



**[00:00] Rob Campbell:** Coming up on the Art of Boring, a conversation with portfolio manager, Jeff Mo. While headlines warn of consumer doom and market volatility, Jeff's on the ground perspective reveals a more nuanced and balanced story. One of resilient, albeit bifurcated consumer spending, margin surprises and a CapEx boom that yes, goes beyond AI.

Though most of my questions are big picture in nature, I think you'll appreciate the way Jeff approaches them. Very much a bottom-up lens with plenty of examples of portfolio ramifications and a real flavor for our U.S. mid-cap strategy.

**[00:37] Disclaimer:** 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.

**[00:54] Rob Campbell:** Jeff Mo, so great to see you.

**[00:56] Jeff Mo:** Great to see you too, Rob.

**[00:57] Rob Campbell:** I was looking back at last time you were on the podcast, Jeff. If I can take you back, it was early April and I think the VIX was close to 50, if not just slightly above.

At the time, the world was certainly reeling from a certain trade policy announcement that had just come out. Today, looking at broad market indicators, that all seems pretty far behind us, at least in terms of where markets are at a bottom mid-April.

If you're up for it, and what I'm hoping we can do today, without making any macro predictions outright, and from somebody who spends most of their day looking at U.S. companies in the small mid-cap space; are there things that we can glean? Some bigger picture economic aspects that maybe bubble up from the bottom-up? One place I thought we would start is, and with respect to the consumer in the U.S., obviously a massive engine behind the U.S. economy and the global economy. What are you picking up from the companies that you look at, from some of the comments you made, the outlooks, the guidance, that might suggest anything that we can glean with respect to the health of the consumer?

**[01:59] Jeff Mo:** The consumer is doing still moderately well. This might be surprising because I think the commentary in mainstream media is that the bottom is falling off. Or certainly something really severe is happening with the consumer. When you look at bottom-up consumption numbers statistically across a broader macro set, obviously assuming that we can get the numbers these days given the government shut down happening, and some of the delays there.



From the stats, we can see consumer spending is still generally positive every month, every quarter and year-over-year. Then when we look at the companies that we invest in or are interested in investing in, generally, the consumers are not robust. I will not say things are growing rapidly, but if you have good products like Shark Ninja, they have been a top holding for over a year now. If you have innovative products like them, consumers are still willing to buy their products, and they're still growing in the mid-teens or better in any given quarter.

We're seeing probably more weakness in the slightly lower end consumers. And there, I think it's a combination of historical inflation and then wage rates not quite keeping up. For them, I'd call it a bit of a bifurcation where there's more deal seeking, there's more stretch budgets. That helps some companies like Murphy USA, which is a holding of ours. They are usually the cheapest gas station in the area that they operate in. When consumers trade down, they're kind of helped a little bit.

Overall, consumer health is, on a bottom-up basis, we're not seeing that five alarm fire that maybe some of the mainstream media articles might suggest.

**[03:38] Rob Campbell:** This K-shaped mess that you alluded to with respect to lower income segments having a tougher time than maybe other segments. Does that observation drive any research priorities for you? I know you mentioned a couple of companies, but thinking about how you look at ideas in space and their developments, how do you take that into your process?

**[3:57] Jeff Mo:** I would say at the margin, it does. If you're looking at two companies that seem to have similar competitive advantages in terms of the strength, and if the DCF valuation looks broadly similar when you do your Monte Carlo analysis, you would bias towards the company that operates in an environment or market that is a little bit more robust.

We've been looking at travel, for example, because that still seems to be relatively resilient; whereas we did exit a retailer a little while ago, I guess it was before all this happened, that served the lower-end consumers in America.

**[04:35] Rob Campbell:** Another thing that's maybe more company-specific, and something you said earlier with trade policy and tariffs, one of the thoughts has been: if a company produces or provides a good or a service that their customers really need, they'll have the pricing power to pass that through.

What have we seen in terms of pricing power or margin dynamics? Anything notable there that you think is worth sharing?

**[04:56] Jeff Mo:** Pricing power generally follows what you would assume about the strength of the competitive advantage. This would be probably less so around tariffs, more so through that inflationary era we saw in the last couple of years. Overall, inflation at one point was running on six or seven percent for a quarter, here or there.

That could mean underlying certain commodities or certain products, intermediate products, are maybe going up ten or twenty percent. That's a lot of price you'd have to push through and that would create a sticker



shock for your customers.

Companies that are able to do it, clearly have strong competitive advantages. A company like Amphenol, which makes interconnects and sensors, have maintained and actually increased their margins over the last three years. Whether the inflation caused by the tariffs or whether the inflation just from the inflationary era, they've done really well.

