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Odyssey of a value fund

Matthew McLennan was born in 1969. The predecessor of the mutual fund he oversees, the First Eagle Global Fund, got started in 1970. How the former manages the latter, and how the latter has flourished in the face of relentless competition from low-fee, passively managed alternatives (the kind that Michael Green excoriated in his talk at the Oct. 1 *Grant's* conference) are the topics before the house.

There's no mistaking the First Eagle fund for an index fund. It charges a one-time sales load of as much as 5% along with annual management expenses of 1.10% (the Vanguard S&P index fund charges 0.03%). McLennan's top position is gold bullion, representing 11.4% of assets (or 15.1%, including mining shares); he calls it his "Tier 1 capital." And while U.S. equities make up 72% of the MSCI World Index, they constitute just 41% of First Eagle's. The fund, whose class A shares are denoted SGENX, holds more cash and near cash (8.73%) than it does shares of companies in the information-technology sector (8.66%), a group that makes up more than a quarter of the MSCI World Index. "We are willing to look different from the market to both prudently participate and prevent the permanent impairment of capital," McLennan tells colleague James Robertson, Jr.

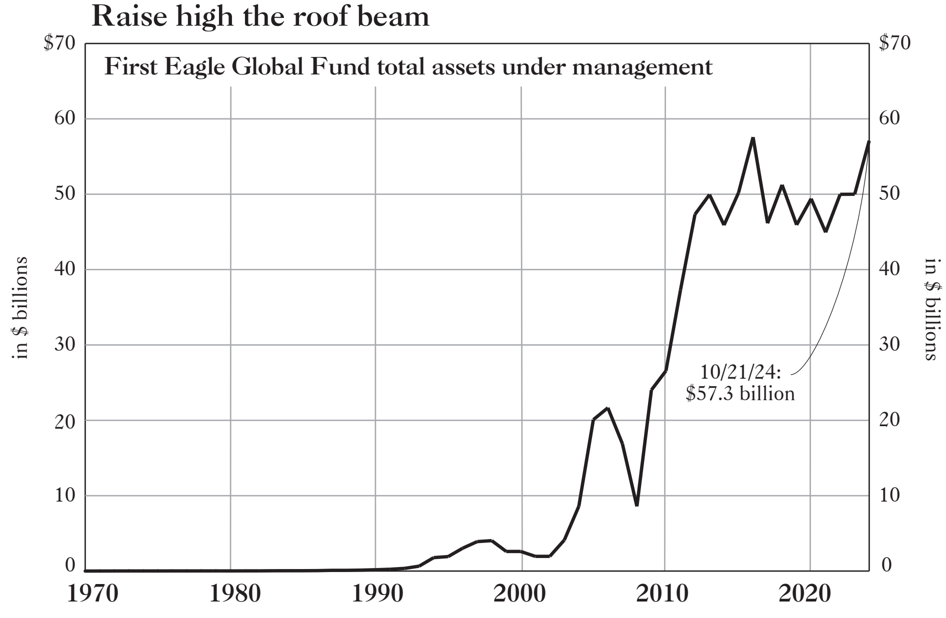
The First Eagle fund manages $57 billion today. It had just $19 million under its wing on the eve of its 10th anniversary in 1979. The SoGen International Fund, as the predecessor institution was known, employed one portfolio manager and not even one analyst. However, that PM was the redoubtable Frenchman Jean-Marie Eveillard.

"Over five years, 1979–83" Eveillard relates in his 2016 memoir, *Value Investing Makes Sense*, "the fund was up 188% vs. 78% for the MSCI World Index." Assets under management reached $95 million in 1987, in which crash-punctuated year the fund gained 13.8%. In the bear-market year 1990, it was down just 1.2%, compared with a 17% tumble for the MSCI World Index.

Eveillard modestly attributes these triumphs not to himself but to the ideas he gleaned from the writings of Benjamin Graham and to the examples of Warren Buffett and Charles Munger, who applied and adapted the Graham approach to modern markets. What makes the book particularly timely reading today is that Eveillard does not neglect his wilderness years. The value style has proven as cyclical as the stock market itself, and the geniuses who excelled with their attention to price and value in the 1970s and '80s could gain no traction in the technology, media and telecommunications mania of the late 1990s. Where had their intelligence gone?

"I for one," Eveillard writes, "always said that I would rather lose half our shareholders (which we did and change in the late 1990s) than lose half of their money, which we did not, when the tide did turn, and the TMT bubble burst." By the time Eveillard handed the reins over to McLennan in 2008, the fund had beaten the index eight years in a row. There was $8.6 billion under management.

