EP 148 | Introducing: The Mawer Global Credit Opportunities Strategy

[00:00:00] Rob Campbell: Hi everyone. I'm your host, Rob Campbell, and welcome to The Art of Boring, the podcast where we dive deeper into Mawer's investment philosophy and thinking in order to make you, our listeners, more informed investors. Ultimately, we hope to connect you with the people at Mawer who find excitement in “Be Boring. Make Money”.

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[00:00:40] Kevin Minas: Hi everyone. In this episode of the Art of Boring, I talked to Global Credit Portfolio Manager, Brian Carney. We'll discuss Brian's career. What drew him to the credit side of the business. As well as what drew him to Mawer, we'll also cover why Mawer's launched a Global Credit opportunity strategy, what problems it can help solve for investors, how it can fit into a well-diversified portfolio, and where we're currently seeing opportunities in credit markets around the globe.

[00:01:04] Kevin Minas: I'm delighted to introduce our guest for today, newly appointed Fixed Income Portfolio Manager Brian Carney. Brian joins Mawer with over 30 years of investment industry experience on both the sell side and the buy side and his focus here at Mawer will be researching and investing in credit securities from across the globe.

[00:01:21] Kevin Minas: Great to have you here today, Brian.

[00:01:25] Brian Carney: Great to be with you, Kevin.

[00:01:28] Kevin Minas: Now, we don't normally start the podcast with biographical details of our guests. Given you're newer to the firm and it's your first time on the Art of Boring. It'd be great to hear a little bit about how you got started in the business, some of your experiences, as well as what drew you to the credit markets.

[00:01:40] Brian Carney: Okay, Kevin, better sit down for this one. Good thing you are sitting down. It may surprise you. I wasn't born a credit analyst. I don't think anyone is. People are born equity analysts and then they have to get converted. So going way back, my dad taught teachers to be teachers at University of Alberta. My mom was an elementary school teacher until she stopped to raise four kids.

[00:02:02] Brian Carney: My sister, the oldest. Went to U of A, she dutifully went into the family business, and she taught English at Vancouver Island University. I've got two older brothers, and they ended up leaving Edmonton. They went to go to school in Boston, and then they went into finance, and ostensibly because they had student loans to pay off, and Wall Street investment banks tended to recruit at Ivy League schools.

[00:02:29] Brian Carney: I followed my two older brothers. Down to the U.S. first for school. And then I joined the credit department at Goldman Sachs. And interesting to us, we all ended up working for the same gentleman, Dick Davis, who had joined Goldman from Moody's Investor Service. So how did I get into financial services? I fell into all that to say, Goldman was an amazing learning ground.

[00:02:54] Brian Carney: I was 23, I was a political science major. I knew nothing about finance, about credit, nothing about the stock market. Shortly after I joined, in fact only a few weeks after I joined, a firm named Drexel Burnham went bankrupt, and that was Michael Belkin's. The Junk Bond King, that was his firm. Robert Maxwell looted the Mirror Group pension plan about a year later.

[00:03:19] Brian Carney: And then I was lucky enough to head over to the UK just in time for George Soros to take down the British pound. For me, finance was fascinating. It had real world implication. And Goldman seemed to be in the middle of it all. I was hooked. As much as I fell into finance, I also fell into credit. And what's attractive about credit? I mean, credit touches everything. It's what feeds or starves the global economy. And more specifically, when we think about the credit markets, they're large and thankfully they're equally as inefficient as the equity markets. There's lots to play in creditors or lenders and lending involves not just fundamental analysis, but also contractual analysis.

[00:04:06] Brian Carney: And for some of us, that kind of complexity is very interesting. At least it's interesting to me, the universe of companies we get to look at is larger than the equity market because our universe includes both public and private companies. And once you decide you might like a company, your job's really only half done because you need to decide what term do I want to lend for and what part of the capital structure do I want to be in? So, I find that very compelling. And it's interesting, all sorts of scenarios where you can have a positive outcome and somewhat perversely in the same name, you can have winners and losers. So, you really need to do your homework and you can make money in distressed and bankrupt companies, which is very difficult to do in the equity market.

