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EP83 | Quarterly update | Q1 2021

Disclaimer	**00:25**	This podcast is for informational purposes only. Information relating to investment approaches or individual investments should not be construed as advice or endorsement. Any views expressed in this podcast are based upon the information available at the time and are subject to change.
David Fraser:	**00:40**	Welcome to The Art of Boring podcast! I hope that everyone has had a great start to the new year and is staying safe and well out there. Thanks for joining us for the Q1 quarterly update. Just to keep everyone on their toes, we're switching things up a little this quarter. Paul Moroz is joining us today. Regular listeners of The Art of Boring podcast will be familiar with Paul, who's our chief investment officer. Paul, thanks for being here today.
Paul Moroz:	**01:05**	Hey, thanks for having me!
David Fraser:	**01:07**	I wanted to start off today by looking back. It's almost exactly a year on from the start of the pandemic. Tuesday, the 23rd of March saw the one-year anniversary of COVID market lows. We had you on a couple of times during the early stages as markets sold off in March and then began to recover.
Paul Moroz:	**01:36**	One of the big ones was monetary policy and the fiscal response. And if you look back over history, you can see how major problems in the economy end up getting a response and that creates something else down the road. Go back to the year 2000, the tech bubble; and 9/11; the monetary response seemed to have created a housing bubble in the United States. And that ended up blowing up and created the crisis we had in 2008 and 2009.
	02:09	What we saw a year ago, is central banks and governments said, "We need more monetary stimulus, we need lower rates. We're cutting it down for a very long period of time. And we are injecting money into the system through direct fiscal stimulus." Mailing people cheques, in some cases. That's probably the biggest impact other than the human effect that we've gone through; finding a vaccine and the logistics of orchestrating that. That's something that has now become more clear, versus a year ago where there was a lot of uncertainty.

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Paul Moroz: 02:45 So, wow we're grappling with "what's next?" "What does this mean?" Again, in that broader time set. Investors are now not worrying about the economy collapsing because of government and central bank support, they're worrying about, one, at what point does everyone get vaccinated and the economy returned to normal? What does normal look like in terms of supply and demand? Because we got all used to using new technologies, Zoom calls, not getting on airplanes, not going into the office. What does the new supply and demand trends look like? And what other consequences will come out of this? Even thinking about how our children are interacting and learning—what sort of impact does this have on them?

03:39 So, there's a lot of question marks towards the future. Stock markets have of course recovered. If you're looking at the last year of your statements, equity markets are up big time from March of last year. And, if you're looking at relative returns that Mawer has provided, well, we've done well on an absolute basis; the relative returns may not look as good. And part of that is there's a lot of pockets in the market where this easy monetary policy ha[s] created some froth. Some areas of the technology sector, there may be some areas of the SPAC markets (special purpose acquisition [company]), and even some brand new things that have emerged like NFTs or non-fungible tokens, that have all of a sudden taken the world by storm.

David Fraser: 04:38 I get a sense that you might be leaning towards that the fiscal and monetary policy that's been so accommodative might've been overkill and you're a little bit concerned with the unintended consequences that might come along as a result. Is that fair?

Paul Moroz: 04:52 It is a concern—whether the world goes that way or not, we just don't know. So, it's possible that there was too much and what we're really going to be dealing with is an inflation problem—if all the central banks and governments have overshot. Right now, central banks are much more concerned with creating inflation; they want lower for longer, more stimulus, because they're worried about a real deflationary scenario, still. Or, really, a replay of what happened in Japan.

05:25 But, David, I'm not sure which way it's going to actually turn out. And when we think about the portfolios, we're still gearing things to be in two spots at the same time. We have certain securities that benefit from inflation. We have certain securities that will do better in a deflationary environment, including the fixed income portfolio as part of a balanced portfolio.

David Fraser: **05:50** And so, speaking about being in two places at once and then unknown scenarios that might play out…looking back, does it give us any indication? Can you walk us through how we performed in the initial selloff and then the recovery? Was one better than the other? Or how did we perform on a relative basis through those different periods?

Paul Moroz: **06:09** Absolutely. Relative performance was consistent in terms of how we think about risk in the past. What we saw in the first quarter a year ago, so first quarter of 2020, as we headed into the tailspin, the companies that we own tend to be better quality, well-managed, strong balance sheets. A lot of those characteristics were reinforced, and we had strong relative performance. And then probably starting in the fourth quarter of [2020] where you had a lot of companies bounce back that were lower quality, or you started to see more speculation in the market, those are areas that we just didn't participate in and we saw that our performance lagged relative to the market.

