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EP57 | Playing the plan CEF

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Andrew Johnson: 00:41

Hi everyone, I'm joined today by our Director of Research and Lead Portfolio Manager of our Canadian equity strategies, Vijay Viswanathanan. Vijay, we didn't really have a chance to chat last week, just given our transition to working remotely, so it's good to see you. How are you doing?

Vijay Viswanathan: 00:55

Yeah, it's good to see you as well. I guess, virtually, things are going as well as they could be given the circumstances. That's both personally and professionally [laugh].

Andrew Johnson: 01:06

Great [laugh]. That was the point of my question. So, just before we get into what's happening here in Canada and with the portfolio, I did want to check in on that transition to remote working. As you said, we're actually recording this podcast remotely rather than sitting across from each other. And one of the ways we've set up our environment at Mawer is [an] open office [concept], and that was done intentionally years ago to foster communication and collaboration, which is a contributing factor to our overall culture. How has that evolved while we work remotely?

Vijay Viswanathan: 01:38

Well I'm glad you asked that question—it's been one of the silver linings in everything that we've had to go through as a team over the course of the last two or three weeks, and it's probably been my biggest learning over the course of the last two or three weeks—how to better harness the power of technology in order to better collaborate when you have a large team in disparate locations. And this has been a problem we've been trying to solve for years and have had very limited success around it. And it was through this massive disruption, through this crisis, that we think—as a firm and as research team—we've taken significant steps to better collaborate.

Vijay Viswanathan: We've been using Microsoft Teams—I'm sure there are maybe listeners right now who are like, "yeah? What took you so long to figure it out?" I don't know. I don't have an answer to that question if that's something that's on people's minds. But for us, that's been the biggest learning: for big groups to get dialogue going, and being able to harness technology better.

And I think it's led to more robust conversations and dialogues. Not that that wasn't existing before, but especially when it's large group formats…we've had the comment from our teammates in Singapore—Josh, Wen, and Peter—their feedback is, "hey, this is the most connected I've felt to everyone in Canada in the last two years." And maybe it took all of us being remote [to gain] a sort of…sense of empathy around that. But maybe on that, being really able to use the power of these technology platforms and solutions we have. It's definitely been the silver lining in all of this.

Andrew Johnson: 03:28 Great. Well thanks for that. Let's shift gears and really get to what's been happening in the Canadian market, maybe the economy in a little bit. The real core of my question is, just how and why has the Canadian market reacted differently? It's certainly… everything out there has been hurt, but the TSX appears to have been hit harder, at least year-to-date. We're seeing numbers down a little over 30% versus somewhere in the 20% range for the S&P 500 and in the ACWI indices. What's been happening in our stock market that's different.

Vijay Viswanathan: 03:59 Well, I think most markets globally have all been hit, so this "black swan" type event/pandemic that we're all dealing with has had huge ramifications across the globe. And the Canadian market—now, what would be some differences, maybe, versus some other markets? Maybe compared to our neighbours south of the border… some of it I think that has contributed to some of that relative weakness is just the universe itself. We have significant amount of energy companies within our investible universe, which has been hit very hard. So I think the short answer is, the Canadian universe is less diversified, I'd argue, than say the American—like S&P 500 or the Dow. I think if you compare Canada to Australia, for example, which has an economy like this—very similar, driven by commodities and banking, industries, things of that nature—it's about the same. But I think all markets are down pretty significantly.

Andrew Johnson: 04:57 What role has currency played in Canada so far?

Vijay Viswanathan: **05:00** That hasn't helped if you have U.S. dollar expenses [laugh]. So, given we've seen quite a sizeable move in the Canadian dollar versus the U.S. dollar, it has a benefit, I guess, to our non-Canadian strategies. So, there is some tailwind there that probably benefits companies within our Canadian portfolios and other portfolios that have more U.S. dollar exposure. But that's also has been a bit of a headwind.

Andrew Johnson: **05:28** What exactly has been the response so far by central banks—and I mean, you can speak generally—but here in Canada, and again, we're recording this on Monday afternoon, March 23rd. Things are going to change from the time we record this to when it gets published, likely, even though we're going to turn it around shortly. What has been the response so far from our central bank, and what's been the intended effects of that?

Vijay Viswanathan: **05:51** Well, banks around the world are doing…there's been lots of action. We've seen central banks around the world move very quickly, trying to shore up liquidity in the market. There're so many different programs that have been announced, too numerous to sort and go through in detail, but that's what central banks are trying to do—is ensure that there's liquidity in the market, that there's confidence in the market; shoring up the financial system and doing all that they can. And [they've] pretty much have said those words, "We will do whatever it takes to make sure that we don't have some seismic or systemic shutdown of the financial system." We've also started to see—and we're seeing more and more on the fiscal side—the governments, whether it's Canada, it's the U.S…and I think the U.S. right now is working its way through the messiness that can be democracy and congress and we'll see what comes out of that.

