Mawer Balanced Fund, Series A

Q3 2022 | Performance Commentary

Market overview

Numerous equity markets declined (in local currency terms) during a volatile third quarter, despite some optimism early in the period that led to a brief rally. Many central banks have continued to hike interest rates and the U.S. Federal Reserve has been unequivocal about its plan to fight inflation; ultimately, how far and how fast the U.S. Federal Reserve will go has been a key factor driving markets. Additionally, currency markets experienced significant volatility and the U.S. dollar was considerably strong against many other currencies.

The Bank of Canada has also remained committed to ensuring that higher prices do not get entrenched into expectations. Headline inflation eased slightly in Canada but remained elevated and Canadian bonds finished the quarter with a positive return as longer dated interest rates moved modestly lower.

Performance commentary

With the backdrop of a more uncertain economic environment, the portfolio was unable to escape a negative return in the third quarter, but was flat to its benchmark.

As the performance of various asset classes suggest, the risks are evident: inflation, central bank tightening, and the associated impacts to growth. This is a transition period from the era of unusually accommodative monetary policy that persisted since the Global Financial Crisis toward one of structurally higher rates. Just as in life, transition periods in markets are often volatile and can be long lasting. But the valuation correction experienced in 2022—while far from pleasant—has its benefits in that gravity is being restored to the system.

With the backdrop of a more uncertain economic environment, there were several companies in our portfolios that performed well over the quarter.

- Businesses we would define as "boring" were some of the stronger performing stocks. Holdings such as insurance broker Aon, reference data provider Wolters Kluwer, and manufacturer of electronic connectors and cables Amphenol, posted steady increases in revenues and operating profits reflecting the stability of their businesses.
- While many global banks declined i, our Singapore bank holding, DBS Group, whose lending book is tilted toward floating rate loans tied to the U.S. Federal Funds rate, has enjoyed the associated higher net interest margins.
- Deutsche Boerse, a financial exchange, has benefitted in the current environment from increased hedging activity.

Companies that have been able to pass on cost increases to customers have also been generally well rewarded in the market. While they had good performance in the third quarter, some of the businesses noted below have seen their stock prices go through a period of decline at some point in the last couple of years.

- Operator of auto-collision repair shops, Boyd Group, experienced higher labour inflation and while there was a lag, the company displayed its pricing power by passing on much of these increased costs.
- Our holdings in Japanese drugstores such as TSURUHA and KUSURI NO AOKI took a positive step towards passing on higher costs in a market which is traditionally averse to price hikes.

On the contrary, holdings that faced increased costs and margin compression have seen their stock prices come under pressure.

- U.K. automobile insurer Admiral Group, which previously benefited from COVID-19 lockdowns reducing the number of overall accidents, has seen this trend reverse with more drivers on the road. In addition, their competition has been intensifying and Admiral has not been fully able to pass through increased claims inflation to its customers.

There are a few other segments of our portfolios that displayed weakness in the quarter.

- Cable and telecommunication companies have been an area that has lagged the broader market as their worlds are increasingly colliding. Companies such as Verizon and Comcast have been impacted as wireless operators are spending heavily to attract internet subscribers with fixed wired access while the cable companies are trying to build wireless businesses.
- Companies tied to the Real Estate market also tended to lag as higher interest rates impacted the sector. Holdings including Colliers International Group, Choice Properties REIT, and Mainstreet Equity had their stock prices decline.
- Other companies that have seen declines include those that have been impacted by macroeconomic uncertainty in China. Both Alibaba and Tencent have reported results that are negative fundamentally, and while both have been under pressure from new competition, the recent results are also a reflection of the economic state in China.

Canadian bonds moved higher this quarter, as longer dated interest rates moved modestly lower, but much more is needed to recover from the losses incurred in the first half of the year. The flattening of the yield curve was a result of the Bank of Canada continuing to hike interest rates to control inflation. The relative outperformance of the Mawer Canadian Bond Fund was driven by our duration decision to switch from long to short relative to the benchmark and curve positioning that benefited from the yield curve flattening. Mawer's Balanced underlying strategies delivered slightly negative returns this quarter and performed in line with their benchmarks.

From an asset mix perspective, we are holding higher than normal levels of cash within our portfolios. After a series of equity trims during 2022, we've now transitioned to an equity weight that is more in line with our neutral level. Bond allocations also remain below our long-term neutral targets. Tilting the portfolio towards this defensive positioning offers some additional resilience to rising interest rates, but as long-term investors we remain comfortable with our current allocation to both bonds and equities.