06:57 That is something that is a feature of the way that we look at the world. We are focused on risk in an absolute sense—making sure that we don't impair a client capital. And that would be absolutely what we would expect in this very extreme environment. In fact, as the CIO, I would be very concerned in Q4 of last year and even into Q1 if we were outperforming in such an environment that was perhaps driven by more froth, lower interest rates, and a bounce back in more lower quality securities.

David Fraser: **07:32** That's a great explanation. And in terms of drilling in a little bit more into the specifics, are there certain types of businesses or sectors that have done well over the last few months with the potential reopening of trade—if you like, people being more "risk on"—industries or businesses that we didn't hold? (And you've explained the reason why we didn't hold them, but those types of names?)

Paul Moroz: **07:55** As an example, industries such as the energy sector, which we typically have a lower weight; the mining sector; commodities that have a lesser competitive advantage historically don't create as much wealth through the cycle. Some of those, and particularly companies that were on the ropes, they had a much bigger bounce. I mean, same thing with airlines. When you're looking at the period, (we are not invested in airlines), some of those companies would have had a pretty big bounce, depending on where you're measuring it from.

08:28 So, that is the general theme. Of course, on the other side, you can imagine some of the safer quality companies—maybe your consumer staples, the Nestlé's of the world—that just continue to peddle Kit-Kat bars and pet food, they weren't as in vogue as much. And in fact, investors were taking capital from those areas of the market and trying to beat the gun and play this inflation trade or rotation trade.

David Fraser: 08:57

So, coming out of the pandemic, does the investment landscape looks significantly different after such a drastic global shutdown? Or is it a case of, “stick to your knitting,” “stick with your investment approach,” and there's always going to be a reversion to the mean?

Paul Moroz: 09:11

Whether or not there's a reversion to the mean...I mean, I just don't know. I don't know whether what we're actually seeing, with respect to the amount of monetary and fiscal stimulus, means that interest rates are going to be a lot higher, there's going to be inflation that's a lot higher, and we don't see a reversion to the mean as we would typically expect.

09:45

As an example, for global equity and global balanced, we added a consulting company in the United States, FTI [Consulting], which specializes not only in the boring world of consulting, but they're focused on bankruptcy law, and forensic accounting—all these very exciting, niche markets. They would actually benefit in a scenario where bankruptcies rise, interest rates rise. The world falls apart, there's more forensic work.

10:16

But that's one particular scenario. We still own Nestlé in, like I mentioned, the boring business of Kit-Kat bars and pet food. We're building in natural contradictions across portfolios so that however the world works out, we're going to be okay. Same thing with oil; we have oil exposure, and [also through] some of our exchanges. There's a number of different ways we get even backdoor exposure to different themes.

David Fraser: 10:42

One of the three pillars of our investment approach is a good management team. So, at these uncertain times, businesses can change and adapt, and a good management team will steer a company through those turbulent waters.

Paul Moroz: 10:57

Absolutely. Businesses evolve. And that evolution, in part, is driven by the people that run them. They make the decisions of who to bring into the organization, and what direction to go strategically, whether they're moving into new or growth markets, whether they're selling units. There is both this flexibility that good management teams and optionality that they provide. But in addition, remember, in whatever scenario that you end up with, there is reinvestment that recurs. And if you have people that can allocate capital and make decisions, there are always going to be opportunities in the world. You look at the world optimistically.

David Fraser: **11:41** I saw an article recently that I want it to pick your brain on because I wasn't sure about [it]. It pointed out that nearly a third of small cap stocks and a third of mid-cap stocks lost money over the last 12 months. And really, as a fundamental investor, part of our job is valuing companies, which typically involves converting or discounting future cash flows back to today's dollars to get a valuation, a sense of what a company might be worth. How difficult is it to value companies in that kind of environment?

Paul Moroz: **12:12** It's difficult because you can't predict the future. It just is. But it's no more difficult now than in the past. So, how we approach this really uncertain world is we recognize [that] it's uncertain. We acknowledge it. We embrace cognitive thought across our team, so we try to look at investment problems from different perspectives and then we look at the world probabilistically, we look at different scenarios. We run Monte Carlo analysis and iterate the valuation of the company hundreds and hundreds of times. That's how we address the problem of uncertainty. And it's a difficult problem. But [what] you end up with is not a precise answer; you get a little bit of understanding, or a sense of, you're in a good-ish part of a specific investment, or a bad-ish part; and you keep on moving through the darkness forward into the future—one step at a time, that way.

