IN CONVERSATION with chief investment officer ANNE METTE DE PLACE FILIPPINI

By: Lisa Ritchie and Anne Maggisano

In March of 2021, Burgundy's vice presidents Lisa Ritchie and Anne Maggisano sat down with Burgundy Chief Investment Officer Anne Mette de Place Filippini. Anne Mette reflects on a year in which investors navigated through massive monetary and fiscal policy stimulus, unprecedented market extremes, uncertain COVID-19 trajectories and accelerated business transformation in response to the pandemic. Amidst the noise, she grounds us in the fundamental principles of what it takes to preserve and grow capital over the long term.

Anne Maggisano (AM): A year has passed since the COVID-19 pandemic was officially declared. What are you seeing from your vantage point as an investor?

Anne Mette de Place Filippini (AMdPF): In March 2020, equity markets dropped dramatically only to recover sharply once governments and central banks stepped in with massive stimulus programs.

The levels of monetary stimulus that central banks around the world are providing resulted in interest rates falling to all-time lows and into negative territory in some countries. In a matter of just weeks, we saw more quantitative easing than we had seen cumulatively since the global financial crisis in 2007–2009. Seldom have we seen this amount of liquidity in the markets.

Add to that deficit spending by governments in 2020 was approximately 20 percent of GDP in Canada, and 15 percent of GDP in the U.S. Most of the fiscal stimulus has not been on long-term spending such as infrastructure spending, but rather, it has been aimed at putting cheques directly into consumers' hands. This meant that personal income rose at the fastest rate in decades despite widespread job losses and higher unemployment. This is counterintuitive. Normally, with higher unemployment numbers, we would see personal incomes under pressure, but

Anne Mette de Place Filippini at Canada's National Ballet School, where she serves on the foundation board.

in aggregate we did not see that.

In addition, markets have been responding to positive vaccine news and this has helped extend the rally. This explains why equity market indices are now higher than they were pre-pandemic.

Lisa Ritchie (LR): Crises are often great levelers. This has not been the case with this pandemic.

AMdPF: It has been devastating to see the pandemic exacerbate and amplify existing socio-economic inequalities around the world.

Wealthier countries have more room to stimulate with both fiscal and monetary policy measures. If you can print your own currency and run your own monetary policy, you have much more room to manoeuvre. But in some developing countries the negative impact on businesses and consumers has been more severe. For example, in Mexico, GDP was down more than 8 percent in 2020. The government of Mexico's fiscal response to the pandemic was 1-2 percent of GDP, much lower than what we experienced in Canada and the U.S.

When we look at how businesses have been affected by the pandemic, we can also say that the impact has been uneven. For some businesses, COVID-19 has accelerated their growth. This crisis is reinforcing and accelerating existing trends, the most obvious one being the digital transformation. For example, e-commerce companies have seen a step change in growth during the lockdowns as more and more people turned to online shopping. For many other companies, the pandemic has been highly disruptive. Companies that are dependent on operating in the physical retail world, and those in the travel and hospitality sectors, have had a much harder time.

The strength of stock market indices globally hides the fact that there is weakness in many businesses. When we look at the fundamentals of companies more broadly, there has been more hardship than what the markets would seem to indicate.

AM: What are your research priorities currently, and during major crises in general?

AMdPF: A wise business owner said to me: "To prosper long term, you must survive the short term." Early in the pandemic, our priority was to make sure that the companies we are invested in would be survivors. So much was unknown about the pandemic and we needed to ensure that companies had staying power in a severe scenario. Did they have the balance sheet strength to make it through this crisis? Sufficient liquidity to keep employees and their businesses operating for one to two years in the face of reduced revenue? In this crisis in particular, management's approach to employee health and safety was also primary. How was management protecting its employees? How were they addressing operating safely during a pandemic, and how willing and able were they to invest and reconfigure their operations to not only ensure employee safety, but also ensure sustainability of the business? A company's culture is always important to assess, but we really had a chance to see company culture in action during the early days of the crisis.

Once the foundation of survival is established, we then start focusing on how companies are responding to the crisis and identifying opportunities to emerge on the other side in a stronger competitive position. The idea of never letting a crisis go to waste. We also ask companies how they are making their businesses more resilient.

