MAWER
newsletter
Second Quarter 2014

Market Overview

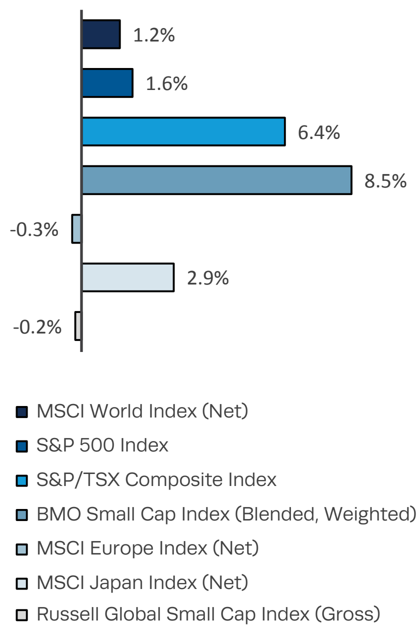
The Q1 GDP data released in April seemed to indicate a stall in U.S. economic growth. Subsequent data revealed a much steeper economic contraction of 2.9%. Was this evidence that the U.S. economy was losing steam and requiring more aggressive intervention by the central bank? Or was this merely a statistical anomaly that was not indicative of the true state of the economy?

Based on additional economic data released during the quarter, it appears that the U.S. contraction in Q1 was indeed an anomaly, mostly attributed to the crippling winter weather that wreaked havoc on much of the country. Q2 data revealed that strong employment growth helped to push the unemployment rate to its lowest level since 2008, consumer confidence improved and the housing market continued to strengthen. Growth has clearly reaccelerated in Q2. The positive momentum in the U.S. economy is welcome news to Canada, as our export economy remains heavily reliant on American consumers. Rising export volumes in Canada have helped underscore the recent strength of the Canadian dollar relative to most major global currencies.

Elsewhere, the economic recovery in Europe appears more precarious as the region continues to struggle with stagnant growth and a banking system that has not fully addressed past indiscretions. But authorities remain vigilant in their efforts to stimulate growth, with sub-zero interest rates representing the latest attempt by the ECB to encourage lending and consumption. Japanese authorities remain equally committed to restoring growth in their economy, while China continues to unwind its credit bubble and transition to a more sustainable pace of growth.

Amidst this mixed macroeconomic backdrop, global equity markets marched higher this quarter, with the MSCI World Index (C$) rising 1.2%. This marks the eighth consecutive quarter that global equities have risen, a period in which cumulative returns have exceeded 50%. Chart A outlines the quarterly performance, expressed in Canadian dollars, of some of the notable equity indices around the world.

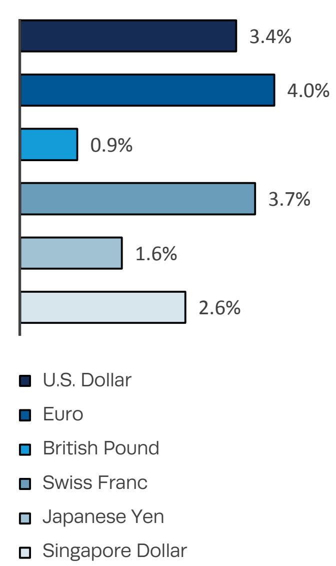
Chart A
Q2 2014 Equity Index Performance (C$)



The stellar performance in Canadian equities is visually obvious, with both the S&P/TSX Composite Index and BMO Small Cap Index noticeably outpacing their global peers. This can largely be attributed to the strong performance of Canada's influential energy sector, as the energy sub-sector in the S&P/TSX Composite Index gained 10.5% this quarter while its small-cap peer rose 15.2%. Violence and turmoil in oil-producing nations such as Iraq, Libya, and Russia have led to concerns about ongoing oil supplies, prompting a rise in oil prices and a rally in energy companies. Companies mining for gold and other precious metals also delivered solid returns this quarter, a reversal from the steep losses many endured during 2013.

While the gap between Canadian equity returns and those from other major regions can be partly attributed to the strong results from the resource sectors, another significant factor this quarter was the strength in the Canadian dollar. Chart B illustrates the appreciation in the Canadian dollar relative to some of the major world currencies.

Chart B
Q2 2014 Canadian Dollar Gains



Source: Bloomberg Spot Rates

This currency effect erased much of the equity returns generated outside of Canada and exacerbated the gap between Canadian equity results and those of its global counterparts. For example, the S&P 500 Index gained 5.2% in U.S. dollars, but after accounting for the strong appreciation of the Canadian dollar, the return in Canadian dollars was reduced to just 1.6% as noted in Chart A.

