Q1 2016 Earnings Call

Company Participants

- David James Bonham
- Eric P. Salsberg
- Vivian Prem Watsa

Other Participants

- Binoy Jariwala
- Gower Ramesh
- Mark Dwelle
- Paul Holden
- Tom MacKinnon
- Zack Perry

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and welcome to Fairfax's 2016 First 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. 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 Rick Salsberg, Mr. Salsberg, you may begin.

Eric P. Salsberg {BIO 1552007 <GO>}

Yes. Good morning. And welcome to our call to discuss Fairfax's 2016 first 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 cited under Risk Factors in our Base Shelf Prospectus, which has been filed with Canadian securities regulators and is available on SEDAR.

I'll now turn call over to our Chairman and CEO, Prem Watsa.

Vivian Prem Watsa {BIO 16700363 <GO>}

Thank you, Rick. Good morning, ladies and gentlemen. Welcome to Fairfax's first quarter conference call. I plan to give you some of the highlights and then pass it onto Dave Bonham, our CFO, for additional financial details.

In the first quarter of 2016 book value per share increased 1.4% adjusted for the $10 per share common dividend paid in the first quarter of 2016. Our insurance companies had an excellent first quarter with a combine ratio of 93.1% with excellent reserving and significant underwriting profits of $122 million.

All of our major insurance companies, again, had combined ratios of less than 100%, with Fairfax Asia at 76.5%, Zenith at 83.4% and OdysseyRe at 90.3%. First quarter operating income was very strong at $247 million, offset by net investment losses in the quarter of $160 million which arose primarily as a result of stock price fluctuations and foreign currency movement.

Excluding all hedging losses and before mark-to-market fluctuations in our investment portfolio, and excluding realized gains and losses, we had pre-tax income of $164 million. Including all hedging losses and mark-to-market fluctuations in our investment portfolio, we reported after-tax loss of $51 million in the first quarter of 2015.

Our insurance and reinsurance business volume was up in the first quarter by 20%, primarily due to Brit, while the combined ratio for our insurance and reinsurance operations, as I said, was 93.1%.

At a subsidiary level, the combined ratios in the first quarter was OdysseyRe, 90.3%; Crum & Forster, 97.6%; Northbridge in Canadian dollars, 98.6%; Zenith, 83.4%; Fairfax Asia, 76.5%; and Brit was 96%. As we have said before, very low interest rates and reduced reserve redundancies means there is no place to hide for our industry. Combined ratios have to drop well below 100% for the industry to make a single digit return on equity with these low interest rates. While the short-term is always tough to predict, fundamentals will eventually play out.

Net investment losses of $160 million in the first quarter consisted of the following. Please refer to page two of our press release. Net losses on equity and equity-related investments of $444 million, resulting from the net losses of $336 million and $108 million net loss on our equity hedge due to stock fluctuations and losses on our hedges. Stock fluctuations in three stocks, BlackBerry, Eurolife, and Bank of Ireland accounted for most of the net losses of $336 million in common stocks.

We have realized losses of $34 million on our equity and equity-related holdings in the first quarter of 2016, of which $68 million was the result of APR Energy being taken private. We continue to hold APR Energy and expect these losses will reverse in the future. This was offset by realized gains on our equity hedges of $32 million. Also, we had gains of $433 million, primarily on our treasury and municipal bond portfolio, because of the impact of dropping interest rates.

The loss on other, principally foreign exchange, was primarily offset by the translation gain on foreign exchange income, comprehensive income on our balance sheet. As we have mentioned in our annual meetings, annual reports and quarterly calls with IFRS accounting, where stocks and bonds are recorded at market and subject to mark-to-market gains and losses, quarterly and annual income will fluctuate wildly and investment results will only make sense over the long term.

Our CPI-linked derivatives with a notional value of approximately $112 billion produced unrealized losses of $55 million in the first quarter. The majority of these contracts, as you know, are based on the underlying U.S. CPI index or the European Union CPI index. Further information is available on page three of our press release, where we've included a table on our deflation swaps.

On average, they have 6.3 years to run. As I've said before, with deflation in the air, these contracts have come to light but they are very volatile. They can change dramatically, quickly, as we saw in the first quarter.

