Q2 2016 Earnings Call

Company Participants

- David James Bonham
- Unidentified Company Representative
- Vivian Prem Watsa

Other Participants

- Jeffrey Fenwick
- Mark Dwelle
- Mikel Abasolo
- Paul Holden
- Tom MacKinnon

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and welcome to Fairfax's 2016 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. 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 Gladwyn Saba (0:37). Mr. Saba (0:38), you may begin.

Unidentified Company Representative

Good morning and welcome to our call to discuss Fairfax's 2016 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, which has been filed with Canadian Securities regulators and is available on SEDAR.

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

Vivian Prem Watsa {BIO 16700363 <GO>}

Thank you, Gladwyn (1:14). 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 half of 2016, book value per share increased by 3.2% adjusted for the $10 per share common dividend paid in the first quarter of 2016. Our insurance companies had an excellent first half in spite of Fort McMurray losses with a combined ratio of 94.5% with excellent reserving and significant underwriting profits of $204 million.

In the second quarter all our operating segments had combined ratios at or below 100% with an overall combined ratio of 95.7%. Zenith had an excellent combined ratio of 83.9%, Fairfax Asia had 83.3% and as shown on page 35 of our quarterly report we realized gains on our investment portfolio of $315 million before equity hedges.

Excluding all hedging losses and before mark-to-market fluctuations in our investment portfolio we earned $490 million in pre-tax income in the second quarter, including all hedging losses and mark-to-market fluctuations in our investment portfolio we reported after tax earnings of $294 million in the second quarter or $239 million after non-controlling interest.

Insurance and re-insurance business volume was up in the second quarter of 2016 by 17.7%. If you exclude Brit insurance which wasn't there last year at this time the increase was 6.8%, and while our combined ratio as I said earlier was approximately 95.7%.

At each of our subsidiaries the change in net premium written and the combined ratios were as follows. OdysseyRe up 13.9% in premium for the second quarter combined ratio of 94.4%, Crum & Forster up 9.3%, combined ratio 98.6%, Northbridge in Canadian dollars up 7.4%, combined ratio 100%, Zenith flat premiums 83.9%, Fairfax Asia up 8.2% with an 83.3% combined ratio and Brit we didn't own last year so the combined ratio was 99.9%.

As we have said before, very low interest rates and reduced reserve redundancies means there is 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 gains of $229 million in the second quarter consisted of the following. Please refer to page two of our press release. Net losses on equity and equity related investments were $413 million resulting from net losses of $208 million on our equity investments due to stock fluctuations and a $205 million net loss in our equity hedge.

Stock fluctuations in three stocks BlackBerry, Eurolife, Eurobank and the Bank of Ireland accounted for most of the net losses of $208 million in common stocks. Our realized losses of $42 million on our individual equity hedges was mainly due to a switch between two individual companies. This is offset by realized gains in our common stocks of $24 million.

Also, we had gains of $640 million primarily on our treasury and municipal bond portfolio because of the impact of dropping long term treasury bond rates. As we have mentioned in our annual meetings, annual reports, quarterly calls with IFRS accounting, stocks and bonds are recorded at market and subject to mark to market gains or losses, quarterly and annual income will fluctuate widely 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 $2 million in the second quarter. The majority of these contracts 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 have included a table on our deflation swaps. On average, they have approximately 6.1 years to run.

These contracts are very volatile. But as I have said many times before our CDS experience comes to mind. When you review our statements, please remember that when we own more than 20% of a company, re-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 12 of our quarterly report, the fair values of our investments in associates is approximately $2.8 billion versus a carrying value of $2.4 billion an unrealized gain of about $400 million not on our balance sheet.

Investment gains have been an important component of our returns overtime; since we began we've had $11.5 billion in realized and unrealized gains. Previously announced, last December Fairfax agreed to acquire a 40% interest in Eurolife, the third largest insurance insurer in Greece, this transaction is subject to governmental and regulatory approvals and closing conditions. Closing is now expected to occur in the third quarter of this year.