[00:04:52] Brian Carney: So, there's always something new. No two days are the same. Going back when I walked through the door at Goldman 30 odd years ago, I'd never thought I'd make a career in financial services. I guess that's the advantage of being the youngest of four kids, but I'd say in an instant gratification world, fixed income seems outrageously pedestrian and credit is the grizzly old school. And that's why I love it. To bring it back to Mawer it puts the boring into “Be Boring, Make Money”.

[00:05:23] Kevin Minas: So, it sounds like you've covered broad spectrum of the credit markets, be it geographically, where you've worked, you moved to the UK, worked in the U.S. You were kind of there in the earlier days of the high yield market, it sounds like very useful experience for running a credit fund. So that's kind of how you ended up in credit. What brought you to Mawer? Why did you join Mawer?

[00:05:44] Brian Carney: I really felt there was a unique opportunity at Mawer to build a global credit business within an exceptional distinctly Canadian firm that had a sterling reputation. And as someone who it may be obvious is in the second stage of his professional life. There was simply no way I could pass it up. So specifically, when I think about Mawer, there's already an existing fixed income platform here. And I think it's one of Mawer's best kept secrets. The firm already manages about 10 billion Canadian in fixed income assets. So, I'm coming into a phenomenal firm with a well-established fixed income business.

[00:06:25] Brian Carney: I get to work alongside Crista Caughlin and the rest of the fixed income team. That's point number one. Point number two, there's a global coverage advantage here. And I think the world may view Mawer as an equity specialist, kind of a group of excellent understated stock pickers, but really, I view them as a bunch of securities analysts. So, we've got over 40 people here executing bottom-up fundamental research across the capital structure of companies around the globe. In my opinion, there's no other Canadian credit focused firm that has the global connectivity and coverage that Mawer does. I think that's incredibly compelling, and the credit team plugs in directly to the broader team and their knowledge.

[00:07:11] Brian Carney: The third point I'd make, for me, this is more personal, it really feels like a homecoming of sorts. And I remember growing up in Edmonton, sitting in the kitchen, my mom had the radio on. And Peter Lougheed way back in the 70s was talking about the need for Alberta to diversify away from oil and gas. I had no idea what that meant. I mean, I was in kindergarten, who knows what diversification means? And I know those diversification arguments are still going on in Alberta today. I don't know exactly what inspired Charles Mawer to start this company, but 50 years later, it really is one of Alberta's global non energy champions. It's a true diversification success story.

[00:07:54] Brian Carney: As a native Albertan, it's a homecoming of sorts for me, even though I'm based here in Toronto. And I think the last point, which of all the ones is probably the most important. It is the most important. The culture at Mawer. Firm culture focuses on clients, community, and employees. On quote, making people's lives better. So, joining with a group of people pursuing excellence and doing it in the right way, not because it's their job, but because it's their passion is very special. I'm thrilled to be a part.

[00:08:28] Kevin Minas: If I could pick up on your first point around the fixed income platform at Mawer being one of the best kept secrets. When we think about the evolution of fixed income at Mawer, of course, you've joined us and a few other members of the team have recently joined to launch a new strategy, the Mawer Global Credit opportunity strategy. Can you just paint me a picture a little bit of as to what that strategy is, what it's attempting to accomplish? Ultimately, what problem is it trying to solve for investors?

[00:08:54] Brian Carney: The new strategy attempts to solve people's investors fixed income challenge. People don't expect to lose money in fixed income and after decades of falling yields market moves over the last couple of years, up until very recently, really violated that premise. People who always believed they needed fixed income have been asking, why should I have any fixed income? In my view, losses in fixed income [shouldn't] lead to, I don't want any fixed income. It should lead to an examination of what type of fixed income am I holding? Am I holding fixed income that is both going to preserve capital in difficult markets?

[00:09:36] Brian Carney: And take advantage of opportunities that are presented at various points in time. We are trying to provide an alternative strategy to passive, or I'll call it gear passive fixed income, which strategies protect them from neither adverse credit nor interest rate moves. And they certainly don't take advantage of the periodic market upsets that provide capital appreciation opportunities. We're managing new strategy with an absolute return focus. That means preserving capital and expensive markets, migrating to higher credit quality, shorter duration, if that's what's appropriate. And when markets are cheap or distressed or dislocating, we're meant to take advantage of that opportunity.