When you review our statements, please remember that when we own more than 20% of a company, we equity-account; and when we own more than 30%, we consolidate, so that mark-to-market gains in these companies are not reflected in our results. As you can see on page 11 of our quarterly report, the fair values of our investment in associates is $2.8 billion, which has a carrying value of $2.4 billion, and unrealized gain of over $0.4 billion not on our balance sheet.

In March, Fairfax India agreed to acquire a 33% equity interest in Bangalore International Airport from a wholly owned subsidiary of GVK Power and Infrastructure Limited for approximately $325 million. Fairfax India, given its current investment restrictions, will invest $250 million and Fairfax will invest the remainder.

Subsequently, we acquired another 5% from the Zürich Airport. The transaction is expected to close in the second or third quarter of 2016. In April, Fairfax India agreed to invest approximately $300 million in Sanmar Chemicals Group through a combination of equity, representing a 30% ownership interest, and debt securities.

Fairfax India, given the same investment restrictions I mentioned earlier, will invest $250 million and Fairfax, or another investor, will invest $50 million within 90 days after the expected closing of Fairfax India's investment in the second quarter 2016. Sanmar is one of the largest PVC manufacturers in India. After these two investments, Fairfax India will have invested approximately $870 million of the approximately $1 billion raised from the initial IPO in early 2015.

Also in the first quarter, Cara entered into an agreement to acquire 100% interest in St-Hubert for approximately C$537 million or $415 million US closing of this transaction is expected to occur by the end of the third quarter of 2016. St-Hubert is the Province of Québec's leading full service restaurant operator, as well as a fully integrated food manufacturer. After this investment, Cara will be the third largest restaurant group in Canada.

Cara completed a private placement offering of subscription receipts at a price of C$29.25 per receipt for gross proceeds of approximately C$230 million, or $179 million that will form part of the finance equity acquisition of St-Hubert.

Each subscription receipt entitles the holder to receive one Cara subordinate voting share upon closing of the St-Hubert acquisition. Fairfax and its subsidiaries purchased approximately C$102 million, or $79 million to maintain Fairfax's equity interest and voting interest in Cara.

In March, Fairfax completed an underwritten public offering of $1 million subordinate voting shares at a price of C$735 per share, realizing proceeds of approximately $705 million, or $523.5 million, net of commissions and expenses. Also in March, the company completed an underwritten public offering of C$400 million, principal amount of 4.5% senior notes due 2023, realizing proceeds of approximately $303 net of commissions and expenses.

Proceeds from stock and bond issue will be used to finance our investment ICICI Lombard, Eurolife and for other corporate purposes. Now 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 many said many times before, by the potential weakness in China and emerging markets.

Again, as we have said now for some time, we believe that there continues to be a disconnect between the financial markets and the underlying economic fundamentals. We see the potential for major dislocations in the marketplace with many significant unintended consequences, and we want to protect your company from them.

As of March 31, 2016, we have $6.3 billion in cash and short-term investments in our portfolio, which is approximately 20.9% of our total investment portfolio to take advantage of opportunities that come our way. As a result, in the short term, our investment income will continue to be reduced.

Now, I'd like to turn it over to Dave Bonham, our CFO, so he can give you some more information on the underlying financials. Dave?

David James Bonham {BIO 15243784 <GO>}

Thank you, Prem. So, the first quarter of 2016, Fairfax reported a net loss of $51 million, or a net loss of $2.76 per share on a fully diluted basis. And that compared to the first quarter of 2015 when we reported net earnings of $225 million, or $9.71 per share fully diluted.

Underwriting profit at our insurance and reinsurance operations decreased slightly to $122 million at a 93% combined ratio, compared to underwriting profit of $127 million at 91% combined ratio this quarter of 2015, a decrease in underwriting profit of $5 million year-over-year.

Our combined ratio benefited from net favorable prior year reserve development in the first quarter of 2016 of $86 million, translating into 4.8 combined ratio points, slightly higher in dollar term than the net favorable development of $68 million in the first quarter of 2015, which represented 4.6 combined ratio points.

Current period catastrophe losses in the first quarter of 2016, all of which were attritional, totaled $31 million, or 1.8 combined ratio points and were slightly higher than cat losses in the first quarter of 2015, which totaled $28 million, or 1.9 combined ratio points.

