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David Fraser: 00:40 Welcome to the Art of Boring podcast, thanks for joining us for yet another quarterly update. I'm definitely looking forward to this one. As usual, Greg Peterson's joining me today. Greg's the asset mix chair and the global balance fund lead manager. Greg, thanks for being here.

Greg Peterson: 00:55 Thanks David. And I hope all of our listeners and their families are doing well and weathering this the best they can.

David Fraser: 01:00 Absolutely. We've certainly had a bit of a ride in the last three months. Daily price swings have been some of the largest since 1929, unfortunately. What's your reaction been to all of this?

Greg Peterson: 01:12 It has definitely been a very different quarter, and very uncomfortable quarter, I'm sure, for many people, given the market volatility that you've mentioned already. Things have been somewhat different, but in other ways they've been much the same for us, just in terms of executing on our investment philosophy and process within Mawer. What's different is we have a very large economic shock that's taking place globally, all at the same time. So that's a little bit different than what markets are used to having to digest, and [has] created a great deal of uncertainty. And, as much as we have uncertainty with us all the time—we never know what's happening tomorrow, even in the best of the times—it's definitely heightened uncertainty to an extent that['s] caused a great deal of market volatility and a lot of price discovery.

David Fraser: 01:51 Yeah, absolutely. And so with that uncertainty, what are we looking at from an asset mix perspective? Are we making any changes there?

Greg Peterson: 01:58 We're looking at [it] the same as we often do. So for us, our mantra is always to stay very well diversified at all times, given that we don't know what's going to take place tomorrow. That's still the case with our balanced approach—to be well diversified. And then, also, we've been expecting at some point we'd have an economic slowdown of some sort (certainly not expecting anything to the magnitude of what's taken place).

If you are expecting things to slow down somewhat, then you're perhaps a bit more defensive. It doesn't necessarily mean making a significant change in asset mix, but shifting away from areas, perhaps, a bit more cyclical like Canada. So we went into this with a lower weight in Canada within the balanced funds and it is the same: staying very broadly diversified and ensuring that our fixed income weights were where we wanted them, and cash weights as well.

David Fraser: 02:43 Staying diversified is certainly crucial. I've had a couple of clients asking me too—you mentioned that we're in uncertain times—is there any thought of moving the cash weight higher? Or is that too short-term focused for us?

Greg Peterson: 02:56 So, we don't try to time the markets, naturally. If you get it right, that's great—you might be lucky. But it's a great way to destroy value by trying to time things, and we don't even know what's going to happen tomorrow, as well. We went into this with what we felt was sufficient cash. The cash weight within the balanced funds was somewhere in the neighborhood of 8% through the middle of March. That moved upward to 10% at some points. So that was enough of a cash holding.

03:19 One of the challenges with holding cash is, it's great in that it doesn't move, so you don't have the volatility that you have in every other asset class, but at the same time, it doesn't provide much of an offset to the equity volatility. So, what did happen during the quarter is bonds still performed their role by holding value and providing actually positive performance over the quarter. Just slightly positive—just over 1%—but that was in the right direction. And that's an important component that provides a little bit of offset to equity. Now, actually, that's not a much bigger return than what you might receive from cash, but it does provide a little bit of offset. And at some points during the quarter, bond yields were lower than what they ended at the quarter. So we had a bit more lift from bonds, if you will, right in the middle of March.

David Fraser: **04:01** Is the inverse correlation between equities and fixed income as strong as it's always been? We're in a lower interest rate environment. Is that still holding out? It sounds like it is.

Greg Peterson: **04:11** So, at the extreme of the volatility—or let's just call it what it was: a sell-off in the middle of March—bond yields were dropping at a faster rate at that point. So, I'm not sure that the correlation is as strong as it's been historically, but it's still in the proper or the right direction, what we want to see. So, there [are] a couple of risk mitigators (well, there's a lot of risk mitigators within the portfolio), but two that we look for [are]: one, is the fixed income providing that offset to equity? And then also the Canadian dollar. There's a lot of currency volatility; the Canadian dollar is a very cyclical currency. And typically when we have bouts of fear like this in the market, the Canadian dollars tends to sell off. So it performed the way we expected during the quarter. Given that we have a good deal of the portfolio invested outside of Canada and in other currencies, a falling Canadian dollar is helpful, just in terms of mitigating some of that volatility from foreign equity markets.

