GoodHaven 2.0

A reboot has revitalized a value-oriented shop.

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There are undiscovered managers, then there are rediscovered managers. GoodHaven Capital Management is more the latter, and in more ways than one.

The firm has been featured here before. GoodHaven and its co-founders, Larry Pitkowsky and Keith Trauner, appeared in the February/March 2012 issue of the magazine, not long after the launch of GoodHaven Fund GOODX.

But the firm and fund featured back then were notably different. Pitkowsky calls that iteration GoodHaven 1.0. In late 2019, just before the pandemic hit, Trauner stepped down as a managing partner and portfolio manager, leaving Pitkowsky squarely in charge. Welcome GoodHaven 2.0.

The revamped strategy has rediscovered its mojo. After years of performance that could objectively be described as horrible, the fund has reemerged as a top performer.

A Smooth Start, Then Turbulence

When Pitkowsky and Trauner launched GoodHaven in November 2010, it was a scion of iconic value investor Bruce Berkowitz's Fairholme Capital Management. They had contributed to the success of Fairholme Fund FAIRX from its 1999 inception through October 2010, helping its performance top the large-value Morningstar Category, with an annualized 13.6% gain versus 3.6% for the typical peer.

Their reasons for striking off on their own are still shrouded—Pitkowsky would not speak to them then nor will he today. Disruptions to Fairholme's investment team likely played a role, with a new comanager apparently supplanting Pitkowsky and Trauner. As we noted in our previous article, "That experience could only fuel the duo's desire to prove themselves on their own."

And prove themselves they did, at least at the start. From its April 2011 inception through the end of that year, the GoodHaven fund outpaced 89% of large-value category rivals. For its first full calendar year in 2012, it topped 91% of peers.

Then followed a string of ugly years, each worse than the next. In 2013, the fund gained 19.4%—reasonable, but less than 96% of large-value peers. In 2014, when the typical peer's fund rose 10.8%, GoodHaven lost 8.9%, worse than 99% of peers. And finally, in 2015, the fund lost 18.4%—the third-worst showing in the category and nearly 20 percentage points behind the S&P 500, the fund's prospectus benchmark. Between then and 2019, the fund had two good years, interspersed with two more bad ones.

Seeds of Change

"I think we did a couple of things that hurt," Pitkowsky says of the performance. The portfolio was structured in three basic parts—higher-quality companies, special-situation turnaround stories, and what he (dis) affectionately calls "stuff in the middle." These were stocks that were neither high quality nor really that special, despite needing to turn around.

Trading wasn't perfect in any of the categories. Some pain came from selling good companies too soon. The portfolio owned a lot of Microsoft MSFT when it was around $25 to $40 per share, but when the managers thought it had grown too expensive, "we felt we needed to sell it all. Once in a while, I wake up in the middle of the night and make that (potential growth) calculation, and it's quite upsetting," Pitkowsky says. (The stock was above $370 at the end of December.)

The burgeoning tech names at the time remind Pitkowsky, in hindsight, of a Mark Twain quote: "The cat, having sat upon a hot stove lid, will not sit upon a hot stove lid again. But he won't sit upon a cold stove lid, either." The point is the risk of being overcautious. In the early/middle 2010s, he could recall the fates of Nifty Fifty stocks or once-dominant companies whose "franchises went cold," making him wary of big winners being able to justify high stock prices. But in the case of today's so-called Magnificent Seven stocks (Alphabet GOOG, Amazon.com AMZN, Apple AAPL, Meta META, Microsoft, Nvidia NVDA, and Tesla TSLA), "they've gotten stronger, proving their valuations never got to be ridiculous." One hot lid he's sat on a long time is Alphabet, which he's held since the fund's inception.

On the other end of the portfolio spectrum, some of GoodHaven's special situations never turned around—names like Sears, Dundee, and Walter Investment. But ultimately, it was the "stuff in the middle" that hurt performance the most, according to Pitkowsky. That stuff was stocks that were decent companies but not that cheap, or statistically cheap companies that weren't that great.

In GoodHaven 2.0, the notion of quality—or a business' competitive dynamics and advantages—has come into sharper focus.

"I think we always talked about quality, we were well aware of it, had plenty of quality in the portfolio," Pitkowsky says. "But we let a bunch of other things creep in, and we were too quick to sell quality when it became not cheap. I'm not sure we weighted it enough."