06:38 We saw this in 2008-2009, where we thought that there'd be a deal then there wasn't. Then it would play out over a few days. We'll see. I think eventually something gets done there. We've seen from our own government here in Canada some announcements around fiscal stimulus and relief programs.

So, I think there's stuff that is happening…and items and things that have been announced. I think more to come around that. I think the "powers-that-be"—for lack of better terminology—are doing all that they think is necessary, and I think they still have more that they can do should they need to in order to shore up the whole economic system. I think, ultimately, this really comes down to how long, I guess, does it take before life can sort of…return to normal. Or whatever "normal" is going to be after we sort of get through this.

Vijay Viswanathan:	**07:27**	And I think that's what everyone is waiting for. I don't think anyone could have predicted or seen a complete shutdown of economic activity. I mean, look at your own behaviour and those who are listening. We all sort of just...aren't doing anything for the most part. Things that you sort of take for granted, we're just not doing. Not going to get a haircut or not going to the gym, for example, has this massive ripple effect through the whole system. So, the powers-that-be are trying to make sure that they shore that all up and we may not see a real shift until, well, we all start going back to our lives.
Andrew Johnson:	**08:04**	Yes, certainly the economic landscape has changed at the very minimum over the short-term...probably bleeds into a medium term. I mean, that's a general view on the state of the economy. What are the practical implications for you as a—you're a lead portfolio manager, but at heart, you're an analyst. [For] your analysis of portfolio holdings as well as the universe in general—what are the implications when you're trying to look at that and try to price stocks going into the future?
Vijay Viswanathan:	**08:28**	Well, it can be very challenging at the best of times to do that. And I think we try to get out of the prediction game. We always say, "think micro, not macro." So yeah, it gets back to, okay, so what are we doing? And I think a lot of the things that we did portfolio-wise, we did before this all happened. And that's not to say that we predicted that there was going to be a massive pandemic as a society [that] we're going to have to deal with, that's not what I'm saying. But it was, we've made shifts in the portfolio around names where we thought maybe the valuations were a little bit pricey; obviously watching balance sheet risk within portfolios. But we've always said, "the time to fix your ship is not when you're in the middle of the hurricane." So I think there's a lot of things that were done before all this happened.
	09:11	And again, not that we knew that this was going to happen, we didn't. So I think that's part of it. And then now, as we're going through the portfolio, I think there haven't been really any big, big moves. I think we're more worried about the probability of a credit event. So we have been reducing financials exposure. That's probably been the big one. And I think on the other side, really thinking about businesses that we think are well-positioned to survive. And I think that's become a really big part of that. And I think that's very conducive and aligned with our investment strategy. It starts with the first pillar of our philosophy: buying wealth-creating businesses. And wealth-creating business usually have pretty good market positions, they earn decent returns on their capital above their cost of capital, and if they're well-run, that means they're mitigating risk within their business so they should be around—they should be able to survive. And I think that's what we have. We have portfolios that are diversified along with those tenants.

Vijay Viswanathan: **10:09** So I think that's what we've been doing: see[ing] if there are any sharp edges on the portfolio, [if there] are there any companies that have potential balance sheet issues that we're worried about. As I mentioned, perhaps the probability of a credit event happening and wanting to reduce those risks. But I mean, it really comes down to a few tenets around this: one, is keep calm, don't panic. Number two: stay balanced, stay diversified—you almost have to be in two places at the same time. And I know there's been some more recent podcasts with our CIO, Paul Moroz, so he's probably talked about this, but this notion of: there are scenarios that are very bullish and there are scenarios that can be very bearish. So we'll have to think about all of those and not get locked into one way that the world is going to play out. The third piece is to think about, well, what are those medium-term and long-term risks and opportunities?

11:00 Because I think we are going to get through this eventually. And for us…think about it as a portfolio manager: if we were to fast-forward six months from now, what are the decisions that we made today, or we wish that we made today? And so that's part of it. So I think that's a lot of what we've been doing. They've been more smaller moves than big moves. And yeah, that's kind of where things are at.

Andrew Johnson: **11:20** I think during times like this, there's a strong urge by investors that they have to do something. That they want to fix things in order to keep their capital safe. Which is completely understandable, but it may not be the most prudent decision all of the time. And it's certainly not the way that I would describe the portfolio activity that we've seen, not just in the Canadian portfolio, but across our portfolios at Mawer.

