The 1 Emerging Markets Idea That Will Make You Money

Description

Which of **Fairfax Financial** (TSX:FFH), **Fairfax India**, and **Fairfax Africa** (TSX:FAH.U) is performing the best so far in 2018?

Truthfully, none of them are lighting up the TSX, but of all three Prem Watsa investment vehicles, Fairfax Financial has done the best, down less than 1% year to date through October 17 compared to a 15% shellacking for Fairfax India and an even worse result for Fairfax Africa, down 24% through almost 10 months of the year.

While a case can be made why you should buy all three stocks, I'm going to focus on Fairfax Africa, because it is part of series I'm currently running on stocks down more than 20% year to date that is worth owning.

Why is FAH.U getting walloped?

If you look at Fairfax Africa's chart over the last year, you'll notice that its stock has been on a very gradual decline from almost US$16 last October to under US$11 today, barely above its February 2017 IPO price of US$10.

Legendary Canadian investor Stephen Jarislowsky once said that you often could buy an IPO 12-24 months later for less than what it sold for in the public offering. Twenty-one months into Fairfax Africa's coming-out party, it's coming perilously close to meeting Jarislowsky's prediction.

Something has to be driving this move back to $10. To figure out what that is, let's have a look at the company's most recent quarterly results.

In the first six months of 2018, Fairfax Africa lost US$983,000 compared to a US$4.3 million profit a year earlier. What stands out in the second quarter is that it had US$26.3 million in unrealized losses on its investments in the quarter along with US$25.1 million in foreign exchange losses.

The explanation for both losses is easy to account.

The value of its public and private African investments were valued at US$394.3 million at the end of the second quarter. Each quarter the investments are revalued and any unrealized gains or losses are accounted for on the income statement.

If you follow **Berkshire Hathaway,** you're probably familiar how this rule wreaks havoc with the income statement. Next quarter it could arbitrarily add US$50 million to the bottom line due to unrealized gains.

Prem Watsa is a long-term investor who doesn't care about the short-term profit swings. Neither should you.

As for the US$25.1 million loss on foreign exchange, it's a result of the weakening of the South African rand versus the U.S. greenback.

Any time you invest in emerging markets, you have to understand that this cuts both ways. At some point in the future, the rand could strengthen against the U.S. greenback, producing profits instead of losses.

Watsa doesn't spend a lot of time on this either.

The bottom line on FAH.U stock

What's important to consider about investing in Fairfax Africa is whether you think the actual business value has deteriorated by 24% in 10 months.

I don't believe it has.

In fact, if you add back the foreign currency gains and losses and unrealized gains and losses on its investments in both Q2 2018 and Q2 2017, you get net earnings of US$9.5 million and US$6.9 million, respectively, a growth rate of 38% year over year, a much better result than the generally accepted accounting principles.

So, from where I sit, Fairfax Africa is one of the best-emerging markets investments you can make money from over the next 12 months.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:FFH (Fairfax Financial Holdings Limited)
2. TSX:HFPC.U (Fairfax Africa Holdings Corporation)

PARTNER-FEEDS

1. Msn
2. Newscred
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