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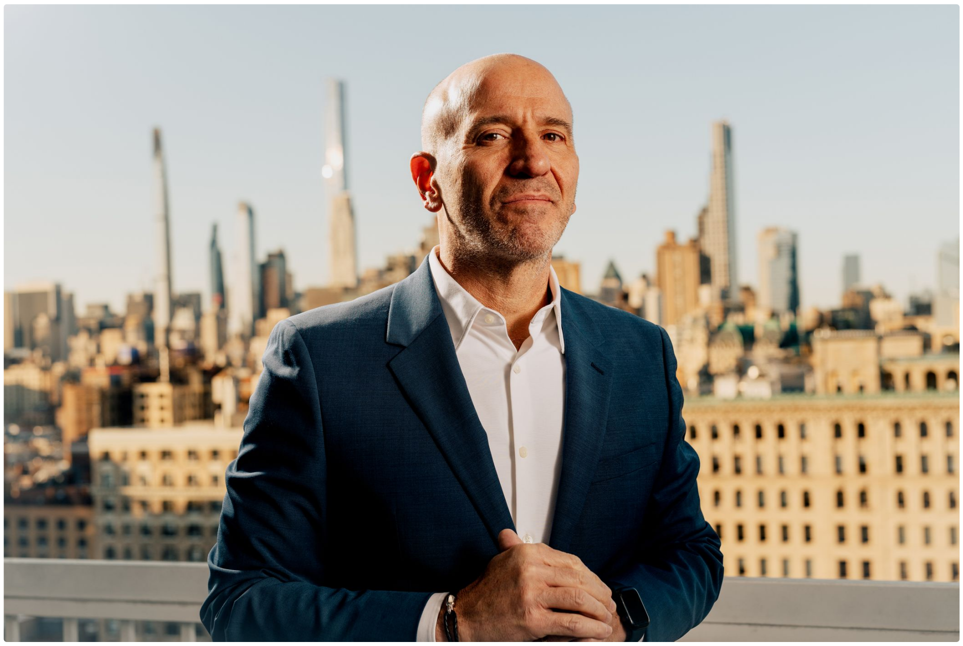
VALUE INVESTING | Q&A

This Manager Sees a Margin of Safety in Stocks Such as KKR and Exor

By Ben Levisohn Follow April 13, 2023 12:09 pm ET



Larry Pitkowsky, co-founder of GoodHaven Capital Management.
Photograph by Clark Hodgin

Call it a comeback. After years of underperformance, GoodHaven Fund GOODX -0.46%, managed by Larry Pitkowsky, has finally started performing the way its founders imagined when they launched it in 2011.

Founded by Pitkowsky and Keith Trauner, GoodHaven (ticker: GOODX) trailed its peers and the S&P 500 from its inception through the end of 2018, as large positions in oil and other commodity-related stocks soured, and bets on turnarounds failed to pay off. Net assets under management at GoodHaven totaled $551 million on Aug. 31, 2014. Recently, the fund oversaw just $110 million.

Realizing that something needed to change, GoodHaven reorganized in 2019. Pikowsky became controlling owner and sole portfolio manager, with Trauner holding a minority stake, along with Markel (MKL), the holding company that had helped seed GoodHaven when it launched. Pitkowsky's plan, laid out in GoodHaven's 2019 letter to shareholders, was to get back to basics by acknowledging that investing is "not an IQ test," among other principles.

The fund's revival was immediate. GoodHaven has returned 25%, including reinvested dividends, over the past three years, outpacing the S&P 500's 18.6% return. Pitkowsky, however, knows he has a lot of work to do to regain investor confidence. While GoodHaven now ranks in the top 10% in midcap-value fund performance over the past five years, according to Morningstar, it still is in the bottom 1% over the past 10. "I would consider myself pleased, but hardly satisfied," he says.

Pitkowsky talked with *Barron's* over the past month about the fund's turnaround, his views on value investing, and his favorite stocks. An edited version of the discussion follows.

***Barron's*: Larry, we have to ask: What went wrong?**

Larry Pitkowski: Portfolio management is a little like chefs in a fine restaurant. Sometimes, you have the resources and talent and there's some reason the food came out really well for a long time. Then it's not quite as good as it should be. And you make some changes and the food starts coming out better. But it was never one thing. It was a whole bunch of—we'll call them not scientific things. Some of us made it a bit harder than it needed to be by getting a little too macro-focused, forgetting that value investing is consistent with owning high-quality, growing businesses. As long as you can purchase them with a material margin of safety, and you're thinking about risk, the markets are there to serve you.

