vancouver's average home price is even higher (with much lower average incomes). Home sales in Vancouver surged 43% year over year.

This double-digit increase in home sales in key markets is great for homeowners. However, wage growth has not kept pace (to say the least). Housing affordability in Vancouver is the second worst in the world next to Hong Kong.

Accordingly, it's no surprise Home Capital has performed well in the past year. For buyers in markets like Vancouver or Toronto, coming up with a 20% downpayment (more than $200K) and having enough income to support a mortgage of $1 million (or much more for a nicer detached home) is out of the question for most millennials.

Since banking requirements are much more restrictive these days, going the traditional banking route just isn't the way most homeowners are choosing to go in overheated markets. Home Capital provides products catering to those without the ability to come up with the downpayment, or have credit scores or income levels that don't meet the criteria of major banks.

Bottom line

Home Capital serves a market that is in need of help right now. That's great. I think it's a company that's filling a void created by burdensome lending regulations that only serve the interests of Canada's largest banks at the expense of young Canadian homebuyers.

However, instead of dealing with the housing affordability issue, the Canadian government is running the risk of inflating this bubble to absolutely astronomical (and dangerous) levels via the central bank's monetary policy stance.

Thus, Home Capital is likely to be a beneficiary in the near term. However, I think when credit quality matters (and it doesn't now), stocks like Home Capital could get hit a lot harder than the banks on the day of reckoning.

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