# Mawer Tax Effective Balanced Fund, Series A

Q2 2023 | Performance Commentary

## Market Overview

Globally, equity markets continued to be resilient in the second quarter with U.S. equites being among the stronger performers. U.S. equity strength was driven by a handful of large technology-focused companies, including some that have been in the spotlight as notable advancements in artificial intelligence dominated news headlines. Meanwhile, Chinese equities declined in the quarter as growth anticipated from the lift in COVID-19 restrictions fell short of expectations.

In Canada, headline inflation declined while GDP growth and the employment market remained resilient despite the challenging monetary policy environment. Ultimately, the Bank of Canada reconfirmed their commitment to fighting inflation as it raised the policy interest rate 0.25% in the quarter. With yields rising over the period, Canadian bonds declined.

The Canadian dollar appreciated this quarter against many currencies, reducing the return of foreign asset classes. One notable exception was the British pound, which strengthened relative to the Canadian dollar as the Bank of England raised interest rates 0.50% in June. The Japanese yen also experienced notable weakness in the period.

## Performance Commentary

The portfolio delivered a slightly positive return in the quarter and narrowly underperformed its benchmark. While our portfolio benefitted from the positive return from equities, our Canadian bond portfolio experienced modest declines as rising yields impacted bond prices.

The recent advancements in artificial intelligence (AI) highlighted how technology continues to bring change, disruption, and new possibilities to the way people engage in everyday activities. Of significance is how fast AI is being integrated into common use. For example, how quickly Microsoft incorporated AI into their search engine, Bing. While the full impact of artificial intelligence's capabilities is yet to be seen, markets are forward-looking and rewarded some of the companies potentially positioned to benefit from this advancement such as Apple, Microsoft, NVIDIA, Amazon, Meta, Tesla, and Alphabet. Of those listed, we have exposure to **Microsoft**, **Amazon**, and **Alphabet** within the portfolio. While these technology businesses were some of our stronger performers in the quarter, our relative underweight to the collective group was a headwind for relative performance.

In contrast to the businesses that may benefit from AI advancements, for others, the impact is less clear. One holding example is the call center operator, **Teleperformance**. While it may be positioned to leverage artificial intelligence to more efficiently serve customers, the driving concern is future, incredibly sophisticated chatbots which may reduce the need for call centers. Considering these potential risks and benefits, we have done scenario analysis around the company's revenue, margins, and their ultimate impact on the valuation of the company. Teleperformance was one of our weaker performers in the quarter after the market also negatively reacted to its offer to acquire a competitor.

When assessing the AI theme and considering our investment horizon, the full, possible impact of artificial intelligence developments is difficult to ascertain. That said, in our experience, rapid technological change tends to drive a wedge between high-quality management teams and weaker ones. To use a surfing analogy, artificial intelligence has the potential to be a monster wave—great management teams will catch it and surf it by improving their value proposition to customers and reducing their costs. Thus, a continued focus on great management teams—as opposed to forecasting specific winners and losers associated with a given theme—will help guide our approach.

Elsewhere, Compass Group, the world's largest catering company, continued their strong post-pandemic recovery. Despite the many challenges facing the catering industry, the company now earns more revenue than it did pre-pandemic. A more difficult operating environment has hurt many of its less-adept competitors, while customers are also 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.

Several of our weaker performers include those impacted by lower demand from both larger pharmaceutical customers and smaller biotech firms. Sartorius Stedim Biotech, which provides equipment and consumables used at various stages in the production of biologic drugs, cut its guidance for the year ahead, and two life sciences companies also faced headwinds—Waters and Bio-Rad.

We trimmed our target equity weight on two occasions during the quarter as equities rallied from their lows. Most of our trim to equities was from the U.S. as our view is that U.S. equities were more expensive relative to other asset classes. We offset the trims by increasing our target allocation to Canadian bonds and cash. Overall, we believe this adds resilience, given the many scenarios that may unfold. Even though the market consensus appears to be calling for a soft landing, the macro picture remains very uncertain: inflation is moderating but still elevated, labour markets are resilient, the recovery in China's economy seems lackluster, and geopolitical tensions remain. As of the quarter end, we remain underweight Canadian bonds and near neutral in equities.

## Looking Ahead

The yield curves in many major economies remain inverted likely signaling we are heading towards a recession, the severity and timing of which is still highly uncertain. With the market remaining hopeful for a soft landing, any perceived deviation from this path could result in volatility for equities. The renewed fight against inflation after a previous pause by the Bank of Canada also points to a potential prolonged period of higher interest rates ahead, an outcome that is also likely in Europe and the United States.

While the banking sector appears to have stabilized for now, the risk of something breaking remains. One well-reported area of concern is commercial real estate, a segment that is experiencing high vacancies and an uncertain outlook given the work-from-home trend.

To prepare against the risks, we've leaned into our bottom-up approach. Our equity investment philosophy naturally leads us to businesses with more stable demand given the criticality of the products and services they provide to their customers. 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 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.

With recession uncertainty still clouding the outlook, we continue to focus on maintaining the course, sticking with the key tenets of our investment philosophy, being balanced, and prepared for a variety of different scenarios.

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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 | 4.7 | 0.6 | 9.9 | 3.0 | 4.3 | 7.2 | 7.5 |
| BENCHMARK | 5.5 | 0.7 | 10.4 | 5.2 | 4.7 | 6.7 | 7.6 |

## Calendar Year, as of December 31:

| | 2022 | 2021 | 2020 | 2019 | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 |
|---|---|---|---|---|---|---|---|---|---|---|
| FUND | (12.4) | 9.2 | 10.7 | 14.9 | (0.3) | 9.9 | 3.3 | 10.2 | 12.2 | 20.1 |
| BENCHMARK | (9.6) | 10.0 | 10.7 | 14.2 | (2.7) | 8.4 | 7.4 | 6.2 | 9.5 | 14.6 |

[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 Tax Effective Balanced Fund Series A Inception: January 8, 1988

## 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.

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

## 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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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 Tax Effective Balanced Fund | Jan 2012: 5% 91 Day Treasury Bill, 35% FTSE TMX Canada Universe Bond, 15% S&P/TSX Composite, 15% S&P 500, 15% MSCI EAFE (net), 7.5% BMO Weighted Small Cap (Blended), 7.5% Russell Global Small Cap<br>Aug 2013: MSCI EAFE (net) returns is used to calculate the blended benchmark from inception. Previously, MSCI EAFE (gross) was used.<br>Oct 2015: 5% 91 Day Treasury Bill, 30% FTSE TMX Canada Universe Bond, 5% FTSE WGBI, 15% S&P/TSX Composite, 7.5% BMO Small Cap (blended), 15% S&P 500, 15% MSCI EAFE (net), 7.5% Russell Global Small Cap<br>Oct 2016: 5% 91 Day Treasury Bill, 30% FTSE TMX Canada Universe Bond, 5% FTSE WGBI, 15% S&P/TSX Composite, 7.5% S&P/TSX Small Cap, 15% S&P 500, 15% MSCI ACWI ex-USA (net), 7.5% MSCI ACWI Small Cap (net)<br>Jun, 2021: 5% FTSE Canada 91 Day TBill Index, 35% FTSE Canada Universe Bond, 15% S&P/TSX Composite, 7.5% S&P/TSX Small Cap, 15% S&P 500, 15% MSCI ACWI ex-USA (net), 7.5% MSCI ACWI Small Cap (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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