Mathew Harrison	**00:07:** Hello, everyone. Welcome to Burgundy Talks. I'm your host, Mathew Harrison, Head of the Private Client Group at Burgundy. And today, we're going to take a deep dive into Burgundy's investment approach and thought process in order for you to become a more informed investor. Today's session is an update with Richard Rooney, President and Chief Investment Officer at Burgundy. He is also the Portfolio Manager for Burgundy's Balanced and Partners' Global Strategies. In today's session, Richard will give his perspective on the current macroeconomic environment at home and abroad and provide some comments on performance, expectations for the future, and the need for liquidity and bonds in a balanced portfolio.
Disclaimer	**00:55:** This recording is for information purposes only and is not to be taken as investment advice, a recommendation, or an offer of solicitation. Commentary, opinions, and answers are provided by the speakers at the time of recording. Burgundy assumes no obligation to revise or update any information to reflect new events or circumstances, although content may be subject to change.
Mathew Harrison	**01:18:** Hi, Richard.
Richard Rooney	**01:19:** Good morning.
Mathew Harrison	**01:21:** So we'll jump right in with the question that we're getting most often from our private clients today. And that is about an upcoming recession. Are you concerned about an upcoming recession, Richard?
Richard Rooney	**01:36:** Well, we always have to be concerned about an upcoming recession because there's always one upcoming, but I would have to say there aren't very many signs that we are going to see one imminently. One of the things that clients are most concerned about, and commentators generally, is the inversion of the yield curve that occurred earlier this year, which is now largely corrected. An inverse yield curve quite often leads to a recession or people might say predicts a recession. It has the effect of reducing lending in the economy. And so there is some real economic consequence of a yield curve inversion. But this time, it was quite an unusual one. Normally, we see the yield curve invert because the government begins to tighten short-term money, raise short-term interest rates because of concerns about inflation. And the long-term rates remain more or less stable. This time, there was a brief tightening at the short end, but most of the inversion occurred because of a very rapid fall in rates at the long end.

So it's kind of unusual. And it means that the bond market is predicting very low inflation rates, which would seem to indicate that it's unlikely that central banks will shut down the system by being aggressive about raising short-term interest rates anytime soon.

As you know, we look at the economy through the eyes of the companies we invest in. And we're getting very few indications of a recession from those sources. We are seeing companies saying that things are definitely slow, slower than they've been the last couple of years, but there's still growth in the economy. And our companies are still reporting modest growth in earnings and revenues.

Mathew Harrison **03:42:** You have often stated that recessions are a result of increasing interest rates and fears about inflation. Is that one of the reasons why you're less concerned about a recession right now?

Richard Rooney **03:57:** That's right. Most of the inflation data is very, very well-behaved. And the bond market is predicting very low levels of inflation for quite a long time. The inflation-linked bonds appear to be predicting inflation of 1% or so for the foreseeable future. So doesn't seem to be any reason that the central banks would have to raise interest rates.

It's been clear that the central banks are really worried about upsetting the apple cart. They do not want to throw the economy into recession. And as I said, we're not seeing any kind of independent evidence of a recession from our companies. So for the time being, I'm feeling fairly comfortable that we'll have a slow growth economy.

Mathew Harrison **04:48:** So we're not feeling that there's going to be price pressure for prices to move upward, but we are in an extremely low interest rate environment and in some economies even negative interest rates. Does that mean that on the other side of the coin, we might be worried about deflation?

Richard Rooney **05:07:** I think that has been the preoccupation of central banks now for quite some time. The Japanese central bank, of course, has had to actually deal with deflation, with price deflation that appeared in their economy over the last decade or so. And their central bank has been extremely aggressive about attempting to offset those pressures. I think the same is true universally in Europe. And it will be in North America, should we end up with deflationary pressures. So the central banks are very, very strongly combating that trend.

Mathew Harrison **05:46:** Is there a historical parallel that, when you look at this market and where we are in it, a historical context of how this looks?

Richard Rooney

06:00: Well, the most recent parallel might be the period between 2010 and 2016. At that point, we had very low interest rates, very low inflation rates, and very low economic growth. And that seemed to give investors a very strong quality bias in their investments. And that worked very much to our advantage. We had very good results in that period. And of late, we've seen quite a few quality portfolios doing better against the benchmarks. As you know, it's been a couple of years when we haven't necessarily been in style.

Another parallel, though, might be the 1990's market where the U.S. outperformed extraordinarily strongly for that entire decade. And they've done it again this time. The American market has roughly quadrupled since 2009, while most other world markets have only doubled. So those would be the two parallels that come to mind.

Mathew Harrison

07:05: Great. And with that, Burgundy is biased towards investing in high-quality, often multinational businesses. We do have concerns about a trade war or trade wars with China. Do our companies – is there threat to our companies through a trade war or a heightening trade war?

