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EP37 | Playing the plan: Mawer's global equity portfolio

00:40	**Cam Webster**	We're here with Christian Deckart, co-manager of the Global Equity Fund, and we're here to talk global equities before we talk specifics—in terms of what's in the portfolio. Nice, small question for you, Christian. First of all, welcome!
00:52	**Christian Deckart**	Thanks, Cam.
00:53	**Cam Webster**	Or, welcome back.
00:54	**Christian Deckart**	Thank you.
00:54	**Cam Webster**	Always a pleasure to have you on. Global equities: lots going on in the world—particularly related to trade or central banks, so let's start there, with the risk picture. What are you seeing from a risk perspective?
01:08	**Christian Deckart**	From a risk perspective we take that into account in our stock picking process, obviously, on the company-specific side. We rank all businesses we invest in: the quality of its business model, the quality of management, and the quality of risks. So, risks are an essential part. Often, we're wondering: are risks high right now, or is it just our perception of risk? And the example I have in my head as a father of two small children is, well, how risky is it that your children fall down the stairs? If they've never done it before, you may not be worried about that. But if they've fallen off just recently, then all of a sudden you see this risk and you're more concerned about it. The question we often have in our minds is: are risks really elevated, or is it perception of risk? Because often in the media, when you hear about risk, what people really try to say is not, "risks are higher" they just say, "our own perception of risk is higher right now." So, I would definitely say that perception of risk seems higher these days. I'm not sure the risks are really higher, right? The risk of a trade war has probably been there since the U.S. got the new President, but now that risk is playing out. So the perception of risk is higher now than it was maybe a

year or two years ago.

But you could argue that the absolute risk actually hasn't changed—like the risk of your kid falling down the stairs hasn't gone up after it's fallen down the first time—it's always been there, you just didn't know.

The other thing I'd like to point out about risk is that news travels very fast these days. If you have an event in India, China—wherever in the world—we in Calgary are very much aware of it. While if you rewind the clock 20 years, 50 years, or 100 years, we wouldn't get all this bad news that is all over the world.

So, it's partly due to media that we are aware of all the risks that happen out there. That again falls under that theme I just talked about: risk versus perception of risk. And I just want to point out that yes, when you open the newspaper, you're going to read bad news from all over the world: bad economic news, bad political news, which probably you wouldn't have done to that extent 20, 50, or 100 years ago.

03:18 **Cam Webster** Let's advance the discussion a little bit and say, well, "what risks matter?" So, in our world, as we manage these global portfolios, what risks matter? Because a lot of it is noise, is what I'm hearing.

03:31 **Christian Deckart** On a company-specific basis, as you may know, Cam, we rank stocks on what we call "The Matrix" on two axes: one is quality, and the other one is return potential. What we're aiming for is to buy the "best" businesses—best defined as highest quality of management, the highest quality of business model, and lowest risks. And we're greedy, so we try to do that also at the best possible return potential. So, best companies at best return potential. Now, capital markets aren't totally efficient, but they're not totally inefficient either, i.e., it's very difficult to buy best companies at the best valuation, so we have to find a balance between the two.

But where do risks come into play? Well, in both axes. On the quality axis, in terms of risks—everything that could affect a company, whether it's a risk that they get sued, that a patent lapses, that a competitor comes up—all these things go into that. And risks that come in on the return axis: if a company gets a hit to sales, or has additional costs, then that impairs the return potential.

