the art of boring™

EP 235 | Global Small Cap: A New Lead Manager on the Missing Premium, Local Businesses, and Talent Density



[00:00] [Rob Campbell] [RC] Coming up on The Art of Boring, Ching Chang joins me to talk small caps. Ching is new to Mawer. He comes to us with a wealth of portfolio manager experience and is taking over as lead manager of our Global Small Cap strategy. It's a chance for you to hear directly from Ching what's shaped him as an investor, and how he sees the portfolio overall.

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[00:35] [RC] Ching, welcome to The Art of Boring.

[00:36] [Ching Chang] [CC] Thank you. Thank you for having me.

[00:38] [RC] Well, I think this must be a record in terms of how soon after joining our firm we've had someone come on our podcast, so I really appreciate you stepping up so quickly. We're here to talk about who you are, what brought you to Mawer, and specifically what that means for our Global Small Cap strategy.

But I thought we'd start with who you are, and if you don't mind, I might ask you some questions that cause you to be a little bit more vulnerable with us and our listeners, if that's all right. Really pertaining to what's driven you, what's shaped you, and what are some of the biases that you're aware of in yourself. So, just to start: as you think back on your investing career, tell us a little bit about that. How did you land on this being the dream job?

[01:22] [CC] Yeah, it started pretty early. I got an interest in business and investing back in high school. What really interested me was actually the psychological aspect, the way that prices move around and the effect that has on people. I'd say it's like 50% mathematics and 50% psychology.

As with all investors, I think we all start on that value-investing path: starting out looking for really cheap stocks, those cigar butts, where it's so cheap that there's no way you can lose money. Inevitably, half of them, or more than half, don't work out, and you lose a lot of money, and you start to learn that buying stuff cheap doesn't always work. So, throughout my university career and starting my first job, there was a slow evolution towards focusing more on quality.

I went to the University of Toronto and studied finance and economics there. After graduating, I spent some time in investment banking, but ultimately I knew I wanted to go into investing. I moved over to the Ontario Teachers' Pension Plan and did both public and private investments.

It was a great learning ground, because you had exposure to private, public, large, and small companies. A lot of



resources, it's such a global brand, so it opens a lot of doors, a lot of different investment opportunities, so you're able to see so many different types of companies come through. They gave you a lot of responsibility to start, so you've got a lot of kicks at the can, and throughout that process, your investment process starts to evolve.

As I said, everybody kind of starts with that cigar-butt type of investing, and then over time you figure out that doesn't work that well, so there's a greater focus on quality. As my journey evolved further, there was a tendency towards looking for companies that can grow. It's great that you have a moat, it's great you can earn a great return on capital, but what's better is that you can compound that over time. So you start looking for these strong, high-quality companies that have the ability to grow. That's where I am today, and that's been my journey over the last 15 years.

[03:29] [RC] I'm wondering if you can be more specific. Are there specific cigar butts that really got you into trouble, or mistakes that shaped that evolution for you?

[03:38] [CC] There have been instances where you look at a sector. I remember looking at the auto parts sector in the U.S. There are three main players there, as you might know: O'Reilly, AutoZone, and Advance Auto. Where I started was, "Oh, I want to buy the thing that's cheaper," and it turns out it's cheaper for a reason. The best performers, the O'Reillys of the world, they just compound their advantage. It might not show up over six months or 12 months, but over three, five, ten years, that gap in performance really compounds. So even though optically you're paying a lower multiple, that turns out to not be the case very quickly. When someone can grow earnings at a much faster pace, if you're looking five years out, they become cheaper much faster.

[04:22] [RC] Through your career, you've been through a number of, in some cases, seismic market events, whether it was COVID, the global financial crisis, or other things that have really shaped investors. Whether it's from one of those or from some other moment in your career, is there anything that really stands out as something that's shaped your thinking?

