



- Andrew Johnson** 00:41 Alright, we have [Paul Moroz](#) here. He is our chief investment officer, as well as the co-manager on our [Global Small Cap Fund](#) and our [Global Equity Fund](#), of which we're going to talk about today. So, welcome back to the podcast, Paul.
- Paul Moroz** 00:52 Thanks for having me, Andrew.
- Andrew Johnson** 00:54 I want to actually go back all the way to 2007. That's time zero for me—when I just joined the firm. This guy named Paul Moroz was launching this fund called the Global Small Cap Fund. And then just a couple of short years later, you were obviously a big part of launching the Global Equity Fund. And I just realized that we're celebrating, well, just a little over 10 years now because it was October 2009. So, I don't know if we say congratulations or [give] some sort of pat on the back, but it's certainly a milestone to have a decade-long track record. So, congratulations to you and the team on that.
- Paul Moroz** 01:27 We're all older. One decade older.
- Andrew Johnson** 01:31 [Laughs] Older and wiser, I hope, along the way. So, that was 2007/2009. And since then, we've actually launched the [Global Bond Fund](#). And then that's allowed us to launch a [Global Balance Fund](#), because we were able to allocate global bonds to our balanced asset mix. And then very recently, we've just launched an [Emerging Markets Fund](#) led by our colleague [Peter Lampert](#). So, clearly one common thread here over the last 10- 15 years or so, is that we've been increasingly investing globally for our clients. And I say increasingly, because we've actually been [investing internationally](#) for, I think, well over 30 years at this point. So, as a client—and you and I are both clients as well as colleagues and employees here at the firm—but I'll wear the client hat, you wear your chief investment officer hat.
- Why is it important for me to be invested globally?
- Paul Moroz** 02:23 I think there's two parts to this. One is context. When you look out and there [are] more options, you gain better context to make better decisions.

And the thought experiment has always been for us: well, if you are just floating along in a boat in the Pacific Ocean somewhere, how would you build the best portfolio possible? Where would you go? What would you invest in? And so it's a bit of a zero-based-budgeting exercise for us in looking abroad and saying, "let's just find the best companies run by the greatest managers where the valuation makes the most sense—regardless of any borders."

03:11 So, one is that context and optimization element, and then the second element—it's more of a hurdle that people have to get over—is the game of investing, so to speak. Mitigating behavioural errors. We all make tons of mental errors. It's unbelievable. That's what we spend a lot of time trying to do. And one of the behavioural errors that happens—and this is proven across all countries in the world, is this idea of a [home bias](#). And shifting our thinking from just investing in what we're comfortable with because it's close to us, and instead, solving for that optimization problem...I mean, that's a major leap.

Anyway, so that's a few of the reasons that we're looking at why we think global has been so important over this last decade and explains our journey.

Andrew Johnson **04:05** I guess I'm also curious about, maybe, what are the practical implications of investing globally? So, the home bias is one thing from a mental bias standpoint, but I think one of the barriers for a lot of people that moves them into a home bias is that maybe there [are] some practical barriers that are in their way to invest globally. I mean, I envision us being registered in various different jurisdictions. So, what were some of the learnings along the way from that perspective of launching both the Global Small Cap as well as our Global Equity Fund?

Paul Moroz **04:34** Well, I mean there used to be a very practical restriction in terms of foreign content rules in RRSPs. If listeners remember back—there are certain limits. At some point, those limits were abolished. And there [are] also challenges in terms of registering in countries just to settle stock and buy stock. There [are] rules around foreign ownership limits. And so, what our clients don't see, is all the hard work our colleagues put into the funds and the investments behind the scenes to make all this stuff work. And there's tons of work that goes in that makes this look really seamless, but there still are challenges. It would be very difficult for an individual to go buy stocks in India and Korea and all these places. It's just extremely difficult that way.

Andrew Johnson 05:28 Yeah, I'm always impressed. I mean, there's this entire machine behind the scenes here that makes not just our clients lives easier, but our lives easier as client-facing as well as portfolio construction professionals. It's unreal how much work goes into that. And it's 24/7.

Paul Moroz 05:44 Absolutely. This is a shout out and a thank you to all our people in Ops [operations] that make this just so smooth and effortless.

