

# Fairfax Financial Holdings Limited TSX:FFH

## FQ3 2013 Earnings Call Transcripts

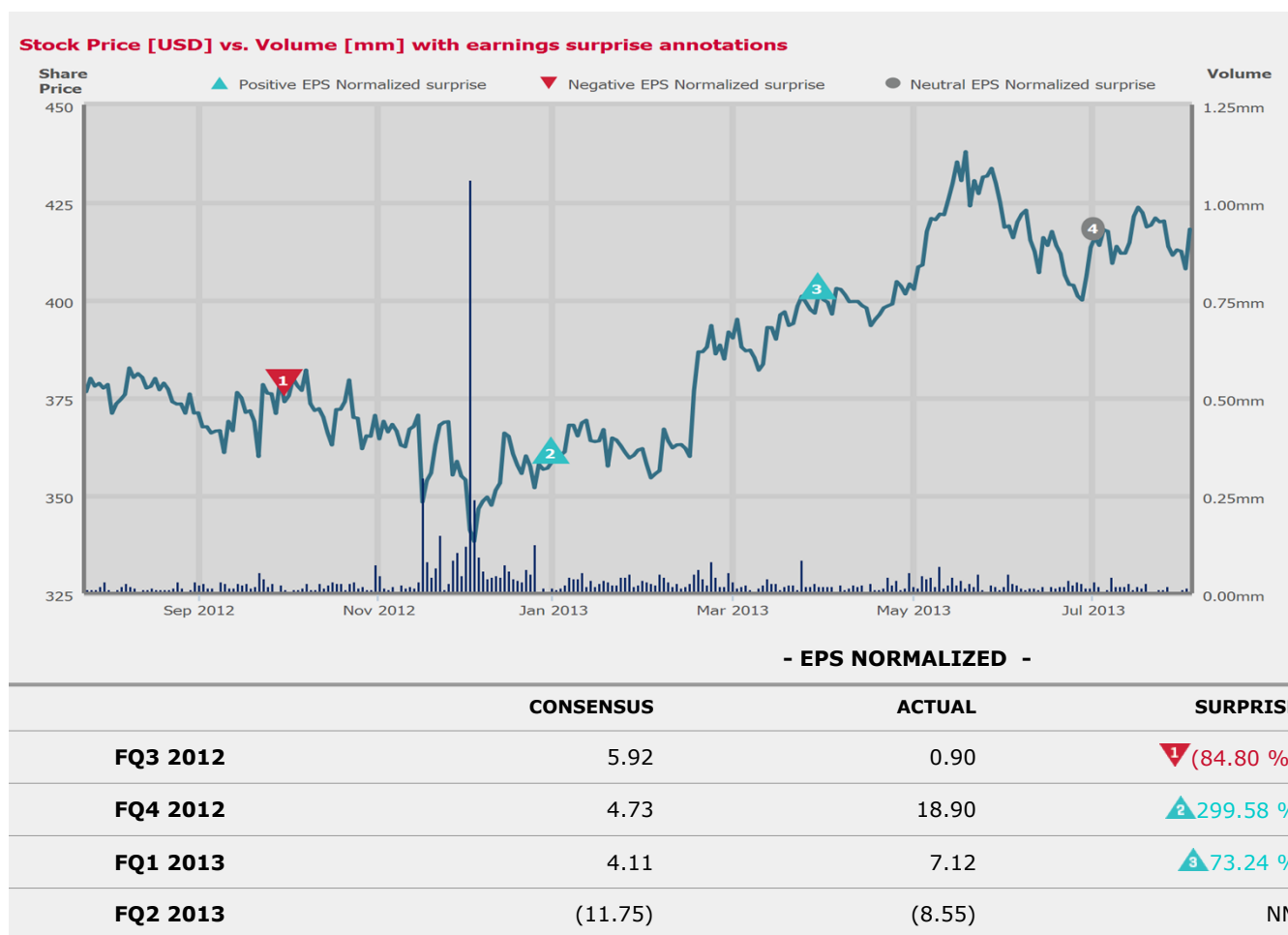
Friday, November 01, 2013 12:30 PM GMT

## S&P Capital IQ Estimates

	-FQ3 2013-			-FQ4 2013-	-FY 2013-	-FY 2014-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
<b>EPS Normalized</b>	-	(29.02)	NM	8.03	-	33.56
<b>Revenue (mm)</b>	1654.15	1954.10	▲18.13	1900.45	6923.10	7754.85

