Foresight: The CPA Podcast

Season 4 Episode 2: Managing investments in uncertain times

Neil Morrison: Welcome to Foresight: The CPA Podcast. I'm Neil Morrison.

This season, we are looking at navigating uncertainty. It's certainly a timely topic. We did just emerge from a global pandemic, and then there is the threat of recession over the horizon. And one sector of the economy that is exquisitely sensitive to the volatility of the current economic outlook is the world of investing.

On this episode, we are speaking with Anish Chopra. Anish is a CPA and the Managing Director and Portfolio Manager at Portfolio Management Corporation. Prior to this, he oversaw over 100 billion dollars in investment management mandates as Managing Director of the Innovative Solutions Group at TD Asset Management.

Anish points out, there's no shortage of things for investors to be nervous about these days. Inflation, interest rates, Russia's invasion of Ukraine, and the lingering threat of COVID and other public health threats. But investors are also focused on things like labor shortages and product shortages. In other words, there's a lot to be concerned about.

Anish Chopra: So when you think about all these different factors are all happening at once, they're happening very quickly, and investors have to react to that. And it's tough when you think about the current problem, which is, when will the Fed pivot or change its stances on rates?

Right now, they seem to be following inflation and going up. That's causing some uncertainty. When should an investor go in the market? Investors are concerned that if rates keep going up following inflation, that's a problem. So it's tough for an investor out there. So they're getting tested by the different factors and the different factors all interact and an investor can't get certainty in the environment we're living through right now.

Neil Morrison: You've been at this for a while. Can you think of another time that's had as much uncertainty as what we're facing today?

Anish Chopra: Well, the uncertainty is always a little bit different and when you look at stock market declines that were rapid as we saw during the March 2020 COVID period, you go back to times, let's say the fall of 2008, that was different though. When you look at the COVID period, there was an element of personal safety, community health, global community health that wouldn't have been there if you go back to the crash in 1987, or the dot-com bubble bursting in the year 2000. You also didn't have that in 2008, but you had a rapid market decline.

But here was something different. At that point, we weren't dealing with significant amounts of inflation. We didn't have labor shortages to work out. We didn't have a product or good shortages to be concerned with. It was really centered around the banking system and US housing.

Here it's much more broad based in the sense that you've got macroeconomic factors having an impact on a variety of different areas. But I would argue what's similar is the uncertainty. It's just the factors around it.

Neil Morrison: Was there any moment in 2008 when, I don't know if panic is pushing it too much, but maybe a deep sense of concern and fear did start to creep in for you?

Anish Chopra: If I go back to the fall of 2008, I remember starting to get in the habit of making sure I was on top of weekend news because generally things were unraveling on Sundays. Whether that was Lehman Brothers heading into bankruptcy, a problem with AIG, the insurance company and its financial services unit. Whether it was Freddie Mac or Fannie Mae, the two US government mortgage companies.

So there were just a lot of events. They seemed to take place on weekends because that gave the US government officials, lenders, time to absorb things because markets close on Friday, but they open in Tokyo on Sunday night, so you got 48 hours to solve some problems. So I would say because it was reverberating all around the world, the leverage problem, that was certainly a challenging period and for a banking sector to go under that's a pretty scary thing.

Neil Morrison: In April of 2022, you said you thought a recession wasn't likely. I'm wondering how your thinking has changed since then. Whether the probability in your mind has grown or decreased or stayed the same, or if you've given up looking into a crystal ball?

Anish Chopra: Well, obviously it's hard to get the answers right in financial markets, so it's a challenge to predict the future. But when you think about whether a recession could come, raising rates aggressively as central banks have around the world is generally a precursor to causing a harder landing. And so far, if you look at a lot of different indicators, despite the fact that central banks have raised rates aggressively, economies around the world seem to have weathered that. But we're still in the early days and it does take time for these things to happen.

So I still think a recession is certainly quite possible, but it's hard to know because there's a lot of factors. The central bank could go and cut rates again rather rapidly. So there's a lot of these future actions that nobody really has a way of knowing. So the future's unpredictable, but if they keep on the rate hike path and you start to get reactions and you are, you're starting to get layoffs in certain sectors like technology - if you look in Canada, the housing sector is certainly slowing. So to expect a slowdown, especially in Canada seems reasonable, but it may take longer than anyone expects for it to really play out.

Neil Morrison: How do you approach this uncertainty that we're facing? I feel like almost dividing this up into two categories, you as an investor and you as a person. How do you make sure, or set yourself up to be able to sleep well at night in an era where there's this much uncertainty?

Anish Chopra: Well, as an investor, you have to be careful about getting too concerned with the macro environment. Generally, things tend to, over time, work out. And I tend to say that the world's at some point will end, but it doesn't end very often. And you get these periods of macroeconomic uncertainty quite regularly but it doesn't mean that the world will end. So how do you manage through it?

When I think about it as an investor, I would say you need to invest in companies where they can withstand pretty tough economic climates. So can they withstand high interest rates? Can they withstand time periods where clients or customers just reduce their purchases of that company's goods or services, but the company still makes it through.