Andrew Johnson 05:51 There you go Ops, so we haven't forgotten about you.

That's some long-term context. Let's set the stage maybe a little bit more recent[ly]. This is a global portfolio, obviously facing some global issues on an ongoing basis. A lot has been said and written recently about the relationship between China and the U.S. Many have characterized it as this "Cold War 2.0." If listeners remember the actual Cold War that we're referring to, there [was] the Soviets and the Americans, and that was more military-focused—building up arms and nuclear arsenals for a conflict. This one seems to be much more about economics and maybe even more so about access to and ownership over technology that the world needs. I'll just ask two questions: one is, maybe provide some perspective: what got us here? And also, what are some of the scenarios that can unfold from here?

Paul Moroz 06:44 Well, what got us here...I mean, we had China grow into a major superpower through an export model. So, thinking back to—I guess it was really Nixon and Kissinger that opened up China. Deng Xiaoping's leadership—in terms of enabling a more capitalist attitude in China. And that really kicked off a boom in commerce and industry, and a whole program where the relationship between the U.S. and China for many years was the Chinese would produce things at a lower cost and they would ship it to the United States. And the United States would pay for it and then the Chinese would vendor finance that by investing in U.S. treasuries. So you had this wonderful program that went on for a long period of time. At this point, China has become a pretty significant economic power. And I think competition is a very human concept. Whether you're watching your kids or you're watching sports. And this is just that concept of competition playing out at a country level.

08:01 Where the Chinese are different than the Russians of course, or the Soviets, are culturally. They have a very long-term view on things. And I think that's played out in a number of the different strategies.

So we're seeing competition playing out on different terms. We're not stockpiling arms, but it's through trade, it's through economics, it's through the diplomatic tactics that each of the countries employ. And I think there's starting to be, really, a fight over technology. And it may be the U.S.'s policy to starve the Chinese or think about containment, but not ideological containment. Containment in terms of technological development. I think that might've answered your first question.

- Andrew Johnson** 08:52 Yeah it did. Second question is, "where the heck do we go from here?" And what kind of scenarios are you thinking are more probable over the next maybe five, 10 years?
- Paul Moroz** 09:02 We're not in the forecasting game, so I think it's tough to say where this goes, but I would suggest that whatever sort of trade deal is actually signed—part one, part two—that doesn't resolve the core issue of competition between the two countries. So, I would suspect that you continue to have trade tension and maybe tension with technology and economic tension between the two countries. Both are expanding in their own ways; China at a more rapid pace. And their influence eventually will start to ruffle feathers to an even greater degree. And I'm thinking in particular their "[Belt and Road \[Initiative\]](#)," where they're providing other countries within their sphere of influence with investments into infrastructure and other projects. Many view that strategy as a long-term debt trap diplomacy, and just extending their influence. And at some point, you're going to have the tensions between the two groups [perhaps] go to another level. But how that unfolds, it's really difficult to say. It could be politically; it could be in a place like Hong Kong or Taiwan. It might play out that way.
- Andrew Johnson** 10:18 So, what I'm hearing is...is it accurate to say that the current negotiations that are happening are more addressing the symptoms, whereas there's still this underlying health issue between, well, not just between the nations, but around the world with their influence and how they share that influence going forward?
- Paul Moroz** 10:34 It doesn't address the core root of why this is happening: the competition.
- Andrew Johnson** 10:41 So, you mentioned Taiwan and you also mentioned Hong Kong. What would it mean for a place like Taiwan? Where they are "somewhat different" (I'm using air quotes here) from China? And we've got some holdings in Taiwan. What does it mean for a region like that?
- Paul Moroz** 10:54 Well, the history here is very interesting because Chiang Kai-shek and the Nationalists were basically chased out of mainland China from the communists in 1949 and retreated to the islands.

So, that's the history. And in fact, if you want to go see some of the best Chinese art and historical artifacts in the world, you go to Taiwan because they brought all this wonderful stuff. Go to the National Palace Museum. But that has created this sort of... long-standing tension between Taiwan and China. China's basically said, "there's one China." And I mean, their program or mandate is eventually to tuck Taiwan back in somehow. And if you talk to most Taiwanese on the Island, they're fiercely independent.