So, what's going right?

Our process has been better, our research has been good. We've behaved opportunistically when presented with things in our circle of confidence. We're slow to part with great underlying companies that we own, which has served us well. It has also been important to not try to make it harder by owning a lot of what I would call "stuff in the middle." We can own a good business that has a competitive advantage and good returns on capital and was bought at an attractive price, or we can buy a special situation with a catalyst that opens value. In the middle are the structurally challenged businesses. I try to avoid those.

It must also help that value stocks are finally performing well again. What makes a good value investor?

It's some unusual mix of complete paranoia and long-term patience. You kind of need both. Being a value investor means resisting the poles of mass psychology at any given moment. You need the complete paranoia because you need to continue to reassess your most beloved thesis. If the market hasn't figured out your super-clever idea within a couple of years, you're probably wrong. I'm in favor of changing my mind.

Having said that, it's a bad idea to change your mind just because the fundamentals and the thesis appear to be evolving. Often investors don't get long-term results from the businesses they own because they don't hang around long enough.

How do you choose investments?

We try to own some high-quality businesses that have high internal returns on capital, are growing, and are run by talented people; businesses that we bought at attractive prices with a big margin of safety. One benefit of not being 25 anymore is you have a lot of companies that you have kept an eye on over the years. We've got a long list of companies that we have admired, that we would like to own at a certain price—but we need to wait for the market to give us that price.

We've got a high-quality portfolio, with companies growing faster than the S&P 500. But at 13 times earnings, it is much cheaper than the market, with some interesting special situations and things that have a lot of upside.

What do you make of the macro backdrop?

This period is very unusual, but it doesn't strike me as one in which there are existential risks to the financial markets or the overall economy of the magnitude we saw in the spring of 2020. We have much higher inflation. We have a Federal Reserve that's raising interest rates to try to get a handle on that. Even with the demise of Silicon Valley Bank, we had long contemplated how rising rates would impact what we own and want to own, and we'd seen runs on the banks before. It isn't a "Lehman Brothers moment," for lack of a better phrase. Regulators were well aware of the need to address it, and they did.

Do you worry about a recession?

All kinds of things are important, but unknowable. The odds of getting that stuff right are extremely low. But one has to assume that recessions will show up periodically, that there is still a business cycle. Occasional market dislocations and downturns often provide potential opportunities.

Which stocks stand out now?

We own Builders FirstSource [BLDR], the nation's largest supplier of structural building products. We stumbled on it back in 2017. At the time, the industry was beginning to consolidate. The company had some leverage, which it was planning to bring down. We also thought there was a potential tailwind from an underbuilt single-family housing market that had never recovered from the financial crisis. We liked the management, and were paying an attractive price.

Things have gone even better than I could have imagined. When we bought it in 2017, it was doing $7 billion in annual sales. Last year, it did $22.7 billion. It was levered over four times back then. Today, it's on its way to being leveraged less than one times. The company combined with its major competitor, BMC Stock Holdings, and the industry continues to become more consolidated. It is a better business, and shares outstanding are higher, but the company is repurchasing shares at a rapid clip.

Why do you like Builders FirstSource now?

In 2021, we wrote that one of these days the housing market is going to cool. But we were OK with that; we think the business is so good. Management is doing a great job, and the price is still cheap—at 14.2 times forward earnings—that we're willing to live through this cycle. The company made $18.71 a share last year. It benefited from higher lumber prices and a still-healthy backlog. It might make only $6 a share this year. But it is unlevered to a great extent, the business is still consolidating, and it is still acquiring smaller companies. Getting overly focused on a slower period in single-family housing construction misses the long-term potential. If the stock price assumed continued earnings as seen in 2022, an unusually good period, well, that might give us some pause. But that's not the case.

You're a longtime holder of Alphabet [**GOOGL**]**. How worried are you about ChatGPT and the potential that** Microsoft [**MSFT**] **has to erode Google's search dominance?**

Google has been talking about artificial intelligence for a long, long time. It's part of the main products in different ways. Microsoft made an aggressive step forward, and Alphabet has taken a more measured approach.

But even predating ChatGPT, growth has slowed. I've been surprised it took so long. There was some pull-forward of results coming out of the Covid lockdowns. And there is the issue of growing the expense base fast, which TCI's Chris Hahn wrote of. If it is a slower-growth environment, what is the right pace of expense growth? That is within Google's ability to address. The secular question about something like ChatGPT? It's too early to tell.

