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EP 180 | A “Balanced” Perspective Amid High Uncertainty

[00:00:00] Andrew Johnson: Hi everyone. In today's episode, Steven Visscher joins to bring us up to speed on the balanced portfolios here at Mawer. We talk equities, fixed income, asset mix, and get his thoughts on some of the big investment themes playing out in the market. Enjoy.

[00:00:36] Disclaimer: 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.

[00:00:34] Andrew Johnson: Hey, Steven, welcome back.

[00:00:36] Steven Visscher: Hey, Andrew, thanks for having me. I always enjoy our discussions. I certainly want to extend a greeting to all of our listeners and viewers today.

[00:00:42] Andrew Johnson: Yeah, absolutely. The last time that we chatted on the podcast, I introduced you and I joked about how many times you've won the office hockey pool, and sure enough, I just checked the standings and there you are in first place. So, if you don't mind, my first question is just, can you take a look at my hockey roster and give me some tips to improve?

[00:00:58] Steven Visscher: Andrew, I think one of the challenges with your team is you've got too many Boston Bruins on the roster. I know you're a big Bruins guy, but they've not had a great year. So maybe you want to switch that up a little bit.

[00:01:09] Andrew Johnson: That could be the issue, but emotions can sometimes get in the way of good decisions. Maybe that's a little harbinger of what we're going to talk about a little bit later on. So, let's put aside the hockey talk for now. Let's get down to business. Maybe we can kick things off by taking a look back at 2024. How did the balanced portfolio perform and maybe how 2025 is shaping up so far?

[00:01:27] Steven Visscher: Thanks, Andrew. I think from an absolute standpoint, returns were really strong in 2024, and that included positive contributions from all asset classes, both cash, bonds, and particularly equity were positive during the year. And in many ways, that was a replication of what happened in 2023. That's the second consecutive year in which all asset classes were positive and led balanced strategies to strong absolute returns. Now pause there and encourage any of our listeners to visit mawer.com. You can view that performance data in greater detail. What I'd also add, Andrew, is that in many ways that absolute performance was a pleasant surprise. If we go back to the mood as we entered 2024, I would describe it as fairly cautious. Remember, we had an environment in which central banks were holding interest rates at peak levels because inflation had still not subsided back into their target ranges. So there was a period of time that lasted for many months in which interest rates were held at these peak levels and more than one economist had been forecasting or at least

alerting to the potential for a hard landing or a recession. The concern was that consumers may finally succumb to the impact of higher interest rates. I recall a number of stories about how consumers had exhausted all of the savings that they'd accumulated during the pandemic. Some were pointing out how the unemployment rate in Canada, U.S., and elsewhere had been on the rise. We had an inverted yield curve, and then on top of that somewhat murky economic outlook, we had the issue of equity valuations appearing expensive relative to historical averages. And so that cautious mood, you know, here we are 12 months later and lo and behold, we've averted a recession. We've seen inflation come back into target without causing significant damage to the global economy. And we've been rewarded with some very strong absolute returns for a balanced strategy.

[00:03:36] Andrew Johnson: It's an odd feeling when we have these consecutive years of really strong returns for people like you and me. It gives us a nervous feeling going forward. But I wanted you to take a look under the hood throughout that same period. Were there any notable areas, whether it was things that went very well, or maybe were a little bit more challenging?

[00:03:54] Steven Visscher: I think by far the greatest challenge for the year was our returns relative to our benchmarks. I've had many client conversations that are really quite pleased with the absolute growth in their portfolio. Market values are very close to all-time highs, but there's a sense of disappointment or concern that our returns relative to the benchmark have underperformed, and we get that. We're unit holders in the same strategies ,and we see this every day. What I think about, we've been managing wealth for now 50 years and we've been able to, for most of that time, do both. We've delivered strong absolute results, but we've also had a strong returns relative to our benchmarks. But over that 50-year period, there have been moments of time when our particular style or our particular approach has not been as rewarding as investing in the benchmarks. And that's unfortunately where we've found ourselves of late, and that was certainly evident in 2024.

