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Rob Campbell: **00:39** Hi everyone, I'm back this week with Paul Moroz, our Chief Investment Officer again. Paul, welcome back.

Paul Moroz: **00:44** Hi Rob, how are you?

Rob Campbell: **00:46** I'm doing okay—it's been almost exactly a week since we last chatted, and I thought we'd get together just because events have continued to unfold, and we thought it would be great to share your thoughts with our clients. As I think back over the past week, I think I read that there was a 19% difference between the high and the low in the S&P 500, so clearly volatility has continued. Markets have edged lower on net, relative to last week. We're now working from home at the firm, and so that's obviously been a change. But maybe the place to start, Paul, is just relative to our last conversation a week ago—what's changed?

Paul Moroz: **01:23** Maybe the starting point is the spread of the virus itself and how that's evolved. So, what we've noticed is that the pattern—both of exponential growth of the virus, and the containment policies—that has expanded out. And Benoit Mandelbrot, who wrote about this concept of fractals, is actually pretty instrumental in our thinking about it, in that when looking at what's happened in Italy, you can apply that model out. And because there's been no cure or no major change, the pattern in each country has been the same. And the pattern has been exponential growth of the virus. And once that virus hits a certain point, the health authorities and the government authorities become more concerned, and then they start containment policies and basically, we're shutting the economy down. And with that is the consequence of the economics. And so that's part of what we've seen over the past week that's come to North America from Europe, that's coming to the United Kingdom—taking stricter policies. And that's resulted in the stock market being more volatile and the stock market expecting more of an economic impact as a result of that fractal pattern playing out.

Rob Campbell: 02:57 We spoke last week about this analogy of a traffic pileup with regards to the credit environment. How has that evolved in the past week?

Paul Moroz: 03:06 It has evolved to the negative. Because what we've noticed is that as businesses are having to be shut down, everything backs up, and so we have heard that companies are starting to lay people off. Companies are continuing to access their credit lines, making credit in short supply. One of the changes over the last week, listeners will have noticed that the U.S. dollar is very strong because there is a demand for U.S. dollars as companies reach out to secure U.S. dollars in financing. That backup in traffic—you can imagine as people have had a difficult conversation, perhaps, with their employer. Imagine you're in the restaurant industry, you have been furloughed or laid-off and now you're faced with a very uncertain situation. That means that maybe you're deferring on some sort of payment in the economy, or maybe forgoing the purchase of something that previously you would have purchased. So that backup in traffic has continued and now it's not just a couple blocks backed up, Rob, it's more. It's two or three and [the] stock market has taken notice of that.

Rob Campbell: 04:28 We spoke last week just about some of the policy responses that we've seen. I think we focused mostly on central banks and just ensuring the liquidity in the system. The policy responses seem to have gone a little bit further beyond that, and policymakers seem to be considering some pretty drastic measures. Can you comment on what those are, and again, the efficacy as you see them play out?

Paul Moroz: 04:51 Absolutely, right, Rob. I think that what's developed from central banks, from governments, is this concept of "raining money," and it's been raining money in three distinct buckets. One of them is the monetary side. We've seen more of that. Significant monetary programs in the United States and coming out of Europe where the central banks are buying back massive amounts of bonds, and we've seen interest rates be lowered in many countries all over the world.

05:23 Second one is on the fiscal side. So, this is expected because we think that monetary policy won't be enough. And sure enough, governments are finding ways and programs to get money into the economy—whether it's creating jobs, whether it's projects. So there are funds that are being set up to stimulate fiscally.

Paul Moroz: **05:42** The last, which is probably the most different [and] that we're maybe not used to, I'll put it into the "helicopter money" bucket. Where governments are starting to talk about directly injecting money into the hands of people. In the U.S. they've talked about handing out thousand-dollar checks. And that also might be in the form of maybe less explicit helicopter money, maybe deferrals—whether it's the deferral of taxes, or tax breaks, or a reduction of interest rates. So, it might take a less explicit route. But those are the three buckets. There's a lot more money and it's raining money out there. And I think that dovetails into the fixed income response as well, which we can talk about later.

Rob Campbell: **06:32** What's your sense, Paul? What is it going to take for these measures to ultimately be successful?

Paul Moroz: **06:36** Part of it is time to work through the system, but then also we have to get people back to work and the economy up and running. And that means going back to—I think that one of the principles we talked about before, this idea that humans are social. And once we figure out the technology around a vaccine and get that out and figure out how to manage and run the economy temporarily and perhaps just solve the virus, things are going to be a lot better off. But that could take time.

Rob Campbell: **07:09** I guess that's the key question, is the duration. And maybe one of the developments that I've noticed over the past week is just in some of the jurisdictions that were earliest hit, they seem to be opening back up their economies. We've got some colleagues in Singapore who have noted just shopping malls—people are getting back out there. So it does seem to be a matter of the duration. And so again, I kind of go back to: are there measures that you think that we're doing, or ought to continue doing, or do more of, to make sure that this containment continues worldwide?