So, now turning to our operating company results, we'll start with OdysseyRe. In the first quarter, OdysseyRe reported an underwriting profit of $45 million and a combined ratio of 90%, and that compared to an underwriting profit of $58 million and a combined ratio of 89% in the same period last year. Catastrophe losses in the first quarter, again all of which were attritional, totaled $27 million, translating into six combined ratio points and that was slightly higher than cat losses of $23 million, which translated into four combined ratio points in the first quarter of 2015.

Net favorable prior year reserve development of $35 million, or 8 combined ratio points in the first quarter of 2016, principally related to property catastrophe loss reserves, and that was higher than in the first quarter of 2015 when Fairfax reported – or when OdysseyRe reported $11 million, or 2 combined ratio points of net favorable prior-year reserve development.

OdysseyRe's net premiums written decreased by 14.2% to $484 million in the first quarter of 2016, and that was reflecting the non-renewal of a Florida property quota share reinsurance contract that we mentioned in the past. It also reflected the unfavorable impact of foreign currency translation on Odyssey's EuroAsia division and lower writings generally across several lines of business due to competitive market conditions.

Moving on to Crum & Forster. Crum & Forster reported an increased underwriting profit of $10 million at a combined ratio of $98 million in the first quarter, and that compared to underwriting profit of $5 million at a combined ratio of 99% in the first quarter of 2015. There was no net prior year reserve development or significant current period catastrophe losses in the first quarters of 2016 or 2015.

Crum & Forster's net premiums written increased by 17% in first quarter, reflecting broad based growth across most of its lines of business, the incremental contributions from the acquisitions that are made last year and the impact of reduced re-insurance costs.

Zenith. Zenith reported an underwriting profit in the first quarter of $31 million at a combined ratio of 83%, and that compared to underwriting profit of $40 million, a combined ratio of 78% in the first quarter of 2015. The change in 2016 reflected lower net favorable development year-over-year, $24 million in the first quarter of 2016, or 13 combined ratio points, and that development reflected in net favorable emergence on the accident year 2012 to 2015, and that compared to $36 million or 20 combined ratio points of net favorable development in the same period last year.

The second driver was a year-over-year decrease of 1.2 combined ratio points in the estimated current accident year loss ratio, and that was due to favorable loss development trends for accident year 2015 that are emerging now in 2016. That was partially offset by estimated loss trends for the 2016 accident year, and modest price decreases that are now beginning to become reflected in that premiums earned. Net premiums written by Zenith of $328 million in the first quarter increased by 6% year-over-year, reflecting an increase in exposure, partially offset by modest price decreases.

Northbridge reported an underwriting profit of $3 million and a combined ratio of 99% in the first quarter of 2016, and that compared to an underwriting profit of $6 million and a combined ratio of 97% in the same period last year. The decrease in Northbridge's underwriting profit principally reflected higher underwriting and commission expenses, partially offset by the impact of higher net premiums earned and favorable non-catastrophe loss experienced related to the current year. And that was primarily due to improved results in commercial automobile and personal property lines of business. Net prior year reserve development and current period catastrophe losses were nominal in both the first quarters of 2016 and 2015.

In Canadian dollars terms, net premiums written by Northbridge in the first quarter increased by 10%, and that was reflective of increased renewals and new business, modest price increases across the group and the impact of reduced reinsurance costs.

Fairfax Asia reported an improved underwriting profit of $12 million at a combined ratio of 77% in the first quarter, and that compared to an underwriting profit of $6 million at a combined ratio of 91% in the comparable period for 2015.

Net premiums written by Fairfax Asia decreased by 14%, and that reflected lower writings at First Capital in Marine Hull, Health, Engineering and Workers Compensation lines of business and also reflected that the impact of a loss portfolio transfer, Pacific Insurance, which reduced net premiums written by $16 million, partially offset by increased retention in First Capital's Commercial Automobile line of business.

The insurance and reinsurance other segment produced an underwriting profit of $8 million at a combined ratio of 93% in the first quarter of 2016, and that compared to an underwriting profit of $11 million and a combined ratio of 91% in the same period last year. The lower underwriting profit principally reflected lower net premiums earned, as well as the inclusion of Colonnade Insurance, which is our newly formed Eastern European operation.

