MAWER
quarterly

Second Quarter 2019

Market overview

"Lower rates for longer!" appears to be the new battle cry, as the 180-degree turnabout by many central banks that we wrote about in Q1 has persisted, with numerous banks cutting rates and/or signalling cuts or other expansionary policies to come.

Most notably, the Federal Reserve held the Federal Funds Rate at 2.50% as expected and confirmed the market's expectation that it is considering rate cuts later this year. In addition, at a presentation during the European Central Bank's (ECB) annual forum, Mario Draghi signaled that the ECB was prepared to cut interest rates and expand other monetary policy tools if a sustained return to their inflation target was at risk. In tone, Draghi's speech resembled previous key speeches including the "whatever it takes" speech in 2012.

This shift to a dovish (looser monetary policy) bias across major central banks in 2019 is likely a major contributing factor to a sharp decline in major sovereign bond yields and a rally in equity markets—bond yields have declined as rate cuts are being priced in and global equity performance remains strong as discount rates have fallen. Overall, most asset classes performed quite well over the quarter, though the translation effect of a strong Canadian dollar led to tempered returns for foreign asset classes. Canadian bonds (as measured by the FTSE Canada Universe Bond Index) rose 2.5%, and global equities, as measured by the MSCI All-Country World Index, gained 1.3% CAD.

Of note, longer-duration securities have done particularly well. While interest rate sensitivity might be a more straightforward concept for fixed income instruments, the concept of "duration" is equally applicable to equities. Quality-growth companies—in other words those with long and sustainable runways—disproportionately benefit from lower discount rates applied to their expected future cash flows. These companies have continued to outperform more value-oriented stocks—a benefit to Mawer portfolios given our emphasis on high-quality business models.

Overall, investor psychology seems to be acutely focused on central bank policies, and this means that some of the macroeconomic slowdown/challenges appear to be overlooked. Some of these risks include: a further slowing of global growth; U.S./China trade war; yield curve inversion; populist politics; Brexit; oil shock due to geopolitical policies; unexpected inflation…to name a few. In the case of the U.S./China trade war, if the rules of trade continue to shift, it could increase overall uncertainty in the global economic system. This runs the risk of management teams putting off capital allocation decisions, delaying expansion plans or easing M&A activities, as well as disruption of supply chains, and the creation of additional frictions that require time and resources for companies to adjust to.

That being said, there is very little conviction on how this will unfold. In fact, many of the macroeconomic risk scenarios are like this—it is hard to predict what impacts (if any) they could have on markets. What is important for investors to remember is that while the current environment continues to be supportive of both bond and equity prices, there is a reason central banks are concerned.

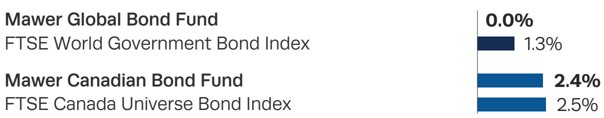
How did we do?

Performance has been presented for the A-series Mawer Mutual Funds in Canadian dollars and calculated net of fees for the period of April 1 – June 30, 2019. See here for full performance history and disclosures.

Overall, the second quarter of 2019 once again saw strong, positive performance from most of our asset classes. As central banks continue to communicate a “lower rates for longer” tone, it’s not surprising that the theme of major sovereign bond yields declining, and lower discount rates carries through much of our performance commentary.

Income funds: performance relative to index (C$)

(Q2 2019 – Series A, Net of Fees)

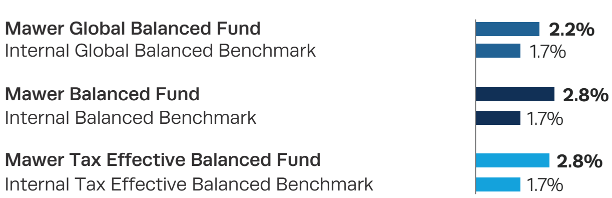


Of note, a shift lower in Canadian sovereign yields and tightening corporate credit spreads provided a tailwind for Canadian bonds over the quarter—for example, the 10-year Government of Canada yield, which was as high as 2.6% at the beginning of Q4 2018, ended the quarter below 1.5%. The Mawer Canadian Bond Fund was up 2.4% in Q2 and a healthy 6.4% YTD.