Currency: USD

Consensus as of Oct-29-2013 2:05 PM GMT



# Call Participants

---

## EXECUTIVES

**David J. Bonham**

*Chief Financial Officer and Vice President*

**Eric P. Salsberg**

*Vice President of Corporate Affairs and Corporate Secretary*

**V. Prem Watsa**

*Founder, Chairman and Chief Executive Officer*

## ANALYSTS

**Howard Flinker**

**Paul David Holden**

*CIBC World Markets Inc., Research Division*

**Unknown Analyst**

# Presentation

---

## Operator

Good morning, and welcome to Fairfax's 2013 Third Quarter Results Conference Call. [Operator Instructions] Today's conference is being recorded. If you have any objections, you may disconnect. Your host for today's call is Prem Watsa, with opening remarks from Eric Salsberg. Mr. Salsberg, please begin.

## Eric P. Salsberg

*Vice President of Corporate Affairs and Corporate Secretary*

Good morning, and welcome to our call to discuss Fairfax's 2013 third 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.

## V. Prem Watsa

*Founder, Chairman and Chief Executive Officer*

Thank you, Eric. Good morning, ladies and gentlemen. Welcome to Fairfax's third 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.

Our insurance companies are doing very well with a combined ratio of 93.4% in the third quarter and 93.9% in the first 9 months of 2013, and we continue to be soundly financed with quarter-end cash and marketable securities at the holding company of \$1.1 billion.

However, we were affected in the quarter with mark-to-market losses on bonds because of rising interest rates in the quarter and a mismatch in our equity portfolios between our common stocks and our hedges. The Russell 2000 index, used much -- used for much of our hedging, was up about 10%, while the S&P 500 Index is up about 5%. Our common stock portfolios were up in the 6% range, not dissimilar to the S&P 500, but significantly less than the Russell 2000. Our long-term performance, as you know, has been in excess of most entities.

As you know, on a quarterly basis, we get fluctuations in our hedging. But over time, it has been very effective and we expect the mark-to-market losses in this quarter to reverse over time. In the meantime, we continue to be protected from a significant decrease in the equity markets.

Our Insurance and Reinsurance businesses continue to expand profitably. Net premiums written by the company's insurance and reinsurance operations in the third quarter of 2013 increased by 3.9%. As I've said, the combined ratio for our insurance and reinsurance operations in 2013 was 93.4% for the third quarter and 93.9% for the first 9 months.

At the subsidiary level, the percentage increase in net premiums written in the third quarter compared to the third quarter 2012 and the combined ratios were as follows: OdysseyRe, a 7% increase in net premium with a combined ratio of 87.6%; Crum & Forster, 1.8% increase in net premiums, 99.3% combined ratio; Northbridge, 1% increase in the net premium, a 101.5% combined ratio; Zenith, 12.4% increase in premium with a combined ratio of 96.8%; and Fairfax Asia, a 1.3% increase in net premiums and a combined ratio of 80.9%.

During 2013, many underwriting initiatives have been implemented, but I wanted to highlight the progress of a couple of companies.

Zenith, which has demonstrated many times over the years its ability to manage the underwriting cycle, has done it again. Cut premiums during the soft market years, 2008 to 2010. Combined ratios for them, because of the lesser premium, has increased, driven by higher expense ratios. Others, participants,

competitors, have entered the market to grow their business significantly. As the industry's underwriting loss increases, prices begin to increase. Reserves develop and peer companies exit the industry, which is what is happening today. Rates continue to increase and Zenith continues to grow its exposure base.

Zenith cut its premium base from \$1.1 billion to about \$450 million when we bought it in 2010. It now writes approximately \$700 million, and it's rising. Over time, I have no question, it will write more than \$1.1 billion. Although common gross premiums written remained flat for the first 9 months of the year, its more profitable specialty business was up almost 11%, while its standard lines business was down 33%. This has led to a 2.5% improvement in their combined ratio year-over-year.

