Mawer Global Equity 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. As signs emerged that the aggressive policy action in 2022 was having its desired effect in tempering economic activity and inflation, many central banks decelerated the pace and magnitude of rate hikes in the quarter. For example, the Federal Reserve raised the overnight rate in the U.S. by a single 25 basis point hike in each of their February and March meetings, lifting the overnight rate to 5.0% and providing hope to the markets that the end of this hiking cycle is in sight.

Growth oriented sectors—such as information technology, communication services, and consumer discretionary—led the charge in the quarter after being the three 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 modestly negative return, the 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 which sent reverberations across the banking industry globally. Swift actions taken by U.S. government authorities to backstop depositors aimed to ensure that the contagion was relatively well-contained. Despite all the volatility in the quarter, currency differentials were largely unchanged and European stocks, which led the advance globally in Q4, continued outpacing both emerging markets and U.S. equities.

Performance commentary

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

On balance, security selection in the industrial and consumer discretionary sectors were the biggest drivers of positive 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.

Another industrial company, FedEx, reported good quarterly results relative to expectations lifting the stock price higher in the quarter. FedEx greatly benefited from a spike in parcel volumes post COVID but as growth rates moderate, it continues to focus on improving operational efficiency. The company is lowering its capital intensity with an efficiency over growth posture and a focus on return on invested capital, in other words continuing to ensure a sharp focus on wealth creation. On the other side of the COVID consumer demand shock, Booking Holdings benefited from room bookings surpassing 2019 levels in the fourth quarter by 10% with all major regions above pre-pandemic levels. It also continued gaining market share in the U.S. where it has historically under-indexed. The business model is asset-light (somewhat unique amongst consumer discretionary businesses) and generates a lot of free cash flow, which is sensibly allocated to buy back shares.

Given the outsized positive returns of many technology-oriented companies after a rough 2022, for this rate sensitive group it's not surprising some of our top performers in the portfolio were Microsoft, Amazon, and Alphabet. However, our meaningful net underweight to technology was the main detractor of relative performance. In a similar vein though, in the opposite market direction, several of our health care holdings

gave back some of last years gains despite continued positive data in their underlying businesses. Moderna released interim data on its Phase III flu candidate which had good results against Influenza A strains (responsible for 95% of influenza-related hospitalization in adults). Organon saw strong growth in its key contraceptive asset and biosimilar franchise though its fertility portfolio was hampered by COVID in China. However, demand is recovering and could be a positive tailwind in 2023.

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	7.2	7.2	3.4	12.3	9.3	12.4	11.7
BENCHMARK	7.2	7.2	0.3	13.4	8.0	11.6	10.6

Calendar Year, as of December 31:

	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
FUND	(11.2)	21.3	9.8	20.7	4.3	17.5	(0.4)	21.5	14.5	34.3
BENCHMARK	(12.4)	17.5	14.2	20.2	(1.3)	15.8	3.1	18.9	14.4	35.2

[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 Global Equity Fund Series A Inception: October 22, 2009

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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:
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Benchmarks:

FUND	BENCHMARK
Mawer Global Equity Fund	Oct: 2009: MSCI World (net) Oct 2016: MSCI ACWI (net)

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