

EP25 | Brick by brick—constructing a resilient global balanced portfolio starts from the bottom up



- 00:23** **Cam Webster** Today we have Paul Moroz, our chief investment officer, on to talk a little bit about global balanced, a little bit of history behind investing globally, why we invest in a global balance mandate at Mawer, and a little bit of a look forward.
- 00:57** **Paul Moroz** I want to take listeners back and provide a little bit of history, because I think the way the world unfolded set up the reason for why we launched Global Balanced Fund in the first place. If you go back far enough—and you think about some major events—globalization changed pretty significantly.
- In 1989, you had the fall of the Berlin Wall, which really signified the end of the Cold War. The world before—it was closed off. Economies were more closed off; stock markets, more closed off. What that effectively meant was, that for global investors at the time, there was a greater chance that stocks would, in one country, zig together as that country's prospects were doing good or poor—and another country, which was not as integrated into the global economy—would go the opposite direction. You would have a better shot at these correlations making sense to buy one country or buy in another country.
- 02:09** **Paul Moroz** I think the way the world was structured—it influenced how investments management companies around the world put together their balanced funds. Asset allocation became, to a large degree, based—at least with the equity sleeve—on which country you want exposure to. “Do we want to increase exposure to U.S. equities or decrease exposure to Canada?” Balanced funds were put together in that manner. But post 1989, the world started to open up. You had Netscape—first internet browser—pop up in 1993, which further opened things up. I think we've seen the last 25 years a whole wave of globalization which has resulted in the world—at least stock market-wise—starting to move more in the same direction.
- 03:08** **Paul Moroz** So I think the entire premise of finding companies within a particular

country and saying, "now is the time to buy this country"...that's not the same as it was before.

I think the other thing that's happened is the companies themselves have gone a lot more global. When we talk about investing—whether it's the UK or the U.S.—these are all really global companies. They themselves are investing globally. They're really conglomerates; they're global citizens at the corporate level.

In the current global paradigm we're in, we found that it made a lot more sense to select individual securities and finding opportunities rather than trying to pull a lever on a country or a region.

L 03:59

Paul Moroz

That's the backdrop for why we think that our Global Balanced Fund made a tremendous amount of sense for this environment. Because we're building it stock by stock, brick by brick—picking up individual opportunities that relate to management teams and business models, and the unique idiosyncratic risks and ups and downs of that individual company and building the portfolio in that manner.

And that's a huge difference compared to the other balanced funds—even our existing Balance Fund—which still moves with levers: "should we increase the United States or Canada exposure?" It's different.

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Cam Webster

I just want to get you to tell us—what the reasons behind picking specific geographies in building a balanced portfolio were back then. Is it: there's less correlation between countries? So that the diversification benefits and getting on a proper efficient frontier back then was more important? The most important element was your country allocation? As opposed to: we've gone through this period of mass globalization, where companies are pulling all their own global levers so, that, from a bottom-up perspective you don't have to worry about country-specific diversification, you have to worry about other buckets?

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Paul Moroz

That's exactly it. Imagine—I don't know, 50 years ago—if you were to buy BMW in Germany—and they're mostly selling BMWs in Germany and maybe Europe...today, there's so much trade that occurs with BMW and

China, that a very good chunk of their profits are actually from the Chinese economy, really. So, if there's something that's going on in China, that's going to hit BMW and their whole supply chain in Germany. That's the interconnection present in today's economic paradigm that wasn't present before. That means you're absolutely right—things are more related. In the past, you had those opportunities where the correlations were different. That's why you thought about things in terms of different countries.

06:11 **Cam Webster** So, the past was country-specific. We've moved to: less country-specific, [more] business model specific. Was that the main driver to launch a Global Balanced Fund?

06:22 **Paul Moroz** Well, the other one is diversification. It's this concept of being better diversified by—whether it's business model, whether it's country, whether it's currency, whether it's political risk.

Our head office, of course, is in Calgary, in the West. How much political change, political risk, have we seen in Alberta over the last few years? It's significant. If we can step back and think about the solution that we're trying to provide to our clients—which is really peace of mind—how can we put together investment solutions that are diversified and resilient and don't rest on any one factor that could have repercussions from an investment standpoint? And we've seen that with, say, Canadian securities. If you were invested just in Canada, you would've been hit by a number of Canadian-specific factors. That's one of the reasons, I think, Global Balanced has done a lot better. It provides that diversification and resilience.