Richard Rooney

07:33: It's certainly a big concern. So far, the main impacts of the trade war have been on essentially secondary processing, things like steel and aluminium, which don't tend to be areas that we invest heavily in. The sector that's seen some significant strains as a result of the trade war is manufacturing, things like autos and aerospace.

We tend to have fairly substantial amounts of consumer staples exposure. Those companies, I would say, are less exposed. People are unlikely to put tariffs on consumer goods to any great extent. But the trade war is an ongoing concern that the market appears to be ignoring, except in the case of manufacturing stocks.

It's been rather unpredictable what the results have been. Every now and again, you get a company that will specify that softness in a given market area might have been the result of tariffs, but so far, it hasn't had a real dampening effect on the markets.

Mathew Harrison

08:49: Great. In Canada, bringing things closer to home, we have just had an election that has resulted in a liberal minority government. Any comments or concerns on the impact to Canadian business and more specifically the energy business in the West?

Richard Rooney

09:09: Yeah, it's – Canada is a pretty complicated place to govern. We have governments on – provincial governments on both coasts that are very interested in the environmental issues. And we have a couple of provinces right in the middle of the country with very large energy industries, which have been under a lot of stress. And unfortunately, the government will have no representation whatsoever from Saskatchewan and Alberta.

We have the ongoing issues of the pipeline and carbon tax and all those kinds of things. I personally think that the right answer is probably to build the pipeline and impose a carbon tax. I see no problem with that. That's essentially where the government is. But it's going to be a very fractious confederation over the next few years.

The other economic impacts I don't think are clear at this point. The country is reasonably well-financed. A major concern, of course, is housing prices in a couple of our markets. The energy business in Western Canada has been under severe strain now for four years. And interestingly, that's not entirely without long-term positive results.

People often talk about the energy industry as though it were simply an object and not a subject, so to speak, as though it's battered by all these various issues of market access and commodity pricing and all that. And that's certainly true. But within the energy industry, there are some very good things happening.

We had a company we were reviewing last week. And it started from a position of great stress three or four years ago. What they've done is focus on their core business, close or sell non-core businesses, really lock down on costs, completely restore their balance sheet to health. And now, they're in a position where they're looking out and saying there are these limited opportunities for investment that are going to yield extremely high rates of return.

So what I'm saying is that the capital allocation of these companies has improved out of all recognition over the last four years. And ultimately, that is a situation that will lead to a good moneymaking opportunity. The energy position we've had in Canada has been acutely painful. It has not worked out. Just about – it would have taken a sadistic imagination to come up with any more things to go wrong for Canadian energy, but we think there are – we certainly have valuation on our side. And we think the fundamentals increasingly will come into line.

Mathew Harrison

12:17: Great. So that's a good overview of the macro environment that we find ourselves in and a little bit about Burgundy and our investments in Canada. How has our style performed overall in this current environment?

Richard Rooney

12:33: In the last six to nine months, I think things have started to turn. Prior to that, we had a period of very strong economic growth in sort of starting around the middle of 2016 until the end of 2018. It was partly a late cycle surge. It was partly that interest rates were very low. It was partly that the U.S. put through a massive corporate tax cut that really boosted earnings.

So that sort of sugar rush is now done. And as I mentioned, we're now back to a situation where we have quite slow economic growth, no real apparent threat of rising interest rates, and no real threat of inflation that we can see. So we always say, our companies are ships that sail best in a light wind. And a light wind is what we have.

So again, I think it's analogous to that period 2010 to 2016 when people really felt that owning our kind of companies with strong balance sheets, perennial profitability, very high free cash flows, those are the kinds of things that do well in that environment. So we're pretty optimistic about that.

Mathew Harrison

13:47: So conversely there, and in a very hot market, investors are less attracted to quality?

Richard Rooney

13:55: Yes, I think you can say that when the economy is growing strongly, there tend to be things like cyclicals tend to do well, deep cyclicals. Things further up the food chain in the commodity sector tend to do well. So that's what we saw in the '16-'18 period.

Mathew Harrison

14:19: Great. And in this, again, in this environment, return expectations moving forward over the mid-term for short-term investments, for bonds, and for stocks?

Richard Rooney

14:35: For short-term investments, I don't think we've finished with the interest-rate reductions that we're going to see from central banks. I think that'll continue for a while. So that would seem to indicate to me that next year, we'll probably collect lower interest rates, lower levels of interest from our money market investments than we did this year.

For bonds, generally speaking, with a 2% yield to maturity, that's going to be about what you collect from bonds over the next few years. So that's not a very exciting outlook. There are still reasons to own bonds, non-correlation and deflation hedge and those kinds of things. But the positive return expectation should be pretty muted.

