MOUNT MURRAY INVESTMENT

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Talking to our portfolio

One of the best parts of being a fund manager is all the really interesting and exciting people we get to talk to, whether it is our clients themselves or the companies into which we invest our clients' assets.

Recently, we were talking to several of the Latin American banks in our portfolios. Now, talking to banks can be less than exciting at times. Across the world, they are heavily regulated, so you get into intense discussions about Basel III, tier 1 capital, and risk weighted models. If you are really lucky, you get to discuss if their net interest margin (the difference between what they lend at and what they borrow at) is going to be 0.305% or 0.310%.

Banks can often be the weak link in an economy. As we saw in the global financial crisis, when the system gets infected, it can take years to recover. That is why they receive so much scrutiny.

This time around, things were decidedly different. Certainly, the sheer scale of the numbers being talked about, the massive adjustments to the economy that Covid-19 has brought, and the real socio-economic effects were all staggering, but generally the mood was upbeat - or, at least, as upbeat as one can be in a global pandemic.

One of the constant themes we were hearing was how these banks' clients had switched to mobile banking, and how relatively seamless the process had been. Despite the lower income levels, penetration of smartphones was not the issue. Cheap Asian brands that gave the required access are plentiful and affordable. Data costs are considerably lower than they are here in Canada – Claro offers 8 GB of mobile data for approximately CAD 20 a month in Peru, whilst Videotron charges us $60 here for the same.

The banks already had the apps up and running; these were not something they had thrown together in a rush. Whether it was pure mobile, or broader online access, these banks were offering a service as good or better than we are used to – one bank even told us how many clicks it took for a client to apply online to get loans postponed under the government forbearance scheme: 3! And once that client had waded through those 3 clicks, the system basically took care of the rest.

The Brazilians were also excited about their central bank's new instant payment scheme which is due to start operations in November. They likened it to India's famous scheme in which every citizen automatically has a bank account linked to his/her ID that can receive government transfer payments. Called Pix, the Brazilian scheme is intended to open up basic banking to the "unbanked", so they can receive their government support automatically, amongst other things. Stepping back for a second, we see one of the world's largest emerging economies copying another one in implementing a technological solution that is beyond the U.S. and other "advanced" economies; apparently the US recently mailed out 1.1 million stimulus cheques to dead Americans. One wonders in turn how many of the living recipients had to take their cheques to Payday loan stores to get them cashed…

Of course, not everything was perfect. When trying to get a feel from one of our banks about the real constraints they faced with persuading clients to switch to these apps, they told us a recent pre-Covid story of how a new member of the board was getting some hands-on experience in a branch, encouraging clients to use the ATMs and touch screens rather than queue in for a teller. The lady concerned seemed very interested, and thought it all very useful, but she would stick with the teller. When asked why, she simply answered "I can't read".

Technology alone isn't going to get these banks through the pandemic. Prudent risk management is the cornerstone of good banking, and we were encouraged that none of them had lost sight of that. Despite strong balance sheets with good loan-loss provisioning well ahead of the crisis, the Brazilians were pre-emptively taking BIG additional reserves. That may have cut into first quarter profits, but those provisions can always be reversed next year if they aren't needed, whilst struggling to increase provisioning after the event always looks unprepared.

Elsewhere, we were reassured that all our banks were holding back on originating new loans to all but the most established customers. Remember, these banks are the survivors. Compared to some of the domestic crises they have been through, the GFC was a blip. They know that poor underwriting now can have a major negative cost later on. So, if that request really is a good business prospect, they will still need that loan later on – after all, no one is going anywhere right now, anyway.

Overall, we came away from our discussions reassured that these companies would continue to be not only blue chips in their respective markets, but also extremely solid in an international context. We often view banks as somewhat boring investments, but sometimes, simply boring is actually pretty good.

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