04:33	**Cam Webster**	Okay, so we have rankings for both those parameters. What do we do with them?
04:39	**Christian Deckart**	Well, we compare them—the companies that we have looked at, that we have researched—and try to find the best trade-off between that best quality and the best price. And the better that trade-off is, the less we have to compromise on any one of the two, or on both criteria axes—the higher we will weight it in our portfolios.
04:58	**Cam Webster**	So a really high quality with a high potential return would get the highest—
05:02	**Christian Deckart**	Would get a higher weight—
05:03	**Cam Webster**	—weight in the portfolio.
05:04	**Christian Deckart**	That said, we have a self-imposed limit of 6% per security. We will not put more than 6% of client's capital at risk in a single position, because the future is always uncertain and we could be wrong. But yeah, towards that 6%—that is the mechanism.
05:19	**Cam Webster**	Off of discussion of that tool—that portfolio construction tool—Christian, it looks to me...recent activity suggests you've been going a little more defensive. There are a few names that—even a Canadian name in the Global Equity portfolio! (Telus.) We've got a few names that, to me, look defensive: Telus, Pepsi, something called Bunzl.
05:41	**Christian Deckart**	Bunzl—that's a name that probably Canadians are less familiar with. It's a UK-listed company. They provide consumables, mainly to retail businesses. So, if you think of your local coffee shop where you go and then you get your coffee mug there, you get your lid, however you call that—what protects your hand against the heat—
06:00	**Cam Webster**	The sleeve!
06:01	**Christian Deckart**	The sleeve. All these things are disposables that are not really the core business of the coffee shop, but they need it to keep the business running. Bunzl is a distributor of these disposables. It's very much a "Be Boring.

Make Money.TM" business. It takes away complexity from—my example was a coffee shop chain—so it takes away complexity from their business. Bunzl takes that over, and it's a nice repeat business.

And as you can see from my coffee shop example...we think that it has a good chance of being less economically sensitive than, say, capex goods. Because in a recession, people maybe trade down in their coffee, but they will still have coffee in some shape or form.

06:40	**Cam Webster**	Thanks for the profile of Bunzl. What I am curious about now, Christian, is based on some of the moves in the portfolio, is this a signal that you're getting more defensive, or not?
06:51	**Christian Deckart**	I'd say we're taking these decisions company by company on The Matrix. As I described earlier, the goal we're aspiring to is to buy the best businesses at the best valuation, so we look at it company by company. The defensiveness might be more a result of that analytical process. It might be that the market after a 10-year bull market is not very much concerned about risks. I can't prove that, right? That's a suspicion I have. And so, companies that are more defensive might—all else equal—be offered at more attractive valuations. Again, that's nothing I can prove. I can just say on The Matrix, when we rank these stocks that are relatively defensive, [they] have a relatively good valuation in our opinion. They are in spots where we think they're a good value. So I would say we're not doing that from a top-down approach, [like] "we're going into defensive stocks now." But if we follow our stock picking approach, I realize that yeah, it seems we're more drawn toward defensive names in the current period. That said, I told you it's a stock-by-stock process, but of course we also have the portfolio in mind as a whole. How will these stocks interact? After that 10-year bull market, we don't mind, actually, if the stock-by-stock process leads us to a more shift towards the defensive names. Which, I agree with you, it seems to do right now.
08:16	**Cam Webster**	Just to summarize: it's not necessarily a conscious decision, it's the use of the tool that informs the decision-making process, and the output is—what I'm seeing as—defensiveness.

08:28	Christian Deckart	And it might be through a feedback process in the market—that the market right now just doesn't value these defensive characteristics, and so that's why we feel we get good quality businesses at good valuations that happen to be in defensives.
08:42	Cam Webster	The defensiveness aspect isn't just coming from something you see?
08:45	Christian Deckart	No, because as I said earlier, it's the result. But on the other hand, when there is a storm, that's not the right time to fix your boat, so we think the right time to fix your boat—to have a balanced, defensive, "Be boring. Make money.TM" portfolio—is when markets are calm. The saying here we have is we don't fix our boat in a storm.
09:07	Cam Webster	Your mention of a boat is a good opportunity to shift gears to: how do you deal with underperforming stocks in the portfolio? We have a portfolio, some go up, some go down, so let's talk about some of the holdings that have gone down recently. What explains it, how do you react to it, how are you using the matrix with it—all that good stuff!
09:27	Christian Deckart	The Matrix applies to all our portfolio management: when we buy a new company, but also while we own the company. So, what happens when a stock is down? If a stock is down without fundamental news, well then it will have moved on the return axis. It will have become better future return potential because the stock is down already. It becomes relatively more attractive, so you would expect us to increase the position. But often stocks are down because something fundamental has changed, and so then it becomes trickier because then you have to compare, well, how much has it deteriorated, how much has the valuation become cheaper? And you have to make that trade-off again. There's really no cookie cutter answer...we look at each situation stock by stock, and often then do more research to process the new information, really.
10:13	Cam Webster	Specifically I would highlight Tsuruha and Seven & i—both Japanese drug store retailers, pharmacies—basically the Shoppers Drug Mart of Japan. One went down 40% in the year, so explain that, Christian, please.