The problem becomes when there's a ton of debt and that debt needs to be repaid in a short period of time. And then you see these bankruptcies. If you go back to 2008, there were a lot of interesting lessons there. Certainly, many companies had quite a bit of debt and then as the economic environment turned against them, like product sales effectively collapsed and then they couldn't service the debt, right? They couldn't make payments of principle, they couldn't make payments of interest, and then the companies went into receivership.

So when you're thinking about it, you really want a company with solid a balance sheet that can last through tough times. A product that's required by the marketplace as opposed to a fad product where people can stop purchasing these, it's just not necessary. As well as strong management teams that can get you through tough times, high returns on capital. So as an investor you have to translate the macroeconomic environment. So sometimes the uncertainty gives you the opportunity to find ideas.

Neil Morrison: What do you mean by that? Find ideas?

Anish Chopra: Well, the valuations of some of these companies come down. So when you're looking at potential investments, there are things that investors may have just said, "Well, it's too expensive, it's too expensive." But for reasons related to the macro-economy or macroeconomic conditions, the price or the valuation of those securities comes down and it's like, okay, it may still be expensive, but the opportunities to get, let's say global consumer franchises doesn't appear very often, but it does appear, right?

So you just have to be prepared and then think through the possible scenarios. So when you look at the consumer staples area, so this would be soft drinks and other sort of products where people are using them on a daily basis. You don't get the opportunity to buy them at reasonable valuations. They trade quite expensive for a reason. And the reason is people buy their products, so the revenue stream, the cash flow streams are quite certain. And it's just in those periods of time when the whole market's going down or sometimes the company itself has a specific issue, but when the whole market's going down, people just have to sell because they want to raise cash. And if you've got a three- or five-year horizon on some of these consumer staple names, it tends to work out reasonably well because they're able to survive as long as their balance sheets are solid.

If you think about it, just as an example, and we don't own it in our current portfolios, but something like a Coca-Cola made it through the Great Depression. You would assume that people would cut back their consumption of soft drinks and you would think the same during severe recessions, but the companies make it through the other end. Sales start recovering. Sales growth may slow, but then it gets back to a higher pace once the economy recovers.

So that would be an interesting example. That whole consumer staples area, so that's like toothpaste, soft drinks, like things that people use. But the companies, the valuations tend to be very expensive, but there are periods when you get your chance. You just have to be prepared to look at the macro and say, "Okay, I'm going to live with this because…," and even if you thought, "Okay, I don't want to take an uncertain bet in a big environment where I have to make a bet on a single company. Maybe I want to bet on a market. So do I buy an index, a product, and just buy the entire marketplace of companies?" Which would be some type of ETF, let's say on the S&P 500 in the US.

So let's say you're looking at March-April of 2020. People were selling just because they needed money. They were very concerned about what would happen, demand's going to collapse. And demand did go down, GDP across the world went down significantly. But the opportunity hasn't really come again to get that in the last couple of years. It will, the opportunity always arises. It doesn't arise on a schedule on a timetable, but there's different ways of looking at investing, right? So you can look at an individual company basis, you could look at it on an entire market basis. So you just have to think it through what makes sense and what doesn't.

Neil Morrison: It also sounds like what you're saying is that you need to take the emotion out of the decision-making process. And I'm wondering, just listening to you talk and the amount of focus that you put on things like balance sheets and the general health of the companies that you're investing in, I'm wondering how much your CPA training actually helps with that, with keeping emotion out of the decision-making process, having that analytical framework.

Anish Chopra: Certainly, the CPAs helped a lot from a very direct point of view. It certainly helps in analyzing company balance sheets and income statements and cash flow statements and the training that you get is very helpful. Now when you get down to managing your emotions, that's a tougher one to master. And I would say it's a bit of a lifelong apprenticeship, right?

So you think you've got it mastered, and I talked to quite a few well-known investors in that 2020, or maybe by the time I was talking it was 2021, and they themselves said they didn't react as well as they normally would have to that level of uncertainty. And I was saying, "Well, there was probably some element of personal safety." It was much more uncertain in the sense that we didn't really understand COVID. We didn't really understand the implications on people's health, how many people across the planet would succumb to it. And then that has obviously, the most important part is health, but it'll certainly have an economic impact.

So I would say on the emotional front, certainly CPA training is helpful, but it's a lifelong apprenticeship and you get tested at different periods. And I would say some periods of uncertainty are a little bit easier as like when I was talking to some of the well-known investors about it, that was something, and they've got a few years on me, and they thought their reaction to the time period or to that era should have been better. They should have been able to take on more risk than they had, but they did not, so.

Neil Morrison: Were you looking back to, you've been through, as you pointed out, you've been through the dot-com collapse in 2001. You've been through the housing collapse in 2008. In 2001, you would've been just not long into the world of investing. Did your younger self react differently to uncertainty? Did emotion come into it more than it does now? I'm wondering if the earlier version of Anish maybe wasn't as successful at it.

Anish Chopra: I would certainly say that. But if you ask me the same question in 10 years, I would say today's Anish isn't as good as the Anish from 10 years from now.

