Mawer International 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 central banks including the Bank of England and European Central Bank raised rates at their most recent meetings. While the influential 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.

European stocks took a breather with modest gains in Q2 after being leaders last quarter, while Japanese and U.S. stocks posted strong returns. Japan remains one of the few regions with a dovish interest rate policy and Japanese companies seem incrementally more focused on shareholder value with an increase in share buybacks. Conversely, China's much talked about re-opening has been more fizzle than sizzle.

U.S. markets shrugged off the government debt ceiling brinksmanship to post excellent returns, buoyed largely by outsized returns from a handful of mega cap technology stocks which are benefiting from frenzied interest in artificial intelligence (AI) as a potentially burgeoning source of long-term secular growth. This had a spillover effect on technology companies globally, with IT one of the best performing sectors in the MSCI ACWI ex. U.S. during the quarter.

Corporate profits remain broadly resilient even though a potential recession remains widely anticipated.

Performance Commentary

The portfolio narrowly outpaced its benchmark in the second quarter.

Compass Group, the world's largest catering company, continued its strong post-pandemic recovery. Despite the many challenges facing the catering business (think: the work from home trend impacting demand for office cafeterias), the company now earns more revenue than it did pre-pandemic. A more difficult operating environment has hurt many of its less-adept competitors all while customers are choosing to outsource more of their catering—a combination that has provided Compass Group with opportunities to gain market share thereby strengthening its competitive advantage.

Two portfolio holdings were involved in M&A activity, with Deutsche Boerse offering to acquire investment management software company SimCorp. SimCorp's shares closed substantially higher on the news—a positive for the portfolio—but the market seemed less convinced of the deal's strategic logic for Deutsche Boerse which moved a bit lower. Put together, given their weights and relative price movements, the net impact on the portfolio was positive.

The portfolio also benefitted from its underweight in China as the country's re-opening has failed to live up to expectations.

Offsetting these positives, three holdings in the portfolio suffered negative returns given softer near-term outlooks. Satorius Stedim Biotech, which provides equipment and consumables used at various stages in the production of biologic drugs, cut its guidance for the year ahead given lower demand from both larger pharmaceutical customers and smaller biotech firms. Chemicals distributors IMCD and Azelis, despite excellent results, have traded lower as other chemicals companies have issued profit warnings due to customer de-stocking.

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Be Boring. Make Money.™

Finally, shares of recently-initiated **Teleperformance** reacted negatively to the company's offer to acquire competitor Majorel. The combination makes strategic sense in that it provides Teleperformance with better access to European markets, cementing the company's position as the global leader in outsourced customer experience management (e.g., call centers). However, the size of the deal may present integration challenges and it will increase the company's leverage profile. Unrelated to the acquisition, the market, and our team, have wondered if Teleperformance will be a winner or loser with AI. On the one hand, Teleperformance is best positioned to leverage AI in servicing its customers; on the other, incredibly sophisticated chatbots in the future may reduce the need for call centres.

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; put differently, that central banks will be successful in their fight against inflation without causing too much harm to the economy. The widely anticipated 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.

Yield curve inversion has historically been a reliable predictor of recessions, and the transmission mechanism is worth understanding. Inversions tend to hurt the balance sheets and business models of banks, who borrow short to lend long. Higher short-term borrowing costs result in lower bank profitability, and the banks typically adjust by cutting back on lending which has a ripple effect across the economy. We've seen some indications of these ripples—the notable regional bank failures in the U.S., Credit Suisse, the guidance cuts among chemicals companies, etc.—but they haven't materialized to the extent one might have anticipated given the degree of curve inversion. It's possible that any reduction in liquidity from the banks is being offset by other sources, e.g., excess consumer pandemic savings, private credit markets, and government fiscal policy. Nevertheless, it would be very unusual by historical standards to have the degree of yield curve inversion seen in many major economies today without an associated recession.

To prepare against the risks, we've leaned into our bottom-up approach. Our investment philosophy naturally 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. 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.

International Equity Fund

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

	YTD	3 Mo.	1 Yr.	3 Yrs.	5 Yrs.	10 Yrs.	Since Inception[2]
FUND	7.7	0.4	19.5	2.9	2.8	7.9	7.5
BENCHMARK	6.9	0.2	15.6	6.2	3.6	7.4	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

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

[International Equities: Insights from the Road | EP136]
Top highlights from the team's recent research trips and a few business models we're excited about.

[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.
All opinions contained in forward looking information are subject to change without notice and are provided in good faith and are based on the estimates and opinions of the portfolio advisor at the time the information is presented. The portfolio advisor has no specific intention of updating any forward looking information whether as a result of new information, future events or otherwise, except as required by securities legislation. Certain information about specific holdings in the Fund, including any opinion, is based upon various sources believed to be reliable, but cannot be guaranteed to be current, accurate or complete and is subject to change without notice.

Benchmarks:

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

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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