



## Nervous About a Crash? Then Buy Fairfax Financial Holdings Ltd.

### Description

Although it's gotten very little in fanfare over the last couple of weeks, the **TSX Composite** hasn't been doing so well.

Since the middle of April—when the index hit a 2015 high of nearly 15,500—shares in Toronto have sold off about 3% to current levels of about 14,900. And that's after the last couple of days have been positive.

Getting excited about a 3% decline is pretty foolish. But positioning your portfolio to do well even during poor markets is a pretty prudent move, especially in an environment where rising interest rates could start to make stocks around the world less attractive. We know another bear market is coming; we just don't know when the carnage will hit our portfolios.

There are several things nervous investors can do. They can cycle into sectors that are more predictable, like consumer staples. They can also buy fixed income instruments, which will likely outperform stocks even in a rising rate environment, as spurned equity investors flee to the safety of the fixed income market.

Or, investors could buy shares in **Fairfax Financial Holdings Ltd.** ([TSX:FFH](#)), which is uniquely positioned to profit during the next bear market.

### The skinny

Remember all the fancy derivatives and credit default swaps that almost brought down the world's economy back in 2008-09? It turns out they weren't bad news for everyone.

Prem Watsa, the man in charge of Fairfax, used derivatives to successfully bet on the U.S. mortgage market blowing up. Although he was a little early—he first shorted the sector back in the early 2000s—Watsa ended up making billions for his shareholders as the market deteriorated. And, unlike almost every company on the planet, Fairfax Financial shares actually went up during the darkest times.

That wasn't Watsa's first successful macroeconomic prediction either. He called the tech bubble back in 2000, the decline in Japan in the late 1980s, and he predicted a crash when stocks declined back in 1987. He's also done well betting on the long side of trends, like being bullish on the developing world, and investing in beaten-up Irish banks.

These days, Watsa has two huge bets currently on Fairfax's balance sheet. The first is on deflation, which is silently sneaking up upon us. According to his most recent chairman's letter, Watsa explained that Fairfax's exposure to Consumer Price Index derivatives around the world are worth more than \$111 billion, and could trigger with just a small decline in consumer prices.

Additionally, Fairfax has completely hedged its equity market exposure. It has derivatives in place that pay out as markets head lower, making it essentially a market-neutral investment. That makes the stock a nice place to hang out if you're worried about the overall state of the markets.

### **There's more**

These bets on declining markets aren't the only reason why investors should add Fairfax to their portfolio.

Over the long term, Watsa's record is unmatched. Since he took over Fairfax in 1985, book value has increased by more than 20% per year. And that's even including some notorious missteps, like buying New York-based insurer TIG back in 1999, a blunder that took years to set right.

Fairfax's great returns have been buoyed by two main factors. Firstly, the insurance business has been consistently good, posting underwriting profits just about every year. This spins off ample cash in the form of investible premiums that will need to get paid out some day—which is known as float in the insurance world.

Watsa then invests the float in a mixture of bonds, value stocks, and certain derivatives, as mentioned earlier. It's the value investing part of the portfolio that gets the most attention. It's gotten to the point where stocks will surge 10-20% just on news that Fairfax is building a position.

For investors looking for something a little different for their portfolios, Fairfax delivers. It offers built-in downside protection, as well as a stellar track record and great insurance operations. That's a winning combination.

### **CATEGORY**

1. Investing

### **TICKERS GLOBAL**

1. TSX:FFH (Fairfax Financial Holdings Limited)

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