Part of it is just understanding that expression "and this too shall pass." We made it through the dot-com meltdown. We made it through the leveraged finance bubble of 2008. Now it wasn't a lot of fun. And if you were in some of those companies, you were an employee in some of those companies, you were a shareholder in some of those companies, you were a bondholder in some of those companies. Certainly, the ones that didn't make it was a painful experience, and the unemployment rate went up substantially in 2008. So, you do make it through, but not all the companies make it through. And there's tough periods for people.

If you were unemployed from Lehman, it was tough to find work after that for many, many, many years because there were just so many financial professionals looking for work. But when you get some perspective and you live through some of these more severe events, you do get more perspective. And you understand you're going to go through these periods and you're going to live through them, but you will get through it, but you just got to make sure you can get through it, right?

So as an investor, you got to make sure the companies are strong. As a person, you just have to realize the world's made it through the use of nuclear arsenal in 1945. We just somehow, you do make it through, but you do want the highest chances of success of making it through. So you may have to be more conservative in the good times to survive the bad times. And I think that's a big part of it.

But understanding that it takes time, recovery takes time. If you think about 2008, that was really starting in 2007, the mergers and acquisitions market slowed down, effectively closed. And then it took a while for it to hit stock prices and bond prices and then it took a while to hit financial institutions. It just takes time and then. But you do come out the other side, but you do have to have perspective and time horizon. And I would say the younger version of Anish just didn't appreciate the time it took and didn't have the perspective.

Today, it's like, we'll make it through COVID, but there'll be some bumps and bruises for sure. But how do we maximize our chances of success on the investing front? That's just being conservative as an investor. And that's certainly how I've looked at it. And hopefully, I'm a better investor 10 years … That's the whole goal, to be better every day. But it takes time and you need to go through the tests.

Neil Morrison: You have said that it's important not to panic, but what would need to happen for you to not panic, but to maybe start losing sleep?

Anish Chopra: Well, once you start losing sleep, it tends to be that you've structured your life or your investments in such a way that you're unable to handle in a way you would like the economic uncertainty that you're facing. And so it's best to make the adjustments.

So if, just to use some examples, if your allocation to equities or to stocks is too high, and then when they start dropping it's difficult to sleep at night and you're thinking, "Oh, what should I do?"

Well, I think there's a lesson to be learned there that you probably have too big an allocation to equities and you should pare it back. And the test really there was you got tested in your emotions. It's like, I always want to sleep at night. I don't want to have to think about my investments. So how much of a decline can I handle, right?

And then you can say, "Okay, can I handle a ..." I don't know. What's my worst case? If you go to March, 2020, you're looking at down 35-40% in three or four weeks. So, I think the test may be that, can I handle down 40-50% in a month? And you go, "Okay, I think I can do that." But then how do you adjust your portfolio to have more cash, more fixed income and less stocks?

But you have to remember, it's easy to forget these things too. It's easy to forget the lessons and then you tend to go back and be more risk-seeking. So, I think one of the challenges as an investor is to be very even keel. Be as risk neutral as you can be. So, you don't want to be overly risk-seeking, but when the opportunities come, you can't say, "Well, I'm really concerned about this and that."

Well, the market's told you that it's concerned, so now you've got to make a decision probably separate from the market. And how do you do that? How do you have the emotional framework to handle that? So, it takes time to develop that risk neutrality, and I think everybody in the investment business is constantly working at how to get there. Because you don't want to be on the side of too much risk avoidance, right? Because then don't benefit from the upside, but then you don't want to be too risk-seeking because you get hurt when the market goes against you. You sort of have to have that right blend.

Neil Morrison: Yeah, you can sleep well if you find that sweet spot, essentially.

Anish Chopra: Right. But you get tested in the market and the world helps you find that sweet spot during the tough down days, right?

Neil Morrison: Right. Anish, I really enjoyed speaking with you. Thank you so much.

Anish Chopra: Thanks for having me, Neil.

Neil Morrison: Anish Chopra is the Managing Director and the Portfolio Manager at Portfolio Management Corporation. And that's it for this episode of Foresight: The CPA Podcast.

On our next episode, we will be speaking with the CEO of Cirque du Soleil, Stéphane Lefebvre. He tells just an incredible story of navigating uncertainty. Perhaps no company was more vulnerable to COVID than the Cirque. In just six days, the company's revenue collapsed from a billion dollars to zero. Stéphane tells us what went through his mind at that moment.

Stéphane Lefebvre: We go to survival mode, right? We, we being myself and a bunch of people from the management team, we knew that the Cirque du Soleil brand hadn't died. So we knew that this was going to be a tough patch and we will go through this and come back in business in weeks or months. We never thought it was going to be months and years but we never lost faith that we could actually bring back the business and operation. So the first thing that goes through your mind is you got to put yourself in survival mode.

Neil Morrison: Stéphane Lefebvre is the CEO of Cirque du Soleil. If you like this podcast, please give it five stars and a review. Share it, subscribe to it, or follow us in the podcast app of your choice. I know everyone says this but it does actually help the algorithm that helps others to discover us.

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I'm Neil Morrison. Thanks so much for listening.