



Kevin Minas (KM): In this episode of The Art of Boring, we take up the main questions on investors' minds today. We'll discuss geopolitics, inflation and bond markets, gold, software businesses, and how the changing world order may affect portfolios over time. It's a broad set of topics, but they all point to the same challenge: how to stay thoughtful in a more complex environment.

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KM: Stu, another quarter in the books. Nice to see you again.

Stu Morrow (SM): Good to see you. Thanks for having me back.

KM: I think we have to start with geopolitics for this quarter. That certainly dominated headlines, dominated markets. We started, it seems like a distant memory ago, but we did start the quarter with the events in Venezuela. There was this brinkmanship or whatever you want to call it in Greenland.

But of course, what's really dominated the market narrative over the quarter and really impacted markets is what's happened in Iran with the U.S. and Israel and in Iran in the ongoing war. Why don't we start there? If you can give us a little bit of a lay of the land as to what's happened, where we're at now, and then what the market implications have been from some of those events.

SM: Sure. Today is April 10th, day 41 since the conflict in Iran began. The impact on markets comes down to one thing: oil and oil shock and potentially what that means for growth or inflation or both.

Maybe the worst combo, a stagflation type of environment, and maybe we can talk about that. Original market expectations going into this was a very brief conflict, 1-3 weeks, and we're clearly past that. The last few days, there's been a two-week ceasefire that's been put on the table and some legitimate doubts about whether that holds up or not. I guess we'll find out sooner than later.

I think it's important, not just from an oil perspective, as you talk about how markets care about this. I think global growth could be impacted the longer this carries on because it's not just an oil story. The Strait of Hormuz, which we're talking about, carries a lot of global oil and gas, a fifth of daily consumption or daily demand.

A lot of seaborne fertilizers go through the Strait, as well as sulfur and other chemicals and products that are used in semiconductor manufacturing. There are a lot of implications beyond just energy: food security, supply chains, potentially AI build-out.

Some real-world examples of how this is coming home and hitting is: Exxon has lost 4% of its global production from Gulf LNG plants. I believe Delta Airlines talked about a pretty big jet fuel bill of 2 billion dollars. Dubai property developers are seeing their bond yields really rise as default risk is rising. It's been a multi-asset, cross-asset impact.



So far, we're seeing the conflict come back and rise at certain times, but it's certainly day-to-day and even has been the last couple of weeks, hour-to-hour at times.

KM: Despite all that, you would think the markets would have sold off more. I guess they did briefly in March. There's been a bit of a rebound already in April. You alluded to the ceasefire, potential ceasefire. That certainly helped the last little while.

It is quite amazing, though, when you think about, to your point, all the different impacts, all of the different business models, commodities, second and third order effects, and yet the markets have held in there quite a bit.

You made a reference to stagflation. If you don't mind maybe expanding on that a little bit because that is the big risk, right?

SM: Yeah. Slowing growth while inflation is rising or disinflation is slowing. If you take Canada, for example, heading into the conflict, you could categorize Canadian growth as slowing or relatively weak, excess supply in the economy, job losses are growing, trade uncertainty with the U.S. So, a very different backdrop perhaps than the recent past.

Inflation pass-through from higher oil prices is the scare there. We have in Canada this combination of a weakening economy or a weaker economy with potentially rising inflation as well. The U.S. entered the war, I would say, with an economy that was chugging along at trend.

All infrastructure was part of that. Tax cuts and stimulus from prior periods were supporting the economy as well. You had a labor market that's probably weakening, or one could say that, but still a lot of stimulus in the background.

And then you have this oil shock potentially driving inflation. So that's it. Both sides would be tough for equities and bonds together. It's the scare from a portfolio perspective.

KM: I guess, to be clear, it's not that we're calling for that scenario. We're not calling for specific economic scenarios generally. But at the margin, the point is: if you think about probabilities of different market outcomes, all else equal, you've got to imagine a stagflationary environment. At the margin, at least, has become more likely. That's one of the concerns right now.