Greg Peterson: **05:00** So, just an example in terms of currency exposures: the Balanced Fund has about just under 55% exposure to the Canadian dollar, which means we have 45% exposure to every other currency in the world, the largest [of] that being the U.S. dollar. So, just over 23% in U.S. dollars. And if you look at the Global Balanced Fund, one of the reasons for the difference between performance in those two funds is that the Global Balanced Fund has about 36% exposure to the Canadian dollar and 35% [to] the U.S. dollar.

05:28 [The] U.S. dollar also performed the way we would expect it to during the times of fear and great uncertainty. As investors are looking to reduce risk and park capital in safe places, that capital typically flows into U.S. dollars. So, the U.S. dollar during the equity market sell-off did push higher against all other currencies as well. So that was a good sign, if you will, in that the reserve currency of the world was performing as expected. And then likewise, as we came towards the end of the quarter, we saw some of that upward pressure on the U.S. dollar pull back a little bit just as risk declined slightly.

David Fraser: 06:03 I think those are some great numbers and it sounds like the currency play, among everything else you're looking at, is a conscious piece of the equation of the appropriate asset mix. Is that true?

Greg Peterson: 06:16 Yeah, we're certainly aware of the currency exposures that we have within the portfolio and it's something that we look at. Allocation to foreign equity markets is sort of our first stop, so wanting to have exposure for instance, to the U.S. or internationally—we'll look at those market characteristics and input from our asset class managers first, and then the currency is a bit of a secondary. I would say that if we were [to] sort of hold international markets and U.S. markets as equal, if we have some uncertain times or, backup, everything is uncertain all the time. But if we're a bit worried, we'd probably favour the U.S. market slightly because of the currency there. And just knowing that we have that protection, if things sell-off, to the U.S. dollar exposure.

David Fraser: 06:58 So, you mentioned the Canadian dollar. In terms of the actual Canadian economy, how resilient do you think we are here in Canada to ride out this type of storm? Given that we're more of a primary resources or commodity-based industry, how do you think we'll hold up here?

Greg Peterson: 07:15 I think the Canadian economy will be certainly challenged. Canada, in particular, is facing two threats or two challenges. One is the economic disruption from COVID-19. So, that's not terribly different than anybody else in terms of the economy slowing down or parts of the economy shutting down. And then we have the added disadvantage of the oil conflict between Saudi Arabia and Russia oversupplying oil markets at a time when demand for energy products is down significantly.

So, suddenly we have a great deal of oil around the world—storage facilities virtually everywhere are very full—which has caused the oil prices to drop by almost two-thirds during the quarter. So Canada has that extra challenge in headwind.

Greg Peterson: **07:56** And you've seen that too, just in the performance of Canadian stock markets. The Canadian market was down as much or more than most during the quarter: we ended up with the TSX down 21% in the first quarter. That's not significantly different than emerging markets, which were down just over 23% in local currency terms. It was challenging for Canada. And the energy component of the Canadian stock market was down 58% in the quarter. So, you really see the direct challenge felt by the energy sector.

08:23 Now, that being said, as much as Canada's felt that, it's not that the game's completely over. We do have some great companies in Canada as well that still perform during a period like this. It's just they have the economic headwind, and it's likely to be there for some time. Now, if we had Saudi Arabia and Russia all of a sudden go back to the way things were before and manage supply better, you could see a fairly quick turn. We do have some progress on pipelines that are starting to move forward, so I think it doesn't change the longer term view. The longer term view is, yeah, we're fairly narrow in terms of what we have to invest in in Canada, but things could still work out relatively well there too. Just likely more challenged in the short term.

David Fraser: **09:03** And I guess that's a contributing factor of why we maintain diversified portfolios with components in Canada as well as the large amount outside of Canada.

Greg Peterson: **09:12** And that's one of the reasons why we continue to hold a lower weight in Canada than we would otherwise with respect to Canadian equities.

David Fraser: **09:18** With regards to central banks, I know around the world there's been a lot of fiscal and monetary stimulus going on. Have central banks done enough?

Greg Peterson: **09:28** Yeah, I think central banks around the world have taken some sharp lessons from 2008 and 2009. As soon as they started to see some cracks in credit markets and problems with liquidity, they jumped in very quickly. And so, unlike 2008 where it was a more gradual and slower response, they've taken those learnings and went to zero interest rates very quickly, started up quantitative easing programs very quickly—(those are programs to buy bonds and provide liquidity in the market). So, as much as COVID-19 has created an economic shock, at the same time, we are starting to have some challenges to the financial system because of liquidity drying up and just the great uncertainty that this causes, not just for markets but for businesses and their access to capital. So central banks stepping in in that capacity really filled that gap very quickly. For us, I think it was nice in that, okay, now we have an economic challenge to deal with and manage through, we don't have a large financial breakdown, which could have potentially happened as well. So central banks have played a very important role in this.

