

Smartest guy in the room on markets

Posted: October 30, 2009, 3:34 PM by Diane Francis

[Greed](#), [economy](#)



Prem Watsa and Fairfax Financial made billions on the meltdown

Property and casualty insurer Fairfax Financial Holdings Ltd. of Toronto not only weathered the greatest financial storm since the Depression, but profited mightily and continues to do so. Its 2009 third-quarter results, released Thursday -- it earned US\$562.4-million, up from US\$467.6-million a year ago, while revenue increased to US\$2.21 billion from US\$2.16 billion -- reflected its steady hand at the helm. Yesterday, founder, chairman and CEO Prem Watsa talked with me about the results and future financial conditions.

Q. In March, when markets turned, you hedged 25% of your equity portfolio (after removing hedges in late 2009) why?

A: “Stock prices have gone up considerably from March 2009, 50% to 60%, but we continue to test parameters. **We look at the biggest potential risk such as a drop in stock markets of 50% and, at the same time, a one-in-250 catastrophe in the insurance world such as a US\$100 billion natural disaster. This would be a hurricane hitting Miami or a major earthquake in California.**”

“**By hedging 25% of our equity portfolio with a short at 1062 on the S&P 500 index we reduced our exposure so that we can better absorb both those events with basically no impact on our cash in our holding company. That’s the type of protection we like to provide our shareholders and company with.**”

Q: One commentator noted that Fairfax's stock has declined by 3.4% this year, why?

A: "We are long-term investors and our company is a long-term investment. Short term fluctuations are market driven and not value driven. **We began in 1985, 24 years ago, with US\$30 million in assets and about US\$7.5 million of shareholders' capital. Today, coincidentally, we have US\$30 billion in assets and US\$7.5 billion in shareholders' equity. That's up 1,000 times. Our per share book value has grown from US\$1.50 to US\$372. Our stock price has gone from C\$3.25 to between C\$375 and \$390 a share. These are all long-term results.**"

"We are thankful for our track record. More recently our book value in 2006 was US\$150 a share and now, as of end of September, it is US\$372 a share, more than double and the stock price has naturally followed suit. Over time the book value and the stock price tend to go together."

Q: There is talk of TARP2 or another bailout for the 100 regional American banks whose industrial/commercial mortgages are seriously under water? Will this affect Fairfax's underlying property and casualty businesses?

A: "We don't think it has much of an impact on our business but it might have an impact on the economy, on bank lending. It might mean economic slowing and, with interest rates low, and a US\$1.5 trillion deficit, you and I might say 'I wonder how much more ammunition governments have? Government cannot revive economic recovery on its own. Private sector spending is required and we are not seeing it yet.'"

"Bailouts like TARP and stimulus programs are what Japan did in the 1990s and the net takeaway is that the nominal GNP of Japan over 20 years has remained flat...which is not the end of the world. Japan built bridges to nowhere, as you know, and spent a lot of money but the economy didn't respond. **If the current administrations continue to stimulate dramatically we might have the Japanese experience for a period of ten years. You have to worry about that.**"

Q: What is your view of commodity, Canadian dollar and TSX outlook?

A: "I don't think a lot of our industries can survive the Canadian dollar being close to par. And **with commodities, if history teaches us anything it's to be careful, oil has gone to US\$33 a barrel, US\$80 now and US\$145 at peak. Commodities are highly volatile and unpredictable.**"

Q: You are in India today, and were born there, how is it doing?

A: "The Indian economy has come back up in spades. This country has recently built the interstate road system which took forever because of their bureaucracies. Now, however, **economic development is spreading out of the biggest cities like it did in the United States one hundred years ago.** India is looking at growth of 8% - potentially

even 10% - next year. Our Indian company, **ICICI Lombard**, was started from nothing less than ten years ago we have **26% ownership of it**, and today it is underwriting almost US\$1 billion. It is **the largest property and casualty insurer in India and the potential is huge. Only 1% of all homes are insured.**”

Q: Bubbles are developing in a lot of asset classes, so what do you continue to bet long-term on?

A: “We like the stocks that we have such as Johnson & Johnson, Wells Fargo. Our thinking is that the stronger get stronger and good management will prevail. Look at the commercial/industrial mortgage problem. There are 100 regional banks in this and say they all go bankrupt. That means there’s opportunities for strong banks like Wells Fargo who can buy regional or smaller banks for cheap.”

Q: You have raised equity capital and privatized two insurers are there more acquisitions in the future?

A: “On the M&A front, we have options available to us but our first priority is to always keep our financial condition strong. That also means keeping capital available for a hard market. We can buy stock, make some acquisitions, if, as and when it makes sense.

We have no plans to make any but we could and we could hold significant amounts of cash if we decide to pay some dividends out of our insurance operations. We had a nominal dividend last year of \$8 a share. We will look closer at our dividend strategy at the end of the year.”

Read more:

<http://network.nationalpost.com/np/blogs/francis/archive/2009/10/30/smarter-guy-in-the-room-on-markets.aspx#ixzz0Vn5u5x8z>

The New Financial Post Stock Market Challenge starts in October. You could WIN your share of \$60,000 in prize. [Register NOW](#)