Q2 2013 Earnings Call

Company Participants

- Dave Bonham, CFO
- Paul Rivett, President
- Prem Watsa, Chairman and CEO

Other Participants

- Jeff Fenwick, Analyst
- Mark Dwelle, Analyst
- Paul Holden, Analyst
- Tom McGinn, Analyst

Presentation

Operator

Good morning. Welcome to Fairfax 2013 Second Quarter results conference call. Your lines have been placed in a listen-only mode. After the presentation, we will conduct a question-and-answer session.

(Operator Instructions)

For time's sake, we ask that you limit your questions to one. Today's conference is being recorded. If you have any objections you may disconnect at this time. Your host for today's call is Prem Watsa, with opening remarks from Paul Rivett. Sir, you may begin.

Paul Rivett {BIO 15243791 <GO>}

Good morning. Welcome to our call to discuss Fairfax's 2013 Second Quarter results. This call may include forward-looking statements. Actual results may differ, perhaps materially, from those contained in such forward-looking statements, as a result of a variety of uncertainties and risk factors. The most foreseeable of which are set out under risk factors in our base shelf prospectus filed with Canadian securities regulators. I now turn the call over to our Chairman and CEO, Prem Watsa.

Prem Watsa {BIO 1433188 <GO>}

Thank you, Paul. Good morning, ladies and gentlemen. Welcome to Fairfax's Second Quarter conference call. I plan to give you some of the highlights, and then pass it on to Dave Bonham, our CFO, for additional financial details. In the first six months of 2013, book value per share decreased 1.6%, adjusted for the $10 per share dividend paid in the First Quarter of 2013. We had a strong and much improved underwriting result in the Second Quarter, and the first half of 2013 on increased premiums, while maintaining disciplined underwriting. We are maintaining our defensive equity hedges as we continue to remain concerned about the financial markets and the economic outlook. We continue to be soundly financed with quarter-end cash and marketable securities at the holding company in excess of $1.2 billion.

Net premiums written by the Company's insurance and reinsurance operations in the Second Quarter of 2013, increased by 1.6% after adjusting for a large property quota share reinsurance contract at OdysseyRe. The combined ratio for our insurance and reinsurance operations in 2013 was 94.2% for the Second Quarter and 94.1% for the first half. At the subsidiary level, net premiums written in quarter two 2013 and combined ratios were as follows. OdysseyRe, after adjusting for the quota share contract, are up 8.1% with a 85.9% combined ratio. Crum & Forster, premiums were down 9.7% or close to 10%, with 102.1% combined ratio. Crum & Forster had a decrease in premiums because of re-underwriting done on standard lines in the second half of 2012. Northbridge was up 5.2% with 100.4% combined ratio. Zenith up 15.2% with a 95.6% combined ratio.

This is the First Quarter Zenith had a combined ratio below 100% since we acquired it in 2010, reflecting significant rate increases and some reserve redundancies. Fairfax Asia was up 10% and had a 90.7% combined ratio. We continue to grow depending on the Company. As we have said before, very low interest rates and the reduced reserve redundancies, means there's no place to hide for the industry. Combined ratios have to drop well below 100% for the industry to make a single-digit return on equity with these low rates. While the short term is always tough to predict, fundamentals will eventually play out.

Net investment losses of $415.7 million in the Second Quarter of 2013, consisted of the following. Please note table on page two of our press release. Net gains on equity and equity-related investments of $71 million was after a small loss on our equity hedge. After unrealized mark-to-market bond losses of $496 million, $16 million in unrealized CPI-linked derivative losses, and other gains of $26 million, we had a net loss of $415.7 million -- all unrealized. Because of rising interest rates in the quarter, we had approximately $500 million in unrealized mark-to-market bond losses, which consisted of $400 million from state and muni bonds, a majority of which are insured by Berkshire Hathaway, and approximately $100 million from long US Treasuries. We consider these unrealized bond losses as fluctuations and expect them to reverse over time.

