Mawer Emerging Markets Equity Fund, Series A

Q1 2023 | Performance Commentary

Market overview

Equity markets delivered positive returns in the first quarter building on the rally that began in Q4 of last year. Inflation, while still high, has continued to show signs of easing in many parts of the world providing hope that the Fed and other influential central banks may not need to be as aggressive as feared in tightening monetary policy. At the same time, corporate earnings have been quite resilient and economic data better-than-feared, increasing optimism that a pronounced recession, or hard landing, may be avoided.

That said, the market's advance was not a straight line. Both equities and bonds exhibited significant volatility, especially in connection to the spectacular collapse of Silicon Valley Bank in the U.S. which sent reverberations across the banking industry globally. Swift actions taken by government authorities helped to ensure that the contagion was relatively well-contained and equity markets continued to push higher into the quarter end.

In this environment, the best performing sectors in the MSCI Emerging Markets Index were those that suffered the greatest headwinds in 2022. The growth-leaning IT and communication services segments outperformed more defensive sectors such as health care and utilities. Equity markets in Mexico and Taiwan benefitted from a more hopeful economic outlook whereas some of last year's better performing regions, the Middle East and India, declined given falling energy prices and jitters associated with a prominent short-seller's allegations of fraud at one of India's largest conglomerates, respectively.

Performance commentary

The portfolio outperformed its benchmark by a significant margin during the first quarter thanks to positive stock selection across almost all sectors and regions.

With the fall in discount rates and an improved economic outlook, two of the portfolio's e-commerce companies bounced back strongly: Taiwan's **momo.com** and Latin America-focused **MercadoLibre.** Both management teams have been steadily investing in logistics over the past several years, recognizing (much as with Amazon) that scale economies and network effects accrue mainly to the market leaders.

Two other higher-growth companies, Polish chat software developer **LiveChat** and Taiwanese drug store operator **Great Tree**, were rewarded for very strong results that affirmed the bright outlooks for their respective businesses. Impressively, their growth hasn't come at the cost of profitability: LiveChat due to the value it provides its customers via reduced costs and a more consistent customer experience, Great Tree as increasing scale and density in a fragmented market led to brand recognition and better procurement terms.

Geopolitics played a role during the quarter too: Mexico's **Vesta** develops and operates real estate properties that are focused on logistics and manufacturing facilities, have stable occupancy rates via blue-chip tenants, and are beneficiaries of customers increasing near-shoring production and distribution closer to the U.S. and away from China.

While it was a very positive quarter, two holdings in the financials sector offered weaker returns: Brazil's **XP** and **First Abu Dhabi Bank**. Investors were spooked by the latter's consideration of a bid for Standard Chartered (as were we, prompting our exit). And newly-initiated XP has faced a combination of headwinds—a double-digit Selic rate which pressures the investment environment and a large shareholder in Itau reducing its stake—both of which provide us with an attractive entry-point into a well-managed company with strong competitive advantages.

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Looking ahead

As recent bank failures and instability in certain frontier markets illustrate, the historic rise in interest rates over the past year has the potential to cause profound impacts on many countries and 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	9.2	9.2	(0.2)	3.1	(1.3)	-	2.3
BENCHMARK	3.8	3.8	(3.2)	6.0	0.1	-	4.5

Calendar Year, as of December 31:

	2022	2021	2020	2019	2018
FUND	(29.0)	0.8	20.4	9.7	(6.2)
BENCHMARK	(14.3)	(3.4)	16.2	12.4	(6.9)

[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 Emerging Markets Equity Fund Series A Inception: January 31, 2017

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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 Emerging Markets Equity Fund	MSCI Emerging Markets Index (net)

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