I would also caution to say that they are exposed, in one division, to AI data set to build out. Naturally, that has a bit of a higher margin given the complexity of the products there. When you read management's commentary, they're talking about pretty robust margins all the way through.

At least the companies we look at and focus on haven't passed prices through, whether it's from the tariffs or from historical inflationary era. Margins, for the most part, I would not say they're at peak in terms of their ability to manage margins. A few companies have started to see their margins roll over a little bit from the peak during the mid part of the inflationary era, but generally still healthy. In most cases actually, margins are higher than they were pre-COVID.

**[06:32] Rob Campbell:** Certain corporate profits have been an area of strength. I assume you'd agree with that, but there are results and there's the market reaction. One feeling I've always had with respect to the U.S. mid-cap space, and feel free to disagree with me here, was that reactions are swift in the mid-cap space and often outsized to either better or worse than expected news.

Have we seen that continue even with broader, better earnings overall? Are there any pockets where you're noticing, either for better or worse, major disappointments or major beats?

**[07:05] Jeff Mo:** Reactions are still quite outsized. We just had to look at payments companies recently. So, it's not a company we own. I joked and said that day when one of the largest payment processors in the world became a mid-cap company, Fiserv, dropped forty-five percent in one day on earnings. Look at the result. They were weak, but if I remember correctly, the sell side was expecting maybe high single-digit organic growth, and they came in at low single-digit and gave a more moderated guidance because of that. The stock was down almost half.

Absolutely, I think that dynamic has continued where markets are very volatile. However, I also think that this gives a bottom-up stock picker opportunities, where maybe it's one day or maybe it's over a period of time. For example, Waters Corporation, which is a maker of life science tools, mostly for pharmaceutical uses, things like liquid chromatography machines or mass spectrometers, they made an acquisition.

In this case, not earnings, they made an acquisition of some assets from Beckman Dickinson, buying their life sciences division. The market didn't like the deal. The stock was down probably 25 or 30 percent from the pre-announcement to the bottom.

To be fair, we also thought they probably paid a pretty full price for those assets. However, it was not so bad that the company overall deserved to trade down 30 percent. We added to our position. As an example of teamwork, this is a company owned in both global equity strategy, and in our U.S. all-cap strategy as well. The teams



huddled together and we shared our learnings. We talked to management a few different times. We modeled it out through the Monte Carlo process and decided, it's really cheap now.

Since then, the stock has recovered all of the draw. That is an opportunity for an investor like ourselves that could take a longer-term view and have a more nuanced way of looking at valuation, rather than just being driven by psychology and momentum.

**[08:58] Rob Campbell:** I definitely want to come back to valuation and your thoughts on that a little bit later. Shifting gears a bit: capital expenditures. We had Grayson on the podcast maybe a month or two ago. One of the themes that I took away from that conversation was how massive the current CapEx cycle that we are in.

Of course, a lot of this tied back to AI. It strikes me as quite different than when you were last on the podcast, where there was just such uncertainty. I think one of the things that we were getting from management teams at the time and recently I think Jamie Dimon said something similar in this regard, "When it's foggy out, you drive slower."

This notion of caution, perhaps amongst management teams and with that uncertainty out there, would investments slow down? Can you reconcile this massive amount of CapEx on the one hand, that we see on the AI side, with this notion that there still is uncertainty out there? Is it still the case that in many places, management teams maybe are a bit more cautious with respect to how they're allocating capital?

**[9:56] Jeff Mo:** That makes sense in theory. We're not seeing a lot of that in practice. In the MidCap space where many of these companies, especially the ones that we are more focused on with competitive advantages, probably tend to have more opportunities to grow. Putting AI CapEx aside, having been a great and huge driver of activity, it has really been kind of driving the economy in the last year and a half.

When we look bottom-up and look at companies maybe only peripherally exposed and not exposed at all to the AI data center build out, we are still seeing companies building new manufacturing facilities. Whether it is a retailer opening new stores or companies including OSI systems, which is the world's largest order scanning and cargo scanning equipment maker.

They continue to build more facilities because demand is at record levels right now. And not just in the U.S., which you might expect given the current administration's focus, but also in many other parts and jurisdictions around the world. Companies that are well-positioned and competitively advantaged continue to stand and meet the demand that they see.

The economy is still growing. The unemployment rate, a lot has been made about incremental hiring being a little bit weaker recently, but you have to remember unemployment rates have been near historic lows for two or three years now, since the COVID spike normalized.

Things are relatively healthy. People have shown some statistics and if you completely remove all AI investment, the U.S. economy is flat or maybe slightly in a recession.

If there was nothing to be done in AI, I would imagine that money would have gone somewhere else. For



example, one thing I think that has actually been delayed slightly because of the AI build out is reshoring. One example is pharmaceutical companies. They've made more CapEx announcements in just the past 12 months than they spent in CapEx over the last decade in the U.S.

