Lead Left Interview – Edwin Cass (Part 2)

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This week we continue our conversation with Edwin Cass, Chief Investment Strategist, Canada Pension Plan Investment Board. Mr. Cass is responsible for CPPIB's overall fund level investment strategy. He also chairs the Investment Planning Committee, which approves all new investment programs and oversees all portfolio risks, including passive, active, credit and liquidity risk. ***Second of two parts – View part one***

The Lead Left: What's your overall view of credit right now?

Edwin Cass: Credit helps diversify our asset mix by providing exposure to volatility and credit spread returns. I also think there are opportunities for relative returns in the credit space. For example, our Antares Capital team can take advantage of the illiquidity premiums and sourcing opportunities in the middle market. They are experienced in seeking credit investments to generate security specific returns.

Lastly, as part of our CPPIB 20/20 program we want to be more cognizant of conditional asset pricing. That is, value in a time-varying sense. Credit can be very cyclical, and we hope to develop strategies to dynamically change our allocation to credit at various points in time.

TLL: Do you mean market timing?

EC: Not market timing per se. We aren't trying to call turning points, but identify significant deviations from fair value. Take credit as an example. Values can and have swung around in the past. Arguably credit got very cheap in 2009. We want to build models to take advantage of mispricing like that.

TLL: Do you see signs that it's time again to increase exposure in credit?

EC: We are long-term value players and big believers in DCF analysis. We have steady rate assumptions. We're trying to discount cash flows back, and then see if something is cheap. Some of those metrics make credit start to look interesting right now.

TLL: Going back to Antares. How do you see that acquisition fitting into your long-term strategy?

EC: Antares is oriented to achieving the objectives we discussed earlier. The middle market is a high-touch asset class requiring lots of manpower to be successful. Additionally, particularly in asset classes like credit, we aren't comfortable investing purely in an index. Acknowledging that, the challenge is where do we want to be positioned in middle market? And how do we penetrate that market? Antares offers us a great opportunity to accomplish our goals. Antares also ties into conditional asset pricing through the choices we make in its capital structure – we can finance these opportunities through debt syndication or potentially from our own balance sheet.

TLL: Ed, CPPIB is a founding investor in the S&P Long-Term Value Creation Global Index. Tell us what got you interested in this project?

EC: The LTVC is something that came out of another initiative. We joined forces with BlackRock and McKinsey two years ago to focus on this issue of short-termism in capital markets. That's the view that public companies are managing to short-term results, too focused on quarterly earnings, rather than on longer-term objectives. If you look back you'll see a number of examples. There's a propensity of CEOs to not to engage in long-term investments if it doesn't help hit quarterly profit targets! We and others recognized there's a problem.

TLL: But how to address it from a practical perspective?

EC: First we got everyone in a room to brainstorm to come up with potential implementable solutions. In 2015, we organized the Long-Term Value Summit to discuss ideas for practical change. What can we come up with that would change behaviors? What type of investment process works? What if we put forward an index that would create one tangible alternative, then hopefully other people will join in.

TLL: What kind of changes do you propose for CEOs and boards of these companies?

EC: We've developed a number of materials as part of the LTVC initiative. But some examples of action steps include:

- Reorienting the portfolio strategy and management of institutional investors
- Unlocking value through engagement and active ownership
- Improving the dialogue between investors and corporations
- Shifting the board's focus to support long-term strategy and sustainable growth

TLL: At the moment, European banks seem to be under stress. What's your view of the region?

EC: Investors have had to deal with greater volatility. What effect has all this had on liquidity in the marketplace? Does systemic risk increase with this volatility? What happens if monetary policy changes in unusual ways? These are all issues that will have to be resolved. As well there has been some tightening of financial conditions which is a further challenge.

TLL: So what are you most worried about during the coming year?

EC: We're not big on engaging in short-term speculation! Lower oil prices should be stimulative at the margin, but with the magnitude of price changes we certainly see a lack of stability. With regard to what's transpiring in China, as we discussed earlier, it's all about how well they manage the on-going re-balancing of their economy. Finally, the U.S. dollar strength will be challenging to some firms. But these are all well-known risks.

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