10:30 And then at the same time we have the monetary stimulus from the central banks, you have also unprecedented fiscal stimulus that's been injected in the market. We haven't had a period where we've had such strong policy response from both government and central banks at the same time. And I think you've seen that reflected in stock markets. So, unlike the fear that took the market down significantly—I think March 23rd was the low at that point—we've had a slight recovery since that. So, it's taken a bit of the risk off the table, despite the fact that we still have a great deal of economic uncertainty ahead of us.

David Fraser: **11:04** And it seems like policy makers have made more of a concerted effort to help out small- and medium-sized businesses this go-around, as well as the larger players. How important are they to when we get back up and running to make sure they survive this period?

Greg Peterson: 11:20

Yeah, so this is an important difference of stimulus this time around. If you think back to 2008-9, most of the stimulus measures and liquidity was provided to businesses. This time, as you've indicated, the government's going direct to consumers by mailing out cheques, essentially, and also helping out the small- and medium-size businesses. So, I would say small- and medium-size businesses are really the core of our economy; in a lot of ways it's a big part of employment, as well. And so the government's trying to stop a complete destruction of demand and also [provide] the ability [for] individuals to put food on the table, as it were. This is a big difference; it's a very important measure given the circumstances.

David Fraser: 12:00

That cashflow need and that lending and borrowing need is so important right now. Some companies are looking at potentially zero revenue or very little revenue for the next little while, depending on their business model. So on that note, I guess one of the pieces that's uncertain and is extremely important when we think about valuations, is the earning potential of a company—which is effectively how it's valued, by looking at its future earnings. With those future earnings being so uncertain, companies have stopped giving forward guidance in a lot of cases because they just don't know—which is fair enough. How difficult does it make valuing companies at this point in time?

Greg Peterson: 12:41

Yeah, that's exactly why you saw stock markets dropping as quickly as you did through the first part of the middle of March. It's just that uncertainty and not knowing what the impact on earnings will be at the end of the day. So, that has certainly created a lot of price discovery, as markets were trying to grapple with: where are we going with the economic slowdown, and just how slower are things going to get? So it does make it very difficult. It's why we focus on things that we have better insight on, or better knowledge. And that's looking at the business models of the companies. Much of the focus of our research team has been on the strength of companies' business model[s], their competitive advantages, their ability to continue to earn revenue as we go through a period like this, and also on the strength of their balance sheet.

Greg Peterson: **13:23** So, I think we've talked about this in past podcasts, but really, as you prepare for a slower economy, one of the things you're looking at is balance sheet strength and needs for capital. And so I would say that overall, our portfolios have shifted to companies that have less need for capital. It's important in a time like this when we're talking about liquidity concerns and access to capital not to be overexposed to the businesses that have more leverage or need more capital.

13:48 So, some of the companies that [we've] focused on are software, online-type businesses. They have relatively low capital needs. And, as it turns out, in this environment with the world shifting online for a lot of business function, it's proven to be fairly beneficial, too. So, companies like Amazon we've been adding to slightly over the past month; Microsoft is a core part of the portfolios as well. Those are businesses that survive through a period like this. We don't need as much clarity perhaps, on net earnings at this point in time with those businesses. But we have good confidence in their ability to survive through this.

David Fraser: **14:22** And some of them will even benefit, won't they? I mean, the two of us are talking right now from our respective home offices, which means we have to get all of that set up and the electronics required to do that. So, some of those companies will benefit from that, won't they?

Greg Peterson: **14:35** Yes, absolutely. There are other companies that benefit from market volatility too, that we've focused on more over the past couple of years. Stock exchanges around the world tend to benefit from greater volatility and greater trading volume. So, companies like the Toronto Stock Exchange, for instance, or TMX Group; Japan Exchange [Group], Deutsche Börse. These are companies that we have in the portfolio that do tend to benefit well.

David Fraser: **14:57** I think you point out there the beauty of diversification. No matter what the world looks like, someone's doing all right out of this and those are a couple of those names aren't they?