Some of these announcements might not come to fruition partially because of the Trump administration's desire to reshore. Some of the pricing dynamics and discussions that were had between major pharma companies like Pfizer and the Trump administration drove some of it. I think a part of it is just a desire after COVID for supply chains to be tighter. This recognition that if you have all your precursor ingredients and supplies being made in India or China, and then global pandemic hits, you might not be able to access the right drugs in a timely manner. That would be a great example of a reason to reshore, or TSMC and Intel building semiconductor fabrication plants in the U.S.

There's general manufacturing on shoring, and not just because of tariffs. Although, tariffs are probably accelerating that and because of the learnings from the pandemic, supply chains got a little bit too stretched globally. One way to kind of manage that is to have more localized manufacturing. Things like robotics, there continues to be advancement in the gap between offshoring to a lower labor locale and just having a more automated factory in North America. That gap continues to close and there's a lot of themes driving it.

The reason I'm saying some of these things are delayed is that, when we look at engineering companies, HVAC installers, and electrical installers, they're all backed up and backlogged out two, three, or four years in some cases. This is crazy, because when I looked at these companies pre-AI boom, they would have three or six months of backlog, maybe, and that was a good situation for them.

**[13:37] Rob Campbell:** But you're saying it's not just the data centers.

**[13:40] Jeff Mo:** For example, if a mid-cap company wants to build a new ball bearings plant in Arkansas or something, and needs to install electrical wiring, the electrical contractor says, "Yeah, I'll do it in 2028, because all the AI guys are paying metop dollar to install electrical wiring in the data centers and you can't afford to pay top dollar to run basic cable in your ball bearings plant." So, I think, things like that is where the AI boom is actually backing out a little bit of other investments.

And so I don't think—absent AI boom—that the economy is in recession. I've read a couple of mainstream media articles about that and I personally don't believe that.

**[14:19] Rob Campbell:** Have there been many adjustments to the portfolio as a result, Jeff? You mentioned those HVAC companies, whether it's them or others, has this shifted your thinking or created investment opportunities for you?

**[14:29] Jeff Mo:** Yes and no. Ultimately, it's a bottom-up stock selection process. Being macro-aware allows you not to overly concentrate in areas that could have pitfalls.

Earlier, we made a comment that while you have two companies that may have the same competitive advantages in terms of valuation—I mean, I don't know of two companies that are exactly the same—but where one serves the low-end consumer and one serves a medium to high-end consumer, you have bifurcations, and you would





make trades or view things like that.

Maybe a company like ITT, which we recently added to the portfolio, that may have been driven a little bit by the fact that they're operating in a reasonable environment. So, ITT is kind of an industrial conglomerate, they call industrial processing. They have things like loaders, bearings, and different little products that go into other industrial equipment.

They have done a very good job under the new CEO who's been around five, maybe six years. They've done a good job of turning around their operations and increasing margins. They were starting to go on an acquisition path, but then they started to turn around those acquisitions. Primarily, it's a bottom-up story around decent competitive advantage, a strong management team and a lot of runway.

But a lot of runway, an aspect of that is our view of the end markets they operate in. That's always how macro plays a role in the bottom-up process. It's not a hundred percent bottom-up, but it's primarily bottom-up.

**[15:55] Rob Campbell:** To stick with that bottom-up theme, we've talked rather thematically so far. I have appreciated how you've woven in these aspects of, just company by company, what you actually look at. Instead of asking you a question that's more thematic in nature, I want to ask you a real bottom-up one directly. Specific companies or industries, what's got you really excited today that you picked up on?

Whether it's because some market dislocation has happened that presents an opportunity, or it could be just a new or newer management team that just makes all the difference in a business. What's really exciting in the portfolio today?

**[16:27] Jeff Mo:** I find defence really interesting right now. That industry has gone through its ESG rollercoaster of a journey. The internal view at Mawer is that, as long as the products and services help to prevent wars and prevent further death, that's probably net a value add to society, especially in a global environment that's much more open to conflict.

I point to probably our current top holding, CACI International. They're a U.S. IT defence contractor. The bulk of the business today is still what you would imagine an IT contractor does, except in this case for the Department of Defense or the various branches of the military.

They would go into the Air Force and help them implement an ERP system and move to the cloud. They'll help the Navy have a system where Naval Command can communicate with the ships in a way that's very secure and seamless. They'll do projects like that.

But over the last 10 years, this management team, in particular, has done a really good job of pre-positioning the company in emerging technologies. After the Russian invasion of Ukraine, some of those recent technologies emerged. I'd say probably 25 percent of their revenues now are coming from emerging or emerged technologies.

