the art of boring™

EP 138 | Vulnerabilities vs. Triggers

Rob Campbell (00:00):

Hi everyone, in today's episode, Portfolio Manager Christian Deckart joins me to talk about non-predictive decision making, a framework that very much encapsulates what it means to "be boring" and managing portfolios.

Christian lays out what non-predictive decision making actually means, and specifically the important difference between triggers and vulnerabilities. Christian later shares his views on some of the more important vulnerabilities that he sees in the world today. And so here we go, my latest conversation with Christian.

Disclaimer (00:51):

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Rob Campbell (01:08):

Christian, welcome.

Christian Deckart (01:10):

Thank you Rob.

Rob Campbell (01:11):

Christian, one of the most common questions that we get when speaking with clients is, "what's your outlook looking forward and how is your strategy positioned accordingly?" And I do ultimately want to ask you that question. You manage our Global Equity strategy, you're our deputy CIO; I know you've answered that question lots of times before, but before we actually do that, I'm wondering if you can pick the question apart for us a little bit first. Does that sound all right?

Christian Deckart (01:35):

Everything you say sounds all right to me Rob.

Rob Campbell (01:37):

Perfect. Well, thinking of the question—what's your outlook and how are you positioned accordingly—at least the way I see it, there are a couple different elements that are at play. First, that we indeed have predictions. The second, [when] looking forward that there's a specific time horizon in mind, I suppose, with respect to those predictions. And then finally, and I think this is the one I really want to dig in with you with respect to this podcast, is the implied causality. That these predictions that we may have about the future and that form that outlook have a direct impact on how we position the portfolio.

So, maybe let's just start there. Is that the right way of thinking about the question? And then focusing on that third element and the link between predictions and positioning of the portfolio, how do you think about that in managing the Global Equity strategy?

Christian Deckart (02:19):

Yeah, at Mawer we often say, "prepare, don't predict." So, we think the future is inherently difficult or probably I should better say, impossible to predict. However, prediction is the way how some people would say, "well, it's the way forward." And we think more of this term: non-predictive decision making. So, the question is, well, how can we make decisions about portfolios, about single securities, acknowledging that we do not know the future, that the future is uncertain. Maybe a useful mental model that, Rob, you and I have spoken about a few times over the last four or five months, is the idea to separate an event we see in the world into vulnerabilities and into triggers.

I mean, we've played around with this thought—you, me, I remember Paul Moroz over the years—we've played around with different themes here. The oldest recollection I have of us playing around with this was actually a question, "how do you invest and how do you manage risk?"

Christian Deckart (03:22):

And I remember telling the story that I said at the time—my daughters were, I think, three and four, so, I have a pretty good idea that this was five years ago [laugh]—and someone asked me about a particular prediction, and I said, "well see, I'd like to answer the question completely differently. Imagine I have my two daughters and they're on a hard stone floor and I ask them to balance a really tall stack of China plates, expensive China plates. And then one approach would be that, well, we bet on which daughter gets furthest on that stone surface as they walk, and which one drops the stack of plates first. You could look at them and you could say, 'oh, this one moves more stably, and this one is older, and this one seems to be more cautious,' but you're predicting. The story, the way we told it at the time was, 'but wouldn't it be smart [to] simply not to have your daughters walk with expensive Chinaware over a hard stone surface?'"

And I think that was the first time we tried to conceptualize this idea of vulnerabilities and triggers. So, the vulnerability here obviously is to have a three and four-year-old walking with expensive stuff in a fragile environment. And who knows what the trigger is! Maybe one of them trips, maybe one of them starts making a joke, or at that age, pushes the other one. All [are] possible. So, our view has always been, well, we would rather avoid the vulnerabilities than being in a situation where we have to predict the triggers.

Rob Campbell (04:46):

But just thinking as somebody who reads the news every day… everything seems to be focused on the triggers themselves as opposed to the actual vulnerabilities. Would you agree […] we as humans tend to be predisposed to focus on the events as opposed to those underlying vulnerabilities?

Christian Deckart (05:04):

Absolutely. And I think there [are a] number of reasons, actually. First of all, the trigger is more visible. When something goes wrong, it's more visible. I think the trigger usually directly precedes the event, so, if in my plate example one daughter pushed the other one, well, then the pushing would immediately precede the China being broken. And then, I think the triggers usually are just more spectacular. They're the stuff that ends up in the news.

