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EP15 | Playing the plan: Mawer's Emerging Markets Equity portfolio

00:24	**Cam Webster**	This episode, we tackle the broad subject of emerging markets with Peter Lampert, portfolio manager of Mawer's emerging markets equity fund. Our discussion covers the current investment environment, Mawer's approach to emerging markets and reviews portfolio holdings in beer, security systems, and bakery machinery.
01:15	**Cam Webster**	Peter, welcome back because we've had you on once before.
01:18	**Peter Lampert**	Thanks, Cam.
01:19	**Cam Webster**	What we've been asking folks to do, Peter, is just give us a little bit of background on yourself, and how you ended up as an investor at Mawer.
01:27	**Peter Lampert**	Sure! I've been at Mawer for 10 years now, but I've always been very passionate about investing. I remember as a high school student following stocks and investing in stocks, and I went to university and continued that passion. By the time I was applying for full-time jobs, I was really happy when the opportunity at Mawer came up. I jumped at the opportunity, moved out to Calgary, and have been here now 10 years. In the meantime, I've also spent two years in Singapore starting our office there.
01:52	**Cam Webster**	Basically your whole career—your whole investing career, professionally—has been at Mawer. Two years in Singapore probably gave you a great exposure to emerging markets, so what I want to give listeners is just a sense of why we now have a dedicated emerging market strategy.
02:10	**Peter Lampert**	Sure. Mawer's been around for over 40 years and we've been investing in emerging markets for a long time—over 30 years in our international fund—but we decided to launch a standalone, emerging markets fund last year. It's now been up and running for a year and a half, and the reason, the rationale was to offer something for our clients who want a dedicated

emerging markets fund in their portfolios ... and can stomach that higher volatility.

02:45	**Cam Webster**	Give us and listeners your perspective on differences of how emerging markets fits into international, versus building a standalone emerging markets portfolio.
02:56	**Peter Lampert**	For a standalone fund it's important for investors to understand there is higher volatility. They might be willing to take on the higher risk for higher return expectations, but they have to be willing to ride out that volatility. One reason we think it's worth taking on that risk is for the opportunities that we find in emerging markets. Emerging markets especially is a great place for active managers like us to try to find opportunities and add value for our clients because the data has shown that stock performance has a wider dispersion in emerging markets—so there's a bigger difference between the winners and losers. So that's a great starting place for investors that have a good philosophy and process to try to pick those winners.
03:35	**Peter Lampert**	At the same time there is higher volatility. More risk. That's also a strength of Mawer, as we always had a strong focus on risk management and that's something that we bring to emerging markets as well.
03:44	**Cam Webster**	In terms of building a portfolio of specific emerging markets holdings versus how it fits into international, why don't we quickly cover that and then we'll really get into emerging markets.
03:53	**Peter Lampert**	Sure, I think the biggest difference is in our international equity fund there's currently a 17% weight in emerging markets, so it adds some diversification. Some stocks have higher return potential—hopefully that adds value over the long term. When we get into the dedicated emerging markets fund, it's obviously 100% emerging markets. There's not as many other places to hide, so when it comes to managing risk ... we have to be more creative.
04:20	**Cam Webster**	That's a great segue into current conditions. So we've got Turkey on the ropes, so to speak—if you look at currencies.

Maybe we'll look at currencies and say: "What optically is the market saying about risk in certain countries?" So, as an emerging markets investor, are you actually evaluating countries first and then digging in bottom up? What's your process from an emerging markets point of view?