On June 27, 2016 the Company through its wholly-owned subsidiary Fairfax Asia Limited, agreed to acquire an 80% in AMAG, an Indonesian insurer. AMAG has an excellent long term track record in the Indonesian general insurance sector a well-diversified sales channel with Panin Bank and there's a great opportunity for us to continue to expand our operations in Asia. This transaction is also subject to closing conditions including the regulatory approvals and is expected to close by the end of the fourth quarter of 2016.

On July 6, 2016 the Company agreed to acquire 100% interest in Zurich Insurance Company South Africa, a South Africa and Botswana insurer. Africa is a continent that represents a long term growth opportunity for Fairfax but where we have traditionally done little primary commercial insurance business. This transaction again is subject to closing conditions, including various regulatory approvals, and is expected to close by the end of the fourth quarter of 2016.

Recently, one of Thomas Cook's subsidiaries, Quess went into public -- went public in India. Under Ajit Isaac the founder's leadership, the Company went public at a market cap of approximately $600 million. It is trading today at a market cap of about $990 million versus our original investment in the company three or four years ago at a market cap of $ 60 million. Fairfax owns 42% of Quess indirectly which is worth approximately $420 million at today's prices through its 68% of Thomas Cook ownership which in turn owns 63% of

Quess. So very significant investment for Fairfax and we think Ajit has a long runway ahead of him.

Fairfax India has now almost fully invested its $1.1 billion that it raised about a year ago in six investments. We like all of them and are excited about the potential in India under Prime Minister Modi's leadership.

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 many times before by potential weakness in China and emerging markets. We have said now for some time we believe there continues to be a big disconnect between the financial markets and the underlying economic fundamentals.

As of June 30, 2016 we have $5.8 billion in cash and short term investments in our portfolios, which is approximately 19% of our total investment portfolios to take advantage of opportunities that come our way. As a result, in the short term our investment income will be reduced.

Now I'd like to turn it 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. Fairfax reported net earnings of $239 million in the second quarter of 2016, that's $9.58 per share on a fully diluted basis and that compared to the second quarter of 2015 when we reported a net loss of $186 million or a net loss of $8.80 per fully diluted share.

Year-to-date Fairfax has reported net earnings of $188 million or $7.07 per fully diluted share and that's an increase from 2015 when we reported year-to-date net earnings of $40 million or about $0.71 per share on a fully diluted basis.

Underwriting profit at our insurance and reinsurance operations in the second quarter and the first six months of 2016 was $82 million and $204 million and that was at combined ratios of 96% and 95%, somewhat lower than underwriting profits of $136 million and $263 million and combined ratios of about 92% in each of those respective periods in 2015.

Quarter-to-date and year-to-date underwriting profit is lower by about $54 million and $59 million and that's principally due to higher current period catastrophe losses partially offset by increased net favorable prior year reserve development.

Current period catastrophe losses were higher in the second quarter of 2016 and totaled $158 million or eight combined ratio points and were $189 million or five combined ratio points in the first six months of 2016.

The most significant CAT event in the quarter was the Fort McMurray wildfires which accounted for $63 million of the quarterly and year-to-date total CAT losses.

By way of comparison, cat losses in the second quarter and first six months of 2015 were $36 million and $64 million and represented about two combined ratio points in each of those periods.

The combined ratios benefited from higher net favorable prior year reserve development in the second quarter and first six months of $175 million and $260 million and that translated into about nine and seven combined ratio points in each of those periods. That compared to a net favorable reserve development of $84 million and $152 million in the second quarter and first six months of 2015.

Net premiums written by our insurance and reinsurance operations increased by 18% in the second quarter and 19% in the first six months and that reflected the incremental impact of the consolidation of Brit's net premiums written that impacted about $201 million in the quarter, $606 million on the year-to-date net premiums written.

So turning to the operating company results, we'll start with Northbridge. Northbridge's underwriting profit was just a fraction better than breakeven in the second quarter of 2016 and was $3 million for the first six months and that produced combined ratios of about 100% and 99% in each of those respective periods. That compared to underwriting profits of $12 million and $19 million and combined ratios of 95% and 96% in those same periods in 2015.

The underwriting results in the second quarter and first six months included $21 million of current period catastrophe losses translating into nine and five combined ratio points at Northbridge and that was almost entirely comprised of the impact of the Fort McMurray wildfires.