I'd like to introduce another example, Rob, for the listeners and viewers, because that's an example you and I have talked about earlier this year[—the] concept of forests. So, if you think of a dry forest, our view is, well, [we'll just avoid the] dry forest because there might be a wildfire starting any minute. Now, one approach you could also take is you say, "no, no, we go in dry forests, but, what we will do is we will have this huge team of people that watch the forest and they're going to tell us when there's a train going through that might [let off] a spark, and we're going to watch the sky to see if there's any thunder coming down."

Christian Deckart (06:09):

And I think ultimately our approach at Mawer to this is, no, this is not how we are doing it. We prefer to go to a rainforest rather than to a dry forest. Because in the rainforest, the risk of a forest fire is just a lot lower. And yes, if you are a firefighter, going into rainforest is a lot less spectacular, a lot less tempting, a lot less exciting, but we think ultimately for clients' money, it's the safer choice. Which might bring [back from your mind, Rob, the motto] of the firm, "Be Boring. Make Money.™"

There was a blog that I think Jim Hall did maybe 10 years ago that said something like, heart surgery should be boring, flying an airplane should be boring. We're not looking for that excitement. So if we want to avoid not running into a forest fire, we would rather pick a rainforest.

Rob Campbell (07:01):

Okay, so if you go to a hospital, you don't want it to be like Grey's Anatomy or ER [laughs], you would be a lot more boring than that.

Christian Deckart (07:06):

Yes, the way we express this thought now is maybe the way you and I and we at Mawer express it, but the fundamental thinking like that has been shaped by other people. And I do think back [to] Charlie Munger, who I think has the expression… said something like, "we haven't learned to clear five-foot hurdles, we've just learned to be patient and keep looking for one-foot hurdles." So, that's also avoiding a vulnerability.

Rob Campbell (07:28):

That sounds a little bit like Warren Buffett. Didn't he say something like, "you know, if you're an investor and you've got an IQ above 130, you can basically give the rest of it away"?

Christian Deckart (07:36):

Something like that! And I remember an event maybe 15 years ago, where I went to a conference and I came back from that conference to my colleague and I told him of all these complicated investment cases people had talked about, and I just gave back my impression, I said, I think some people that are really intelligent, they have the urge to look for investment cases where they really need all their intelligence [laughs].

And I think that is in a way the opposite of non-predictive decision making—the trick is like, no, look further until you find those one-foot hurdles. We try not to get lost in the things that require a lot of predictive ability, but in the simpler ones, where we can just observe in the present moment what the odds are.

Rob Campbell (08:19):

I'm thinking as you're describing a lot of that Christian, that a lot of it comes back to first principles as well—just in terms of thinking less portfolio-wide, but just about specific businesses that we invest in. I'm wondering if that concept of triggers-versus-vulnerabilities can apply there and non-predictive decision making.

Can you walk through the investment philosophy that we have and just how that might be embedded in the three elements of it?

Christian Deckart (08:43):

Our investment philosophy is to invest in wealth-creating businesses that are run by excellent management teams and that we can buy at a discount to intrinsic value. So, I think a great business is less vulnerable to changes, recessions, and so on. Or should be less vulnerable, and so on, to any changes. Competitive advantages should give companies a better chance to continue to earn wealth-creating returns. Same thing with management teams. If you have aligned management teams that are aligned with shareholders, that have skin in the game, that's just avoiding the vulnerability that in tough times management might otherwise run away from you or not act in your best interest.

Rob Campbell (09:24):

That really puts it together for me. So, if you're looking at a company and analyzing the management team, the trigger would be, "hey, can I predict when the CEO might leave for another job or another opportunity or to retire…" whatever it is. That would be predicting triggers. Whereas if you just focus on management teams with skin in the game, or avoiding those that don't have skin in the game, you're suggesting that that's more like the vulnerability aspect of assessing management teams?

Christian Deckart (09:48):

Exactly, yeah.

Rob Campbell (09:49):

And then the third element—?