[00:10:22] Brian Carney: And we are meant to move rapidly and decisively. We can create significant capital appreciation potential. We're trying to give people an alternative to either exiting fixed income entirely, or perhaps for retail investors going into GICs, or institutional investors thinking about annuitizing portfolios. There are alternative strategies where you can extract significant value out of the fixed income markets. We think the global credit strategy is one of those.

[00:10:53] Kevin Minas: So corporate focused, unconstrained in that you're flexible on credit, you're flexible on duration, ultimately seeking best opportunities wherever that may be. So that's a very broad opportunity set that you've kind of painted a picture of. How do you think about narrowing down that opportunity set to find the best ideas and what types of opportunities are you looking for? What types of dislocations in the credit market would you be focused on?

[00:11:17] Brian Carney: Point one, the investable universe. It's huge. And as we look at it and define it, it's well in excess of 20 trillion Canadian dollars. About two thirds of that is denominated in U.S. dollars, 20 odd percent in Euros, and then you get into the peripheral markets, sterling, yen, and our favorite, Canadian dollars. The companies within that universe, about 50 percent are domiciled. In the U.S., about 20 percent in Europe, and then trickles on down. There's a whole lot of stuff that we could potentially look at. We have put together what we consider a fairly sophisticated screening tool. Kevin, you can come take a look at it and tell us if it's sophisticated or not based on what you've seen.

[00:12:04] Brian Carney: But it really helps isolate down to what is a much more manageable universe of names to dig into. And then from that, get down to the 30, 40, possibly 50 names that ultimately go into the portfolio. It's a similar exercise using a different screening tool. That our colleagues on the equity side utilize. Kevin, I think it's important to outline what the strategy is not as much as what the strategy is. The strategy is not dedicated to high yield, it's not dedicated to leverage loans, not dedicated to private credit, it's not dedicated to emerging markets. The latitude exists within the strategy to invest all those various sub asset classes.

[00:12:52] Brian Carney: But it's not our focus. If something's compelling and high yield, we'll invest in high yield, but we don't have to have any high yield in the fund. If the markets are expensive, we'll migrate up too much higher quality. What type of dislocations are we looking for? Could really put them into two different baskets. One is issuer specific. Something happens to a company; the market perceives it negatively. Credit spreads widen bond prices fall. We look at the situation and our analysis says the company will survive and the prices of the securities provide enough protection for us to get involved. If you think over history, any number of big company names have run into trouble.

[00:13:36] Brian Carney: You think Boeing a few years ago with the 737 Max, Boeing unfortunately having more issues today. Those types of names where there's a company specific event, we dig in, we take a different view than the markets and we can take advantage of that for our investors. And then there are the overall market dislocations, which aren't as frequent as the company specific events, but they do come along. It's very hard to predict when they're coming or what precipitates them. But think of credit crisis in 2008. Think of Euro debt crisis, 2000. Think of pandemic 2020, where there's an external event and suddenly everything becomes cheap virtually overnight. For that, like our colleagues on the equity side, we have a backup inventory list of names we think are interesting, possibly compelling at the moment.

[00:14:31] Brian Carney: The prices aren't right, but when you have one of these market dislocations, suddenly, things become very interesting. In those types of environments, the complexion of the portfolio from a credit quality point of view can change dramatically in a very short period of time, going from very little high yield to a much higher percentage of high yield. Unlikely to ever go to 100 percent high yield because if the high yield markets are selling off, there's a good chance that the investment grade markets are selling off too. You probably have a mix of unique situations in both high yield and investment grade.

[00:15:07] Brian Carney: I would say one of the things that's very important in this strategy is if things are expensive, you need to protect capital and the more capital you protected at the top of the cycle. The more capital you have to put to work at the bottom of the cycle and the greater the capital appreciation potential that you can create in this fund. Preserve capital in expensive markets, take advantage of opportunities when they come along.

[00:15:34] Kevin Minas: Excellent. And so, I guess in the current environment, where would we fall on that range of preserving capital versus thinking more opportunistically?

[00:15:43] Brian Carney: This is my first podcast. I'd love to say, hey we're going to be at 80 percent high yield because there's a whole bunch of cheap stuff out there. Unfortunately, that's not the case. If you think about credit spreads, incremental spread compensation that you get today for lending to a high-quality U.S. company, they're at reasonably tight levels. Historically you earned about 1.5% above U.S. treasuries to lend to high quality U.S. companies. Today it's about 1%. For lower quality companies, Mike Milken's old junk bonds, high yield bonds. Today, you get about 3.75% for lending to that type of company. The long-term average is about 5.4%. High yield and investment grade spreads are reasonably tight. The good news is, Kevin, is benchmark yields are higher than they were a few years ago.