While falling yields also had a positive effect on global bonds, the Mawer Global Bond Fund has a much lower duration than that of its benchmark and therefore didn’t participate as extensively in the rally, particularly in euro-denominated bonds where negative yields have again become pervasive. The Fund was approximately flat in absolute terms over the quarter as the gains were essentially completely offset by the translation effect back to a strong Canadian dollar.

Balanced funds: performance relative to index (C$)

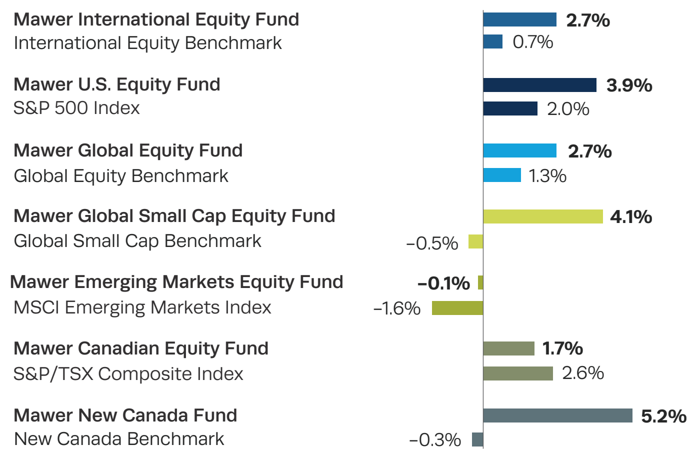
(Q2 2019 – Series A, Net of Fees)



Canadian dollar strength, in particular versus the U.S. dollar, had an impact on Canadian investors with more globally-oriented portfolios. The CAD has strengthened by 1.9% versus the USD in Q2. This is one of the reasons the Mawer Balanced Fund outperformed the Mawer Global Balanced Fund, but our Global Balanced Fund still had a solid quarter, and all of our balanced funds outperformed their benchmarks. In fact, YTD, the Balanced and Global Balanced Funds are up a meaningful 10.4% and 9.3%, respectively.

Equity funds: performance relative to index (C$)

(Q2 2019 – Series A, Net of Fees)



Almost all of our equity funds outperformed their benchmarks. Our small cap portfolios were very strong during the quarter, both in absolute and relative terms. With the move toward lower discount rates, high quality companies with sustainable growth runways and management teams focused on prudent growth-by-acquisition strategies performed well. For example, collision repair shop operator Boyd Group held in our Canadian small cap portfolio continues to execute effectively on its growth-by-acquisition strategy, and management has indicated that opportunities to deploy capital at attractive rates of return remain plentiful. And in our global small cap portfolio, Addtech, a Nordic-based conglomerate of industrial component distribution/manufacturing companies, saw strong organic and inorganic growth. The company indicated that they see good opportunities for further acquisitions and that demand continues to be strong in most of their business segments.

High quality companies with strong competitive advantages—even if they may seem expensive on a price to earnings basis—continued to thrive. These included Verisk Analytics, AptarGroup, Ansys, and Microsoft in our U.S. equity portfolio, along with the usual suspects, Visa and Mastercard. Similar attributes can be found in Sika, Spirax–Sarco, and Halma in our international equity portfolio. Despite all being optically expensive stocks, our valuation work suggests we may still earn attractive returns given the sustainability of their cash flows and management's ability to execute and capitalize on their competitive advantages. This is the beauty of wealth–creating companies that earn a return on capital greater than their cost of capital: in theory, their intrinsic value should appreciate every day.

The one exception to outperformance on a relative basis was our Canadian equity portfolio. Energy is still a challenged sector in Canada, and a number of our holdings (Suncor and smaller cap names like ARC Resources, Kinder Morgan and Peyto Exploration) lagged the broader energy sector. Outside of the energy sector, some of our holdings are being impacted by cyclical slowdowns. Richelieu Hardware is exposed to a slowdown in housing, higher consumer indebtedness, and slowing demand for renovations. Toromont, a heavy equipment dealer, may be seeing the signs of slowing global growth in the form of declining bookings and backlog. In both cases, we believe that their management teams will be able to navigate through a more challenging backdrop over the long–term.

Looking ahead

The bottom line is that we seek to construct diversified, resilient portfolios. Nevertheless, we remain exposed to external shocks that result from systemic risk: specifically, meaningful changes in discount rates or the general level of business activity.

As discussed earlier, discount rates have moved lower and, all else equal, would be supportive of risky assets if they remained at this level. On the other hand, high–quality companies have benefited from this decline in yields over the past decade but might react negatively if the Fed were to disappoint the market's thirst for interest rate cuts.