Raise high the roof beam

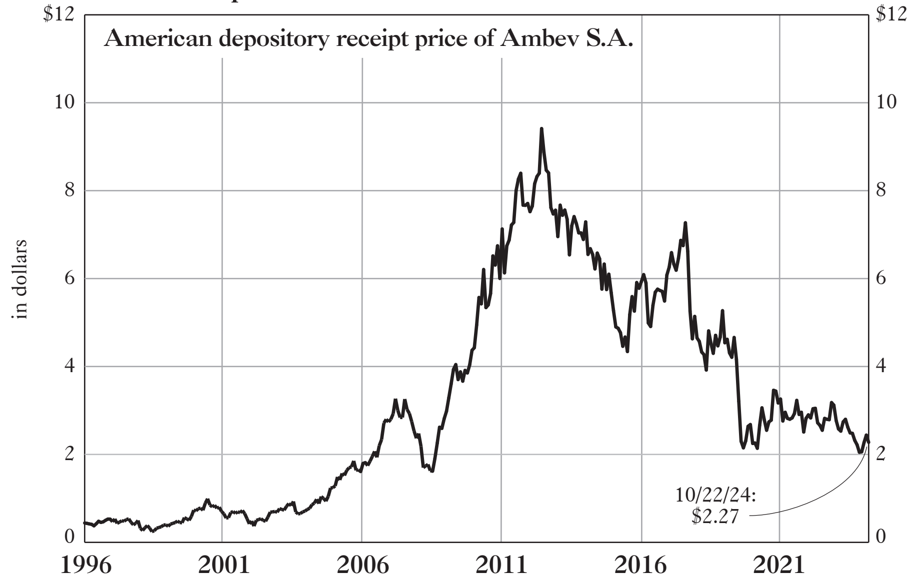


source: The Bloomberg

McLennan has a different cross to bear than Eveillard's. Not so much a cyclical as a secular, or even existential, one. Is security analysis worthwhile? Does valuation matter? Is unsecured paper money compatible with "price stability"? Does geographic diversification add value to an American portfolio? Is "capital preservation" a useful concern in the age of hair-trigger central-bank intervention?

"In the past couple of decades," McLennan advises Robertson by email, "we were in an environment characterized by a decline in the cost of capital, so being passively long beta or long-duration was on average a good outcome—especially with low cost. With Treasury yields breaking out on the upside from a 40-year downtrend, and risk aversion being quite low with scope to increase, we could be on the cusp of an increasing trend in the cost of capital, which would symmetrically yield disappointing returns to passive beta and long-duration-based approaches. Only time will tell. I understand the arguments for passive. I also understand the argument for an artisanal approach based on business selectivity, a valuation margin of safety and alignment with thoughtful management teams which is aimed to avoid the permanent impairment of capital (as opposed to minimizing tracking-error risk). In short, caveat emptor to the index faithful—there is no free lunch."

Bottoms up?



source: The Bloomberg

You can't call the First Eagle portfolio "concentrated." There are 124 positions, none much larger than 3%. Among the bigger ones are some high-flying American technology names that do not ordinarily turn up on value screens. They include Meta Platforms, Inc. Class A, Oracle Corp. and C. H. Robinson Worldwide, Inc., which combine for an average trailing p/e ratio of 35. Material companies constitute the largest sector in the portfolio (16%), followed by consumer staples (13%) and financials (12%). The average price-to-book ratio for the fund sits at 2.3 versus 3.6 for the MSCI World Index. Respective holdings trade at 18.5 times earnings for the First Eagle fund and 21.7 times for the index. The fund's average holding period is a decade.

"We don't try to make regime predictions," McLennan says, "but the challenging events of recent years have produced value in some emerging markets, and with that leading businesses have become available at undemanding prices. An example of this would include Ambev S.A., our largest Brazilian holding and the leading brewer in South America." Ambev controls 62% of the $56 billion Brazilian beer market. The ADRs (ABEV on the New York Stock Exchange) have fallen 18.9% this year and change hands at 14 forward earnings. Cash covers debt by R$12.1 billion ($2.2 billion). It's a 0.71% position.

"Elsewhere," McLennan goes on, "we have found that complex holding-company structures have tended to produce double discount opportunities." One example is Hong Kong–based Jardine Matheson Holdings Ltd. (trading on the Singapore Exchange as J36), a diversified holding company whose businesses include auto dealerships, luxury hotels and supermarkets. The company, a 0.48% portfolio position, trades at 0.62 times book value and 12.3 times forward earnings.

As for gold, McLennan winds up, "its valuation to us doesn't seem outsized relative to the broader equity markets that we might want a potential hedge against, nor is it outsized relative to the stock of government debt globally."

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