04:44	**Peter Lampert**	We're definitely always bottom up investors first and foremost. We have a clear, well defined investment philosophy of looking for wealth creating companies with excellent management teams and buying these companies when we think they're trading at a discount for their intrinsic value. That's Mawer's investment philosophy. That's what we apply across our different funds or strategies. It's no different in emerging markets.
05:05	**Cam Webster**	Just continuing with Turkey as an example—were there any holdings or any opportunities that bubbled up from that bottom up process that entered the emerging markets portfolio? Or, do we have any exposure in Turkey?
05:16	**Peter Lampert**	We previously held one stock in Turkey. It's no longer in the portfolio. We sold it in January earlier this year, but that was an example of just following our bottom up process where we found Logo, a great software company, a leader in its niche, generating good profitability, but we had started to see the business deteriorate. We had loss of confidence in the investment. At the same time, we saw that the economic conditions in Turkey were deteriorating, the political conditions were deteriorating ... and those two combined were enough to lead us to sell the stock. So, even though we're bottom up investors, when we see macro risks out there, and if that feeds into higher discount rates and lower fair value estimates, certainly we don't ignore those macro risks and we try to take them into account in our bottom up process.
06:01	**Cam Webster**	A lot of times we distinguish in the marketplace between what's noise and what's signal. So, there's lots of headlines every day—some of it's noise, some of it's signal. (Maybe all of it's noise.) ... Within emerging markets, what's signal and what's noise right now?
06:18	**Peter Lampert**	I think as long-term investors, that's one of our most important jobs—distinguishing between signal and noise. And a lot of the headlines that we see in the newspapers every day, a lot of the things that markets

tend to focus on, is often noise. It's short-term, it's not meaningful, wouldn't change the long-term outlook for many of our investments. This, I think, is a bit different. A lot of headlines we're seeing out there, there is signal. You mentioned Turkey, the turmoil going on earlier this year. There's turmoil in Argentina. Both currencies have depreciated very significantly over the year, and I think that is signal that we are starting to see cracks emerge in emerging markets.

06:55 **Cam Webster** Good pun! Cracks emerging in emerging markets. So, what do we do about it? If there are signals out there, how are you adjusting the portfolio?

07:01 **Peter Lampert** Yes, I think the first thing to realize is that this is a part of normal cycles. This is how markets typically operate. Maybe this one's been unusually long and with low interest rates. For the last 10 years, we've had very low interest rates and money has been flowing into seeking higher returns, reaching for a yield, reaching into riskier places, ending up in emerging markets—places like Turkey and Argentina.

Now with the stronger U.S. dollar rising, U.S. dollar interest rates...that may be unwinding. If that is a normal cyclical pattern, it wouldn't be surprising to see that show up first in emerging markets.

07:37 **Peter Lampert** Our job is to position portfolios to recognize that cycles are inevitable, long-term investors have to deal with them, and for us, it's about building a resilient portfolio that can survive those cycles and thrive over the long term.

07:52 **Cam Webster** Okay, so we're building resilient portfolios, Peter, but at the end of the day, what does that mean? Can you give listeners a sense of what does 'resilient' mean to us and how does that add value over time?

08:04 **Peter Lampert** For us a resilient portfolio is one that can withstand shocks, withstand downturns. The core of that—how we build those portfolios—is to buy great companies, invest in great companies that generate resilient cash flows. Yes, the stock prices move up and down. But underneath it all, we're buying businesses that generate cash flows that deliver value to their customers, deliver value to their shareholders. And over the long term, we think that these businesses are going to be worth a lot more over the next 10, 20 years than they are today.

So, we're prepared to ride out the volatility. The stock prices can move up and down in the meantime with the understanding that over the long term, these companies are compounding their capital and generating value over time.

08:43 **Cam Webster**

So ... what I'm hearing is recurring cash flow might be what we're seeking. But is there any volatility in the cash flow you're looking for? Like, if it's characterized as a resilient company, then to me I'm hearing, "Well, maybe the stock price goes down but actually the cash flow stays stable."

09:02 **Peter Lampert**

That's the ideal. Certainly no companies are immune to economic cycles and there's some volatility in underlying cash flows, but we definitely have a preference for those more stable cash generators. Especially when the evaluations are attractive.

09:16 **Cam Webster**

We've defined resiliency. We've kind of talked about the current environment. So, Peter, why don't you give us a sense of what are you doing in the current environment, specifically? What types of businesses are making the grade in terms of showing resiliency as opposed to maybe some that you're making a judgment that might not?

