Is the Trump Win Bad for Fairfax Financial Holdings Ltd.?

Description

Fairfax Financial Holdings Ltd. (TSX:FFH) has been on a steep decline since the U.S. presidential election. In fact, since November 8 the shares have dropped like a rock.

default watermark

Is there a correlation between its share price and the election results? There's reason to believe so.

Despite the company reducing its equity hedges after the election, it has not stopped the share-price decline. That's because the company's big bets aren't playing out, at least, not in the near term.

The equity hedge

A few days after the U.S. election, Fairfax Financial Holdings reduced its equity hedges from 112.7% of its equity and equity-related holdings (at the end of the third quarter) to about 50%.

The reason for the reduction, as stated in the press release, was because the company "believe[s] the U.S. election may result in fundamental changes that may bolster economic growth and business development. As a result, there is the potential for a longer-term rally in U.S. equity markets that reduces the need for the capital preservation protection of equity hedging."

It's probably a good thing that the company reduced its equity hedges. After all, hedging costs money. If the company believes the U.S. market is going to rise, it only makes sense to reduce the hedges.

The pressure on the shares is probably caused by sales from investors who initially bought the company with the expectation to get a huge payout when the market crashes. However, it doesn't look like that's happening any time soon. Instead, the market is expected to continue to steadily rise.

Image not found or type unknown

Coins, dividends, money, cash 16-9

The deflationary bet

The company has hedged against a deflationary scenario by buying derivatives that are linked to consumer price indexes in the United States, the European Union, the United Kingdom, and France.

These were sitting on unrealized losses of $513.6 million at the end of the third quarter. One of its big deflationary bets in the United States accounted for nearly 41% of its unrealized losses.

This bet on the U.S. is expected to result in bigger unrealized losses now that the exact opposite, inflation, is anticipated to occur. This is because Trump will become the president, and he plans to spur growth in the U.S. economy by lowering corporate taxes and investing in infrastructures.

However, let’s not forget that the contracts for these deflationary hedges have an average life of 5.9 years; the biggest bets in the U.S. and the European Union will last for 5.9 years and 5.2 years, respectively.

So, there’s still a possibility that shareholders could get a big payout in the form of capital gains should a deflationary scenario occur within the roughly six-year time frame.

Summary

Fairfax Financial Holdings’s big bets aren’t playing out in the near term. So, its shares have been under pressure as of late. Still, they could make sense as a small position in a diversified portfolio as a hedge for a market crash or deflationary scenario.

default watermark

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:FFH (Fairfax Financial Holdings Limited)

PARTNER-FEEDS

1. Yahoo CA

Category

1. Dividend Stocks
2. Investing

Date
2025/08/16
Date Created
2016/11/18
Author
kayng

default watermark