S&P Capital IQ

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Fairfax Financial Holdings Limited TSX:FFH

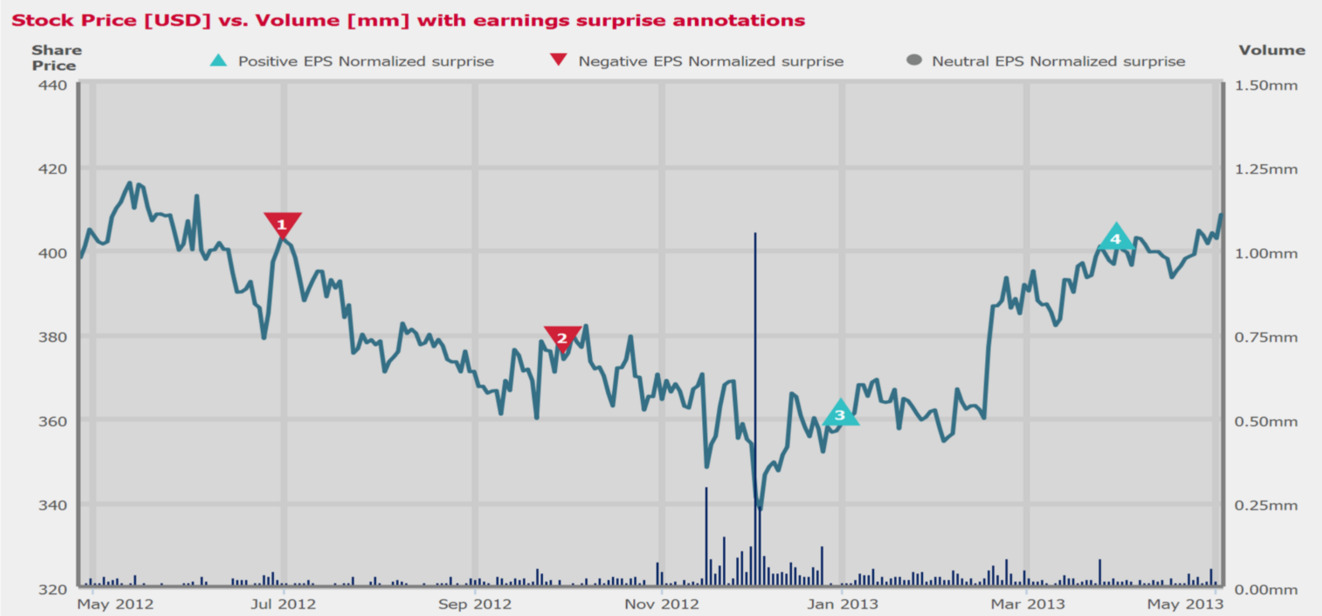
FQ2 2013 Earnings Call Transcripts

Friday, August 02, 2013 12:30 PM GMT

S&P Capital IQ Estimates

	-FQ2 2013-			-FQ3 2013-	-FY 2013-	-FY 2014-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	(11.75)	(8.55)	NM	3.19	10.50	23.76
Revenue (mm)	1669.13	1705.60	2.18	1954.53	7334.40	8123.50

Currency: USD
Consensus as of Aug-02-2013 11:35 AM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ2 2012	6.74	3.85	(42.88 %)
FQ3 2012	5.92	0.90	(84.80 %)
FQ4 2012	4.73	18.90	299.58 %
FQ1 2013	4.11	7.12	73.24 %

Call Participants

EXECUTIVES

David J. Bonham
Chief Financial Officer and Vice President

Paul C. Rivett
President

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

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Tom MacKinnon
BMO Capital Markets Equity Research

Presentation

Operator

Good morning, and welcome to Fairfax's 2013 Second Quarter Results Conference Call. [Operator Instructions] 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 C. Rivett
President

Thank you, Teresa. Good morning, and 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'll now turn the call over to our Chairman and CEO, Prem Watsa.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

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 onto Dave Bonham, our CFO, for additional financial details.

In the first 6 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 quarter 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 2 2013 and combined ratios were as follows: OdysseyRe, after adjusting for the quarter 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 reunderwriting 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 hard 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 2 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 $413.7 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 U.S. treasuries. We consider these unrealized bond losses as situations 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 6 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 movement 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 portfolio 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?

