Mawer EAFE Large Cap Fund, Series A

Q1 2023 | Performance Commentary

Market overview

After a disappointing 2022, equity markets sharply rebounded in the first quarter of 2023. Inflation prints, the topic du jour last year, finally started trending in the right direction and corporate earnings remained resilient. Signs emerged that the aggressive policy action in 2022 was having its desired effect in tempering economic activity and inflation, though many central banks including the European Central Bank, Bank of England, and Swiss National Bank continued with their rate hiking programs, albeit in some cases at a slower pace.

Growth oriented sectors—like information technology, communication services, and consumer discretionary—led the charge in the quarter after being three of the worst performing sectors in 2022. Information technology particularly benefited from lower bond yields through the transmission mechanism of higher discounted future cashflows. On the other side of the equation, energy, the best performer last year, posted a flat return, the second lowest in the investment universe thanks to a pullback in oil prices.

While the markets finished the quarter strong, it wasn't a smooth ride as both equities and bonds exhibited significant volatility, especially after the spectacular collapse of Silicon Valley Bank and rescue of Credit Suisse, which sent reverberations across the banking industry globally. Swift actions taken by government authorities to backstop the banking industry helped to ensure that the contagion was relatively well-contained. Despite all the volatility in the quarter, currency effects were muted and European stocks, which led the advance globally in Q4, continued outpacing other regions in the MSCI World Index.

Performance commentary

The portfolio outperformed the benchmark in the quarter. Reflecting the broad nature of the market's advance, most portfolio holdings delivered positive returns.

Exposure to industrials through both our overweight to the sector and underlying positions drove most of the outperformance. Two of our top performers were critical professional service data providers RELX and Wolters Kluwer. The products and services offered by both firms are deeply embedded in their customers' businesses and typically represent a small portion of their cost structure—a highly attractive dynamic. Both companies reported strong organic revenue growth and underlying operating profit growth for fiscal 2022.

More recent additions to the portfolio in the industrial sector—specifically defense companies such as Thales, and BAE—also helped to bolster the portfolio's return. Both companies performed well reflecting expectations for structurally higher defense spending by NATO. BAE was the standout performer, with strong demand driving a record year for orders alongside continued management success at reducing exposure to fixed priced contracts which have hurt BAE's results in the past.

Two outstanding performers were luxury goods conglomerates LVMH and Kering. LVMH benefitted from the market's preference for growth-oriented companies and from the re-opening of the Chinese economy, an important end market. Kering announced the hiring of a new creative director for their key brand Gucci. This is important to revitalize the iconic brand which accounts for close to three quarters of Kering profits.

Partially offsetting these positives, several of the portfolio's holdings in the financial sector weighed on relative performance. Nordic P&C insurer Sampo was penalized for delivering softer-than-expected results. Singaporean bank DBS Group sold off on concerns that tightening financial conditions from higher borrowing costs and a stronger U.S. dollar would impact demand and credit performance. Svenska Handelsbanken sold off on cyclical concerns pertaining to the impact of rising interest on the Swedish housing market.

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Finally, two health care companies, Roche and Eurofins, were penalized as the unwinding of pandemic-related revenues tied to diagnostics and testing has impacted margins and earnings. Eurofins has also struggled with cost pressures and customer contracts that do not include any inflation indexation and that are only renegotiated once a year.

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	10.1	10.1	2.1	-	-	-	6.6
BENCHMARK	8.3	8.3	6.9	-	-	-	8.8

Calendar Year, as of December 31:

	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
FUND	(17.1)	15.0	-	-	-	-	-	-	-	-
BENCHMARK	(8.2)	10.3	-	-	-	-	-	-	-	-

[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 EAFE Large Cap Fund Series A Inception: May 29, 2020

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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

Benchmarks:

FUND	BENCHMARK
Mawer EAFE Large Cap Fund	MSCI EAFE Index (net)

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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