David Fraser: **13:13** I know the Research team is made up of smaller groups. Once we maybe find some new information, a new process, a better way of doing things, how do we actually share that information across the Research team?

Paul Moroz: **13:26** We're really lucky. A big part of our competitive advantage is the culture of the team, how we work together. Part of it is we share it through regular meetings and communications. We are avid users of Microsoft Teams, which if you haven't used it before it acts as a chat platform. By typing your conversation into the platform, you're sharing it with the whole team. And so we'll have these really wonderful conversations that are now all captured within the program.

13:55 Another big one is, our technology people have built us a marvelous database called M42. And all sorts of information is captured there. Notes on companies, thoughts from individuals, pieces of research, our information from models are uploaded, our conversations with management teams regarding engagement projects, ESG projects that we have...that's all captured. And that is shared amongst the entire team in our organization.

David Fraser: 14:29 I always wonder if that's one of the benefits of remote work—they might have been conversations in the past, where, if you weren't present, you didn't get that information. But now everyone's remote, they're there and they're documented, and people can look back and see those types of conversations in Teams and M42 and whatnot. Is that what you're seeing?

Paul Moroz: 14:50 Absolutely. That's one of the ways that the world has changed. And it's—when I mentioned before about business returning to normal—it's a question mark around, well, what's normal going to look like? Are we going to go back to an office environment where people have one-on-one conversations verbally and that's not captured? We might find that this system that we've ended up with, and I know other companies have too, where more communication is captured in your chat application. That's a lot better for communicating and for team building.

David Fraser: 15:23 I wanted to ask you a couple of things as well in regards to the asset mix strategy. So, Greg Peterson who's normally here, is the Chair, but you have a big role to play there as well. So firstly, we did a press release to let investors know, however, if listeners aren't aware, we are in the process of closing our Global Bond Fund. Can you provide some context around what led us to that decision?

Paul Moroz: 15:46 Well, we launched the Global Bond Fund close to half a decade ago, and we were in a different monetary time. We've learned a lot, too. This was an ultra-safe bond fund. We invested in high-quality government bonds, short duration, and what we found is that interest rates have collapsed over time, and with that, the fund operated much more as a currency fund. The valuation and fluctuation and asset value day-to-day, month-to-month, was more impacted by changes in currencies and less by the value of the income that was being collected from the change in the value of the individual bonds.

16:33 We recognized we had a choice, it was basically this specified: the environment was different, we could try to hedge the fund and change strategies that way; we could reclassify it as a currency fund; or, we could regroup and close the fund. And that's what we chose to do. We have some other ideas that we're working on with fixed income, as we've invested in the team and tools and technology, and we'll explore some of those ideas. But certainly not the last that you'll hear from us on the fixed income front. But we felt that the Global Bond Fund was one that we needed to regroup on.

David Fraser: **17:11** The second piece of the asset mix questions I wanted to touch on, I just wanted to get a little bit more colour around equity weights, we've let them drift higher recently. What's behind that decision?

Paul Moroz: **17:22** One of the factors that we've considered is, of course, the income that we'll get from bonds compared to how the stock market is valued. And we think that that spread, if you will, on expected returns still favours equities. And in fact, we've had equities move to a place where, in the scenario where the globe opens up—and certainly industrial production numbers are becoming good, we are expecting more people of course to get vaccinated and return to a new normal—there's still lots of fiscal stimulus, people are concerned about inflation…this is actually bullish for the economy.

And so, if you take that into consideration when looking at businesses, there might be a very good scenario where the economy is growing quickly and inflation doesn't get out of control, and that's actually a pretty good climate for equities. So that went into the decision to let our equity position increase or drift a little bit within [our Balanced strategy].

David Fraser: **18:32** Great, thanks for that. Looking ahead a little bit, I wanted to touch on two Is which seem to have dominated the headlines in recent times, so that would be inflation and interest rates. It seems to be uncommon for bonds to dominate the headlines, but that seems to be true recently. There's a lot of talk around the 10-year rate in the U.S. What are we seeing in the bond market and with interest rates?

Paul Moroz: **18:55** You're seeing a couple of things. Most central banks still have the front end of the curve pinned, and have said that, "we're not really taking our foot off the gas," in terms of monetary policy, because they want to make sure that we get a full recovery. There's going to be stops and starts because of lockdowns, they don't want to take any support away from businesses that are already struggling. Some businesses are challenged more—especially smaller, main street businesses.