Net premiums written by the insurance and reinsurance other segment decreased by 27% in the first quarter of 2016, reflecting the non-recurring impact in the first quarter of 2015 on Polish Re of the QBE loss portfolio transfer. There Polish Re reported net premiums written and incurred losses in its income statement and that was both equal to the value of the loss reserves that they assumed in that portfolio transfer.

The decrease in the insurance and reinsurance other segment also reflected the impact on Group Re of the cancellation of an intercompany quota share agreement in the fourth quarter of 2015 between Group Re, Fairfax Asia and the unfavorable impact of foreign currency at Fairfax Brazil.

The runoff operating loss of $15 million in the first quarter of 2016 was comparable to its operating loss of $13 million in the same period in 2015, and there were no significant transactions to report in the first quarter of 2016.

Looking at our consolidated results, consolidated interest and dividend income increased from $114 million in the first quarter of 2015 to $153 million in the first quarter of 2016 that reflected increased holdings of higher yielding government bonds year-over-year and the impact of consolidating Brit's portfolio investments.

Due to our small base of pre-tax income in the first quarter of 2016, we had an unusually high effective tax rate, which primarily reflected losses that we incurred mainly at the holding company that we do not capitalize on our balance sheet as deferred tax assets, because the recognition criteria under IFRS are not met. And the effect of that is partially offset by the benefit to our effective tax rate of non-taxable investment income.

And moving to our financial position, our total debt to total capital ratio increased to 23.4% at the March 31 2016 from 21.8% at December 31, 2015. And that was primarily as a result of the issuance of the C$400 million principal amount of 4.5% unsecured senior notes in the first quarter, and that was somewhat offset by the increase in our common shareholders' equity that resulted from the issuance of 1 million subordinate voting shares, and those were principally to finance the investments in ICICI Lombard and Eurolife. We ended the quarter of 2016 with an investment portfolio, which included holding company cash and investments of $29.6 billion, compared to $29 billion at the end of 2015.

And now, I'll pass it back over to you, Prem.

Vivian Prem Watsa {BIO 16700363 <GO>}

Thank you, Dave. Now, we are very happy to answer your questions. Please give us your name, your company name, and try to limit your question to only one so that it's fair to everyone on the call. So, Bob, we're ready for the questions.

Q&A

Operator

Our first question is from Paul Holden from CIBC. Your line is open.

Q - Paul Holden {BIO 6328596 <GO>}

Thank you. Good morning.

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Hey, good morning, Paul.

Q - Paul Holden {BIO 6328596 <GO>}

Wondering if you're able to comment at all on your exposure, if any, to cat events that have taken place so far in Q2, thinking specifically of the earthquakes in Japan and then Ecuador?

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Yeah, Paul, on the earthquake in Ecuador and in Japan, very minimal losses for us. In Ecuador, I think it'd be fair to say - earthquake insurance is not really available, so the insured losses, even though the total losses will be significant, insured losses are very minimal. And in Japan, our reading is it's not significant for us.

Q - Paul Holden {BIO 6328596 <GO>}

Okay. Good to know. Thanks for that. And then, Prem, as part of your prepared remarks, you pointed two, three specific equity investments that led to the loss in the quarter. And did I hear it right that it was BlackBerry, Bank of Ireland and then Eurolife?

A - Vivian Prem Watsa {BIO 16700363 <GO>}

I am sorry. You're watching exactly what I'm saying, so hearing it properly. No, it's Eurobank.

Q - Paul Holden {BIO 6328596 <GO>}

Eurobank, okay.

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Eurobank, Paul, sorry, but that is Eurobank. Eurolife of course is a private company and we're in the process of closing that purchase.

Q - Paul Holden {BIO 6328596 <GO>}

Right, which is I wanted to ask. Okay, that's all the questions I had. Thank you.

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Terrific Paul. Thank you very much. Bob, next question.

Operator

Our next question is from Mark Dwelle from RBC Capital Markets. Your line is open.

