Mawer Canadian Equity Fund, Series A

Q1 2023 | Performance Commentary

Market overview

After a disappointing finish to 2022, the Canadian equity market rebounded sharply in the first quarter of 2023. Except for energy, an outstanding performer last year, every sector in the S&P/TSX Composite Index was in the green to start the year. The big winner in the quarter was the information technology sector, up more than three times the next best sector, as risk taking reappeared given hopes central banks will soon pivot back to easy monetary policies.

The Bank of Canada made a single 25 basis point rate hike in January lifting the overnight rate to 4.5%, though the Bank held the line at their March meeting marking a pause in their aggressive hiking cycle. Inflation prints, the topic du jour last year, finally started trending in the right direction and corporate earnings also remained resilient.

However, it wasn't a smooth ride in the quarter as both equities and bonds exhibited significant volatility, especially after the spectacular collapse of Silicon Valley Bank which sent reverberations across the banking industry globally. Swift actions taken by U.S. government authorities to backstop depositors helped to ensure that the contagion was relatively well-contained. The spillover effect for the Canadian financial sector was relatively modest—only one of the Big 5 posted negative returns in the quarter.

Performance commentary

The portfolio modestly underperformed the benchmark in the quarter driven primarily by exposure to the information technology sector (both companies we owned and those we didn't). Reflecting the broad nature of the market's advance during the quarter, most portfolio holdings delivered positive returns. However, in the technology space the positive returns from positions such as CGI, one of our largest holdings, and Enghouse Systems, were not enough to keep up with some of the highest performers in the quarter which we don't own such as Shopify, Open Text, and Blackberry.

Real estate businesses in the portfolio rebounded nicely after a challenging 2022. Granite REIT reported strong fourth quarter results increasing occupancy rates by 50 bps to 99.6%. Additionally, they have already renewed 80% of 2023 lease expiries with average rent increases of 20% highlighting strong pricing power, a key attribute we seek in our portfolio companies. Colliers International Group continued successfully diversifying their business model away from cyclical real estate brokerage revenues to more economically resilient sources of recurring revenue from outsourcing, advisory, and investment management services. Conversely, Telus traded lower after reporting fewer mobile phone subscriber additions and higher customer churn in the quarter, both signs industry competitive intensity has increased.

A positive development for Canadian Pacific Railway was the regulatory approval of their acquisition of Kansas City Southern Railway without any major concessions. Through this merger, Canadian Pacific becomes the only railway in North America to directly serve Canada, the United States, and Mexico and provides the company with potential growth runway, additional scale, and cost efficiencies.
Our portfolio holding TD Bank, the Canadian bank with the biggest personal and commercial banking exposure in the U.S., saw negative returns in the period. Despite this exposure, the net impact of our financial exposure overall was broadly in line with the benchmark.

Gold producers outperformed during the first quarter. The portfolio has very limited exposure to gold producers (small exposure to Agnico Eagle Mines which was trimmed in the quarter) as our philosophy favours businesses with long-term track records of wealth creation. After several years of improving balance sheets and very little M&A, we observed improving free cash flow generation leading to the initiation in Agnico in 2020. However, while gold prices have moved higher in recent years, production costs have also trended much higher and some miners have recently returned to doing large M&A, suggesting capital allocation discipline may be deteriorating once again. During short-term periods of stress and market volatility gold producers may outperform, however over the long-term we continue to rank this business model lower relative to others that can more clearly reinvest their cash flows at high rates of return due to an enduring competitive advantage.

Looking ahead

As the recent bank failures illustrate, the historic rise in interest rates over the past year has the potential to cause profound impacts on many companies, often in unexpected ways. However, the underlying vulnerability we are most concerned about is that certain businesses became overly reliant on steadily rising asset prices and easy access to cheap capital during the preceding era of artificially low rates.

We are skeptical of businesses with high degrees of leverage for this very reason, but there are plenty of other general categories of vulnerabilities:

- Unprofitable companies that rely on continued access to capital markets to fund their operations;
- Businesses whose very existence depends heavily on the government's will to allow them to operate;
- Enterprises that produce negative externalities for the environment or the communities in which they operate;
- Companies whose stock prices provide no margin of safety.

With uncertainty as to the path forward and given significant lags between policy implementation and the impact in the real economy, there are bound to be other unanticipated surprises on the horizon.

To be sure, there are scenarios in which any company can be zeroed; even the strongest businesses have vulnerabilities that can be exposed by the right trigger. This is why we employ a non-predictive decision-making approach that focuses on steering away from areas where those vulnerabilities are sharpest as opposed to forecasting specific events. This requires a disciplined investment process, a culture in which different points of view are celebrated, and appropriate diversification that builds natural contradictions into the portfolio. And even though this "boring" approach may sacrifice possible short-term gains in certain market environments, we believe it should lead to better and more consistent outcomes over time.

Performance summary[1] (%)

As of March 31, 2023:

	YTD	3 Mo.	1 Yr.	3 Yrs.	5 Yrs.	10 Yrs.	Since Inception[2]
FUND	4.0	4.0	(3.7)	15.1	7.1	8.8	9.0
BENCHMARK	4.6	4.6	(5.2)	18.0	8.8	7.9	8.3

Calendar Year, as of December 31:

	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
FUND	(5.6)	23.7	2.7	20.7	(9.8)	8.7	15.8	(0.3)	15.8	25.4
BENCHMARK	(5.8)	25.1	5.6	22.9	(8.9)	9.1	21.1	(8.3)	10.6	13.0

[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 Equity Fund Series A Inception: June 3, 1991

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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.

Disclaimer

Opinions and Forecasts:
This report includes certain statements that are "forward looking statements". All statements, other than statements of historical fact, included in this report that address activities, events or developments that the portfolio advisor, Mawer Investment Management Ltd., expects or anticipates will or may occur in the future, including such things as anticipated financial performance, are forward looking statements. The words "may", "could", "would", "should", "believe", "plan", "anticipate", "expect", "intend", "forecast", "objective" and similar expressions are intended to identify forward looking statements. These forward looking statements are subject to various risks and uncertainties, including the risks described in the Simplified Prospectus of the Fund, uncertainties and assumptions about the Fund, capital markets and economic factors, which could cause actual financial performance and expectations to differ materially from the anticipated performance or other expectations expressed. Economic factors include, but are not limited to, general economic, political and market factors in North America and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological change, changes in government regulations, unexpected judicial or regulatory proceedings, and catastrophic events.

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Benchmarks:

FUND	BENCHMARK
Mawer Canadian Equity Fund	S&P/TSX Composite Index

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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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