Prem Watsa Is Bullish

Description

Often referred to as "Canada's Warren Buffett," Prem Watsa of **Fairfax Financial Holdings Ltd.** (TSX:FFH) has just completely reversed his trading strategy. The company recently announced a 180-degree shift in strategy from one of defensiveness and caution to one of outright bullishness for the markets moving forward.

With such a sharp shift in strategy, investors are taking notice. I'll take a deeper look at the reasons why Mr. Watsa has made the shift and some of the potential risks and benefits for Fairfax shareholders moving forward.

Rationale behind the shift in strategy

Fairfax has been one of the most traditional "cautious" conglomerates, invested in largely by defensive institutions with mandates to protect or hedge a portion or all of the underlying holdings. In fact, in February 2016, Fairfax announced that it had hedged over 115% of its holdings in preparation for the eventual downturn which did not materialize, given the recent boost financial markets have seen due to the election of President Trump.

Prem Watsa issued a statement recently to this effect: "Fundamental changes in the U.S. in the fourth quarter … may bolster economic growth and business development in the future. Consequently, we have removed all our defensive equity index hedges."

The company's stock price has been on a slide since the election with the stock price slipping from above $700 to just above $600. It appears the company has reason to believe that the bull market will continue into 2017, and the downside hedges have proven to be too expensive to bear, at least in the short term.

What this investment strategy shift means for investors

Moving away from a rigid and pervasively bearish defensive investment strategy with portfolio hedges exceeding 100% to a “naked” investment strategy in which none of the company’s holdings are hedged to the downside means investors in Fairfax will need to re-assess if this is a holding still makes sense.

The more likely scenario investors envisaged with Fairfax was a gradual removal or reversal of hedge positions over time. This swift shift in strategy contradicts statements Mr. Watsa made in his most recent letter to shareholders last year, in which he expressed significant caution with markets, noting “much pain to come for sure!”

For bullish investors looking to access the holdings of Fairfax unencumbered by hedges, this move is a significant ray of sunshine. Fairfax has seen profits hampered significantly in bull markets in the past, and forward-looking investors with a bullish perspective of the market will certainly view this change as a positive move.

Conclusion

One reason why I have followed Fairfax for so long is because of the cautious nature of the investment strategy the firm imposed, so I was shocked and distraught by the recent comments made by Mr. Watsa. In assessing this company moving forward, I will consider the fact that defensive institutional money may move away from Fairfax and will wait to see what the market’s response to this move will be over the coming quarter.

Stay Foolish, my friends.

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