

Time to Buy ~ May 2009!



By Brian Madigan LL.B.

Here are a series of articles dealing with market timing all published in May 2009. In part, there are references to Prem Watsa, Warren Buffet suggesting that the time is right to start looking for business opportunities. It should be noted, they did not mention real estate, and what's more, their comments can not really be taken to support the

acquisition of any particular local property.

TIME to Buy!

Well, it's over! It's now "time to buy".

I know that everyone has been waiting for that advice. And, I have it on good authority. Canada's own Warren Buffet, **Prem Watsa** pointed out to the Fairfax AGM that the worst is over. The stock market has found its bottom. The recession is not over, but the worst news is behind us. It's now time to look to the future.

You might well recall that Prem Watsa's Fairfax Holdings was the only company to increase its value in the stock market since October 2008 crash.

Prem Watsa has been investing in securities that would take advantage of failures in the US banking industry, and the financial services industry. At one time he was one voice in the wilderness, but now, he has the voice that everyone wants to listen to.

Watsa's point is simply that the worst is over. So, you should now be looking for **good opportunities**. *That doesn't mean buy anything and everything right now.* You have to do your own "due diligence". You must be careful. You must investigate. And, remember just about all the stock market gurus got it wrong. That includes Warren Buffet the world's richest stock market investor, Ben Bernanke the current head of the Federal Reserve and Alan Greenspan the former head of the Federal Reserve. Yet, for the last five years this is precisely what Prem Watsa has been saying.

But, don't forget that Prem has made some mistakes too. He bought Torstar, Can-West Global and Abitibi-Bowater, all at prices that were somewhat optimistic by current standards. So, nobody's perfect!

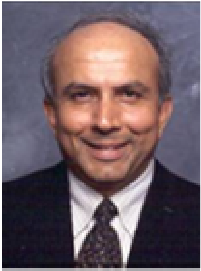
However, one thing that I can say for sure is that Prem Watsa does his homework

before the deals are done. Sometimes, projections, descriptions, assumptions just don't work out. So, place your bets accordingly.

Diversify and don't put all your eggs in one basket.

Note: Fairfax AGM, April 2009

Some Comments from Prem Watsa ~ April 2009



By Brian Madigan LL.B.

Since the drastic drop in the stock market and the world financial crisis, Prem Watsa has been the “go market guru”. After all, he bet on this crash 5 years ago.

In October 2008, Prem Watsa was the voice of doom and gloom:

- You were wondering about a buying opportunity? Forget it
- Think instead about a long and deep global recession
- Think about stocks crashing “50 per cent in Canada or the United States from their highs
- It was nothing less than the end of “a 20-year phenomenon of excess optimism
- So I don't think we should expect it [to be over in] six months

That was six months and by mid April 2009, Prem is saying “It's over.” This does not mean the recession but the decimation of stocks, corporate bonds, bank loans, mutual funds, house prices, oil, and nearly every other asset, which sent investors piling into government bonds and gold, is over.

Watsa now explains:

- pessimism is rampant
- Because you'd need a cattle prod to get the typical retail investor to buy a global equity fund
- Risk “is not being repriced, it is repriced
- You're getting paid for taking risk. For the longest time, you weren't
- Fairfax has sold most of its government debt – now 16 per cent of the \$20-

billion investment portfolio, down from half in 2007. In its place are mortgage debt, municipal debt and stocks

- Fairfax owns more shares now than at any time in its 23-year history
- Fairfax is not hedged against a falling market this time
- Fairfax's blunders on CanWest Global and Torstar haven't deterred him. Mistakes happen
- Look at the other opportunities
- Johnson & Johnson, a fabulous company that a decade ago traded for 40 times earnings and has habitually traded for at least 20, now sells for about 12
- Kraft Foods is down 37 per cent since the early days of the credit crunch, though earnings have barely budged. Fairfax owns both
- Do people stop buying Oreos in a recession? Do they cease to need Band-Aids? No. They stop buying cars
- We think the next five years, maybe 10, are going to be good for value-oriented investors
- It might be just exactly the right time to have a buy-and-hold strategy
- None of which is to say that the market won't fall again, or that we are past the worst in the economy
- Higher unemployment is a sure thing
- It's just that, barring another Depression, most of the bad stuff is already priced in

Watsa predicted a 50-per-cent market drop? From last summer's peak to the low of March 9, the S&P/TSX composite declined 49.8 per cent.

“You can be sure,” Mr. Watsa said, “we're having a lot of fun in the office these days.”

So, those are some of his current views:

- 1) Buy good companies, and
- 2) Hold them for a longer term.

That's good advice, and the same is true for the real estate market.

Note: Prem Watsa is current the Chancellor of Waterloo University.

Comments: as reported in the Globe and Mail 16 April 2009.

Prem Watsa Interview



By Brian Madigan LL.B.

Since this is such a rare interview, I thought that I might reproduce it in its entirety as it appeared in the National Post.

Interview with Fairfax chief Prem Watsa

Diane Francis, Financial Post Published: Thursday, February 19, 2009

The year 2008 will go down as one of the worst for the economy, but it was the best year in the history of Canada's Fairfax Financial Holdings Limited.

Chairman and CEO Prem Watsa and his team were among the few money managers who forecasted, and profited, from the economic catastrophe.

As a result, Fairfax has become one of North America's 10 largest property and casualty companies. Fairfax is a significant investor in Canwest Global Communications Corp., publisher of the National Post.

Here are the highlights of its 2008 financial results.

- Fairfax's 2008 earnings were US\$1.4-billion, making it Canada's most profitable corporation.
- It posted record investment gains of US\$2.72-billion.
- Book value increased by 21%.
- The year ended with US\$1.56-billion in cash or cash equivalents in Fairfax's treasury.
- Common shareholders' equity rose to US\$4.9-billion from US\$4.1-billion.

