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Disclaimer:	00:22	This podcast is for informational purposes only. Information relating to investment approaches or individual investments should not be construed as advice or endorsement. Any views expressed in this podcast are based upon the information available at the time and are subject to change.
Rob Campbell:	00:38	Well, Paul, it's been a few weeks since we last checked in. I think the last podcast you and I did together was back on April 2nd, and the market has certainly moved a lot since then. And so, I thought we'd just chat about juxtaposing just...some of the sheer scale of the negative economic data that's coming out, with the technical bull market that we're in at the moment. Just the reaction in the market, versus the data that seems to be coming out. So, maybe that's a place to start. Can you help provide us some context as to what's going on?
Paul Moroz:	01:07	Well, you are having a lot of statistics, basically, "fall off the cliff." Whether it's industrial production, whether it is consumer confidence, or whether it is unemployment figures that parallel the Great Depression. So, the economic indicators in "the now," including commodity prices, including things like the price of oil, for a moment that traded negative... it's really been unbelievable. And that's also what you would expect if you're in an environment where, literally, the economy had a heart attack. It stopped. Governments and health officials around the world told people to "go home, social distance." In a way, that's kind of how we thought that would be playing out. Maybe what is less expected, is the extent of the market rebound or the rally in equity markets. Central banks around the world have stepped in and they've started buying all sorts of things—in terms of bonds and credits, to support the liquidity of market.

Paul Moroz: **02:15** They've gone further, I think, faster than in 2008 and 2009. And the equity markets are drawing a lot of strength, I believe, from that response. And that's the "tug-of-war" we talked about before. Even though we know that earnings are going to be bad, there's going to be an earnings recession, and Main Street is going to have trouble. We have such low rates, there is no alternative to invest in it, and investors are looking out the other side.

This is dangerous in a couple of ways, because I think that you could be in a scenario where we have to social distance [for] longer than people expect, and we get sort of these…rolling waves of this virus. That means we could be in a period of 6 months, 12 months, 18 months, 2 years, where the stats are really bad and equity markets correct to the downside, where you're almost in a depression scenario.

03:15 By the same token, it's dangerous because the cat is out of the bag in terms of direct fiscal stimulus. Basically, writing people cheques. And down the road, that could be abused and extremely inflationary if put into the wrong hands—if used in a manner that's out of proportion with just combating the deflationary pressures that are in the market today because of the collapse in demand, as a result of social distancing.

In that case, equity markets might be your best hedge, in some cases, against inflationary forces. Looking 24 months out, the distance between scenario A and scenario B are extremely widened. We're really trying to make decisions under uncertainty as to what's going to happen for our clients.

Rob Campbell: **04:09** So, I'd like to unpack a lot of what you just said, because I think you covered an awful lot in that that maybe deserves a little bit more attention. So first, just on the stimulus side of the tug-of-war, can you dig a little bit further into just…some of the more traditional things, perhaps, that have been done to stimulate the economy? And then what's maybe new, or unprecedented at this point?

Paul Moroz: 04:30 Core traditional would be reducing the overnight rate. That's at the core. And so, if you reduced the overnight rate at which banks can borrow money from a central bank, they can turn around and lend that money out to people who are, say, buying a home. And the cost of money is lower for people who require that loan, whether you're buying a house or funding a loan for your business. So, the prime rates of banks has come down because of the overnight rate coming down. So, that's standard.

05:05 The second big bucket—this is maybe less traditional but increasingly traditional because we saw this out of the 2008, 2009 playback, where you had quantitative easing—this is the central banks printing money to buy back bonds and forcing the interest rates in the bond market down, which effectively pushes capital into other places in the world.

It displaces the capital in the bond markets, and all of a sudden, you're incented less to invest in, say, bond markets. And the theory was that, well, banks would not hold bonds, they would lend to their customers. You have investors and speculators that, rather than holding bonds, they would reach into other parts of the market. So, it just facilitates more incentive to reach for yield and to invest.

05:56 But the real big one, has been writing people direct cheques. So, this is really creating money and sending it out to individuals. We've seen this in the States, and I think many countries around the world have these programs to help people. And this is fine, it's kind of Keynesian economics; it's fiscal stimulus to offset the collapse in demand. But what's so unique about it, I think, in this history of time, particularly in the UK, where they've basically said, "We're not even going to bother with the idea of issuing bonds to raise money and send it to individuals. We're just going to print money," where it's almost a merger between the central bank and the treasury: "we're just going to print money and we're going to hand it out." And that is really unprecedented.