[00:16:39] Brian Carney: If you think a U.S. 10 year is about 4% today, three years ago, that was 1%. So, spreads are tighter, benchmark yields are higher. There's some income and fixed income these days, which is good. But overall spreads are a bit skinny, and we expect corporate defaults to rise over the next 12 months or so. In this environment, the emphasis is more on protecting capital. And we think that's much better than diving kind of whole hog into high yield. That said, when we think about the portfolio, we've been able to put together a group of companies. With a yield in excess, 5.5%. And so, to put that in context, the yield on a five-year Government of Canada bond is about 3.5%.

[00:17:27] Brian Carney: We think that's decent for where we are in the cycle. Again, more focused on preserving capital, waiting for the next opportunity.

[00:17:36] Kevin Minas: And then within that portfolio that you've just mentioned, maybe if there's an example or two of, you mentioned there's always opportunities in the market. You're sort of talking high level spreads, maybe being a little less attractive, but sort of looking under the hood, that bottom-up work that you guys do, there's always opportunities. Where right now do you see some opportunities?

[00:17:53] Brian Carney: We can kind of give you three different buckets, and these have been sourced by our internally developed screening tool. We're also building on the in-house analysis that's already been done by our friends on the equity side and just through kind of years of experience. So, one of the areas where we think it's a good place to be at the moment, maple bonds. And for those who aren't familiar, maple bonds are non-Canadian companies who've issued in Canadian dollars. And there's a variety of reasons that companies do that. We don't need to get into that. We think there are some shorter dated maple bonds that.

[00:18:31] Brian Carney: are a good safe haven and provide a pickup versus domestic competitors. So, Heathrow, the airport over in the UK has borrowed money in Canada. It's a decent low single A type credit. You can pick up 125bps buying a Heathrow bond. JP Morgan has a short, dated bond. You can pick up a little over a 100bps owning that. And JP Morgan, even though it's a much bigger bank, we think probably more stable than many of the Canadians trades a little behind Canadian banks. And then Verizon also has short data paper and Verizon, very strong investment grade telecom company down in the U.S. Again, trades a little behind where domestic Canadian telecom companies trade.

[00:19:16] Brian Carney: So, we think that's interesting. JP Morgan and Verizon are both well-known on the equity side here at Mawer and their holdings in some of our equity strategies. So again, we talk about leveraging the large installed knowledge base here on the equity side to the advantage of our fixed income investors. I think JP Morgan and Verizon are good examples of that. A name on the industrial side, Brunswick Corp. I don't know if you have a cottage, Kevin, but if you've been in a recreational boat anytime during your life, you were probably powered around by a mercury motor. And Brunswick Corp is the company that makes those. Solid cashflow generating company. We've got a seven-year bond that yields about 1.75% over comparable U.S. treasuries. Very good investment grade company. So that's an example of an industrial date, even in a relatively expensive market, you're getting significant pickup for lending money to Brunswick. And then on the high yield side, another pick of our equity friends, this one, a Canadian name Mattr, if I'm pronouncing that right.

[00:20:32] Brian Carney: They've got a Canadian high yield bond outstanding, and the Canadian high yield market is really small. Shawcor Mattr has issued in the Canadian market. They've got a 2026 bond, which if it gets called on its first call date yields about 6.3%. Again, another interesting, stable company, well known to our colleagues on the equity side. You've got Maple Bonds, you've got an industrial example, U.S. pay issuer, and then you've got high yield examples. Those are the types of names that are in the portfolio and those are the types of names in this environment that we'd consider going forward.

[00:21:14] Kevin Minas: Excellent. Okay. So, all this sounds like there's opportunities. It's just a question of, of course, where and scaling your position. So basically, thinking about your risk budget as well. Excellent. If we were to shift gears a little bit and think about asset mix or asset allocations, so you've made some compelling arguments as to why this type of strategy makes sense, especially in light of what we've seen over the last number of years and more traditional fixed income markets, headwinds with rising rates, uncertainty now with interest rate volatility. But if investors were to think about, where could they potentially source room in their portfolios for this type of strategy. So, in other words, if they were trying to create a well-diversified portfolio, how does this fit? Where does it fit in?