[04:41] [CC] Yeah, just to complete the loop here: after Ontario Teachers, I spent almost 10 years at Burgundy Asset Management, working on their emerging markets team, first as an analyst, then launching their dedicated China strategy in 2020, and taking over their emerging markets strategy in 2022.

Over that almost 10 years, I spent a lot of my time looking at Asia, and specifically China. I think China is such an interesting market, because it's so fast-paced, and a lot of investors over the last 15 years who have looked at Western markets have never really experienced a big drawdown. You had COVID in 2020, and in 2022 we had a market sell-off, but those tend to recover quite quickly. Whereas in China, if you take the period from 2018 to say 2025, you probably went through three full cycles, full market up, full market down.

Going into the post-COVID period, the Chinese market was absolutely booming. It was seen at that point as somewhere everybody needed an allocation. Valuations got very stretched, it was very bubbly, and then all of a sudden you had this regulatory action. The market, I think, from peak to trough, sold off over 60%, and then it was a prolonged drawdown over probably two or three years. Then, going into '24, there was this big recovery, where essentially markets doubled over a few months.

So you see these huge cycles. It gives you a lot of hair on your chest, it really ages you, but it's a good



experience, because you see the optimism, the pessimism, the periods where people get euphoric, the periods where people get depressed and believe there's no end to this and throw in the towel. It builds that resilience that you can then take to other markets. I think it's unique, because there's maybe no other market over the last decade that's seen that kind of volatility, that's really tested people in that same way.

[06:46] [RC] Okay, and going back to your high-school days: that 50% psychology obviously drove a huge part of this, as an investor, through those years.

[06:53] [CC] Yeah, I think what helps during those periods is just having a good team. You've got to really have the support of your team. They act as therapists, as much as analysts and coworkers, right?

[07:04] [RC] Very good. Well, you can always come onto The Art of Boring, I'll get a pipe or something, and you can lay back and we can dig into some of this. Last question on background: you mentioned your history, like many, starting as an analyst and then shifting over to the portfolio management side. What are some of the key changes you've had to make as an investor in that shift?

[07:23] [CC] I think the key shift, and it might sound simple, is that you're focusing on the overall portfolio rather than individual names. As an analyst, you don't have ownership of the whole portfolio, so you tie a lot of your self-worth to the names you do have in it. Whereas when you become a portfolio manager, you have to dissociate yourself a bit from individual names and think about the overall portfolio as a whole.

You might love certain companies, but they might not fit in the portfolio. They might not fit with everything else you have, or with the risks you want to take, and then you also have to think about portfolio construction: how do you weight certain names, how do you think about risk, how do you think about sector allocation, how do you think about geographic allocation, especially when you're running a more global or multi-region portfolio?

You're taking that step up where you're not trying to make the perfect decision. As an analyst, you always want to be perfect on certain names, on certain companies; you want to get it right. Whereas from a portfolio standpoint, you're trying to satisfy; you're not trying to get the perfect answer, but the answer you can live with, that's going to, over time, hopefully deliver outperformance and a good experience for clients.

[08:42] [RC] That rhymes with a couple of things I've heard from other guests hosting this podcast over the last several years. One was this notion that when they started out, they wanted to pick winners, find the stock no one else has, and watch it skyrocket, whereas as they matured, especially in a portfolio context, it became more about reducing errors across the portfolio.

And the other, on the psychology side, is this lesson that language matters. When you call something “my stock” as an analyst, you're binding yourself to the idea, and it makes it harder to let go of part of it. As Paul Moroz said, the stock doesn't know that you own it. So, definitely some psychological stuff there too.

Like I mentioned at the top, you've just joined Mawer, and you've been named lead manager of our Global Small Cap strategy. Why Mawer, and why Global Small Cap?

