Mawer Canadian Equity Fund, Series A

Q2 2024 | Performance Commentary

Market Overview

Unlike most other regions globally, Canadian equities had a tough go of it in the second quarter with the S&P TSX Index posting modestly negative returns overall. Only four of eleven sectors were positive and only two—materials and consumer staples—posted returns above one percent. Within materials it was largely a story of metals and mining companies benefiting from rising metal prices while consumer staples were led by a strong price surge from Dollarama. Pipeline companies within the energy sector also did well as natural gas prices were up by more than 30% in the quarter. Information technology was down more than five percent, largely because of weaker performance from Shopify and CGI.

Compared to the first quarter, market expectations for future interest rate cuts were reduced as the U.S. Federal Reserve and Bank of Canada grappled with stubborn inflation. Nonetheless, central bankers in Canada diverged from their American peers by kicking off their policy easing cycle with a 25 basis point cut in the overnight rate in June. Markets are putting decent odds on another couple cuts through the rest of 2024 in Canada. However, headline and core inflation remain above the two percent midpoint of the Bank of Canada's long-term target and the Bank's messaging to market participants has stressed that future policy action will be measured and data dependent.

Performance Commentary

The portfolio marginally underperformed the benchmark in the quarter.

Security selection was a positive factor for relative returns led by providers of basic consumer goods such as **Dollarama** and **Loblaw Companies**. Dollarama reported strong but moderating growth in Canada, and beyond Canada, the company announced a deal to acquire an additional ten percent of Dollarcity and a new joint venture with the management team to enter Mexico in 2026. Adding Mexican operations may provide an additional long-term growth runway as Canada matures. Similarly, Loblaw Companies reported a solid quarter albeit with decelerating growth. Margin expansion through operating leverage and positive sales mix shift from Loblaw to Shoppers Drug Mart (a higher margin segment) continues to drive improved overall profitability.

Several of our financial service companies also did well in the quarter. Of note, **Manulife's** management team adjusted their return on equity (ROE) target from 15% to 18%. There are three key components to the target ROE expansion: (1) low ROE long-term care and variable annuity products are running off, (2) the Asia segment is approaching 50% of earnings by 2027 and is typically a higher ROE segment, and (3) wealth management growth continues to improve the earnings mix. While we're closely assessing how realistic management's new targets are, the market seemed to find this announcement encouraging. **Royal Bank** saw a strong return, bucking the trend for the bank complex in Canada. It's second quarter ROE was materially higher than the rest of the big banks and continues a trend of Royal pulling ahead of their peers on business quality and management execution. This was also the first quarter where the recently closed HSBC acquisition hit the financials and very early signs suggest the previously disclosed cost synergy assumptions of the deal are reachable.

After being a top performer last quarter, **Canadian Pacific Kansas City** railroad gave back some of its gains and was the largest detractor to relative performance in the portfolio. Transportation volumes were down industry wide and investors may have been expecting a quicker positive impact from the Kansas City Southern acquisition.

Bank of Montreal and **Bank of Nova Scotia** traded lower as did most of the other big six banks. BMO noted higher than expected credit loss provisions as high interest rates continue to stretch borrowers and Bank of Nova Scotia saw earnings decline as they've been reducing the size of their mortgage book.

Telus International continued to feel the effects of declining sales to some of their large technology customers (namely Meta), however, there were some green shoots as sales to Telus and Google grew in the quarter. Guidance from company management implies growth through the rest of year, however recent share price weakness suggests the market remains skeptical on how much AI will negatively impact this business model. Global IT services firm **CGI** also saw a slowdown in growth which we are seeing across their industry. The company managed to maintain margins and has lots of dry powder ready for M&A.

Looking Ahead

This quarter marked the start of the next phase of this cycle, one where the Bank of Canada now officially has a bias towards easing policy rates. The questions remain when and at what pace will we see further rate cuts. Our current view is that inflation will remain sticky, and as a result, cuts could be slower than market consensus. The interplay between growth, inflation, and interest rates will likely have a large effect on the Canadian equity market in the coming quarters.

Thinking longer-term, we worry about the trend toward more protectionist policies, less globalization, more conflict, and a multi-polar world. In 1989, the fall of the Berlin Wall was an inflection point that served to catalyze more inclusive global economic growth, increased productivity, trade, and formidable stock market returns over the ensuing three decades. While global economic growth remains positive, it has slowed and we note that the word "deflation" has started to occasionally creep into conversations with company executives, a shift relative to the last few years. Current trends, along with a higher cost of capital, may imply lower real returns from equities moving forward.

As for the non-Canadian AI-related market darlings which have surged ahead and caused the Canadian equity market to lag many regions globally, the late Roy Amara once said, "We tend to overestimate the effect of a technology in the short run and underestimate the effect in the long run." Put differently, there's a risk of over-exuberance in markets extrapolating today's pace of AI-related demand, with many companies lacking the data or infrastructure to deploy generative AI widely within their organizations. Return on investment is also unknown. But the mismatch between the timing of investment and returns may create significant future opportunities, particularly where competitive advantages are strongest.

As always, valuation is the great equalizer and both axes of our Matrix—quality and valuation—are important. AI-related or not, companies with competitively advantaged revenue streams should benefit from continued economic growth while providing a measure of defensiveness should the macroeconomic environment deteriorate. Purchasing such securities at a discount to their intrinsic values should, in theory, offer greater upside in a bullish scenario yet better downside protection should markets correct. We aim to get the balance right. While not a formula for avoiding shorter-term negative returns, we believe this approach should minimize the probability of permanent impairment of capital while leading to long-term compounding of wealth.

Canadian Equity Fund

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Performance Summary[1] (%)
As of June 28, 2024

	YTD	3 Mo.	1 Yr.	3 Yrs.	5 Yrs.	10 Yrs.	Since Inception[2]
FUND	6.0	-0.7	11.8	5.8	8.0	7.1	9.0
BENCHMARK	6.1	-0.5	12.1	6.0	9.3	7.0	8.4

Calendar Year, as of December 31:

	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
FUND	9.4	-5.6	23.7	2.7	20.7	-9.8	8.7	15.8	-0.3	15.8
BENCHMARK	11.8	-5.8	25.1	5.6	22.9	-8.9	9.1	21.1	-8.3	10.6

[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 Canadian Equity Fund Series A Inception: June 3, 1991

Selections from Mawer's Art of Boring blog and podcast:

Quarterly Update | Q2 2024 | EP161
Portfolio Manager Crista Caughlin discusses the economy and factors that drove markets in the second quarter of 2024.

[Navigating the U.S. Mid-Cap Landscape: Resilience Amid Uncertainty | EP160]
In this episode, Portfolio Manager Jeff Mo makes the case for investing in U.S. mid-cap equities, highlighting the country's strong business environment, large domestic market, and GDP growth. He discusses current market trends, including artificial intelligence, and his team's risk management evaluation, especially with a pivotal U.S. election looming on the horizon.

[From Buy to Bye: Sell Discipline and Overcoming Behavioral Biases | EP159]
Portfolio Manager Jeff Mo discusses common behavioral biases that can hinder clear sell decisions, and the tools, such as checklists and trigger points, that can help slow down emotional thinking.

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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 Canadian Equity Fund	S&P/TSX Composite Index

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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