Most prominently, counter-UAV. Jamming drones and forcing them to fall out of the sky, they would have some of the technologies to do that. In one case, they can carry that thing around on a backpack, as an example. They



also have technologies to allow for more secure and unjammable communication.

You've probably heard about the RF radio frequency jamming going on in the Russian-Ukraine front lines. The U.S. government has seen that and recognized the weakness of radio communication, RF communication through Wi-Fi and, so on. They're helping the U.S. government build out an optical communication network.

So, optical or visual, using light. It's really cool. I don't know the full technology behind it, and in my mind, I'm imagining a very sophisticated Morse code-style communication, where you just kind of flashlight each other and you communicate that way.

The CSCI has talked a little bit about it in the public domain. There are some classified things, so I don't know exactly how this technology works. Things like that, where 10 years ago they started investing in this and today they're the leader. In fact, I read somewhere, and I don't know if this is true or not, but I think they're the only U.S. provider of counter drone technologies to the U.S. military.

I imagine that over time other companies will do that too. It gives you kind of a sense of their lead.

**[19:01] Rob Campbell:** Long-term thinking, positioning your business for the eventual threats that might emerge.

**[19:06] Jeff Mo:** Correct, yes.

**[19:07] Rob Campbell:** Well, I do want to ask you one last question, Jeff. I promised I'd come back on the topic of valuation. Certainly, it's very topical in markets lately. We usually hear that, and to your comments earlier about mainstream media, it's often in the context of the S&P 500 lately, with respect to AI beneficiaries.

Can you speak to valuation more generally as you see it across the U.S. landscape and particularly with respect to the mid-cap space where you're focused?

**[19:33] Jeff Mo:** I would say valuations are actually decent in the mid-cap space. It could be because mid-caps, and I'm talking as index now, have underperformed large-caps for several years, if we're being generous.

**[19:46] Rob Campbell:** And, more recently, I think it's underperformed small-caps too.

**[19:48] Jeff Mo:** That's true. Small-caps have recovered, but mid-caps have generally kind of stayed flat. Looking at numbers on the Russell mid-cap, as of mid-November when we're recording this podcast, I'm seeing 21-times trailing and 17.5-times forward P/E.

I would say, for the health of the economy and for what we're seeing in the macroeconomic environment, these seem like reasonable valuations. They're not cheap. I've been around long enough to remember high-quality companies trading at 10 times P/E back in 2009, but they're not crazy expensive either.

So much attention and probably passive flows have gone toward large-caps. To your point, I think recently there's been a narrative that small-caps have been left behind, so some money has kind of flown into small-caps as well. But the mid-caps are hanging out there and going, "well, what about us?"



We're happier because we can see the default capital into great companies at pretty reasonable levels of valuation. When we do our discounted cashflow models, we come out with an implied internal rate of return for the kind of price that we're paying. And generally, we're looking at nine percent perpetual returns, and in a few cases, even ten percent. That is pretty robust. That's kind of the century-long average for the S&P 500. Things are looking decent on valuation.

You have pockets of things that are expensive. Many stocks that are very obviously exposed to the AI theme, at least on an optical basis, on a P/E basis, are looking pretty high in their price-earnings ratio. On occasion, if you model out the company and you have some pretty robust assumptions for the next few years, they can still make sense.

By and large, I believe our portfolio probably is underweight AI, although AI is a little bit harder to figure out right now. There's no sector. AI could be anything from installing electrical lines, to pouring foundations for data centers, to NVIDIA and the chips, and all that complex that people understand and naturally attribute to AI.

I think the valuations are pretty robust there, and we certainly have been finding it a little bit tougher to find good, well-positioned companies with long-term longevity there. Putting that piece aside, I think everything else in the market looks quite reasonable. In fact, a few places are starting to look pretty cheap. Might be that people have overlooked those areas because of this AI investment theme.

**[22:10] Rob Campbell:** That's a bit of the theory behind the strategy. It's less concentrated thematically and more focused on this vast array of companies across industries that, perhaps, many of us haven't heard about and not necessarily the smallest of caps. We still want companies with established competitive advantages, but sort of under the radar, and with the added bonus of perhaps valuations that are relatively more attractive than in other parts of the market.

Jeff, appreciated the tour today. I know we covered a lot of ground. I really appreciate all the work you do for us and for our clients.

**[22:43] Jeff Mo:** Thank you for having me on, Rob.

**[22:45] Rob Campbell:** Hi everyone, Rob here again. To subscribe to the Art of Boring podcast, go to mawer.com, that's M-A-W-E-R.com forward slash podcast, or wherever you download your podcasts. If you enjoyed this episode, please leave a review on iTunes, which will help more people discover the Be Boring, Make Money philosophy. Thanks for listening.