Our muni bond portfolio was mainly acquired in the last quarter of 2008 at an after-tax yield of 5.79%. Realized gains from stocks and bonds during the quarter were $171.4 million, and $336.7 million in the six months of 2013. The Company held in excess, as I said before, of $1.2 billion of cash, short-term investments and marketable securities at the holding company level at June 30, 2013. Finally, we continue to be approximately 100% hedged in relationship to our equity and equity-related securities, which include convertible bonds and convertible preferred stock. Any movements above or below 100% are balanced in the following quarter. We continue to be very concerned about the prospects for the financial markets and the economies of North America and Western Europe, accentuated, as we have said before, by potential weakness in China.

As we have said now for some time, there continues to be a big disconnect between the financial markets and the underlying economic fundamentals. As of June 30, 2013, we have over 29% or $7.5 billion in cash and short-term investments in our portfolios to take advantage of opportunities that come our way. In the short term, our investment income will be reduced. Now, I would like to turn it over to Dave so he can give you some more information on the underlying financials. Dave?

Dave Bonham {BIO 15243784 <GO>}

Thank you, Prem. First, I'll focus on Fairfax's consolidated results for the Second Quarter of 2013, and then I'll move on to the operating Company results, and, finally, finish up with the consolidated financial position. For the Second Quarter of 2013, Fairfax reported a net loss of $158 million, or a net loss of $8.55 per share on a fully diluted basis. That compares to the Second Quarter of 2012, when we reported net earnings of $94 million, or net earnings of $3.79 per share on a fully diluted basis. On a year-to-date basis, the Company reported net earnings of $4 million, that translated into a net loss of $1.32 per diluted share in the first half of 2013, and the net loss on a per-share basis results because earnings per share is calculated after deducting preferred share dividends.

That compares to net earnings of $91 million in the first half of 2012, or $3.04 per fully diluted share. Our underwriting results have shown significant improvement in the first half of 2013. In the Second Quarter and first six months, our insurance and reinsurance operations reported combined ratios slightly above 94%, and our underwriting profit was $84 million, and $170 million during those respective periods. Our combined ratios in the Second Quarter and first six months of 2012, were approximately 98%, and our underwriting profits were $33 million and $49 million during those respective periods. So that's about a 4-point improvement in the combined ratio year over year, which reflects, in 2013, increased net favorable development of prior year's reserves, partially offset by higher catastrophe losses.

In terms of reserve development, we experienced $106 million and $142 million of net favorable development prior year's reserves in the Second Quarter and first six months of 2013. And that benefited our combined ratio by 7 points and 5 points during those respective periods. In the Second Quarter and first six months of 2012, we experienced approximately $50 million of net favorable development, which benefited our combined ratio by 4 points and 2 points, respectively. Excluding the benefit of net favorable development, our accident year combined ratios were 101.6% and 99% in the Second Quarter and first six months of 2013, and that compared to 101.2% and 100.1% in the Second Quarter and first six months of 2012. In the Second Quarter of 2013, we also had catastrophe losses of just under $112 million, and that added about 8 points to the Second Quarter combined ratio.

In the first half of 2013, we had catastrophe losses of $144 million, and that accounted for 5 points on the combined ratio in the first six months of 2013. As mentioned by Prem already, net premiums written by our insurance and reinsurance operations increased in the Second Quarter and first half of 2013 by 1.6% and 3.6%, prior to giving effect to two unearned premium portfolio transfers at OdysseyRe, related to a specific quota share reinsurance contract. I wanted to note for you that page 39 of our Second Quarter interim report contains a detailed discussion of these transactions, including their impact on OdysseyRe and on Fairfax in general. Now turning to our operating Company results and we'll start with OdysseyRe, in the Second Quarter and first six months of 2013, Odyssey reported underwriting profits of $79 million and $174 million, and combined ratios of 85.9% and 84.4%.