Christian Deckart (09:50):

If something is priced for perfection, that's just a vulnerability because any deviation from the plan can impact the value of the business negatively compared to the price you've paid. So, I think our investment philosophy is built to avoid vulnerabilities or to build a "margin of safety," to use the words of Ben Graham.

Rob Campbell (10:09):

Okay, great. So, that's kind of at the individual business level, but bringing it back to the portfolio level—so, non-predictive decision making portfolio-wide—I can imagine that diversification is a pretty central element to that.

Christian Deckart (10:22):

Diversification is important because the lack of diversification would create a vulnerability in and of itself because the fate of a single stock could then be very much married to the fate of the portfolio.

Rob Campbell (10:34):

How do you think about redundancy in that context? I get that exposure to a wide variety of businesses that operate in different parts of the world that could add diversification to the Global Equity portfolio... But redundancy—I mean, if you find a business model that you love, is it worthwhile from a portfolio context to maybe have two of them in the portfolio? In the sense that you know anything could happen in one of the businesses. Does that redundancy add to reducing vulnerabilities?

Christian Deckart (11:01):

It may or may not, depending on the particular circumstances of the company, of the investment in question. Is it the same country? Is it exactly the same exposure? So, that is something that has to be answered at the micro level, and that is obviously where we spend most of our time, but I think it's hard to answer that in isolation.

However, when I hear the word "redundancy" from you, I would think that one of the main tools we use here to introduce redundancy and reduce vulnerabilities is our cognitive diversity—because the fact that several people look at stocks here and we all try to rank our investments according to quality and valuation. From the outside, if you came to our company as a business consultant, you might look at this and you might say, like, "a lot of the things you guys do is redundant [laughs]. You could take out a lot of these people; many of them seem to do overlapping things!" And we think: yeah, that is on purpose! We want different cognitive backgrounds to look at the same problem because we want to see the investment from different angles. We think that helps us make best ideas win, which ultimately is in the benefit of our clients. That's actually what came to my head when you said the word redundancy.

Rob Campbell (12:15):

Thinking at the portfolio level, how do you balance being an active manager expressing conviction based on all the research that you've done, and yet staying non predictive? Those are kind of two ends of the spectrum. What's the right medium? Or how do you think about that?

Christian Deckart (12:28):

We have a tool here, The Matrix, that some of the listeners or viewers will have heard of before. So, it's the idea that we rank all our investment ideas on two axes, the quality axis and the return potential axis (the valuation axis). And we're looking for the best combination of, quality of an investment of a company and the valuation we get. And obviously, the less of a trade-off we have to make, the higher quality we get at the better valuation, the higher we would make a weight.

For some of you that might resonate, and you might say, "yeah Christian, you're just describing Kelly criterion." And in a way I would say, yes, absolutely I'm describing Kelly criterion. The twist we have here [at Mawer is that] we have a guideline cutoff at 6%. So, even if we found something that is really close to this best quality at the best valuation, we would do a 6% cutoff. Because first of all, the future's always uncertain [laughs] and so that's where we would definitely be non-predictive. The second one is, even if we think something is really good and [has a] really attractive valuation, that may not be right—we may make an error in today's assessment.

That is the balance. We express conviction by weighing ideas according to how good we think the trade-off is between quality and valuation. But then at 6% we do a cutoff because the future is always uncertain, and we don't want to risk too much of our client's capital in one idea.

Rob Campbell (13:52):

So, roughly 60 stocks is kind of where you end up in terms of balancing those?

Christian Deckart (13:58):

In the Global Equity portfolio, I think we end up in the 50 to 55 range now.

Rob Campbell (14:06):

Okay, so, all the conviction in the world—I'm glad we've got limits on that. But that brings another question of balance, which is how do you balance incredibly deep research relative to that humility that I know is so important as investors?

Christian Deckart (14:18):

There [are] two extremes you could take. I'll just describe two extremes and then I'll tell you what we're doing. I don't think these extremes exist out there in that extreme, but one extreme could be you say like, "I can know everything about a company. If I just count cars in front of all McDonald's branches in the world every day, I will know more than others, and I can totally know what is here today, how the world looks today, and how it's going to unfold. And therefore, in an extreme scenario, why would I own more than one stock at all?" With research and then very high conviction.

