Canada’s Warren Buffett Predicts Coming Pain for Investors

Description

A common saying in investing is that the best time to be greedy is when others are fearful, and the best time to be fearful is when others are greedy. Nowadays, with major stock indices trading at record highs, that saying implies that we should be especially frightened. And this was precisely the message delivered Wednesday by Prem Watsa, chairman and CEO of **Fairfax Financial Holdings** (TSX: FFH), at the company’s annual general meeting.

The man often known as Canada’s Warren Buffett was explaining why Fairfax’s investment portfolio was so conservative. To illustrate, 31% of the portfolio is held in cash, while only 22% is held in stocks. And the stocks are fully hedged. An institutional investor from Fidelity even commented that the portfolio “has a hand tied behind its back.”

China is a big worry

Mr. Watsa is especially worried about the Chinese economy, and during his presentation he made some very interesting points.

For example, the Chinese real estate market has added the equivalent of 50 Manhattans over the past five years. In 2012 alone, 20 million housing units were built, compared to 2 million per year by the United States at the peak. Home ownership rates in China are over 100%, compared to only 65% in the United States.

It is this building activity that has fueled China’s growth over the past decade, and many economists believe this has led to a severe property bubble. If the bubble pops, the whole country’s economy could be seriously affected.

Could this lead to deflation?

If China crashes, then that would lead to a steep drop in demand – and prices – for commodities. And this drop in commodity prices would lead to lower prices for goods and services in general, also known as deflation. Deflation is very rare, with Japan being a notable exception over the past 20 years.

But this exactly what Mr. Watsa is betting will happen. And investors should hope that he turns out to be wrong, because deflation can be devastating for both economies and stock prices.

What's the best way to follow him?

For investors looking to follow Mr. Watsa's lead, there are a few things that can be done. First of all, it's important to avoid the most cyclical, China-dependent sectors. So avoiding mining stocks would be a good start. Going a step further, another option is to reduce your weighting in stocks altogether, while holding safer assets such as cash.

Yet a third option is to bet against the market, and there are ETFs that can help you do that. The most popular ones are the **Horizons Betapro S&P 500 Inverse ETF** (TSX: HIU) and the **Horizons Betapro S&P/TSX 60 Inverse ETF** (TSX: HIX), which allow you to bet against U.S. and Canadian stocks, respectively.

Foolish bottom line

Mr. Watsa makes some excellent points about China, and his outlook on equities is very sobering. But one must also remember that timing the market, especially based on macroeconomic insights, is very difficult. Even an investor as accomplished as Mr. Watsa has struggled in recent years trying to predict a market correction. Time will tell if he is vindicated – if his long-term track record is any indicator, then he will be.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:CNDI (BetaPro S&p/tsx 60 Daily Inverse ETF)
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