Meanwhile, after the FTSE TMX Canada Universe Bond Index gained 2.8% in Q1, it delivered another 2% this quarter. Fixed income markets in the U.S. have experienced comparable returns. These results have taken some economists and investors by surprise. The general consensus is that bond yields in recent years have been artificially suppressed by the intervention of central banks, such as the ongoing bond-buying program conducted by the U.S. Federal Reserve. When the Fed announced last year that they would gradually scale back this intervention, the belief was that bond yields would rise and bond investors would suffer. While this did occur to some extent in the latter part of 2013, so far in 2014, bonds have experienced a healthy rally despite the waning presence of the Fed.

To understand why this is occurring, it is helpful to recall that a bond is simply a loan to a company or government, and its yield is simply the return that an investor demands on that loan. Naturally, a bond investor wants to be compensated for the risks they take with any bond they purchase. And since inflation is arguably the biggest risk for a bond investor, a premium for inflation is typically demanded.

How does this relate to the low level of yields? From a traditional viewpoint, the low level of yields implies that inflation expectations are low. Yet this flies in the face of what many believe is an economic recovery in North America; if the economy is truly recovering, then inflation expectations should be higher—as should yields, all things being equal. So is the economy actually recovering and yields are wrong? Or are bond investors just not seeing inflation in North America? Is there something else going on?

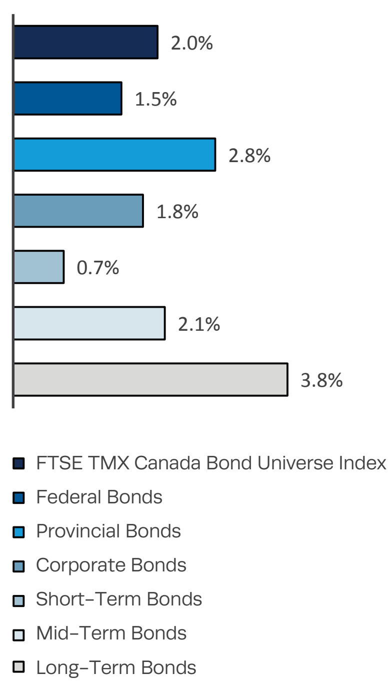
One possibility is that investors are demanding a lower *real* rate of return on bonds, which is the portion of return an investor demands after the risks of inflation over time have been subtracted. It is possible that investors do have inflation expectations but are, for whatever reason, willing to accept a lower overall real rate than they have in the recent past.

There is another possible explanation for low yields. It could simply be a case of structure in the fixed income market and the current state of supply and demand. In general, the net new issuance of fixed income securities by governments has decreased as fiscal deficits have improved following the financial crisis. Typically, if there are fewer securities to buy, the price of those securities will rise to reflect that scarcity.

From a demand standpoint, there are market participants that appear to be stepping to the forefront to replace the waning demand of the Federal Reserve. These participants include pension funds and insurance companies, who must match long-term liabilities with long duration assets, as well as certain institutional investors, who may also have strict guidelines to maintain a minimum allocation to fixed income. Many participants may not have the luxury to wait for more attractive yields. With a declining supply of new issuance and a steady demand from numerous categories of investors, the real rate of return demanded may simply be lower than what it has been in recent decades.

In Canada, the supply and demand dynamics noted above contributed to the bond rally, as did a robust credit environment. Provincial bonds were especially rewarding this quarter as noted in Chart C below:

