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EP66 | Playing the plan: Mawer's Canadian equity portfolio

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Andrew Johnson: 00:40 All right! Welcome back to the podcast Vijay.

Vijay Viswanathan: 00:43 Thanks for having me back—good to see you.

Andrew Johnson: 00:45 Yeah, you too. How have you been?

Vijay Viswanathan: 00:47 We've been adjusting. Seems to be the best adjective to use. We're adjusting and rolling with the punches.

Andrew Johnson: 00:53 Adapting.

Vijay Viswanathan: 00:54 Yeah, kind of like the portfolio.

Andrew Johnson: 00:55 Yeah. Well, good segue! [Laughter]. It's almost as if we planned to talk about the portfolio today. It has been, I think, almost exactly three months since you and I actually sat down on the podcast previously. Let's just talk about what's happened since then. There's been a meaningful recovery in markets in general, but has that happened here in Canada? And if so, what's been driving it?

Vijay Viswanathan: 01:16 Well, it seems like everything has changed since we last spoke. It's actually hard to believe it's only been three months where all of this has transpired.

Vijay Viswanathan: So, if we look back at the tail end of the first quarter, or the last two weeks of Q1, we started to see a rally in markets. And at the end of Q1, the [Mawer] Canadian Equity Fund was down 18%, the TSX was down 21% to end Q1. You're never happy to be down 18% in a quarter, but at least take some solace from a relative standpoint, the portfolio performed the way we would expect it to perform in that sort of market.

And then subsequent to the end of Q1, as I mentioned, starting in almost the second or third week of March, we saw a pretty substantive rally and we've seen that—where the TSX is up, I haven't checked today, but it'd be up close to 40%—if not rallied close to 40% off the lows. That is a significant move.

02:18 You're thinking about two very significant moves over the course of the last, let's say, pretty short period of time. We've seen that. And so, while I'm happy with the way the portfolio has performed in that rally—we definitely participated—just not to the same degree. Again, in line with how we think the portfolio should perform in these types of markets.

And we've seen a lot of the names that have done well over this subsequent rally have been those companies that were hit significantly harder at the end of Q1. We've seen some real strength in energy names. We've seen strength in gold names, where we've been historically underrepresented. But a lot of companies [where] there was some questions about whether they were going to make it, they subsequently have survived, and we've seen significant rallies there.

03:07 That's what's happened. I think that overall, if we look back, it's like we essentially put the economy into a self-induced coma, and we are now slowly coming out of that as we start to see economies around the world—if we dig into Canada, we're seeing provinces start to open up. And we're seeing the recovery that's coming from that. So that, in conjunction with the significant amount of liquidity that's been pumped into the system by the central banks, notably the Fed—we've also seen that in Canada with the Bank of Canada—as well as fiscal relief, government relief programs. That's both in Canada, the U.S., and around the world.

Vijay Viswanathan: 03:46

Those all in my mind were the right things to do. They needed to happen to essentially save the economy from where it was going. And that's kind of where we're at now. In talking to the companies, we continue on with the blocking and tackling of managing the portfolio. We continue doing all the work that's necessary to follow the process around that. And we've talked to a whole host of management teams [of] companies in the portfolio and most of them have started to see a recovery in demand—at least off the lows. Not to where things were pre-COVID, but definitely some cautious optimism from there.

Andrew Johnson: 04:25

Yeah, I just wanted to pick up on that because that was my general assessment too, is that there's cautious optimism both from the government level as well as maybe the executive level in corporations.

And I think you've alluded to it, but is that the sense that you're getting from them? You mentioned that there's some pickup in demand and they're seeing that and they're reporting that to you, but going forward, what's the consensus from some of the executives that you're speaking with?

Vijay Viswanathan: 04:48

Those seem to be the two words that come together. And I mean, as I said, I'm thinking, oh, that's such a cop-out—"cautiously optimistic." But that is where it seems people are at. And I mean, I think the biggest unknown, really, is how things move forward. [And it's] really going to be based on something that is out of our control to a certain degree, and that's health outcomes.

We just don't know how that's going to play out. From our standpoint, we're not epidemiologists. We're not going to sit there and spend all our time trying to figure out how that's going to play out. I think you've heard it, our listeners would have heard it on previous podcasts, whether with myself or Paul Moroz or others. We are looking to be at two places at once with the portfolios to stay balanced, stay diversified, because we don't know how the future is going to unfold.

