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TRANSCRIPT: EPISODE 61
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Please note that these are unprecedented times and markets can react very quickly to news. The views expressed are at the time of recording and could change.

[INTRODUCTION]
Darius McDermott (DM): Hi I'm Darius McDermott from FundCalibre and this is the Investing on the go podcast. Today, I'm delighted to be joined by Dave Eiswert, portfolio manager on the T. Rowe Price Global Focused Growth Equity fund. Dave, good afternoon from me, I think it's probably a good morning from you.

David Eiswert (DE): Good afternoon Darius, thank you very much for having me.

[INTERVIEW]
[0:27]

DM: We live in extraordinary times and your career spans a similar length to mine. This is my third market crash, how are you finding this one? How does it differ or is playing out similar to, to what you've experienced before?

DE: Yeah, it is very interesting. A lot of people have one, maybe two crashes in their careers. I think you and I now have three, so let's hope, maybe this is our last one, but three and then, and then I would argue a bunch of mini crises as well. You know, the key difference in today with this crisis, I think in, in contextualising it, is that this is very similar to a natural disaster, right? Versus what I think we've seen in our careers either in the tech bubble, or the global financial crisis. Those were, you know, I think about it, in terms of literature, in the great themes of literature: man versus machine; man versus nature; man versus man. I think the credit bubbles in the tech crisis and the global financial crisis were both sort of man versus man, this crisis is man versus nature, right? Which is a very different kind of crisis. And it has elicited a different response from both central banks and governments. And I think that we're all in it together. The natural disaster element really makes this crisis different.

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DM: So in to the fund then a little bit because, and this has been one of the most volatile market corrections, if you like, and certainly the quickest. Did you make any changes in to the fund in those early weeks? Or did you hunker down in favourite names or was there a little bit of rotation?

DE: Yeah so you know, we came into the year and it was really quite Goldilocks, right? Trump had managed to get the Federal Reserve to cut interest rates, the China trade war was ending, it was really quite a Goldilocks period of time and I think people floated up in risk a little bit and it makes sense, I mean people were looking for cyclical recovery. What we really did first off was cut any places we had balance sheet risk. So we have a saying on the team, if you're going to panic, panic early. And so we tried to panic early and remove really any kind of balance sheet risk, credit risk covenants, anywhere in the portfolio where we thought that risk, that's the first thing we did. Right.

Then the next question then is, you know, okay, what's our framework for the crisis? Then we kind of go through that. Who benefits from the crisis, and what names do you really want to own on the other side? That's sort of the stages of going through a crisis. We wrote a piece for our clients, really three-part piece about how we went through that process.

[3:19]

DM: When we dialled into your call a couple of weeks ago, you talked about markets and you know that they were likely to bottom not before things got better, but before things stop getting worse.

DE: Yeah.

DM: Can you explain your thinking behind that and do you maybe think, I know I think the call was about three to four weeks ago when we listened to you, do you think given that markets have already bounced that maybe we've been through that or how do you feel?

DE: Yeah. So one of the most, I think this idea of ‘stop getting worse’ is one of the most powerful things that I've learned in my career around investing. Whether it's an individual country or individual company, a country, a market, this idea of ‘stop getting worse’. And what that means is markets bottom, not in the absence of risk, but when risks stop accelerating, when you start to see how risk could moderate. We really thought early that there were three key parts of this ‘stop getting worse’ in this market.

The first was the response of governments, right? What would central banks do and what would governments do? And I think, I mean, you can argue philosophically long term about how governments should behave in a situation like this, but I think that in general central banks and governments, especially the US Fed and government did an amazing job of stepping in and keeping the plumbing functioning. So that was the first element of 'stop getting worse'.

The second really is around testing treatments and although we have a long way to go on that, we think we're past the worst in how we test and treat the virus. And in fact, we're seeing hospitals, you know, pass their peak. You know, this locked down, it was really all a function about saving our healthcare systems more than it was about people dying in the streets of the virus. Right? We wanted to save the healthcare system. And I think we've done that. So that's the second, the second part of that testing and treatment.

I mean third really was around when would cases peak in major economies. And so we sort of saw that in China and we really use China to project how Europe would play out and how the US would play out. There was clearly differences, but this idea of peaking cases. So those three elements I think, those are the key elements of 'stop getting worse'. I think we are through that now and markets as they do, you know, as soon as they sense that 'stop getting worse', they begin to rally and that's what we've seen to this point.