SM: For sure. I think it's important to point out, as you said, we're preparing for potentially multiple scenarios, how this could play out over the coming days, weeks, months, quarters, the near-term impact, the longer-term gain. It's quite variable.

So from what you're seeing—certainly over the last quarter or two or before the conflict—from your seat, some of those changes that you would note in our process or our stock selection, how we've adjusted or came into this already adjusted or are adjusting as we go through this conflict and crisis?

KM: One thing we've talked about—we might have talked about on the last podcast, certainly in other episodes of this podcast and other publications—we've talked a bit about this. And this is not our own idea. This is, I think, widely accepted: this concept of a changing world order.

At least historically, you had post-World War II for, I guess, the better part of 80 years, relative stability, certainly conflicts here and there, but nothing at a global level that sustained itself for a very long period of time. As a result, increased globalization, and all your Econ 101 concepts, right?



Comparative advantages, focusing on what you're good at as a country and producing as much of it as you can at the lowest cost and the best quality and exporting it around the world. And so that's been the backdrop for the last 80 years. And I think what we've seen over the last, certainly the last 12 months, but even over the last couple of years, you can go back into 2022, I think that's probably where the shift really started, is some of that breakdown in globalization and increased levels of conflict.

And there are—to your question, I think was around process and what we're looking at—I do think there are some changes, not necessarily in the philosophy. You're still looking for the same sort of companies, but when you think about it, we're quality investors. So, we're trying to generate returns by selecting businesses that can generate a good return on capital.

When you think about it from a forward-looking perspective, though, in terms of quality, these shifts, the changing world order, realistically, I think it probably does lead to a change in the sort of businesses that you would think are high quality. The obvious example is defense.

That's changed over the last couple of years. Historically, we didn't tend to invest in that space, relatively modest returns on capital. And that's obviously changed meaningfully as defense budgets have skyrocketed the last few years and don't necessarily see that slowing down anytime soon.

Commodity producers would be another example where we have been leaning a little bit more into that over the last 12 to 24 months, both on the metals, the mining side, as well as the energy producers. That's been good for portfolios, certainly. Obviously, we weren't expecting what's happened in the last quarter, necessarily.

But as resource independence and security has become much more of an important issue, that's all else equal additive to those types of business models. So, we have leaned in there a bit as well.

Same approach as always, but the businesses that meet the quality standards and the return potential standards, that shifts over time. And that has been a more noticeable change over the last year or two.

SM: And broadening out too, right? That is broadening out exposures and broadening out diversification so that we're positioned for multiple outcomes potentially, but also increasing opportunities for us to potentially take advantage as scenarios change, right? Increasing the number of holdings in certain strategies to diversify away and into some sectors that we may have, as you said, traditionally not been weighted in or reducing those underweights or reducing overweights. So, call it that broadening out.

KM: Exactly. Why don't we talk a little bit about performance? You've given a good setup in terms of what happened, or what may have impacted equity returns. Why don't we go into there and if you can tell us a little bit about what happened in the quarter, as far as the equity markets are concerned.

SM: Yeah, for the equity markets, headline numbers would suggest things were calm, I guess, if you look to just quarter results, which wouldn't say anything. But if you looked at it from a sector basis, a regional basis, and then obviously, as we do, as individual names and companies, it would be a very different story than just in the aggregate. But the standout from the equity markets would have been the energy sector, which also helped Canada.

So Canadian equities and developed international equities did well this quarter, outperforming the U.S., which was an extension of what we saw in the trend that we talked about last quarter in this podcast. The U.S. big cap names, the mega cap names, the hyperscalers, their increased spending and capital expenditures was coming under some scrutiny in the quarter, as well as disruption in AI towards the software sector. Specifically, there was a research paper from [Cintrini Research](#), which drove a lot of doubt as to the future cash flows and terminal value of some software companies.



That was a bit of a change in shift over the quarter before the war, and since. Interestingly, though, the gold trade and fixed income or bond yields, both moved how you wouldn't have expected them to as a traditional more safe-haven vehicle. Gold has typically held up in those types of environments.

It certainly had declined from its peak in January, and bond yields did rise on the margin. So, over the quarter, there were a lot of shifts underneath the surface.

