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Comment

The market area offering its widest discount in 20 years

Joe Bauernfreund is portfolio manager of the AVI Global Trust

For an investor, finding the hidden investment opportunity that the rest of the market has overlooked is something akin to the holy grail of stockpicking.

Inefficiencies within the market can throw up anomalies such as strong, high-quality companies trading at a wide discount to true valuations. However, finding these companies requires looking in areas of the market where others do not.

Uncovering prime investments is a time-consuming task, but worth it to reap the long-term returns. Historically, some of the best of these overlooked companies have been family-controlled holding companies.

At this late stage of a bull market, discounts in this small area of the market are close to the widest we have seen over the past 20 years, and are closer to levels one would expect at times of severe market stress and dislocation.

Family holding companies suffer from a lack of research and low investor interest. With the meteoric rise of US technology companies, investor attention has been drawn elsewhere, with many ignoring more obscure and less liquid companies. This, in turn, has led to widespread mispricing of assets, and as a result has created strong opportunities for canny investors.

Not only are they a less researched area, but family-controlled holding companies are predominantly found in Europe or Asia. Given Europe's slow growth and lukewarm sentiment, firms on the continent have been hit hard by low levels of investor interest. However, the reality is many of these companies are in fact global in nature, owning attractive quality assets across the world, and are being unfairly penalised.

Macroeconomic sentiment is, we fear, misguiding investors and suppressing the valuations of these companies, particularly when combined with a lack of both investor interest and meaningful sell-side research.

Nonetheless, we believe the opportunity in family holding companies is significant. Owning a handful of businesses – between five or ten – listed or unlisted and operating anywhere in the world, makes them quite complex. Few sell-side analysts provide research on them, which means many are overlooked by investors who simply do not have the time to spend examining them in full.

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Diversification

However, missing out on the opportunity to own family-controlled holding companies means missing out on a stock that can act as a well-balanced diversifier for an investment portfolio.

Family businesses are not just interested in the next quarterly earnings; they seek to create wealth to pass on to future generations. This alignment and long-term outlook allows family-controlled holding companies to take advantage of contrarian opportunities. The very best examples are companies with strong balance sheets and proactively minded families, which are able to take advantage of market dislocations and generate value from their holdings.

EXOR – the investment vehicle of the Italian Agnelli family – is a prime example of the attraction of family-controlled holding companies. Listed in Italy, EXOR owns controlling stakes in listed companies Ferrari, Fiat Chrysler and CNH Industrial, as well as 100% of Partner Re, an unlisted re-insurance business. EXOR trades at more than a 30% discount to its net asset value (NAV).

John Elkann, the great-great grandson of Fiat's founder Giovanni Agnelli, has developed a strong track record of compounding wealth, well in excess of global equity markets. Elkann actively manages EXOR's portfolio with an eye on value creation.

In 2016 EXOR spun Ferrari out from Fiat Chrysler, helping shine a light on its luxury brand characteristics, which the market previously overlooked. Since then, its share price has more than doubled.

Currently EXOR, ever the active owner, is trying to unlock value trapped inside CNH's conglomerate structure, splitting the company into two specialised businesses. Meanwhile, they have also been busy trying to find a partner for Fiat Chrysler.

While the proposed merger with Renault appears off for the moment, it seems that a suitable deal will be found in time, as other players come to recognise the need for consolidation across the industry as car companies battle the challenges of electrification and automation. Active, ambitious ownership such as this, which aims to release value, is a key attraction of family-controlled holding companies.

EXOR is just one example of how these businesses offer investors a way to align their interests with skilled capital allocators, managing portfolios of quality assets to generate wealth over the long-term.

The diverse nature of holding companies means even a highly concentrated portfolio of the most attractive names still results in a well-diversified look-through exposure of quality, often well-known businesses. Accessed via the holding company, one gains exposure to these at a significant discount, adding the potential for even greater returns from discount contraction.

A combination of this diversity, the quality nature of their underlying assets, and the long-term family mindset make family-controlled holding companies well placed to navigate volatile markets. At a time of increasing uncertainty and global tensions, investors would be wise not to overlook this significant opportunity.