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Mawer U.S. Equity Fund, Series A

Q2 2024 | Performance Commentary

Market Overview

The story of the second quarter of 2024 was a continuation of the key themes and results of the first quarter—strength in public equity markets led largely by artificial intelligence (AI) related businesses and rising bond yields weighing on fixed income returns.

Information technology comfortably led all sectors in performance as the demand for semiconductor chips continued unabated. Communication services was the next best performer thanks largely to Alphabet (Google), and coming in third was utilities, a sector impacted by AI exuberance because of expectations that more data centers being built will lead to more electricity demand.

So far this year, only 25% of the stocks in the S&P 500 are outperforming the index—the lowest amount over the past fifty calendar years—with the majority of those being large cap U.S. growth stocks ultimately lifting the results of the broader U.S. market.

Compared to the first quarter, market expectations for future interest rate cuts were reduced as the U.S. Federal Reserve grappled with stubborn inflation. Meanwhile, central bankers in Canada and Europe have begun reducing policy rates, but their messaging to market participants has stressed that policy action will be measured and data dependent.

Performance Commentary

The portfolio significantly underperformed its benchmark in the second quarter. A primary source of relative underperformance came from our large underweight to semiconductor stocks and not owning Apple, the sum effect of which accounted for half of the strategy's negative relative performance in the period.

Customers of **Waters**, supplier of laboratory instruments and consumables, have been going through their inventory pileup accumulated during recent years and have been more cautious with new orders while delaying replacement of equipment. Otherwise, sales from China have continued seeing weakness, and headwinds from the region have also been felt at **Nike**. The leading athletic footwear company noticed lower demand from consumers, and increased competition from indie running brands. Management has reiterated its key focus towards cost cutting—which has already led to margin expansion—along with product innovation. Finally, healthcare conglomerate **CVS** was impacted by higher-than-expected medical costs in its Medicare insurance business and also had to deal with some product recalls.

Elsewhere, the stock price of supplier of aggregate **Martin Marietta** and paint manufacturer **Sherwin-Williams** slightly pulled back from their all-time highs on macroeconomic headwinds.

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Technology focused stocks were the big winners in the portfolio. **Microsoft** and **Alphabet** both saw excellent growth in their cloud computing businesses and for Alphabet, the main concern from the past year that generative AI will materially impair Google's search business, appears to be waning as the company integrates AI technology into its search product. On the same theme, global manufacturer of connectors **Amphenol** has continued seeing strong demand for its products in AI data centers, its fastest growing business segment. Amazon has also been a beneficiary; its cloud computing platform AWS has continued seeing substantial growth in demand and margins.

Many of the same themes from this quarter were also the primary sources of relative underperformance over the past year, notably **Nike** as well as some of our holdings in arguably more defensive sectors such as health care and consumer staples: **Bio-Rad**, **Abbott Laboratories**, and **Hershey**. A lower exposure to AI-beneficiaries and semiconductor stocks in particular had a large impact on the strategy's relative underperformance over the past year.

With high momentum stocks like Nvidia, we continue to closely monitor them but ultimately, in our view, the range of outcomes for these types of companies are very wide and current valuations reflect market assumptions that earnings growth rates and margins will stay elevated for many years to come. While of course possible, we find these sorts of scenarios hard to envision with high probability. This reduces our confidence that these stocks are trading below intrinsic value and reinforces our belief that sticking to our philosophy and process, despite the temptation to chase the current trend, is a sound strategy.

Looking Ahead

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 AI-related market darlings, 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.

U.S. 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	10.0	-0.7	16.8	8.5	11.2	13.6	8.7
BENCHMARK	19.6	5.4	28.8	13.8	16.1	15.7	10.7

Calendar Year, as of December 31:

	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
FUND	14.4	-12.1	23.6	14.7	25.7	9.6	12.8	5.5	19.3	20.9
BENCHMARK	22.9	-12.2	27.6	16.3	24.8	4.2	13.8	8.1	21.6	23.9

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

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.

Disclaimer

Opinions and Forecasts:

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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 U.S. Equity Fund	S&P 500 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

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