Mawer U.S. 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 providing hope that the Fed and other 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.

In this environment, the best performing sectors in the S&P 500 were those that suffered the greatest headwinds in 2022—specifically, the growth-leaning IT, consumer discretionary, and communication services segments—which outperformed more value-oriented and defensive sectors such as health care and utilities.

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 which sent reverberations across the banking industry globally. Swift actions taken by government authorities to backstop depositors 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 underperformed its benchmark in the first quarter, driven largely by its exposure (or relative lack thereof) to the hottest parts of the market, namely some of the largest technology-related stocks.

Taken together, seven companies—Apple, Microsoft, Alphabet (i.e., Google), Amazon, Tesla, NVIDIA, and Meta (i.e., Facebook)—represent 24% of the index and delivered an average return of approximately 45% during the first quarter alone. The portfolio's exposure to this group is both more selective and more modest: we own Microsoft, Alphabet, and Amazon with a combined weight of just under 11%. All three had very strong returns during the quarter backed by falling discount rates and enthusiasm tied to cost-containment measures. But our relative positioning in these seven companies alone explains virtually all of the portfolio's underperformance over the period. (Though it is worth remembering that this same posture helped the portfolio to outperform its benchmark in 2022 during the significant sell-off in longer-duration, technology-oriented stocks.)

Elsewhere, in another reversal from the past year, the absence of holdings in the underperforming energy sector provided some ballast to relative performance. And while the portfolio has a significant weight in the financials sector, the only bank we own is JPMorgan, a large, diversified, and well-capitalized bank. By contrast, the majority of our financials exposure tends to be in insurance brokers, credit card networks, and exchanges—i.e., business models with much less leverage on their balance sheets. As a result, the portfolio was relatively unscathed by the direct fallout from recent bank failures. In fact, our position in CME, a leading futures and options exchange for interest rates and various commodities, may actually benefit from greater volatility as this tends to drive more hedging activity through its platforms.

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	3.5	3.5	(0.3)	12.7	11.1	14.4	8.4
BENCHMARK	7.4	7.4	0.0	16.6	12.3	15.5	10.0

Calendar Year, as of December 31:

	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
FUND	(12.1)	23.6	14.7	25.7	9.6	12.8	5.5	19.3	20.9	41.8
BENCHMARK	(12.2)	27.6	16.3	24.8	4.2	13.8	8.1	21.6	23.9	41.3

[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 U.S. Equity Fund Series A Inception: December 11, 1992

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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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 U.S. Equity Fund	S&P 500 Index

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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