Underwriting profit in the Second Quarter of 2013 was comparable to the underwriting profit in the same period in the prior year, but reflected higher net favorable development of prior year's reserves, partially offset by higher catastrophe losses. Underwriting profit in the first half of 2013 increased by about $37 million, principally reflecting higher net favorable development of prior year's reserves. Catastrophe losses in the Second Quarter and first six months of 2013 of $57 million and $89 million added 10 points and 8 points to the combined ratios of OdysseyRe in those respective periods. And that was higher than the catastrophe losses of $31 million and $54 million in the Second Quarter and first six months of 2012. The flooding in central Europe and the flooding in Alberta reduced OdysseyRe's underwriting profit by $23 million and $15 million, respectively, in each of the Second Quarter and first six months of 2013, as these were both Second Quarter events.

OdysseyRe's combined ratio in the Second Quarter and first six months 2013 included the benefit of $36 million, or 7 points, and $54 million, or 5 points, of net favorable development of prior year's reserves, principally related to net favorable emergence on prior year's catastrophe losses. OdysseyRe wrote $502 million of net premiums in the Second Quarter of 2013, down from $620 million in the Second Quarter of 2012. That's a decrease of 19.1%, or about $119 million. The decrease of $119 million included the effect of the two significant unearned premium portfolio transfers, one inwards transfer, which occurred in the Second Quarter of 2012, and another outwards transfer in the Second Quarter of 2013. They both related to a significant Florida quota share reinsurance contract. Without these portfolio transfers, net premiums written increased by 7.8% and 11.4% in the Second Quarter and first six months of 2013. And for more details, please see page 54 of our Second Quarter interim report.

Moving on to Crum & Forster. Crum & Forster's underwriting results on a year-over-year basis improved modestly in the Second Quarter of 2013, and with a more noticeable improvement in the first six months of 2013. And that's on lower operating expenses, higher net premiums earned, and the absence of net adverse reserve development in 2013, whereas the first six months of 2012 included 1 combined ratio point, or $5 million of net adverse development of prior year's reserves. Crum & Forster reported underwriting losses of about $6 million in each of the Second Quarter and first six months of 2013, and that compared to underwriting losses of $7 million and $22 million in the Second Quarter and first six months of 2012. Current period catastrophe losses had a nominal impact on Crum & Forster's combined ratios, which were 102.1% in the Second Quarter, and 100.9% in the first six months of 2013. Net premiums written by Crum & Forster in the Second Quarter and first six months of 2013 decreased by 9.7% and 7.7%, primarily reflecting lower standard lines gross premiums written, specifically a reduction in workers' compensation business, and that was partially offset by higher specialty lines and gross premiums written.

Zenith reported significant improvements in its combined ratio, which decreased from 116.4% and 117% in the Second Quarter and first six months of 2012, to 95.6% and 102.6% in the Second Quarter and first six months of 2013. The improvements reflected the following -- year-over-year decreases of 11 and 8 points in the accident year loss ratios in the Second Quarter and first six months of 2013, and that reflected earned premium price increases that were in excess of estimates of loss trends; secondly, net favorable development of prior year's reserves of 6 and 3 points in the Second Quarter and first six months of 2013, and that development primarily related to the 2012 accident year; and, finally, decreases in the expense ratio of 4 points and 3 points in the Second Quarter and first six months of 2013, and that was as a result of 16% and 14% increases in net premiums earned year over year.

Net premiums written by Zenith of $144 million and $430 million in the Second Quarter and first six months of 2013, increased year over year by 15% and 13% reflecting premium rate increases. Northbridge also reported a significant improvement in its combined ratios, which decreased from 106% and 105% in the Second Quarter and first six months of 2012, to 100.4% in each of the Second Quarter and first six months of 2013. The improvement in the first half of 2013 reflected increased net favorable development of prior year's reserves, partially offset by higher year-over-year current period catastrophe losses. Northbridge's combined ratio included the benefit of net favorable development of prior year's reserves across most accident years and lines of business, of $54 million, or 22 points, in the Second Quarter of 2013, and $62 million, or 13 points, in the first half of 2013. And that compared to net favorable development of $21 million, or 9 points, and $27 million, or 5 points, in the Second Quarter and first half of 2012.