Q - Mark Dwelle {BIO 4211726 <GO>}

Yeah, good morning. A couple of questions. First on the Bangladesh (sic) [Bangalore] Airport deal. Is that something that's going to be consolidated in the other affiliates line, or is that going to be below the threshold that it will just be another equity investment or whatever you would call that?

A - Vivian Prem Watsa {BIO 16700363 <GO>}

I'll pass it on to Dave on that. Dave?

A - David James Bonham {BIO 15243784 <GO>}

Yeah, from what we know now that will be in equity accounted investment, and it will reside in the other reporting segment as part of the Fairfax India column.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay. Second question is, it looks like you added fairly substantially to the fixed income portfolio in the quarter. I thought some of that was just regular appreciation, but were there any – did you do anything with the duration there, or maybe just some color on where you made the addition?

A - Vivian Prem Watsa {BIO 16700363 <GO>}

We, during the quarter, Mark, we added to US Treasury Bonds, long US Treasury Bonds and reduced our cash positions. So, what you see is mainly the increase in US Treasury Bonds.

Q - Mark Dwelle {BIO 4211726 <GO>}

And the last thing I wanted to add is really just maybe an observation or an open-ended question you don't need to answer, but I was wondering whether if Fairfax would consider reporting some type of a number that might be regarded as an operating income number. As you noted at the beginning, there is so many quarters where there such volatility in the investment portfolio. It seems that the net income number has a tendency to obscure what have been absolutely terrific results in the insurance units.

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Yeah. I know your point is well taken. Mark our operating income, which is underwriting profit, from the 93% combined and interest in dividend income is $247 million, which is a very good number. And I've said in our annual meeting and annual reports that IFRS skews these numbers, positive or negative, because you got fluctuations. There's always fluctuations in stock prices, fluctuation in bonds. Until you realize it, till you really realize them, or in some cases if you're holding them for a long time, on a quarter-by-quarter, or perhaps even on a yearly basis, it doesn't make any sense. We've sort of tried to give you that by looking at operating income, but we'll look at it again, Mark. That's a good observation that you have. We'll look at it again. We tend to – on page 31 of our quarterly statement, which is a very nice way to look at it, we show you underwriting profit and we show you the interest in dividend income, we show you what happens in the run-off area and non-insurance businesses we show you – so it's broken down and then we show you the unrealized swings, show you the realized gains, that page 31 is a good (27:11)

Q - Mark Dwelle {BIO 4211726 <GO>}

I like page 31 quite a bit. Maybe there is a way that it can be included within the press release to get it more visibility rather than just in the supplement.

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Other than keeping it buried in the quarterly report. Okay, no, we'll think about that Mark.

Q - Mark Dwelle {BIO 4211726 <GO>}

Thanks very much. (27:31)

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Thank you. Next question Bob?

Operator

Thank you our next question is from Tom MacKinnon from BMO Capital. Your line is open.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Yes, thank you. Good morning Prem and Dave.

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Good morning Tom.

A - David James Bonham {BIO 15243784 <GO>}

Good morning.

Q - Tom MacKinnon {BIO 2430137 <GO>}

A bit more of maybe bit of a detailed question, maybe Dave might be able to help but I found the $108 million equity hedge loss a little bit confusing in the quarter, especially given that the Russell 2000 was down a little bit in the quarter? So...

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Yes.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Just what contributed to the hedge loss in the first quarter?

A - Vivian Prem Watsa {BIO 16700363 <GO>}

That's a very good question. That's a very good question, Tom. Very simply we – as we said in our press release at year-end, we added to our Russell position, meaning we increased our short position to about a 100% in – in that quarter. And our timing wasn't the best and so the Russell moved up after we increased our short position, so that's part of it.

And the other part of it, Tom, was very simply some individual names that we shorted went up. And so, the combination of the two resulted in about $100 million, we'd like to say fluctuation, but that's what it was for the quarter.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. That's great. And also you noted a $642 million of net cash received in connection with the shorts in the quarter. That seems a little high. Maybe just help me understand some of the mechanics of those things? Or is it settled every – are they settled every quarter?

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Yeah. Dave can answer that, Dave?