[00:04:51] Andrew Johnson: And just shifting gears a little bit, just in terms of strategic decisions around asset allocation, what were some of the things that you were doing in the portfolio over the last year or so, if anything at all?

[00:05:03] Steven Visscher: We spoke about that somewhat uncertain outlook as we entered 2024, and our approach was to keep a fairly neutral stance within the portfolio, within the strategy. What I mean by that is, we've got a long-term strategic target of 60% in equity. We were diligent throughout the year of not allowing the strategy to stray too far from that 60% target. So as equities performed well during the year, that did result in a number of occurrences through the year where we were just diligent and disciplined about trimming back some equity just to keep that target weight close to 60%. So, the view was we wanted to be cognizant of that recession or hard landing scenario. We didn't want to have the portfolio tilted too aggressively. We wanted to build that resilience should that unfold. But at the same time, we also didn't want to get too conservative because we knew that there was still that possibility that authorities could orchestrate a soft landing. So that was just the balance that we took through 2024. What I think is maybe more interesting for listeners is that in maintaining that neutrality, we did execute what I would call more of a structural change in the portfolio. What I'm referring to there is we've introduced an allocation to our U.S. mid-cap strategy, and you may recall—for those that are less familiar with that strategy—this was launched in the latter part of 2021, so it's been in place for almost three-and-a-half years now. The mandate for the mid-cap strategy was, as its name might imply, investing in U.S. businesses, but really focused on medium-sized companies, so looking beyond the large mega caps and instead finding businesses that we thought may have a longer-term growth potential as compared to their more established peers. What we found in early 2024 was by introducing the U.S. mid-cap strategy, not only could we better diversify the U.S. component of the portfolio, but it also allowed us to improve the valuation metrics. So our observation was that mid-caps were trading at more attractive valuations than their larger peers. By making that shift, which we executed a number of occurrences through 2024, we feel we've been able to better diversify the portfolio, improve the valuation metrics, and by the end of the year, we stood at an allocation to mid-caps of about 3%.

[00:07:39] Andrew Johnson: Yeah. Maintaining that exposure to the U.S. market, which fundamentally has shown some strength, but like you said, better diversification within that, better valuation opportunities for our stock pickers to go out and hunt for some great businesses that will fit in the portfolio. On the fixed income side of things, the last time you and I chatted on here, you mentioned global credit and the potential that it may have to also improve diversification. Is that something that you continue to think about?

[00:08:06] Steven Visscher: Yeah. First of all, I love the fact that you're going through the archives and you're digging up conversations that we had at our last podcast. For anyone who says that being a host is an easy gig, I think you're proving how much work goes into it. But you are right—we did talk about global credit last time, and that continues to be something that myself and my co-manager, Greg Peterson, and the other members of the asset allocation committee have spent the year looking at quite closely. The global credit strategy was launched just over a year ago, and we've continued to just gain more and more confidence in the strategy. I think you've had Brian Carney on the podcast in the past. We've been really impressed with how Brian and the rest of the global credit team have integrated within the broader research team. There's been plenty of examples of collaboration between our global credit colleagues and the broader research team, so that has all gone according to plan. The performance of the strategy thus far has been as we expected, and it's gone well given the environment we're in from a credit spread standpoint. And so yeah, I think Andrew, I'm glad that you're checking in on that again. The response would be it's still on our radar. It's not currently within the balanced strategies, but everything that we've seen so far has been very encouraging.

[00:09:25] Andrew Johnson: Yeah. Certainly Brian and the credit team are taking the same approach that many of our equity strategies and our overall balanced strategies take, where risk management is at the forefront, and although that might mean a little bit of a governor on returns relative to what we're seeing in the broader market, it is the prudent way forward. Speaking of uncertainty and risk management going forward, we recently had Mark Rutherford on to talk through tariffs and the impact on Canadian equities. How do big, albeit somewhat unpredictable, things like the potential for tariffs influence investment decisions when you're looking at the balanced strategy?