[5:49]

DM: Do you feel markets, I hate to use the phrase, over rallied, but you know they went down really hard and fast to face news about the virus itself and they've rallied, you know, S&P and NASDAQ had fantastic runs, but do you think markets can accept this sort of economic fallout of lockdown and company profitability?

DE: Yeah, it's a great, it's a great question because this is a natural disaster and not a credit cycle. That's really important, right? Because you know, if you look at autos or semiconductors, usually when you have a downturn, you go through a big negative inventory and distribution cycle. But since we already had that in semis in 2018 and 2019, you're not getting that in this cycle. I bring that up because this natural disaster is very different than a credit cycle. Things like Netflix, Amazon e-commerce, Zoom video conferencing, which we are on right now. You know, those were not, usually those types of businesses are in bubbles going into a breakdown. In this case, the virus actually boosted their positioning and accelerated their adoption. And so that marks, it makes this kind of cycle very, very different.

So the other thing is academically, if the Fed is going to buy every asset class, if central banks are going to step in and support the economy through the, through the virus, the peak virus risk, multiples should go higher, right? Multiples should go higher, credits more available, interest rates are lower, right? So the fact that asset prices go up after that sort of response is not surprising. And you could argue, you know, it's a more, there's more liquidity out there now than there was before the virus.

I do think we're moving through stages, right? So the first stage was sell your risk. The second stage was own the companies that are boosted by the virus. Again, Netflix, Amazon, Zoom, you know, Team Viewer in Europe, another example. The stage we're entering now I think is more around, we call it 'pleasant surprise'. And so we're looking for companies, I'll give you a good example in the UK, Ashtead [a company that rents construction equipment in the UK, US and Canada] in the UK is a good example, a name we own in the portfolio. Why is Ashtead a pleasant surprise? Well, because the market initially reacted by thinking Ashtead was going to have major downward revisions and it turns out that construction in the US is largely still going on and so you get a pleasant surprise. So we're looking across the portfolio now at these sort of ideas of pleasant surprise.

The two other areas that I think are interesting and we'll have to see what happens is one, the epicentre names around travel, airlines, those are all still just wrecked, right? And so those have not rebounded. And the other is financials, interest rate sensitive, yield curve sensitive names. How do they respond and energy, right? So, I guess if I summarise that, the market because of this is the nature of a natural disaster versus a credit cycle. The market is very heterogeneous and so saying something's rallied and something's not, right? There's plenty of parts of the market that are still disasters and there's other parts that really did deserve to do better. So that, what I would say to you Darius is it's going to get more and more difficult as a stock picker to, you know, be contrarian in some areas. Things that are bombed out or things that have done really well. It's not as easy in some ways, even though the panic was terrifying. There were some, looking back, extremely easy parts of this crisis. And I think things are not as easy anymore.

[9:42]

DM: Well, I was just reading your part three note that you've been distributing to clients today and I think you touch on being tempted into value, but just, you know, sticking with the knitting, is there any sector or stock which, you know, maybe, not a fallen angel is probably a bad word to use, but things which now look like value, but have got some special sit[uation] up behind it or?

DE: Yeah, I mean it's a great question. I, the value space, I even have a hard time understanding what value is, right? The highest ranked value managers are growth managers, right? And they sort of will tell you why Microsoft is a value stock at 30 times earnings. It's hard to even understand what value is. I think that there are some bad neighbourhoods, you know, in value, whether it's commodities or financials where there are some good ideas. Charles Schwab is a big holding of our portfolio. We think Charles Schwab has the characteristics that make it more of a growth scale asset despite the fact that its short term earnings are very sensitive to interest rates. So that's a stock that got really destroyed in March, traded under $30 a share, you know, our analyst has like worst case earnings of just over $2. And so we were adding to a name like that, right, which is in a bad neighbourhood, I'll call it financials, but has characteristics… So we're trying to be carefully contrarian in the portfolio around names like that without just rushing into value as a sector, right. Morgan Stanley is another name we added to the portfolio in Q1. Again, it traded down to 0.7 times book. We like the management team. We like some of the different exposures in the shift of wealth management. And so, you know, we thought that was an extreme value situation. So we are being cautious. I think you've heard me say this before, you know, we try to be carefully contrarian in some of these names, don't run into a burning building, but if you can pick off an asset that you think has growth characteristics, you should be willing to do that.

[12:04]

DM: And most of the listeners to the Investing on the go podcast are either UK or European based, maybe you just touch on what lock down has been like briefly in the US for our listeners. And obviously you're based in the US, the US is the biggest weighting within your fund. And things are sort of rapidly changing there, 22 million people are unemployed, is that likely to bounce when lockdown ends? What's it like in the US?