Chart C
Q2 2014 Canadian Fixed Income Returns



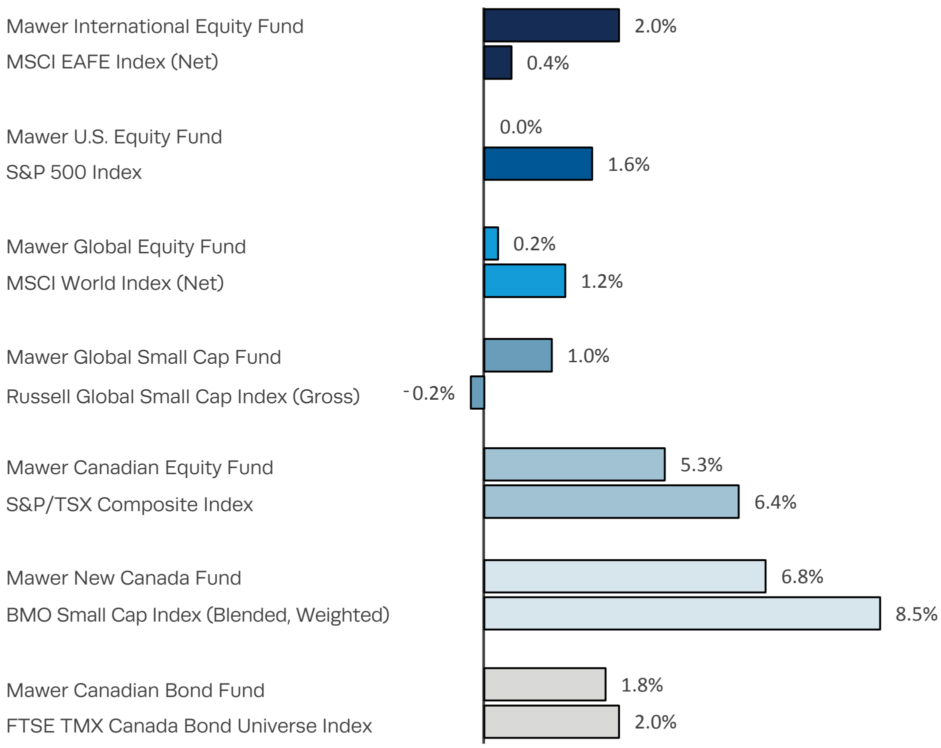
How Did We Do?

Mawer's relative performance this quarter was mixed. In some asset classes we trailed the performance of our respective benchmarks, whereas in other asset classes we outperformed. Overall, we had positive contributions from fixed income and equities, helping our Balanced Fund to deliver a quarterly return (net of fees) of 2.1%. The year-to-date gains in our Balanced Fund now stand at a healthy 6.5%. Chart D on the following page highlights the quarterly performance (net of fees) of various Mawer funds relative to their benchmarks.

The International Equity Fund returned 2% this quarter, exceeding the MSCI EAFE Index (C$) return of 0.4%. Our emphasis on European companies and underweight exposure to Japan proved to be unfavourable as Japanese equities noticeably outperformed European equities. Having less than 2% of the Fund invested in the energy sector was also detrimental as this was the strongest performing sector within the MSCI EAFE Index (C$). Fortunately, we overcame this positioning with strong security selection. For example, the Japanese companies we own had an average return of over 18% this quarter, compared to the 2.9% gain within the Japanese component of the MSCI EAFE Index (C$). Nihon Kohden, the largest Japanese medical equipment provider, led the way with a quarterly return of approximately 21%. Security selection was also particularly strong within the consumer discretionary sector. Multiplus, a Brazilian consumer loyalty program operator, gained approximately 46% and helped carry the average return within this sector to over 10%, noticeably greater than the 0.3% decline among consumer discretionary companies in the MSCI EAFE Index (C$).

While the International Equity Fund outperformed its benchmark by 1.6%, our U.S. Equity Fund lagged the S&P 500 Index (C$) by the same margin. Energy represented the strongest sector within the S&P 500 Index (C$) with gains of over 8% this quarter, while financials were the weakest sector with losses greater than 1%. The U.S. Equity Fund's underweight in energy and overweight in financials contributed to a lag in performance. Security selection among a number of sectors also detracted from performance, particularly

Chart D
Q2 2014 Fund Performance Relative to Index (C$)



within the technology sector where Oracle, IBM, and Visa all posted losses greater than 4%.

The Global Equity Fund lagged its benchmark by approximately 1% this quarter. The same factors noted above – an underweight position in Japan, an underweight position in the energy sector, and security selection, particularly among U.S. equities – contributed to this slight underperformance.

The Global Small Cap Fund earned 1% this quarter while its benchmark, the Russell Global Small Cap Index (C$), shed 0.2%. This outperformance was almost entirely attributed to security selection. Performance in the financials sector was particularly strong with our selections earning over 4% while the financials within the Russell Global Small Cap Index (C$) lost approximately 0.7%. Some of our real estate companies and mortgage lenders also performed well. For example, Alony Hetz Properties, an Israel-based real estate holding company, gained approximately 11% this quarter and Eurocommercial Properties, a Netherlands-based commercial property manager focusing on markets in Italy, France, and Sweden, added approximately 8%.