Greg Peterson: 15:07 They're doing all right, or at least relatively better. It's much like our portfolios performed relatively well during the quarter and all of our equity asset classes were ahead of their benchmarks. But you still don't feel great about an absolute decline during that period. So, a lot of these businesses, the stock exchanges included—returns would have been negative over the course of the quarter in many cases. But compared to other financials, such as European banks and so forth, [which] were hurt much more. And so on a relative basis, the exchanges were a better place to allocate capital and didn't carry as much risk as some of those banks.

David Fraser: 15:39 So it's a backdoor play on financials, by the sounds of it.

Greg Peterson: 15:42 Yeah, we've had a different approach to financials for some time. So, less emphasis on the banking sector and more emphasis on exchanges, insurance, and consulting firms such as AON and Marsh & McLennan. So, just a different mix within our financial group.

David Fraser: 15:57 And the actual bank names that we do hold, have we taken action there? I know we don't hold any European banks, but we do hold some.

Greg Peterson: 16:06 Yeah, we do hold some banks. So, we've trimmed the bank exposure just slightly. I wouldn't say that it's been a wholesale shift, but just taking care of some of the allocations. So, trimming the likes of JP Morgan in the U.S., DBS in Singapore, and just scaling back the weights slightly. But they're still an important part of the portfolio, for the time being at the very least. And so it's much like our approach—and you've probably heard others talk about trying to be in two places at one time—on the one hand we want to provide downside protection or some risk mitigation within the portfolios, so that would involve trimming some of those securities. (Much like trimming back our weight in Canada and in some respects.) But the other side of it is you don't want to entirely take away the ability for your portfolio to recover. So we haven't eliminated those names. They're good quality companies. We adjust that weight with the expectation that the economy and markets do recover; we want to be positioned for that at the same time.

David Fraser:	**16:57**	So, despite the general pullback, some companies have held up better than others. Are there any names we've trimmed to dampen the risk as a result of higher relative valuations to the rest of the market that's pulled back more significantly?
Greg Peterson:	**17:10**	Yeah, valuation is an important factor in our investment philosophy. We've been trimming businesses with higher valuations, really, for the last few years. So again, in the expectation that eventually you do run into an economic slow down, we've been trimming higher valued companies or trimming it or eliminating in some cases. Some of the businesses that have had high valuations in part due to their success that we can trim back are companies like Halma [plc] in the UK, which is a sensor and detection company; Descartes in Canada, which is a logistics provider. These are really good companies, but because of such strong performance and the fact that the market was recognizing that, became expensive. So we've been trimming those back just to provide some better downside protection in the portfolio.
David Fraser:	**17:53**	This may be an unfair question I'm going to throw at you, but I'll get it out there anyway: do you have any strong feelings on whether this is more likely to be a V-shaped recovery where things snap back relatively quickly? Or a U-shaped recovery where things stay lower for longer?
Greg Peterson:	**18:09**	Sounds like a crystal ball question, David! Actually, given that we don't have the crystal ball, we don't know how things will recover. On one hand, you have pretty much everybody staying at home in big chunks of the world, and so you could make the case for having a lot of demand building up that's not able to be fulfilled at the moment. And so, once the challenges of the virus subside, you could make an argument for a fairly quick rebound in demand.
	18:33	I think what's probably more likely is that this is a gradual recovery. So, just some early signs that we've seen from areas like China—China has been through this, they seem to have things fairly manageable. Although, I would also look to other parts of the world for, perhaps, clearer evidence of the next steps and where we go from here. But in any event, if you take some of it as you will, their economy's gradually getting back online, you gradually have workers going back to work. So I think just from that early evidence it's not an immediate rebound and it's not a quick recovery. You can call the shape whatever you like, but it'll likely be fairly gradual, I would guess.

Greg Peterson: **19:09** And I think just from a planning perspective too, it's better to expect that things are gradual, rather than hoping for anything that's terribly quick. And the difficulty, too, is just not knowing where the COVID-19 virus goes from here. Do we have another resurgence in it later this year? Or perhaps a third at some point? The unknown still, too, is on the medical technology—in terms of when the vaccines are available, or perhaps some other treatment that's more readily available, as well. So it would be best to plan for a gradual recovery. I would also expect to see more volatility just as we have some ebb and flow to virus numbers around the world.