Paul Moroz: 06:48

We've kind of crossed the Rubicon. It's—our chairman, Jim Hall, coined it, "the collapse of the bond standard," a little bit of a play on how the gold standard collapsed, but this is really different. We're in a different world, where I think governments around the world, central banks, or a combination of them now, are going to look to solve economic problems by creating money and issuing it directly to people. And that's a very different world than the "bond standard" that we've lived in for a long period of time.

Rob Campbell: 07:24

Great. And from my perspective, I know we spoke probably four or five months ago just about some of the forces driving negative interest rates. And I would think that the coronavirus outbreak has just deepened some of those deflationary forces. On the flip side, I would think that the end of the bond standard, as you're describing it, has the potential to be very inflationary. Is that another tug-of-war that's taking place right now in terms of the inflationary outlook?

Paul Moroz: 07:50

Yes. I mean, you phrased it very well. The end of the bond standard is dangerous if the people in charge abuse that power. In the short-term, it's a very useful tool to help counteract the severe deflationary forces that we're seeing, and to also reallocate capital, reallocate wealth and resources, to those that are in dire need of those resources during this unique period of time. So, over time, though, it's the Goldilocks story of Goldilocks is tasting the porridge and one bowl of porridge is too hot, one bowl of porridge is too cold, one bowl of porridge is just right. And that's sort of your spectrum.

08:40

It's unlikely that what the central banks and the governments are doing is going to be just right off the bat. It's a much higher degree of likeliness that we're either, the porridge is way too cold or way too hot, and one side's deflation, the other side's inflation, and there's going to have to be some adjustment. At first, the risk, I think, is deflation. That's why the liquidity is being provided. It's why the resources are being provided. It's why wealth is being effectively redistributed. It's only later on, where we're going to learn about the consequences of this, and to the extent that these tools are abused. Because now, that precedence has been set.

Rob Campbell: 09:25

In a way, it's no different than the conundrum always facing central banks, in terms of where to set their policy rate. You can let things overheat, you can go too far in terms of where you actually move that rate. Now, is the thought that just...the bazooka is that much bigger? And so, the danger of going one way or the other, or abusing it, results in greater distortions? Am I thinking about that right?

Paul Moroz: 09:45

Well, I think maybe the bazooka is bigger, but the check and balance may have disappeared. There is this concept of an independent central bank, even if it wasn't fully independent at all times. Conceptually, that was the check and balance for politicians not to run away and kind of...wreck your economy and wreck your fiat money program. So, that may have been removed, and it will be very easy now to argue, to say, "Well, look what happened. Look what we did in 2020. We used this tool to help things out. We'll just do that again." Where's your check and balance?

Rob Campbell: 10:28

Fair point. Are there other parts of the world that have done this before? I mean, I'm thinking, obviously, there are hyperinflationary emerging markets that have maybe got into trouble that have had less of a separation. But you know, in a way though, I acknowledge that this is different—just the sheer scale of asset purchases that other jurisdictions like Japan have done...I mean, that's a market that's been pretty heavy deflationary forces for many years. A pretty active central bank, to my understanding, or government purchase policies. How has that played out, maybe somewhere else?

Paul Moroz: 10:59

Well, certainly, one argument out there [is] that what has happened in Japan is a leading indicator for what could be happening in North America. Where, you don't see things completely run away in terms of inflation or the powers that central banks, that governments have. They actually don't lead to any sort of inflationary pressure. But what you're actually managing for is kind of a lost decade, a lot of deflation. And that might be at least, inductively, that might be your base case. I mean, if I asked you the question: "Rob, are you more worried about deflation in the short-term, and the prospect of a depression? Or inflation longer-term?"

Rob Campbell: 11:44

I think the analogy is clearly, governments have declared states of emergency that would allow them to do specific things. We're all adhering to various social distancing measures. These things are understandable, and good in the height of the moment. The question is, what does it do over the next 10, 20 years if those things really become entrenched? So, if I just think about the U.S. and just some of the chats that I'm having with some of my friends who happen to be there, they're happy to give up their freedom, so to speak, for a little while. But if this extended for 10 years, then it could be different. So, that's, I guess, the way that I'm thinking about it, in terms of the problem.

Paul Moroz: 12:19

My perspective in terms of framing it, would be that…the probabilities of something where you're actually seeing the evidence in the here-and-now, deserve more attention. So, I'm personally more concerned about deflation and a depression, because that evidence is here. Whereas, the consequences of these new "tools," perhaps, and the evolution of those and the prospect of inflation because of those…those are all hypothetical. They could happen, but maybe not at all. So, in terms of how I weight the portfolio—this goes back to something we've been talking about before, about being in two spots at the same time. It's like, you'll be very concerned; it seems like all this is deflationary, and maybe Japan, as you pointed out, is actually your base case for how things play out. But be in a spot where [you have] optionality: you can kind of guard against these alternative scenarios that could spiral out over the course of two to five years.