KKR **KKR +1.21%** [**KKR**] **is one of your 10 largest positions. Don't higher rates make it more difficult for the company to make solid investments?**

When rates move as much and as fast as they have lately, there is a bit of an adjustment factor. Higher interest rates affect all valuations to some extent, so I'm happy that they took some markdowns on some investments. But KKR has a lot of different engines. They have alternative credit, infrastructure, and real estate strategies, in addition to the core private equity. It still seems that alternative-asset managers are garnering share from lots of the pockets of the investment business. KKR has used downturns in the past to opportunistically deploy capital and continue to grow the business. The stock is $51, and they've got almost $20 a share of quality investments, so we think you're paying less than 10 times earnings for the core business.

Exor EXO +0.52% ▲ **[EXOR.Netherlands], another GoodHaven holding, is controlled by the Agnelli family, and was once considered a baby** Berkshire Hathaway **[BRK.A, BRK.B]. But a lot has changed as CEO John Elkann appears to be focusing on luxury brands after selling PartnerRe, Exor's reinsurance company. What makes Exor attractive?**

Elkann is taking the company in a certain direction. He got out of insurance, so I don't think he's looking to replicate the exact structure that Berkshire put together, marrying insurance and reinsurance with operating businesses and an investment portfolio. But I like what he's doing. Elkann is moving more capital into potentially higher-growth—and higher-return—areas, including some venture capital, and companies like Christian Louboutin. Ferrari [RACE] is a one-of-a-kind luxury brand. [Exor owns nearly a quarter of the Italian car maker.]

Exor shares have been periodically available at a discount to net asset value. But I like that Elkann is focused on growing the underlying value, as opposed to being obsessed about where the stock is versus net asset value.

Thanks, Larry.

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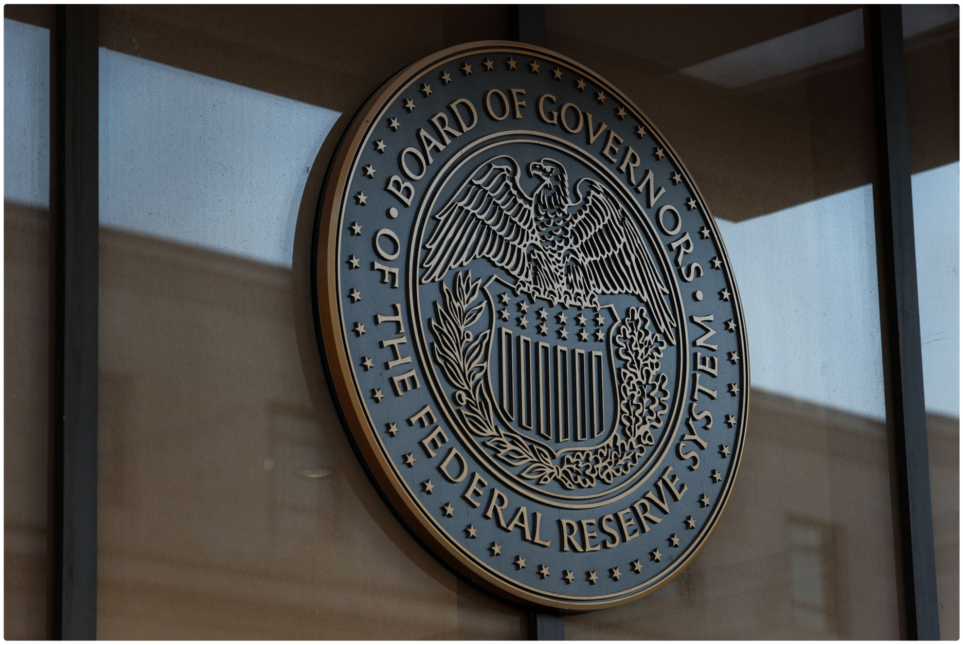
ECONOMY & POLICY | THE ECONOMY

The Yield Curve and Inflation Might Be Sending a Positive Message

By Allan Sloan Updated April 13, 2023 9:21 am ET / Original April 13, 2023 1:45 am ET



The Federal Reserve is trying to keep trillions of yield-hungry dollars from flooding the financial markets and forcing down rates.
Kevin Dietsch/Getty Images

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6 minutes

*This is a commentary by **Allan Sloan**, an independent business journalist and seven-time winner of the Loeb Award, business journalism's highest honor.*

Today, let's have some fun with numbers by looking at two important economic indicators in unconventional ways. What they are telling us may surprise you.

The first indicator is the inverted yield curve, which shows that since November, three-month Treasury bills have been yielding more interest than 10-year Treasury notes. The conventional...

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