Energy represents nearly 27% of the S&P/TSX Composite Index and rising oil prices helped the sector surge over 10% this quarter to carry the overall benchmark to a 6.4% gain. Although the energy investments within the Canadian Equity Fund gained approximately 13%, our allocation to the sector was approximately 15%, noticeably lower than the 27% allocation within the benchmark. This proved to be the primary drag on relative performance. Weakness in the telecommunications sector, particularly a loss of approximately 5% in Rogers Communications, also contributed to the relative underperformance. Overall, the Canadian Equity Fund gained 5.3% compared to the 6.4% rise in the S&P/TSX Composite Index.

The New Canada Fund trailed its benchmark by 1.7% this quarter. This was almost entirely attributed to security selection within the materials sector, as our companies in this sector declined by approximately 6% while those in the index gained 8.5%. This wide divergence is attributed to the fact that our companies in the materials sector operate in industries such as packaging (Winpak and Intertape Polymer) and treated wood products (Stella Jones) whereas performance was driven primarily by the gold and precious metals sub-sector that surged over 14%. While there are times when this lack of gold mining exposure has hampered our relative performance in Canadian small caps, some of our historical added value in this asset class can be attributed to emphasizing higher quality businesses outside of the mining sector.

Finally, in fixed income, our Bond Fund gained 1.8% compared to the 2.0% gain in the FTSE TMX Canada Universe Bond Index. Given the relatively strong performance from longer-duration bonds this quarter, our decision to target a lower duration than the index was the most significant factor to our relative performance. Security selection within the Federal sector was beneficial whereas the overall sector allocation and security selection within the Provincial and Corporate sectors modestly detracted from returns.

ETFs and Liquidity Risk

Despite signs of investor complacency, we see no shortage of potential risks lurking on the horizon. Such risks include the threat of rising interest rates, waning growth, excessive asset valuations, and the potential for current geo-political conflicts to draw in other nations and escalate into full-fledged wars. Many of these risks have been discussed in past quarters. Another risk that has emerged on our radar pertains to Exchange Traded Funds (ETFs).

The first ETF was launched in the U.S. in 1993. The premise was quite straightforward—the ETF (named the S&P 500 Depository Receipt) would simply hold all 500 companies in the S&P 500 Index, at their respective weights. There would be no attempt to outperform the benchmark, only to match it. As such, there was no need to hire a team of professional money managers or incur significant research costs. Investors, with just a single purchase, would enjoy immediate exposure to the S&P 500 Index, at a lower cost than most professionally managed mutual funds. Their performance would mirror that of the underlying index — less the fees of course.

This inaugural ETF was appealing to some investors, particularly institutional investors. So ETF providers began to offer a wider array of products, dissecting the equity markets by size, sector, and country. By 2002, there were approximately 100 ETFs trading in the

U.S., although the net amount of assets was relatively insignificant.

In recent years, the proliferation of ETFs has exploded. After equity markets were sufficiently dissected into every imaginable niche, ETF providers then expanded into fixed income products, commodities, and currencies. Some ETFs offer double or triple leverage to an underlying asset and allow one to go long or short virtually any segment of the market. Latest estimates suggest there are over 1,300 ETFs in the U.S. alone, and worldwide assets exceed $2 trillion.[1]

While many have debated the merits of ETFs relative to actively managed portfolios, this is not our purpose today. Instead, we simply note that ETFs have increasingly become a topic in our discussions on risk. We worry that as the size and complexity of the market has exploded, there is growing potential that an "ETF accident" could occur.

For example, when an investor buys $100,000 of an ETF, the ETF provider deploys this cash into securities that replicate its benchmark. Remember, there is little or no opportunity for a portfolio manager to exercise discretion in this process. If the benchmark is the S&P 500, then those 500 securities are purchased. Likewise, when an investor sells, the ETF sells across those 500 securities. But what if a herd of investors decides to sell billions of dollars simultaneously? The sales commence, again, with little human supervision. In the case of a market like the S&P 500, there would likely be sufficient liquidity to execute these sales without much turmoil. But since ETFs have now carved financial markets into such tiny niches, sometimes enhanced with leverage, executing the sales in these narrow segments could prove difficult.

Imagine a scenario in which the Fed surprises the markets with a rate hike (after all, U.S. unemployment is at 6-year low). Maybe it's accompanied with language about further rate hikes. Fixed income investors conclude, en masse, that it's time to get out of bonds. A surge of selling ensues including leveraged ETFs that may be concentrated in a narrow segment of the fixed income market. But without warning, bond dealers show little interest or ability to purchase these securities. ETFs have created an illusion of liquidity when little exists. But the trade must take place in order to meet investor redemptions, even if it prompts bond prices to gap down considerably. A minor market surprise (e.g., rising interest rates) has suddenly been transformed into a market shock because of both the automated nature of ETFs, and their newfound market prominence.

