Mawer U.S. Mid Cap Equity Fund, Series A

Q2 2024 | Performance Commentary

Market Overview

Strength in public equity markets in the second quarter was led largely by enthusiasm toward artificial intelligence (AI) solutions. But while the S&P 500 Index delivered positive returns, much of the advance was concentrated in large-cap U.S. growth stocks, which outperformed both small and mid-cap companies. The Russell Midcap Index actually posted a negative return.

Communication services, information technology, and even utilities led all sectors in performance as the demand for advanced chips continued unabated. For utilities, the AI-related boost stemmed from expectations that more data centers should lead to more electricity demand. Consumer-driven sectors and more traditional industrial businesses were among the biggest laggards in perhaps a worrying sign for the sustainability of economic growth.

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's return underperformed its benchmark in the second quarter.

Two health care companies, **Charles River Labs** and **Bio-Rad Labs**, were hurt by continued weakness in the spending environment for drug development. Charles River is the leading contract research organization for early-stage drug development in the world, helping pharmaceutical and biotech companies outsource their initial drug discovery and safety assessment work, whereas Bio-Rad produces and distributes lab and diagnostics tools and consumables. Despite near-term headwinds, we believe the long-term secular tailwinds behind both businesses are very favourable. We took advantage of the share price weakness in Charles River to add to our position.

Two recently initiated holdings in the consumer discretionary sector also were a drag on performance as their management teams offered more cautious forward guidance. **XPEL** is a leading provider of protective films and coatings for automotive and architectural applications. Port delays and weakness in the auto aftermarket in the U.S. were contributing factors. Makeup and hair retailer **Ulta Beauty** declined after management offered more cautious guidance on consumer spending. In both cases, we believe the market reaction is overblown and continued to build our positions.

Partially offsetting these negatives, companies such as **Amphenol** and **KLA** continue to enjoy AI-related tailwinds propelling their share prices to all-time highs. Both companies possess robust competitive advantages: KLA, for example, is the dominant market leader in semiconductor manufacturing process control and wafer inspection, crucial in ensuring high yields in their customers' production processes. Amphenol's exposure is a bit more indirect: as a major producer of electronic interconnect systems, Amphenol is seeing high demand for its products as one of its key end markets is data centers. Finally, the portfolio's top holding, household appliance designer **SharkNinja**, continues to demonstrate consistently strong execution and market share gains.

Looking Ahead

Though we are very much bottom-up investors, the juxtaposition of the current macroeconomic and geopolitical backdrop with most equity markets at, or close to, all-time highs has us increasingly puzzled. Beneath the surface of the headline performance of many global indices, we worry about the lack of breadth in markets' recent advance. Consumer-related stocks and more traditional industrial bellwether segments point to potential underlying weakness. 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.

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, peace, increased productivity, trade, and formidable stock market returns over the ensuing three decades. 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 value 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. Mid Cap 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	5.2	-4.3	14.6	-	-	-	3.3
BENCHMARK	8.9	-2.3	16.7	-	-	-	4.8

Calendar Year, as of December 31:

	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
FUND	17.7	-14.5	-	-	-	-	-	-	-	-
BENCHMARK	14.1	-11.3	-	-	-	-	-	-	-	-

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

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

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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

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