09:32 **Peter Lampert**

Yes, and we have to look at both sides. We want to emphasize those companies that we think will be resilient, that have those strong competitive advantages and strong cash flows, and reduce ones where the risks may be higher—try to manage that risk on the down side.
Some examples recently: we've sold two stocks, Naver and JD.com. Naver is often called the Google of Korea and JD is often called the Amazon of China, so they're leading internet companies in their respective industries. They've done a fantastic job. They're both led by visionary entrepreneurs who have really built leading positions in search and e-commerce respectively.

10:07 **Peter Lampert**

What we've seen, though, is as the companies have continued to grow and dominate their own industries—they've increasingly looked to expand into adjacent industries. And they're investing more and more money to expand into other areas outside of search and e-commerce. For us, that's a bit of a concern because we don't know what the payoff will be.

This is highly risky investments that these companies are making and it's highly uncertain what the outcome will be. The one certainty we do have is that we know the cash flows will be lower today as a result of this higher investment spend for the hope that we'll have higher cash flows in the future.

10:41 **Peter Lampert**

So, we see the risks increasing. And that, combined with our earlier discussion about rising interest rates and rising discount rates ... as we're pushing these cash flows further out into the future, and discounting them at higher discount rates, they're worth less today in their present value terms.

When you combine the strategies, how these managers are allocating capital, with what we're seeing in interest rates out there in the world, the risk profile of these stocks is increasing. So, for that reason, we exited Naver completely. We've reduced our position in JD.com. We continue to hold it because we think it's a fantastic business—they're doing a great job in their core e-commerce business. They have very strong long-term prospects. But the risk profile has increased and we've reduced that position, which is generally how we approach risk management.

11:25 **Cam Webster**

Okay, so what I'm hearing is you're adjusting position sizes, whether it's an exit like Naver, or a reduction in the actual position size for JD.com. Just your overall assessment of business risk along with valuation ... Did I summarize that correctly?

11:45 **Peter Lampert**

Yes, definitely. And then on the flip side, we're looking for other places to allocate that capital to those resilient businesses that aren't as risky and where rising interest rates and rising higher discount rates aren't as much of a headwind.

12:05 **Peter Lampert**

Some really good examples in the portfolio that we hold in the Mawer Emerging Markets Equity Fund are two beer companies.

One is Heineken Malaysia, and the other, CCU Chile. They're both excellent companies. They each have between 60 and 70% market share in their home countries; they face virtually one competitor; and they have strong brands, strong distribution... and this allows them to earn very good profits, high levels of return on capital, very stable cash flows. They both happen to be subsidiaries of Heineken, so they also are well-managed companies overseen by a good, well-operated global beer company.

12:40	**Peter Lampert**	So, for all these reasons, we think they're good businesses and as well—because they generate steady cash flows, they pay good dividends—we're not pushing those cash flows out into the future as far. (Like some of those tech companies with the big investments.) So, have less impact from rising discount rates, rising interest rates impacting the valuation. Those are places that we think are resilient businesses. They can weather a storm. They'll continue to do well over the long term.
13:05	**Cam Webster**	I'm curious on Heineken Malaysia. You were in Singapore...how much due diligence did you do on Heineken Malaysia?
13:12	**Peter Lampert**	Yeah, I checked out Tiger—Tiger's their main brand. I checked out their Tiger factory in Singapore.
13:18	**Cam Webster**	Did they offer samples?
13:21	**Peter Lampert**	That's the point of the tour.
13:22	**Cam Webster**	Good, good. I think that makes it clear for listeners that the contrast between e-commerce and the amount of capex you have to invest in a potentially higher discount rate world means that there might not be as much value there. (As opposed to a really steady beer business.) One of the other aspects I think across all Mawer strategies is our strategies are all cap. So there's no restriction for you as emerging markets manager to eliminate small cap or stick to large cap or mid cap ... so talk a little bit about the small cap space in the emerging markets. How it might be different, what you think fits in the portfolio.
14:01	**Peter Lampert**	Definitely. As an all cap portfolio, we have the ability to invest in small caps and we certainly have taken advantage of that. I think often small caps are overlooked. We can find some of these great businesses, these resilient businesses that we talked about at a pretty attractive valuation. A couple examples: one is S1 Corporation in Korea. Another one, Tehmag Foods in Taiwan. They both really fit that profile—those types of businesses we love to invest in. S1 is the leading alarm security systems operator for business customers in South Korea. As you can imagine,

that's a great business. Once they install the equipment at the customer's premise, they generate a recurring monthly subscription fee.