David J. Bonham
Chief Financial Officer and Vice President

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 a 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 in undiluted -- 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 6 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 6 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 of prior year's reserves in the second quarter and first 6 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 6 months of 2012, we experienced approximately $50 million of that 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 6 months of 2013, and that compared to 101.2% and 100.1% in the second quarter and first 6 months of 2012.

In the second quarter 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 6 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 2 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 6 months of 2013, OdysseyRe 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 6 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 6 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 6 months of 2013, as these were both second quarter events.

OdysseyRe's combined ratio in the second quarter and first 6 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 2 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. And 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 6 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 6 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 6 months of 2012 include a one 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 6 months of 2013, and that compared to underwriting losses of $7 million and $22 million in the second quarter and first 6 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 6 months of 2013.

Net premiums written by Crum & Forster in the second quarter and first 6 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 gross premiums written.

Zenith reported significant improvements in its combined ratio, which decreased from 116.4% and 117% in the second quarter and first 6 months of 2012 to 95.6% and 102.6% in the second quarter and first 6 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 6 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 6 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 6 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 6 months 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 6 months of 2012 to 100.4% in each of the second quarter and first 6 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 6 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 6 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 intercompany 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 6 months of 2013, reflecting modest growth in writings at Federated and Northbridge Insurance and increased premium retention following the termination of that intercompany quota share reinsurance contract.

Fairfax Asia's combined ratio increased modestly from 88.8% and 90.4% in the second quarter and first 6 months of 2012 to 90.7% and 90.9% in the second quarter and first 6 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 6 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 hull.

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 6 months of 2012 to 99.3% in the first 6 months of 2013.

Runoff reported pretax losses of $129 million and $143 million in the second quarter and first 6 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 U.S. runoff also contributed to runoff's pretax result in the first 6 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 of $235 million in the first half 2012 to $212 million in the first half 2013.

Rounding out a 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 2 main reasons: the first, we incurred significant pretax losses in the U.S., where tax may be recovered at 35% statutory income tax rate in the U.S. And that's a substantially a higher rate than the Canadian statutory rate of 26%. And secondly, we continue to receive a considerable amount of nontaxable investment income in the form of interest income on our U.S. municipal bonds, intercorporate dividends on common stocks and certain net capital gains in Canada, where 50% of the gain is nontaxable.

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 a tax provision attributable to each of those jurisdictions.

We ended the quarter with an investment portfolio, which include a 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-à-vis the strengthening of the U.S. dollar relative to many of the currencies in which Fairfax's non-U.S. 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 6 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%.

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

V. Prem Watsa
Founder, Chairman and Chief Executive Officer
Thank you, Dave. I'll be happy to answer your questions. [Operator Instructions] Okay, Teresa, we are ready for the questions.

Question and Answer

Operator

[Operator Instructions] Jeff Fenwick of Cormark Securities.

Jeffrey Michael Fenwick
Cormark Securities Inc., Research Division

So Prem, I wanted to focus my questions in on the U.S. P&C area. I mean, obviously, some clear signs of hardening in different parts of the market down there, and that's benefited Zenith in particular. But I wanted to ask about Crum. I mean, Crum has been going through, it 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 this hardening that we're seeing today in the U.S.?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Yes, Jeff, that's a good question. Crum, as I said, reunderwrote its -- 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. But we -- I'd say that you're exactly right when you say that transitioning from standard lines to specialty lines, we are also being careful on the excess in surplus lines, making sure that we're -- that it's profitable business. So I'd say, in the next -- as long as the market conditions remain, that we would see some growth in the next 6 months to 1 year. The marketplace is -- 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.

Jeffrey Michael Fenwick
Cormark Securities Inc., Research Division

And I guess, Prem, along with that is 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 to the -- back the the board to deliberate? Or do you -- can you maybe just elaborate on what the steps are going forward from here?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Yes. What happened is -- that just came on Friday, of course, Jeff. So what happened 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'd expect, we're reviewing all our options and we'll just wait for the board to get back to us.