Rob Campbell: 13:20

So, can we go back to the market and just the market's reaction over the past month? Clearly, one side of that tug-of -war is winning, in the near term. Is it the same businesses that have sold down earlier in the year that have come back? Or is it different?

Paul Moroz: 13:33

Yes and no. I mean, at first for the most part, everything sold off during a little bit of the panic. But stuff that started to recover quickly has certainly been technology companies. So, the companies like Amazon, as you can imagine, and Microsoft. And partly, just because of this coronavirus has reinforced a lot of existing trends, but also, from a balance sheet perspective, those companies that have the financial strength to withstand 6 months, 12 months, two years of a real tough environment, are just in a better spot. That's one of the things that has happened.

Notably, companies that haven't done as well, haven't bounced back to the same extent, would be banks. Which of course, are going to have to bear the brunt of cleaning this up. And at this point, the provisions—if you look at the United States as kind of a leading case in this area, where JP Morgan and Wells Fargo and Citigroup and Bank of America—they basically all came out and are accounting for really significant loan loss provisions.

14:43

But even then, it's only a guess. They don't know. So, those are securities that have not bounced back to the same extent. There [are] some securities—healthcare stocks, in some cases—are at 52-week highs because it's more essential, and balance sheets are in good shape. So, it's very much depends on the sector. Small cap versus large cap: small cap has been lagging. And you might expect this part. If you can imagine a small cap cycle, you're probably not going to do as well because small caps typically have weaker business models and don't have the same sort of access to capital. So, not all stocks have been made equal in this recovery.

Rob Campbell: 15:25

You mentioned small-caps and access to capital. I recognize that you're speaking broadly about the category. What would you say, broadly, about the category of emerging market stocks? Would that be similar?

Paul Moroz: 15:36

I think that it's similar in that it's a peripheral asset class. Valuations are perhaps different. You could argue coming in, emerging market stocks had already gotten beat up and had a lot better valuation statistics—traditional statistics—than say, the U.S. small-cap market. And then you get into a debate around the strengths of the business model and the impacts that say, currency has, and rules and regulations. There's a whole bunch of other factors that you have to consider in emerging markets, so they're a little bit different. Very much depends on the country you're in too, Rob. I mean, China's stock market has done remarkably well in this context and there's other markets which have not done as well.

Rob Campbell: 16:22

So, in terms of managing the global equity portfolio at Mawer, what have you been doing in the past month?

Paul Moroz: 16:27

We made a series of changes as this news unfolded, mostly in March, where we were strengthening our positions in companies that we thought would get ahead. We added to our Amazon position; we added to our pharmaceutical positions; we reduced our banking positions. We reduced stocks that had idiosyncratic risk, in that we were unsure about how they would do, should this environment continue for a longer period of time. Over the past…call it over April, three weeks or so, we haven't done so much because we've already adjusted the portfolio as best we could with the information that we had. So, we adjusted for the new information and now, the information is out there, and what's changed over the last bit has been mostly valuation. So, there hasn't been a whole bunch of activity.

Rob Campbell: 17:27

Great. Switching gears a little bit, we're in week seven of working from home at Mawer. How is that going across the team?

Paul Moroz: 17:34

Pretty good. It has forced a lot of innovation that wouldn't have naturally occurred. And that's been innovation through technology and trying different things because you're forced to—through different formats—for surfacing information.

Paul Moroz: So, one of the things that we started doing in our weekly research meetings is, because we're using Microsoft Teams and they have this really interesting "Team" categories, where you can invite everyone across the team into the different groups—we have them broken out according to asset class. You can see the conversations that people are having, but you don't necessarily have to be there on, [at] the same time. That's the wonderful thing. It's not like you're having a verbal conversation with someone that doesn't get captured, and that can't be shared. Whereas, when it's written down in one of these chats, that can be shared across the team.

18:31 So, what we started doing is looking back, and over the course of the week, picking up some of these themes, and then there'd be some emergent properties of these topics that we would then pick up and use in our weekly research meetings.

And I think that's led to a lot cleaner aggregation system for thinking about different ideas, because you kind of capture the wisdom from crowds in a very efficient manner. So, that's just an example of a small innovation that's come about of it. But certainly, that's been a really nice unintended benefit of these pretty dire set of circumstances.