[00:10:03] Steven Visscher: Really good question. I mean, you can't escape these things, whether it's an announcement from a central bank on interest rate policy or the outcome of a too-close-to-call election. And now your question here on what will trade and tariff policy look like. We’re watching closely. They're fascinating to observe. But ultimately, we don't feel we have the ability to consistently forecast or predict these outcomes. In many ways they're unknowable and I think even if you can predict the outcome, you then have to understand the market reaction. History shows that in some instances, markets price these things well in advance, and when the actual event occurs, it ends up being somewhat of a nonevent. In other cases, we see these types of situations lead to knee-jerk reactions where markets overreact in one direction and then move in the other way shortly thereafter. So, from an asset mix standpoint, this isn't something that we will aggressively pre-position a portfolio

for. We just don't think that's the prudent way and appropriate way to manage things from an asset mix standpoint. What I would say, Andrew, is that these types of questions are often asked through an asset allocation lens. Tariffs are coming. What changes are you making at the asset mix level? And there's another element to this, and it's at the security level. You had Mark on the podcast recently; I'm sure he spoke about how leading up to the U.S. election and leading up to the inauguration and potential for this flurry of tariffs and changing policies, that they would have gone through the companies that they own in the Canadian portfolio and started to identify ones that might be more vulnerable should tariffs be enacted versus others that may be a little bit more resilient or less impacted by that type of policy. Obviously, we didn't make wholesale changes to the Canadian equity portfolio, but at the edges, around the margins, we did shift capital away from some businesses that we thought could be more vulnerable towards others that could be more resilient. So I think that question, again, it's often asked from an asset mix lens, there's a really important bottom-up security-specific approach that we can take in terms of managing risk and identifying opportunities that can be exploited.

[00:12:25] Andrew Johnson: Tariffs aside, I will ask you from an asset allocation lens with so much uncertainty out there, how are you thinking about positioning the balanced portfolio from here on out?

[00:12:36] Steven Visscher: We entered 2025, again, fairly close to neutral. What we've seen so far in the year has been a really strong performance in equities out of the gate. Our allocation to equity has just naturally drifted a little bit higher than that 60% neutral. But I think more importantly, when we look underneath and look at the actual regional exposure, we continue to have an overweight to U.S. equities, and so that's looking at our U.S. equity strategy and our U.S. mid-cap strategy together. Having that overweight exposure to U.S., where that economy has proven to be so much more resilient than many other parts of the world, we do find appeal in that. We still have an overweight exposure to international equities. We've got a healthy allocation to Europe. So far this year, what we've seen is a bit of a change in leadership. It hasn't been the U.S. that's led markets higher, but Europe has outperformed the U.S. by a significant margin so far. That's a welcome development from the sense of our balanced strategies, given that exposure to international markets and our overweight exposure to Europe. We're still underweight Canada. And that's not because of tariffs; that's been a structural underweight for some time now. We've had concerns on Canadian productivity, certainly the level of exposure to housing. Canadians are highly leveraged in the housing stance and should higher interest rates start to impact borrowers … We’re seeing a lot of consumers that had taken out mortgages at the ultra-low levels in 2018, ’19, ’20. A lot of those are coming for renewal now, and that I think can act as a drag on Canadian consumption. Certainly just overall growth in Canada has been somewhat uninspiring, especially given how much population growth that we've enjoyed. So as that potential change in population growth changes as our immigration policy is amended there's some concerns on future Canadian growth, so having an underweight to Canada has also been something we're comfortable with. Then I think I'll finish off: What are we thinking about going forward? It's maybe still more of those structural changes. I think continuing to explore shifting more capital into the U.S. mid-cap strategy and having greater balanced among the U.S. portion of the portfolio. And then as we've talked about, continuing to explore global credit and how that may be a long-term benefit to the balanced strategy.

