Mawer International Equity Fund, Series A

Q1 2023 | Performance Commentary

Market overview

Equity markets delivered strongly 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—particularly in Europe—much better-than-feared, increasing optimism that a pronounced recession, or hard landing, may be avoided.

In this environment, the best performing sectors in the MSCI ACWI ex. U.S. Index were those that suffered the greatest headwinds in 2022. The growth-leaning IT, consumer discretionary, and communication services segments outperformed more value-oriented and defensive sectors such as health care and utilities. And regionally, European stocks led the charge after a challenging 2022.

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, prompting the rescue of 166-year-old Credit Suisse. 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.

Performance commentary

The portfolio outpaced its benchmark in the first quarter, mainly thanks to steady contributions from several long-standing portfolio holdings. Reference data providers Wolters Kluwer and RELX delivered strong results reflecting the recurring nature of their businesses. We have extremely high regard for management at Wolters Kluwer and the thoughtful way in which the company manages its pricing strategy which is intrinsically connected to the value of productivity enhancements that it delivers for its clients. Luxury goods conglomerate LVMH benefitted from the market's preference for growth-oriented companies and from the re-opening of the Chinese economy, an important end market.

More recent additions to the portfolio—and specifically defense companies like Rheinmetall, Thales, and BAE—also helped to bolster the portfolio's return. All three companies performed well reflecting expectations for structurally higher defense spending by NATO. Germany's Rheinmetall was the standout, as it further benefitted from a shift in the German government's payment terms. Historically, German defense contracts have employed a pay-on-delivery model whereas going forward they will shift to milestone payments which should reduce Rheinmetall's working capital intensity and thereby improve its returns on invested capital.

Partially offsetting these positives, several of the portfolio's holdings in the financials sector weighed on relative performance. Nordic P&C insurer Sampo was penalized for delivering softer-than-expected results. Swedish bank Handelsbanken sold off on cyclical concerns pertaining to the impact of rising interest on the Swedish housing market. Italy's Finecobank was another detractor and an area of heightened focus mid-March given that, much like Silicon Valley Bank, Finecobank holds a large portfolio of sovereign bonds with unrealized losses. However, Finecobank has a more diversified deposit base than SVB and, crucially, has access to backstops courtesy of the ECB that mean it can hold those positions to maturity. Nevertheless, it sold off given the jitters in the broader banking industry.

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 include minimal 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	7.3	7.3	2.8	6.2	3.0	7.9	7.6
BENCHMARK	6.7	6.7	2.9	9.9	3.5	7.7	5.2

Calendar Year, as of December 31:

	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
FUND	(16.7)	7.3	12.4	14.4	(4.0)	22.6	(3.3)	20.3	9.1	22.6
BENCHMARK	(9.9)	6.9	8.7	15.4	(6.5)	18.8	(3.0)	19.0	3.7	31.0

[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 International Equity Fund Series A Inception: November 6, 1987

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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.

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Benchmarks:

FUND	BENCHMARK
Mawer International Equity Fund	Jan 1988: MSCI EAFE (net) Oct 2016: MSCI ACWI ex-USA (net)

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