Mawer Canadian Bond Fund, Series A

Q4 2022 | Performance Commentary

Market overview

Markets had a positive return in the fourth quarter offering a brief reprieve driven by the narrative that the end of the tightening cycle is drawing closer. The Bank of Canada and the U.S. Federal Reserve continued to raise policy interest rates, and while the path forward remains uncertain, the Bank of Canada left the door open to slowing its hiking cycle. Inflation remained above the Bank of Canada's target range, with the latest core CPI print being 2.98% on a 3-month annualized basis and 5.55% on a year-over-year basis. In the Bank of Canada's latest survey, inflation expectations remain elevated which will cause the Bank continued concern.

U.S. banks have tightened lending standards to levels usually seen during recessions. This will likely affect the economy as businesses and consumers find it more difficult to access credit. We are seeing recently that U.S. consumers are pulling back amid inflation and higher rates with retail sales declining 1.1% in December and prior declines being revised down more. Consistent with weak PMIs, industrial production declined 0.7% month-over-month for a second month in a row. The manufacturing component of industrial production is now negative on a year-over-year basis, and 2016 was the only time in history manufacturing was negative when there was not an economic recession. With many of the weaknesses in the economy, unemployment rates and jobless claims remained resilient and at a historically low level.

In the fixed income markets, 10-yr rates rose sharply in December after the rally in November, following the tightening of policy rates. The front end of the yield curve soared in the quarter, and the long end moved higher to a lesser extent. Yield curves are deeply inverted which historically has been a fairly reliable indicator of recessions. For instance, the 10-yr – 2-yr was at -75 basis points. Overall investment grade corporate credit spreads widened in late October but tightened marginally over the quarter.

Performance commentary

For the three-month period ending December 31, 2022, the Mawer Canadian Bond Fund marginally outperformed the FTSE Canada Universe Bond Index.

Over the fourth quarter, the front end of the yield curve continued to move higher in tandem with central bank's tightening policies and the long end moved higher to a lesser extent. In general, securities with longer duration performed worse and credit spreads modestly tightened during the quarter.

The Fund's relative performance was driven mainly by sector allocation and security selection decisions. As spreads tightened over the quarter, the Fund benefited from our higher relative exposure in corporate bonds, though we took the opportunity to upgrade the credit quality of the portfolio. In addition, security selection benefitted relative performance, driven by the Fund's corporate holdings and in particular, our positioning and trades within financial and industrial. The Fund's duration positioning also added to relative performance driven by our short duration bias since December.

Looking ahead

Interest rate hikes are starting to have a material impact on consumers through debt servicing given the amount of household debt that exists in Canada. We think Canada structurally requires lower rates than the U.S., and, therefore, we believe the Bank of Canada is closer to the end of the hiking cycle than the Fed and can start cutting rates in the second half of 2023. We think yield curves can remain inverted in the near term but as central banks respond to the recession, it can eventually steepen.

We expect growth to continue to slow with global recession being the base case. With the recessionary outlook, the Fund is more cautiously positioned with respect to the overall spread exposure than previous quarters to control downside risk. From a bottom-up credit perspective, we have moved up in the credit quality and are taking on a more defensive approach. We are focused on higher quality issuers with strong credit fundamentals such as conservative leverage and cash flow stability. We think that credit security selection matters in this time of the cycle and more credit opportunities can arise as spread products get cheaper in a recessionary environment.

We continue to play the plan by focusing on researching the interaction of growth and policy through our top-down macro process by monitoring key economic indicators such as inflation, employment, and survey-based indicators and gaining more insights on the evolution of the economic milestones. We emphasize businesses that can withstand economic shocks, run by excellent management teams, and priced at an attractive valuation through our bottom-up credit research. Our portfolio construction process combines both our macro and credit insights in a systematic and repeatable manner thereby leading us to risk-adjusted return opportunities that responsibly steward our clients' capital through uncertainty.

Performance summary[1] (%)
As of December 31, 2022:

	YTD	3 Mo.	1 Yr.	3 Yrs.	5 Yrs.	10 Yrs.	Since Inception[2]
FUND	(12.0)	0.2	(12.0)	(2.5)	(0.1)	1.0	5.0
BENCHMARK	(11.7)	0.1	(11.7)	(2.2)	0.3	1.6	6.0

Calendar Year, as of December 31:

	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
FUND	(12.0)	(3.0)	8.7	6.4	0.8	1.3	0.9	3.1	7.8	(2.2)
BENCHMARK	(11.7)	(2.5)	8.7	6.9	1.4	2.5	1.7	3.5	8.8	(1.2)

[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 Canadian Bond Fund Series A Inception: June 14, 1991

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

[Quarterly Update | Q4 2022 | EP125]
A review of last quarter, the major themes and takeaways from 2022, and what's on the horizon for the new year.

Canadian Bond Fund

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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 Canadian Bond Fund	FTSE Canada Universe Bond 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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