11:47 Now, where this gets interesting, is the most technologically advanced semiconductor company in the world is in Taiwan. That's [TSMC](#) or Taiwan Semiconductors. And China has been trying, with great difficulty, to ramp up their technical knowledge and their production of semiconductors. And just to set the stage for just, well how the world's changed—and this is a 2018 stat—China imported \$260 billion of semiconductors in 2018. And just for reference, that compares to \$162 billion of oil imports. So, is technology the new oil? Is Taiwan the new Middle East? Can we see tensions there? Maybe. What does that mean for companies like TSMC? Well, they still have a huge technological lead. I think that they are out in front of the competition. They make a lot of the chips for Apple, but they have a target on their back in terms of...never mind regular corporate competition, but an entire country that wants to catch up somehow. And you have this unresolved geopolitical issue that, I mean, who knows what happens? But I've thought to myself, would you ever see a situation where, due to technology, the Chinese move in on Taiwan for some reason... to try to secure technology, even if it was just transferring IP. Now, this is just total speculation. Maybe it goes a completely different way. But it's fascinating to think about that backdrop and what that could mean as the world continues to evolve.

Andrew Johnson **13:31** The other fascinating thing that comes to my mind—and I think you've talked about it before too, and again, speculation, but—as things unfold from here, does the United States accept some of the further influence that China's going to have in the world? And in so doing, do they give up some of their (what we have currently), which is financial dominance around the world? With the U.S. dollar as a reserve currency, but also the economic engine of the United States in the world, as well. Do they have to give up some of that to accept China's influence?

Paul Moroz **14:01** Well, that's another significant topic. And you have a rising superpower and the question is, well, would you ever see a situation where the U.S. could lose their reserve currency dominance? I mean, it happened previously. Britain kind of was the reserve currency. And that started to slide away on them.

And you know, at the time, the U.S. dollar was all backed by gold, but it came off in a couple of pieces. In 1933, FDR took the U.S. dollar off the gold standard internally. So, you or I, if [we] were living in the United States, we couldn't convert our dollars into gold. But externally between countries, it was still backed by gold.

- 14:52** And then—this was sort of as the second World War was coming to an end—in 1944, the [Bretton Woods Agreement](#) basically outlined the new global system with the U.S. dollar as the reserve currency. And the deal was the U.S. dollar was backed by gold, and then all the other currencies were then pegged to the U.S. dollar. The United States secured its place.
- 15:15** And then the real switcheroo to set this all up—in terms of U.S. monetary dominance—was during the Vietnam War. In 1971, Nixon took the United States off the U.S. dollar peg internationally. So, now you have the entire system set up on U.S. dollars. They can issue dollars if they want, and it's not backed by anything. It's a fiat system. Now, I mean that's sort of evolution to put the United States there I just find fascinating because they have a really dominant position.
- 15:46** So, what would it take to upset that entire monetary system? Well, one of the arguments that some people have is that China is being really progressive on payments technology and ideas like bit-yuan. There's this idea that maybe they could innovate their way as a means to eventually achieve this sort...of reserve currency status. Whereas the United States, if you think about their position, it's really the innovator's dilemma. They have everything to lose. They don't want to change anything. It was really interesting to watch [Facebook's Libra Project](#) start to play out; there wasn't a lot of pickup or support for any of this. It maybe highlights that the U.S. has the pole position in terms of monetary policy, but some of the stuff they're doing in China from a technological point of view—if any of the listeners have used WePay on WeChat in China, I mean they're light years ahead of the United States in a lot of ways with payments technology. And I could see that evolving where, maybe, the U.S. loses the lead position around the next turn.

Andrew Johnson 16:58 Not unlike what we see happening in the industry commonly.

Paul Moroz 17:01 Sure.

