

The Interview - Mario Gabelli, Gabelli Asset Management: "The strong will get stronger"

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Mario Gabelli, whose firm Gabelli Asset Management is sub-advisor to Skandia Investment Group's Skandia US All Cap Value Fund, says the recovery in the US economy expected next year is likely to lead to more strategically-driven deal activity, as companies buying other companies in order to enhance growth, and will benefit investment firms that focus on bottom-up stock-picking.

GFM: Will the US be the first country to lead the way out of the crisis? How do you assess the administration's actions up to now?

MG: Economic stimulus is co-ordinated, global and powerful. The US economy represents 24 per cent of nominal world GDP, and is about 60 per cent greater than the faster-growing China, Russia, India, and Brazil combined. However, we have our challenges. Within the US, the consumer is about 70 per cent of our economy and has been in a recession for the past year and a half. About nine per cent of Americans are now unemployed, and consumer spending remains hamstrung by rising unemployment, reduced wealth and the decline in stock market and housing prices, but also by the limited availability of credit.

An unintended consequence of the stimulation is likely to be inflation. We think the stimulus will work and that stocks are a good place to be. Both fiscal and monetary policy will work on a global basis, with speed bumps along the way. President Obama inherited a very difficult situation. Under the new administration we have had significant government intervention in the markets, which will be reduced as conditions in the economy improve.

GFM: What are you telling your clients? Have you changed anything in your investment strategy?

MG: The US economy should improve in 2010, helped by an uptick in auto spending and improvement in housing and the ongoing stimulus. There is upside operating leverage in corporate earnings, partly due to cost cutting. The secular themes are the US deleveraging and transferring its wealth to China. We expect more strategically-driven deal activity, as companies buy other companies to enhance growth. Our emphasis, as always, is on POSP - plain old stock-picking.

GFM: Do you think that the crisis could change the industry? What are your thoughts about hedge funds and ETFs?

MG: The crisis has altered the financial services industry and most others by generating opportunity for those most responsive to change.

We have hedge funds that are an integral part of our investment products. Our merger arbitrage funds have been active for nearly a quarter of a century and have never had a down calendar year.

We do not manage an index fund. We buy individual businesses at deep discounts to their intrinsic values. We are active, research-intense stock-pickers.

GFM: As a value investor, is your investment philosophy still valid in the current environment, and are you optimistic? Where do you see the greatest opportunities?

MG: We are optimistic and opportunistic. This is a stock-picker's market. The strong will get stronger - companies with the financial wherewithal will pay substantial premiums for global growth. We are able to identify companies that are selling substantially below intrinsic value and that have the ability to survive during these tough times.

We are market capitalisation-agnostic in our stock selection and will invest wherever there is opportunity. We are able to add to our portfolio returns through fundamental bottom-up research. We favour companies that are often unloved and not followed by large Wall Street brokerage and research firms. There are enormous opportunities in the market today, but we can't go on an undisciplined buying spree - you need to get back to basics.

GFM: What is the turnover in your portfolios? What is the average period you hold a stock in your portfolio?

MG: The value team's turnover is in the area of 30 per cent, with a holding period of around three to five years.

GFM: What is your sell discipline?

MG: For more than 30 years we have been experts at identifying industries and, more specifically, companies that are takeover candidates. We sell securities when they are trading in the public market at or near our estimate of their private market value, or if the catalyst we expected to occur fails to materialise.

GFM: What are your thoughts on fixed income, and how does it fit into your product line-up?

MG: The global market consists of USD60trn of debt and USD30trn of equity. Our firm has grown over time to include one of the best money-market funds in the business. The Gabelli US Treasury Money Market Fund has some of the highest returns and lowest costs in its peer group. We have also added other fixed-income products, including Gabelli Intermediate Credit.

GFM: What are the advantages and disadvantages of a being a public company?

MG: Since we went public in February 1999, our stock is up 180 per cent, about three times the return of the US equity market. Being a public company has several advantages. We raised capital to expand our business, public awareness of our firm has increased, and it has allowed us to reward our talented team of new professionals with ownership.

In addition, we attracted a significant investment in GAMCO Investors, Inc from Cascade Investment, Bill Gates' private investment company. There are, of course, disadvantages to being public as well. The cost of complying with Sarbanes-Oxley has become increasingly expensive.

GFM: What are your assets under management? How many people work at the firm?

MG: At the end of 2008 we managed more than USD21bn in assets. We have about 200 team-mates and have offices in London, Shanghai, and Hong Kong that augment our research team in the US. We follow specific industries on a global basis.

GFM: Are you launching any new products this year?

MG: One of our new initiatives was the rebranding of our SRI Fund mutual fund as the Gabelli SRI Green Fund. The market is seeing the emergence of hundreds of new companies, as well as the repositioning of existing ones, in areas such as clean power generation, energy storage, recycling and waste, water, energy efficiency, transportation solutions, smart grid and distribution, carbon capture, forestry, agriculture and medicine.

GFM: Do you think there could be a GAMCO after you?

MG: Thirty years ago, I was the portfolio manager for assets managed in our value style. Since that time, we have continued to grow and expand. Today, I am the chief investment officer of the value team, which now consists of 30 analysts and nine portfolio managers.

We have been fortunate to attract many highly-motivated professionals and most of our equity research analysts have all been trained in our proprietary approach to stock selection, known as private market value with a catalyst, based on Graham & Dodd. Several currently manage assets using this methodology, ensuring the continuity of our highly successful investment process. For instance, our GAMCO Growth mutual fund under Howard Ward has enjoyed outstanding performance.

GFM: Do you have any plans to retire?

MG: No. When I started at Loeb Rhoades, John Loeb was 67, and he continued to manage money until he was 94. Investing is one profession where you get better as you get older. Warren Buffett, who is 78 years old, points out that money management does not require hand-eye co-ordination.

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