Northbridge's underwriting results in the second quarter and first six months of 2016 included the benefit of net favorable prior year reserve development of $38 million and $37 million respectively of 17 and 9 combined ratio point's favorable emergence there was primarily arising on the accident years 2013 and prior and relating to casualty lines of business.

In Canadian dollar terms, net premiums written by Northbridge in the second quarter and first six months increased by 7% and 9% and that reflected increased renewal business, new business writings and modest price increases across the group.

Moving over to OdysseyRe. OdysseyRe reported underwriting profits of $30 million and $74 million and a combined ratio of 94%, 93% in the second quarter and first six months of 2016 and that compared to an underwriting profit of $71 million and $129 million in those same periods in 2015.

Catastrophe losses in the second quarter and first six months totaled $75 million and $102 million and that translated into about 14 and 10 combined ratio points in each of those respective periods and that was an increase from the cat losses of $33 million and $56 million that we experienced last year in the second quarter and first six months of 2015.

OdysseyRe's combined ratio in the second quarter and first six months of 2016 included the benefit of $68 million and $103 million of net favorable prior year reserve development that's about 13 and 10 combined ratio points respectively and that principally related to favorable emergence on prior years' catastrophe loss reserves.

Odyssey wrote 631 million and just a little over 1.1 billion of net premiums in the second quarter and first six months of 2016 and excluding the impact of the non-renewal of the Florida property quota share reinsurance contract on June 1, 2015 so that's last year and we've mentioned that on prior conference calls. Net premiums written increased by 2.4% in the second quarter of 2015 and decreased modestly by 1.8% in the first six months of 2016.

Turning to Crum & Forster, Crum & Forster produced underwriting profits in the second quarter and first six months of 2016 of $6 million and $16 million with combined ratios of about 99% and 98% respectively. That compare to underwriting profits of about $10 million and $15 million in the prior year and there is no net favorable prior year reserve development in either of 2016 or 2015 at Crum & Forster.

Crum & Forster's net premium written increased by 9% and 13% in the second quarter and first six months and that primarily reflected growth in accident and health lines of business combined with incremental impact of the 2015 acquisitions of Redwoods, Travel Insured International and Brown .

Zenith reported an underwriting profit in the second quarter and first six months of 2016 of $32 and $63 million with corresponding combined ratios of 84% in each of those periods. That compared to underwriting profit of $22 and $62 million in the second quarter and first six months of 2015 respectively.

The combined ratios included 10 and 12 combined ratio points of net favorable reserve development in the second quarter and first six months of 2016 and Zenith wrote net premium written of $163 million and $491 million in the second quarter and the first six months of 2016, that's an increase of 4% in the first six months and that's principally reflecting an increase of an exposure, partially offset by modest price decreases.

Turning to Brit, in the second quarter and first six months of 2016 Brit contributed $352 million and $758 million to consolidated net premiums written and produced underwriting profits of $400,000 and $14 million. During those periods the combined ratios were 99.9% and 98% respectively. And as a reminder, Brit was acquired in June 2015 so comparative figures for 2015 are only for the period in which Fairfax owned Brit.

The underwriting results in the second quarter and first six months of 2016 included current period catastrophe losses of $32 million and $35 million which translated into nine and five combined ratio points during those periods. Cat losses were principally comprised of the impact of the Fort McMurray wildfires where Brit incurred net losses of $22 million and that increased its combined ratio by six and three combined ratio points in each of the second quarter and first six months of 2016.

Brit also experienced net favorable prior reserve developments of $22 million in the second quarter and first six months benefiting the combined ratio on those periods by six and three combined ratio points. Reserves development primarily reflected better than expected emergence on casualty and property reinsurance lines of business.

Fairfax Asia's underwriting profits of $13 million and $25 million and combined ratios of 83% and 81% in each of the second quarter and first six months of 2016 improved when compared to underwritten profits of $8 million and $14 million combined ratios of about 90% in the comparable periods in 2015.

The insurance and reinsurance other segment produced underwriting profits of $1 million and $9 million, and combined ratios of 99% and 96% in each of the second quarter and first six months of 2016. Lower underwriting profit in 2016 principally rose from higher current period catastrophe losses and the lower benefit of net favorable prior year reserve development partially offset by improved non-catastrophe loss experience related to the current accident year.