Fairfax Brazil, a start-up in 2010 with 0 premium, has built a first-class operation over the last 3 years with approximately 60 people. For the 9 months of this year, the company has written \$115 million gross, \$48 million net at a combined ratio approaching 100%. We expect Brazil to be a contributor to our overall underwriting profitability well into the future under Jacques Bergman and Bruno Camargo's leadership. Odyssey and Fairfax Asia, of course, continue to hit the ball out of the park with excellent combined ratios.

So 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 will 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, we think, will eventually play out.

Now in terms of the investment area. Net investment losses of \$828.6 million in the third quarter of 2013 consisted of the following. Please note table on Page 2 of our press release. Net losses on equity and equity-related investments of \$478 million was after a \$816 million net loss in our equity hedge. Because of the mismatch between the Russell index and our portfolios, we expect this to reverse over time. This happened before, in the fourth quarter of 2011. The realized loss of \$577 million on our equity hedges was due to the sale of common stocks and, consequently, a permanent reduction in our hedges and also the reduction of our hedge ratio to our target, 100%. On a year-to-date basis, our net equity losses after our equity hedge was approximately \$300 million.

As we have mentioned in our annual meeting, annual reports and quarterly calls, with IFRS accounting where stocks and bonds are at market and subject to mark-to-market gains and losses, quarterly and annual income will fluctuate significantly and will only make sense over the long term.

Because of rising interest rates in the quarter, we had \$215 million in unrealized mark-to-market bond losses, a majority of which are in munis and short buys, Berkshire Hathaway. We consider these unrealized bond losses as fluctuations and expect them to reverse over time. Our muni bond portfolio was, as you know, was mainly acquired in the last quarter of 2008 at an after-tax yield of 5.79%.

The core inflation continues to be at or below 1% in the United States and Europe, levels not seen since the 1950s. This is in spite of QE1, QE2 and QE3. Our CPI-linked derivatives, however, are down 76% from our cost and are carried on our balance sheet at \$130.5 million. Even though they have almost 8 years to run, our CVS [ph] experience comes to mind.

When you review our statements, please remember that we own more than 20% -- when we own more than 20% of a company, we equity account; and about 30%, we consolidate so that mark-to-market gains in these companies are not reflected in our results.

Let me mention some of these gains. As you can see on Page 13 of our quarterly report, that's Page 13 of our quarterly report, the fair values of our investment in associates is \$1.752 billion versus a carrying value of \$1.409 billion and unrealized gain of \$343 million not on our balance sheet.

Also, we own 75% of Thomas Cook, 74% of Ridley, which are consolidated in our statements. Unrealized gains on market values as of October 29, 2013, on both these positions is approximately \$146 million. Thus, total unrealized gains not reflected on our balance sheet is \$490 million.

Finally, Euro Properties, an investment we've made in an exceptional Greek REIT with outstanding management, where we have increased our investment through their rights issue, has another unrealized

appreciation of \$141 million as of October 29, 2013. And that also is not included in our balance sheet. So when you add all of that, we have a total of \$631 million of unrealized gains that are not on our balance sheet.

Of course, all of this works out in the long-term, so take these mark-to-market fluctuations as just that, fluctuations that have no impact in the long term. The worst mark-to-market loss we've had was in the fourth quarter of 2011 of \$915 million, again, when the Russell 2000 significantly outperformed the S&P 500.

As I've said before, the company had in excess of \$1.1 billion of cash, short-term investments and marketable securities at the holding company level at September 30, 2013. We continue to be approximately 100% hedged in relationship to our equity and equity-related securities, which include convertible bonds and convertible preferred stock. 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, we believe there continues to be a big disconnect between the financial markets and the underlying economic fundamentals.

As of September 30, 2013, we have over 30%, or \$7.2 billion, in cash and short-term investments in our portfolio to take advantage of opportunities that come our way. As a result, in the short-term, our investment income will be reduced.

Now I would like to turn it over to David Bonham, our CFO, 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 third quarter of 2013, then I'll move on to the operating company results and finish with the consolidated financial position.

