Mawer Canadian Bond Fund, Series A

Q1 2023 | Performance Commentary

Market overview

Treasuries had a turbulent quarter, with yields across most maturities reaching their lowest levels of the year in March led by shorter-dated securities. A broad measure of Treasury volatility, the ICE BofA MOVE Index reached its highest level since the financial crisis. The FTSE Canada Universe Bond Index recorded one of the best quarters in history, led by securities with longer duration and higher quality. Yield curves remain inverted and steepened over the quarter. Overall investment grade corporate credit spreads widened, and government spreads widened less than corporate spreads.

After a 0.25% hike in January, the Bank of Canada left the policy rate unchanged in March and became the first major central bank to halt its monetary tightening efforts. The Federal Reverse hiked policy rates by 0.50% over the quarter and mentioned that additional policy firming may be needed to declare victory in its fight against inflation. Overall, the cumulative amount of interest rate hikes is working its way through the economy, and, in Canada, the core CPI has come down and is running at 2.5% (3 month annualized). Despite a tight labour market, manufacturing PMI is in contraction territory, housing has deteriorated, and business outlook is weak. Manufacturing ISM fell to the lowest level since May 2020 and the new orders index fell to levels not seen since the financial crisis. In the U.S, core CPI is still elevated at 5.2% (3 month annualized) and wage inflation continues to be at a high historical level.

Performance commentary

The portfolio marginally underperformed its benchmark during the first quarter.

Our duration strategy contributed to relative performance. We started with a short duration bias at the beginning of the quarter and purchased duration to stay neutral at the end of February as rates sold off and became attractive. In addition, we sold duration and maintained a short duration bias. The yield curve strategy also contributed to relative performance as we reduced the flattener bias and moved to a steepener.

We have been reducing the exposure to spread products by reducing corporate and provincial securities and focusing on securities that have strong credit profiles and fundamentals. Security selection contributed positively largely driven by our exposure to bank bonds. As we were overweight in the front end in banks, the spread roll down from the curve contributed to security outperformance as the spread curve was steep. Our positioning within the insurance industry was another positive contributor as we reduced our exposure given our credit analysis on the security call features. Our utility and energy investments favourably added to performance, driven by positioning in Enbridge Gas and North West Redwater Partnership.

Looking ahead

The cumulative amount of interest rate hikes is working its way through the economy. In Canada, core Inflation is running at 2.5% (3 month annualized) and is at the point where inflation is in line and we believe the Bank of Canada is done their hiking cycle. In the U.S., inflation continues to be elevated (5.2% 3-month annualized) and it is our view that the Federal Reserve may hike further. We are paying more attention to wage inflation which we think will be key to understanding the trajectory of inflation.

With the recent bank crisis, central banks have used liquidity programs to shore up the banking sector and we believe they will continue to use traditional monetary policy (interest rates) to fight inflation. And so for now…the inflation fight is not over. Post bank crisis, our view is that we are going to see an increase in the tightening of financial conditions which will bring forward the growth slowdown and central bank easing. We expect the growth slowdown to start showing up in the economic data which will translate into a decline in inflation.

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With respect to financial market outlooks and positioning, these key themes will guide us forward:

- We think the yield curve can remain inverted in the near term, but as central banks respond to recession, it can eventually steepen. This involves closely tracking key economic indicators and gaining deeper insights into how economic milestones are evolving. We are currently positioned to prepare for this scenario to unfold.
- As we are more conservatively positioned in the overall spread products than previous quarters, we have more flexibility to take advantage of a potential cheapening valuation in credits when volatility presents.
- We continue to improve portfolio resilience, emphasizing higher quality issuers with strong credit fundamentals such as conservative leverage and cash flow stability.

We continue to play the plan: our macro process remains focused on studying the interplay between growth and policy through a top-down approach and select individual companies that can withstand economic turbulence run by excellent management teams. By adopting a systematic and repeatable approach to portfolio construction, we can identify risk/reward opportunities that allow us to prudently manage our clients' capital, especially in times of uncertainty.

Performance summary[1] (%)

As of March 31, 2023:

	YTD	3 Mo.	1 Yr.	3 Yrs.	5 Yrs.	10 Yrs.	Since Inception[2]
FUND	3.0	3.0	(2.4)	(1.9)	0.5	1.2	5.0
BENCHMARK	3.2	3.2	(2.0)	(1.7)	0.9	1.9	6.0

Calendar Year, as of December 31:

	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
FUND	(12.0)	(3.0)	8.7	6.4	0.8	1.3	0.9	3.1	7.8	(2.2)
BENCHMARK	(11.7)	(2.5)	8.7	6.9	1.4	2.5	1.7	3.5	8.8	(1.2)

[1]Performance figures are net of management fees and operating expenses. Periods greater than one year are annualized. Performance figures are in Canadian dollar terms.
[2]Mawer Canadian Bond Fund Series A Inception: June 14, 1991

Selections from Mawer's Art of Boring blog and podcast:

The Case for Non-Predictive Decision Making
How do investors figure out what a company is worth? (Especially in a higher inflationary and interest rate environment?)

Inflation's one-two punch
It's inflation's second punch that can deliver a blow that investors may not be expecting.

Post-Mortem: Learnings from 2022 | EP128
Chief Investment Officer Paul Moroz shares takeaways from the Research team's annual post-mortem discussions.

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Disclaimer

Opinions and Forecasts:

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Benchmarks:

FUND	BENCHMARK
Mawer Canadian Bond Fund	FTSE Canada Universe Bond Index

Performance Disclosure and Requirements:

Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the fund facts and the prospectus before investing. The indicated rates of return are the historical annual compounded total returns including changes in unit value and reinvestment of all distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any securityholder that would have reduced returns. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated. Mawer Funds are managed by Mawer Investment Management Ltd.

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