19:28 So, that has been their stance. And the front of the [yield] curves are still very low; overnight interest rates are low, even negative in places around the world.

But the market is starting to recognize if you do this too long, and as the economy recovers, then maybe inflation is going to come onto the scene. And we've seen, well, pretty rapidly in the United States, the 10-year bond increase. And we're sitting at the time of this discussion at about one-and-a-half percent for the U.S. ten-year bond. That's what it's yielding.

19:58 And that's been a pretty big move quickly. So, the $64,000 question is, how much inflation will there be? Because there's still this tug-of-war going on between people that have not fully reopened, and some businesses are suffering. And that's being kept afloat by the fiscal and the monetary stimulus. So, at some point you are going to get tapering, both fiscal and monetary. And to the extent that that's a smooth transition...I think it can be this wonderful transition to a nicely growing economy, but if you get that wrong, if you're too fast coming off, or if you leave it on too long, that's going to impact inflation and the economy and markets.

20:49 And of course, this is all very iterative. It's tough to isolate just inflation, or just interest rates, or just the growth of the economy and the valuation of any of the investments that we're looking at. So it's a big question, those two “Is” that you mentioned.

David Fraser: **21:05** I think for someone who's new to investing, you can think of interest rates as the cost of money. So, with higher interest rates it's typically cost more to service that borrowed money and like you said, maybe it depends. But if we do see a move higher in rates, do you think current debt loads are manageable?

Paul Moroz: **21:25** You can think of debt both at the consumer level and at the government level. Now, at the government level, the government's deciding how much money to print; they're deciding how [many] bonds to issue; they are still very much in control of their position. And they also have this wonderful, special property: they can tax people and companies. And that's one of the things that we're seeing around the world—we're starting to hear places like the UK, places like the United States, maybe in Canada (we have a budget coming out later in April)...there's a move towards higher taxes. So, there is flexibility. And you might see that the governments use that tool to manage and make sure that the debt is manageable.

22:14 Now, at the consumer level, that's a little bit different because that has to do with, say...quite often lots of people's wealth is in their home, in mortgages. I think it's a bit of a two-speed economy, in that for some people—and this is perhaps a demographics issue as well—if you own your home, you're not really sensitive to that. If you've just bought a new home, if you have a pretty significant mortgage and it's variable, that's where there's a challenge. And I think that there's less give or the policy has to be different, to manage consumer debt levels.

22:50 And it differs around the world and there's different sensitivities, but as a consumer, you don't have that special power just to create more income and manage and service your debt. That is an issue we might be at a point in...call it the “debt supercycle,” where central banks don't have the ability to raise interest rates too much without endangering the consumers who are in a precarious situation with housing.

David Fraser: 23:18 And then if you take it back to something like our Balanced Fund that has a portion of fixed income, and I guess it's a big if, but if interest rates do rise, in the long run, does that help that type of portfolio? Because for so long now we've seen yields so low, that there's really been, not a lot of yield from that part of the portfolio.

Paul Moroz: 23:41 That's a great question, because on one hand, many investors and people are scared about interest rates or discount rates rising, because you automatically get an immediate effect of all assets are worth less. That is just mathematically correct. And the other factor that warrants less attention in the press or less consideration, I think, in the minds of investors, is that your reinvestment rate is better when that happens.

24:11 And so, imagine the income for the bond coupon that now gets reinvested at a higher rate—you're compounding money to fast return. Same thing for stocks, same thing for companies buying back shares or investing in new projects. Over time, that reinvestment rate is really important. And so, there is an offsetting factor with time. I think that's the really important thing—you have to have that time horizon to take advantage of that offsetting factor of a better reinvestment rate.

David Fraser: 24:40 I think that's a good point. I just wanted to reiterate a point you mentioned which I think is important for investors, which is, when we talk about discount rates, that's what we use to what I touched on earlier, which is take those future cash flows—so, think of a dividend stream—and discount them back to present-day value. And interest rates are a significant piece of that discount rate, aren't they? So, as you say, from a mathematical perspective, if interest rates go up, everything's worth a little bit less. But I just wanted to point that out because we touch on it a lot on this podcast and hopefully that little bit of an explanation helps to explain that a little bit more.

Paul Moroz: 25:16 Yeah, it is counter-intuitive, because if you're investing for the long-run, you actually want a higher discount rate; you want to be able to compound your wealth at a higher real return. If the assets are marked less, you actually pay less fees to your investment manager, and so on. So, it is counterintuitive, but it's not a bad thing to have a higher discount rate or higher real interest rates.

