the art of boring™

EP 186 | Finding Silver Linings: International Investing Through Trade Policy Turbulence

[00:00:00] Rob Campbell: Today on the Art of Boring: Peter Lampert, international equities and lots on tariffs, and how the international equity team is evaluating their impact. Plus, the recent True Social post that resonated the most with Peter.

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.

[00:00:15] Rob Campbell: Peter Lampert. Welcome back to The Art of Boring.

[00:00:18] Peter Lampert: Thanks, Rob. It's always great to be back.

[00:00:20] Rob Campbell: Well, hey, listen. People who listen to our podcast might not know this, but you and I had initially intended to record this podcast about a week ago, and instead we got bumped as we released a couple of unscheduled episodes focused on more pressing market concerns. But we're here now, and I was actually wondering, can we start by looking backwards and not just the last two weeks, but well beyond—how prominent a role did trade policy and tariffs play in portfolio construction discussions on your team and what have you been doing over the past year or so?

[00:00:55] Peter Lampert: Sure. As we're recording today, we're in the middle of this tariff storm of changing headlines every day. But, if you recall Trump during his presidential campaign last year was talking a lot about tariffs. He called it the most beautiful word in the dictionary. It's something that he's been ideologically supportive of for decades. So it's a risk that we took seriously. Nobody knows what will happen. Even now that some of the tariffs have been announced, some have been postponed. As always, the future is uncertain. And it seems the last two weeks has highlighted that more than ever.

[00:01:32] Peter Lampert: But our job is always to prepare for a range of outcomes. So during that campaign and after Trump got elected, with tariffs being an essential part and focus of his campaign, it's something that we paid a lot of attention to. And earlier this year, when the S&P 500 was hitting all-time highs in February, our assessment was that the markets were being fairly benign on the tariff risk.

[00:01:58] Peter Lampert: We don't know what's going to happen, but if these tariffs come in as high as Trump's been talking about or proposing, even in some cases going ahead with and then postponing, that could have very significant impacts on many businesses around the world, at companies that export into the U.S. but also on the overall economy if it leads to a recession, if it dampens consumer and business sentiment if companies are postponing investment. So that's a risk we thought when we look at individual companies and do the bottom-up work. Our assessment is that the risk is generally to the downside over the last few months. And so we've been more cautious on companies who are exporting into the U.S., companies that have more cyclical exposures that

would be hurt in a bigger tariff-induced recession. Just really weighing the odds and the risk reward as the cards were coming up.

[00:02:56] Rob Campbell: Can I pull on a few of those threads? The first, I guess you mentioned being a bottom-up investor. When you've been on the podcast before, you've talked about the diversification of the portfolio from a revenue perspective and despite being an international portfolio, roughly a third of the revenues come from the U.S. Can you talk a little bit more about what work you've specifically done on a company-by-company basis to evaluate the impact of U.S. revenues, potential tariffs, and what that looks like for those companies. But then how they roll up.

[00:03:26] Peter Lampert: Yes, certainly. Our goal when building a portfolio of individually great companies is to put them together such that the portfolio is resilient, regardless what scenario plays out, the portfolio can do well, but when a specific risk starts to emerge—tariffs—that's one that we go through. We assess and reassess as the information is coming out and we've gone through company by company in the portfolio to assess where the risks are. And specifically, as you mentioned, we do have significant U.S. exposure. The good news is nearly all of our U.S. exposure is companies that operate domestic U.S. businesses.

[00:04:04] Peter Lampert: So even though this is an international portfolio, take Compass for example, they're based in the UK. They're headquartered in the UK, but 60% of their revenue comes from the U.S.. This is the—

[00:04:16] Rob Campbell: I was going to say, this is the catering company.

[00:04:18] Peter Lampert: Yes, the largest catering company globally, they operate the cafeterias in offices, hospitals, universities. And as you can imagine, that's a local business in the U.S.. They are hiring local U.S. workers, sourcing local U.S. food, and operating local cafeterias. So that has nothing to do with exports. Sure, any business can be impacted by the knock-on recession impacts, but if you go through the portfolio, by and large, one by one, we don't have a lot of export exposure.

[00:04:49] Peter Lampert: Even in cases where we do have big exporters, like TSMC exporting its chips from Taiwan, there's no other alternative. TSMC, the stock has been selling off, but they are the global leader. My favorite pun is that they hold all the chips. In this case, there is no alternative for TSMC semiconductor chips.

