

Don't You Believe Them

This article is authored by MOI Global instructor Massimo Fuggetta, managing partner at Bayes Investments, based in London.

By the time I started writing my [D.Phil. thesis](#), I had pretty much come to the conclusion that academic life was not for me. So I decided to try and see what it was like to work in the City, and got a summer job at James Capel. Subsequently bought by HSBC, James Capel was then a prominent UK stockbroker and one of the few to pioneer into European equity research. So it was that, overnight, I became their 'Italian Equity Strategist'.

I wanted to dip a toe in the water – I got a breath-taking full-body plunge into the wide ocean. In no time I was talking to all sorts of 'clients' about all things Italy – a true life shaping experience. I still remember – or was it a nightmare? – being in front of a big shot from the 'Danish Pension Fund', trying to answer as best as I could his full cartridge of very detailed questions.

It didn't last long. First, being at work at 7am was definitely not my thing. Besides that, I soon realised I wanted to be on the other side – the buy side, not the sell side. A fund manager, not a stockbroker. So when my friend Bruno got me an interview at JP Morgan Investment Management, where he was working as a company analyst – 'I'm there at 9am and I can manage my time quite flexibly, as long as I get the job done' – I was all for it.

But before leaving James Capel I wrote my final piece for their [European Equity Strategy](#) publication. It resurfaced recently in a house move. Reading it again after such a long time (yes, the London phone code was 01) made me laugh out loud:

The Italian stock market has gone up 9% by the end of July since the beginning of 1988. This relatively poor performance can essentially be ascribed to fundamental market uncertainty on the critical issues of political stability and fiscal policy, which constitute both the primary target and the key test for the new coalition government headed by the Christian Democratic leader Mr de Mita.

A global reform of the institutional and administrative apparatus of the Italian state is another major concern of the de Mita government. The aim is to make legislation a less lengthy and cumbersome process and to increase the efficiency of the Public Administration.

Political uncertainty – which has kept foreign investors out of Italy for two years – is certainly among the key factors which explain the poor relative growth of the Italian market and the low level of current valuations relative to the performance and prospects of the Italian quoted companies.

As Bruce Hornsby had been singing a couple of years earlier, 'That's just the way it is – Some things will never change'.

Since the launch of the [Made in Italy Fund](#), now more than three years ago, I have been banging on this point. Viewed from a top-down, macro perspective, Italy has always looked like an unattractive place to invest. Unstable governments, inefficient public services, bulky

debt, higher bond yields and, before the euro, a chronically weak currency. Add for a good measure a few evergreens, such as corruption, the South backwardness and organised crime. And, from a stock market point of view, a limited number of quoted companies – currently about 350, against more than 800 each in France and Germany – mainly concentrated in banking and finance, utilities, oils and a few consumers. The whole lot worth about 600 billion euro – less than Apple. Who would want to invest there?

So common is this ‘country’ way of thinking that it takes some [unlearning](#) to realise how fundamentally wrong it is.

Investors do not buy countries. They buy companies – companies that happen to be based in a certain country and are therefore, in most cases, quoted on that country’s Stock Exchange.

But what does that mean? Is Microsoft a US company? Is Nestlé a Swiss company? Yes, that’s where they are headquartered and quoted. But no, not in the sense that their performance is related in any meaningful way to the performance and vicissitudes of their country of origin. What is the relationship between LVMH and the growth of the French economy? Or Ferrari and the stability of the Italian government?

The national dimension of equity investing is largely a remnant of a long-gone past, when most businesses were predominantly domestic. This is clearly not the case today, and not only for the big global corporations, but also, and increasingly so, for smaller firms selling their products and services around the world. To think that there is any direct link between these companies and the economic conditions of their country of origin is lazy at best.

There are still of course many companies whose business is mainly domestic. For these, the linkage to the state of the national economy may be stronger – but it is far from being linear, stable or reliable. Indeed, for some companies a weak economy may create opportunities to gain market share from competitors or to introduce new products and services.

So it is never as simple as economy=stock market. This is so in general, but it’s especially true for Italy, where the sector composition of the market bears no resemblance to the country’s economic reality.

Then what’s the point of the Made in Italy Fund? Isn’t its very name meant to evoke the same national dimension that I am saying makes no sense?

No. The Fund does not invest in Italy as a country. It invests in Italian companies with a market capitalisation of less than one billion euro, quoted on the Milan Stock Exchange.

Why only those and why only there? Two reasons:

1. It is a good place for finding [pearls](#) – companies with high growth prospects, strong and sustainable profitability and attractive valuations. Many of them are smaller companies, leaders in specific market niches, where good management and Italian flair allow them to build and maintain a solid competitive advantage in Italy and abroad. Of course, there are many good companies elsewhere. Buy in Italy they tend to be cheaper. Why? Precisely because investors snub Italy as a country! This is clearly true for many foreign investors, indolently clinging to their ‘country’ way of thinking. But in the last few decades it has been increasingly true also for domestic investors, who in a post-euro, pan-European world have been shedding a sane [home-country bias](#) in favour of a snobbish xenophilia.

2. Soon after I joined JPMIM after James Capel, I started managing the Italian slice of their

international equity and balanced portfolios. This was – hard to believe – thirty years ago. Since then I have done many other things, but my involvement with the Italian stock market has hardly ever stopped. I am – I fear to say – a veteran. As such, I like to believe that my experience, together with my ‘Italianness’ – in language, culture and mores – make me especially suited to spotting Italian pearls and, as importantly, avoiding Italian pebbles and duds.

Italy is my country. Like most Italians, I have a complex love-hate relationship with it. Di Maio or de Mita, its politics has always been messy, its public finances rickety, its international credibility regularly in the balance. In my thirty years as an Italian fund manager, I have never been able to build a credible top-down investment case for Italy as a country (incidentally, can one do so for France or Germany or any other developed nation?). But when I flip it around and look bottom-up at Italian companies, especially the smaller ones that form the backbone of the Italian economy, I have no hesitation. In a universe of around 280 companies with less than one billion market cap – now steadily increasing through a sustained flow of new IPOs – I have no trouble selecting thirty or so to include in the Made in Italy Fund. If anything, the problem is to keep track of all the opportunities.

So my attitude to chronic Italian bears is, with Bruce Hornsby: ‘Ah, but don’t you believe them’. Country allocation should not be about countries. It should be about finding pots of value around the globe, and focused managers able to extract them.