07:27 **Cam Webster** Diversification and resilience—the asset mix. Let's talk a little bit about asset mix and maybe a few comparisons here to our Balanced product. If we look at the world capital markets, Canada's roughly 3% of global stocks. Yet, we have a Balanced product that has over 20% in Canadian equity and we have a Global Balance that's roughly 7%. Let's just talk through diversification and resilience benefits over time there.

07:56 **Paul Moroz** I think there's a couple of points here. Pure investing is really done to solve a problem. You're trying to think about: what expenses, whether it's an individual or an organization, has in the future—for whatever it is you're

trying to achieve, whatever goal. Whether it's your education, or whether it's buying a home; or whether it's some foundation that requires capital for a cause. Right? All you're trying to do is figure out: how can we match off those expenses with the asset? It's an asset-liability matching problem.

- 08:38 **Cam Webster** Right. On my hospital foundation, all my donation money comes in—it's all Canadian. All my capital is coming in Canadian...yet do we invest it all Canadian? Is that the mindset?
- 08:50 **Paul Moroz** Well, that's exactly where I'm going. It really depends on, well, where's that expense located? Is it that you were going to buy Canadian real estate that's going to be paid for in Canadian dollars? Each person or organization has to look at that match. But the truth is, even though you might be buying things, or solutions, or whatever it is in Canada—a lot of that stuff is imported in anyway. It's a global market! Whether that's steel, whether that's a BMW car, whether that's wine for Italy.
- 09:21 **Paul Moroz** I think many people have a home bias—this is true, not only for Canada, but everywhere else—that's inappropriate. It overestimates the match that required for expenses in your local currency. In reality, it's a psychological issue. There's been a number of scholars that have done work on the cognitive fallacies that people engage in in thinking about this home bias. Really, it's an investment error, quite often. That's one of the things that the Global Balanced Fund corrects for. Let's put the best portfolio together regardless of where you're sitting in the world. We're really trying to bring that to our clients.
- 10:09 **Cam Webster** Okay. Help me understand: Global Balance would be designed, first and foremost, for a Canadian-based client? Or...could be anybody?
- 10:16 **Paul Moroz** Well, it certainly has some Canadian exposure, but I think the answer is: it would be anywhere. The thought experiment that we have—this is for global equity, which makes up the equity portion of the Global Balance sleeve as well—is, if you were just completely agnostic, you were floating in a boat in the middle of the Pacific Ocean and you want to put the best investment portfolio possible—

- L 10:43 **Cam Webster** [laughs] I don't know if I'd be thinking about investments if I was just floating in the Pacific Ocean...but, okay.
- L 10:46 **Paul Moroz** That's exactly what I'm thinking about, Cam. How do you build that portfolio if you're not tied? What's the best—both theoretical and practical—portfolio that you can put together?
- L 11:00 **Cam Webster** Okay. That's the objective. You mentioned “new paradigm.”
- L 11:03 **Paul Moroz** Well, yeah. There's a couple of new paradigms.
- L 11:05 **Cam Webster** We won't list them all off, but the most obvious one is trade wars going on. If you think back to where we started the podcast: closed markets. Are we coming full circle? Or, how do we position a Global Balanced portfolio in, for lack of a better term, a “new paradigm?”
- L 11:22 **Paul Moroz** I think that it's important to know the future—how far the countries take this—but there are certainly leaders in power that seem to be retrenching. They're pulling back. I don't know how far it goes. There's obviously some legislation that came in in the United States during the Great Depression. I think it was the Smoot-Hawley Act, which really clamped down on trade. It was responsible, some people think, for a much more significant recession and slowdown. I'm not sure we're going to go that far and we're going to look back on the relationship that China has with the United States and say, “wait a minute—that's the equivalent Smoot-Hawley Act.” It's really tough to say.
- L 12:08 **Paul Moroz** But we have, from a portfolio perspective, made little changes that recognize there has been a subtle shift. It's things like—companies that maybe are more dependent on the existing tariff system. We've shifted away from those. Our investment in Intertek, which benefits from trade—they're a testing inspection company—we've reduced our position because we think, well, maybe the cards have come up. Maybe there's going to be less work, or the growth prospects aren't as much as this paradigm has shifted. That's one element of new paradigm.
- L 12:46 **Paul Moroz** I think, frankly, we have a bit of a new paradigm in Canada—in Alberta,

too. This has been on my mind a lot. Because I think, given the political challenges of, very simply, building a pipeline and moving oil out of Canada—which is a pretty big part of the Western Canadian economy—it doesn't seem like this is getting done anytime soon. The Alberta economy, I think, is struggling more and more—even from a stock market perspective, given where real estate prices are. I think we saw the other day Vancouver prices had declined a little bit.