[09:35] [CC] As I was looking around for my next opportunity, Burgundy was acquired by BMO, and if I look at



what I wanted out of my workplace, I value independence. I think there's a natural fit in philosophy between Burgundy and Mawer: we've been intellectual peers in how we think about investing, in that deep fundamental research, that quality focus, that downside protection. So I think all of those aspects meant there was a natural alignment between what I was looking for and what Mawer was looking for.

[10:10] [RC] So, at the risk of revealing my own ignorance, I've also found that Burgundy and Mawer have had similar tenets: great businesses, great management teams, and paying an appropriate price. My feeling, though, is that historically, at least in the last 10 or 15 years, Burgundy has emphasized more the valuation side of things, whereas Mawer has historically emphasized more the quality-of-business side of the equation. Is that a fair characterization, and if so, how much of a shift is it for you to join us here at Mawer?

[10:40] [CC] I think it's a fair characterization overall, but there was autonomy within the portfolio managers to execute their strategy in a way that fit how they thought about the world and their universe. If I looked at my universe in emerging markets, there was a tendency towards growth; a lot of these companies are on that growth trajectory, they're not at maturity, they're seeing fundamental growth, seeing whitespace, seeing opportunities. For me, there was a stronger leaning towards focusing on quality and growth rather than just valuation.

Why global small cap? I think global small cap has many of the characteristics of emerging markets. There was a natural fit in skill set: you have a lot more volatility, a lot less disclosure, where due diligence can add a lot of value. These names are less covered, less well known, less entrenched, and not just volatile from a stock-price perspective but from a business-fundamentals perspective, too. You have to be much faster to react, much faster to see changing fundamentals within your companies. So I think in terms of skill set and experience, there was a great fit between what I'd built and how that translates into the global small cap universe.

[12:07] [RC] Can I ask you a couple of questions on small caps in general? You mentioned the similarities. One of the conundrums, at least for someone who went through the CFA program in the late 2000s, was this notion of a small-cap premium, which seems to have gone absent over the last 10 or 15 years. Any views on that? Is now a great time to be investing in small caps, given the trend has gone the other way for a long time, or what are your thoughts on the value of small caps to an overall portfolio?

[12:33] [CC] I think there are a few reasons why that small-cap premium has gone missing, as you say. One is that companies tend to stay private much longer; you have a much more robust private equity and venture capital ecosystem. Whereas before, if you look at something like Amazon, it was able to be in the public markets while still fairly small, so a lot of that value creation happened in the public markets.

Take what we see today, like Anthropic: they're reportedly looking at an IPO somewhere in the one-and-a-half to two-trillion-dollar market cap range. So the bulk of that value creation has happened within the private markets. We see that over and over: companies are IPOing later and later in their life stage, so a lot of that value creation is happening in the private markets, whereas historically it went to the small cap investor.

[13:26] [RC] Effectively bypassing the small cap phase of a company's lifecycle.

[13:30] [CC] Right. Even where it's not an Anthropic, you see it with Uber, Airbnb, a number of companies that have IPOed much later in their lifecycle. That's one reason. The second is that we're seeing such technological



change that the companies driving it are able to scale at an unprecedented pace. You have companies like Google or Amazon that continue to grow at astronomical rates despite already being so big, and they continue to deliver outperformance despite being worth trillions. Those leaders in the stock market that have been driving the bulk of the returns haven't faced the law of large numbers the way they have historically.

That's part of this pace of change, part of the fact that, especially with this AI buildout, these are fairly asset-light models that allow companies to scale without needing much capital and keep growing even though they're already so big. So I think those two reasons have been big contributors to why large caps have outperformed small caps over the last decade or so.

In terms of the role of small cap, I don't know if that premium is coming back. If you look at where the world is, these large companies don't seem to be slowing down, rather they continue to accelerate, so I don't know if the small cap premium is coming back. But I think the role of small cap is really as a diversifier to your portfolio: it adds different exposure, a lot more local businesses, local to their specific geographies or regions, and a lot less AI exposure versus the large-cap index. That can act as a diversifier whenever there's a big AI sell-off.

