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Mawer U.S. Equity Fund, Series A

Q3 2024 | Performance Commentary

Market Overview

In the third quarter of 2024, under the weight of previous central bank interest rate increases, global growth continued to slow. But in September, the U.S. Federal Reserve made its first interest rate cut this cycle, joining the Bank of Canada and other central banks who had already begun reducing rates due to retreating inflation. This has provided some relief for certain households and businesses who have been struggling with a higher interest rate environment. While the path of inflation and interest rates are never certain, it does seem we are now on the easing side of this cycle.

Equity market performance remained strong while broadening out over the third quarter with interest rate sensitive sectors such as utilities, real estate, and financials propelling the S&P 500 to an all-time high. The technology sector lagged, however, as investors questioned higher valuations for companies benefiting from artificial intelligence spending. Though performance was strong overall in the quarter, we did see bouts of volatility and market drawdowns, particularly in late July/early August when the U.S. posted weaker economic data. Despite the volatility, tighter credit spreads and all-time highs for several equity markets may suggest that investors have priced in a low probability of a recession.

Performance Commentary

The portfolio outperformed its benchmark as many of our “boring” businesses shined this quarter, especially through the market drawdowns after the U.S. reported weaker economic data in late July. Financial exchange operators **Intercontinental Exchange** and **CME Group** are prime examples of antifragile businesses—as they benefit from volatility—and play a key role in protecting the portfolio against market uncertainty. Heightened volatility experienced during the quarter has led to a substantial increase in trading volume across exchanges, and CME Group expanded its margins as it continued to show strong cost control.

The most notable performers were steady, resilient portfolio stalwarts that had lagged during the earlier waves of market exuberance this year, including supplier of laboratory instruments **Waters**, health insurer **UnitedHealth**, and paint manufacturer **Sherwin-Williams**. Early indications of relief from temporary challenges, coupled with consistent solid performance from management, were highly appreciated by investors of Waters and Sherwin-Williams. And despite lower revenue from its residential construction segment, the paint manufacturing company benefited from declining raw materials costs, resulting in margin expansion and confirming profit sustainability in this segment.

Elsewhere, enthusiasm in the market slowed for mega-cap technology stocks as investors seemingly moderated their expectations surrounding AI. While the portfolio benefitted from its relative underweight to these companies, it was not completely shielded either as the share prices of **Microsoft**, **Alphabet**, and manufacturer of interconnects products **Amphenol** slightly pulled back from their respective all-time highs after going strength to strength for many quarters. Finally, earnings of dollar store operator **Dollar General** continued to be negatively impacted as its lower-income customers have been disproportionally affected by higher inflation, especially in rural areas, despite gaining market shares from direct competitors.

Overall, we would characterize the current market as exuberant with the S&P 500 rising 25% this year—the best performance of the index in the first three quarters since 1997—and 36% over the past year. This type of outlier performance in the market with extremely narrow leadership and strong momentum is typically an environment where our quality at the right price investment style is challenged to keep pace. Insurance broker Marsh & McLennan's performance of +18% the past year is an example of a "boring" company that has done well… but not kept pace with the market leaders. And given the magnitude of the underperformance over the past 12-months, this has impacted longer-term figures.

The more recent performance earlier in the quarter is aligned with our expectations: we outperformed in late July/early August where the macro-economic situation appeared more precarious and underperformed later in the quarter as the market started pricing in a no-landing scenario. We would argue the declining confidence amongst U.S. consumers

Looking Ahead

While corporate earnings remain on an upward trajectory, many of the world's economic engines such as the U.S. and Europe are slowing with PMI data declining across the globe. Further, there are both top-down and bottom-up signals that the world's 2nd-most impactful economic force given its size and purchasing power—the U.S. consumer—might be facing headwinds. (Editors' note: the Fed is likely #1). As an example, a meaningful slowdown in the auto sector, which is a significant driver of manufacturing activity and jobs in the West, doesn't portend well for aggregate demand. While central banks should be commended for their handling of the economy over the last two years, investors may be placing too high a probability on a "no landing" scenario.

On the other hand, speaking of central banks, the denominator impact of lower rates and the start of the easing cycle should generally be supportive of risky assets on the assumption that inflation is falling for the right reasons and not due to more worrisome deflationary forces. The most recent stimulus in China is a great example of the impulse and impact to sentiment that this denominator effect can provide. "Don't fight the Fed" has been a rather prudent mantra historically.

Looking ahead, there will undoubtedly be no shortage of events to preoccupy markets; war and the upcoming U.S. election spring immediately to mind. But to paraphrase former U.S. Defense Secretary Donald Rumsfeld, it's the "unknown unknowns" that often produce the largest surprises… much like a global pandemic to the vast majority of market prognosticators prior to 2020.

This is why "Prepare, don't predict" is such an important mindset at Mawer and lies at the heart of our investment process. Investing in a diversified portfolio of real businesses with strong competitive advantages, that generate recurring revenues, that have flexibility in their cost base, that maintain dominant industry positions, that are run by competent managers, and that refrain from taking undue risk from a leverage perspective, should lead to genuine wealth creation. While market sentiment can shift quickly and unpredictably in the short run, attractive risk-adjusted returns over the long term are the real prize.

Performance Summary[1] (%)
As of September 30, 2024

	YTD	3 Mo.	1 Yr.	3 Yrs.	5 Yrs.	10 Yrs.	Since Inception[2]
FUND	16.3	5.7	23.6	9.0	11.5	13.8	8.8
BENCHMARK	25.1	4.5	36.2	14.3	16.4	15.5	10.8

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 | Q3 2024 | EP168
Portfolio Manager Crista Caughlin discusses the economy and factors that drove markets in the third 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.

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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 change frequently and past performance may not be repeated. Mawer Funds are managed by Mawer Investment Management Ltd.

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