14:43 **Peter Lampert**

They're the market leader with over 50% market share. They have a great brand, a long track record, and they're well trusted in the market. So that's a great business. The other one, Tehmag Foods, is the leading distributor of food ingredients to bakeries in Taiwan. This is a great example of a "bread and butter" business that we love to invest in.

15:04 **Peter Lampert**

It's a small company but they dominate their small niche. They deliver flour, sugar, butter, all the basics to their bakery customers, but as well, they add additional service and advice. They have original recipes that they provide to their customers and help them with their business. So that allows them to earn high margins, good profitability, and management's grown the business by expanding it to China where they have a large growth opportunity.

These are the types of resilient companies that we love to invest in. When we think about resilience, a lot of other investors try to time the market—get in and out of emerging markets, or any markets—but we just don't think that's possible. Nobody can do that on a consistent basis—successfully time the market. We think this approach of investing in resilient companies and building resilient portfolios around them is the right strategy and the best way to invest through the volatility that we see in emerging markets and all markets.

15:59 **Cam Webster**

Maybe you can give us a sense a little bit, Peter, of where you think we are in that cycle.

16:04 **Peter Lampert**

We've seen some of these signals—we talked about Argentina and Turkey and some signals that this long bull market that we've had may be unwinding. We may be getting quite late in the cycle...but that doesn't really change how we invest. Because we're always focused on building resilient portfolios and managing risk and we do that throughout the cycle. We don't know when the next downturn's going to come. Back to my last point, we don't think anyone can time the markets like that, so our approach is to build these resilient portfolios. We talked a lot about the resilient companies at the core of those portfolios, but at the portfolio level, there's some things we do as well.

16:37	**Peter Lampert**	For example, the limits you talked about, one is a 6% position size. So the biggest weight we could have in any single stock is 6%, just to make sure we don't get too carried away, too excited about any one stock. At an industry level, similarly, we have a limit of 20%.
16:54	**Cam Webster**	Industry meaning banks—not financials. As an example.
16:55	**Peter Lampert**	Yes.
16:56	**Cam Webster**	So, not sector, industry. Okay, I just want to clarify that.
16:59	**Peter Lampert**	And at a country level we don't have a specific limit, but it's also something we very much look at. We try to make sure we're well diversified across countries, across currencies, and we don't have too much exposure to any one single risk.
17:11	**Cam Webster**	On that, what would be the top three regional exposures within emerging markets right now?
17:16	**Peter Lampert**	In the fund today, the top three are China, India, and Taiwan. To put that into perspective, our biggest weight is in China where we have 19% weight. Given the size of the market, the amount of opportunities we've seen there, that is our largest weight. But, to put that into perspective, compared to other emerging markets funds or the index, it's not as high—the index has 33% weight in China. So we've found some opportunities there, but we want to make sure we're well diversified. We don't want to get too carried away in one country.
17:44	**Cam Webster**	Thanks, Peter, for giving us a really good perspective on more or less how we manage risk in emerging markets. There's a lot of worry out there right now, I think, and thanks for coming on to maybe dispel some of that worry.
17:57	**Peter Lampert**	Thanks for having me.

17:58 **Cam Webster** Okay, well, you're not done yet. I'm not letting you walk out. So, what we like to do is "one Mawer thought." For you, today, given that we're talking about emerging markets ... what do you enjoy most about investing in emerging markets?

18:11 **Peter Lampert** I think what I love about investing in emerging markets is the same as investing generally, which is every day we're learning. Every day is a challenge. We're always thinking about how to make better investment decisions, thinking about different risks, learning about different companies...and ultimately that's the challenge every day, and that's what makes a reward.