11:42 One area that is on a lot of investors minds, and may or may not speak to the sharp edges that you mentioned, but especially here in our home country of Canada, is the energy sector. The sector is facing that uncertain duration and depth of the demand or the consumption shock that we're seeing around the world, but they're also faced with this kind of…price war that's happening out there, where we're seeing massive increases in supply at a time when demand is being constricted and were falling off considerably.

We've got relatively lower amounts of direct energy exposure, but some companies do play a significant role in the portfolio, such as Suncor and Canadian Natural Resources. How are you and the team thinking about energy in general and the role that it might play in the portfolio? Especially when framing that question [as] looking back in time to today, what are some of the things that you might do?

Vijay Viswanathan: **12:29** You mentioned, with energy, it's obviously a big part of the investible universe in Canada. It's a big part of overall GDP. And you mentioned that our own direct exposure within Canadian equity strategies is low, at least on a relative basis. We have positions in Suncor and Canadian Natural Resources; we do own Enbridge as well, though that's going to be your transportation base. But if there's nothing moving between the pipes [laugh] that won't be good for Enbridge.

The energy industry...it's been a one-two gut punch for the industry, and one that has dealt with lots of headwinds for almost the last three or four years. And you mentioned there's a demand shock or demand issue with how we're dealing with the issues around coronavirus and just [this] slowing or stoppage or pausing of economic activity. So there's the demand side of it. And then you mentioned there is the supply shock. And that is the decision by the Saudis to sort of “turn on the taps” and to essentially flood the market with oil.

13:34 So that is the one-two gut punch for the industry. You've seen the industry react, you've obviously seen the reaction to the stock prices. For us, we think it is really going to come down to how long does it stay with this type of environment. I don't think anybody's really making money at these price points. And you've seen companies already significantly reduce their capex budgets—there may be more to come on that. But it's definitely not the place where we think that there's necessarily a huge opportunity and we haven't been adding. Our thinking there is that it is going to be tough. We think Suncor and CNQ should be survivors, and if they do, they're reasonably well-positioned to take advantage of better times ahead for a commodity price. And usually the remedy for a low commodity price is a period of low commodity prices.

14:27 And all this stuff could change. To us, “why aren't you 0% weight in energy if you're negative about supply-demand dynamics?” Short answer there is that, look, this could change pretty quickly. We could get a handle on the virus, economic activity could start back up relatively quickly; and then on the supply side, we get some type of agreement between OPEC and all of a sudden that supply and demand balance gets better. But definitely tough times ahead for energy. And I think what we're more worried about—which I know you didn't ask this question about, but I'll answer it anyway—what I'm more worried about is the second-order impacts around it. So, the direct exposure to energy, yes we spoke to. But then there's all kinds of impacts from a secondary standpoint: what happens for people who are working in energy patch? What happens to them? And then, what about all the companies that are suppliers for the oil patch? So, there are second-order impacts to the country and that affects the whole country. Not just Alberta from what's happening there.

Andrew Johnson: 15:19

Yeah, you kind of touched on a concept that we talk a lot about here at Mawer: first-level thinking versus second-level thinking. You characterize it as second-order impacts. Just to shift gears slightly, but related to the energy question—I've had a couple of conversations with friends over the past week or so, who framed a similar question to me, and it's along the lines of, "hey, I see some companies out there that are just getting beat up pretty bad. Things can't be this bad. They should pull through this eventually. Should I target buying some of these kind of distressed businesses and hold onto them?" What are your thoughts on a question like that?

Vijay Viswanathan: 15:56

Well, it's a tough question to answer. It really depends on, well, survivability. Companies in a distressed situation—what exactly are they doing to survive? And it's like, are they burning the furniture to heat the house? Can you use that analogy? A lot of times if companies are doing that, they're on a treadmill and that treadmill may be going very, very fast. So, we've typically shied away from those situations. For us, I think, where we found better opportunities…we're looking for companies that we think have real franchise value that are providing a product or service that we think is going to be around in three years/five years as a balance sheet. Then we'll be able to get through what may be a very difficult period of time for an extended period of time. And I'd say, most cases, those distressed situations are not the best situations that you want to be in. They may get worse before they get better and survivability can be a real question mark.

Andrew Johnson: 16:56

I have to imagine that as much as you guys are paying attention to balance sheets, stock prices, business models, and how they're holding up, you're also probably taking stock of…a lot of the decisions that management teams are making in a time like this or had made prior to this. Can you speak to some of the questions that you've been dealing with, with management teams that you've been talking to over the last couple of weeks?