- 13:28 **Paul Moroz** Obviously, there's another side to that. You want to make housing affordable. But that has an impact on the banking system. And of course, energy and financials are big parts of the Canadian stock market. So, just from a, playing defence and from a capitalist point of view, if I look at the next five years and weigh the odds of what's going to happen with the Canadian stock market, I think that there's a good chance, going global, you just absolutely clean up on a relative basis.
- 13:57 **Cam Webster** That's a strong statement. "Absolutely clean up."
- 14:00 **Paul Moroz** Absolutely clean up.
- 14:01 **Cam Webster** What makes you think that?
- 14:02 **Paul Moroz** Well, in that scenario—because you still might not have a pipeline moving out, you don't have companies reinvesting in the energy sector. Real estate—you might've seen the best days because of all the quantitative easing, and, basically, you have prices that are stagnating or declining. And that might weigh on what banks can do in terms of loan growth. If you do hit the end of the business cycle, you very well might have a recession that creates credit problems and you see real estate prices lag down in Canada.
- I'm talking about a very specific scenario; I'm not forecasting. But in that scenario, having all your eggs in one basket, just in Canada, presents some tremendous risk. And then you get clubbed over the head with the currency declining in certain scenarios.
- 14:57 **Paul Moroz** When I compare that to having a global balanced solution, I think that's

pretty attractive. Now, there's another side to it because maybe you don't end up in that negative Canadian story. Maybe we get the pipeline built, oil prices go up, Canadian dollar's strong, housing market holds together. In that scenario, your Canadian balanced funds are going to do very well. There's going to be a currency impact, too. That's one thing that a listener should know. We run unhedged portfolios, currency-wise, for the diversification. In that positive—call it “the positive Canada event,” your Canadian dollar's increasing—

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Cam Webster

Rising—
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15:38

Paul Moroz

—and that's making the relative returns of foreign investing a little less.
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Cam Webster

Right. And then, vice versa.
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15:45

Paul Moroz

Right.
- L

15:47

Cam Webster

Let's quickly cover why we don't hedge. Why would we not hedge?
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15:50

Paul Moroz

Diversification. Resilience.
- L

15:52

Cam Webster

Okay, but hedging is a form of that. Why wouldn't we formally hedge currencies?
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Paul Moroz

Well, let's think about that. Hedging is a form of putting all your eggs in one basket. If you were in, I don't know, Iceland, during the financial crisis and you hedged all your foreign currency back and then the banking system blew up and your currency declines...there's a heck of a lot of risk in that strategy. What people see as risk is really just—in the currency markets—volatility. I would take a volatile, well-balanced, currency-diversified global portfolio any day over putting all my eggs in one basket—in any currency. It doesn't matter whether I'm living in Canada or Singapore. I would never have all my assets in one currency. The exception being, I would think about that asset/liability matching problem. If I knew I had an expense—a future expense—then I'd do the math and I'd make sure that was covered off.

- 16:53 **Cam Webster** If you have a known cash flow in a certain currency, then okay.
- 16:56 **Paul Moroz** Exactly!
- 16:57 **Cam Webster** Hedge it, you can sleep at night.
- 16:58 **Paul Moroz** Yeah.
- 16:59 **Cam Webster** Help us understand within Global Balanced, the global bond component. Where does that fit in the resiliency and diversification bucket?
- 17:07 **Paul Moroz** Imagine the scenario where Canada has a housing crisis like what happened in the United States, and you have bank failures...imagine what happens to the Canadian currency. Even just the option of having the Global Balanced Fund, where we can shift away and diversify if there starts to be a problem. That's a huge option. It's absolutely huge. As I tell my wife with things that relates to our kids, low risk doesn't mean no risk. The Global Bond Fund within the Global Balanced Fund, I think, has significant strategic value and optionality. That's one thing that's not well understood. Because most people are looking at the current, existing paradigm where you get paid and currency's fine. But I think it's our job to think around corners and [about] different risks that might occur—even if it's a very low probability.
- 18:05 **Cam Webster** Why don't we just wrap it up with, on a go-forward basis, Paul ... the top three reasons as an investor, you should be thinking global?
- 18:14 **Paul Moroz** Well, I think you have access to better opportunities, in general. I would always give a broader mandate to active managers. You have better resilience and diversification. I think the set up in Canada doesn't look good over the next three to five years. Not saying that's what occurs, but just playing the odds, here. Certainly, my money's in Global, for what it's worth.
- 18:42 **Cam Webster** Okay. Thanks for joining us and explaining: “why Global Balanced?”
- 18:46 **Paul Moroz** Thanks, Cam.