And then the Iran conflict triggered that right as energy shock, potentially higher inflation, and then the impact that that could have on central bank cuts, which I'll let you to talk through that. But from a performance perspective, we did see that the quality-oriented portfolios that we run at Mawer, for the most part, didn't keep up with benchmarks in the quarter.

There's a quality issue as well. Quality typically as a style has underperformed more recently. It's tracked and held up with a broader market, where the markets typically start to deteriorate, and then recover strongly, usually when markets reassert themselves. That is something we're keeping an eye on.

But the underperformance is also a factor of what's traditionally been, or historically been more recently, the momentum-driven markets, concentrated markets. And then as I said before, this AI-driven disruption, going from software to also freight and asset-light business models as well, drove some disruption.

KM: So there's a lot to unpack there. You talked about gold, you talked about rates, you talked about a few different sectors and themes. Why don't we start with gold?

You mentioned it didn't behave necessarily as the safe-haven asset that you would expect in a period like we just saw in the last quarter. What's your view on what explains what happened in the last quarter? Is it just a function of what we've seen over the last few years, and it was just so hot? Or is there something more to it?

SM: There's probably some of that. The chartist in me would look at that and say, yeah, that seems in hindsight it could be the case. There's some mean reversion in that, but probably not a fundamental breakdown. If you look at some other indicators over the quarter, there potentially was some forced deleveraging that happened.

So, investors were forced to raise capital as financial conditions tightened. Gold in its certain forms has been more liquid. Demand from Gulf countries as well, or sovereign demand slowing.

You saw fiscal obligations are still high, but energy flows are disrupted. There's some talk or some indications that those were also potential reasons for the downdraft that we saw in gold price. But we saw this before, if you go back to 2008 and 2020, gold did sell off sharply in those crises. And then what looked like a failing hedge, but it was really more short-term. It's tough to say that that's the case now.

We won't know, but it seems some forced selling has occurred, but longer-term deficit spending, energy scarcity, elevated inflation risk, those things are still there. I still think that there is reason to hold gold and maybe in the short term it's sold off for other reasons other than fundamentals.

KM: That's fair. Yeah. Some of those long-term drivers, as you said, haven't really gone away, but combination of the valuation had moved up so much and, yeah, some sources of liquidity, I guess, for investors' portfolios.

The other thing you mentioned is just around the bond markets and the impact inflation might have had. Both the Bank of Canada and the Fed were on the sidelines in the quarter. Canada's starting point, the overnight rate is lower at 2.25% versus I think it's about 3.5% or so in the U.S.

So, they had a higher starting point. Both central banks stayed on the sidelines. Partly they've already done a fair



bit of cuts in 2025, but then obviously as the quarter wore on, there were political issues that we mentioned earlier.

And of course, then the knock-on effects and inflation. All else equal, the banks didn't move. They did indicate that they're on a wait-and-see.

Basically, to the conversation we talked about earlier, that tension between rising inflation expectations, but not necessarily clarity as to whether it will be the T word, transitory. But at the same time, the longer it lasts, obviously it might impact growth, right? They're trying to balance those two forces.

If they step in now and start cutting and this situation resolves itself, then you've relaxed monetary policy perhaps earlier than they needed to. Particularly if you end up in a stagflationary environment—higher inflation, lower growth—then that's a really tough position to be in. If they've already been cutting aggressively, they don't necessarily have as many tools in their toolkit to use.

So that's certainly been a big factor in the bond markets in the quarter. As a result, when you talk about yield curves, they flattened. Yields generally across the curve went up, relating to that comment you made earlier around bonds not necessarily acting as a safe-haven.

They sold off when markets were selling off, but it was really more of an inflation concern. And so, yeah, in the short term, it didn't necessarily provide a great hedge. And then in terms of the flattening, basically what that means is you had front-end yields, so shorter duration bonds, 1-, 2-, 3-, 5- year, as opposed to 10- and 30-year bonds that moved out more.

