MAWER quarterly

First Quarter 2020

Market overview

The emergence and spread of the COVID-19 virus have precipitated an extraordinary effort to contain the outbreak globally. While these initiatives are of utmost importance in defeating the virus' spread, they have also resulted in significant economic deterioration, including the closure of businesses, a rise in furlough or unemployment, and have fueled steep declines in risky assets around the world.

Authorities have acted quickly to support the economy through unprecedented monetary and fiscal stimulus, and investor sentiment has whipsawed ever since in the tug-of-war between the positive impact of the stimulus versus the continued suppression of economic demand. Despite liquidity injections, credit markets remain in a fragile state as companies' working capital becomes stretched. Combined with the oil price conflict between Russia and Saudi Arabia, we've seen substantial volatility as global financial markets attempt to discount the economic impact in the face of heightened uncertainty.

As is typical during periods of market strife, Canadian equities and the Canadian dollar were particularly hard-hit given the procyclical nature of the Canadian economy and the heavy weighting to commodities (both directly and indirectly). Additionally, small cap stocks broadly suffered due to the tenuous nature of many of the business models in the investment universe.

On a slightly brighter side, lower government bond yields led to solid performance from global sovereign bonds while the Canadian bond market provided a modestly positive return, somewhat subdued by the underperformance of corporate credit.

How did we do?

Performance has been presented for the A-Series Mawer Mutual Funds in Canadian dollars and calculated net of fees for the 3-month period of January 1 – March 31, 2020.

Our equity portfolios were certainly not immune from significant losses—the majority of stocks we own suffered negative returns. Our steepest losses were in companies exposed to the pullback in energy (Suncor, Canadian Natural Resources) and those with higher degrees of leverage (brewer AB InBev, Indian agrochemical manufacturer UPL, pipeline coatings company Shawcor). Those most exposed to the near-term economic shutdown also languished (InterContinental Hotels Group, UK-based travel agent On The Beach, Booking Holdings, on-premise caterer Compass Group) as did those with greater economic sensitivity such as several of our bank holdings (JPMorgan, Singapore's DBS Group, Brazil's Itau Unibanco) and cyclicals (industrial lubricant producer Fuchs Petrolub).

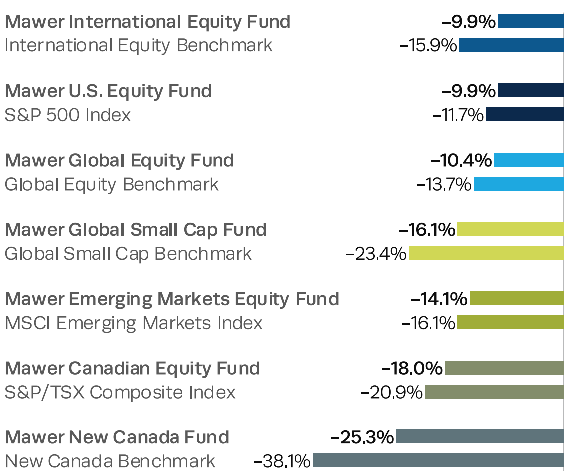
Yet, there is a silver lining to be found: our equity portfolios provided downside protection, often meaningfully, versus their benchmarks. Sources of this outperformance include:

- Being underweight (and in many strategies having a complete lack of) direct energy exposure.
- Our holdings within financials have been less severely punished than the broader sector, due to a lower exposure to banks (and not owning any European banks) in favour of exposure to exchanges that benefit from greater volatility (Japan Exchange, Deutsche Boerse, TMX), insurance brokers (Aon, Willis Towers Watson), and financial data providers (S&P Global).

- Exposure to companies with internet or software-based businesses, especially those embedded in their customers' processes. Wolters Kluwer is a great example, as it provides critical reference information and software to professionals such as doctors, lawyers, and tax accountants. Others include Microsoft, contact centre management software provider Enghouse, and payments processor Adyen.
- Higher quality holdings—even those carrying above-average earnings multiples—tended to outperform, especially those in industries with more defensive demand characteristics. This includes those stocks mentioned in the prior bullet point, Japanese drug store chains (Tsuruha, Kusuri No Aoki), staples (Nestle, Hershey, Loblaw), as well as health care companies (Roche, Recordati, Gilead, Baxter).