Developing 2.0

Pitkowsky owns his role in these shortcomings: "It's important to note on 1.0 that whatever imperfections there were, I was in the room for those imperfections." Still, he knew something had to change. In 2019, Pitkowsky and Trauner started talking about what might turn things around. As with the departure from Fairholme, Pitkowsky won't share a lot of details of how the decision was made, but the upshot was that Trauner left the firm at the end of November that year, leaving Pitkowsky as the firm's leader, primary owner, and sole portfolio manager. Trauner holds a small ownership stake but is no longer involved in day-to-day operations.

Pitkowsky describes the move to 2.0 as taking "a step back and a hard look at bringing the process of decision-making to a better spot, which it had been at many other points in my career." Doing so wasn't out of character. "I do think people who know me would say, 'Oh yeah, it's not surprising for him to look in the mirror and say, Wait a minute, why isn't this going as well as it should? What do I need to do differently and where has the decisionmaking magic somehow gone a bit awry?' People who know me could see me being obsessed with that."

Looking at changes in portfolio holdings from early 2019 to about mid-2020 gives some insight into the stuff-in-the-middle stocks Pitkowsky was eager to jettison. Out were stodgy businesses like airlines (American AAL and Delta DAL), telecom provider Verizon VZ, and department store Macy's M.

At first, replacements were mostly financial stocks—Bank of America BAC and JPMorgan Chase JPM, KKR KKR, and Progressive PGR. But he also gave more room in the portfolio to some existing holdings, like legendary insurer-cum-value investor Berkshire Hathaway BRK.B, building materials provider Builders FirstSource BLDR, and homebuilder Lennar LEN.B. Those stocks saw their weightings double in the period.

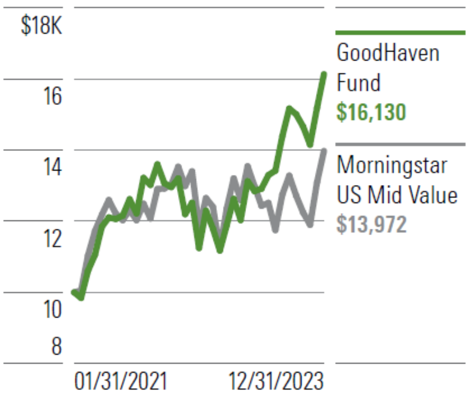
A Distinct Portfolio

It's an eclectic mix overall. Conceived as an all-cap approach benchmarked against the S&P 500, the fund has consistently landed in the mid-value Morningstar Category since September 2015. In the 2.0 era, Pitkowsky has overweighted financials by about 35 to 45 percentage points over the S&P 500. In the four years since its reconfiguration, the fund has owned not a single healthcare stock and very few tech stocks.

Larry Pitkowsky, managing partner and portfolio manager at GoodHaven Capital Management.

GoodHaven Fund GOODX

Growth of $10K



Morningstar Category	Mid-Cap Value
Morningstar Rating	★★★★
Expense Ratio (%)	1.10

Source: Morningstar Direct. Data as of Dec. 31, 2023.

"Healthcare is a very tricky sector," Pitkowsky says, pointing to large pharmaceutical company stocks whose prices have stagnated for years, and parts of the sector, particularly biotechnology, that require specialized knowledge to understand. "Was UnitedHealth UNH something I could have understood? The answer is yes," he mused. "The only thing I can say about having not owned it or something like it is that it was a mistake."

The portfolio has also held a lot of cash at times. For example, as of August 2023, about 36% of portfolio assets were invested in cash or short-term Treasuries after an influx of new investments—an estimated $60 million of the fund's $215 million total. Nonequity holdings were about 25% when 2.0 started in November 2019. That said, for most of the intervening period, cash was around 10%—still fairly high, but not as much as the period's bookends might suggest. In December 2023, Pitkowsky says cash had fallen to the high 20s, and he expected it to continue to decline as he put more of it to work on portfolio names.

A much smaller portion of the nonequity stake falls into what Pitkowsky calls special situations, or investments that have "dramatic upside potential but may be riskier and more esoteric" than the portfolio's stocks. They include stock warrants—a type of derivative security—on Occidental Petroleum OXY; preferred shares of Fannie Mae, which has been in government conservatorship since the global financial crisis in 2008; and bonds issued by Ligado Networks. In all three cases, Pitkowsky believes the positions to be small, prices paid to be attractive, and upside to be potentially significant. (TheOccidental warrants are in the money.)

