REMARKS FROM RICHARD ROONEY:

2020 IN REVIEW

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I recently had the privilege of speaking with a long-time Burgundy client who has shown rare discernment in all of the investments he makes. As we concluded our usual wide-ranging discussion, it occurred to me that his investment philosophy, successfully implemented over many years, was based on three pillars: knowledge, quality, and scarcity. I thought those might be good lenses through which to view our current situation as Burgundy investors at the end of 2020.

KNOWLEDGE

The year has certainly been a learning experience. We learned that managing a pandemic is an extraordinarily expensive and difficult thing. We learned that the nation state, when all is said and done, is the primary actor in a crisis and that supranational organizations are feeble and lack effectiveness when the superpowers do not support them. Our experience in 2020 taught us, yet again, that when monetary policy is aggressive and interest rates are falling, it can put a floor under asset prices. We found out that when this monetary ease is allied with powerful fiscal stimulus, securities prices can go to new highs even as economies are faltering under pandemic restrictions. We discovered the truth of the old saying that "it's an ill wind that blows nobody good" as catastrophe in many sectors (travel, lodging, tourism, dining) proved to be an enormous tailwind in others (e-commerce, home entertainment, distance work and learning).

The lessons here for 2021 are several. National policies on trade, regulation, taxation, and spending are going to be very important in the future. Globalization is in retreat. No government on earth wants higher interest rates, so monetary ease will remain the dominant theme. The shape of the pandemic recovery, even with vaccines being rolled out, is uncertain and governments should be very careful about the measures they take to reduce deficits. Targeted government assistance may allow survival for many affected sectors and prevent the decimation of a generation of entrepreneurs and family businesses. The big cash pile that many consumers have accumulated during the lockdowns and restrictions should fuel a recovery when the pandemic comes under control.

QUALITY

Quality companies were a good thing to own in 2020. Owning quality businesses may not have enabled you to keep up with the mad scramble into stay-at-home and technology stocks, but it generally protected the downside in March and allowed investors to participate in the recovery. Even then, some small-cap and peripheral emerging market stocks did poorly in the March liquidity crunch despite their high-quality characteristics. As usual, companies with cyclicality and financial leverage were poor performers in the downturn, though they have often done well in the recovery. Traditional quality sectors like healthcare and consumer staples generally did the job they were supposed to do in 2020.

The decline in interest rates has driven multiples in these stable, cash-generative businesses to quite high levels. But they are usually still good value relative to the growth companies that have led the markets for several years. Within technology, the highly profitable businesses like Microsoft and Alphabet (Google) have not done as well as the conceptual and unprofitable ones.

All in all, quality companies as we define them often did not do as well as the indexes in 2020. Relative performance depended on the size of the technology sector, which was overwhelmingly large in the U.S. and China and much less in Europe and Japan. But quality is a long game. Ideally and if properly invested in, it should provide strong long-term returns while protecting against wild price swings, whether caused by sentiment or cyclicality.

SCARCITY

With the lockdown in March, investors became fixated on growth as the scarce commodity in the market. With the economy shrinking overall and being impacted by massive disruptions, it is unsurprising that investors began to focus on the companies whose growth prospects had gone literally overnight from good to utterly spectacular. A lot of rather puzzling stocks went along for the ride, with Tesla being the prime example for New Age thinking. Generally, at year end, with growth stocks representing a larger and more expensive proportion of the market than ever before, it seems safe to say that prospects in most of these companies are fully discounted, and then some.

What is very scarce is quality at a reasonable price, where quality means steady margins, high profitability, and free cash flow generation. None of these things has been in favour in the last year, except in the crisis days of March. We think in a reopening economy, there will be a reallocation of resources away from the virtual sectors into the in-person economy. As it currently stands, any substantial reduction in the growth rate of the “concept stocks” would have dire implications for their stock market performance. The safe place to be will be in companies that are perennially profitable, cash generative, and managed by people who perform for all shareholders, not just for themselves.

That is where we try to position ourselves at Burgundy, so we look forward to 2021 with cautious optimism. We are determined to take the harsh lessons of 2020 and turn our learnings to our clients’ advantage.

Respectfully submitted,