Jeffrey Michael Fenwick
Cormark Securities Inc., Research Division

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

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Yes. So Jeff, over 28 years, you know and I've said this to you before, you never can tell when these opportunities come. We bought the Hartville, as you know, a pet insurance company. If you had asked me a year ago, I probably wouldn't have been able to say that, that would would've happened or American

Safety. So the -- so we're 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 the -- which means that 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 as and when they -- it comes our way.

Operator

Paul Holden of CIBC.

Paul David Holden
CIBC World Markets Inc., Research Division

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

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Yes. First of all, Paul, Odyssey has got a worldwide spread of business. It's got many, many dials that it can move up or move down. In 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 OdysseyRe is positioned, Paul.

Paul David Holden
CIBC World Markets Inc., Research Division

Okay. And 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?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Yes. I mean, if history is any guide, when you have these significant losses and there's -- the numbers have yet to come out in terms of being firm for Alberta, but it might well be the biggest loss we've had in Canada. And when you have these types 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 reinsurers raising their rates and, eventually, the primary companies will do the same. That's just historically what happens.

Operator

Tom MacKinnon of BMO Capital.

Tom MacKinnon
BMO Capital Markets Equity Research

One question or 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. So are you just trying to write more of the overall Fairfax business in Zenith instead of Crum? Or I mean, what's happening there?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

No. I think Zenith is getting price increases. If you look at Zenith's business, they will 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. And -- but Zenith is a specialized insurance company in California. It's 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 -- this equal to rate increases, like -- so there's not a lot of volume above the rate increases. So Zenith is very careful as you -- 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 about 100% if you take out the reserve redundancies that we had in the second quarter.

Tom MacKinnon
BMO Capital Markets Equity Research

And I noticed that Zenith has traditionally been contributor to holdco capital. But in this quarter, I think you put capital into Zenith. What's the reason behind that?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

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. But 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 it wasn't significant, and Zenith is well capitalized. And we expect Zenith -- if the opportunity continues, we'll write a lot more business.

Tom MacKinnon
BMO Capital Markets Equity Research

And finally, if I could squeeze one more with the ASI and the counterbid. 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 you'd -- or the complexities involved because, I believe, you are selling a piece then of ASI to the Tower Group. How does that fit in with this process?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

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

Operator

Mark Dwelle of RBC Capital Markets.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

A question I wanted to ask about was the -- related to the CPI-linked derivative contracts. The notional amount outstanding on that has increased about 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, is the size of the notional position. Because it's -- 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.

V. Prem Watsa

Founder, Chairman and Chief Executive Officer

Yes. At term, we have about $523 million invested in it. And at cost, I think that market is a fraction, it's like $120 million, something like that. It's a fraction, and it's got 8 years to go. It has 8 years to go, Mark. And in nominal terms, it's about, as you pointed out, $75 billion. But of course, you'll never get $75 billion. That means there's a 100% loss, right? We figured 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 U.S., half of it is European. It's an NOI that -- so we think of it as, Mark, like what we are thinking today, and I'll just highlight it for all of you in the call, and we've said it before. There's a big disconnect between financial markets and economic fundamentals. So what do I mean the economic fundamentals? Now you look at the stock market, you think that things -- 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 4 2012 came out at 4%, revised down to 0.1%, basically flat. The last 5 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 2 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've said to you for some time, about deflation. Everyone's worried about inflation, and have been worried for 5 years. Remember, 2 things, and we've said that it in our annual meeting. One, it took 5 years for deflation to set, to come in, in Japan. After the bubble broke in 1989, it was 1995 that deflation set up began. And then for the next 17 or 18 years, you had deflation in Japan. And the second is just because we are 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 weren't bearish in 1925, there was a 1-in-100 chance you'll survive the Depression, 1-in-100 chance. If you weren't bearish long before 1929, meaning 1925, there was a very small chance you survived. So we are very concerned. We don't take this lightly. We're watching this very, very carefully. I mean, if we hadn't hedged, we'd make, I don't know, another $500 million, something like that. Now we can easily buy corporate bonds. We've been in the business for 40 years, and they're stepping away. We think you're not being paid for risk, so we're stepping away from the marketplace. I'll remind you, then, in 2008, 2009, when stock markets were down, we were fully invested. And when spreads were wide, we bought corporate bonds and we bought all sorts of bonds. 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.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Teresa, 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.