05:34

So I think that's one of the big unknowns, the health outcomes. As we open up the economy, what happens? Is there another wave? Does that lead to further shutdowns, or not? And we just don't know. We don't know what the impacts are going to be from the roll-off of support programs that have been essentially well, rolled out. We don't know what the impacts [are] going to be on employment. We don't know what the impact that'll have on businesses, whether they stay open, whether they reopen when that happens.

Vijay Viswanathan: Canadian debt levels weren't that great to begin with pre-COVID, so I can't imagine that's been helped out during this time period. And so we don't know if there's going to be change in behaviour—people start saving more.

06:17 And then the last one, just geopolitical tensions. Again, we don't know how that plays out, but that's China and the U.S. Between them, we're caught in the middle of that as Canada. So again, that's an unknown.

So there's lots of unknowns, again. And that's why we're not spending that much time focused on that. We're focused more on the micro, and on the portfolio names itself. And again, trying to be two places at the same time. It's not all bad. I think there are some green shoots for Canada, and we're starting to see that. We're hearing that from companies. At least things aren't getting worse, and in some cases, getting better. In Canada, we're lucky that we still have a lot of stuff that the world wants. We just have to get it to those markets.

06:59 We have been a very open country. I personally have reaped the benefits of that. This country opened up its arms to my dad when he came from India in 1966. So I think immigration has been a great tailwind to economic growth. And it's a place, when you look out globally, people want to come to Canada.

So, I think that's positive. And we're actually starting to hear from our companies themselves that they're seeing in their own recruiting efforts that the talent pool has grown as Canada becomes a place, I guess, maybe even higher on people's radars to come and work and make a better life for themselves. We're seeing that in our own recruiting efforts. So those are some positives.

Andrew Johnson: **07:40** Personally speaking, I think that's a promising thing to hear, or a very positive thing to hear—that that trend continues and maybe is even amping up in the medium term.

So, look Vijay—there's obviously some intense macro changes happening in the world. They've already been in place likely, and maybe they've just been accelerated. Maybe there's new things that have come to the forefront…and it certainly feels palpable. That there's change happening and that's change that's happening fast. I know we don't spend a lot of time in the macro world, but it obviously has an impact on the micro side of things. What kind of shifts and changes that you guys are sensing right now may have an impact on some of the business models that you're looking at?

Vijay Viswanathan: **08:20** I can talk about macro and micro. The best quote I heard around what's happening is from Tobi Lutke, the CEO of Shopify, one of our portfolio holdings, and his quote was, "this all feels like 2030 is happening in 2020." I would agree with that comment, in the sense that it seems like there's just been an acceleration of trends that were already happening.

On the macro side, we've seen unprecedented actions by central banks. Like, I thought what happened in 2008/2009 was unprecedented. This is like…if anyone reads the work done by Ray Dalio, the last time you saw this type of intervention was in the late 1930s, early 1940s, and at that point, we were in the midst of World War II. So there's significant change. We think the world has changed, and we don't really know what the unintended consequences of all those actions could be, but it could be a real turning point history-wise. That could be a whole other podcast—on that piece [laughs].

09:16 At the micro level, there could be some changes happening thematically. It's hard to tell right now whether those are temporary, whether those are structural. And it's really difficult to know when you're in the middle of something. We're in the middle of a pandemic—it's hard to know what's happening. It also could be dangerous to make generalizations on the way things will play out. I think in a world where there's financial repression, a world where there's lower interest rates for longer, it's probably a tougher environment. More challenging for banks and life insurance companies. And that was something they were dealing with before, and that's something that maybe [has] accelerated through this crisis. We've seen other themes accelerate, one being ecommerce. So, when, essentially no one was allowed to go [anywhere], we saw ecommerce penetration go to 100% pretty much, because you weren't allowed to go and buy stuff in the store.

10:08 Now that's obviously shifted, and that's not sustainable, but the question becomes: as more people have embraced ecommerce [and] companies embrace multichannel or omni-channel distribution strategies, does that fundamentally change the way people approach retail? So that could be positive. That could be positive for a company like Shopify, that could be positive, and shows again the importance of wireless networks, internet.

I think we all thought the internet is pretty important. And this will probably tie into another theme—those of us who are blessed or lucky enough that we can work from home or out of an office, well, the internet connection is pretty important. So it really highlights the importance of that industrial real estate you need for that type of real estate. Maybe [that] has a tailwind.

Vijay Viswanathan: **10:55** And on a flip side, retail office space, do we need as much? And maybe we do. And maybe we don't. But that's something we definitely are on top of and monitoring. I mentioned working remotely or working from home…there's this massive experiment going on, again, for those who are lucky enough that they can work from home.