A - David James Bonham {BIO 15243784 <GO>}

I think it kind of dovetails with what Prem just mentioned in the fact that the Russell 2000 declined significantly inter-quarter and the timing of the settlements of cash kind of corresponded to when the Russell came down to its lowest point. So, we've received a lot of cash in and then kind of mid-quarter from there the Russell proceeded back up. So, a lot of that reversed, and that's what you're seeing in the overall mark-to-market losses on the (29:49)

A - Vivian Prem Watsa {BIO 16700363 <GO>}

And in fact there we have a payable, I guess, of approximately $600 million, which reflects that I guess.

A - David James Bonham {BIO 15243784 <GO>}

That's right. So, a lot of that cash that we received in the quarter is now accrued to be paid out if market conditions don't change.

A - Vivian Prem Watsa {BIO 16700363 <GO>}

If the market conditions hold here, Tom, we would be paying that money out.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. So, you've got cash in when you settled those things inter-quarter but the movement since you increased your positions, you didn't have to settle that in cash, is it?

A - Vivian Prem Watsa {BIO 16700363 <GO>}

No. no, it's like what is that Dave? Every 30 days or 90 days?

A - David James Bonham {BIO 15243784 <GO>}

Yeah. Some of them are 30 days, some of them are 90 days. Yeah.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay.

A - Vivian Prem Watsa {BIO 16700363 <GO>}

30 days, 90 days, depends when it comes in and then, of course, over the course of the year it balances itself off, but in any particular quarter you could get inflows and outflows.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. Great, thanks for that explanation. That helps. Thanks.

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Thank you Tom. Next question, Bob.

Operator

Thank you. Our next question is from Gower Ramesh from Picton Mahoney. Your line is open.

Q - Gower Ramesh {BIO 19735681 <GO>}

Hi good morning.

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Good morning, Gower.

Q - Gower Ramesh {BIO 19735681 <GO>}

Thanks for taking my question. So, I was just wondering, with central banks kind of increasingly running out of bullets to prop-up the global economy, the US GDP data that came out yesterday was the weakest in two years. Would you be thinking about increasing your position on the CPI-related put options, or are you happy with where you are right now on that?

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Yeah, Gower. That is a very good question. Yeah, the US GDP was weak, Gower, as you said. Today the European numbers came out, they're weak. In Europe, there was deflation of about minus 0.2%, I think, year-on-year for April. And so, we're in a deflationary environment, and we have weak economic growth, and the worry, we've said for some time, is with all of this QE1, QE2 and QE3 in the United States and then followed by Europe and followed by Japan, and negative interest rates in Japan and a whole bunch of negative interest rates in Europe. I mean, I think more than half the German (32:12) market is now negative.

And so, in spite of all of that, the economy is very weak. If we go into a recession and after six, seven years of economic growth, it won't be unusual if we go into a recession, our view has been for some time that we have no bullets, we have no ammunition. And that's all in a setting where, as you know, China has got many markets that it's trying to support, the foreign exchange market, the bond market, the real estate market and, of course, the stock market.

So, you have that problem and you have a lot of debt that's been raised in the United States. So, the banks we think are relative safe, because they've gone through some tough times in 2008 – 2007, 2008, 2009 but the risk now is in mutual funds. So, there is a lot of high-yield debt in mutual funds, there's a lot of corporate bonds, and there's emerging market bonds all in mutual fund setting, where you can have redemptions at any time.

So, we think, Gower, that – that's what I said, there's many unintended consequences. And we're happy with our position. I mean, it's more than $100 billion that we have. They can increase and decrease. In the quarter they went through $400 million interim in terms of market value. I remember the credit default swaps, and I mentioned it in our Annual Report between June 2007 and February 2008. That's February, that's not September when Lehman went under. Our credit default swaps went from $200 million to $2 billion, ten times, and that's like in an eight month period. So, these things can change dramatically. We're happy with our position but we have no plans to add to it but, of course, we keep ourselves flexible, but thank you for mentioning that point, Gower. Bob, next question.

Operator

Thank you sir. Our next question is from Zack Perry from Vine Street Capital. Your line is open.

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Good morning, Zack.

