

Mawer U.S. Mid Cap 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, buoyed largely by outsized returns from a handful of mega cap technology stocks that are benefiting from frenzied interest in artificial intelligence (AI) as a potentially burgeoning source of long-term secular growth. Despite underperforming the S&P 500, the Russell MidCap Index delivered strong returns in the quarter. And though a potential recession is widely anticipated, corporate profits remain broadly resilient.

Performance Commentary

The portfolio delivered a positive return but underperformed its benchmark in the second quarter.

Several portfolio holdings were rewarded for strong earnings reports. Digital media business operator IAC and data analytics company Verisk are two examples. 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 and 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. We've been adding to IAC as the results support our view that management are shrewd operators and valuation remains attractive.

By contrast, shares of Concentrix reacted negatively to the company's latest earnings announcement. In addition, the market, and our team, have wondered if Concentrix will be a winner or loser with AI. On the one hand, Concentrix can leverage AI in servicing its customers, leading to efficiencies; on the other, incredibly sophisticated chatbots in the future may reduce the need for call centers.

Finally, several companies in the health care sector contributed to underperformance. Bio-Rad, a life sciences company, fared poorly given surprisingly lower demand from both larger pharmaceutical customers and smaller biotech firms. We exited Premier Inc, a group purchasing organization for hospitals, as a string of disappointing results has surprised us and new learnings through our scuttlebutt process lowered our assessment of business quality. Humana sold off sharply as larger competitor UnitedHealth warned of higher medical care costs ahead.

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.

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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, most notably with the regional bank failures in the U.S., but they haven't materialized to the extent one might have anticipated given the degree of curve inversion.

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 characteristics and better balance sheets, providing 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 companies with excess inventory levels may face margin pressures in the coming quarters, as demand softens and supply chain disruptions abate from COVID highs. 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	8.0	0.9	18.7	-	-	-	(2.7)
BENCHMARK	6.5	2.4	17.9	-	-	-	(1.5)

Calendar Year, as of December 31:

	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
FUND	(14.5)	-	-	-	-	-	-	-	-	-
BENCHMARK	(11.3)	-	-	-	-	-	-	-	-	-

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. Mid Cap Equity Fund Series A Inception: September 27, 2021.

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.

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Benchmarks:

FUND	BENCHMARK
Mawer U.S. Mid Cap Equity Fund	Russell Midcap Index (TR)

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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