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No problem can't be solved with a lot of money

1832 Asset Management's Dana Love argues that while the short-term outlook is uncertain some global opportunities have emerged

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It's unclear whether the worst is over for markets, argues Dana Love, vice-president, senior portfolio manager and head of global core equities at Toronto-based 1832 Asset Management, a unit of Bank of Nova Scotia. But as an optimist, he believes better valuations have emerged and investors who take a long-term approach will eventually be rewarded.

"The 'short' answer is that I don't know, because it requires forecasting and I am not a big fan of that," says Love, lead manager of the 4-star gold-rated $1.1 billion Dynamic Global Equity Fund F. "We have never had a global pandemic like COVID-19. The ultimate outcome as to how this plays out is total speculation, particularly when the foremost healthcare authorities in the world cannot agree on when it is likely to end."

Is the worst over?

Yet it appears that the market has discounted the worst of the pandemic and it is off to the races. "Last week was statistically the best week for the Dow Jones since 1932 and for the S&P 500 since 1974," says Love, referring to market performance the week of April 6th.

"If markets are insinuating the worst is behind us, then in some cases the markets have almost fully healed and we'll see where we go from here," says Love, a native of Kitchener-Waterloo, ON, and a 26-year industry veteran who joined 1832 Asset Management in 2013, after 14 years at Invesco Investment Management. "But policymakers and governments have thrown everything they can at this and it appears that the one lesson that we keep learning regardless of the kind of the crisis—like the global financial crisis in 2008, or the bursting of the technology bubble in 2002— is that there is no problem, according to the markets, that cannot be solved by a lot of money.

"I've been cautious and conservative over the past couple of years because I thought prices and valuations were very high," says Love, whose 5-person team oversees $6 billion in assets in aggregate across a number of global and international equity and balanced offerings as well as several region-specific equity funds. "But when prices drop, future expected returns improve. I am much more optimistic than I was at the beginning of this year."

Love admits he does not know if global economies will rebound in the next couple of quarters, as there are a lot of unanswered questions. "We don't know if this is the first wave, and we relax the social distancing, and it flares up again. All we can do is guess. But given the evidence we see in the media, that countries such as Austria, Germany and Spain are relaxing some of the social distancing measures the worst of the economic impact is probably behind us and there will start to be some improvement by the fourth quarter, although it will depend on the structure of each economy."

Will valuations improve?

"We make most of our investment decisions based on the merits of each business. If there is one common thread in conversations with many companies, it's that they have no visibility on the implications for the end-markets for most of their business. So prices are lower, but earnings power and companies' financial characteristics are impaired, whether it's short term or long. It's very difficult to assess how much better valuations might be."

As a stock picker, Love is reluctant to be categorized in terms of investment style, but for the most part he seeks companies that have strong management teams, good growth opportunities and whose stock is trading at reasonable valuations.

On a geographic basis, Love has allocated about 62% of the portfolio to international markets, and only 25% to the U.S., mainly because of its high valuations. From an investment perspective, he has not made any dramatic sector changes as a result of the current volatility and the top four sectors are: consumer cyclical at 21.4%, financial services 19.4%, technology 16.8% and communications 9.7%. But Love is fully invested, having spent the 11% cash that existed before markets declined.

Dynamic Global Equity Fund F has between 30 and 40 names. “We don’t trade a lot. That’s part of our process,” says Love, adding that turnover is fairly low year to year. “We are truly long-term investors and take a view over a full business cycle, which is typically 5-7 years but can sometimes go longer.”

In selecting companies, Love applies three hurdles:

1. Is it a good line of business to be in, and does it generate high returns on capital?
2. Is this a good company and what makes it unique in terms of its competitive advantages and financial strength?
3. Is it attractively priced in terms of cash flow yield and other measures?

Once they overcome these hurdles, Love and his team arrive at an acceptable rate of return for the stock, based on the risks in owning it for the long term.

Top holdings

One top holding is Hong Kong-based power tool manufacturer Techtronic Industries, whose brands include Milwaukee and Ryobi and floor care tools such as Dirt Devil. “They are the best-in-class operator that has capitalized on the trend towards cordless tools and appliances,” says Love, adding that battery packs allow consumers to switch easily between tools. “If you buy one Milwaukee power tool you can extend it to other power tools in their range by using the same battery.” Competitors have tried to match Techtronic’s range of tools but haven’t succeeded. “There is a very high degree of customer loyalty, which is attractive to us.” In addition, the company founder is the controlling shareholder. “It has all the ingredients we seek: growth opportunities, the ability to improve its profitability through scale and scope advantages, loyal customer base, and it’s taking market share from the competition.” The stock generates a 7% normalized free cash flow yield and trades at 17 times forward earnings.

Another favorite name is Topdanmark, a leading Danish property and casualty insurance provider. “It’s one of the most efficient, highly profitable property and casualty firms on the planet. It continues to deliver year in, and year out,” says Love, adding that the firm has been in the portfolio since the launch of the fund in November 2013. “It has withstood all sorts of crises and operates only inside Denmark. A very simple company and a very simple business, and it has rewarded investors.” The company generates a 20% return on equity and its stock trades at 16 times forward earnings.

From a performance standpoint, the fund returned -6.15 year-to-date (as of April 24), versus -9.63% for the Global Equity category. Over the past five years, the fund has averaged 7.46%, compared to 4.36% for the category.

Looking ahead, Love is optimistic, yet also advises investors to be patient, and avoid panic. “If investors do these two things, then they will survive and come out the other side,” says Love.