So that could have some big impacts on [the] demand and need for office space, which has lots of ramifications through the universe; through the Canadian equity universe, but then also through the portfolio. And every company we've talked to in the last two months…management teams have talked about re-evaluating and reassessing the real estate footprint.

This stuff…again, we don't know whether it's structural or temporary, but this is what is happening out there. So that is something that's out there. I think telehealth is another one that we've seen an uptick [of]—that maybe there's been an acceleration of that theme.

11:48 A company in the portfolio, Telus, has a large health business that people probably don't even know exists! And I think that that's accelerated the use of telehealth because we had no choice. You couldn't go to the hospital, you couldn't go to the clinic. So you had to do stuff—whether that's with doctors or other healthcare professionals—having to use that distribution channel.

[That's] only scratching the surface of things that are changing out there, and one we're definitely discussing internally. I don't have any real answers for you on that right now, but [it's] one that we're definitely staying on top of and monitoring closely.

Andrew Johnson: **12:24** I wanted to come back to what we talked about very early on, where you mentioned that we had two very sharp movements in the market. And one of the conversations that we have with our clients, or really the consulting community or whoever it is that we're talking to, is that they typically try to bucket investment managers into a certain style. And the one that I've heard over and over for us in particular, is that we get described as a value investor. And I'm not sure if it really hits the mark; I think it's a little more nuanced than that.

I just wanted to ask you: how would you describe our investment style?

Vijay Viswanathan: **13:00** Well we've been put in a few different buckets or style boxes. Yeah, I've heard that before, we've been referred to as value investors. Although when I think value investor, I think Benjamin Graham. Essentially starting with valuation, looking to buy companies at a discount to their net-net assets…sort of true value investors, or the intelligent investor value investors. I've heard that, I wouldn't put us necessarily in that camp. I've heard "GARP," growth at a reasonable price. We've been put in that box. I think we've referred to it sometimes as quality at a reasonable price, but I think that's trademarked, so I'm not going to use that.

So, essentially we're probably closest to growth at a reasonable price, but I like Warren Buffett's quote around this…all intelligent investing in his mind is value investing, in the sense that, who wants to pay more for something than it's worth? Whether it's taking a position in a company, whether it's buying a washer and dryer or a new vehicle—whatever it is!

13:55 So for us, I think we're probably closer to growth at a reasonable price, again, or quality at a reasonable price, than what would be the traditional value investor. And that fits with our philosophy: wealth-creating businesses, excellent management teams, discount to intrinsic value. And we start with the first one: the wealth-creating business is the first pillar for a reason, that's where we start. Knowing that we've got to make trade-offs along those three. And where we have historically made trade-offs is on valuation. We've made trade-offs on management team[s]. Where we have not made trade-offs is on the business model, the ability to create wealth over a sustainable period of time.

So, I don't know if that answers your question or if that helps.

Andrew Johnson: **14:32** It does. And you answered my follow-up question too, which was I wanted to ask, it's very unlikely that we're going to hit all three tenants of our philosophy out of the park with every investment that we have. It's never going to be a strong business model, top-tier management, and excellent discount to intrinsic value, or estimate of intrinsic value.

I was curious if we were willing to negotiate on certain aspects of that and where you were going to take a firmer stance.

Vijay Viswanathan: 14:57 Well, never say never on that. Yes, I think in most situations we've got to make trade-offs. I think there can be dislocations in the market that may provide opportunity. So 2009, I think, is a great example where we were able to buy what we think are very wealth-creating businesses, well-run businesses at what we thought was a significant discount to intrinsic value. Didn't really see that in the most recent market pullback because it happened so quickly that we rallied back. It definitely was different. That was one of the main differences, I'll say, [between] 2009 [and] this time period, because of how fast things shifted, we weren't really able to do as much. Not that we didn't find anything, but it happened so fast that we weren't really able to do it.

I know I'm not answering your exact question, but to give you some context, yeah, got to make those trade-offs and sometimes the market will present those opportunities.

Andrew Johnson: 15:53 So on that note, it looks like the market did present a few opportunities over the last few months for you and the team. I think there was four new names, if I'm not mistaken. One in particular that I think our clients and our listeners are going to be curious about is our purchase of a gold company. I think [in] my time and your time at the firm, we haven't done it. I don't think it's true historically, but I just wanted to get your sense on that and maybe share with our listeners the thinking around that recent addition.