Christian Deckart (14:45):

On the other end of the spectrum, you might have a very nihilistic-almost approach where you'd say like, "oh it's all around mental models and I don't need to go deep and who knows?" And our approach at Mawer is, I would say (well, in my opinion) a gold middle between the two, where we do a lot of deep research.

Last year we interviewed roughly a thousand management teams. We aim to talk to customers, competitors, suppliers. We do forensic accounting on companies to see if numbers have been manipulated. And then after we've done all that work, we step away and we say, "good work, and, we still do not know." All we have done is we have narrowed down the probabilities. We still don't know the future and probably even our understanding of the present is incomplete. But again, what we have done, we have narrowed down the probabilities.

So, I think it is this combination of, yes, willing to do a lot of hard work and then after the hard work, acknowledging that also there's benefit to the other approach to say, the future is not predictable.

Rob Campbell (15:48):

What are the benefits of focusing on the vulnerabilities as opposed to the triggers?

Christian Deckart (15:52):

There are several aspects. The first one is a vulnerability, the drive force, that is observable to the skilled eye. Or you could measure it. Like, we measure returns on capital, we measure management alignment, and aspects like that. Triggers… If you think of the investment situation, triggers are things in the future that are not observable yet. They are just theoretical risks. So, trying to find triggers is inherently something where you make a prediction about the future, while the vulnerability, you look at something which is actually there today—which you can observe and which you can even measure.

Because we want avoid the combination of vulnerability and its trigger. It's easier in maybe the intellectually more humble approach to mainly focus on vulnerabilities, as just statistically speaking, over time, every vulnerability will meet its trigger at some point in time. The bigger the vulnerability, the more you would expect that it will be encountered in a shorter time period.

Rob Campbell (16:53):

If I push back on that for a bit, I mean, you are managing an equity portfolio, our clients are paying us to take risk. Is there a risk in a non-predictive approach that really seeks to avoid vulnerabilities? Does that become a risk-minimizing exercise? And does it cause us to miss out on opportunities that our clients might expect us to take a chance on?

Christian Deckart (17:14):

I have two answers for that. First of all, a narrow one. Well, you could totally avoid vulnerabilities, or you could accept them, monitor, and manage them.

Christian Deckart (17:34):

I'll give you example of why that might be reasonable. I'll talk about our Global Small Cap asset class. In small caps often you have to take a vulnerability, which is dependence on a few key personnel. That's just the way it is. A company with a few hundred employees [are more dependent] on the CEO or a few people at the top than at a very large company like, say, Marsh Mac[Lennan] or BMW. Or, if I take the example of our Canadian Large Cap [strategies, Canadian Small Cap [strategies], they just don't have an endless universe, so you have to take some vulnerabilities. The other, however, bigger zoom-out point is that, as you said Rob, as equity investors we're not paid to avoid risk and we don't do that.

The trick is to find mispriced risk. So, to find risk where the market for some reason, well, really shies away from a risk and therefore misprices a security. And that is then where the fundamental analysis of a security starts and where we do the work. And then for listeners in Alberta, after you and I had spoken about wildfires in March, Rob, in May, we actually got wildfires pretty early in the season and the kids had to stay inside in school and it was unpleasant during their breaks, and so on. And so if you had offered a wildfire insurance to families in Alberta there and said, like, "you have to pay X dollars and we ensured that the air stays clean," probably people would've taken that right after the wildfires and the insurance could have priced that really highly. Why? Because, well, people are always afraid of the last catastrophe.

Christian Deckart (18:51):

That's how we're wired as humans. Or, as I think in military they say, "generals always fight the last war." So, what we find in investing often is once a wildfire has happened, there is actually good opportunities to pick up securities at a bargain in these sectors. Also, keep in mind that after a wildfire has gone through a forest—(and I'm not sure if you've that present in your head, but how a forest looks after a fire's gone through)—I can tell you [for] the next 10 to 20 years it is unlikely that that forest burns again, because everything that's combustible is just gone.

So, what I'm saying is, no, avoiding is not our only strategy. Mainly, you want to find mispriced risk. And then often you find mispriced risk actually where wildfire has happened just before.

