



Has Canada's Warren Buffett Lost His Touch?

Description

Fairfax Financial Holdings ([TSX:FFH](#)), the investment vehicle for Canada's 43rd-richest person, Prem Watsa, has often been compared to Warren Buffett's famous holding company. Both conglomerates are powered by insurance floats and managed by investment wizards who have delivered extraordinary returns for shareholders over several decades.

Despite the similarities, investors in both companies have seen their returns deviate in recent years. While **Berkshire Hathaway** has delivered 43.7% in shareholder returns since the start of 2015, Fairfax stock has been flat over the same period. Fairfax's 2% dividend yield over that period doesn't quite make up for the gap in performance.

After four-and-a-half years of lacklustre returns, should investors throw in the towel or double down on the stock? Here's a closer look at what's happening under the hood at Fairfax.

Overly pessimistic

Watsa's bearish stance may be the root of the stock's underperformance during one of the longest bull markets in history. As American and Canadian stocks climbed to historic highs, Watsa hedged his equity holdings and bolstered bond investments, which ultimately eroded the portfolio's alpha.

The investment manager seems to have changed his outlook after Donald Trump took office in early-2017, reducing his hedges and bond holdings substantially. However, this fresh bullish stance will take a while to be reflected on Fairfax's balance sheet. There's also a chance Watsa gets his timing wrong and the market turns sour just as he bets bullish.

Looking abroad

Meanwhile, Watsa seems to be looking further afield for pockets of value. Since 2014, he has launched two new [investment ventures in India](#) and Africa, while also expanding investments in distressed Greek banks.

While the Indian venture has already delivered phenomenal returns, the African investment arm is yet to hit its stride. Eventually, Watsa's bet on these two emerging economies along with investments in distressed assets outside North America could be a source of significant alpha.

Fundamentals

The intrinsic value of any investment holding company hinges on its book value and the fair value of its assets. In its most recent quarter, Fairfax reported \$450 in book value per share. That means its stock is trading at a 39% premium to book value. Compare that to Berkshire's 42% premium to book value, and Fairfax seems fairly priced.

However, the reported book value doesn't take into account the price appreciation in the company's equity holdings and the market value of its various subsidiaries. Fortunately, Fairfax has calculated and reported this excess figure as well — \$211.2 per share pre-taxes. Coupled with the 15% return on equity Watsa claims to be aiming for, the stock seems remarkably undervalued.

This could be the reason the company has been aggressively buying back its shares in recent years.

Bottom line

Even the best investors in the world can't avoid periods of underperformance or a few bad bets. However, investors seem to have over-punished Watsa's holding company, and it is now trading below its fair value.

For investors who are optimistic about growth in emerging markets and confident in Watsa's ability to create value over the long term, Fairfax seems like the perfect opportunity at the moment.

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