[00:05:11] Peter Lampert: Whether you want to tariff them, whether they increase prices one way or another, U.S. companies will need those chips. And in other cases, we look at Hitachi, Schneider, other companies that could be more cyclical. Could be areas of concern. But as we go through, they're selling into equipment that's used in the electric grid in data centers. And a lot of that investment, if it goes forward, their products and the majority of their products sold in the U.S. are manufactured in the U.S. So, on a company-by-company basis, our companies are well protected, well positioned for this scenario. And if you look around the world, it's a similar story.

[00:05:48] Peter Lampert: China being the largest. China still has the distinction of receiving the largest tariff so far, we're looking at 145% tariffs on Chinese products going into the U.S. if what's been announced so far stands, but our companies in China are largely serving the domestic Chinese market. We have NetEase doing video games, Tencent Music, doing online music streaming. So that's domestic market. They're not exposed to exports.

[00:06:42] Peter Lampert: We're reasonably well positioned where we have had sharp edges. We've been willing to shift on that. So one example is DSV. This is a global freight forwarder. They are reliant on global trade. They help their customers arrange shipping and that's their entire business model. And in January, we exited our position there, largely because the company's done such a good job. Our investment thesis has largely played out that the management team has done a phenomenal job in the industry, making great acquisitions, getting a lot of value out of that. They recently acquired DB Schenker, which is the largest acquisition in their history. There's not a lot of room after that for big acquisitions that can move the needle. So your upside—not as much upside left in the investment case. And meanwhile, you have this downside. If the tariffs do come through and lead to a slowdown in global trade, that could hurt them. It could be a short-term impact, it could be a longer-term structural impact. If trade flows are rerouted, we don't know. It brings in a lot of uncertainty. Downside risk, when we look at that skew, the upside versus downside, that is one of the few shifts we made in the portfolio, in anticipation of the tariffs coming in.

[00:07:54] Rob Campbell: Fantastic. So it sounds like there weren't a ton of adjustments that were needed, but of course, still doing the work, trying to understand and being very deliberate in terms of where we want to have exposure to more export-oriented business models. And what offsets there might be. There are the direct impacts—who's actually exporting into the U.S. Can I ask you about those maybe second or third order impacts? And you mentioned one earlier, just with respect to what this might do to the global economy and certainly here in North America, we've seen consumer sentiment data come out and drop, in some cases quite precipitously. How do you think about that with respect to the portfolio? How exposed are you to consumer spending, and what's the posture in the portfolio there?

[00:08:39] Peter Lampert: Generally, we look for businesses that can do well in a variety of environments. We do have some that would be a bit more exposed to consumer spending. One company is Ferguson that distributes plumbing products, which could be used in both commercial projects as well as residential. So, think of home construction and renovations. That's a smaller position in the portfolio, but one example where there could be some impact if there is a pullback in consumer spending. But by and large, we expect many of our businesses to be more resilient. Like Compass, the catering company, they got through Covid. We certainly don't expect another downturn to be as harsh as that was for them in terms of the number of office buildings shut down. That was a great example where a great management team demonstrated that they can thrive in challenging conditions and come through the other side even stronger.

[00:09:31] Peter Lampert: And we expect that if we do go into another downturn, who knows? That's certainly a possibility scenario that we're considering. We feel good about the management teams that we've invested in, the companies being led by great management teams that can navigate a changing landscape. So if tariffs come through, if they don't, it's really up to the management teams and the best ones will really show who can adjust and who can come out of that even stronger.

[00:10:01] Rob Campbell: Great. Just behaviorally, Peter, I found myself last week just refreshing market screens and—this is on one of the more volatile days—seeing what's been up, what's been down. What do you do from that regard? I assume that it's material when stock prices move around individually as much as they have, and yet I would also assume that getting out of the noise might be helpful for clearheaded thinking. What do you do on these crazy volatile days?