Rob Campbell (19:37):

One of the things you said there triggered me because this idea that "the generals fight the last war..." people are predisposed to kind of avoid things that are burned. And just going back to the initial part of the conversation where we talked about how human beings are just predisposed to focus on the triggers—how do you coach this? You're one of the leaders within our team. Like, what are things that you do to help people on our team think about portfolio construction in that way?

Christian Deckart (20:01):

Well, first of all, you teach it through the philosophy and you teach it through the process. Our whole process is there to keep emotions out and so that we slow down, that we reflect about our biases. This is also where the cognitive diversity helps us. And then on the coaching aspect, when people join Mawer, they go through an analyst training program, they go through cultural indoctrination. So, I think we do a lot of work to familiarize new joiners with our ways of working together and of thinking about risk and uncertainty.

Christian Deckart (20:31):

Again, coming from the main thought that in our opinion, the world is inherently uncertain and yes, we need to do all this work to narrow down the probabilities, but once we've done all that work, we have just only done that. We have only narrowed down the probabilities. We obviously still cannot predict the future.

Rob Campbell (20:54):

I wonder…maybe just to play the other side of this, are there ever moments where the signals are so strong that you really ought to throw this whole non-predictive thing out the window?

You've been investing for a long time, so I'm curious about your career, but I'm just thinking more recently if there were clients who might've said, "well, it wasn't obvious that inflation pressures are building and we'd have these massive rate hikes? Shouldn't you have taken a bet in the portfolio in a particular direction at that time?"

So, I'm just curious, thinking back on your career, how often do these opportunities arise where it's a priori the right move to move away from a non-predictive approach?

Christian Deckart (21:29):

Well, I think you stick to that non-predictive approach, and you can do these… you call them "calls" or "bets," but they're not really bets in my opinion, they're something different. You can make these with a non-predictive approach, and I'll give you an example.

Interest rates in the inflation and interest move in 2021—at that time, inflation had started, rates weren't up. And when we put stocks on our matrix, when I looked at the Global Equity matrix, we could see that some securities just didn't pay us for the duration risk we would take. So, I have to zoom out here—the duration risk is the idea that the higher interest rates go, the more stocks are vulnerable that have their cash flows further out into the future, so, think tech, growth stocks, and so on. As we looked at the valuation of companies in 2021, we found that the duration risk is one that, well, that vulnerability had always been there and then it maybe became even a bit more concrete because one could already think of the trigger, but it was mainly the vulnerability. And we looked at that and after stocks had appreciated, we didn't find that we got compensated for it.

Christian Deckart (22:35):

So, it was less a predicting-exactly-what-would-happen, but looking at something and just saying like, "I don't like the price of this." I don't like not knowing how the world's going to unfold, but just given that there are several things that could unfold, I don't think this is priced for that.

Because you said career… There is one point in my personal career, so, in my professional career where I did take a bet—and I as I think about that, I think this is very similar to how I think about investing—there was a point in time 20 years ago where I had two offers. One from a broker in Germany and one from a broker in England. And the offers seemed fairly similar. It's a bit like buying a stock: at first you don't know; what is the best decision will depend on the future.**Christian**

Christian Deckart (23:17):

I remember looking at it at the time and thinking, well, where's the downside lower? And I used what in German law we call an "anyways" argumentation. So, "in any" case argumentation, where I said like, "I will pick the London route because if this doesn't work out and if it's not pleasing for me, 'hey at least, anyways,' I will have lived in a foreign country. And so even if the career move itself didn't work, I have won something anyways."

If I abstract that out to investing, the logical figure is you try to look for things where the downside is limited. Where on the downside, definitely you have something—ideally, as much as you put in—and there is an upside. Other people might call that an asymmetric payoff profile or a positive skew. For those deeper into math, you would call that convexity. So, basically if something goes wrong, nothing happens. And if it works, it's great. Basically, having the China-plate example of my daughters but have them do it on some protective mat so if they drop it, nothing happens.

Rob Campbell (24:18):

Sounds good. Well, let's go back to the initial question which was, "what's the outlook and how you position the portfolio?" I'm gleaning from this conversation that's sort of the wrong question based on the way that we manage portfolios. It's more, "Christian, where are you seeing vulnerabilities right now in the world that you think investors should be paying attention to?"

Christian Deckart (24:37):

I don't know what other investors should do, so, having [a] law background, first of all, I'll rephrase your question, I'm sorry Rob! [laughter] "Christian, what are you paying attention to?"