Business resilience has a new meaning in this crisis. The pandemic has expanded our understanding and thinking about a business' capacity to be resilient. Traditionally, we think of business resilience in terms of financial strength, breadth of products, services and customers, management depth and succession, and operational redundancies such as back-up data centres. Over the last year, a company's resilience was severely tested in terms of capacity to reach customers, suppliers and employees in different ways. As an example, the most resilient restaurants are the ones that have adapted to include multiple ways to engage their customers: they have dine-in, patio, online delivery and curbside pickup options. Businesses that have embraced this omni-channel strategy are less vulnerable because they are not dependent on operating in only one dimension.

We have also expanded our thinking of a business's supply chain resilience. Typically, companies optimize supply chains for efficiency and costs, but this crisis exposed the danger of not sufficiently considering the security of the supply chain. One example we can all relate to is pharmaceuticals. If vaccines are not manufactured here in Canada, where are they coming from, how secure is that supply, can we depend on it and where are we in the priority queue? Businesses that take the opportunity to build more resilient supply chains will emerge stronger on the other side of the pandemic.

Finally, all companies have had to think hard about how to foster a resilient internal culture when they can no longer gather in a physical space. How do they communicate as a team? How do they train their people? For example, an Indian IT services company, Tata Consultancy, migrated much of its training online some years ago and that made it more resilient and better prepared to deal with the challenges of today. As many of us continue to work from home, we are seeing many businesses continue to innovate their internal capacities.

Our thinking around assessing business resilience has expanded across all dimensions because of this crisis, whether it relates to engaging with customers, suppliers or employees.

LR: How are investors responding to this uncertain environment?

AMdPF: With the pandemic came tremendous uncertainty – how long is it going to last, when will vaccines be administered, what will be the long-term ramifications? Investors responded by shortening their time horizons, focusing on the near term. Many investors are still not willing to apply a long-term approach to investing in businesses.

Psychology is playing a major role. When it became clear last March that we were dealing with a global pandemic, we witnessed extreme fear with markets plummeting in some cases 30 percent or more very quickly. Fast forward to today and we have extreme exuberance in some pockets of the market. It has been a roller coaster ride. Recency bias may be falsely leading investors to believe that the recent price rally will extend indefinitely into the future.

The current enthusiasm is partly driven by individual investors who are involved in the market in a way we have not seen before, aided by trading platforms like Robinhood that make it very easy to trade at "no cost" from your mobile phone, desktop or tablet. It reminds me of when I first started out in the investment industry and everyone thought the stock market was an easy way to quickly make money.

Many investors are compelled by stories, especially if they hold world-transforming narratives that can capture their imaginations. A good example is the narrative around Elon Musk, founder and CEO of Tesla, who has achieved a cult-like status amongst his followers. In early January 2021, Musk tweeted "Use Signal," apparently referring to an encrypted messaging service app named Signal, and many investors poured money into shares of Signal Advance, a medical device company. This led to a market rally in Signal Advance of more than 5,000 percent in three trading days, but the stock has since crashed and

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returned to its value prior to the tweet. Similarly, the promise of Bitcoin as a form of digital currency that will transform how we transact is fueling a price rally with Bitcoin hitting all-time highs in February of this year. We have seen some companies change their names to sound like Bitcoin companies so they can partake in the speculative excess.

As a result of all these forces, we are in a market that is very short-term oriented, highly narrative-driven, and demonstrating very little quality or price discrimination. In this kind of environment, it is especially important to be mindful of our psychology as investors. It would be a normal emotional response to want to participate in popular trends, for fear of missing out on returns. It is very difficult to "do nothing."

But we need to remember that investing is about compounding capital over the long term. We need to be steadfast in terms of our investment beliefs and return to the fundamentals of investing. At its core, investing is about buying good businesses, and not overpaying, so that we can preserve and grow capital.

AM: The technology sector is one area of the market that is doing well. How does this compare to the dot-com bubble of 1999/2000?

