How to Hedge Your TFSA Against Another Market Crash

Description

The stock market is roaring once again. It feels as though it's been a while since stocks were rolling over on the coronavirus, while a cash crunch crushed the bond market. While it's good to be optimistic, as the economy makes moves to safely re-open, investors should not grow overly complacent by looking to put all of their money to work by May. The worst of the coronavirus seems like it's over, but with Dr. Anthony Fauci warning that we "could be in for a bad fall," as another coronavirus outbreak could overlap with flu season.

Prep your TFSA for another wave of volatility

Now that investors are growing greedy once again, it may be a good time to take a little bit of profit off the table and put it to work in a hedge that'll allow your Tax-Free Savings Account (TFSA) to be better prepared for whatever happens next with this pandemic.

Now, I'm not suggesting that you make the rash decision of selling a chunk of your equities for gold. If your TFSA is overexposed to some of the riskier sectors of the market, however, it makes sense to scale into a hedge, so your TFSA will only take limited damage if the markets were to retest their March lows.

Consider shares of **Fairfax Financial Holdings** (TSX:FFH), a Canadian insurer run by legendary investment guru Prem Watsa, a man who's also known as the Canadian Warren Buffett.

Unlike Buffett, Watsa has been known to have a pretty unorthodox investment strategy. You could say he runs Fairfax more like a hedge fund and less like a traditional investment holding company through his use of various instruments to protect him and his firm from downside risks. Fairfax did a terrific job of navigating the Financial Crisis, actually coming out of the ordeal ahead of most other firms thanks to Watsa's well-timed hedges and his knack for spotting macroeconomic trends.

Unlike the Financial Crisis, nobody saw the coronavirus pandemic coming. Regardless, Watsa is the type of man you'll want to invest alongside if you're looking for downside protection in these unprecedented times. Not only is Fairfax built with downside protection in mind, but the company is also priced at a huge discount to its intrinsic value.

Fairfax teases a bittersweet quarter

Fairfax partially pulled the curtain on some of its first-quarter numbers, which included a staggering $1.5 billion in investment losses due to soured equity positions. While the numbers were alarming, it’s worth remembering that few investors escaped the first quarter unscathed and given the abrupt April rebound, Fairfax’s second-quarter results could ease worries about “losses” in Fairfax’s equity holdings.

For an insurer like Fairfax, investors should look to the underwriting performance, which has been improving of late. Fortunately, the company hasn’t been devastated by lofty insurance claims relating to the coronavirus. As we head into the latter part of the year, I’d look for Watsa to place bold bets to combat any potential downside risks as uncertainties continue to mount.

Foolish takeaway

Fairfax is a wonderful business that aims to protect shareholders from excessive downside. The undervaluation of shares (shares trade at just 0.4 times sales), I believe, adds another layer of protection for investors who are growing wary of the recent market rebound.

Stay hungry. Stay Foolish.

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