What's attractive about small caps is that skill still matters. Managers can really differentiate themselves and add a lot of value, because it's less well covered, because there's still opportunity for inefficiencies and opportunity to generate alpha, maybe more so than in well-covered universes like large caps.

[15:34] [RC] Going back to the cigar butts, I don't know if you'll agree with this, but I've always thought that, okay, small caps writ large, but perhaps because of some of the trends you mentioned, there's a good chunk of that small cap universe that's just gotten junkier, which a quality manager might not naturally be inclined towards. So I've always found you can differentiate between the really good small caps and the junkier small caps in terms of where you want to spend your time.

You mentioned the local nature of many small cap businesses. That's another thing I wanted to ask about. We're in an era right now of de-globalization, of greater walls between jurisdictions. For businesses that are a lot more local in nature, what implications does that have for someone managing a small cap portfolio?

[16:16] [CC] It creates opportunity for a lot of businesses that historically you may have outsourced or offshored production for. Now you have to build that locally, which means the person producing locally has an opportunity to scale up that they may not have had historically. These trade barriers, this desire to build resilience in supply chains, give opportunities to companies that may have had their production in the U.S. or Europe that historically they wouldn't have needed. What you might see is a replication of capacity around the world, and that buildout of capacity is going to benefit a lot of these local companies, local construction and engineering companies, or the people who can provide those services locally.

[17:05] [RC] Another thing many market prognosticators have focused on with respect to small caps is the relationship with either a rate-hike cycle or rising bond yields more generally. I think traditionally that's been seen as a negative for small caps when you enter that kind of cycle. How do you feel about that? We do seem to be in a different interest rate regime than the 2010s. How does that change the way you look at certain small caps?

[17:27] [CC] Yeah, I think the reason people view small caps that way is that a lot of them have had weaker



balance sheets. That's an area where you're already taking more risk, since these companies are less entrenched and operate in a more dynamic environment, so you don't want to add financial risk on top of that. So I think focusing on companies with stronger balance sheets, ones that are resilient to a rate-hike cycle or to more volatility in rates, is important. If you have a strong balance sheet, you have that resilience. So that's a big focus in terms of the companies we own and look at.

[18:03] [RC] Can I ask you about the U.S.? It's a huge part of your universe, and a jurisdiction our strategy has, from the very outset back in 2007, been quite underweight. How are you going to approach the U.S. specifically, and geographic diversification more generally?

[18:21] [CC] We're still going to focus on fundamental, bottom-up stock picking, but we're going to have overlays in terms of thinking about regional weights and relative exposure. The reason behind that is that ultimately, we're not macro investors, and when you build a portfolio on a purely bottom-up basis, it can result in implicit bets you don't mean to make. You might be overweight a certain geography or sector, and those tend to move more with macro factors, which isn't where our expertise is. It's hard to say whether Brazil or Japan is going to perform better, and at the same time you're adding currency risk, geopolitical risk, and local political risk to the portfolio that you might not mean to take on.

A great recent example is Brazil, where there was an election the market didn't like the outcome of: the currency was down almost 10%, and the market was down 15%. That wipes out perhaps all of the good stock-picking you've done in that country, because of an overweight you may not have even meant to take. So being more aware of some of those regional risks matters, because ultimately, even though we're bottom-up stock-pickers, a big part of your underlying return is driven by that local beta, how that local market does.

[20:01] [RC] It sounds particularly important in a market where companies are a lot more domestically focused. If you've got a portfolio of multinationals, some of that diversification might happen more naturally, but it might actually be quite a bit more difficult to understand where your overweights and underweights really are.

If I heard you right, you're saying you could find a terrific Brazilian company that's gaining share and growing, but if the currency gets wiped out, it doesn't matter, your stock-picking gets overwhelmed by some of those bigger factors, even though the starting point and the bulk of the work is bottom-up in nature. You've described a better awareness and intentionality around factors and geographies. What's your view on how important it is for a bottom-up manager to actually have a macro view?