As for the general level of business activity, the environment is still quite supportive (fiscal, monetary) and global growth continues to be positive. However, the global economy does appear to be slowing. The slowing global economy and trade wars are having an impact on some areas of our portfolios and are certainly an area of general concern, but broadly speaking our portfolio holdings are healthy and remain wealth–creating.

But on both of these points (interest rates, business activity), we have no control over, or real insight into, what might happen. The evolution of the "consensus" view on the Fed's path over the past year is a perfect example of this: a year ago, market participants expected four rate *hikes* in 2019 (versus rate cuts now). Therefore, we much prefer to stay diversified, strike an approximately neutral position between equities and bonds (60/40), and focus on individual companies' fundamentals.

Despite all the headlines about rates and trade–wars, we're still finding attractive businesses. And we're typically funding these adds/buys by diligently trimming from companies that we believe are at the higher end of their valuation range.

As always, with individual companies and portfolios overall, it's about striking a balance between upside potential and downside risks.

Total net returns (Series A)

For periods ending June 30, 2019

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Equity funds	3-Mo	YTD	1-Yr	3-Yr	5-Yr	10-Yr	Since Inception*
Mawer International Equity Fund	**2.7**	**10.0**	**2.2**	**8.6**	**9.0**	**10.7**	**8.1**
International Equity Benchmark*	0.7	8.7	0.6	9.4	6.6	8.2	5.3
Mawer U.S. Equity Fund	**3.9**	**15.8**	**16.0**	**15.4**	**15.9**	**15.1**	**8.4**
S&P 500 Index	2.0	13.4	9.7	14.4	15.3	16.1	9.8
Mawer Global Equity Fund	**2.7**	**12.8**	**11.2**	**12.6**	**12.6**	**–**	**13.3**
Global Equity Benchmark*	1.3	11.2	5.0	11.7	10.9	–	11.6
Mawer Global Small Cap Fund	**4.1**	**15.3**	**7.8**	**13.0**	**12.4**	**17.7**	**12.8**
Global Small Cap Benchmark*	–0.5	10.0	–3.6	10.6	9.3	11.8	7.0
Mawer Emerging Markets Equity Fund	**–0.1**	**9.1**	**5.2**	**–**	**–**	**–**	**8.3**
MSCI Emerging Markets Index	–1.6	5.8	0.5	–	–	–	9.0
Mawer Canadian Equity Fund	**1.7**	**14.5**	**2.8**	**7.7**	**6.2**	**10.8**	**9.3**
S&P/TSX Composite Index	2.6	16.2	3.9	8.4	4.7	7.8	8.3
Mawer New Canada Fund	**5.2**	**16.4**	**7.2**	**6.4**	**5.1**	**15.5**	**13.4**
New Canada Benchmark*	–0.3	10.4	–8.1	0.6	–1.7	6.9	7.3
Balanced funds							
Mawer Global Balanced Fund	**2.2**	**9.3**	**8.7**	**8.1**	**8.8**	**–**	**9.8**
Internal Global Balanced Benchmark*	1.7	8.3	5.8	7.8	8.0	–	9.2
Mawer Balanced Fund	**2.8**	**10.4**	**7.0**	**7.4**	**7.8**	**9.9**	**8.5**
Internal Balanced Benchmark*	1.7	9.4	4.0	6.7	6.1	7.8	7.8
Mawer Tax Effective Balanced Fund	**2.8**	**10.4**	**7.1**	**7.4**	**7.7**	**9.9**	**8.0**
Internal Tax Effective Balanced Benchmark*	1.7	9.4	4.0	6.7	6.1	7.8	7.9
Income funds							
Mawer Global Bond Fund	**0.0**	**–1.6**	**2.1**	**0.3**	**–**	**–**	**1.9**
FTSE World Government Bond Index	1.3	0.8	4.8	1.2	–	–	4.7
Mawer Canadian Bond Fund	**2.4**	**6.4**	**7.0**	**1.8**	**3.1**	**3.8**	**5.9**
FTSE Canada Universe Bond Index	2.5	6.5	7.4	2.7	3.9	4.5	7.0
Mawer Canadian Money Market Fund	**0.3**	**0.5**	**1.0**	**0.4**	**0.3**	**0.3**	**3.2**
FTSE Canada 91 Day TBill Index	0.4	0.8	1.6	1.0	0.9	0.9	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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