For the third quarter of 2013, Fairfax reported a net loss of \$572 million or a net loss of \$29 per share on a fully diluted basis. That compares to the third quarter of 2012, when we reported a net profit of \$33 million or net earnings of \$0.84 per share on a fully diluted basis.

Year-to-date, the company reported a net loss of \$568 million. That translated into a loss of approximately \$30 per diluted share in the first 9 months. And that compares to net earnings of \$125 million in the first 9 months of 2012, or approximately \$3.80 per fully diluted share.

Fairfax's underwriting results have shown significant improvement in the third quarter and first 9 months, with our insurance and reinsurance operations reporting combined ratios of 93.4% and 93.9% and underwriting profits of \$105 million and \$275 million during those respective periods. That's a year-over-year increase in our underwriting profit of \$33 million in the third quarter and \$154 million in the first 9 months of 2013. In the third quarter and first 9 months of 2012, we reported combined ratios of 95.5% and 97.2% and underwriting profits of \$72 million and \$121 million.

So that improvement, representing about 2 percentage points on the quarter-to-date and 3 percentage points on the year-to-date combined ratio, principally reflects increased net favorable development of prior year's reserves, partially offset by slightly higher catastrophe losses in 2013.

In terms of reserve development, we experienced \$86 million and \$228 million of net favorable development in the third quarter and first 9 months of 2013. And that benefited our combined ratio by approximately 5 combined ratio points in each of those periods. That's a little bit more than double the amount of net favorable development we experienced in the third quarter and first 9 months of 2012.

Excluding the benefit of net favorable development, our accident year combined ratios were 98.8% and 99% in the third quarter and first 9 months of 2013, and that compared to 97.9% and 99.3% in the third quarter and first 9 months of 2012.

Current-period catastrophe losses increased modestly in 2013 relative to 2012 and, in the third quarter of 2013, amounted to just over \$74 million, adding 4.7 points to the third quarter combined ratio. In the first 9 months of 2013, catastrophe losses amounted to \$218 million and added just about 5 points to the combined ratio. Third quarter catastrophe losses of \$74 million were principally comprised of the impacts of the Toronto floods affecting Northbridge and OdysseyRe with consolidated losses of \$28 million, the Germany hailstorms primarily affecting OdysseyRe with consolidated losses of \$17 million and an additional \$15 million of reserves in the third quarter that related to the second quarter Alberta flood event. On a year-to-date basis, that brings our catastrophe losses on the Alberta flood up to \$67 million, primarily at Northbridge and OdysseyRe. Our underwriting results in the first 9 months also included catastrophe losses of approximately \$29 million stemming from the Central European floods.

As mentioned by Prem already, net premiums written by our insurance and reinsurance operations increased in the third quarter and first 9 months of 2013 by 3.9% and 3.7%. The 3.7% increase is prior to giving effect in the first 9 months of 2013 to 200 premium portfolio transfers at OdysseyRe related to a specific quota share reinsurance contract. I wanted to note for you that Page 53 of our third quarter Interim Report contains a detailed discussion of these transactions, including their impact on OdysseyRe and Fairfax.

Now turning to our operating company results, starting with OdysseyRe. In the third quarter and first 9 months of 2013, OdysseyRe reported an underwriting profit of \$84 million and \$258 million and combined ratios of 87.6% and 85.6%.

Underwriting profit in the third quarter of 2013 was slightly lower year-over-year, reflecting higher catastrophe losses. Underwriting profit in the first 9 months of 2013 increased by about \$26 million, and that reflected increased net favorable development, partially offset by increased catastrophe losses.

Catastrophe losses in the third quarter and first 9 months of 2013 of \$50 million and \$138 million were principally comprised of the Germany hailstorms and flooding in Toronto in the third quarter and the Alberta floods and Central European floods in the first 9 months of 2013.

OdysseyRe's combined ratio in the third quarter and first 9 months included the benefit of \$26 million or 4 points and \$80 million or 5 points of net favorable development, principally related to favorable emergence on prior year's catastrophe losses. OdysseyRe wrote \$730 million of net premiums in the third quarter of 2013, up from \$682 million in the third quarter of 2012, an increase of 7% or \$48 million, principally reflecting increased writings of U.S. crop insurance.