[00:10:32] Peter Lampert: Yeah, that's a big part of it. For us, we have a clear investment philosophy, a clear

process, but it's only as good as the team implementing it and we need to keep our emotions in check, make sure we're sticking to the process. And being disciplined on that. So, Trump was posting a lot on Truth Social the last few weeks. A lot of crazy stuff out there. But one where I really agreed with him, if you recall, I think it was Monday when a lot of volatility, markets going crazy and he posted "Be Cool" and we can all agree with that. You gotta be cool. You gotta keep a level head, stay balanced. If you ask for me personally, I start my day with a quick meditation, have a coffee before I check the news headlines and before I check the stock prices. Just make sure I'm ready to take on the day. And then having a great team around us is very important to help each other. If we think somebody is letting emotion or bias take over, we have that team and we have those high trust levels that we can help keep each other in check and make sure we're really sticking to the process. And of course, having a clear process is very important as well. So again, making sure when we are making decisions, when we're talking about whether or not to, what to do with DSV, for example, are we sticking to the process? Are we being rational and logical? Weighing the upside, downside, not doing some knee-jerk reaction, letting emotions take over. And when you have that lens, I think you can properly view the volatility in terms of both risks and rewards. It's easy to feel scared in moments when there's a lot of uncertainty, when volatility is high. And certainly, we've spent a lot of time talking about how we as a team have assessed and reassessed those risks as the new information is coming up. Where are our exposures? Is the portfolio in good shape? Do we need to make any shifts? But we're equally thinking about the opportunities.

[00:12:34] Peter Lampert: Where are the opportunities? Last week, one of the stocks on our watch list—a phenomenal business; we would love to have this in the portfolio, the price has just been too high—it sold off. It was probably down 30, 40% on the week. It got pretty close to our target price. We didn't pull the trigger—wasn't quite there, but volatility remains high. We could get other chances and we're out there looking for the opportunities as much as we're also out there protecting risks on the downside.

[00:13:03] Rob Campbell: Well, I do certainly appreciate those aspects of our culture that allow us to operate the way that we need to in a tough time. Anything, Peter, you feel investors or the market is really underappreciating at the moment, maybe because of how short-term oriented or how easy it is to get sucked into the short-term daily noise?

[00:13:25] Peter Lampert: The one thing I would highlight is that, of course, people are rightfully trying to understand what's going on with tariffs and what impacts that could have. But at the same time, people are thinking about the risks and the downside. You're hearing a lot of talk about will this lead to a recession, even if the tariffs don't get unwound or continue to be postponed or come off the table. Just the uncertainty alone could lead to a recession if consumers aren't willing to spend, if businesses aren't willing to invest. So you're hearing a lot of that talk, but I'm not seeing as much focus on some of those silver linings, some of the positives that we're seeing.

[00:13:59] Peter Lampert: For example, as the U.S. has been pulling back and withdrawing the global security umbrella, Europe has really stepped up, especially Germany, and they've launched a major investment plan to invest in defense, invest in infrastructure. We expect the rest of Europe to be on board with this, and that's great for Europe. They needed an impetus. This was the catalyst to get them to invest, to help revitalize their economies and bring the strength out in their economies. And they need to have more European defense, more European infrastructure to improve their economies. So that's something that's positive that has come out from that. We expect it to benefit European economies. We expect it to benefit many companies that sell into Europe, and then as well, China.

[00:14:55] Peter Lampert: China's another one where for years they've been talking about the need to shift their economic model toward more domestic-oriented consumption. They know that they're too reliant on manufacturing and exports. It leads to some of these global imbalances, the trade surpluses that are causing a lot of the friction in the world. And it's just not a sustainable economic model for them. So they understand the need to shift. Maybe this is a catalyst that allows them to do that, that gives the government the opportunity to do more domestic stimulus to encourage domestic consumption and help shift that economy. And in that case, that could be beneficial for the economy to make that shift. And maybe you need a difficult time to make some of these difficult shifts. And there could be many companies that would benefit from more consumption and consumer spending within China, some in our portfolio, that would benefit from that. So I think a lot of people thinking, rightfully so, thinking about the risks and the downsides. But as well there are some silver linings and some positives we've seen from an international investing perspective.

[00:16:05] Rob Campbell: Fantastic. Well, Peter, appreciate the balance. We'll let you get back to work. Thank you for sharing your thoughts and for everything that you and the team have done to help prepare the international equity portfolio for a difficult time. It does indeed seem to be demonstrating the type of behavior and resilience that we'd hope for. So thank you.

[00:16:21] Peter Lampert: Thanks very much, Rob.