

IVA's de Vault: Gold Still Seems Underowned

Despite gold's sharp increase in price compared with past valuations, owning the commodity is not a mainstream trend yet, says IVA's Charles de Vault.

Fund Manager Q & A | 09-16-11 | By Liana Madura

Charles de Vault is a partner, portfolio manager, and chief investment officer at International Value Advisers.

Looking at IVA Worldwide (IVWAX), he recently spoke with us on how he effectively navigates the market's extreme volatility, his thoughts on how the eurozone debt crisis will affect overseas investments, and where to put cash to work when investing in today's market. He also comments on the prospects for gold and looks at some top picks in the consumer discretionary and consumer staples sectors.

1. You try to mitigate risk by trying to anticipate what could potentially go wrong in the marketplace, but given the market's extreme volatility and uncertainty, how are you able to do this effectively?

We do not actually anticipate in the sense of forecasting, nor do we think about the market place in the sense of guessing where markets may go, up or down. We are not forecasters, and we do not engage into market psychology. What we do is think a lot about what can go wrong at a specific company level. (Is the business changing for the worse? Is management likely to allocate capital properly? How would the business likely fare in a recession?) We then compute not only base-case intrinsic values for those companies but also worst-case intrinsic values.

We also insist on owning mostly well-capitalized businesses and sometimes go higher in the capital structure (such as investing in preferred stocks or corporate bonds) if the equity seems too risky. We also think about the big picture, monitoring in particular areas of the world where credit might have been too loose. We think of volatility as our friend, as it is easier to buy low and sell high when things move up and down like a yo-yo.

At the portfolio level, we are able to reduce volatility through an ownership of mostly good businesses that are well-capitalized, using high-yield bonds at times, using gold which sometimes acts as

a hedge (that is, it moves in an opposite way than most stocks and/or bonds). We also hold cash at times which helps buffer the volatility, and our flexible foreign exchange hedging policy can also help mitigate volatility.

We are mindful of correlations in the portfolio. For instance, owning commodity-related stocks might not offer much diversification if held alongside Chinese stocks; both are probably quite joined at the hip and would go down if China were to experience a hard landing.

2. Europe continues to remain the second-largest regional allocation in the fund. In what way do you think the eurozone debt crisis will affect the portfolio's investment in this area?

Europe does remain the second-largest regional allocation in IVA Worldwide, after the United States. The European debt crisis has an impact but only a modest one. One, we do not own any banks in Europe, except for a substantially overcapitalized regional bank in Switzerland which has virtually no exposure outside its country. European banks remain thin or even undercapitalized and as a result, unsafe. We also own no holdings in Greece, Spain, Portugal, and Ireland, and just small holdings in Italy. What is intriguing about Europe is that there are many companies that are very global in scope (Total (TOT), the oil company, Nestle (NSRGY), the food company, and Sodexo (SW), the food-catering company, but also much smaller companies, such as France-based Robertet (RBT), which has significant sales in the U.S., and so many others).

Finally, because we also own so many euro-centric names (such as Vivendi (VIV), the telecommunications company, or GDF Suez (GDFZY), the electric and gas utility) we have been for quite a while 50% hedged on the euro in IVA Worldwide, which, incidentally, has hurt the performance a little year to date as the euro is up against the U.S. dollar.

3. Where would you put the portfolio's cash to work given today's volatile environment and emphasis on capital preservation?

During the past few months, we have been slight net buyers. We have found a few new names such as three media-related names in the U.S., one in Italy, a Europe-based retailer, a U.K.-based telecommunications company, and a European insurance company. We have been able to add to a few of our names in Europe whose prices had declined, but we were comfortable that their intrinsic values had not (for instance, Vivendi). We are comfortable with some U.S. retailers such as Wal-Mart (WMT) and believe that a few large U.S. tech names remain cheap (such as Microsoft (MSFT) and Dell (DELL)) Some exposure to energy can be gained cheaply through Total or Devon Energy (DVN). A few high-yield corporate bonds are starting to look interesting as well as some Asia currency-denominated sovereign debt.

Equally important is what to avoid: most European banks and still most emerging-markets holdings that do not appear cheap enough to buy. We also are shying away from long-dated bonds and in fact have a small short position on 10-year Treasury futures. We so far have not bought into heavily cyclical companies yet.

4. Gold still remains one of the fund's top 10 holdings. Do you believe that gold is in a bubble? Why or why not?

Bubble is a strong word. If gold is in a bubble, then U.S. Treasuries might be in an even bigger bubble. We think gold is reflecting a growing distrust in policymakers and central bankers and therefore a distrust of fiat money around the world. Gold's action is also reflective of the fact that real interest rates are either negative or quite low in many currencies. Conversely, higher real interest rates would become a hurdle, a big negative for the gold price. Yet we do not believe real rates are about to go higher anytime soon.

Finally, gold reflects that there are few sound currencies left in the world (besides a few Asian currencies, the Singapore dollar in particular, or the Swiss Franc), and we are seeing some central banks beginning to buy gold again (for instance, those of South Korea and India). We are also intrigued by the fact that gold is not being bought on credit (by and large) and is bought out of fear, not out of greed. More importantly, it is remarkable that even though gold is up sevenfold from its lows of 10 years ago, it still seems underowned. A few months ago, a large institutional investor, University of Texas, announced that it had bought some \$1 billion worth of gold bullion (approximately 4% of its assets under management), and that

was big news. In other words, owning gold is not mainstream yet. We would probably reduce our gold weighting significantly if we were to find many truly compelling bargains among stocks and bonds around the world.

5. Which firms look the best-positioned in the consumer discretionary and consumer staples sectors?

On the consumer staples side, we are very comfortable owning names such as Nestle, with its strong balance sheet, significant exposure to emerging markets (close to 40% of food and beverage revenues), and reasonable valuation. Some of the Japanese cosmetic companies (such as Kose and Shiseido) might not offer much growth but are very cheap and overcapitalized.

On the consumer discretionary side, we are still very comfortable with Genting Malaysia, the only casino operator in Malaysia, as well as the Washington Post (WPO) where the growth prospects might be limited but which we believe trades at a significant discount of its sum-of-the-parts intrinsic value.

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**Important Information Concerning the Attached
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Past performance does not guarantee future results. As of 9/30/2011, the IVA Worldwide Fund's top 10 holdings were: SIGB (Singapore Government) 2.25% 2013; 3.625% 2014 (4.9%); Gold bullion (4.0%); Wendel 4.375% 2017; 4.875% 2016; 6.75% 2018 (3.2%); Secom Co. Ltd. (2.9%); Astellas Pharma Inc (2.7%); Genting Malaysia Berhad (2.4%); GDF Suez SA (2.3%); Sodexo SA (2.1%); Nestle SA (2.0%); Microsoft Corp. (2.0%).

The portfolio is actively managed and holdings are subject to risk and can change at any time. The commentary represents the opinion of Charles de Vault and Chuck de Lardemelle as of the date hereof and is subject to change based on market and other conditions. Any statistics contained herein have been obtained from sources believed to be reliable, but the accuracy of this information cannot be guaranteed.

There are risks associated with investing in funds that invest in securities of foreign countries, such as erratic market conditions, economic and political instability and fluctuations in currency exchange rates. Value-based investments are subject to the risk that the broad market may not recognize their intrinsic value.

An investor should read and consider the fund's investment objectives, risks, charges and expenses carefully before investing. This and other important information are detailed in our prospectus and summary prospectus, which can be obtained by calling 1-866-941-4482 or visiting www.ivafunds.com.

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