[00:15:06] Andrew Johnson: You mentioned a few already, but what are some of those broader investment themes that you and the team are watching closely?

[00:15:12] Steven Visscher: Good question on broader investment themes. I think there's two that come to mind. First, trade and tariffs are going to dominate the headlines this year. We're already seeing that and it's changing very rapidly, so that is front and center. We don't obviously know exactly what these policies are going to look like, but again, the level of uncertainty does seem higher than normal. Things are always uncertain, but a few of us have noted that this particular moment in time does seem particularly precarious from a global trade standpoint. The implications for that are broad. It impacts global economic growth. It impacts the volatility and the movement of currencies. It'll be interesting to see how authorities respond to the potential imposition of tariffs, both from a monetary and from a fiscal standpoint, so I do think that this will be an important theme in 2025, and I think you want to just be, again, mindful of the fact that there's a broad array of potential outcomes. You don't want to get caught off-guard, positioning the portfolio aggressively for one particular scenario.

Maybe the other theme that I think is going to be pretty interesting—and this is maybe more of a longer-term theme and not something that is going to come to a conclusion in 2025—but just the notion that we could be on the cusp of a real inflection point on productivity. We could see a real productivity boom. We've noted a number of countries have rejected incumbent governments and have started to shift towards more right-leaning leadership where you have less regulations and maybe more of a focus on generating wealth as opposed to redistributing wealth. So that could be one source of productivity. But I think the other one would be just how rapidly things are changing from an artificial intelligence standpoint. Thus far, so much of the attention and so much of the rewards have accrued to those Magnificent Seven businesses and others that are in that AI space, the semiconductors, the producers of the hardware and the models. But I think as time goes on, what we may see is the businesses that can harness AI technology, integrate that into their business model, and drive efficiency and drive productivity may ultimately prove to be the biggest winners of this trend. I think that's something that as investors—I know each of our underlying asset class teams—as they're evaluating companies, that's at the back of their mind: How is this business potentially transformed by AI?

[00:17:53] Andrew Johnson: It's certainly going to be a fascinating thing to watch unfold over the coming years. I think you're right—we're just on the cusp of widespread adoption and infiltrating business models and also individuals and productivity at that level. I was just thinking the one final question that I wanted to leave you with before we sign off: You join me today, you're meeting with clients on a regular basis, you're having these conversations that we just had, you're taking these questions that we just talked about. What's your final message to them as you end those conversations until the next time you get to talk to them?

[00:18:26] Steven Visscher: I think just recognizing that, yeah, uncertainty is high. We live in interesting times, and there's things that are changing rapidly. What we just saw last year was, I think, a good example where if you get too dialed in to a particular scenario, you can find yourself offside. Our approach here is, again, to stay focused on a long-term perspective, to stay broadly diversified, to adhere to our philosophy and process, knowing that it doesn't always work in every moment in time, but we certainly feel that we've demonstrated over long periods of time what we're doing works. So, I think the message that I've communicated to a lot of clients is, this is an environment where you have all the ingredients to make a real big behavioral error. I think you've just got to step back, keep your emotions in check, make sure you're not too greedy, you're not too fearful, and you got your eye on a long-term perspective, as opposed to what the next three months or the next 12 months might look like.

[00:19:29] Andrew Johnson: That's a great message to leave at any point in time in history so let's leave it at that. Steven, thanks for joining us. And maybe a little bit later in the year, we'll check back in with you and see how 2025 is going.

[00:19:40] Steven Visscher: I'm looking forward to that. Thanks for having me today.

[00:19:43] Andrew Johnson: Hey everyone, Andrew here again. To subscribe to the Art of Boring podcast, go to mawer.com. That's M A W E R dot com forward slash podcast, or wherever you download your podcasts. If you enjoyed this episode, leave a review on iTunes, which will help more people discover the "be boring, make money" philosophy. Thanks for listening.