DE: Yeah, yeah. So, you know, the US economy has been strong, right? It's been strong. You know, I think unemployment's been exceptionally low. We went into this crisis, from a position of strength I think, and again, the government is buffering that temporary unemployment situation, you know, some people argue even too extreme, right? So to the point where workers are, would rather be on unemployment than they would to go work at the factory right, now that has a lot of social implications around why is there, why are they being treated so poorly to begin with working at their, at their jobs.

But in general, the US is a very divided society right now between, pro-Trump administration and, and other, right, I call it sort of an other, and our States divide along that line as well. So States in the Northeast, lockdown is more severe. In the South you see much more willingness to get back to work quickly. And so it's, in some ways it's chaotic, right? And it will be a sort of chaotic recovery. Is that positive or negative for the world? We're gonna see some tests, whether it's Georgia or Florida, in how quickly can people come back to work. Because I think those States are going to be more aggressive. So yeah, I think the US is going to, is almost to a certain degree taking more risks than certainly than China. Right? Which is still strongly locked down. Right. Although there's some back to work, you know, there's still government implemented rules that people listen to. I think Europe, you know, there's an element of more cooperation and I think you come to the US and you see a very heterogeneous group of people and you're going to see risks taken and we're going to see the implications of whether that causes reinfection rates or not. And so, you know it's risky. I do think Darius, when we move through this, I think the US economy is still very stable. I think, you know, we have low unemployment. I think that will continue. So I think when we move out of this, there's no reason why we can't get back to a stable economic environment in the US.

[14:54]

DM: Yeah and I know you talked about earlier about the Goldilocks scenario. If we were, if we had had this conversation on the middle part of December or even maybe the middle part of January Corona[virus] might not have been at the top of our things to talk about, but the US election probably would have been.

DE: Yes.

DM: The impact on healthcare and whatever other sectors we could have got into. But I wonder if the actual sort of Coronavirus itself will impact on the US election. As you say, how lockdown comes out for various different States, whether they would be natural Donald Trump supporters or not, or whether he's actually doing good or damage to his brand within your home market. Any thoughts on that?

DE: That’s great. It's a great question. First of all, let's hope we have the election, right? I mean, I think if you did end up with a second wave of virus, you have an issue of in-person election, in-person ballots in the US, which will be interesting. So let's hope that, that we actually do have an election.

Look the main risk for financial markets was taken off the table when Joe Biden became the nominee for the Democratic party. The risk of Bernie Sanders versus Donald Trump, I mean, that is a extremely uncertain situation in the US, and so, because you basically, we would end up with a activist populous part of our population or voters ,that is in some situations it's difficult to distinguish a Bernie supporter from a Trump supporter. There's some very similar threads…

DM: Characteristics, yeah.

DE: Yes there are, anti-globalisation, anti-technology, right. And so I think the biggest risk is off the table, and so that's positive for us that that has implications for how we invest in healthcare, managed care in the US becomes more attractive in a Biden versus Trump election. So there are some opportunities there. You know, I, the jury is still out. I think it's not clear whether Trump's handling of the virus and his war with different Governors around the country has led to improving popularity for him or declining. It's really not clear yet. So I think in the next few months, you know, three to four months, we're going to start to see how the trajectory out of the virus, and you know, if the US economy emerges very quickly and strongly, I think that's in Trump's favour. If it's more rocky, I think that's more towards Biden's camp. But yeah, it's very, it's very, it's very uncertain if we start to see some of these Republican States that go back to work early following Trump's sort of, that's been his sort of dog whistle, right, to get back to work.

DM: Yeah.

DE: If they start to have increases in cases, you know, I think this will be very negative for Donald Trump. Either way I'd tell you, I think I feel like a lot of the political risks in 2021 and beyond has come off the table. I do think that both candidates will be attacking China. And so we have to think about that in the portfolio, because they'll try to one up each other in going after China in the election. So that's something to think about.

DM: Well listen, Dave, thank you so much for taking the time to talk about the portfolio impacts of COVID-19 and some of the thoughts on your home market. As you were concluding in, I think there's a lot left still to go on both politically and economically in 2020. So thank you very much for your time. For more information on the T. Rowe Price Global Focused Growth Equity fund, please visit FundCalibre.com and to subscribe to the Investing on the go podcast, please also visit FundCalibre.com