Mawer Canadian Bond Fund, Series A

Q2 2023 | Performance Commentary

Market Overview

Providing a modicum of relief for central banks globally, inflation continued to decelerate in the quarter, though core inflation which strips out more volatile food and energy prices remained stubbornly sticky in many countries including Canada and the U.S. Despite the deceleration in price growth overall, many central banks including the Bank of England, Bank of Canada, European Central Bank, and Reserve Bank of Australia raised rates at their most recent meetings, and while the Federal Reserve paused in June, Chairman Powell continued to jawbone markets into expecting several more hikes before 2023 is through.

The FTSE Canada Universe Bond Index return -0.69%, with the poor performance driven by higher overall interest rates. After a brief steepening in Canadian and U.S. yield curves in April following the U.S. regional banking crisis, yield curves reversed course and resumed inverting to end the quarter. Long bonds performed the best, and short-term bonds outperformed mid-term bonds. Investment grade credit spreads tightened on average and bonds with higher spread exposure performed better over the quarter.

Performance Commentary

The portfolio modestly underperformed the benchmark in the quarter.

We took the opportunity to purchase duration with overall rates moving higher in May, and this positioning helped contribute slightly to positive relative performance. With inflation remaining elevated and better than expected economic data, the Bank of Canada continued to hike overnight rates and yield curves flattened. This resulted in a negative contribution from our yield curve positioning as we were positioned for a steepener rather than a flattener.

Our sector exposure contributed favourably to relative performance driven by our positioning within corporates. Corporates spreads tightened more than provincials, therefore our trimming of corporate exposure and adding to the steeper part of the provincial curve provided more efficient portfolio carry.

Overall, from a security selection perspective, we continue to favour issuers that have conservative leverage and strong credit fundamentals. Our exposure in the government space, specifically our reduced exposure within federal spread products, detracted from relative performance, however, provincial security selection partially offset the negatives, driven positively by our Quebec positioning. Our industrial exposure also favourably added to performance, driven by our investments in Canadian Pacific Railway.

Looking Ahead

The combination of historically inverted yield curves, strong year-to-date gains in equity prices, benign credit spreads, and well-anchored longer-term breakeven inflation expectations are all consistent with the consensus outlook for a soft landing. The risks lie on both sides of this consensus: either that the impact of recent monetary policy impairs demand more substantially than expected (a hard landing), or that inflation persists longer than projected, emboldening policymakers to hike even further than currently expected. Both would likely be negative for risk assets.

Recession has been our base case, and over this quarter, we have seen more rate hikes from central banks to curb inflation with every additional hike further increasing the probability of a future recession as the cumulative interest rate increases continue to work their way through the economy. The aggressive tightening of financial conditions should bring forward a slowdown in growth and central bank easing. We think the yield curves can remain inverted in the short run—they have reached levels only last seen in the 1990s (e.g., 2s10s at -123bps)—but we think the risk/reward for a steepener is attractive given many of the headwinds that the economy currently faces, and eventually the central bank will need to react when the economy weakens. We closely monitor key economic indicators and gain deeper insights into how economic milestones are evolving.

We continue to play the plan: our macro process remains focused on studying the interaction between economic growth and monetary policy through a top-down lens. We are conservatively positioned in spread products overall, which provides us more flexibility to respond to a potential widening of credit spreads. Our credit process leads us to businesses with more stable demand given the criticality of the products and services they provide to their customers, and we always have an eye on our companies' balance sheets as lower debt provides resilience in times of crisis. By adopting a systematic and repeatable approach to portfolio construction, we can identify risk/reward opportunities that allow us to prudently manage our clients' capital and add value in the long term.

Performance Summary[1] (%)
As of June 30, 2023:

	YTD	3 Mo.	1 Yr.	3 Yrs.	5 Yrs.	10 Yrs.	Since Inception[2]
FUND	2.2	(0.9)	2.9	(4.2)	0.3	1.5	4.9
BENCHMARK	2.5	(0.7)	3.1	(3.7)	0.6	2.1	5.9

Calendar Year, as of December 31:

	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
FUND	(12.0)	(3.0)	8.7	6.4	0.8	1.3	0.9	3.1	7.8	(2.2)
BENCHMARK	(11.7)	(2.5)	8.7	6.9	1.4	2.5	1.7	3.5	8.8	(1.2)

[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 Canadian Bond Fund Series A Inception: June 14, 1991

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?)

Rising Debt and its Potential Consequences: Canada's New Normal?
We need to understand where we are in the debt super cycle to inform our investment decision making.

Artificial Intelligence: The Return of The Centaurs
Recent AI breakthroughs are underscoring the power of the centaur model—humans + machines—creating something more potent than either model operating independently.

Disclaimer

Opinions and Forecasts:

This report includes certain statements that are "forward looking information" or "forward looking statements" (collectively, "forward looking information") within the meaning of applicable securities legislation. 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, beliefs, plans, goals, objectives, assumptions, information and statements about possible future events, conditions, results of operations, are forward looking information. The words “may”, “could”, “would”, “should”, “believe”, “plan”, “anticipate”, “expect”, “intend”, “forecast”, “objective”, “will” and similar expressions are intended to identify forward looking information. Undue reliance should not be placed on forward looking information. Forward looking information is subject to various risks described in the Simplified Prospectus, uncertainties, and assumptions about the Fund, capital markets and economic factors, which could cause actual results to vary and in some instances to differ materially from those anticipated by the portfolio advisor and expressed in this report. Material risk 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. The foregoing list of risk factors is not exhaustive.

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Benchmarks:

FUND	BENCHMARK
Mawer Canadian Bond Fund	FTSE Canada Universe Bond 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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