Paul Moroz: **07:38** Different countries may have different approaches. You could put them into, maybe, three buckets (and North America is still trying to figure out their exact policy). But I think China took a really strict containment policy. And it seems at least from the data that's coming out of China is that they have that under control. Whereas Singapore, it was containment, but also testing. Testing, testing, testing. So, I guess you'd call it containment through testing. And so people are continuously tested and you sort out very quickly who has the coronavirus or not and then you deal with that. So, that's a second way to do it.

08:18 India right now, reportedly, does not have many cases, which I do not believe. I think the cases in India are much higher. And it's possible that they may have a situation where the virus spreads, but the containment might not be possible, but the economy keeps on moving along. But it means that there's more people that are impacted by the actual virus. So, those are three in my mind, very different buckets or approaches to managing through this.

Rob Campbell: 08:50 Can we go back to markets for a moment? Can you comment on the liquidity conditions in the markets?

Paul Moroz: 08:55 Because we talked about this traffic accident and subsequent a traffic jam creating a credit crunch, we've seen that play out. And what has been in short demand has been the U.S. dollar. Companies have reached for credit, and I think individuals, anyone who is running their personal life or business with less slack, is realizing that if you're not going to get paid for a bit, perhaps then you have to tighten up. That's all happening at the same time. So, it's not quite an SOS scenario, Rob, it's an SES scenario. So we have a sudden economic slowdown and that is resulting in liquidity challenges in lots of different parts of the market.

Rob Campbell: 09:43 One of the curiosities I've noticed over the past week, maybe week and a half, is that as stocks have sold off, bond yields have actually backed up. And commodities—things that are usually safe havens like gold—have sold off as well. What's causing this breakdown in the correlation that we've come to expect between these various asset classes over the last little while?

Paul Moroz: 10:04 I think...remember the response of, "raining money." It's raining money in terms of monetary policy, in terms of fiscal stimulus, in terms of giving people money directly, and deferring payments. I think what happened is after the announcement that perhaps the U.S. would consider directly mailing people thousand-dollar checks, the bond market started to consider the question of, who is going to pay for all this? And I think that's one of the factors that may have contributed to a slight backup in yield.

10:42 Now, don't forget there's just volatility in financial markets and interest rates don't always head straight down. But that's a factor. Another factor to this native correlation or the reason why equity markets and bond markets are declining, both at the same time, is that some institutions may actually be rebalancing. So, even though investors are repricing the equity markets downward because of the economic issues, at the same time, investors may be selling bonds in order to reinvest in the equity market and rebalance things. And that's maybe a structural element of the market that you'll see as we head into the end of the quarter, where I think a lot of investment committees will be asking themselves the question, well, "how should we rebalance?" And there might be a shift in fund flows.

Rob Campbell: 11:36 Certainly. I've noticed that with some of my clients as well, whose policy statements we may be testing some of the limits of the ranges that they've given us from an asset mix perspective. If those ranges have been quite narrow, you know the question of…do you remain in compliance, or take an action to get back into compliance versus letting things drift, is certainly on top of many committee's minds.

11:55 Paul, can I shift gears just a little bit and focus more internally? What are we doing from an investment process perspective in this extraordinary time? And maybe I'll start with just the analysis of companies. With a focus more on valuations, just given how much markets have moved, what are some of the things that we're doing from a valuation perspective to assess whether we're still able to purchase companies with a margin of safety, or whether companies have moved far enough that it warrants a second look at this point?

Paul Moroz: 12:23 There are some cases where when we look at valuations that some companies may actually be worth more because the current environment is leaving a real impression on people's behaviours. So, for example, we're conducting this podcast from our homes, we're using a new type of technology. Everyone is being forced to trial new technologies. Necessity is the mother of invention. So I think what comes out of this is a number of behavioural changes. And certainly what we're seeing in the portfolios is, technology companies are probably going to come out of this very well because any previous trends of getting people to adopt technologies, whether it's ordering things online, whether it's using online technologies, whether it's plugging into the cloud and figuring out how to do things remote, that's all going to be done in, I think, a lot greater scales. So that's one element of valuation—is recognizing the trends where business models have structurally shifted.

13:30 There's a few spots where we're also questioning with valuation. Well, if we go through a difficult period of time, even if the business model is viable—will the business make it with the current debt capacity? So that's a factor that we have to look at where, for the most part, corporations' debt levels—at least in the universe that we look at at Mawer—operates with a fair amount of slack. This is a different period of time. If you're forced to shut down your business for six months, you'd have to take that into consideration for evaluation.

14:03 So, in general, the valuation ranges are wider. We're also considering the prospect for some businesses that seem to be in a spot where they're tending towards more of an option value. Where the payoff might be quite significant, but the companies might have enough debt where if this economic environment persists for a year or two, then maybe the company goes bankrupt. It's like an option that would expire. So, I think there's a few of those that we're looking at and trying to understand how can we look at that valuation a little bit differently just to make sure we're capturing the right range of scenarios and probabilities around it.