Chart A

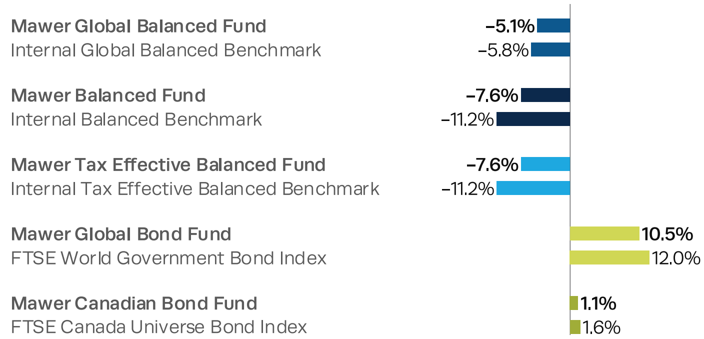
(Q1 2020 – Series A, Net of Fees)



For our Balanced strategies, YTD losses now stand at -7.6% for the Mawer Balanced Fund and -5.1% for the Mawer Global Balanced Fund. For perspective, these returns put both strategies back to where they were earlier in 2019, re-emphasizing the adage that things are never as good, or as bad, as we believe them to be. The fixed income portion of our balanced strategies have provided ballast in the current environment as intended, and portfolios with a lower domestic bias have done better than those with a heavier reliance on Canadian asset classes.

Chart B

(Q1 2020 – Series A, Net of Fees)



Activity

Given the extraordinary recent developments, what have we been doing in response?

Our team has emphasized increased communication both internally and externally. Internally, we've increased our use of technology to effectively share information and have also increased the frequency of meetings across teams to facilitate remote work. Externally, our research team has been in ongoing contact with companies and industry participants to better understand the economic consequences of the past weeks, as well as the potential implications for the future.

Much of our work over the past month has focused on evaluating the "survivability" of the businesses we own. This has meant focusing on their liquidity: what resources do the companies in our portfolio have in terms of cash on hand, undrawn credit facilities, and net receivables, compared to the average amount of overhead in their business, the overall amount of debt, and any significant maturities on the horizon? We don't want companies to be forced to burn the furniture to heat the proverbial house, and we don't want the going-concern for any of our investments to be dependent on somebody else's good graces, whether it be a landlord, a bank, or a government.

Yet, one of the mantras at Mawer is that the middle of the storm is not the time to fix your ship; rather the ship should be fortified long before setting sail from the harbour. In other words, we've felt that our portfolios were well-positioned coming into this, all things considered. And so far, though portfolio activity has been a touch higher than average, it has still been modest: turnover rates in most portfolios have been mid- to high-single digits. Some examples of recent activity include:

- Bank positions in portfolios have been trimmed given a confluence of risk factors: the prospect of lower interest rates for longer, a global recession, and greater credit risks (JPMorgan, State Street, DBS Group, Bank of Nova Scotia, Canadian Western Bank).
- We decreased our positions in businesses where debt and access to liquidity are of greater concern (UPL, medical equipment manufacturer Becton Dickinson, bus manufacturer NFI Group). These companies may be too stretched to perform well financially and operationally.
- Though equity portfolios already had below-average (and in some cases no) energy exposure due to the nature of our investment philosophy, we reduced our energy exposure further (exiting PrairieSky, Shawcor, and CES Energy Solutions).
- We trimmed our weights in companies with high earnings multiples that have outperformed the broader market based on relative valuation (logistics provider Descartes, sensor and detection manufacturer Halma, specialty chemicals company Sika, engineering software developer Ansys).
- Conversely, we've emphasized internet- or software-based businesses that should benefit from behavioural shifts accelerated by the economic slowdown and where growth may effectively be pulled forward. Examples include: Chinese online game developer NetEase, e-commerce giants Alibaba and Amazon, online business networking site operator New Work, and Adyen, a payments processor that should benefit from its unified platform and exposure to e-commerce transactions.
- We've put a premium on businesses with more stable, defensive demand (Microsoft, Novartis, Nestlé, Recordati).
- We've reduced credit exposure within our Canadian fixed income portfolio to improve liquidity, while retaining positions in high-quality issuers.
- And we've opted for patience from an asset mix perspective; we have not fought the downward drift in equities. This is similar to the approach we took in 2008/09. We don't think it's the time to spit into the wind.

Finally, we constantly remind ourselves that despite the accompanying emotions, corrections, and volatility are natural parts of financial markets. We strive to stay calm and carry on.

Looking ahead

The coming recession is likely to be different than anything we've seen before. Governments are deliberately opting for widespread shutdown of economic activity in the hopes of containing the coronavirus' spread. The drop in demand is not a permanent impairment: once the virus is under control and containment policies are lifted, people will once again socialize and economic activity will return. But depending on the length of the shutdown, many companies may not survive through to when these measures eventually ease. On net, we believe the drawdown has been surprisingly rational thus far: prices have generally moved in proportion to the degree of risks on a stock-by-stock basis.

