Prem Watsa is upbeat because everyone else is not

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Early last October, with the financial markets in the grip of a post-Lehman seizure, Prem Watsa was the voice of doom. 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," he said. "So I don't think we should expect it [to be over in] six months."

He warned us. That was six months and 10 days ago. What's the renowned investor saying now? "It's over."

Don't misunderstand. He's not talking about the recession. It's still nasty, still going and will grind on for many months, as any honest interpretation of yesterday's survey of business conditions by the U.S. Federal Reserve Board would tell you. But the savage beating of stocks, corporate bonds, bank loans, mutual funds, house prices, oil, bubble-gum cards and nearly every other asset, which sent investors piling into government bonds and gold, may be done. The 22-per-cent rally since March 9 may indeed be an early sign of a financial spring thaw.

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Fairfax Financial's AGM

BNN speaks with Prem Watsa, chairman and chief executive office of the holding company

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Why? Because, as Mr. Watsa puts it, "pessimism is rampant." Because you'd need a cattle prod to get the typical retail investor to buy a global equity fund. Because the Elgin Theatre in Toronto was packed – packed! – last week for Eric Sprott's "Night with the Bears," at which one of the panelists predicted, astonishingly, that the Dow Jones industrial average would fall to 1,000, or 93 per cent from its peak. And, even more astonishingly, was taken seriously.

"If you had done [that event] a year ago, you might have had 10 people attend," Mr. Watsa told the throng at the annual meeting of Fairfax Financial [FFH-T], an insurance and investment company that he controls.

That line drew a few guffaws in the crowd, which otherwise spent much of the three-hour affair congratulating Mr. Watsa on his boffo performance and themselves for their prescience in buying the shares. Fairfax investors have always tended to be of the true-believer variety, but now they've arguably put their chairman on a higher pedestal than ever before. He did call it, after all.

Years ago, at this same meeting, he talked about the growth of junk consumer debt, the hazards of securitization, and the lassitude of the credit agencies, who seemed all too prepared to give triple-A ratings to mortgages or car loans backed by deadbeats in return for big fees. Fairfax – beset by its own debt problems at the time – hunkered down. It hoarded government bonds, bought a form of credit insurance against vulnerable U.S. and European banks and financial companies, hedged its stock portfolio against a decline and waited for the implosion. And waited.

When it finally came in mid-2007, Fairfax made a killing. It has since earned more than $2-billion on the credit insurance bet alone, and its huge stash of government bonds rallied in the flight to safety. But now that's over and the big money has been made.

Risk "is not being repriced, it is repriced," Mr. Watsa said. "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, yes, stocks. The company owns more shares now than at any time in its 23-year history, Mr. Watsa said, and they're 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," Mr. Watsa said. "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.

One other thing. Remember his prediction of 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.”

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