Vijay Viswanathan: 17:18

Well, I think […] even for management teams, I'd use the same analogies. When you're in the middle of a hurricane, that's not the time to be fixing the ship. So I think the management teams…I think we have a lot of good ones in the portfolio and the time to make sure your balance sheet was strong, if there was liquidity and things of that nature—would[‘ve been] done before all of this [laugh]. Trying to do stuff now, you might not have the best negotiating power, or you might not be able to do that with your bankers or with investors. So, I think that a lot of the questions we've had with management teams more recently—we haven't got that many on the Canadian side—but I know if we look across the platform has been around liquidity, and what do you do, and survivability, and how long can you survive?

Vijay Viswanathan:	**18:00**	Then I think you look across the portfolio, you've got companies that for the most part, are in pretty decent shape—have a higher survivability. Doesn't mean that it's not going to be painful. Doesn't mean that there aren't going to be tough times for companies to endure. In fact we've already seen it—whether it's in the Canadian equity portfolio or across other portfolios. We're just seeing management teams make tough decisions. Whether it's temporary laying off staff, cutting capex—which I spoke to in the energy patch. Those are all tough decisions that are being made, but they're all being done because the hope is to survive, to fight another day.
Andrew Johnson:	**18:32**	Well look, I know we're all dealing with some long days here, but before I let you get back to it, is there anything that you want to share with our listeners and clients while we have you here?
Vijay Viswanathan:	**18:41**	I think I'd come back to some of the things we've talked about earlier. This idea of thinking of…well, what are we doing? Clients are like, "what are you guys doing!?" And I think it comes back to: what's our mission, what's our objective for our clients? It's to provide financial peace of mind for our clients. And I want clients to know—those who are listening right now to the podcast who are clients, maybe those who are thinking about it who aren't—that's what we're doing. That's what I'm spending [my time]; that's what the rest of the research team is doing. That's what everybody at the firm is doing—is thinking about how can we better provide financial peace of mind to our clients so that they can focus on other things that are more important to them, which might be just the health and wellbeing and safety of their families right now. So that's what we're doing. And how are we doing that?
	19:25	Well, back to those tenets I talked about: we're keeping calm, we're not panicking, we're staying balanced and diversified because we don't know how the future will unfold. We're thinking micro, not macro—going to the micro level on all our companies, to [find] any undue risk or sharp edges that we have. Keeping our eye on the medium- and long-term of what are those opportunities and potential risks out there from what is this dislocation in the market or what's happening in markets right now. So, that is what I hope the message would be to clients. And I guess the last piece would be… look, we as a firm have been through these types of financial crises before; we as a society have been through this before, and we will get through this as well. I mean, "this too shall pass." Not to sound too biblical, but this too shall pass.

Vijay Viswanathan: 20:18 And it's when there is great stress—because as a society we are dealt with great stress—well, it brings out some of the worst qualities in us as humanity [laugh], which we probably talk about a lot. It also brings out the best in us. And I'm not trying to get all lovey-dovey here, but it's true. And I think those stories of hope, those stories of people coming together—whether that's at the community level, whether that's individuals, whether that's companies—that stuff doesn't get press. That stuff isn't on the front of the website or on the news right now. What's on the news right now is some running tally of how many people have coronavirus. What isn't there is companies like LVMH that's changing their production to produce more sanitizers. The fact that 3M is producing a whole bunch of ventilators—the small business distillery in Calgary that was producing gin [and] is now producing hand sanitizer.

21:13 The fact that people—I mean I have a story of a friend of mine who just happened to be going up to the town where my parents live, and because he was going go visit his parents, just gave me a call out of nowhere—I hadn't talked to him in three or four months—and said, "hey, I'm going up to your hometown, can I pick up some groceries for your parents?" I think those are great stories that we don't talk about and those are the ones that I think are really important—that we can all focus on. Because we will get through this and there will be better times ahead. And our hope is, what we're doing as portfolio managers, as a team, is we are better positioning client's portfolios for that eventuality—for that light at the end of the tunnel. It looks bleak now, it may get bleaker, but better days will be ahead.

Andrew Johnson: 22:00 I can't think of a better place to end it. As always Vijay, thanks for sharing your time and your thoughts. I know how busy we all are right now, but I look forward to chatting with you again soon.

Vijay Viswanathan...: 22:10 Yeah I look forward to chatting, I look forward to seeing you again [laugh]! So stay safe out there and make sure to take care of your fam. I guess we'll catch up on the other side.

Andrew Johnson: 22:18 All right, take care.