AMdPF: There are some similarities and some differences. If we think back to the dot-com bubble, the excitement was around technology companies building the internet. Numerous companies that were highly valued at the time lacked viable business models and turned out to be worthless. But there were also companies like Amazon that turned out to be winners over the long term. Yet, if you invested in Amazon in March 2000, you would have experienced a 94 percent price drop over the ensuing two years. It would have been very difficult psychologically to hold onto that stock.

Today, there are some phenomenal companies in the technology area. Stocks in this sector have performed well recently because investors are looking for business growth, which has been scarce during the pandemic. But the market appreciation of many of these stocks has gone up more than their fundamental business growth. As investors, it comes back to the question of what they are worth. Not all quality companies make quality investments. It is not a quality investment if we overpay.

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It is important to understand the broader context as well. Growth has been constrained ever since the global financial crisis of 2007 to 2009. Productivity growth has been disappointing worldwide and overall growth has been muted. Even China, which is still showing good overall growth, has slowed down considerably. Because of the combination of slow global economic growth and very low interest rates, investors have been willing to pay more for companies able to demonstrate attractive absolute growth.

LR: What is the appropriate mindset for us as investors during this period?

AMdPF: The challenge is to keep focused and disciplined in the process. A good analogy would be to think of yourself as a tennis player who practices every day and then goes out to play matches: How do you stay focused? How do you stay in the moment? How do you keep practicing your techniques repeatedly and stay disciplined to your plan, and not get distracted by everything else that is going on? Because at some point, there will be commentators and sponsors and various other people on the sidelines second guessing what you are doing. Your challenge as an athlete is to stay focused and stay with the fundamentals of your process, even when you know that it isn't going to work every minute, every day or every week. But you know that over the long term it has been proven to work.

When it comes to investing, the fundamentals of our process really come down to three areas: assessing the business risk, financial risk and valuation risk against the opportunity of any investment. What is the competitive advantage, or economic moat, of the business? What is the likelihood that the moat will be eroded, and how quickly? Does the business have attractive growth opportunities? How aligned is management with shareholders? Does the company have the financial strength to withstand shocks? How can we manage the risk in the purchase price? Amidst the short-term noise, how do we stay focused on generating long-term absolute returns?

Anne Mette de Place Filippini at Canada's National Ballet School.

I am a big fan of the tennis player Rafael Nadal and there is a famous anecdote about his Uncle Toni, who was his coach. They were probably one of the best pairings in sports that we have ever seen. Uncle Toni would never tell Nadal how long a practice session was going to be. It could be one hour, it could be two hours, it could be three hours, it could be four hours. Think how hard mentally this would be. Imagine you are out on the court and Uncle Toni is running you around for an unknown amount of time.

LR: So, you do not know how much energy to preserve.

AMdPF: That is right, you do not know. Uncle Toni crafted those practice sessions to emulate the real world, to emulate match play. I think one of the reasons Nadal has become one of the world's best players is because he was trained this way. You cannot "run the clock down" in tennis. To win in tennis means to win the final point no matter how long that takes.

In tennis, there will be an end to the game at some point. But investing is infinite, there is no end point. When there is no end point, what becomes important is to really sign up for what you are doing, enjoy the process, keep your eye on the ball and not get too distracted by the short-term score card.

What is tough for us now and for our clients, is that we are up against an opponent – call him "Mr. Market" – that has been playing in the zone more than we have in the last few years. We have been disciplined in following our investment philosophy and our game plan, and we are learning along the way, adapting and making small adjustments. When we look up at the short-term score board we may not be happy with the relative results. But now is the time to stay focused, disciplined and to maintain a long-term orientation.

We are in such uncertain times, not just in terms of equity markets, but on a very existential level. Our natural tendency is to gravitate towards being part of a herd. Standing apart from the herd is a very difficult thing to do. Burgundy's Chairman Tony Arrell wrote about this 28 years ago in an early View from Burgundy, *Outside Zebras*: "Being a value investor is often an uncomfortable position to be in. It requires the willingness to do what is unpopular and the discipline to stick with your decision while the majority of investors are going in a different direction."

The pandemic has motivated many of us to rethink different aspects of our lives. But taking a long-term, fundamental, bottom-up approach to investing is not something that we should be rethinking. **M**