Q1
March 2022

Investment Objective: To achieve long-term capital appreciation and to exceed the returns of the MSCI All Country World (ex U.S.) Index through the active management of a focussed portfolio of listed equity investments in family-backed holding companies.

Introduction

Hobbes' characterisation of life as "*nasty, brutish and short*" provides a suitable synopsis for the first quarter of 2022. Russia's invasion of Ukraine is first and foremost a humanitarian tragedy. From a market perspective it also presents a real problem, dually accentuating inflationary prices whilst dampening the outlook for economic growth.

Whilst there has been considerable volatility across fixed income, commodity and currency markets, at the index level global equities have been relatively subdued. Having bounced off the March lows the MSCI AC World index closed the quarter down (just) -3.3% in Euros.

Within this context, the FHC fund returned -7.9% versus -3.4%% for the MSCI ACWI Ex-US (EUR).

Performance review

During periods of market stress, the double whammy of discount widening on top of NAV declines is a painful headwind to performance. As such we expect to underperform during these periods, and outperform as discount levels and risk appetites normalise. We try to take advantage of such periods to generally improve the quality of the portfolio, and deploy more capital into new or existing ideas on much wider than average discounts.

Performance in Q1 was consistent with this framework. Only 5 companies made positive returns in the first quarter, and the portfolio weighted average discount widened from 26% to 30%.

IAC – the north American internet-focussed holding company controlled by Barry Diller – was the most significant detractor from returns (-163bps) with the shares declining -23%, as a -12% decline in the NAV was compounded by a widening of the discount from 23% to 33%.

IAC specialises in building businesses that are trying to transition sectors from offline to online, such as Expedia for travel, and MTCH for dating. Such businesses are typically capital light, exhibit network effects and enjoy strong structural growth trends. IAC, who describe themselves as the "anti-conglomerate conglomerate", have a track record of spinning these off to shareholders when they reach maturity, having spawned 10 public companies.

Having spun-off MTCH and Vimeo in 2020 and 2021, today IAC is back in building mode with a portfolio as follows: **1)** Dotdash Meredith, a digital media company formed in 2021 when IAC's Dotdash acquired the illustrious media assets of Meredith Corp; **2)** a listed stake in Angi, the leading homeservices market place; **3)** a listed stake in MGM Resorts International, whose BetMGM is a leader in the nascent US sports betting and online gaming market; and **4)** a collection of smaller unlisted assets, the most promising of which are Care.com, a marketplace trying to bring the $300bn care market online, and a minority stake in Turo, a peer-to-peer car rental marketplace.

Investors tend to get excited about IAC when they are about to spin-off an asset, and grow despondent during the lulls when there are no "obvious" catalysts on the horizon. This is reflected in discount widening.

On top of this IAC's NAV has suffered from a sharp decline in Angi, shares in which are down -38% so far in 2022, as the correction in US internet / tech multiples combined with weaker than expected results created the perfect storm. Investors are highly sceptical as to whether (relatively) new CEO Oisin Hanrahan can successfully execute on the fixed price strategy and reinvigorate growth. We admit the jury is still very much out, but note that IAC management – arguably one of the most experienced builders of internet businesses - are seeing enough traction in the KPIs to keep investing in the strategy, and there is significant downside protection in the form of the "real option" available to them of restoring profitability at the expense of growth spend if they so chose. We believe the risk-reward from here to be highly attractive.

Turning to the discount, so far in 2022 IAC's discount has widened from 23% to 33%. Given IAC's history of spinning assets to shareholders, which acts as a pull to par, we believe the fair discount is close to zero. We are optimistic about prospective returns from discount narrowing, as well as NAV growth, with, on our estimates, a dollar invested in Silver King (the precursor to IAC) when Barry Diller took control in 1995 having grown to $33 today, compared to $14 for the S&P 500 over the same period.

Other meaningful detractors included Christian Dior, VNV Global and EXOR, which detracted -126bs, -120bps and -109bps, respectively.

At the other end of the portfolio, **Berkshire Hathaway** was the largest positive contributor as the shares rose +18%. Perhaps attesting to its veracity, investor letters often trot out the Mark Twain line that "*History Doesn't Repeat Itself, but It Often Rhymes*". Well, there's certainly echoes of the dot-com bubble bursting as Berkshire shares keep hitting new highs whilst unprofitable tech stocks recede. Returns have been driven by NAV growth (+21%) with the discount widening slightly to 16%. We believe this to be an attractive level at which to invest in a diverse and attractive quality set of companies with broad based exposure to the US economy.

Q1 portfolio activity

Trading activity was relatively muted during Q1. We continued adding to Eurazeo (now a 5% position) as well T Hasegawa. Having trimmed D'Ieteren at €177 in December we were able to re-top-up below €120 in March as the shares sold off following worse than expected results, before the shares closed the quarter out at €153.

Purchases were funded by a partial sale of Investor AB at a close to single digit discount level, whilst we also exited an unsuccessful investment in Associated British Foods ("ABF"). The position was initiated in late 2020 with a thesis predicated on the re-opening of the physical economy. Social restrictions continued to disrupt trading, and not unfounded worries about the deterioration of Primark's competitive positioning stopped the company from re-rating. Cognisant of thesis creep, and with Primark's thin margins likely to be tested by higher rates of inflation, we took the decision to exit the position

Outlook

As bottom-up fundamental investors we construct our portfolios based on our assessment of fundamental valuation, with no regard to index weightings or some grand macroeconomic theory. On the other hand, our portfolios companies do not operate in a vacuum. That is to say: we cannot ignore the big picture entirely.

In this vein, the broader environment has become more challenging over the last few months. Compounded by Russia's invasion of Ukraine, so-called transitory inflation has proved anything but. Whilst central bankers retired use of the word a little while ago, it will take more than semantics to abate it. The tightrope between quelling inflation on the one hand and not extinguishing growth on the other is a narrow one.

We however remain humble and frank about the fact the future is unknowable. Our experience shows that the key to generating strong long-term returns is to focus on the fundamentals. In this vein much comfort is sought from the portfolio of attractive quality, well managed, conservatively financed assets we have assembled, as well as the 30% portfolio weighted average discount at which they trade – having widened from 26% at the start of the year. With 4.6% cash on hand we have firepower to take advantage of dislocations in new and existing names as and when they arise.

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IMPORTANT INFORMATION

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