So, the yields went up by a larger magnitude than the long end. And that's simply a function of if you're worried about near-term inflation and you're worried about potentially flipping from rate cuts by the central banks to hikes, that's going to naturally impact the front end of the curve more than it'll impact the long end.

The long end is more a function of long-term growth fundamentals and long-term inflation. I think generally speaking, both the central banks and the market, the view is if there's a resolution relatively soon, you shouldn't get multi-year growth and inflation impacts, but you are getting it right now in the short term.

That's simply why you've got this big shift in the yield curve at the front end and not so much in the long end. But overall, given that yields were up across the board, that's not great for bond investors. So that was a headwind in the quarter.

And then the other big piece is just around spreads. And we did see a bit of spread widening, both in global investment grade, so higher quality bonds, as well as in high yield, combination of factors. Geopolitical tension is not helpful, of course, growth concerns, which we've already talked about.

I can't remember if you might have alluded to private credit already, but certainly there have been a lot of headlines right now around private credit, lending to software companies, investors not necessarily being able to get their funds back when they want.

That's not necessarily bled directly into investment grade and high yield markets, but all else equal, they are correlated markets. Borrowers that tend to play in the private credit market, they also tend to overlap in the broadly syndicated loan and high yield markets.

Certainly, what happens in one market does have a knock-on effect on others. And then just generally a risk-off tone also affecting spreads. As a result, a little bit of a sell-off in terms of the price of corporate credit securities generally.



So, it is a bit of a tougher period for bond investors. You've even already seen a bit of a snapback in yields just in the last week or two since the end of the quarter, as the news of the potential ceasefire was announced.

SM: When I said gold, people were doubting gold as the hedge. And as I said, you just explained—when you hear people say, “Well, why hold bonds in a portfolio in those proportions?”—Is it still playing a role in portfolios today?

Traditional diversified fixed income, right? What sort of pushback would you give to that statement? Because it seems whenever yields are rising and equities are falling, they say exactly why own bonds as diversified equities, but we typically look through a cycle.

But what are your thoughts on that?

KM: Yeah, I think the general view or house view would be in terms of asset allocation is different asset classes play different roles in different regimes. So, one asset class is not going to perfectly provide a hedge in all environments. As I said, we are in a potential inflationary shock situation.

Well, in Canada, for sure, you've got slowing growth. So that stagflationary scenario that we talked about, the risk of it is increasing. And in that environment, it is tough for bonds to provide a hedge because the central banks can't provide as much monetary support by cutting because they've got to worry about inflation. You don't usually cut when inflation is a concern, or at least you can't cut as much. That's certainly not a reason to not have bonds.

What I would say, though, is that diversification is the only thing you can do to protect yourself. And that applies to asset allocation too. It's not just within stocks or within bonds, but actually across asset classes, but also within them. So, we've added global credit to our balanced mandates about a year ago. That's going to do well in certain environments and not so well in other environments. So in a period where government securities are going to do really well—when they're really aggressive, there's a risk-off environment, they're cutting rates—that's going to be very additive to have core fixed income, to have traditional duration, probably less so to have credit.

But the flip side is if you don't get that major sell-off in spreads, then it's quite helpful to have some global credit because you've got a meaningful yield advantage. The way that that strategy is run, you've actually got low duration. So higher duration in your traditional fixed income, quite a bit lower duration in your global credit, non-traditional fixed income, whatever you want to call it, they're going to do well in different environments.

Over time, that should produce a better result. That's asset allocation 101: you get different allocations that have different correlations, different risk profiles that do well in different environments. I definitely would not say that it's diminished the reason to have bonds, but it maybe is an indication for investors that aren't necessarily as diversified as they could be in their fixed income.

That's probably a good step would be to think about how you diversify within your fixed income.

SM: Well said. I agree. You touched on software a little bit too. I mentioned it in my macro comments. Did you want to talk about that a little bit more? Specifically, what has happened to software, how we've reacted in some ways in portfolios?

KM: Yeah, sure. Software has definitely been a challenge. Software-as-a-service providers in particular, but software more generally.

