Mawer Global Small Cap Fund, Series A

Q3 2022 | Performance Commentary

Market overview

Investors looking for a volatility breather in Q3 were disappointed as equity markets continued their bruising run in 2022. Despite some optimism early in the summer that led to a brief rally, most asset classes resumed their downtrends as the U.S. Federal Reserve and an increasing number of influential central banks have been unequivocal in their commitment to fighting inflation, which has increased the probability of a global recession. 10-year U.S. Treasury yields approached 4%, credit spreads widened, while the British pound, euro, and Japanese yen weakened precipitously relative to the U.S. dollar.

Performance commentary

The Mawer Global Small Cap Equity underperformed its benchmark during the third quarter. The underperformance came mostly from our overweight position in Europe (including the United Kingdom) at the expense of an underweight position in the United States.

The strength of U.S. companies this quarter can be seen by looking at the top contributors to our performance where 4 of the top-5 are either U.S. companies or companies deriving most of their revenues in the U.S.

Notable contributors include 4imprint, a direct marketer of customized promotional merchandise, which posted better than expected revenues and profits. The company attributed the strong growth to the brand building initiatives they have been carrying out over the last three years finally starting to pay off in the form of higher customer growth and market share gains. We also saw the payoff of management's long-time focus on culture as they indicated that despite the tight labour market, they have not yet run into issues attracting or retaining talent. Winmark Corporation, a franchisor of retail concepts that specialize in second-hand goods, was another positive contributor posting better than expected results on the back of continued store count and sales per store growth.

Rising input costs due to inflation and macro concerns around the economy were two other themes that affected our portfolio. Our largest detractor this quarter was motor vehicle insurer Sabre Insurance. The stock declined following an announcement to increase reserves set aside for claims as both repairs and injury costs are rising in the UK. Our research suggests that while Sabre has been taking the lead in raising premiums ahead of inflation, the industry more generally has been slower to follow. We believe that over time these costs should get passed through to customers as auto insurance is non-discretionary and less profitable competitors are unlikely to write loss-making policies indefinitely. A number of our IT value added resellers and consultants, such as Atea, Softcat and KnowIT, lagged mostly due to worries around future IT spending slowing down.

Weakening consumer sentiment affecting discretionary spending, combined with delays in passing on increasing input costs through higher prices has also affected companies such as Italian small appliance manufacturer De'Longhi. Despite current headwinds, the company has maintained their long-term investments in brand, marketing, and product innovation. Although this will affect margins in the near-term, we view the decision to be wealth-creating in the long term.

Looking ahead

As the performance of various asset classes suggests, risks are clear and present: inflation, central bank tightening, and the associated impacts. The probability of a global recession appears high. In retrospect, the

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COVID-induced recession that we surely would have had two years ago were it not for policy intervention may merely have been delayed, with the trigger now being higher rates.

As such, 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. Investment across the economy can occur in a more efficient manner when there is a genuine cost of capital. Moreover, as investors, discounted cash flow models have more meaning when discount rates aren't unusually low.

Activity in the portfolio so far this year has broadly focused on two key themes: improving diversification (often by reducing interest rate sensitivity) and improving economic resilience. Process-wise, we have been focused on building our high-quality inventory list of companies we'd love to buy when the opportunity presents itself. But we're also being patient. On the one hand, the risks are hard to ignore, and future earnings estimates could see further downside, but the spring appears tightly wound on the bearish side too: any signs of moderation in the run-rate of inflation may precipitate a sizable relief rally.

And 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	(25.6)	(3.7)	(27.6)	(0.8)	3.3	11.6	9.6
BENCHMARK	(19.9)	0.9	(18.4)	4.2	4.3	10.2	6.3

Calendar Year, as of December 31:

	2021	2020	2019	2018	2017	2016	2015	2014	2013	2012
FUND	4.8	14.8	24.4	(2.6)	20.8	(0.7)	29.1	12.1	47.0	29.5
BENCHMARK	15.1	14.3	18.4	(6.7)	15.7	8.3	18.3	9.1	33.7	15.6

[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 Global Small Cap Fund Series A Inception: October 2, 2007

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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 global small cap portfolio | EP116

Why small caps may zig while large caps zag, the advantage of businesses that sell scarce skills (CBIZ, Insperity, RS Group), and why eyewear retail is harder than it…looks.

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.

Disclaimer

Opinions and Forecasts:

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Benchmarks:

FUND	BENCHMARK
Mawer Global Small Cap Fund	Oct 2007: Russell Global Small Cap Oct 2016: MSCI ACWI Small Cap (net) Total Return index

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