Catastrophe losses in the Second Quarter and first six months of 2013 of $34 million related to the Alberta floods, and added 14 and 7 points to the combined ratios during those respective periods. In contrast, catastrophe losses in the Second Quarter and first six months of 2012 were approximately $6 million, and added 2.1 and 1.3 points to the combined ratios during those periods. After adjusting for the impact of the inter-company unearned premium portfolio transfer between Northbridge and group Re that we described in the First Quarter and which is explained in more detail on page 47 of our Second Quarter interim report, net premiums written by Northbridge increased by 4.7% and 5.4% in the Second Quarter and first six months of 2013, reflecting modest growth in writings at Federated and Northbridge insurance, and increased premium retention following the termination of that inter-company quota share reinsurance contract. Fairfax Asia's combined ratio increased modestly from 88.8% and 90.4% in the Second Quarter and first six months of 2012, to 90.7% and 90.9% in the Second Quarter and first six months of 2013.

Net premiums written by Fairfax Asia increased by 10% and 6.9% on a year-over-year basis in the Second Quarter and first six months of 2013, principally as a result of increased writings of property and workers' compensation lines of business, and that was partially offset by a reduction in writings related to Marine Hall. The combined ratios of the insurance and reinsurance other division improved from 100.7% in the Second Quarter of

2012 to 100.2% in the Second Quarter of 2013, and improved from 101.7% in the first six months of 2012 to 99.3% in the first six months of 2013. Runoff reported pretax losses of $129 million and $143 million in the Second Quarter and first six months of 2013. That compared to pretax profits of $79 million and $132 million in the same periods in the prior year. The year-over-year decrease in profitability primarily related to net investment losses in the Second Quarter of 2013.

A gain on a significant reinsurance commutation partially offset by net reserve development in US runoff also contributed to runoff's pretax result in the first six months of 2013. Our consolidated interest and dividend income increased from $106 million in the Second Quarter of 2012 to $112 million in the Second Quarter of 2013. The increase primarily reflected lower total return swap expenses as a result of the timing of a dividend payable on a short equity index total return swap derivative contract that was partially offset by lower investment income earned. The effect of lower investment income earned in the first half of 2013 was more pronounced, and resulted in a decrease in our interest and dividend income from $235 million in the first half 2012 to $212 million in the first half 2013.

Rounding out our review of the income statement, the Company recorded a recovery of income taxes of $150 million, and $202 million in the Second Quarter and first half of 2013. The effective tax rates implicit in these recoveries of income taxes are higher than our statutory tax rates for two main reasons. The first, we incurred significant pretax losses in the US where tax may be recovered at the 35% statutory income tax rate in the US, and that's a substantially higher rate than the Canadian statutory rate of 26%. And secondly, we continue to receive a considerable amount of non-taxable investment income in the form of interest income on our US municipal bonds, inter-corporate dividends on common stocks, and certain net capital gains in Canada, where 50% of the gain is not taxable.

For further details, I will draw your attention to note 14 on pages 20 and 21 of our Second Quarter interim report, where in addition to our customary income tax rate reconciliation, we have added a table showing the breakdown of our pretax earnings and losses by jurisdiction and the tax provision attributable to each of those jurisdictions. We ended the quarter with an investment portfolio which included holding company cash and investments of $25.2 billion compared to $26.1 billion at the end of 2012. A significant portion of the decrease related to the effect of foreign currency translation vis-a-vis the strengthening of the US dollar, relative to many of the currencies in which Fairfax's non-US dollar investments are denominated, as well as the unrealized depreciation on the Company's bond portfolio.

