

Mawer U.S. Equity 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. While the Federal Reserve opted not to hike rates at its most recent meeting in June, Chairman Powell continued to jawbone markets into expecting more hikes before 2023 is through.

U.S. equity markets shrugged off the government debt ceiling brinkmanship to post excellent returns in the quarter, buoyed largely by outsized returns from a handful of mega cap technology stocks. Taken together, seven companies—Apple, Microsoft, Alphabet (i.e., Google), Amazon, Tesla, NVIDIA, and Meta (i.e., Facebook)—represent 28% of the S&P 500 index and delivered an average return in excess of 20% during the second quarter ... this in addition to their even stronger gains in Q1. All are benefiting from frenzied interest in artificial intelligence (AI) as a potentially burgeoning source of long-term secular growth.

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

Performance Commentary

The portfolio underperformed its benchmark in the second quarter.

The portfolio's exposure to the group of seven technology-related companies mentioned above is both more selective and more modest than the benchmark's: we own Microsoft, Alphabet, and Amazon with a combined weight of just over 11%. All three had very strong returns during the quarter backed by enthusiasm for the new opportunities and efficiencies that AI has the potential to unlock. But our relative positioning in these seven companies alone explains all of the portfolio's underperformance over the period.

While corporate profits were generally strong across the portfolio, there were a few exceptions. Dollar General suffered as inflation took its toll on the business model with inflation in both inventory costs and capex resulting in lower operating margins. Ultimately, the company's ability to pass along additional price increases appears limited given the pressures facing their core customers. Two life sciences companies also fared poorly—Waters and Bio-Rad—given surprisingly lower demand from both larger pharmaceutical customers and smaller biotech firms.

Positives during the quarter included construction materials supplier Martin Marietta and P&C insurance data provider Verisk. As opposed to Dollar General, Martin Marietta enjoyed substantial strength in aggregates pricing. Data analytics company Verisk reported higher revenue growth and margins as management is refocusing the businesses on its core P&C insurance customers. These results align with the impressions one of our analysts gleaned after attending a recent Investor Day, meeting with various senior managers; since divesting from its non-core operations, the company's culture seems to be benefitting from a clearer set of priorities and mission.

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, if 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.

U.S. Equity Fund

Q2 2023 | Performance Commentary

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., Dollar General's earnings, 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.

Performance Summary¹ (%)

As of June 30, 2023:

	YTD	3 Mo.	1 Yr.	3 Yrs.	5 Yrs.	10 Yrs.	Since Inception ²
FUND	7.7	4.1	16.5	9.5	11.1	14.1	8.5
BENCHMARK	14.2	6.3	22.7	13.5	12.4	15.4	10.2

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

¹Performance figures are net of management fees and operating expenses. Periods greater than one year are annualized. Performance figures are in Canadian dollar terms.

²Mawer U.S. Equity Fund Series A Inception: December 11, 1992

U.S. Equity Fund

Q2 2023 | Performance Commentary

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.

[U.S. Equities: ChatGPT, Banks, and Earnings | EP134](#)

Why management teams matter, energy companies rarely meet our investment criteria, and JPMorgan and State Street differ from many regional banks.

[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 U.S. Equity Fund	S&P 500 Index

Performance Disclosure and Requirements:

U.S. Equity Fund

Q2 2023 | Performance Commentary

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.

The Funds mentioned in this document are not registered with the United States Securities and Exchange Commission and they are sold in the United States only in reliance on exemptions from registration.