Vijay Viswanathan: 16:22 Yeah, so it has been a long time since we owned a gold producer in any of the portfolios and the Canadian Equity portfolio. I had to go back. It was before, as you mentioned, Andrew, before your time, before my time at the firm. The last time we made a gold producer purchase was September 11th, 2001. So, most people would remember that day. It was a horrible day. And that was the last time we made a gold purchase—was that timeframe. And you're right, we have owned gold companies in the past.

Let me start with, we're not dogmatic about anything that we own. Ultimately our job, our responsibility is to provide financial peace of mind for our clients, and to make investment decisions that we think are in their best interests and that are going to provide the best risk-adjusted returns over the long run.

17:13 That's our job. That's why our clients trust us. That's why they give us their hard-earned capital to be stewards of. So, let's start with we're not dogmatic about any investment. And yes, it may have been 20 years since we owned a gold producer, but that doesn't mean that we would never do it. We've always said we wouldn't [never]. We've always revisited our assumptions over that two-decade period where we haven't, and just...weren't able to wrap our heads around it.

Vijay Viswanathan: And that, I think, is important for listeners and clients to know. If we think about producers and why we haven't in the past, invested in them...quite frankly they just didn't make money. They didn't earn a return on capital that was greater than their cost of capital. And post 2008/2009, a lot of the ingredients were there for it to make sense, but unfortunately, the decisions that were made by the companies just weren't wealth-creating in nature.

18:09 And what happened is there was a period of time where there was a lot of M&A at significant premiums. A lot of that was through issuing equity and stressing the balance sheets of the companies. And that led to a pretty negative outcome. And for us, at least something that we couldn't get around.

So for us, it just didn't fit. We revisited every year. Every year I've been working Canadian Equity, I have spent time revisiting gold producers. For us, it just didn't meet the criteria. Wealth-creation wasn't there, we weren't there on management teams. And you needed pretty big heroics from a valuation standpoint, from a gold price standpoint, to justify it. The unit economics weren't there.

So what's changed? Well, in our mind, if you look back over the last five years, there's been significant change in the way that gold producers—and it's not a sweeping generalization—but we've seen some change.

19:00 Where this idea c[a]me from I think is important: we did a blind screen of the universe. We screened the whole Canadian equity universe, but we blocked out the ticker, or the name of the company. We wanted to be as unbiased as possible. We had a bunch of criteria we were looking at. And lo and behold, when we did the great reveal of the names that were near the top for things we would look at around return on assets, proving return on equity, balance sheet, profitability...a lot of gold producers were at the top of that list [laugh].

And so for us, that was an eye-opening moment. Whereas maybe our biases would have taken over if we knew the names beforehand—we may have just filtered them out because of that—but by doing it as a blind screen, I think that opened up our minds a little bit more.

19:52 And that led to a much deeper due diligence dive on a bunch of companies; we did management interviews. And ultimately at the end of it, decided that we would initiate a position at Agnico Eagle under what we think are pretty reasonable commodity price assumptions.

Vijay Viswanathan: They earn a decent amount and a significant amount of cashflow. Balance sheet-wise, pretty close to no debt. That's pretty difficult to find in the Canadian context, so I think that helps with survivability. And I think from a management standpoint, just understanding that, hey, this is how they need to run a business. This is the actions they need to do in order to generate wealth for shareholders over time.

So for us, we think it fits the criteria and I just want to be really clear on this: the reason it's in the portfolio is because it fits from an investment philosophy standpoint, from a micro standpoint.

20:44 There is an added benefit—but this is a secondary consideration, so I want to be clear, it's a secondary consideration. The portfolio benefits that I think that this can add to the portfolio. It does add a nice contradiction and can be a name that could do reasonably well if we had a pretty high inflationary environment or deflationary environment, where real rates stay low for a long period of time, so they could benefit from that. And then just benefit from the unknown of the significant amounts of liquidity that has been pumped into the system and perhaps the devaluing of currency.

Now, again, that's secondary. Primary reason it is in the portfolio, as we say, is it an "n"? Does it deserve to be in the portfolio? Can stand on its own merits? And the answer we think is yes. And we've seen some positive evidence of some change, and we'll continue to monitor that over time. And if the facts change, then we will change our minds.

Andrew Johnson: **21:44** That's a fantastic overview. And you nailed a few pretty important topics. I think, one: just in life in general, when you are presented with new facts, if you're not willing to change your mind, then you might find yourself into some bad decision making.

I [also] wanted to pick up on the conversation about biases in particular, because I thought that was a really illustrative example of how we can very practically try to tackle our biases. Are there any other examples like that? And you don't have to just look at your team at Canadian Equity, you're Director of Research, you [can] look out at the team. Is there anything that you're doing as a research team that's exercising or actively trying to limit that effect of biases?