Looking at runoff, runoff reported operating losses of $1 million and $16 million in the second quarter and first six months of 2016 that compared to operating income of $25 million and $12 million in those same periods in 2015, the decrease and operating profitability year-on-year was principally the result of lower interest and dividend income.

Turning to our consolidated results, consolidated interest and dividend income increased from $147 million and $261 million in the second quarter and first six months of 2015 to $161 million and $314 million in the second quarter and first six months of 2016. And that principally reflects holdings of higher yielding government bonds year-over-year and the impact of consolidating Brit's investment portfolio.

We ended the second quarter with an investment portfolio inclusive of holding company cash of $29.5 billion compared to $29 billion at the end of 2015.

And turning to our financial position, our total debt to total capital ratio increased to 23.2% at June 30, 2016 from 21.8% at December 31, 2015 primarily as a result of the issuance of 400 Canadian principal amount 4.5% unsecured senior notes in the first quarter and that was offset to somewhat by the increase in our common shareholders' equity where we issued 1 million subordinate voting shares. The proceeds from these offerings will principally be used to finance investments in ICICI Lombard which closed in the first quarter of 2016 and the acquisition of Indonesian insurer AMAG and Eurolife in Greece, both are expected to close later in 2016.

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

Vivian Prem Watsa {BIO 16700363 <GO>}

Thank you very much, Dave. Now, we're happy to answer your questions. Please give us your name, your company name and try to limit your questions to be fair to everyone on the call. Okay Nicole, we're ready for the questions.

Q&A

Operator

Thank you. Our first question is coming from the line of Paul Holden of CIBC. Your line is now open.

Q - Paul Holden {BIO 6328596 <GO>}

Thank you. Good morning.

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

Good morning, Paul.

Q - Paul Holden {BIO 6328596 <GO>}

I have two questions. One is related to the bond portfolio and second is to the insurance operations. So, with respect to the bond portfolio, it looks like in the quarter you sold just over a $1 billion worth of munis and then redeployed that into U.S. treasuries. So wondering if that's purely just duration driven, and if you'd have capacity to do more of the same?

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

Yes. So, Paul, that's right, we sold approximately $1 billion in muni bonds. These are mainly pre-refinanced. They call it pre-re bonds which have been refinanced by municipalities which own underlying treasuries, 0.6%, 0.7%, 0.8% to the date of refinance. And we bought treasuries, we bought long treasuries, and so our treasury position, long treasury position is a little above $6 billion.

And interest rates, Paul, as you know have come down significantly in the past six months. So, for example, in Germany they've dropped by 110 basis points, one point -- there's a long German bonds, 1.5% to 0.4%. In the U.K. in spite of Brexit it's gone down from 2.7% to 1.7%, so approximately 100 basis points again, and the 6 points I'm talking about.

And then the United States has dropped about 70 basis points from three to two, -- 3% to 2.3%. But the United States still has the highest rates and the spread is in fact higher than it used to be in the past. We've talked about that at our AGM. So, we still have treasury bonds. We think it reflects these rates coming down. Of course reflects the quantitative easing in Europe and Japan, but it also reflects the fact there's too much supply in the world on a global basis and the lack of ability for the global economy to get traction.

So, yes, so we like treasury bonds and we like the position that we have today Paul, and that position we have. We never talk about what we will do in the future of course, but we like what we have.

Q - Paul Holden {BIO 6328596 <GO>}

Okay, good. And then the question on insurance operation is specific to OdysseyRe and the favorable reserve development in the quarter, which was equal to roughly 13 points of premiums earned. More than double of what we've seen in the recent period. So, I guess my question is, where do those PfADs come from on the property cat given that we haven't seen any major cat events since 2011. And then, is there capacity for those same PfADs to favorably impact future quarters?

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

Yes. So, Paul, the way we've always said, we like to put the reserves in a conservative way, so that - and as time goes by we have redundancies as opposed to deficiencies and so, because it's a very uncertain world we live in. And so for us we put the accident loss ratio at levels which we think are conservative and we expect reserve redundancies over time and so we continue to feel very comfortable about our reserve positions across all our companies.

