Mawer International Equity 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. In the end, all sectors in the MSCI ACWI ex. U.S. index finished the quarter with negative returns.

Performance commentary

With the backdrop of a more uncertain economic environment, the Fund was unable to escape a negative return during the third quarter. Notably, semiconductor manufacturer TSMC fell as it faces a less robust outlook in demand for its products, while China's Alibaba and Tencent traded lower given a slowing domestic economy, greater competition, and the longer duration profile of their cash flows. Finally, those companies that have reported margin pressures have been punished (e.g., health-related companies Eurofins Scientific and Recordati).

That said, the Fund meaningfully outperformed its benchmark in Q3 as "boring" worked. Top holdings such as insurance broker Aon, reference data provider Wolters Kluwer, and recurring consumables distributor Bunzl posted steady increases in revenues and operating profits reflecting the stability of their businesses.

Other companies whose stock prices had been hit hard earlier in the year bounced as their businesses proved more resilient than the market feared. Construction equipment rental company Ashtead's most recent results demonstrated how quickly they have been able to pass along cost of goods sold (COGS) inflation. Ashtead has a leading position in a fragmented market which requires its smaller peers to pass inflation along rapidly or become unprofitable. The year-to-date phenomenon of COGS inflation above operating expense inflation has translated into margin expansion and the opportunity for Ashtead to gain market share.

Elsewhere, a relative lack of exposure to banks in the UK, Europe, and China helped. Instead, financial holdings such as Deutsche Boerse continue to benefit from higher interest rates and volatility, leading to more hedging transactions and higher income on their float, whereas Singaporean bank DBS, whose lending book is tilted toward floating rate loans tied to the U.S. Fed Funds rate, has enjoyed the associated higher net interest margins.

Finally, it should be noted that all of the companies named above have significant U.S. exposure, despite being headquartered elsewhere. Bunzl and Ashtead, for example, derive most of their revenues from the U.S., while DBS has clearly benefitted from the Fed's interest rate hikes. Overall, the businesses in the Fund tend to have more U.S. dollar exposure than the broader benchmark, and this has been an additional tailwind to performance given the strength of the greenback.

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 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.

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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	(25.8)	(1.1)	(22.8)	(1.7)	0.8	7.3	7.1
BENCHMARK	(20.0)	(4.0)	(18.8)	(0.3)	1.1	7.2	4.8

Calendar Year, as of December 31:

	2021	2020	2019	2018	2017	2016	2015	2014	2013	2012
FUND	7.3	12.4	14.4	(4.0)	22.6	(3.3)	20.3	9.1	22.6	19.5
BENCHMARK	6.9	8.7	15.4	(6.5)	18.8	(3.0)	19.0	3.7	31.0	14.7

[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 International Equity Fund Series A Inception: November 6, 1987

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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Opinions and Forecasts:

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Benchmarks:

FUND	BENCHMARK
Mawer International Equity Fund	Jan 1988: MSCI EAFE (net) Oct 2016: MSCI ACWI ex-USA (net)

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