The net investment gains were the result of shorting stock indices, hedging existing common stock positions, buying credit default swaps (a form of insurance against bond decreases) and profits from sales of U.S. government bonds.

What's most interesting, however, about Fairfax's huge success is its avoidance of any counter-party risk in terms of its credit default swaps. In other words, Fairfax bought these swaps from the world's three pre-eminent banks and required full collateralization. Others, by contrast, have found that the party who insured the bond prices went under and the profits with it.

In an exclusive interview with Prem Watsa on Thursday we talked about the future, what stocks he has begun to invest in and other opportunities.

Q How did you avoid the counter-party risk with these swaps?

A "We worried about the collateral that these people would have and the possible bankruptcy of banks and our counterparties. So we did these with Citibank, Deutschebank and Barclays Bank. We also, unlike anybody else, were concerned about this and the banks thought we were crazy. We wanted them to collateralize their obligation to us so they put treasuries into an account in our name, held in trust, in order to backstop their obligations to us. At one point, the collateral was US\$1-billion. We had very little counter-party risk because we dealt with Citibank, which the US government would not let go under; with Barclays, which the U.K. would not let go under; and Deutschebank, which Germany would not let go under. But even if Citibank went bankrupt, we had the collateral. We also bought tradeable contracts so that we could sell them through the bank into the marketplace.

"We sold US\$12.6-billion of these swaps, the cost was US\$271.5-million and we're shocked at how much we got, which was US\$2.2-billion. The remaining US\$8.87-billion cost US\$161-million and have a value of US\$415-million.

"We think the major gains in the CDS contracts are over."

Q Does that mean you believe the markets are at the bottom?

A "Bottom? Stock prices are down 50%, credit spreads are very wide in the U.S., and Obama has come with a very significant stimulus plan. The Treasury Secretary has a very thoughtful way of handling the banks and yet no one believes it's the bottom.

"Today we've some of the biggest actions by the U.S. government in terms of stimulus, interest rates at zero and nobody believes it'll have any impact."

Q What has to change to get out of this?

A "We still have to worry about deflation because, remember, while Obama and the U.S. government are spending this money, the rest of the economy - businesses and individuals - are deleveraging. We are saving, not expanding capacity; people are scared. It's also important to note that the U.S. federal government is only 20% of the economy. It's spending, but 80% of the economy is deleveraging.

"Demand is the issue and what we have to worry about. Also remember that in the last five years, half of the increase in consumer spending in the U.S. was home equity loans borrowed against appreciation of homes. And that's all gone.

"The ultimate test is will the 80% start spending and we will not know that for some time."

Q So does that mean it won't and that you are not investing again yet?

A "We have been negative on common stocks for four or five years, and hedged our positions. But we stopped hedging in November 2008 and have bought long-term valuable, big companies with good, tested management such as Johnson & Johnson, Dell Computers, Kraft Foods, Wells Fargo, Intel and others. We believe these will pay off five years from now. We also like corporate and muni [tax-free municipal bonds] bonds.

"U.S. municipal bonds always sold at a lower yield than U.S. treasuries because one is tax-free and the other is taxable. In the fourth quarter, we were able to sell treasuries, yielding pre-tax 3% to 3.5%, and have been buying munis yielding an average of 5.75% after tax. This is unheard of. We bought munis guaranteed by Berkshire Hathaway [Warren Buffett's company]."

Q Will inflation come roaring back with all the spending by governments?

A "It's a potential problem in the future but right now the problem is demand - excess capacity all over the place. It will be a worry a few years from now but not currently."

Q How long will it take for fear to disappear?

A "The U.S. reacts quickly, as opposed to Japan. But it's a question of pessimism, which means it's not a bad time to buy for the long term. We could have four or five years of difficult times. We really don't know."

Q Some call this the end of capitalism. What do you think?

A "No I don't see that. Obama believes in private markets. But we had 20 years without a recession, because of monetary policy, which is why this one is so severe. Recessions take out the excesses in the system by slowing things down, lowering stock market and housing values so interest rates come down and the correction occurs. But for 20 years we didn't have that."

Warren Buffet is Buying!



By Brian Madigan LL.B.

That should be good news. Warren Buffet, the world's most successful stock market investor, investment guru, and economic philosopher is looking to buy. That's what he told 35,000 shareholders who attended the annual meeting of Berkshire Hathaway, the investment holding company that he manages.

And, the price of admission isn't cheap. Anyone who bought shares in Berkshire Hathaway likely spent over \$100,000 to buy one share.

The recent trend for the stock has not been good. Investments in the oil business immediately before the sharp drop in oil prices were not helpful. Yes, even "gurus" make mistakes! The trend in 2009 has not improved much: Berkshire shares are down 5% this year and 31% from a year ago.

Here are a few quick comments made at the AGM by Warren Buffet, Chairman and Charlie Munger, the Vice-Chairman:

- Berkshire Hathaway is ready to make a deal at the right price
- B-H has nothing in its shopping cart right now
- Berkshire has \$20 billion in cash and is "perfectly willing to make a deal that's compelling"

- Buffet expects the troubles that laid the markets low last year to pay off for Berkshire shareholders in the future
- Munger said that those judging the firm's performance by short-term swings in its stock "are acting like fools"
- "If you think we're in trouble because the stock price went down, you don't understand what's going on," (Munger)
- Berkshire has been running what he described as "Andrew Carnegie's playbook" - referring to the steel tycoon's practice of grabbing market share from weakened competitors that run short of cash during economic downturns

So, all in all, that's fairly good news. Berkshire Hathaway has a war chest and its looking for good deals **NOW**.

Note: The AGM comments were made 3 May 2009.

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