Despite the exceptional volatility, we've attempted to stay balanced and diversified, both with respect to our portfolios and our decision-making. We're attempting to be in two spots at the same time: making decisions so that portfolios are relatively well-positioned whether developments turn positive or more negative. Our investment criteria haven't shifted. We've stuck to our long-term philosophy, emphasizing companies that have strong business models and strong balance sheets—ideally both! In general, these companies tend to generate more recurring revenue, are less discretionary in nature, are typically highly cash generative, and, when led by shrewd managers, should be in a position to take market share in a weakened competitive environment.

Like others, we have no crystal ball. But it is important to remember that the mathematical function of compounding wealth remains intact for those with the patience and time horizon to invest wisely.

Total net returns (Series A)

For periods ending March 31, 2020

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Equity funds	YTD	3-Mo	1-Yr	3-Yr	5-Yr	10-Yr	Since Inception*
Mawer International Equity Fund	**–9.9**	**–9.9**	**–3.8**	**4.0**	**4.4**	**8.7**	**7.7**
International Equity Benchmark*	–15.9	–15.9	–10.0	0.2	1.6	6.2	4.8
Mawer U.S. Equity Fund	**–9.9**	**–9.9**	**1.7**	**10.2**	**9.6**	**14.0**	**8.1**
S&P 500 Index	–11.7	–11.7	–0.9	7.4	9.2	14.3	9.4
Mawer Global Equity Fund	**–10.4**	**–10.4**	**–1.5**	**7.8**	**7.6**	**12.3**	**11.8**
Global Equity Benchmark*	–13.7	–13.7	–5.4	3.7	5.4	10.1	10.0
Mawer Global Small Cap Fund	**–16.1**	**–16.1**	**–5.8**	**5.3**	**6.9**	**14.7**	**11.1**
Global Small Cap Benchmark*	–23.4	–23.4	–18.0	–2.4	2.0	8.1	4.9
Mawer Emerging Markets Equity Fund	**–14.1**	**–14.1**	**–13.7**	**–0.1**	**–**	**–**	**1.5**
MSCI Emerging Markets Index	–16.1	–16.1	–12.3	0.5	–	–	3.0
Mawer Canadian Equity Fund	**–18.0**	**–18.0**	**–12.1**	**–1.7**	**1.5**	**7.5**	**8.5**
S&P/TSX Composite Index	–20.9	–20.9	–14.2	–1.9	0.9	4.1	7.4
Mawer New Canada Fund	**–25.3**	**–25.3**	**–13.1**	**–4.4**	**1.3**	**9.7**	**12.4**
New Canada Benchmark*	–38.1	–38.1	–35.3	–15.9	–6.8	–1.5	5.7

Balanced funds							
Mawer Global Balanced Fund	**–5.1**	**–5.1**	**1.3**	**6.1**	**5.5**	**–**	**8.5**
Internal Global Balanced Benchmark*	–5.8	–5.8	0.4	4.5	4.8	–	7.9
Mawer Balanced Fund	**–7.6**	**–7.6**	**–1.1**	**4.0**	**4.3**	**8.4**	**8.1**
Internal Balanced Benchmark*	–11.2	–11.2	–5.8	1.2	2.7	6.0	7.4
Mawer Tax Effective Balanced Fund	**–7.6**	**–7.6**	**–1.2**	**4.0**	**4.3**	**8.3**	**7.7**
Internal Tax Effective Balanced Benchmark*	–11.2	–11.2	–5.8	1.2	2.7	6.0	7.5

Income funds							
Mawer Global Bond Fund	**10.5**	**10.5**	**9.3**	**4.0**	**–**	**–**	**3.5**
FTSE World Government Bond Index	12.0	12.0	13.1	6.6	–	–	6.4
Mawer Canadian Bond Fund	**1.1**	**1.1**	**3.7**	**2.8**	**1.9**	**3.6**	**5.8**
FTSE Canada Universe Bond Index	1.6	1.6	4.5	3.7	2.7	4.3	6.9
Mawer Canadian Money Market Fund	**0.3**	**0.3**	**1.1**	**0.7**	**0.4**	**0.4**	**3.2**
FTSE Canada 91 Day TBill Index	0.7	0.7	1.9	1.4	1.0	1.0	4.0

* Refer to www.mawer.com/funds/performance/ for Fund Inception Dates and Benchmark History.

Mawer Mutual Funds are managed by Mawer Investment Management Ltd. Mawer Mutual fund returns are reported in Canadian dollars and calculated after management fees and operating expenses have been deducted. In comparison, index returns do not incur management fees or operating expenses.

Index returns are supplied by a third party—we believe the data to be accurate, however, cannot guarantee its accuracy. Index returns are sourced from FTSE Russell, FactSet, and BMO Capital Markets.

Performance returns for the Mawer Mutual Funds and benchmarks are calculated by Mawer Investment Management Ltd. These returns are historical simple returns for the 3 month, YTD, and 1 year periods, and annualized compounded total returns for periods after 1 year.

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