I'm paying attention to and I'm fascinated by the higher rates out there in the world. Higher rates are different from my kids dropping plates on stone. Higher rates don't do damage immediately, it's going to take time. So, as I watched the higher rates, what's happened here in the last year and a half… I think long duration stocks, companies with a lot of debt…you want to think really well about those vulnerabilities. And it doesn't mean we will absolutely shy away from that, but that is one vulnerability that you definitely want to get compensated for if you take it.

Rob Campbell (25:19):

Just to clarify, the higher rates—are those the trigger or the vulnerability?

Christian Deckart (25:23):

Well that's an interesting one. So, the most underlying vulnerability is probably when companies have too much debt, when maybe even a business model doesn't really have a justification for existing in a normal interest rate world. So, where we're back to rates between 5% and 10%, that might be a vulnerability.

And then the rates… are they still a trigger? At this point in time, I might say like, "higher rates…we're learning to live with that." That might be part of the overall vulnerability now. That's an excellent question.

Rob Campbell (25:51):

It sounds to me like it might be a bit of both, in the sense that I've heard you use this example—I have a friend of my own who flips houses—and I think the question was, was this a genuine business model or did this person in a very low interest rate environment simply benefit from being able to go back to the bank, borrow again, and know that the asset will have gone up in price two years later?

The vulnerability there was the business model, the trigger was higher rates. But I think if I'm understanding you correctly, we've maybe moved past that, with some of that having gotten washed out. Maybe not all of it, but that the actual vulnerability right now might be the higher rate.

Christian Deckart (26:26):

For some companies. Now, a trigger might be simply that they need to roll a loan, that they need to renew their credit agreement and the bank looks at it and the bank says, "with the amount of earnings you make, you are not good anymore for that old amount."

So, the trigger today in this world might be the bank renewal. Because, if we get back to the previous idea in the very beginning where I said vulnerabilities are things you tend to be able to observe in the present moment, you do not need to predict—I think higher rates we can observe in the present moment. So, we could argue well, that is part as of today—July 2023—this is already a vulnerability and risk, or trigger events... now, trigger events that make the risk materialize might be something like a loan renewal or credit markets becoming tougher, or, well, any other event where a company all of a sudden has a higher external cashflow need.

Rob Campbell (27:21):

A vulnerability identified. I think you've talked about one of the pieces, so, avoiding companies with higher debt. Are there other ways that you've positioned the Global [Equity] portfolio recognizing that vulnerability?

Christian Deckart (27:32):

We have made some changes in terms of portfolio duration, but that is in the past. You and I, Rob, know that at Mawer we've spoken about the problem of equity duration and that not all equity returns are made equal. Some are made by taking a lot of interest rate risk. I think we had a podcast on that in 2019, so, it's been something fairly familiar to us. I think that is, again, possibly the last battle already. So top of my head, no, I don't think there's anything else we're doing right now on that.

Rob Campbell (28:00):

What other vulnerabilities do you see out there?

Christian Deckart (28:03):

Well, I think the decrease in global trade and cooperation is a vulnerability on a micro scale to some companies that have relied just on being able to produce in countries with lower labour cost and had some temporary cost advantages there. That's one micro which is actually fairly straightforward to analyze.

On a more macro or global level, what worries me more is that trade in a way is a peacekeeper. Rob, imagine you and I, we're different nations. As long as we trade together, we have a big interest not going [to] war with each other. Because hey, we need each other to make money to trade. And so I think trade has a huge peacekeeping mission in this world. And so as countries withdraw from this community or the world becomes more isolationist—and I mean most countries in the world are on that path—I think a vulnerability we might create is that there might be less voices to speak up against a war if everyone's gotten used to trade only with themselves. So, that's a huge vulnerability. (If I think ahead a decade or about the lifetime of my kids.)

Rob Campbell (29:05):

I know that we haven't held any securities in China within the Global Equity portfolio for a little while—is that basically based on this concept of avoiding vulnerability? Is that playing into that?

Christian Deckart (29:14):

Every investment decision is driven by the Matrix. So, we compare the quality and the valuation of each security. And so, Chinese companies just haven't, in our opinion (the Global Equity team), haven't had a place on the Matrix where they deserve a place in the Global Equity portfolio. Now, why is that? That is a combination of valuation; also legal protection might play into that. There [are] several aspects that play into [it].