Moving to our financial position, our total debt to total capital ratio increased to 27% from 25.5% at December 31, 2012, due primarily to additional debt issued net of repurchases in the First Quarter of 2013, and the decrease in our common shareholders equity during the first six months of 2013. We have $183 million of OdysseyRe debt maturing in the fall of 2013, which we funded by the issuance of debt in the First Quarter of 2013. After repayment of the OdysseyRe debt in November, on a pro forma basis, our debt-to-capital ratio is expected to return to approximately 25.8%. Now, I'll pass it back over to you Prem.

Prem Watsa {BIO 1433188 <GO>}

Thank you, Dave. Now, we'll be happy to answer your questions. Please give us your name, your company name, and try to limit your questions to only one so that it's fair to all on the call. Okay, Theresa, we are ready for the questions.

Questions And Answers

Operator

(Operator Instructions)

Jeff Fenwick, Cormark Securities.

Q - Jeff Fenwick {BIO 15350794 <GO>}

Prem, I wanted to focus my questions in on the US P&C area. Obviously some clear signs of hardening in different parts of the market down there. That's benefited Zenith in particular. I wanted to ask you about Crum. Crum has been going through looks like a transition towards more specialty lines and that's making it tough to grow premiums overall. When do you think that process is complete and do you get a sense that it's positioned to benefit from some of the hardening that we're seeing today in the US?

A - Prem Watsa {BIO 1433188 <GO>}

Jeff, that's a good question. Crum as I said re-underwrote bids, particularly its workers comp and standard lines in the second half of 2012. So as we go into the second half you're going to see an improvement. I'd say you're exactly right when you say they're transitioning from standard lines to specialty lines. We are also being careful on the excess and surplus lines, making sure that we're -- that's it's a profitable business. So I'd say in the next -- as long as the market conditions remain, that we would see some growth in the six months to a year. The marketplace, it's not a traditional hard market. But there's 5% or 10% price increases broadly available. Property prices, particularly exposed to catastrophe, are down of course from very high levels. But we see Crum continuing to expand in the specialty lines area.

Q - Jeff Fenwick {BIO 15350794 <GO>}

And I guess Prem, along with that, you're seeing I think some opportunities to grow through M&A. And you announced your agreement with ASI in the quarter. That was followed up with a bid from another player at a higher level. What's the process from here? Does ASI take that -- that goes back to the board to deliberate, can you just elaborate on what the steps are going forward from here?

A - Prem Watsa {BIO 1433188 <GO>}

Yes. What happens is that -- that just came on Friday, of course, Jeff. So what happens is the Board has to deliberate on this offer. They have to get a firm offer of course, and then they have to contact us. From our standpoint, and as you would expect, we're reviewing all our options and we'll just wait for the Board to get back to us.

Q - Jeff Fenwick {BIO 15350794 <GO>}

And anything broadly speaking, do you think there's perhaps some other M&A opportunities in the US market here, just with things not quite back on -- on a hard market yet, is that still an area where you may see some other opportunities.

A - Prem Watsa {BIO 1433188 <GO>}

Jeff, over 28 years, I've said this to you before, you never can tell when these opportunities come. We bought the Hartville as you know, pet insurance company. If you had asked me a year ago, I probably wouldn't have been able to say that, that would have happened or American Safety. So we are opportunistic and we look at opportunities as they come our way. But as I said before, we've got a very diversified book of business. Globally diversified. And we have extremely good management running our Companies.

So in the proper environment we have -- which means prices are going up, we have the ability to expand significantly. So we don't need to do any acquisitions. We like where we are. And we'll wait for -- we're long-term in our thinking, long-term in building our Company, and so we'll react to opportunity when it comes our way.

Q - Jeff Fenwick {BIO 15350794 <GO>}

Thank you, I'll re-queue.

Operator

Paul Holden, CIBC.

Q - Paul Holden {BIO 6328596 <GO>}

Prem, I wanted to ask you on the reinsurance side, it looks like the July 1 renewals were a little bit soft. And looks like that's an important period for Odyssey based on the seasonality of its premiums written. So wondering what your experience was with Odyssey with respect to the July 1 renewals.