[20:46] [CC] How I view it is that it's quite difficult; it's not where our training has been, it's not where our expertise has been. Maybe over time you can develop that on rare occasions, but I'd rather do no harm: not take these big macro views, like thinking a recession is coming or that a market is going to do better, and let that macro view feed into your stock picking. I'd rather do no harm, be more neutral on those macro factors, and then go out and pick the bottom-up stocks I think are going to do well.

[21:20] [RC] It's really about focusing on where you have an edge, where you have ability, and building an awareness around these other things. Maybe going back to the edge side: we've talked about valuations, we've talked about business quality, but we haven't talked much about an area I know you're passionate about, which is management teams, what separates the good from the bad from the ugly. I don't know if that's the right



framework for this topic, but in your career, what have you found to be the real hallmarks of what separates a good management team from a truly excellent one?

[21:51] [CC] As I've evolved as an investor, I've tried to look for the leading indicators of what makes a great management team, rather than the output. I think a lot of people look at things like, what's their track record, what's their alignment in terms of ownership, what's their compensation structure, what are they incentivized to do. I'm trying to find more of the intrinsic motivations, and what feeds into that.

So I look for management teams that are customer-focused, that are really focused on what their customers need, how to create value for them, how to do better by them every day. A great example is Costco: they're always so focused on how to deliver value to the customer.

[22:34] [RC] A little outside your market-cap range, but yes.

[22:36] [CC] A little bit, a little bit. Something we'd love to own, obviously. I think a lot of organizations, when they're small, that's their focus, because you need every customer to survive. But as you get bigger, internal institutional pressures can take precedent: the need to meet a quarterly earnings number can mean making your product 1% worse to save that cost and hit the number. That compounds over time, until eventually your customers notice your product is worse, or there's shrinkflation, whatever it might be, and they go somewhere else.

Similarly, I look for companies and management teams that can attract the best talent, that have talent density. One way we try to do this is by speaking with people who work in the industry and asking them where they want to go to work. You'd be surprised how consistent that message tends to be. That's a great sign, because if you have talent density, there's a lot you can do; you have that intellectual passion of people who can deliver great results for you.

We also try to look for management teams that are adaptable. The world is uncertain and fast-changing. Can you adapt your business? Can you recognize a mistake and change course, or are you stubborn and set in your ways? You want someone with conviction, but you also want them to recognize when they're wrong and change course, because that's hard to do.

Then, lastly, you want continuous learners. A lot of ideas get stuck because people say, ”this isn't how we do things here,” or “this isn't how we do things in this industry.” But when you find management teams that can learn from other companies and industries and apply those practices to their own, that's valuable. You want to find management teams for whom this is their life's work, not just about money or ego; they want to leave a legacy. Those are unique. One investor I admire says that with a lot of management teams, you're not able to really distinguish between, say, someone in the 60th percentile and someone in the 40th percentile**,** but you can notice the top 10% and bottom 10%. That's what we're looking for.

[25:00] [RC] One last question before I let you go. You're now lead manager of our Global Small Cap strategy, which has had some challenges with its track record over the past couple of years. What's your key message to clients looking forward?



[25:13] [CC] I think we're making the necessary changes to the portfolio. As I said, there's a greater focus on some of those historical regional bets, where macro factors have sometimes overwhelmed the bottom-up stock-picking. It's just a greater awareness around that. The team is energized to find the best ideas we can and deliver much better performance going forward.

[25:38] [RC] Terrific. Well, stop talking to us, get to work! Very happy to have you on board. Thanks so much, Ching.

[25:50] [CC] Thank you, Rob.

[25:52] [RC] Hi, everyone, Rob 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, please leave a review on iTunes, which will help more people discover the Be Boring, Make Money philosophy. Thanks for listening.

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