Rob Campbell: 14:46 One of the first things that we did back in January when we started hearing about this virus was really focus on our companies based in China, as well as companies that we own that may not be based there, but have significant revenue exposure to China. And one of the things that our research team had done was to basically go back to our discounted cash flow models, wipe out a year of cash flows, and understand how that impacts our assessment of the intrinsic value of the business. What I'm struck by, is the virus has really gone global very quickly, [and] that if you're to carry that same analysis today, you probably have to do it for every single company in the portfolio. And so maybe just to broaden the question a little bit, how is the team handling just the sheer volume of information and change in a short period of time?

Paul Moroz: 15:31 I think that's a great question. I think at an individual company level, we're spending a lot of time working through models and looking at companies business models and saying, okay, well how has this changed? What are the opportunities? And reassessing. And some of it we just don't know. We're not going to know until we come out the other side what it actually looks like, but we have to make decisions under uncertainty. So you can imagine our research team is working...put it this way: we're putting a tremendous amount of effort into that. I think everyone's in overdrive to try to understand valuation and generate the most logical price discovery we can under uncertainty. And at that micro-level, if you think about what we're doing and the sheer amount of information and volume and the uncertainty at the company level, that explains why at the stock market level as well, there's going to be some volatility. We have to work through that.

Rob Campbell: **16:32** And I can certainly appreciate the value of the stochastic approach that we take in terms of our Monte Carlo simulation in this type of environment. What about focusing on other aspects of the investment philosophy and what we're looking for at this time? Given that we're all working remotely, we're not out on the road as much, what are we doing given that important parts of the process are speaking to management teams, collecting scuttlebutt, "boots on the ground?" How are we adjusting in the current environment where we're all sort of in isolation at home?

Paul Moroz: **17:02** Well, there's a few things that we're doing. I mean first of all, we're ramping up the communication internally with the team. That's a big one. And even some basic human factors. We had a virtual Saint Patrick's Day drink the other day—a bunch of people on their screens. We're testing it out, we have to evolve. We've implemented a daily check-in with people. We've now moved more of our meetings to Teams, which is a collaboration tool developed by Microsoft, and we're experimenting how to run meetings on that. So there's a lot more communication going on, and we keep on trialing different ways to do it.

17:45 I think the second element is external communication where luckily we're pretty used to this as an organization. This is where having most of our team based in Calgary plays to our strengths because we've already had to figure out how to connect with management teams and people who are in different cities all over the world, because Calgary is not necessarily the same sort of financial center that New York or Toronto is.

18:11 So, we've ramped that up both with connecting with management teams and as well, I'd say, other professionals in fields where we can get an understanding on how the virus is working its way through the value chain of the economy. I just got off the phone with a contact in real estate trying to get a sense of, if someone can't pay, who's on the hook? Is it really the tenant that has the most damage? Can they get out of a lease? Is it the landlord? Is it the bank? How do they share the pain in this? So, lots of conversations like that to understand how businesses evolve. That's ramped up, Rob.

Rob Campbell: **18:54** You talked about moving to a daily check-in, in a way you and I are having a weekly check-in. How are you doing Paul? personally for yourself, but also a CIO? How are things with you?

Paul Moroz: 19:03 Yeah, I'm doing pretty good. I mean working longer hours, lot more communication. We have, and I reflected on this I think the last conversation we had Rob, we have a wonderful starting point. We have extremely good portfolio of companies. The market has recognized that with performance, even though it's been tough on an absolute basis. We have managed liquidity and have the highest quality short-term paper in our money market funds. So we own T-bills, and we have ample cash to manage liquidity in our equity funds, but we have high-quality bonds. So, all of that sets up a situation where we're going from strength to strength. And that just psychologically makes it so much easier to connect with people and manage. So, stress-wise, I'm personally doing great. And it's been just such a pleasure to work with our team, both on our research team and all of our people across the organization, whether in operations or business technology or have a client-facing role. That makes all the difference in the world in terms of everyone's disposition.

Rob Campbell: 20:22 Great. I think it also highlights the importance of all the investments we've made in culture over the years. This is when that culture really comes to bear—when we can't be with each other socially. Having to rely on video chats are great, but it's not the same. Starting from that strong basis is really important. You mentioned long hours, so I don't want to keep you too much longer. Maybe one last question: what messages do you have to either the team, or to our clients this week?

Paul Moroz: 20:46 I'll just share the same message that I've provided to our research team and other people across our organization. The first is well, keep calm, carry on. The world evolves. It's rarely as dark or as brilliant as you think it might be. It's usually somewhere in between.

21:09 Second is, stay balanced and diversified. Both in terms of your portfolio and the decisions that you make in your life. And I think related to that, is one of the things that we're trying to do is be in two spots at the same time. And that comment relates to the uncertainty that we're faced with, where we could be having a very rapid recovery, or we might have a tough period of time for longer. So you want to be in a position where you're resilient—you can do okay in either scenarios.

21:44 And finally think long-term. We're looking for the long-term risks, but also the long-term opportunities. Because we're seeing already the world change. And I said before, necessity is the mother of invention. There's going to be some wonderful opportunities that come out of this for some companies and entrepreneurs.

Rob Campbell: **22:05** Great. Well, Paul, thanks again for your time. I think we can all appreciate how busy you must be in this market environment. So thank you very much, I'm sure we'll chat again soon.

Paul Moroz: **22:13** Thanks Rob.