Moving on to Crum & Forster. Crum & Forster's underwriting results improved in the third quarter of 2013, with the improvement even more pronounced in the first 9 months of 2013 on lower operating expenses, higher net premiums earned, the lower catastrophe losses and the absence of net adverse reserve development in 2013. Crum & Forster reported underwriting profit of about \$2 million in the third quarter and an underwriting loss of about \$3 million in the first 9 months of 2013, and that compared to underwriting losses of \$4 million and \$26 million in the third quarter and first 9 months of 2012.

Current period catastrophe losses had a nominal impact on Crum & Forster's combined ratios, which were 99.3% in the third quarter and 104% in the first 9 months. Net premiums written by Crum & Forster increased by 1.8% in the third quarter of 2013. That primarily reflected a shift towards more specialty lines of business and away from standard lines of business, primarily in the areas of workers' compensation, where pricing was considered inadequate.

Turning to Zenith. Zenith reported significant improvements in its combined ratio, which decreased from 114.7% and 116% in the third quarter and first 9 months of 2012 to 96.8% and just over 100% in the third quarter and first 9 months of 2013. The improvements reflected the following: Year-over-year decreases of 9.4 and 8.7 points in the accident year loss ratios in the third quarter and first 9 months of 2013, and that reflected earned premium price increases that were in excess of estimates of loss trends.

Secondly, net favorable development to prior year's reserves of 4.6 and 3.7 points in the third quarter and first 9 months of 2013, and that development primarily related to the 2012 accident year. Finally,



decreases in the expense ratio of 3.9 and 3.4 points in the third quarter and first 9 months of 2013, and that was as a result of 11% and 13% increases in net premiums earned year-over-year.

Net premiums written by Zenith of \$144 million and \$574 million in the third quarter and first 9 months of 2013 increased year-over-year by 12% to 13%, reflecting premium rate increases.

Northbridge's combined ratio experienced a slight deterioration from 100.7% in the third quarter of 2012 to 101.5% in the third quarter of 2013, but improved from 103.6% in the first 9 months of 2012 to 100.8% in 2013. In both the third quarter and first 9 months of 2013, Northbridge's underwriting results reflected increased net favorable development of prior years's reserves, partially offset by higher year-over-year current period catastrophe losses.

Northbridge's combined ratio included the benefit of net favorable development across most accident years and lines of business of \$45 million or 18 points in the third quarter of 2013 and \$108 million or 15 points on a year-to-date basis. And that compared to net favorable development of \$24 million or 10 points in the third quarter of 2012 and \$51 million or 7 points in the first 9 months of 2012.

Catastrophe losses in the third quarter and first 9 months of \$22 million and \$56 million related to the flooding in Alberta and Toronto. These 2 events together added approximately 7 points to the combined ratios in the third quarter and first 9 months of 2013. In contrast, catastrophe losses in the third quarter and first 9 months of 2012 were significantly lower, approximately \$9 million and \$15 million, adding 3.3 and 2 points to the combined ratios during those respective periods.

After adjusting for the impact in the first 9 months of 2012 and 2013 of the intercompany unearned premium portfolio transfers between Northbridge and Group Re that we described on Page 46 of our third quarter Interim Report, net premiums written by Northbridge increased in the third quarter and first 9 months of 2013 by 4.4% and 5.9% when expressed in Canadian dollars, reflecting increased premium retention following the termination of that quota share reinsurance contract and modest growth in writings at Federated insurance, partially offset by slightly lower writings at Northbridge insurance.

Fairfax Asia's combined ratio improved from 83.2% and 87.9% in the third quarter and first 9 months of 2012 to 80.9% and 87.3% in the third quarter and first 9 months of 2013. On a year-over-year basis, net premiums written by Fairfax Asia increased by 1.3% and 5.2% in the third quarter and first 9 months of 2013.

The combined ratios of the insurance and reinsurance other division improved from 102.5% in the third quarter of 2012 to 96.4% in the third quarter of 2013 and improved from 102% in the first 9 months of 2012 to 98% in the first 9 months of 2013.

