TFSA Investors: Should You Bet on Canada's Top Publicly Traded Hedge Fund?

Description

Fairfax Financial Holdings (TSX:FFH) is one of the most remarkable securities that trade on the TSX. It's a holding company run by Prem Watsa, the man also known as Canada's Warren Buffett, and although the company is primarily in the business of insurance and reinsurance, it's actually more like Prem Watsa's personal hedge fund.

Nice hedgie… not really!

Now, Fairfax is a holding company by definition, and it operates as a decentralized conglomerate similar to Warren Buffett's Berkshire Hathaway. Unlike Berkshire, however, Fairfax isn't a run-of-the-mill investment holding company that goes long only. Prem Watsa is an unorthodox investor, and he's a not afraid to make a bold bet if he genuinely believes in an investment idea, whether it's long or short.

Watsa, unlike many other conglomerate chiefs, isn't afraid to hedge his bets if he believes there could be dark days ahead. That way of thinking is only prudent, after all!

Before Donald Trump's presidential victory, Watsa has been pretty pessimistic on the stock market. Watsa famously bet big on credit default swaps prior to the Financial Crisis, and as a result, Fairfax came out as one of the few winners in 2008, a time when most securities lost more than half of their value from peak to trough.

Watsa doesn't have a crystal ball, however. He's only human, and he's had his blunders, most notably the overhedging that caused Fairfax to miss out on the big gains that the market clocked from 2009 to 2013. Watsa overhedged his bets to protect his shareholders from substantial downside, but doing so came at a high opportunity cost. And although Fairfax didn't plunge in value, the move made many investors question Watsa's abilities.

That's not to say Watsa isn't a smart man though. He's a deep-value investor and he really takes a page out of the book of Benjamin Graham with his investment style. He isn't afraid to make a big bet, and he isn't afraid of short positions. The man usually hedges his bets and considers downside protection with a "what could go wrong" mindset.

I know it sounds pretty pessimistic, but this way of thinking allowed his firm to navigate the last financial disaster unscathed.

Watsa's bullish… sort of

Today, Watsa is pretty bullish on Trump and his corporate tax cuts, but he's still cautiously optimistic with his US$40 million in deflation swaps that aim to protect his firm from the harmful effects of, you guessed it, deflation. It's indeed a black swan event, but given the potential for a "collapse in world trade," I think investors shouldn't shrug off Watsa's hedge against deflation, especially given the man's abilities at spotting bearish macroeconomic trends and protecting himself and his shareholders from their menacing effects.

On the investment side, Watsa has been scavenging the wreckage for opportunities both at home and around the world. Whether it's partnering with Sagard to purchase Bauer's assets, giving Toys "R" Us Canada a new breath of life or hunting down the next potential emerging markets multi-bagger, Prem Watsa is a man who's been burning the midnight oil. After Fairfax's 20% peak-to-trough flop, I think investors should be licking their chops at the entry point into a stock that I believe has a significant margin of safety.

Foolish bottom line

You're essentially getting to invest alongside one of Canada's greatest investors at a discount at today's levels.

Although Prem Watsa's track record hasn't been perfect lately due to mediocre underwriting, I think Watsa still has the investment skill to provide investors with excess risk-adjusted returns throughout the long haul through his "oddball" hedge fund-like strategy that considers the long and short scenarios, not just the long. Given today's turbulent market, I think investors should appreciate that in spite of Watsa's recent more bullish bias.

Stay hungry. Stay Foolish.

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Author
joefrenette