And we just went through our audit committee at the end of June and we looked at Peter Clarke who does our Chief Risk Officer, looks at reserves in each of our companies and we feel very comfortable with the reserve position that we've got.

Q - Paul Holden {BIO 6328596 <GO>}

Okay. Thank you, Prem.

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

Thank you very much, Paul. Next question Nicole.

Operator

Thank you. Our next question is coming from the line of Mark Dwelle of RBC Capital Markets. Your line is now open.

Q - Mark Dwelle {BIO 4211726 <GO>}

Yes. Good morning.

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

Good morning, Mark.

Q - Mark Dwelle {BIO 4211726 <GO>}

Good morning. First, I'd like to thank you for putting that operating earnings and earnings reconciliation table on the front page. It's really helpful to have that up right at the front and center?

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

Reacting to your comment Mark, and we were thinking about what make sense and it's a simplified version of what's available in our income statement that's in our quarterly statement, interim reports, but as you pointed out putting it up there, makes it a little easier for all concerned. So thank you for that.

Q - Mark Dwelle {BIO 4211726 <GO>}

That's definitely appreciated. Second question, maybe this is just a little bit more general question, but I was little bit surprised to see that Brit had exposure to Fort McMurray fires. I guess I had thought that Brit's book of business was a little bit more U.K. and Euro centric. Obviously, I wasn't quite right in that assessment. But I was just curious I guess what lines of business that might have been in? And maybe just a little bit of description about maybe my own identification isn't quite right about where they really do most of their writings?

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

No. Your observation is right that a significant portion of that business is in the United States particularly, then of course the U.K. and Europe. But the beauty of the Lloyd's franchise is that it's worldwide, and it's a worldwide book of business that they have written in London, 450 people, it's now a little more than - little - approximately a year since we bought it. And I much say we are very happy with our Brit acquisition led by Mark Cloutier and Matthew Wilson.

But they do also have reinsurance book, Mark, that is also a worldwide treaty book. And so when you have a cat like we had in Fort Mac, well, that flows right through, well within limits and well within their expectations and that was a horrendous loss for the community, Fort Mac, but of course reinsurance and insurance helps and the Canadian companies were all protected from this type of loss.

But anytime you have a loss like that worldwide we'll have some impact, it will be some impact on us. Brit on the other hand in their way of - their cat margin they don't release still now. Really the - it's more focused on the end of the year, the third and fourth quarters, because that's where the exposures come from with the Florida wind storm and European storm.

So, we focus on - they focus on that and we are comfortable with that. And so, we are very happy with our Brit acquisition year ago for the record, Mark, the South African purchase that we made and announced just recently came from Brit, came from Mark Cloutier particularly. He identified it. They did their due diligence with our group of course and Andy and Paul are all involved in it. But it came to fruition, but the lead was Brit through Mark. And it's a terrific acquisition that we'd love to tell you a lot more about as it goes through the process through regulatory approval to closing. But we are very excited about it as we said in our press release.

Q - Mark Dwelle {BIO 4211726 <GO>}

Thank you. That's helpful. The other question that I had relates to the CPI derivatives. And I know you've consistently disclosed what the average amount remaining duration is on those various positions. I was curious what the nearest term expiration as which is to say, is there some part of that book that is getting close to rolling off that will either need to be renewed or otherwise just allowed to lapse?

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

Yes. Mark, that's a good question. There's enough – so we have enough flexibility Mark, like we can extend the term. We can refresh it as and when. The most, the closest one may be four years, four years something like that. So, we don't expect any expiry. But we do have the ability to freshen it up and/or extend term. We would have to pay more money for it, of course. We've done it in the past as you know and we can do it in the future, but we have – the closest one is perhaps four years to go something like that.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay. Very good. Sounds like there's still pretty fair amount of runway there. Thank you for that and good quarter.

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

Thank you, Mark. Nicole, next question please.

Operator

Thank you. Our next question is from Jeff Fenwick of Cormark Securities. Your line is now open.

Q - Jeffrey Fenwick

Hello. Good morning, Prem.

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

Hey, good morning Jeff.

Q - Jeffrey Fenwick

I just want to follow-up here on the CPI-link derivatives and I guess this pertains to Brexit and some of the potential for changes in the EU. And I'm wondering how does that impact if at all the CPI contracts that you were to have a country or more countries leave the EU. Does that change or nullify or somehow impact the return or the way those contracts are going to work?

