



Safe Investing With the Warren Buffett of Canada!

Description

Fairfax Financial ([TSX:FFH](#)) is an insurance and investment holding company that owns several property and casualty insurance companies, both commercial lines and reinsurers. The company's subsidiaries operate throughout the world with significant exposure to developing economies. Fairfax has always been focused on compounding book value growth over the long term, primarily through outperformance in its investment portfolio. Fairfax holds nearly \$40 billion in investment float and can be viewed as a leveraged investment vehicle.

Fairfax's corporate objective is to grow book value by 15% per year over the long term. Under the leadership of CEO Prem Watsa over the last 34 years, the company has easily surpassed that target with 18% growth in book value.

An attractive feature of Fairfax is the company's ability to take advantage of high volatility to make smart capital-allocation decisions. Fairfax's investment portfolio has low correlation to the S&P 500 and has historically outperformed during global market panics. At present, Fairfax's valuation multiple is the lowest it has been in the last seven years. Fairfax has averaged a combined ratio of 96% between 2012 and 2019, representing low financial risk.

Although Fairfax's high underwriting leverage implies limited capacity to take on more business during stressed times, the large float should help Prem Watsa buy great companies hand over fist in a depressed market. Fairfax's portfolio has a heavy weighting in treasury bills that positions the company well in times of extreme volatility.

Traders have often criticized Fairfax's defensive approach, but Prem Watsa and Fairfax's board of directors has remained steadfast in the company's investment approach of not bowing to complaints of short-term investors. Fairfax's ample liquidity and credit default swaps should allow the firm to deploy several billions of dollars should the escalating trade war with China lead to market opportunities.

Fairfax's investment portfolio reported good results in the first quarter of 2019. The company's equity holdings increased 10% year to date modestly, behind the S&P 500. The company's bond portfolio continued to perform well and has outperformed the benchmark over the last three decades under the

stewardship of bond guru Brian Bradstreet.

Investment gains in 2019 substantially offset portfolio losses incurred in the last quarter of 2018. Fairfax continues to move capital from cash into equities on an opportunistic basis. Portfolio cash weightage has now dropped to 19% of total investments compared to 48% a year ago and is at the lowest level since 2009. The allocation to fixed income increased and higher interest rates are expected to increase investment income for the company.

Fairfax's executives have indicated an appetite to exit positions that no longer fit with the 15% book value growth objective. The company is expected to participate in significant share buybacks over the next decade, which should bode well for long-term, patient shareholders.

Some of the risks identified on conference calls include unexpected losses from one-time insurance events, foreign exchange risk due to Fairfax's large developing market exposure, miscalculation of property risks, and an underperforming investment portfolio. However, at a valuation multiple of one times book value, [the market's pessimistic view](#) on the company appears to be unwarranted. Fairfax is not complaining and has significantly ramped up share repurchases to take advantage of the company's depressed valuation!

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