A - Prem Watsa {BIO 1433188 <GO>}

First of all, Paul, Odyssey's got a worldwide spread of business. It's got many, many dials that it can move up or move down. The property side, the prices have come down 10%, 15%, maybe a little more, and this is cat exposed property business. So as you'd expect, Odyssey is writing less of it. Still profitable but writing less of it. But the other business is holding steady and they've had excellent combined ratios and we like where Odyssey Re's positioned Paul.

Q - Paul Holden {BIO 6328596 <GO>}

Thanks. One additional question. Following the flood losses in Canada, both Alberta and Toronto, some of your competitors are indicating that maybe we should expect a hardening of rates in the primary property market. Is that consistent with what you would expect at Northbridge?

A - Prem Watsa {BIO 1433188 <GO>}

Yes. If history's any guide, when you have these significant losses, and the numbers have yet to come out in terms of being firm for Alberta, but might well be the biggest loss we've had in Canada, and when you have these type of losses then prices have to go up to make up. Many, many companies will have significant losses. We had our share as we've disclosed to you both at the Northbridge level as well as at the Odyssey level. So I think you'll see re-insurers raising their rates and eventually the primary companies will do the same. That's just historically what happens.

Q - Paul Holden {BIO 6328596 <GO>}

Okay. Thank you very much.

Operator

Tom McGinn, BMO capital.

Q - Tom McGinn {BIO 20541399 <GO>}

A question with respect to Crum. Seems like the premiums are going down due to a reduction in workers comp and then you go to Zenith and they're going up because you get an increase in workers comp. Are you just trying to write more of the overall Fairfax business in Zenith instead of Crum? What's necessarily happening there?

A - Prem Watsa {BIO 1433188 <GO>}

I think Zenith is getting price increases. If you look at Zenith's business, they'll tell you that some of the areas like Los Angeles are very, very competitive and they wouldn't be writing business there. Their combined ratios in Los Angeles for Zenith would be above 100% and they make up in other areas. So what Crum's doing is just getting off areas where they think combined ratios are much higher and it's similar to what Zenith is doing. So it's not different from what Zenith's doing.

But Zenith is a specialized insurance Company in California, has been doing that for a long time and Zenith's price increases now in California have been very significant. But even Zenith you'll note, Tom, have increases that's equal to rate increases. So there's not a lot of volume above the rate increases. So Zenith is very careful as they get these price increases. Their renewal rates are very high, in excess of 90%. But they're not writing a lot of new business because the business has been priced at very low rates and so they're very sensitive to getting appropriate rate increases before they expand and -- but they are expanding. Their combined ratios are 95% in the quarter, 95.6% in the quarter, but they're basically running around 100% if you take out the reserve redundancies that we had in the Second Quarter.

Q - Tom McGinn {BIO 20541399 <GO>}

And I noticed that Zenith has traditionally been a contributor to hold co capital but in this quarter I think you put capital into Zenith. What's the reason behind that?

A - Prem Watsa {BIO 1433188 <GO>}

We just put a little, Tom, $10 million, just in terms of keeping levels at where we think was appropriate. But Zenith has enough capital and the capital models have risk charges for all sorts of items which we figure by the end of the year will normalize. At any point in time, we might have to contribute $10 million or $5 million or whatever and then we normalize it. Because there's lots of charges for the regulatory models and once we get a sense for that, those charges, then we normalize it. But wasn't significant and Zenith is well-capitalized and we expect Zenith -- if the opportunity continues, we'll write a lot more business.

Q - Tom McGinn {BIO 20541399 <GO>}

Finally, if I could just squeeze one more with the ASI and the counter bid, would you be able to share with us any of the -- I don't know if there's any potential break fees associated with the deal or the complexities involved because I believe you are selling a piece then of ASI to the Tower Group. How does that fit into this process?

A - Prem Watsa {BIO 1433188 <GO>}

Break fees are, Tom, quite simple, as disclosed in the proxy. It's 9 million, 9.5 million in that area. There's 10 million shares outstanding so it's about $1 a share. That's what it is. This came out on Friday and so as I said earlier that we are reviewing our options and looking at what the possibilities are.