This wasn't the first quarter where that was the case, but it was certainly acutely felt this quarter. I think what maybe shifted or was a bit of a change quarter over quarter is that it started to broaden out. It wasn't just the direct software providers or the data providers for those software, but a lot of other business models that maybe



at first glance don't necessarily seem all that connected, but they got caught up in this AI loser narrative, basically being concerned about AI disintermediation.

So that's on the consultant side, even insurance brokers, wealth managers, a lot of different financial services, anything really that's data-heavy and/or technology-heavy, not necessarily a pure tech stock or pure software provider, but anywhere at the margin. Theoretically, the idea is it becomes easier to disintermediate these businesses by upstarts because of basically being able to use LLMs and AI to put together programs that can make it easier to have an upstart company. Upstarts can either take away market share, or even if the incumbent's not necessarily losing a lot of share, put pricing pressure.

That is really what we've seen this quarter is that broadening out. It's caught up a much larger swath of stocks and business models. The one thing you alluded to earlier about quality businesses is that a lot of quality businesses tend to be asset-light, or at least historically have been asset-light.

When you think about all the different businesses that I mentioned, whether it be consultants or the wealth providers, insurance brokers, those tend to be asset-light businesses. So historically, we've tended to have a lot of exposure into some of those businesses. You alluded to this earlier during the performance section. It has been difficult right now because a lot of those businesses are being seen as losers in the short term, not necessarily because it's actually reflected in the fundamentals.

Their earnings have not necessarily deteriorated. But when you think about trying to discount future cash flows, I think that's where the market is. There's a lot of selling. Everybody's basically guilty until proven innocent. And so, I think what we've been trying to do is really think through this.

One of our analysts—this might have come up on another podcast, but just to reiterate for those that didn't hear it—we're looking through and trying to figure out characteristics that we think about as we sift through these business models. How are we assessing them?

And we have sold some, we have trimmed, we've actually added as these stocks have sold off. And really the criteria we're looking for are things like, do you have enriched proprietary data? Datasets that are very difficult to replace, deeply embedded in customer use cases.

You know, all else equal, you probably have a better chance coming out on the other side of this in a fairly good position. Do you have high operational entrenchment? So that would be things like you're very integrated in your customers' workflows. It's harder to remove that software for an upstart, or at least it seems as risky. It's not worth necessarily the risk of doing that. And then is it in an industry where the risk of hallucination is high?

Think about heavily regulated industries, healthcare, things like that, where there's greater risk to trying something new as opposed to sticking with the incumbent who can adopt AI tools themselves, maybe have a better offering, maybe offer it at a lower price. But again, that should hopefully slow down the risk of disruption. We've made quite a few trades around a lot of these themes and across our mandates, but that's how we're looking at it.

So it's not a wholesale retreat from these software names and from these other business models, but we have had to be discerning. We have made quite a few portfolio adjustments. I suspect we'll make more over the next few quarters as more data comes out and as we get a better sense of which business models are holding up and which are maybe more likely to be disintermediated.

But, yeah, it's definitely highly topical and I imagine it'll be for the foreseeable future.

SM: Yep, well said.



KM: We've covered a lot of ground. Do you have any final thoughts to close with?

SM: Yeah, I think the immediate issue we started talking about was the Middle East and how that's a wildcard. There are different outcomes. It could be containment, prolonged shock.

It could be broader escalation, de-escalation. Perhaps the market hasn't priced all of those in yet or favored one or the other. And you go back to what we've written about and talked about previously, which is, this is thought of as an isolated shock and those old assumptions around globalization or stable globalization and low inflation, capital-light growth are all being tested.

We're set up for potential more disruption or less disruption, which is important. And our process, as you said, is unchanged. We're really looking for competitive advantages, durable returns on capital and disciplined management teams to execute.

And the playbook may be updating or updated, but the broad diversification, the careful sizing of positions that we talked about, those are certainly updated, but not the process. I think in a world of uncertainty, that discipline, active management approach and quality approach that we have is really what matters and carries people through to the other side, which will eventually come.

KM: Well, that's probably a good place to stop. Thanks very much. Great talking with you, Stu, and looking forward to next quarter.

SM: For sure. Thank you.

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