19:44 So, markets are still going to be somewhat cautious despite what feels like more recent optimism. I think it's best for investors to plan for and expect more market volatility, just in reaction to both the virus numbers, but the other is also we're about to see economic numbers come out as well. The markets really haven't had much in the way of firm numbers to work with from either economics or earnings for individual companies. And despite expectations being adjusted and relatively low—and we all know that unemployment numbers will spike—I think once you see the numbers actually come out, there's probably a bit of sticker-shock there too, and you see the core volatility come back in the markets. So we're not past that. However, we also think that this will be somewhat rational, as we start to see numbers come out you have a better sense of what stock value should be and will lead to that gradual recovery.

David Fraser: **20:34** What numbers will you be looking at? And will they cover the extent of the coronavirus thus far, or will they only paint part of the picture? Because it's all happened so quickly.

Greg Peterson: **20:45** Yeah, this has happened very quickly. For us, it'll be looking at employment numbers, earnings adjustments for businesses, as well as looking at the virus as well. So, I think we're moving down that path as far as the progress of the virus and so now we're starting to look for stronger science on the economic piece.

David Fraser: **21:02** If you're a client who's kicking around these types of thoughts in their own mind, perhaps, what are you telling clients who are looking to drastically make a shift in their individual asset mix, I guess? And potentially even going to cash to get out of this market completely because they just don't know what's going to happen?

Greg Peterson: 21:20

I always believe it's best to stay to your long-term plan. A period like this is not a time to make a drastic adjustment to that. For clients, it is important to have cash available to meet their day-to-day needs. So for instance, if you live entirely off of your portfolio and rely on that income, then you want to make sure you have sufficient cash to fund your living expenses and any other capital needs over the next year or longer. I think that's important. That's typically the advice that we provide: stay to the long-term plan, ensure that we have the right investment strategy set up to meet your objectives, and then to ensure that you have that liquidity available as well, just to meet your needs as we work through this. So, fully believe that equity markets will work through this over time. That's the difficult part to define though is, well how long is that time? Is it a year? Is it two years? And that's why it's important to look at those cash needs.

David Fraser: 22:10

Some clients out there also have been asking me—in terms of investing funds they might've had on the sideline or even a recent house sale is an example of one of my clients—in terms of getting back into the market or getting into the market with fresh cash, how do you determine that? Do you go in all at once, or incrementally? And if it's incrementally as, in staging in, what sort of time period are you thinking is most appropriate for that? For your typical client.

Greg Peterson: 22:37

Yes, this is an equally tricky question on market timing. Advice is largely dependent on individual circumstances as well. As I was saying before, volatility is likely to remain fairly high, still going forward. And so, I think that some people would find comfort in staging in gradually. So, it doesn't mean hold back today, but perhaps put some into the market to invest today and stage the rest over the next 6 to 12 months for instance, and just sort of regularly over that time period. On the other hand, if you have an exceptionally long time horizon and no needs for liquidity, then I don't worry about when we enter the market so much—today is just as good a time as any from that perspective. But I think most people would prefer to have some comfort that they're not investing today and tomorrow [in] the next wave of some selloff in equity markets. So staging them over a period of time is much likely more comfortable.

David Fraser:	**23:26**	So there's a lot of doom and gloom out there—we might've added to it today with this podcast [laughs], I don't know how we avoid that. But every event is different, historically speaking, when you look at these types of events in the markets. But are there some positives—to end on a positive note!—that these type of market pullbacks generate that we can look forward to in long-term?
Greg Peterson:	**23:46**	Yeah, I think one of the things you can look at, just maybe from a bright side, is the response that we've had from policymakers. They have responded what seems to be [in] the right direction to help and support markets, businesses, and consumers. So there's some positive there. I mean for us, from a longer term view, too—stock market selloffs do open up opportunities as well. Our research team always has an inventory list of businesses that they've done their homework on [that] they like for many reasons, and for one reason or another they haven't added that to the portfolio. Quite often that reason is valuation. So, it has opened up some opportunities to add to companies like Alibaba, NetEase, which is a Chinese online gaming company. These are companies that previously were expensive by our measure and have become more attractive as stock markets have declined. So there is reason to be optimistic, it does open up some opportunities to add businesses that you haven't been able to otherwise, and really, just to take that longer term view.
David Fraser:	**24:38**	Well, we did it, we were able to end on a positive note there, so thanks for that. Hopefully there [are] more positives to come, and I hope everyone's staying safe and well out there with their families, thanks so much for joining us today. And Greg, thanks so much for your insights.
Greg Peterson:	**24:52**	Thanks very much, and everybody stay well.