- Andrew Johnson** 17:02 The huge established dominant firms...they don't necessarily get complacent, but they don't have that same entrepreneurial drive as what a disruptor or an upstart would have, and that can leave them vulnerable.
- Paul Moroz** 17:15 Yeah. By the way, I should say because we're talking geopolitics and we're talking other scenarios...in terms of people, I just had such wonderful experiences in Taiwan and China and the United States. I think that's important to say, because there's a very human element there. I've liked everyone everywhere I've went, it seems, so.
- Andrew Johnson** 17:36 We can't connect the two. We can't sit here and say [like] all the headlines are, "it's these two nations against each other." No, we're living in a global world, consuming global products and sharing global technology. Like you said, there is a big human element to that. So, that gives me optimism that there will be some sort of shared way forward. But that remains to be seen.
- Paul Moroz** 17:56 We're all human and there will always be that element of competition between groups.
- Andrew Johnson** 18:03 So, that discussion really highlights for me just how persistent uncertainty is in the world, especially when we're trying to build a portfolio of wealth-creating businesses that can be there for our clients over the long term. There's always going to be uncertainty. We never know what's coming around the corner. You mentioned forecasting earlier, and that we don't really play in that game. (The only guarantee that a forecaster can really make is that they're going to be wrong most of the time.) But, I guess, the question that we often ask ourselves around here, [and] also our clients are asking us, is, what can we do about it? If you go back to 2009, I remember when we first launched the Global Equity Fund and we referred to it as "the tank." This was really...we wanted it to be our answer to uncertainty. We wanted it to be our approach; to be resilient through many different scenarios and through time.
- 19:24 And one of the observations that I've had more recently—probably over the last 18-24 months—is that there's been a big focus on making sure that we've got very high quality business models in the portfolio, but we're also balancing that with the potential to earn higher returns over time. Because we're not just here to preserve capital—although that is a primary concern of ours. We're also here to grow capital for our clients over the long term. So, what are some examples of how you've made those shifts over the last several quarters in the portfolio, and how do you feel about those going forward?

Paul Moroz

- 19:29 Well, often the businesses themselves have characteristics of both. There [are] core attributes of businesses that are much like that tank characteristic. Or, maybe another analogy—because right now in Calgary it's very cold where we're taping this; it was -34 centigrade this morning—and you think about what you have to do to prepare for this. Well, in my truck, it already has snow tires on and it has four-wheel drive and I have a balaclava in the glove compartment and extra gloves and Long Johns and all my survival kit. And that's kind of the way that we approach portfolios. It doesn't mean that you won't run into bad weather. You will. But you're going to be better prepared for it when you do. (I have a tow strap in the back of the truck too, in case you go into the ditch.)
- 20:20 And many of the things that we are looking for are characteristics of the business model on the competitive advantage. The revenue tends to be more recurring; cashflow characteristics tend to be extremely strong. There are some businesses where you know your liability right away. There [are] other businesses where your liability is estimated, so you can shift that way. There are some businesses where they have high market share, and there's very high barriers to entry; or there [are] network effects. There [are] all these things that make it difficult for competition to get in. Well, we prefer those. That's why that's such a core pillar of our philosophy.
- 21:54 And then we're constantly trying to measure the value of the investments so that there's a little bit more safety. We don't know how people—investors—are going to price the securities we invest in, but we try to measure valuation and keep on shifting to better spots. So, that's kind of the base rate or the “core element” of what we're looking for with regard to safety.
- 21:21 We've invested in a company called [Intertek](#), which is a UK-listed company, but they provide testing, inspection and certification services all over the world. And what's nice about Intertek is their revenue is generated not necessarily by product volume, so it's less sensitive to the ups and downs of how much trade is going on, but more about product breadth. So, for example, anytime a new toy comes out that's going to have to be shipped somewhere, they're going to test it to make sure it meets various standards and internal standards for the company. This is really a service that doesn't require a lot of capital, so there's not a huge amount of capital that's paid out or consumed for capital expenditures. Instead, they can pay out dividends, they can acquire businesses to grow the business, they can buy back stock and improve the economics on a per share basis for their shareholders.

22:21 That's all the "your truck with four-wheel drive with your snow gear in the back, your emergency kit." Where you see some spots where you can get ahead, is when the company has an opportunity to do something and grow. And Intertek has a wonderful opportunity because their vision of the world is, well, we're already doing all this testing and inspection and certification business...what if we provided companies basically an audit on the sustainability of their business? Imagine a situation, where, when you're reading a company's financial or annual report, there's the financial section—which is of course audited by the auditors—and there's that nice little audit letter at the beginning and it's signed off by KPMG or PWC or whoever. Imagine the way the world is evolving, where sustainability is so important and crucial to long-term success in business where you have a sustainability report. And Intertek's set up with, effectively, auditors all over the world to provide that information and test different criteria and elements and then come back and certify that. So, it might well be Intertek that's signing off on a sustainability report years in the future.