Rob Campbell (29:37):

Okay, so higher rates, rolling back globalization or trade… I think a lot of these have been pretty front and centre with respect to headline news over the last little while.

Are there vulnerabilities that you think are a little bit more under the radar that you're focused on or that you think maybe don't get as much attention as they deserve?

Christian Deckart (29:55):

One we think about a lot because it's one that we think there might be a chance that we can exploit it is governments around the world have gotten easier with their cheque books. If we think back about the global financial crisis and then COVID-19, governments have learned that whatever the problem is, if we just subsidize things and write cheques (I'm painting things slightly exaggerated here), then our chances of being re-elected are higher.

And so, I think this has led to a profound change in parts of the population and maybe the willingness to participate in the labour force is getting impaired because, well, governments are creating a large incentive in many countries, not at all not to do tough jobs. So, skilled labor shortage I think is a function or is partly explained by the government's willingness to write cheques. And labour shortages of course can then be seen as an investment opportunity.

Christian Deckart (30:50):

So, we do have a few companies in the portfolio where we think they have a tailwind or they can capitalize on skilled labour being a scarce resource—specialized professionals being difficult to get—and there can be a competitive advantage in having access to such talent.

Also, what plays into this, Rob, is that the world is getting more and more specialized. Knowledge is getting more and more specialized. We're far away from the days where we were all farmers and basically all did the same thing. One company that's actually a larger holding in the Global Equity fund, FTI consulting, they do all sorts of specialized consulting for court trials and in bankruptcy and so on. That is an example where, yeah, you need skilled labour, very highly trained people.

Rob Campbell (31:35):

My last one just on the vulnerabilities—and you may argue that this borders on predicting actual triggers—but I know you and the Global [Equity] team did some analysis recently just with respect to the recurrence of revenues of the various businesses across the portfolio and sort of loosely bucketing things as either cyclical, quasi-cyclical, or non-cyclical. Have you noticed a change in the portfolio in that regard, and has it been non predictive?

Christian Deckart (32:00):

I would say, you know at Mawer the motto is "prepare, don't predict." So, we may now talk more about what we think is a recurring nature of a lot of the revenue streams our companies have, but I would say it has been there in the past. It's not that we have changed the portfolio to prepare for that.

Something that we've said in the past—I think this is also a saying from Jim Hall—is, don't fix your ship in a storm. The comparison I have is, when you go out of the harbour and try to cross the Atlantic by boat, you don't go out there and say like, "oh, my ship is not ship-shape, and I'll fix it when there's any problems coming up—when I see the clouds gathering." Well, then it's probably too late.

So, as soon as we leave the harbour and have the portfolio out there, we want it to be ship-shape and to be able to withstand a storm, because again, we think predicting storms is very difficult.

Rob Campbell (32:47):

Okay, and this might be another one, I presume, where rates [are] kind of involved here with respect to either the vulnerability or the trigger when focusing on why recurring revenue might be so important.

Christian Deckart (32:58):

Recurring revenue is so important because, well, it makes it economically less sensitive to the business. So the business can plan better and there is less risk of a revenue shock to the company, to the organization. The worst thing a company can have—I shouldn't say the worst thing. One of the really bad things that can happen to a company is that all of a sudden it depends on the kindness of strangers. I.e., needs to ask other people for money. Not great if you have to ask shareholders for money, but certainly worse if in a stress situation you need to go to the bank or to the bond market. And yeah, if you have recurring revenues, sale revenues, the odds of that happening are just lowered.

Rob Campbell (33:38):

Well Christian, I appreciate you coming on, I appreciate you talking about the theory behind non-predictive decision making, how it actually plays out in practice in the portfolio. And if nothing else, I was thinking from this conversation the next time that I'm planning a trip to the Caribbean, I might get a great deal if I time it right in the fall during hurricane season, but a better non-predictive approach might be to pick a time in February. I might pay a bit more, but I can be better assured of a better outcome for my vacation.

So anyway, thanks Christian—always appreciate having you on the podcast.

Christian Deckart (34:08):

Thank you Rob.