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

Yes. They've never faced that, Jeff, in terms of a country. Brexit taking place, of course is the first one in a long time. And our thinking is the CPI index will just be adjusted and it goes forward, but a good question, we don't see any impact from that. But we'll review that again, but we basically don't see much of a change, you know I forget 16, 17 countries in Europe, well, their CPI Index will go forward.

Q - Jeffrey Fenwick

Okay. That's all I had.

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

Thank you, Jeff. Next question, Nicole.

Operator

Thank you. Our next question is from Tom MacKinnon of BMO. Your line is now open.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Hi, good morning, Prem.

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

Hey, good morning, Tom.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Question just following up on this reserve development discussion, in your prepared remarks you continue to point to reduced reserve redundancies in the industry, and I get that, but Fairfax is running sort of the highest we've seen over the last 10 years in terms of favorable reserve developments. And just given the prepared remarks on the industry do you suspect that your favorable reserve development would be able to trend higher going forward or lower going forward?

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

Yes.

Q - Tom MacKinnon {BIO 2430137 <GO>}

I know it's around 9 points on the combined ratio now and its sort of average about three over last ten years?

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

So, Tom, if you look at the pricing, the pricing you know in the industry we operate worldwide and the cat area has come down very significantly, like even in the last quarter cat pricing, property cat this is down 8%. So cat prices have come down significantly, but for the other lines of business they're flattening out, maybe a little down but basically flattening out.

And the point I'm trying to make on that when I make the comment on low interest rates like even if you get a combined ratio below 100% with these interest rates every time a bond renews, right, you have a lower investment income. And for you to make a 5% or 6% rate of return is going to be very significant at these low interest rates. So you need an underwriting profit. And now you are seeing in the industry combined ratio is moving up as people are discounting in different areas and eventually our thinking is that, that will change. It's still not a hot market by any stretch of imagination. It will turn when capital gets tight. And our thinking that might well be on the asset side. It always happens of course if you have a major catastrophe, earthquake in California or huge wind storm in Florida.

But it also will be affected by changes in the asset side, spreads widening, common stock prices coming down, stock markets coming down, all of that will impact the industry and we like where we are, Tom, in the sense that you know we are very decentralized, so we have the ability to expand significantly and you have to be ready to expand in terms of people and capital when the opportunity comes and we are in that position, and have been in that position for some time. I'm not forecasting any change but if it takes place we would take advantage of it.

And so, as I said earlier, our reserving position is very, very solid, you know this reflects of course, Tom, 30 years in the business and we've seen cycles up and cycles down, and we recognize that our reserves always have to at very high levels and we're not frighten to reduce premiums. And so, OdysseyRe if you look at, its premiums have been flat to coming down some and if you look over the years. So, that's our position there, Tom.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. So, if the current pricing environment persists do you think especially like at OdysseyRe that we'd be able to sort of maintain these very high levels of favorable development or do you think they should probably come down a little bit?

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

They could well come down, Tom. They could well come down over time and yes, they could well down over time, and particularly with – and particularly in a soft market. But remember OdysseyRe is a global company insurance and reinsurance and they have the ability to pick their niches, pick their – the products and countries where they can expand or contract.

And it's a tremendous franchise that Brian Young runs, that Brian and Andy built over 20 years. The OdysseyRe by the way is celebrating 20 years, it is just one outstanding company, now run by Brian Young. And it's a global franchise run from New York and Stanford and it's one of the premier broker reinsurance companies in the world. So, they have – they've built a tremendous company that we are very proud of.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. Thank you.

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

Thank you very much, Tom. Nicole, next question.

Operator

Thank you. Our last question is from Mikel Abasolo of Solo Capital Management. Your line is now open.

Q - Mikel Abasolo {BIO 3756596 <GO>}

Thank you very much Mr. Watsa for taking my questions. Very briefly and my first question revolves around your renewed bid on deflationary trades being loading up on treasury bonds and inclusion of equity hedges coming from someone who shares completely your deflationary scenario. Don't you think that you're concentrating the investment portfolio too much into that theme, meaning that it works for your advantage that will be a big hit and a big success, but otherwise it could be big hit to the company? That's my first question.

