



A conversation with Bert Clark, Chief Executive Officer

As IMCO reaches the halfway point in its current Five-year Plan, our CEO recently sat down for an interview to discuss the organization's progress on investment strategy, creating long-term value for clients, and future priorities.

CAN YOU DESCRIBE IMCO'S OVERALL APPROACH TO INVESTING?

We are fundamental investors. That means we don't believe in trying to time markets or generating returns through complex trading strategies or highly engineered investment portfolios. We look to invest in high quality companies and assets that generate solid long-term returns.

WHAT ARE THE BIGGEST OPPORTUNITIES AND RISKS YOU THINK ABOUT?

In terms of opportunities, I'm a long-term optimist.

Growth assets like equities, infrastructure, credit, and real estate should generate healthy returns over the long-term. \$100 invested in the S&P 500 in 1928 would be worth almost \$800,000 today, whereas \$100 invested in 10-year US Treasuries in 1928 would only be worth around \$10,000 today.

The biggest advantage an investor can have is time, meaning modest portfolio outflows and a tolerance for near-term return volatility. This allows them to invest in growth-oriented assets and earn a long-term premium over lower risk assets.

Thankfully, most of our clients have this advantage, so we look to take advantage of it by investing in growth assets to generate solid long-term returns for them.

Risks, unfortunately, are an unavoidable aspect of investing and individual investments can run into trouble. Companies that at one point in time look infallible, fail. Nortel, Sears, Enron, PG&E, Kmart, Swissair, Arthur Andersen, WorldCom, Bear Sterns, Lehman Brothers, and AIG were all dominant companies that failed.

As well, large segments of the market regularly suffer surprising downturns: The Nikkei index peaked in 1989, crashed, and then took 34 years to get back to the same level; when the dot com bubble burst in 2000, it took the Nasdaq 15 years to reach its former peak; and in 2008 the price of oil reached \$147 per barrel. It has not yet regained that price level.

Even segments of the market that are considered to be very safe are subject to surprising events. In 2022, the US Federal Reserve raised interest rates faster and more than at any other time in the previous 40 years, resulting in negative 39% returns for 30-year Treasuries. This safe harbour investment contributed to the failure of Silicon Valley Bank and resulted in over \$600 Billion in unrealized losses for US banks.

Surprises are inevitable, which is why it is important to avoid “big bets” on individual companies or market segments. Big bets are typically for those investors trying to generate really high returns. They take the risk that their concentrated bets surprise to the downside.

Our clients are not looking to generate really high returns. Their objective is to generate solid, stable, long-term returns to meet their obligations. This is why we avoid big bets and focus instead on building well diversified, growth portfolios.

WHAT HAVE THE BIGGEST INVESTMENT CHALLENGES BEEN SO FAR?

The last few years have been interesting, to say the least!

We went from worrying about “lower for longer”, to navigating a pandemic (and riding the sugar high of coordinated fiscal and monetary policy during the pandemic), to weathering the biggest and fastest increase in interest rates in decades, and the reemergence of war in Europe and the Middle East, as well as protectionist trade policies.

Some might say that this was not a great time to launch an investment management organization!

But I suppose every investor thinks they are living in challenging and risky times.

The bigger challenge for us has been doing the hard work of adapting the portfolios we inherited from clients when we first launched so they better reflect our approach to investing and our capabilities.

For example, combining the portfolios of multiple clients meant we were initially overdiversified when it came to external managers. We had about 220 managers; that number leads to what Peter Lynch would call “deworsification.” Your best-case scenario is that you get broad market results, less costs. We have been working to focus our manager roster on a core set of best-in-class partners.

At the same time that combined portfolios were overdiversified in terms of managers, they contained very large concentrations of risk, particularly in Chinese Public Equities, office and retail Real Estate, and value style investing in US Public Equities. We have been gradually reducing those positions, to align with our approach of avoiding big bets.

Finally, we had very small allocations to asset classes that have become fairly conventional and strong performers in recent years, like private equity and private credit. We have now built these programs for our clients and helped them increase their allocations.

Before we were created, our clients were amazingly effective at managing relatively large portfolios with small teams and limited systems. They deserve real credit. But our scale, operational latitude, and enhanced capabilities have allowed us to work with them to improve their portfolios. With each year, the portfolios we manage better reflect our approach to investing.