[00:21:55] Brian Carney: A couple of ways to answer that question. First is reaffirming the need to have fixed income in the portfolio. If you think about why do individuals, why do institutions have fixed income, diversification, income, and both capital preservation and capital appreciation potential. So, I think individuals, institutions reaffirm we need some fixed income. I like to say, fixed income is as critical to a sound investment plan as rain is to farming, you don't want too much, but if you have too little, it can be devastating. Reaffirm fixed income, and then how does credit fit? I think this strategy first is suitable for both individual and institutional investors with a long-term investment horizon. If you're going to make a down payment on a house in three months, this is not the strategy for you. You must have a long-term investment horizon. Second, it could be the entirety of your fixed income holding. I believe that. And managing with a capital preservation opportunistic bent, it could be the entirety of one's fixed income holding, or it could be a specialty sleeve within a much broader fixed income allocation.

[00:23:14] Brian Carney: So, I think it's a good fit for people with set spending requirements. Again, individuals, endowments, foundations, it's got an attractive return profile. So, you could pair it with other fixed income. You could, depending on your view or your institution's view on where we are in the equity markets, you could think about this as an offset or a reduction to some of your equity exposure. I think there's a number of ways that this strategy fits what I would say to people watching is we think it's very important that people understand our process and how we've come to the holdings that are part of the strategy. So, we aim for transparency and the more an investor knows about the how and the why decisions are made, the better and the better they sleep at night, and they can leave the sleepless nights to us. I think this strategy fits in a whole bunch of different ways. We very much look forward to talking about the strategy, where it may fit with all the people out there, individuals and institutions.

[00:24:32] Kevin Minas: I definitely concur on the, it's important to understand the process and the philosophy. Perhaps we can have you on the podcast a second time.

[00:24:39] Brian Carney: I'm in. What date works for you?

[00:24:41] Kevin Minas: That'll be a whole other set of interesting topics that we should go through as well at another time. Maybe just a final question to wrap things up. We've talked a lot about your background, why we've launched the Global Credit strategy. Some of the compelling reasons that investors should consider. I guess the obvious last question would be why should investors consider investing in our strategy in particular? Why do Global Credit with Mawer?

[00:25:06] Brian Carney: There's a number of reasons. And I think ultimately it comes down to, I believe we've got the best chance to pick the cheapest securities. When those opportunities become available. We've got 40 plus investment professionals who do nothing but look at individual companies around the globe and try and figure out what makes those companies tick. We've got the best research team, I'm convinced in the country, possibly the world. We've got what I would call a large installed knowledge base. We have a proprietary system internally that we call M42, where all of that analytical information is stored and warehoused and is accessible to anyone on the research team, myself and the fixed income team included.

[00:25:56] Brian Carney: We've got access to an enormous amount of information. The screening process, which I mentioned, helps us take that big investable universe of over 30,000 bonds and bring it down into something manageable, which we can then marry up with M42 and our existing analytical expertise. I think the final point is the unconstrained nature of the strategy. We're not tied or forced to invest in high yield or forced to invest in leveraged loans. Like many strategies are, we have the ability to move anywhere on the credit spectrum, anywhere on the duration spectrum. And when you're focused on preserving capital, taking advantage of opportunities, focused on making sure you generate positive, absolute returns over the life of the strategy.

[00:26:49] Brian Carney: I think that's the way I've given you four reasons. When we do the next podcast, I promise I'll give you four more, but I think those are four pretty good ones.

[00:26:58] Kevin Minas: Excellent. I appreciate the lists; I think in lists as well. So that's a helpful way to frame it. So, it's been awesome chatting with you today, Brian. Hopefully the first of many conversations together. We've already got another one earmarked. So, we'll do that sometime soon. Thanks so much for your time today. It's been great.

[00:27:12] Brian Carney: Thanks for having me, Kevin. Appreciate it.

[00:27:13] Rob Campbell: Hi everyone. Rob here again. To subscribe to the Art of Boring podcast, go to mawer.com – that's https://www.mawer.com/podcast. Or wherever you download your podcasts. If you enjoyed this episode, please leave a review on iTunes, which will help more people discover the "Be Boring, Make Money" philosophy. Thanks for listening.