



It's Official: Why I Won't Invest With Canada's Warren Buffett

Description

Fairfax Financial Holdings ([TSX:FFH](#)) has intentionally been modeled very much like **Berkshire Hathaway**.

Led by Prem Watsa — a man many call Canada's Warren Buffett — Fairfax has been one of our country's top long-term investments. Watsa used Fairfax's solid underlying insurance operations to buy undervalued stocks, just like Buffett. The deep-value approach worked, and Fairfax grew significantly.

From 1985 to 2019, Fairfax grew book value per share from US\$1.52 to US\$486.10. That's a compound annual growth rate of more than 18% per year. I think every investor who took a chance on a young Prem Watsa back in 1985 has to be happy with that.

But things haven't been so rosy lately. COVID-19 and its impact on the economy hit Fairfax hard. The company's various insurance divisions reported huge losses, as claims piled up and expenses increased. The total loss was US\$1.4 billion, which was a 12% haircut to book value. It was one of the worst quarters in Fairfax's history.

Investors reacted to the news by sending Fairfax shares sharply lower. Before the crisis, Fairfax stock was trading at approximately \$600 per share on the Toronto Stock Exchange. These days, one Fairfax share will cost you \$384. That's a decline of approximately 35% since the start of the year.

It gets worse. Thanks to the recent selloff, Fairfax shares have basically gone nowhere over the last decade. The total return is a mere 2% per year, and that all came from the dividend. Considering the company's long-term track record, that's a very disappointing result.

I think more of the same is coming for Fairfax shareholders over the next decade. Here's why I'd avoid an investment with Canada's Warren Buffett.

Terrible stock-picking skills

Watsa's unique deep-value approach worked well when choosing stocks in the 1980s, 1990s, and

even in the first decade of the new millennium. It's been atrocious over the last 10 years.

It seems like every stock Canada's Warren Buffett touches immediately turns into a lump of coal. Fairfax is still underwater on its **BlackBerry** investment — something it has held for nearly a decade. It invested in Reitmans, which recently [declared bankruptcy](#). Many of its large U.S. investments didn't perform very well either, which was especially disappointing. Remember, the U.S. market had a fantastic decade from 2010 to 2019. Fairfax's performance lagged significantly.

Will Watsa pivot to a more successful strategy? Will a deep-value approach come back and pay off? I'm not sure, but I sure wouldn't be investing with Canada's Warren Buffett until he can show a few years of solid investment performance.

Macro bets

Watsa made Fairfax shareholders a lot of money when he bet against the U.S. mortgage market in 2008. Rather than quitting while he was ahead, Watsa has made additional macroeconomic bets. These investments have not paid off.

For instance, Watsa spent more than US\$600 million on derivative contracts that would pay out [some US\\$100 billion](#) if deflation hit certain developed economies in a big way. At the end of 2019, the fair value of these contracts was just over US\$6 million, good enough for a 99% loss.

To be fair, Fairfax has made some successful warrant and call option investments. And like I mentioned, the company made a lot of money betting against the U.S. mortgage market. But are derivatives really the best use for shareholder cash here?

It looks pretty obvious to me that Watsa should take a more Buffett-inspired approach and look to buy excellent companies at fair prices and then hold these stocks for a very long time. He should forget about speculating in the derivatives market, that's for sure.

The bottom line on Canada's Warren Buffett

Prem Watsa deserves a lot of respect for what he's accomplished. But, as the investment industry likes to say, past results are no indication of future returns. Unless Watsa changes his investing ways, this analyst thinks Fairfax will continue to disappoint going forward.

CATEGORY

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