David Fraser: 25:41 There's been a lot of talk of inflation. I won't ask you what your prediction is, that's probably not fair, but how does inflation actually impact investors?

Paul Moroz: 25:49 Inflation impacts investors in terms of…well, first of all, you have to look at your real returns when you're investing. So, throughout history there's been periods of higher or lower nominal returns, and what you have to remember is the real game is in understanding those real returns over time. There are different business models and different securities that are going to benefit more or less from inflation.

26:19 For example, in Japan we own a company called Tsuruha. Tsuruha is a drugstore chain, and one of the things that's going on with Japan right now is because of their demographic situation—their demographics are tilted towards an older population—there is effectively fewer young people to work in the positions involved in a drugstore, [and] there has been more wage inflation in that business. At the margin, what we've noticed is that has directly impacted their business because SG&A as a percentage of their revenue has increased. Now, this is a very small increase. Japan as a whole doesn't have a massive inflation problem right now, but that's a feature of the business model you have to be aware of.

27:09 There's other businesses that will benefit from that. In the past I've spoken about CME Group, a futures and options exchange in the United States. They, as part of their business (about a quarter of it), [provide] a market for people to trade interest rate derivatives. That's a business that will benefit [from] inflation. It'll still have more speculation; it'll create greater open contracts. So, it means different things at the very stock-specific or security-specific level. Same thing for bonds, where you have a preference maybe for shorter-dated bonds as opposed to longer-dated bonds.

All these factors come into play; the trick is you still don't know which way this is going to go. And in the face of uncertainty, it is best, in our opinion, to take a very balanced approach in this, so that whatever scenario you end up in, inflationary or not, you're still going to do relatively okay.

David Fraser: 28:10 We might've discussed a few topics that are creating noise in the market, but I know you're an optimist and there's plenty to be positive about, isn't there? So, [the] forecast is expecting strong economic growth coming out of, hopefully, lifting global lockdowns. We've seen a big stimulus package in the U.S., and other central banks and policy makers around the world have done similar—so there's a lot to be excited about too, isn't there?

Paul Moroz: 28:35

I think so. I think there is going to be more spending on infrastructure—absolutely in the United States. If you've been to New York City, just looking around at some of the infrastructure, you recognize that there are some things that could be rebuilt, that could use a little bit of restoration.

There's also some tremendous innovation; there is wealth being created. In particular, the technology sector. There's some wonderful technological innovations, and companies are making strides in the health and medical industries too. Never discount the ingenuity of people. People—humans—are builders. We're creators. And that has positive impact for the economy and growth—and ultimately for investing in general.

David Fraser: 29:22

Yeah, and that's one big positive with this, isn't it? If we are able to innovate our way out of this pandemic and create significant organic growth, then things are looking pretty good. And if we look ahead on the—if you think of it as the global reopening [to] trade—what are some names in our portfolios that come to mind that would really do well from a quick and a sustained reopening of the global economy?

Paul Moroz: 29:49

I will caveat that by saying, well, we might reopen or we might find ourselves in a different scenario. So, this is not a foregone conclusion. And often price plays such an important role. But as an example, we own in our U.S. mandates and in Global Equity, a company called bookings.com [Booking Holdings], which is an online travel agent, effectively. And they will benefit from more travel. People do want to go on vacation. We really do want to go to warm destinations and experience unique cultures. I think that will return. And so, to the extent that we get back to normal with that trend in a reasonable timeframe, they will benefit from that and the economic results will improve.

David Fraser: 30:41

Great! We've covered a lot today. I just wanted to give you the opportunity to mention anything that might be on your mind as you look back over the last 12 months, or even looking at what's ahead. Is there anything we haven't touched on today that you think investors should be aware of?

Paul Moroz: 30:56

Well, just that the events of the pandemic have, will, are, creating long-term consequences. Just like the last crises we've had over the past couple of decades. But you evolve with it. And I think the trick is one of psychology: keeping level and just having the right temperament with this. I think it's very dangerous to get too excited and likewise it's always dangerous to get too scared.

So, it's important for whoever you are in terms of your investment knowledge, is just keeping a real balanced mindset when you're approaching investment decisions.

David Fraser: 31:35 I appreciate that—always wise words. And I know our listeners always enjoy hearing your thoughts, so, I really appreciate you being here today.

Paul Moroz: 31:43 Absolutely. Thanks for having me, David.