Long-Term Investors: 1 of the Best Stocks to Preserve and Grow Capital During Uncertain Times

Description

For long-term investors, it is paramount to find companies to invest in that are run by like-minded management teams. As an investor, I always want the managers of the companies I invest in to make the optimal decisions that will maximize shareholder value. It's important that management doesn't get caught up in worrying about quarterly targets or estimates, which end up hurting the company long term.

Prem Watsa's — "Canada's Warren Buffett" — company is a favourite among value investors because it does just that; it is specifically focused on building long-term shareholder value, primarily through growth of book value per share. **Fairfax Financial Holdings** (TSX:FFH) is a holding company that owns insurance companies alongside a large investment portfolio.

The stock has been rangebound the last few years, as the investment portfolio has underperformed relative to its long-term performance. The average return on the investment portfolio since inception is 8%, yet in the last five years it's only been 3.1%.

That may see underwhelming, especially considering the bull market the global economy has been on; However, Prem Watsa is typically a contrarian investor, and when you look at the long-term performance, the numbers are more than respectable.

Insurance

The insurance segment of Fairfax has a large global presence. It operates insurance and reinsurance businesses in over 20 countries and on all major continents. Fairfax has been criticized in the past for having sub-par underwriting; however, recently it has refined its underwriting process, and this has helped to improve its numbers.

The combined ratio measures an insurance company's profitability by dividing expenses and claims paid out over premiums received. In the last eight years, Fairfax had an average combined ratio of

98% on a whopping $61 billion in cumulative net premiums written. Recently, that ratio was even lower, coming in at 97.3%, with catastrophe losses of 6.5%. This suggests that the insurance business is getting more profitable over time.

Investment portfolio

Most investors believe what moves the stock and creates or destroys value for investors is in the investment portfolio. Currently, the investment portfolio is highly liquid, consisting of 45% cash and short-term UST bonds, 26% common stocks, 8% in two- and three-year IG Corp bonds, 7% other government bonds, 11% corporate bonds, and the last 3% is listed as other.

For Fairfax, capital preservation is the top priority. Prem Watsa is only interested in creating shareholder value through long-term compound growth in book value per share. The investment portfolio is quite large with the top 10 holdings accounting for $3.2 billion, or $118 per Fairfax share.

The low-duration portfolio is key as it brings volatility of earnings down, while also keeping liquidity available. Currently, cash and cash equivalents equate to around $260 per share.

Financials

One of Fairfax’s core guiding principles is to always be soundly financed. This is shown through a respectable net-debt/net-total-capital ratio of 18.5%. Moreover, the interest coverage ratio stands at 3.2 times. Fairfax also pays a small 2% dividend, and with a price-to-book ratio of 1.1, Fairfax is getting as cheap as it gets.

Although the investment portfolio has lagged in the past five years, the company is still among the best. The improved insurance business coupled with an investment portfolio that has delivered an incredible 33-year compounded book-value-per-share growth of 18.7%. Compare that to 7.8% for the S&P 500 over that same amount of time, and you can see why Fairfax is a clear winner.

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Date
2025/08/16
Date Created
2019/05/21
Author
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