23:40 So, that's something that I would characterize as a real option in the business. But it could be worth a tremendous amount of value if the world was to evolve that way and they were to execute. That's what we're trying to look for: where, how can we with our making investments that protect to the downside that are resilient, that aren't going to fall apart, also have some upside skew to them.

Andrew Johnson **24:05** And a big part of that resilience that we like to see, and you mentioned it, is recurring revenues or recurring cashflow. How do you measure that as a portfolio manager, as an analyst? How is that measured and how do you get comfortable around that number?

Paul Moroz **24:19** Well, some of it is the organization's internal metrics, but some of it is understanding how the business model works and getting into the detail of the particular segments. And understanding, well what does a company actually do? How do they make money? How are they paid? And frankly, we're just as much business analysts in the research department as we are looking at stocks, as we have to understand the business. And if that means spending more time with management or going out to see the assets so that we understand how that works then that's what we do.

Andrew Johnson **24:57** So, it's more about, I guess, having that higher visibility of what cash flows are going to come in over the next few years, which gives you confidence in building a model out around valuation, I would assume.

- Paul Moroz** 25:10 Sure. And I mean it's all how it's priced. We're not trying to avoid risk in the portfolios, we're trying to price risk. We have businesses that will have more cyclical and that's fine. But you build that into your models and your understanding of reality.
- Andrew Johnson** 25:25 Yeah. In many ways we are in the business of taking risk. It's just a matter of to what extent and at what price.
- Paul Moroz** 25:31 Yep.
- Andrew Johnson** 25:32 Before we wrap up, Paul, why don't we talk about a live example of a new holding in the portfolio that you've added over the last three, six months? One that comes to mind for me is Recordati, so maybe you take our listeners through that business and what our thoughts are on it.
- Paul Moroz** 25:46 Sure. So [Recordati](#) analyzes and commercializes mostly off-patent drugs. 90% of what they do is off-patent. They're based out of Italy and a lot of the business is out of Europe. And actually, that's an important part to the investment thesis because culturally, in terms of aggression levels with pricing and risks associated with regulation, that European climate reduces risk substantially. Versus, say, a company that is operating in the United States and maybe is more aggressive in what they're doing in terms of pricing and different practices. I think there's more regulation risk in the United States, even before considering what could happen with the government.
- 26:33 The other 10% of their portfolio is, they call it their "orphan portfolio" or their "rare disease portfolio," which they make better margins on, but they're commercializing cures or treatments to diseases that are very infrequent. And the definition of a rare disease would be something that occurs in less than 0.05% of the population. And so this has been growing very rapidly, and I think there's just a need for companies to deploy capital and solve this problem for people. To give you a sense of the extent of the problem, there's something in the order of 7,000 rare diseases, but only treatments or remedies for 300 of them. So, we have a situation where the stock is reasonably valued. It's not that cyclical, it's going to stand up in a recession, given the type of company that it is and the business model that it has. And there is some upside optionality for commercializing and bringing to the market more treatments for diseases where there's no treatment available. And I think that's a win for society, and I think they can make some money doing it, and I think our clients can benefit and it fits with the portfolio in terms of making it more resilient should we get stuck in a snow storm, or just some really cold weather.

- Andrew Johnson** 28:06 So, similar to Intertek—quality base business model and some upside potential that perhaps isn't fully priced in at this point in time.
- Paul Moroz** 28:15 In my experience, a lot of times the behavioural error is, it's difficult to value these real options over a long period of time. And so that's how you can do really well in the stock market. The real money's in the holding.
- Andrew Johnson** 28:28 Well, congrats again on 10 years, (talking about holding for a long time). And thanks for joining us today. Here's to another great 10 years.
- Paul Moroz** 28:35 Absolutely. Thanks for having me, Andrew.
- Andrew Johnson** 28:07 Thanks, Paul.

