

In our last Research Perspectives [note](#), we talked about stock-picking extremes vs. our contrarian [Business, People, Price](#) approach. What about the less extreme feeling but potentially false sense of security consensus that is indexing? Passive investing can make sense as part of many portfolios. That said, we still have trouble getting excited about prospective index returns at a multiple well above 20x the next-twelve-months' free cash flow (FCF) for the S&P 500, as we also wrote in February. Beyond the numbers, an interesting sentiment measure hit our radar since our last note:

(Bloomberg) -- ██████████ lost about \$900 million so far this year from two teams focused on index rebalancing, a strategy recently upended by global stock market volatility, according to people familiar with the matter.

Index rebalancing – often highly leveraged – involves betting on which companies enter or exit various stock indexes, and it can be lucrative for giant multimanager hedge funds like ██████████

"Giant multimanager hedge funds" aka "pod shops" such as the one in the Bloomberg article above (no need to call them out, it could have been another one) are one of the few places in active public equity investing getting material inflows. Their strategy of having a portfolio manager (PM) of sub-PMs feed winners and cut off losers sounds appealing. While the approach is more complex than that summary, we do not think it is way more complex. If each sub-PM has the fear that their pod's assets could get yanked at the first sign of underperformance, might such an approach lead to too much short-term focus on too few stocks that have "never let you down," plus too little attention paid to stocks that are undervalued quality but do not always grow in a straight line and therefore present excessive career risk?

Similar factors are at play in indexing: the biggest parts of the indexes seem to get safer, and companies are kicked out of indexes when they are fiercely disliked. As contrarians, we are wary of the favorites, and we are more intrigued by the broadly unliked and/or ignored, because we are looking for stocks where sentiment has good odds of getting better. The fact that one firm was able to lose, not just invest, \$900m in a strategy that is trying to guess indexing says something about where we are in terms of consensus pod-supremacy in "active" and index-safety in "passive." The key questions: are pods really that active if a material part of them aggregates up to index-chasing, and how passive are indexes when the importance of their decisions has this much riding on it? Are there a lot of surprisingly correlated, leveraged bets that could go wrong quickly? It has happened before – from 2007's mini-quant-blow-up as a harbinger of 2008 to 1987's portfolio insurance consensus leading to the worst day in stock market history.

At the moment, these questions are not asked much. The less asked, the better for those who are focused on minimizing the wrong kinds of risk. We are focused on minimizing the risk of permanently losing money and are reminded of the classic Warren Buffett quote: "You pay a very high price in the stock market for a cheery consensus." Our most attractive stocks today are not the safest-feeling flow-getters. We can live with a temporary fear of market disappointment when we invest in a strong business run by aligned partners on offense. Volatile quarter-to-quarter earnings and/or some kind of "temporarily look dumb risk" can be a friend of the long-term investor, since astute partners use this mispricing to grow value per share (well-timed share repurchases and asset buys/sales) to increase the odds we get paid in the future. Nothing is risk-free, but we have learned lessons about avoiding companies that cannot solve their own problems and therefore have too much of the bad kind of permanent loss risk. When companies have higher FCF/share a few years from now (even if it does not get there in a straight line), and we pay low multiples of this FCF/share power, we win and can sleep at night.

Our first example where we have so far benefited from this dynamic is supermarket chain **Albertsons**. We believe it is a strong [Business](#) that earns a teens plus return on capital with a valuable real estate safety net (39% of stores owned). Local market shares in many of the company's markets are high and stable, and where market shares are lower, there is often a more logical owner of the assets nearby who is willing to pay a better price than is capitalized within the current multiple. These "hidden segments" within Albertsons speak to the importance of the [People](#) on the case. If they are not willing to constantly upgrade the portfolio and buy back stock at the right time, opportunities will be missed. We are excited to partner with the CEO & CFO team of Sue Morris and Sharon McCollam. They are supported by private equity firm Cerberus, which has been involved for nearly twenty years. This team has already correctly answered an important

question: “will you sell the company at the right **Price**?” This is how we got our shot at investing in the company last year. Albertsons had agreed to sell itself to Kroger in 2022 for an adjusted stock price above \$27. The price then was a good one for Albertsons shareholders. However, this kicked off a long review process, during which the government ended up blocking the deal late last year. This wait created a dynamic where no one fearful of a stock price drop if the deal got blocked wanted to buy ahead of that decision. It was not too hard to tell that an Albertsons stock price in the teens (a single digit multiple of FCF) was at a big discount to its value per share of \$25 to \$30+. We bought a partial position during this uncertainty and then filled out our position when the price dropped briefly on the blocked deal news. The next day, a prepared Albertsons team was out with a plan, and the stock has been up since. It is still undervalued today, as it is taking time to get back on the active investor radar and is not in the S&P 500 (yet) like Kroger. Additionally, the business is a safe and steady one. If the macro situation gets worse, it is rare to find something like that trading at a reasonable multiple (10x our opinion of growing FCF power).

Canal+ has a different kind of dynamic making it an attractive investment, but it rhymes with what we wrote above. We first came across this French media company when we invested in its former parent, Vivendi, in the 2000s. As we have learned through multiple ownership periods since then, being the worldwide leader in French language media can be a great **Business**, but it does not always happen smoothly quarter-to-quarter. Even though approximately 80% of the company's revenue comes from a stable base of subscribers, there are multiple business lines from Europe to Africa to other parts of the globe. The legacy France Pay-TV / Streaming business is incorrectly viewed by the market as the most important asset and a challenged one, but it is getting back to profits after correcting overpriced sports rights costs, fending off competition and growing subscribers. The better business in Africa will this year be significantly improved by a rational merger with MultiChoice to create the leading media company on that continent. Assets in other European and “Overseas” markets are profitable, growing and boring. StudioCanal will likely keep mining its valuable library and creating hits like the Paddington franchise. The **People** combination of CEO Maxime Saada and large ownership of the Bollore family should ensure capital is allocated prudently as the company emerges from a holding pattern put in place by the pending MultiChoice merger and a complex spinoff from Vivendi that happened late in 2024. Spinoffs are a classic way to get a great **Price**. The limited public track record of the spun company creates a situation where indexes often do not own the new company, and fearful active investors do not want to buy until there is a more established track record in the stock market. Canal+ in particular, as a French company trading on the London Stock Exchange, has all the more reasons to ignore it. But when it is trading at less than £2 per share and worth more than £5, we are not going to wait for a cheery consensus. Insiders have been buying, and we think it is telling that the company's compensation plan pre-spin had near-term targets based on a value above £5, suggesting that the company agrees with our appraisal. We believe Bollore could pay a fair price to own these assets in full, and global media companies could be interested as well. In the meantime, we own this business at less than 5x growing FCF power.

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