Q - Zack Perry {BIO 21697762 <GO>}

Yeah, good morning. Thanks for taking the questions. You partially answered this question from the gentleman before. I fully appreciate your rationale and reasons for worries about deflationary pressure with all the excess spending in emerging markets in China and the debt. But it's always good to ask the other side of the question, if you look at the US, with the Fed seemingly on hold, there actually seems to be a lot of inflationary pressures from wages, from rents, basically the American public maybe (35:22) of the things you need to buy, there seems to be lot of inflation. Do you think about that at all in terms of the risk given your position on deflation? Or do you think that's strictly transitory at this point in time?

A - Vivian Prem Watsa {BIO 16700363 <GO>}

No, Zack, that's a good question. We watch it carefully, of course. But as we look and see, there' no real pressure on wages yet. Velocity of money – we looked at velocity, we talked about that in our annual meeting. Velocity of money in the United States, in Europe and in Japan are coming down significantly, and that happens when you've got too much debt in the system.

There're too much debt in the United States; there's a lot of debt in Europe, even more than the US in terms of percentage of GDP; and then, Japan of course is the highest. So, you're not able to get inflation going, because if velocity of money is just plummeting – and the last time it did that was in the 1930s in the United States.

And so, we watch it and we examine it, but it seems to us that it hasn't impacted that yet. And it's an interesting thing. Most recently this is being shown with interest rates going down, negative interest rates and interest rates going down, the Federal Reserve and the ACB and the Japanese Bank of Japan, they are expecting people to spend more, but just the opposite is taking place.

So, in Sweden, if you look, and you can see statistics there, interest rates saving – interest rates in banks and deposit rates have come down significantly and, on the other side, savings rates have gone up dramatically in Sweden. And we're seeing it in different places because you have to save more money if interest rates are lower to have the same type of income, and so that's contrary to what people expect, what the Federal Reserve expects and what the other central banks expect.

So, there's a lot unintended consequences. We worry about them, we want to protect our company from these problems, and we want to survive them. And because we've got this deflation swaps, we expect to make quite a bit of money also in that connection. But thank you for your question, Zack. Bob next question?

Operator

Our next question is from the Binoy Jariwala from Sunidhi Securities & Finance Ltd.

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Good morning, Binoy.

A - David James Bonham {BIO 15243784 <GO>}

Good morning.

Q - Binoy Jariwala {BIO 15214317 <GO>}

Good morning, Prem. And thank you for the opportunity for the question. My question pertains to one of the subsidiaries, which is Thomas Cook India. On the financials, you've mentioned that you've taken an asset impairment of approximately $13.8 million. Could you share something more on this? And secondly, your thoughts on how is Thomas Cook

India performing? Is it as per your expectations, exceeding your expectations, how is it doing? Thank you.

A - Vivian Prem Watsa {BIO 16700363 <GO>}

No, thank you, Binoy. Yeah that $13.8 million, as you know, was an impairment of Sterling. It was accounts receivable. It was a surprise, and they follow the traditional accounting policies in the industry, but they felt that it was not conservative. They got right on top of it under the Ramesh Ramanathan and took a hard look at it and decided - we're always, Binoy, when we see a problem, we react and we take our heads upfront, and that's what Ramesh did, and it's a good thing. In terms of - and then he can forward and build his business in Sterling as we go forward.

Thomas Cook under Madhavan Menon has (39:43) foreign exchange and the travel business. And that business over time, because in a country like India, travel is going to increase significantly, over time that's going to do very well. And we like Madhavan and what he has done. We bought Kuoni, which is a major competitor and he has integrated it very well. This happened recently. We like the Sterling Resorts and the possibilities as we go forward in India. And then on top of that, we've got Quess, as you know and the Quess has I think publicly said that they will be going public in the next few months. And that's a very good company run by Ajit Isaac. And Ajit has built an outstanding company. So, when you look at Thomas Cook and its various parts, we remain very optimistic for the longer term for the future. We always do things for the long-term basis. We don't really care about quarterly earnings, Binoy, but we think overtime it will do very well. But thank you for that question. Bob, next question?

Operator

At this time we have no further questions.

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Well, if there are no more questions, thank you all for joining on this call. We look forward to presenting to you again in the next quarter. Thank you, Bob.

Operator

That concludes today's conference. Thank you for participating. You may now disconnect.