The second is, I see that you have raised equity this year in the March underwriting exercise in the previous years at multiples that are 1.2, 1.3 book value and since you're very well capitalized and ready to capture opportunities, I was wondering if that is a statement of what you consider to be a fair value or fair economic value for Fairfax Financial.

And my last question if I may, you mentioned in your prepared remarks that some of the equity losses came from two companies. I don't know if you could be more specific and say which one of those if that is pertinent? Thank you very much.

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

Thank you very much Mikel for your questions. The first one is as you point out we worry about deflation and we bought some long treasury. In a deflation environment Mikel, the worry will be a lack of investment income. If you look at what happened in Japan over 20 long years as interest rates came down and down and down and now they are negative. But they've been like 1% for maybe 10 years. And so, there's very little investment income that you can make and our worry has been that.

And if you take credit risk which you might be able to get more income, and most insurance companies are doing that, taking credit risks at very low spreads. So we don't like taking credit risks right now, we'd rather take duration risk or term risk in terms of buying treasuries and our focus on the fact that income in the future might be tough to get, meaning these rates could last at low levels for a long time in a deflationary environment.

And so that's our thinking. And we watch this very carefully. Treasury bonds are easy to sell if we change our minds. We have no expectation that we will, but we can change our minds very quickly. So, we feel comfortable with that position that we have. Mikel on the valuation of our own company at 1.1, 1.2, 1.3 times book whatever the current number is, you know we always say you have to make that judgement, as to what you think is fair value for our company.

We're long-term. We've always been long-term. We don't worry about fluctuations in our stock price. Fluctuations in stock markets or bond markets, but we look at the fact that we've taken a book value over 30 years from a US$1.5 to $400 change and that's a compound growth of 20% in the past. In the future we expect to make 15%. But our first criteria is to be financially sound, is to survive whatever comes in front of us.

Today we have all sorts of possible pitfalls. You just had Brexit. Brexit by itself is not a significant factor, but it is significant in the fact that it's taking place at a time when interest rates are negative, zero, pretty well in the western world and you have too much debt in the system. So that's when Brexit is taking place. You got Scotland looking at leaving Britain, leaving the U.K. You've got problems with Northern Ireland surfacing. You've got the possibility of France having a referendum, Holland having a referendum, Italian banks there's a concern. So you have all of these taking place, with Germany having negative interest rates. Switzerland - every bond is negative, even the 50-year bond is negative today.

So, it's not an environment that is without risk and that's the point that we are trying to emphasize, and it's difficult in this environment to make a return. And so, we are focused on stability, on downside protection and only then on making a return for our shareholders. And so, if any of these unintended consequences come, take place, we will not only survive, but we will thrive and for that we take a cost. There's a cost to that and we in the last few years we paid that cost, but we think that if any of these unintended consequences take place we will thrive.

And so, we've got a terrific group of shareholders who I thank very much because they all take a long term view and we benefit from the fact that our shareholders - we see them every year. We saw them in April and at our Annual Meeting, and we benefit from that. But your point is well taken and as far as the companies and equity issues I just highlighted one in our case Quess, but I didn't know if you - I - you were thinking some losses, what did you have in mind, Mikel there. Sorry.

Q - Mikel Abasolo {BIO 3756596 <GO>}

No. I was - I think that you mentioned that the equity losses that you recorded and I didn't quite understand if it was in the first half or in the second quarter?

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

Oh, yes. So, what I was saying there Mikel is just that you have fluctuations in stock prices so I was highlighting the fact that BlackBerry's and Eurobank and Bank of Ireland had come down in the quarter. And their fluctuations and you know, they've shown us unrealized losses and important point to make is they are unrealized our view is overtime we'll still do well on...

Q - Mikel Abasolo {BIO 3756596 <GO>}

Okay. Thank you very much for the clarification.

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

You are very welcome Michael and thank you very much for your question and Nicole, is there any more questions.

Operator

At this time, there are no questions in queue.

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

So Nicole if there are no more questions thank you all for joining us on this call. We look forward to presenting to you again after the next quarter. Thank you, Nicole.

Operator

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