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How IAIC Is Managing Volatile Markets during the Coronavirus Outbreak

An Interview with Brian Durno, IAIC Portfolio Manager

We recently spoke with Brian Durno, CFA, CFP, a portfolio manager with IAIC, to learn more about how he and the team at IAIC are working to manage client investments through the unprecedented economic disruption caused by the COVID-19 coronavirus outbreak.

Here's what Brian told us:

IAIC – You've been an investment manager for almost 25 years. Have you ever encountered market conditions similar to what we're seeing today?

Brian – From a market perspective, the simple answer is yes, at least four times, if you count the European debt crisis in 2011 and skip all the “normal” corrections along the way. From a fundamental perspective, I have never seen a market impacted as quickly by a virus as this one. Every bear market is rooted in different causes but the symptoms that play out in markets are almost always the same: steep market declines (this one was one of the fastest in history); emotional decision-making; investors focusing more on “noise” than facts; and, sadly, more fear-based journalism than ever before. And of course, a real fundamental impact on earnings and business activity.

In my experience, there are at least two clear stages in markets like this. The first stage is the initial move down that occurs from the market making its collective best guess on the fundamental impact of the event even though there is not yet any data to support its forecast -- think of this first stage as the “anticipation stage”. The second stage has just started in the last day or two and is where we begin to see the extent of the actual fundamental impact, including jobless claims, manufacturing data, earnings, etc. We expect volatility to remain elevated in this stage as the market compares this flow of factual data to its earlier forecast that is now embedded in today's prices. Some data will be positive, and some data will be negative which will lead to quick adjustments in prices. The market's reaction will depend on what has been priced in before consuming the data.

IAIC – We all understand that when we invest in the stock market there will be ups and downs, but even those of us who have seen market dips before get nervous when we see the news every day about how the virus outbreak has affected markets. Tell us about the conversations you are having with clients through this pullback. What are you advising clients and how are they reacting?

Brian – Client contact is always important, as the client is at the centre of all our actions. Being able to access the portfolio manager and “check in” is a huge benefit for those clients who want that level of interaction.

It is normal for clients to be nervous during times of uncertainty. We have no crystal ball for when it will end and recognize that the daily ups and downs can be difficult for most investors. But we

are confident that these conditions of heightened volatility that we have seen will not be the “steady state” for markets over the long-term. Health care providers and organizations, governments, central banks, business leaders and communities and individuals around the world are all focused on the problem at hand and taking significant actions to manage this threat. We can assure clients we are monitoring developments very closely and feeding that back into each of the portfolios we manage.

For me personally the conversations are literally everywhere in the range from “how fast can I send you more money to buy what you think is cheap” to a more reassuring kind of conversation about the blue-chip, large capitalization nature of most of the holdings. Everyone experiences markets like this differently and may need a different response depending on their source of concern.

IAIC – Clients often ask what our portfolio managers are doing during the pullback to manage their investments, but a big part of the answer is the work you and our team put into portfolio construction well before the market pullback. Can you explain that?

Brian – Right, that’s a very important point to make. We have always maintained that diversification is a critical building block in portfolio construction. We structure our clients’ portfolios with the recognition that an event just like this may happen at some point in the future. The client portfolio is designed at the outset to weather the storm. Depending on the client’s capacity and appetite for risk, we balance stocks with cash and income-producing securities, such as corporate bonds. In “up” markets clients are sometimes disappointed with the drag on returns from cash and bonds but are now seeing the benefit of combining all the major asset classes in portfolio design. And the stocks that we select are ones we believe will perform well in economic downturns relative to the larger index.

IAIC – You’re one of our 14-person team of portfolio managers at IAIC, which in turn is supported by a large team that helps with research analysis and administration. In addition to your meetings with clients, tell us about your role within the portfolio management team and how the team is working behind the scenes during this virus outbreak. Has your role or the work done by the team changed at all during the virus outbreak as compared with “normal” times?

Brian – Generally our process and activity is accelerated in markets like this. We are fully focused on the fundamental impact on companies. Sales, margins, debt – the same traditional analysis still applies, so we are uniquely positioned with prior “bad market” experiences in our collective pasts to help us test our scenarios and make sound decisions in client portfolios.

More scenarios than usual are created for both upside and downside that may not have been as evident a few months ago. Models and valuations may be revisited many more times than “normal” as new information flows. Subjective views and scenarios are tested and re-tested in our team to fine tune our thinking. This is happening more frequently now than in a “normal” market.

Our portfolio managers are all generalists and are comfortable in every sector, however each of us also specializes in specific sectors. For me, it is the consumer staples, discretionary and health care sectors, so I contribute detailed analyses in these sectors when we discuss strategy. Right now our team is having almost daily meetings to assess and analyse any new flow of fundamental news and data to continually test our thesis. We are comforted by the strength and competitive position of our holdings. We are also actively monitoring the markets for potential new ideas that have become attractive based on long-term fundamentals.

We continually review client portfolios to ensure they reflect our most up-to-date thinking on asset mix and security selection.

IAIC – Anything else to add in terms of work you’re doing behind the scenes with client accounts we haven’t already touched on?

Brian – The most important focus is on value, not price. Price is what you compare to value to determine if a security is attractive. If you are reasonably certain about the value of something, the price does not have to represent a signal that has to be responded to or acted on. Price in some markets is more a reflection of a temporary mismatch between supply and demand (i.e. more sellers than buyers) than a true signal of the underlying value of a security. I know it may be painful to watch the prices when they are moving so dramatically, but it is unlikely that the value of a business is fluctuating by the same amount as what we’ve seen lately. Comparing

prices to these calculations of value is the best investment idea that we know and is one that works over a long period of time.

During rebalancing we are continually performing this discipline within client portfolios.

IAIC – Before we wrap up, let’s shift gears a bit... In order to protect our team and clients, we have mandated that each of our employees work from home. How has that affected your ability to do your job?

Brian – Almost half of our workforce and most of our portfolio managers normally work from home on a regular basis, so, thankfully, the “work-from-home” requirement is pretty much business-as-usual for us. I have always been set up with two large computer screens, fast internet in a separate area of the home (and yes, a floor heater, I am in Ottawa!) and a wide range of ways to communicate remotely with our team and clients. The main impact has been that we are no longer able to meet face-to-face with clients, which is certainly a shame given the nature of our client conversations in these market conditions.

IAIC – Right, technology is great, but we’re all feeling that sense of physical separation, aren’t we. One last question before we let you get back to work. How are you and your family doing amidst all the upheaval caused by the virus outbreak?

Brian – Amazingly, I seem to have a lot more time in my evenings to review the day’s events and watch overseas markets because there is nowhere to drive my kids around to. As for the mornings, it is clear we need another coffee maker in the house.

In volatile markets like this I have always found that for me, it’s better to be in a noiseless, separate environment for clear thinking. It is easier to focus on the signal and not the noise in the quiet confines of a home office. So, I would say there has been no real impact, but I understand it would be an adjustment for people that are new to this.

IAIC – Brian, thank you very much for your time, which I know is very precious these days. Please take care and stay healthy!

IAIC Disclosures

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