Q - Tom McGinn {BIO 20541399 <GO>}

Thanks very much.

Operator

Mark Dwelle, RBC Capital Markets.

Q - Mark Dwelle {BIO 4211726 <GO>}

Question I wanted to ask about was related to the CPI linked derivative contracts. The notional amount outstanding on that has increased 50% from year end. It's now reached the point where it's really double the size of the overall balance sheet. I understand the concept of protecting the balance sheet. I guess what I'm interested in understanding more about is the size of the notional position because it kind of ceases to be a hedge, it starts becoming kind of a directional call. And I was wondering if you could talk about that a little bit.

A - Prem Watsa {BIO 1433188 <GO>}

We have about $523 million invested in it, at cost, I think at market it's a fraction, like $120 million, something like that, it is a fraction. And it's got eight years to go. It has eight years to go, and in nominal terms it's about as you pointed out $75 billion, but of course you'll never get $75 billion. That means 100% loss, right. We figure maybe 5% or 10% in the extreme case, not 100%. So you can't compare that $75 billion to our total assets. Half of it is US, half of it is European. It's an -- we think of it as, Mark, like what we're thinking today and I'll just highlight it for all of you on the call, we said it before, there's a big disconnect between financial markets and economic fundamentals. So what do I mean economic fundamentals?

You look at the stock market, you think things are -- the economy is roaring along. Look at the First Quarter of 2013 for the United States. The first number, GDP, came out at 2.4%, revised down to 1.8%, ultimately revised down to 1.1%. Quarter four 2012 came out at 0.4%, revised down to 0.1%, basically flat. The last five quarters on average are at 1.4%. Each quarter. So that means it's a very tepid economic growth and on top of that you have -- if you take core inflation, excluding energy and food, it's the lowest in 50 years.

Now, you look at these two facts and think about the fact that you've had QE1, QE2, QE3, and you've had huge stimulus in the United States, and you've had such weak growth and no inflation to speak of. Now, if the economy stumbles or if China has a problem and there's all sorts of concerns about China as you all know, and Europe continues to be flattish, we worry about things like that and we worry as we said to you for some time about deflation. Everyone's worried about inflation and have been worried for five years. Remember two things, and we've said that in our annual meeting. One, it took five years for deflation to set to come in Japan. After the bubble broke in 1989, it was 1995 that deflation set up, began, and then for the next 17 out of 18 years you had deflation in Japan.

And the second is just because we're all here very big fans of Ben Graham. Ben Graham said in 1925 -- in the '30s he said, after the crash, after the Depression took hold, that if you want bearish in 1925, it was a 1 in 100 chance you would survived the Depression, 1 in 100 chance. If you went bearish long before 1929, meaning 1925, there's was a very small chance you survived. So we are very concerned. We don't take this lightly. We're watching it very, very carefully. If we had a hedge we'd make another $500 million something like that. We could easily buy corporate bonds. We've been in the business for 40 years and we're stepping away. We think we're not being paid for risk so we're stepping away from the marketplace. I'll remind you that in 2008, 2009 when the stock markets were down we were fully invested and when spreads were wide we bought corporate bonds and we bought all sorts of bonds.

But today, we think there's a significant amount of risk and we think you have to be very, very careful and there's all sorts of unintended consequences in the marketplace, because of what's happening in the United States particularly but perhaps elsewhere. And so this is our way of protecting ourselves like we did with our credit default swaps and just being very, very careful.

Q - Mark Dwelle {BIO 4211726 <GO>}

Thanks very much for that Prem. That's a helpful overview of your portfolio and your outlook. I'll stop there. Thanks.

Operator

(Operator Instructions)

A - Prem Watsa {BIO 1433188 <GO>}

If there are no more questions, thank you all for joining us on this call and we look forward to presenting to you again for the next quarter. Thank you very much.

Operator

This concludes today's conference call. Thank you for your participation.