Runoff reported pretax losses of \$113 million and \$256 million in the third quarter and first 9 months of 2013. That compared to pretax profits of \$13 million and \$146 million in the same periods last year. The year-over-year decrease in profitability primarily related to net investment losses in 2013.

Our consolidated interest and dividend income decreased from \$101 million and \$336 million in the third quarter and first 9 months of 2012 to \$61 million and \$273 million in the third quarter and first 9 months of 2013. And this reflected the combination of sales in 2012 of higher-yielding bonds that were replaced with lower-yielding, short-term investments and the impact of sales and dividend-paying common stocks in 2013.

The company recorded a recovery of income taxes of \$212 million and \$413 million in the third quarter and first 9 months of 2013, representing effective income tax recoverable rates of 27.1% and 42.3%. The higher effective tax rate in the first 9 months of 2013 primarily related to significant pretax losses in the U.S., where tax may be recovered at the U.S. tax rate of 35%, and that's a substantially higher rate than the Canadian statutory income tax rate of 26.5%.

Moving to our financial position. Our total debt to total capital ratio increased to 28.6% from 25.5% at December 31, 2012, due primarily to additional debt issued net of repurchases in the first quarter of 2013 and a decrease in our common shareholders' equity during the first 9 months. We have \$183 million of OdysseyRe debt maturing in November 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 be approximately 27.5%.

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

**V. Prem Watsa**

*Founder, Chairman and Chief Executive Officer*

Thank you, Dave. Now we are happy to answer your questions. [Operator Instructions] Okay, Audra, we are ready for the questions.



## Question and Answer

---

### Operator

[Operator Instructions] And there's a question from Sashen Sah [ph] with Albert Fried [ph].

### Unknown Analyst

So I just wanted to find out, in regards to the BlackBerry offer, I wanted to see if there was any update. I believe the deadline is coming up on Monday. So I just wanted to see where things stood, if there was a chance for a possible extension, or just wanted to get a little understanding on that situation.

### V. Prem Watsa

*Founder, Chairman and Chief Executive Officer*

Thank you, Shashen [ph], for your question. As you know, we cannot make any comments on BlackBerry as we have a bid for the company. So we really can't make any more comments on that until, as you say, November 4. So thank you for your question.

### Operator

[Operator Instructions] There's a question from Paul Holden with CIBC.

### Paul David Holden

*CIBC World Markets Inc., Research Division*

I wanted to ask you about Northbridge. So if you look at the accident year combined ratio for Northbridge. I mean, 2013 has been another tough year. Granted, some of that has been related to cats. But I think even if you factor that in, it's still not a great year relative to your other underwriting businesses. Now you mentioned that competitive conditions remain challenging, so that's probably fair. So sort of a 3-part question for you on Northbridge: A, do you see any early signs that competitive conditions and Canadian P&C are easing, i.e. are rates starting to firm following 2013 cat events? B, are there company-specific actions that you are taking that could lead to an improved accident year combined ratio in 2014? And C, would you ever consider trading this asset for a higher-margin business in a different market?

### V. Prem Watsa

*Founder, Chairman and Chief Executive Officer*

Thank you, Paul. First of all, the accident year combined ratio is a high. I think it ran at 115%. But you'll notice there was a -- we have very significant reserve redundancies. So our reserve accident year combined ratios are high, but on the other side, our redundancies are also high. And so we're very careful in our reserving. And over time, that accident year combined ratio will reflect the underlying conditions. But we're very, very careful in terms of reserving. We want to be sure that the reserves are appropriate. In terms of your first question, in terms of the industry changing, Canada has always lagged the United States. The U.S. first moves up, and then Canada follows. We've had the catastrophes like the Calgary floods, the Toronto storms, so rates are not going down. They're going up some, and we think it'll improve over time. And the supplies to the United States, too, of course, are in some areas like -- I was talking about Zenith, workers' compensation -- many, many companies in the United States have taken reserve increases, big reserve charges, have been pretty well in the course of being put into runoff. And so the price increase that Zenith enjoys is in the 15% area. If you have -- you had to have not written a lot of business during the soft markets to be able to take advantage, like Zenith is doing today. So we think -- and that will follow in Canada, too. In Canada, we have our Northbridge segmenting the markets and being more focused on certain target markets. And so we think, over time, our combined ratios will be well below 100% under Silvy Wright's leadership. As far as selling any of our companies, Northbridge, Fairfax Asia, Odyssey, any of them, Brazil, we've said specifically about -- clearly in writing in our annual report, none of our companies are for sale. Any of our subsidiaries, insurance subsidiaries are not for sale. We're going to hold them forever. And secondly, Fairfax itself is not for sale. I've said it very clearly to companies. I have a -- in my boarding interest, I consider it to be a controlling interest. And I said to our