Looking ahead

As we move forward, the market will continue to keep a close eye on economic data that may signal how central banks will respond in the coming months. Given the macroeconomic headwinds facing markets, the probability of a global economic slowdown remains high—though we will point out the market has the potential to be surprised if inflation moderates faster than expected. Supply chains have improved and commodity prices have moderated. Some companies also noted elevated inventory levels in the quarter, a sign that demand may be softening.

Higher discount rates combined with the potential for diminished earnings growth can have a material impact on company valuations. While markets globally may have the rise in discount rates priced in, many still do not have an earnings recession reflected in valuations. Ultimately, additional headwinds to company valuations might remain.

As we have mentioned before, one of the risks is something breaks. We don't have to look further than the recent mini-budget announcement in the U.K. to see the delicateness in the current market environment. The

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British pound nearly hit parity with the U.S. Dollar and U.K. yields were sent soaring on the news. The vast speed the situation unfolded highlights how sensitive the market can be to surprises.

With all the macroeconomic headlines dominating markets, we continue to stick to our bottom-up process and focus on the quality of the companies we purchase. At the same time we are being cognizant of thematic or macroeconomic exposures to determine if there are sharp corners that require addressing. Regardless of how the economic outlook may evolve, we take comfort in the notion that over the long term, stock prices tend to follow wealth creation. As such, we continue to lean heavily into the durability of our philosophy and process in an effort to responsibly steward our clients' investments through uncertainty.

Performance summary[1] (%)
As of September 30, 2022:

	YTD	3 Mo.	1 Yr.	3 Yrs.	5 Yrs.	10 Yrs.	Since Inception[2]
FUND	(16.9)	(0.5)	(13.6)	1.1	3.7	7.2	7.8
BENCHMARK	(14.0)	(0.5)	(10.8)	2.6	3.9	6.3	7.3

Calendar Year, as of December 31:

	2021	2020	2019	2018	2017	2016	2015	2014	2013	2012
FUND	9.3	10.6	15.0	(0.3)	10.0	3.2	10.5	12.1	20.2	11.4
BENCHMARK	10.0	10.7	14.2	(2.7)	8.4	7.4	6.2	9.5	14.6	8.1

[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 Balanced Fund Series A Inception: February 12, 1088

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

Quarterly Update | Q3 2022 | EP118
Market swings, central bank moves, and rising interest rates. A look at Q3.

Playing the plan: Mawer's international equity portfolio | EP115
The impacts of inflation, interest rates, and sharp currency movements on the portfolio, and the importance of leaning in to process and keeping a long-term perspective.

An energy-fuelled debate: Are renewables actually becoming cheaper? | EP114
The team debates the thesis that renewables are becoming "cheaper" than traditional energy sources, unpacks why the ultimate cost to the end consumer shouldn't be missing from the conversation, and delves into the investment implications.

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Disclaimer

Opinions and Forecasts:
This report includes certain statements that are "forward looking statements". 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, are forward looking statements. The words "may", "could", "would", "should", "believe", "plan", "anticipate", "expect", "intend", "forecast", "objective" and similar expressions are intended to identify forward looking statements. These forward looking statements are subject to various risks and uncertainties, including the risks described in the Simplified Prospectus of the Fund, uncertainties and assumptions about the Fund, capital markets and economic factors, which could cause actual financial performance and expectations to differ materially from the anticipated performance or other expectations expressed. Economic 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.

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Benchmarks:

FUND	BENCHMARK
Mawer Balanced Fund	Jan 2012: 5% 91 Day Treasury Bill, 35% FTSE TMX Canada Universe Bond, 15% S&P/TSX Composite, 15% S&P 500, 15% MSCI EAFE (net), 7.5% BMO Weighted Small Cap (Blended), 7.5% Russell Global Small Cap Aug 2013: MSCI EAFE (net) returns is used to calculate the blended benchmark from inception. Previously, MSCI EAFE (gross) was used. Oct 2015: 5% 91 Day Treasury Bill, 30% FTSE TMX Canada Universe Bond, 5% FTSE WGBI, 15% S&P/TSX Composite, 7.5% BMO Small Cap (blended), 15% S&P 500, 15% MSCI EAFE (net), 7.5% Russell Global Small Cap Oct 2016: 5% 91 Day Treasury Bill, 30% FTSE TMX Canada Universe Bond, 5% FTSE WGBI, 15% S&P/TSX Composite, 7.5% S&P/TSX Small Cap, 15% S&P 500, 15% MSCI ACWI ex-USA (net), 7.5% ACWI Small Cap (net) June 2021: 5% FTSE Canada 91 Day TBill Index, 35% FTSE Canada Universe Bond, 15% S&P/TSX Composite, 7.5% S&P/TSX Small Cap, 15% S&P 500, 15% MSCI ACWI ex-USA (net), 7.5% MSCI ACWI Small Cap (net)

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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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