Vijay Viswanathan: **22:22** I don't have the answer, Andrew. This has been the problem, dilemma we've been trying to solve for, I guess, all the time I've been here. And I know if Jim were doing the podcast with you right now, he'd be like, "hey look, I've been trying to deal with this for the last 20-some years." And so we don't have the answer, but I can talk about what we've done. We've got to with this. Because this is one of the biggest issues or dilemmas we need to solve, is removing bias.

It's probably the biggest detractor to success in managing a portfolio. It's ourselves, it's our brain—our own pesky brains, our own biases that we bring in. So what's the antidote? How do you deal with it? And where we've landed is, well, you have to have a systematic process. You have to have a process in place that we try to reduce as much bias as possible.

23:12 I think the biggest one that we have, or I guess there's a couple, one is utilizing the matrix as a tool. So that's a tool we use for portfolio construction. It does not give us the answer, it's not formulaic in nature, but it's a systematic way to go through and rank companies and assess businesses. There [are] things we're working on right now to improve it and get more systematic. But as a way to rank companies based on quality and return potential becomes a common language for us, combined with the second piece, which is a culture of being open and curious [with] dialogue and dissent [to] at least [have] that discussion within the team to try to look at things as objectively as we can.

Vijay Viswanathan: **23:51** So I think those are a couple, in my mind, that we're doing across the platform to try to deal with biases, knowing that we're not going to be able to do it. Maybe that's the third one Andrew, is know that. Just accept we have biases as human beings. We're going to have to deal with it. And ways to deal with that—we have to manage it probably just like risk. You can't eliminate it, you've got to manage it. So the way we manage it is through process and culture.

Andrew Johnson: 24:16 I want to keep this train going because I've known you a long time, but you've also been doing this for a while. And I also know that you've had some great mentors along the way and learned a lot of lessons, and you just touched on a bunch of those.

So, since we have a few more minutes here, I'll just ask—what's one thing that you think investors out there, whether you're just getting started in the industry as a recent graduate, or maybe you're somebody that just loves investing and you're doing it on your own…aside from those biases that we just talked about, what's something that you think people underestimate as a contributor to success? Or at least setting yourself up for success?

Vijay Viswanathan: 24:52 There are a bunch that come to mind, but I'll pick one. So I think the power of optionality built into businesses. And I think that that optionality within businesses increases the "Luck Surface Area." So, if you have a business that is wealth-creating, well-run, and you're not paying for what I call "upside optionality"; the ability to move into new verticals, to cookie cutter how you do things in other geographies, would be a couple examples. To be able to cross-sell or upsell existing customers with new products, new innovations over time that you're not necessarily paying for…

I think that increases the Luck Surface Area. And what it means is that increases the opportunity for good things to happen to a company, and then by a by-product to the portfolio that you never thought when you first initiated a position in the company.

25:50 So to me, that's a big one. There's lots of other ones out there, but that's one in my mind that we probably underestimate—is that luck does play a part. And a lot of that is, you can make your own luck to a certain degree. I've been positively surprised over my 13-14 years here at the firm of just…if you have a logical philosophy and a systematic process that you run day in, day out, how many times you can end up being lucky with a company. And I think that upside that's there from optionality that's built within a business is a big one that I personally have underestimated as a contributor to success.

Andrew Johnson: 26:26 That's awesome. I know for a fact that our listeners love hearing you on the podcast, not just talk to about the portfolio, but to really share some of your experience in investing and managing the team here. So, much appreciated.

Vijay Viswanathan: 26:38 I figured it was just my family that was writing in all those nice comments when I'm on the podcast. [Laughter]. I have a big family.

Andrew Johnson:	**26:45**	Well, I can assure you it's more than just your family—we greatly appreciate it Vijay. So, thank you. And we'll look forward to having you on the podcast sometime down the road. I know we've already had you on twice this year, so maybe we'll give you a break for a little bit.
Vijay Viswanathan:	**26:57**	Happy to join any time. And it's always a great way, not able to connect one-on-one with every client, but this seems like just a great way to be able to have that connection with our clients who, hey, without our clients and their support and their trust, well, we don't exist.
Andrew Johnson:	**27:15**	I couldn't agree anymore. And I think that's a great point to end on. So thanks again!
Vijay Viswanathan:	**27:19**	Okay, take care and stay safe, and all the best to you. Say hi to the family.
Andrew Johnson:	**27:24**	Will do.