shareholders that if someone comes in with a price, twice today's price, I wouldn't sell. So that's it for -- this is our 28th year, and I've said that, I think, 4 or 5 times over that time period. So Paul, yes, none of our companies are for sale. Because of that, we have -- we enjoy a huge amount of loyalty from our people. I've said this also before. The presidents of our companies who have run our subsidiaries, we've never lost one president, never lost one president who has been successful in our operation. We've had retirements early on in our 28 years. We've had full competence, and we've had people that would leave us. But people who've been successful have been with us for a long time: Andy Bernard, the better part of 20 years; Brian Young, better part of 20 years; and on and on and on. Silvy is -- Silvy Wright's been with us for the better part of 20 also. So for all those reasons, it's a big, big competitive advantage, we think, to have our subsidiaries owned forever, that it will never be sold. So our presidents can look after the operations, not having to look back and see if the head office will decide to sell them because they have 1 year or 2 of poor performance. So I want to be very specific. Thank you for asking that question, Paul, but I want to be very specific to all our shareholders.

### **Operator**

Our next question is from Howard Flinker with Flinker & Company.

### **Howard Flinker**

A few years ago, we pondered what kinds of underwriting ratios, industry-wide, would generate enough returns to attract competition. In the recent weeks, I've seen 3 companies, including some with historically respectable underwriting disciplines, underwriting the, say, 85% to 89% rate. And their annualized rates of return on moderately leveraged equity are between 8.5% and 11% -- 8.5% and 12%. So even 85% to 89% doesn't generate a high enough return to attract a whole lot of competition. 8.5% or 9% or 10% is not really exciting. So that indicates -- to me, if I'm -- and like you'd comment, that it indicates to me that there's still plenty of room on the upside in rates. Is that correct?

### **V. Prem Watsa**

*Founder, Chairman and Chief Executive Officer*

Yes, that's not a bad comment, Howard. The only problem is our industry, over long periods of time, hasn't made good returns on equity. I think Chob [ph] or other companies that have been in business for 25 years, if you look at their returns, they've been in that 10% area, plus/minus. And so unlike other industries, including the S&P 500, which has had 14% and 15% return on equity. So that's -- but your point's well taken. That's why, with these low interest rates, you have to have low combined ratios, like combined ratios much below 100%, to even have any chance of making a 10% return. You see 8.5% to 11% making a 10% return. So every time a bond, a 5-year bond matures -- and mostly the investment portfolios of insurance companies are invested like a 5-year bond...

### **Howard Flinker**

Yes, they're pretty short.

### **V. Prem Watsa**

*Founder, Chairman and Chief Executive Officer*

So every time it matures, Howard, investment income drops, and so this is going to continue. And the pressure to make a return will be very significant. To get a really hard market, our experience over the last 30 years is that you need to have an event. You need to have something that happens, either on the liability side, on the insurance side, obviously, a big catastrophe or something like that, or on the other side is on the investment portfolios. Like if you have spreads suddenly widening -- like we have very few corporate bonds today, one of the reasons that the spreads are very tight. And so as spreads widen, people are reaching for yield, not only in the insurance business, but all over the United States and Canada and perhaps the world. As these low interest rates prevail -- well, if spreads widen significantly, there'll be losses in the bond portfolios. And so -- and if you have -- and I mentioned CPI deflation swaps. Inflation is very low today in spite of QE1, QE2, QE3, also -- and lots of fiscal stimulants. Inflation is in that 1% area. The most recent number in Europe was 0.7%, 0.7%. So if you -- and it takes some time before deflation sets in. We continue to, Howard, worry about the inflation. Of course, if that happens, we

don't do too badly because of the swaps that we have. So we've protected ourselves for some time from all of these events. It doesn't show in our statements, but we're long term in building value.