CAN YOU DESCRIBE IMCO’S OVERALL APPROACH TO ASSET MIX?

The broader asset management industry is very focused on net value add, meaning outperforming at the asset class level. This is understandable because most investment managers don’t manage all of an investor’s portfolio. They only manage some portion of an individual asset class for the investor. So, discussion and analysis of asset class net value add dominates the industry.

But generating net value add at the asset class level is nowhere near as important as getting the overall asset mix right. Choosing which classes to be in, and to what extent, has a much bigger impact on total returns and risk than the net value add within asset classes. At the end of the day, total returns and risk are what matter.

We are fortunate that we manage all our clients’ funds. So, we can focus on helping them get their asset mix right.

The key elements of our asset mix approach include the following.

STICK TO THE PLAN - We do not tactically adjust asset mix to try and take advantage of predictions about near-term market movements. We allow some natural drift in the asset mix to capture the momentum of asset classes and we systematically rebalance at preset thresholds to capture the benefits of “selling high and buying low.”

AVOID BIG BETS - We don't make big bets on asset classes or market segments within asset classes. As I mentioned earlier, surprises regularly happen, and big bets can hurt.

DON'T VENTURE TOO FAR AFIELD - We focus on developed markets where we can leverage our investment advantages and there is less ESG risk.

NEVER GET CAUGHT BETWEEN THE BASES - We take a cautious approach on liquidity, relying primarily on high quality government bonds to navigate market events. Lack of liquidity can hurt investors even more than big bets. It can result in crystallized losses and the inability to meet obligations as they come due.

RIDE GROWTH ASSETS UP - If there are two basic strategies for generating the sorts of returns that our larger clients need to meet their obligations - more growth assets or significant use of short-term borrowing - we focus on owning more growth assets. We have advantages in private growth assets that we can leverage to enhance returns over the longer term.

ONLY LOOK TO OUTPERFORM WHERE WE HAVE ADVANTAGES - We look to outperform by leveraging our investment advantages, such as a longer investment time horizon, a tolerance for illiquidity, and the ability to partner with best-in-class managers. We are prepared to accept market returns in asset classes or market segments where we have fewer advantages. For example, we do not look to generate net value add in government bonds and about 50% of our public equity portfolio is invested in passive and factor strategies.

LOOKING AHEAD, WHAT ARE THE BIG INVESTMENT PRIORITIES?

We are going to continue to focus on the keys to long term investment success.

By the end of this year, we hope that we will have all our clients in, or targeting, customized asset mixes that we believe are optimal for them. This is by far the most important thing we are working on.

We are also working to reposition our real estate portfolio. It has become clear in the last few years that it is not really meaningful to lump all real estate together. Older office is different from new office. And office, retail, logistics, multi-residential, life sciences, storage and data are all very different. A diversified real estate portfolio needs to be diversified across market segments, not just geographies. We still have some work to do on that front and current markets haven't made repositioning the portfolio easy.

We continue to build our internal fundamental public equity program, which is focused on smaller and pre-IPO companies. We believe that our investment time horizon and tolerance for illiquidity (in the case of pre-IPO companies) gives us advantages that should allow us to outperform over the longer-term.

We will continue to invest alongside our key partners in Credit, Infrastructure and Private Equity, particularly in sectors that align with our World View (e.g., healthcare in Private Equity; clean energy and digital Infrastructure; and private middle market lending in Credit).

We will also continue to look for opportunities to invest in opportunities that don't fit neatly into any asset class – because these often have superior risk-return characteristics.

ANY PARTING THOUGHTS?

I feel very good about where we are mid-way through our Five-year Strategy.

We are helping clients build better portfolios that leverage their long investment horizons, by investing in diversified portfolios of growth assets.

We are eliminating big bets - big risk concentrations at the asset class, market segment or individual investment level.

We are only looking to outperform where we have advantages and accepting broad market returns in other areas.

We are avoiding unnecessary portfolio complexity and the temptation to try to time markets.

And we are focused on costs.

I'm very confident that the investment program we have built is going to generate strong returns for our clients over the longer term.