10:29	**Christian Deckart**	So [laugh] well, what we see fundamentally there—and what is also spooking the market—is labour shortage in Japan. You know that the country has a declining population [and] aging population, so they have shortages in skilled labour. So, you do see cost inflation in people that sell in a convenience store, or in a pharmacy. Pharmacists are becoming more expensive. And now—this is the great thing about global investing—there's always a new challenge. Because the mental model we would apply in the West is, well, if labour cost inflation hits convenience stores or pharmacies, all competitors are going to be hit by that equally. All workers will want higher salaries. The result will be that labour cost is going to go up, and the convenience stores and pharmacies are going to increase prices towards the consumers. And in the end, it's the consumers that take the cost of that increased labour. That is what strategic logic would suggest. By the way, Strategic Logic is a great book on the fundamentals of why companies are profitable. Strategic Logic would suggest that yeah, this gets all passed onto the consumer—and we see that work out like this in Western countries very often in many companies we've invested in. However, Japan is a bit different, and that's what makes global investing intellectually so stimulating. Because you can't rely on all the mental models you've used in other parts of the world, and in Japan, it seems effectively that the convenience stores and pharmacies are taking the hit from that cost increase. Which goes against all logic, but that seems to be how it is there.
12:06	**Cam Webster**	Next question begs: what do you do with that position? It's down, yes. There was a fundamental change, but maybe your valuation changes. So how do you deal with the position size?
12:16	**Christian Deckart**	Exactly. So, our current assessment of future cash flows is lower than it was a year ago, and at the same time, the stock price is down. So overall, there's not much reason to change a lot in the position. It would have been great if we could have anticipated that move in the stock market, because if we had had some proprietary information on that labour cost inflation in Japan and that they wouldn't pass it on...but we didn't. We just didn't in this case. So here we're actually taking into account how the stock has performed and what we think of future cash flows. Probably the weight we have right now is a reasonable weight.

12:54	**Cam Webster**	Let's look forward a little bit and say, well, "okay, the world is always changing, so what are you doing now, Christian?" to create opportunity for the portfolio?
13:03	**Christian Deckart**	We quite like phases with market volatility like now, because it allows us to look at new businesses we haven't looked at before—where prices are maybe down 20%, 30%, 40%. It is a difficult situation once that happens to companies that are in the portfolio, because then you might get tricked into doubling down, into falling into the psychological trap of trying to validate your previous findings and just buy more—although maybe the information has changed. But we do like situations where things fall that we don't own already [laugh], because well, given that we don't own it, we think we have a clearer judgment on things. So we can go out, talk to these companies, do our research... right now the team is pretty busy looking at new ideas, new businesses to invest in. And the saying is, "you get rich in a bear market, you just don't realize it at the time." It's really in times like this—in volatile times—where we, if you will, produce future performance. Because it's in times like this that we can be wealth-creating businesses, with excellent management teams, at a discount—
14:07	**Cam Webster**	Discount!
14:07	**Christian Deckart**	—to intrinsic value. In other words, we'll reap the benefit of today's work over the next few years. And we don't know when exactly, but an environment like this is a good ingredient for us to find good businesses at reasonable prices.
14:22	**Cam Webster**	All right. There you have it, the words from the chef! We have good ingredients in Global Equity. Thank you for joining us, Christian. We'll have you on for sure sometime soon.
14:31	**Christian Deckart**	Thank you!