In the case of equities, we do have markets that are currently rubbing up against all-time highs. And valuations are rather extended. So you can't really expect from here that over the next five years or so, we're going to see equity-like rates of return by which I would mean sort of 9% to 11% compound. I think that's unlikely. I think we're more likely in the mid-single digit range, perhaps 6%.

Mathew Harrison **15:56:** But putting that in a bit of context, that return expectation for stocks of 6% is also in the context of a low inflation.

Richard Rooney **16:08:** That's correct. So if the bond market's expectations are currently accurate, then that's almost a 5% real rate of return on equities, which is not far off what the historical rate of return on equities has been.

Mathew Harrison **16:25:** And I just wanted to circle back on one thing you said about bonds and the importance of owning them because they are non-correlated. And by non-correlated, you mean non-correlated to stocks.

Richard Rooney **16:35:** Correct.

Mathew Harrison **16:36:** Why is that important for investors to consider?

Richard Rooney **16:40**: Well, I think clients often find themselves in a position where they're seeking yield and seeking returns. And that's fine. That's what we all do. But if you let yourself get too far out on the risk curve, and all of a sudden, the stock market gives you a strong negative number as it's been known to do from time to time, you don't want to be in a position where you have to sell those assets cheap.

Bonds tend to move differently from equities. They tend to be a stable reserve at times equities go into bear markets. Usually, bonds are a pretty good thing to be in. So it's really just a safety first kind of thing for investors that need that, for investors with a shorter time horizon.

Mathew Harrison **17:30:** So that's a good segue into talking about asset mix and liquidity. What's your general advice to investors, having a portfolio of assets and having some liquidity requirements, what's your general advice to them on asset mix?

Richard Rooney **17:50:** Clients who are living off their portfolios or largely living off their portfolios should always have about three years of known and certain expenditures in money market. So that means your cottage renovation, your daily living needs, charitable donations you want to make, everything that you know you're going to do with money over the next three years I would say you should have in money market.

Mathew Harrison **18:21:** And what kind of time horizon do you feel is necessary for equity investors?

Richard Rooney **18:28:** Equity investors should have a 7 to 10-year time horizon. Equities are the most reliable long-term asset you can own and the least reliable short-term asset you can own. That's the ongoing contradiction of equity investment.

Mathew Harrison **18:44:** So just sort of backing into the math here, if we say you need a time horizon of 7 to 10 years for holding equities, and we're going to have three years of our cash needs in money market or cash, that would – we'd back into a four to seven years of your liquidity needs should be invested in bonds. Does that make sense?

Richard Rooney **19:09:** That does make sense. That sounds good.

Mathew Harrison **19:11:** At Burgundy, we have always been a proponent of owning high-quality businesses and owning them for the long run. What is the case for owning high-quality businesses today?

Richard Rooney **19:25:** Well, I think as I mentioned before, they do tend to give good return characteristics in this kind of an environment. But I think generally – and this even refers back to what I was saying about the Canadian energy industry – investing in companies is a great thing because companies are organisms. They're human organisations. They have survival instincts. They have adaptation characteristics.

So you look back over the last 50 or 60 years and think of all the different environments for inflation, for geopolitics, for economic growth. You think about the sort of controlled chaos of the way an economy develops, the arrival of the internet. I mean, it's been a truly extraordinary period.

And investing and the way companies have managed those changes is pretty extraordinary. And the way that they can continue to maintain profitability, lots of cash flow, reward us as investors with dividends and stock buybacks and growth of their basic businesses has been pretty extraordinary.

	So I think equity investing contains all kinds of free options. If you're buying a really superior business with a good business culture, I think it's going to be able to grow and prosper long term. So it's not like – bonds we've been mentioning. They certainly have a place. Money market has a place. But really, those are just contracts for cash flows. They don't have any sort of existence beyond that, whereas companies, companies have an actual personality. And they have great capabilities and the ability to, as I said, adapt and grow.
Mathew Harrison	**21:31:** So with history as our guide, your belief as with ours, the rest of us at Burgundy, is that equities in the long run will be the place to adequately compound capital over the long run.
Richard Rooney	**21:43:** I believe that'll be the case. As I said, they're fiendishly unreliable in the short term, but in the long term, almost any long-term period, 10-year period, 15-year period, over the last century, you would have made good money in equities.
Mathew Harrison	**22:00:** Great. Well, thank you very much for your time today, Richard. Appreciate it.
Richard Rooney	**22:05:** Thank you, Mat.
Mathew Harrison	**22:06:** And thank you to everyone for listening in. We hope you enjoyed this session. And we also hope to bring you more like it in the future. If you have any questions or comments, we'd love to hear from you. Please reach out to your investment counsellor or to Burgundy in general from our Contact Us page. Thank you very much for listening.

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