Night-and-Day Returns

With the benefit of hindsight over the past four years, few market observers would have expected significant outperformance from a fund that held nearly no tech or healthcare stocks and that was in a seven-year performance rut entering the period. But Pitkowsky's distinctive portfolio has distinguished GoodHaven for the better since the revamp.

In fact, its performance has been outstanding since the move to 2.0. Over the four years ended Nov. 30, 2023, GoodHaven topped all mid-value category peers, pounding both the mid-value benchmark and typical peer (by about 7 percentage points annualized each). It also beat its prospectus benchmark, the S&P 500, by 2.4 percentage points annualized. This is despite the hurdle of a 1.1% expense ratio, which is above average for a midcap fund. The fund's trailing returns show the stark contrast between the 1.0 and 2.0 eras. Its one-, three-, and even five-year returns through November 2023 beat 94% or more of peers. Even so, the fund's 10-year performance—despite the outstanding returns of the past four years—still ranks among the worst 5% of the pack.

Pitkowsky has done this with a team of only two, including himself. Artie Kwok, a nearly 10-year veteran of the firm and managing director, contributes research and insights to the portfolio. Pitkowsky points to David Abrams of Abrams Capital, Warren Buffett of Berkshire Hathaway, and Tom Gayner at Markel as examples of successful but very small teams. (Markel is both a part owner and a client of GoodHaven.)

"If it was all about resources, every shop with a gigantic research budget would outperform dramatically," he says. Still, having so much responsibility rest on Pitkowsky's shoulders creates key-person risk—it's hard to imagine the fund's future without him.

What's important to Pitkowsky is to "really be patient with finding things we think we can understand" that also offer a margin of safety, or discount to what he thinks they're worth, and to be willing to take a profit or kill a beloved idea when the facts change. "It helps that we're not managing $100 billion," he adds.

The fund is indeed nowhere near the approximately $3 billion asset limit where Pitkowsky would consider closing to new investors, so there's plenty of room for investors wishing to rediscover the fund. Granted, this distinctive all-cap strategy may not have broad appeal, but GoodHaven 2.0 has found a receptive audience: That significant inflow of cash last summer came primarily from new clients.

The GoodHaven Fund's investment objectives, risks, charges, and expenses must be considered carefully before investing. The statutory and summary prospectuses contain this and other information about the investment company, and may be obtained by calling 1-855-OK-GOODX (1-855-654-6639) or by visiting www.goodhavenfunds.com. Read carefully before investing.

Mutual fund investing involves risk. Principal loss is possible.

The Fund is non-diversified, meaning it may concentrate its assets in fewer individual holdings than a diversified fund. Therefore, the Fund is more exposed to individual stock volatility than a diversified fund. The Fund invests in midcap and smaller capitalization companies, which involve additional risks such as limited liquidity and greater volatility. The Fund may invest in foreign and emerging market securities which involve political, economic and currency risks, greater volatility and differences in accounting methods. The Fund may invest in REIT's, which are subject to additional risks associated with direct ownership of real property including decline in value, economic conditions, operating expenses, and property taxes. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities. Investment in lower-rated, non-rated and distressed securities presents a greater risk of loss to principal and interest than higher-rated securities.

Holdings are subject to change at any time, and are not a recommendation to buy or sell any security.

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Per Morningstar (as of 3/31/25 in the Large Value category), the GoodHaven Fund was ranked in the top 48% for 1YR (vs 1,158 funds), top 1% for 3YR (vs 1,092 funds), top 1% for 5YR (vs. 1,030 funds), and top 54% for 10YR (vs. 808 funds). Morningstar Rankings represent a fund's total-return percentile rank relative to all funds that have the same Morningstar Category. The highest percentile rank is 1 and the lowest is 100. It is based on Morningstar total return, which includes both income and capital gains or losses and is not adjusted for sales charges or redemption fees. Past performance does not guarantee future results.

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Morningstar rates funds from one to five stars based on how well they've performed (after adjusting for risk) in comparison to similar funds. Within each Morningstar Category, the top 10% of funds receive five stars, the next 22.5% four stars, the middle 35% three stars, the next 22.5% two stars, and the bottom 10% receive one star. Funds are rated for up to three time periods—three-, five-, and 10 years—and these ratings are combined to produce an overall rating. Funds with less than three years of history are not rated. Ratings are objective, based entirely on a mathematical evaluation of past performance. They're a useful tool for identifying funds worthy of further research, but shouldn't be considered buy or sell recommendations.

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