# Mawer Emerging Markets Equity Fund, Series A

Q2 2023 | Performance Commentary

## Market Overview

Providing a modicum of relief for central banks globally, inflation generally continued to decelerate in the second quarter, though core inflation which strips out more volatile food and energy prices remained stubbornly sticky. Despite the deceleration in price growth overall, many influential developed market central banks including the Bank of England and European Central Bank raised rates at their most recent meetings. While the U.S. Federal Reserve opted not to hike rates in June, Chairman Powell continued to jawbone markets into expecting more hikes before 2023 is through.

Though the actions of the Fed are felt globally, the economies of many emerging market countries face quite diverging outlooks. Brazil had been early to raise interest rates to fight inflationary pressures and has cut rates more recently providing support for its domestic equity market. India's economy is roaring and despite some of the loftier valuations among emerging markets, Indian equities delivered strong returns in Q2. By contrast, China's much talked about re-opening has failed to live up to expectations—more fizzle than sizzle—with deflation a potentially more important risk for domestic policymakers.

## Performance Commentary

The portfolio outperformed its benchmark during the second quarter.

Corresponding with the broad decline in Chinese equities, many of the portfolio's biggest laggards during the quarter were Chinese companies: chemicals logistics company **Milkyway**, premium baijiu producer **Wuliangye Yibin**, outsourced drug manufacturer **Wuxi Apptec**, and construction project manager **Greentown Management**. Yet the portfolio's substantial underweight in China actually helped bolster relative returns.

By contrast, three Brazilian holdings rode the wave of the country's strong returns: broker-dealer **XP**, energy company **Prio**, and facilities management company **GPS**. All three were added to the portfolio over the past year, each with fortuitous timing.

Elsewhere, there was a divergence of returns among a few of our higher duration holdings. Taiwan e-commerce leader **momo.com** gave up some of its recent gains as the trend toward e-commerce post-COVID has begun to normalize with customers returning to shop at physical stores. In Eastern Europe, fast-growing Polish grocer **Dino Polska** and Lithuanian online classifieds **Baltic Classifieds** enjoyed resilient returns, perhaps in the face of the market's pessimism both with respect to high inflation and geographic proximity to war. A combination of strong market positions and low competitive intensity have allowed both to increase prices with inflation and maintain margins.

## Looking Ahead

From a global perspective, the combination of historically inverted yield curves in major economies, 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; put differently, that central banks will be successful in their fight against inflation without causing too much harm to the economy. The widely anticipated global recession, should it ever arrive, is expected to be mild.

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 equities.

# Emerging Markets Equity Fund

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Valuations in emerging markets continue to appear very attractive relative to their developed market peers; on a forward price-to-earnings basis, the MSCI Emerging Markets Index trades at levels 26% and 36% cheaper than the MSCI World and S&P 500 indices, respectively. Of course, investing in emerging markets can be more idiosyncratic too. As the activity over the past several quarters illustrates, we've chosen to navigate the uncertainty by leaning into our investment approach. From a portfolio perspective, this means ensuring diversification; despite lower valuations, the portfolio's weight in China has come down meaningfully as geopolitical tensions have risen.

And from a bottom-up perspective, our philosophy naturally leads us to businesses with more stable demand given the criticality of the products and services they provide to their customers. We always have an eye on our companies' balance sheets as lower debt provides resilience in times of crisis. Our forensic accounting checklist is designed to ensure that we avoid getting caught up in narrative, and instead methodically comb through financial statements for clues with respect to changes in business or management quality. In the current environment, and especially as COVID-19 supply shocks have encouraged many companies to build up their inventories, companies with excess inventory levels may face gross margin pressures in the coming quarters should demand abate from its current trend. As such, in addition to continuing to understand how companies are coping with inflation, we're looking closely at cash conversion and days of inventory, especially when coupled with valuation levels that, year-to-date, have outpaced earnings.

Yes, "boring" work. But ultimately an approach that should prepare the portfolio to be resilient for the multitude of scenarios that may play out going forward.

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

| | YTD | 3 Mo. | 1 Yr. | 3 Yrs. | 5 Yrs. | 10 Yrs. | Since Inception[2] |
|---|---|---|---|---|---|---|---|
| FUND | 9.4 | 0.2 | 11.7 | (2.2) | 0.0 | - | 2.2 |
| BENCHMARK | 2.4 | (1.3) | 4.4 | 1.3 | 1.0 | - | 4.1 |

### Calendar Year, as of December 31:

| | 2022 | 2021 | 2020 | 2019 | 2018 |
|---|---|---|---|---|---|
| FUND | (28.9) | 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

## Selections from Mawer's Art of Boring Blog and Podcast:

[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.

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[Inflation's one-two punch](#)
It's inflation's second punch that can deliver a blow that investors may not be expecting.

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**Benchmarks:**

| FUND | BENCHMARK |
|---|---|
| Mawer Emerging Markets Equity Fund | MSCI Emerging Markets Index (net) |

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