**Howard Flinker**

Monetary velocity in the United States is the lowest on record, and the record being roughly 110, 115, 100 years, I forget the exact period.

**V. Prem Watsa**

*Founder, Chairman and Chief Executive Officer*

I think that's right, Howard, yes.

**Howard Flinker**

That is deflation area in itself. And one other event I was going to add is that there's not -- 2014, not 1914, 2014 has a severe -- or has a downward year in the stock market, that could be the event that you're [indiscernible]...

**V. Prem Watsa**

*Founder, Chairman and Chief Executive Officer*

Well, that would -- that's the sort of environment we are protecting ourselves against, Howard. But of course, no one knows what will happen in 2014. Thank you very much for your comments, Howard.

**Operator**

There are no further questions at this time.

**V. Prem Watsa**

*Founder, Chairman and Chief Executive Officer*

Audra, 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, Audra.

**Operator**

Thank you. Today's call has concluded. Thank you for participating. Please disconnect your phone line at this time.

The information in the transcripts ("Content") are provided for internal business purposes and should not be used to assemble or create a database. The Content is based on collection and policies governing audio to text conversion for readable "Transcript" content and all accompanying derived products that is proprietary to Capital IQ and its Third Party Content Providers.

The provision of the Content is without any obligation on the part of Capital IQ, Inc. or its third party content providers to review such or any liability or responsibility arising out of your use thereof. Capital IQ does not guarantee or make any representation or warranty, either express or implied, as to the accuracy, validity, timeliness, completeness or continued availability of any Content and shall not be liable for any errors, delays, or actions taken in reliance on information. The Content is not intended to provide tax, legal, insurance or investment advice, and nothing in the Content should be construed as an offer to sell, a solicitation of an offer to buy, or a recommendation for any security by Capital IQ or any third party. In addition, the Content speaks only as of the date issued and is based on conference calls that may contain projections of other forward-looking statements. You should not rely on the Content as expressing Capital IQ's opinion or as representing current information. Capital IQ has not undertaken, and do not undertake any duty to update the Content or otherwise advise you of changes in the Content.

THE CONTENT IS PROVIDED "AS IS" AND "AS AVAILABLE" WITHOUT WARRANTY OF ANY KIND. USE OF THE CONTENT IS AT THE USERS OWN RISK. IN NO EVENT SHALL CAPITAL IQ BE LIABLE FOR ANY DECISION MADE OR ACTION OR INACTION TAKEN IN RELIANCE ON ANY CONTENT, INCLUDING THIRD-PARTY CONTENT. CAPITAL IQ FURTHER EXPLICITLY DISCLAIMS, ANY WARRANTY OF ANY KIND, WHETHER EXPRESS OR IMPLIED, INCLUDING WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE AND NON-INFRINGEMENT. CAPITAL IQ, SUPPLIERS OF THIRD-PARTY CONTENT AND ANY OTHER THIRD PARTY WORKING WITH CAPITAL IQ SHALL NOT BE RESPONSIBLE OR LIABLE, DIRECTLY OR INDIRECTLY, FOR ANY DAMAGES OR LOSS (INCLUDING DIRECT, INDIRECT, INCIDENTAL, CONSEQUENTIAL AND ANY AND ALL OTHER FORMS OF DAMAGES OR LOSSES REGARDLESS OF THE FORM OF THE ACTION OR THE BASIS OF THE CLAIM) CAUSED OR ALLEGED TO BE CAUSED IN CONNECTION WITH YOUR USE OF THE CONTENT WHETHER OR NOT FORESEEABLE, EVEN IF CAPITAL IQ OR ANY OF THE SUPPLIERS OF THIRD-PARTY CONTENT OR OTHER THIRD PARTIES WORKING WITH CAPITAL IQ IN CONNECTION WITH THE CONTENT HAS BEEN ADVISED OF THE POSSIBILITY OR LIKELIHOOD OF SUCH DAMAGES.

© 2017 Capital IQ, Inc.