Rob Campbell: **19:08** How would you characterize the morale within the team? I mean, it's week seven, there's no longer sort of…a commute between being at home and being at work, [we're] not able to socialize as much in person. Is that something that you're worried about in your seat as CIO, and looking across the team as we stay home for potentially quite a bit longer?

Paul Moroz: **19:26** Yes and no. Yes, I'm worried about in terms of: have people completely reinvented their health regimes yet? And the answer is, well, probably not. I think we're all individually experimenting with it. And even little things like [laughs] remembering to have a shower in the morning, rather than just rolling up out of your bed onto the computer. I mean, this is a very real thing that everyone's trying to deal with.

Paul Moroz: So, I started a program with my kids: I drag them out of bed in the morning, and we go for a little jog around the block. And then that's my cue to have a shower. That's how you create habits. And then my reward or the final thing, (if you're into creating new habits you have to have [a reward]), is my cup of coffee. This is the small routine that I do.

20:16 The other one that I do for exercise, which is related to that, is I'll zip around—I'll pretend to commute to work on my bicycle, but it's just a big loop. So, I'll make 12 kilometres and then I'm like, "Oh, I'm here."

Now, this is important, we're all innovating. One of our teammates—by the way, we have this program where we have a learning stipend. Everyone across the team has some funds that they can apply to learning. And so—this is just to give people some context of the culture we're trying to continue to create and push on—one of our team members is toying with the idea of basically, [talking to] an industrial psychologist or sports psychologist. And a lot of the feedback they've gotten, is, well, you have to create these routines, these little things. Whether you're getting dressed in the morning and putting on your work clothes, or whatever it is for you to create a sense of normality.

21:10 So, in terms of health, that's one element. We're working hard to do that, but I don't think it's perfect. The positive thing in terms of how we work together and team morale would be...the neat thing about working with Microsoft Teams, (again, another plug), is that they have this really simple tool where when people enter comments in, well, one, if you have a bunch of introverts working on your team, introverts can more easily participate and feel included.

And so, there's been more people in terms of introverts and people in our Toronto and Singapore office that say, "I've never felt as included in the team since I started working in a different spot." So, that's a real positive thing for mental health and team morale.

21:55 And the other one that Microsoft Teams allows for is, it's simple, but when someone posts a comment, people can basically put that they liked the comment or little emojis.

Paul Moroz:

But basically, this small psychological indicator that the comment was appreciated, that the person is liked, that there is a laugh or a reaction. And that—you might think it's a really small thing, but the level of appreciation because of those tools has probably increased...I don't know, a hundredfold. Because normally in a meeting, you wouldn't, there'd be no feedback mechanism to share that appreciation and suggest that you care [for] the teammate or that that was a bright idea or a smart idea.

And so, that's been, again, it's small but it's really revolutionary. And certainly, it's made me think, with other people: in your family, across the organization, well, how else can you improve the level of appreciation, improve the motivation, improve the mental health and team morale? It's just small, but really significant, I think.

Rob Campbell: **23:10**

Paul, I want to go back to something you alluded to earlier, which is this idea of a learning stipend, but I actually want to move this in a different direction. Is it too early for us as a team to reflect and take learnings away from what's transpired so far in 2020?

And I guess my perspective is, we've always been an organization that takes a good inward look to reflect on mistakes or things we missed, or just attempt to get better. Is it too early to sort of...tease some learnings out of what we've experienced over the past four months?

Paul Moroz: **23:44**

Probably. I mean, I've had this debate with my colleague, Christian Deckart, our deputy CIO, and the debate has been around these post-mortem reports that we'll do on a stock. When we really muck up on a stock, we've tried to figure out, okay, what happened, what went wrong? And there's some interesting case studies that we've created over the years.

But the debate is around, well, at what point do you write that post-mortem report? Is it a month after? Is it a year after? I think right now, we're in the category where, A) I think it's too soon. And then of course, [B)] intellectually, you have to hold lightly that, in the exact same scenario but in a different universe, the results may have been different.

Paul Moroz:		Humans may have decided that…in general, they may have said, "Well, we're going to follow the Swedish model. We're not going to be too concerned about this," and then all of the decisions you made that maybe were managing risks, you shouldn't have been, because the scenarios didn't play out that way.
	24:49	So, there's both a time aspect and then a universe aspect to the problem, Rob, and either way, I think we're just too early to judge.
Rob Campbell:	**24:59**	Thanks for coming on again this week and for everything that you're doing for our clients.
Paul Moroz:	**25:01**	Thanks Rob.