Do we think that an "ETF accident" will definitely occur? Do we know when? Of course not. But the notion that the ETF market could exacerbate a liquidity crisis and lead to heightened volatility is a real risk in our view and worthy of close attention.

Portfolio Positioning

In light of a heightened liquidity risk due in part to the growing presence of ETFs, we have continued to build more liquidity within our portfolios. Having identified our Canadian and Global Small Cap asset classes as having the least liquid securities, we have modestly reduced our exposure to both asset classes this quarter. De-emphasizing small caps in favour of larger businesses has been a recurring theme for several quarters now.

We've highlighted valuation risk in previous quarters and this continues to persist. The aforementioned reduction in small caps helps address this risk, but we also remain very active within each asset class in repositioning capital from businesses that we believe are more fully valued towards those that are more reasonably priced. Some notable examples of businesses that we have trimmed this quarter based on valuation concerns include: Constellation Software, Nike, Smith & Nephew, and Aspen Insurance. Examples of companies that we believe warranted a higher weight due to more appealing valuations include: CI Financial, Intuit, Visa, and China Mobile.

Our emphasis on global equities relative to Canadian equities has added a significant amount of value in recent years, but this positioning worked to our detriment this quarter. Nonetheless, our belief that diversification outside of Canada aids tremendously in managing overall portfolio risk has not changed. To that end, we also shifted a modest amount of capital from Canadian equities to U.S. equities this quarter.

We encourage investors not to become complacent regarding their asset allocation strategy. For our discretionary clients, we have been disciplined throughout this multi-year equity rally by rebalancing portfolios to maintain an allocation to cash equivalents, bonds, and equities that we feel is prudent. In the absence of disciplined rebalancing, the relative outperformance in equities will have caused equity weights to rise considerably, and potentially to levels that are no longer congruent with investor risk tolerance levels. Now is an opportune time to measure your current asset mix relative to your longer-term objectives and rebalance if needed.

Mawer Investment Management

[1] *2014 Investment Company Fact Book: A Review of Trends and Activities in the U.S. Investment Company Industry*. 54th edition: ICI Investment Company Institute

Total Net Returns

For periods ending June 30, 2014†

	3-Mo	YTD	1-Yr	2-Yr	3-Yr	4-Yr	5-Yr	10-Yr
Equity Funds								
Mawer International Equity Fund	**2.0**	**7.0**	**23.4**	**21.7**	**12.1**	**14.9**	**12.5**	**7.6**
MSCI EAFE Index (Net)	0.4	5.0	24.8	23.8	11.7	13.3	9.9	4.5
Mawer U.S. Equity Fund	**0.0**	**4.1**	**22.8**	**25.1**	**19.5**	**18.3**	**14.3**	**4.6**
S&P 500 Index	1.6	7.5	26.6	25.5	20.6	20.2	16.8	5.4
Mawer Global Equity Fund	**0.2**	**5.9**	**25.3**	**24.3**	**16.8**	**18.7**	**–**	**–**
MSCI World Index (Net)	1.2	6.4	25.3	24.0	15.5	16.3	13.0	4.8
Mawer Global Small Cap Fund	**1.0**	**8.7**	**40.6**	**35.3**	**24.1**	**26.4**	**23.3**	**–**
Russell Global Small Cap Index (Gross)	-0.2	6.2	25.3	24.2	13.3	15.4	14.4	7.0
Mawer Canadian Equity Fund	**5.3**	**11.2**	**29.4**	**23.7**	**13.9**	**17.0**	**15.7**	**11.1**
S&P/TSX Composite Index	6.4	12.9	28.7	17.8	7.6	10.8	11.0	8.8
Mawer New Canada Fund	**6.8**	**15.6**	**51.9**	**39.9**	**25.2**	**26.0**	**27.1**	**15.7**
BMO Small Cap Index (Blended, Weighted)	8.5	18.2	36.2	17.8	5.3	11.3	16.3	8.5
Balanced Funds								
Mawer Global Balanced Fund*	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Internal Global Balanced Benchmark**	1.4	5.6	16.7	14.9	11.1	11.5	9.7	5.1
Mawer Balanced Fund	**2.1**	**6.5**	**19.6**	**17.1**	**12.2**	**13.3**	**12.1**	**8.1**
Internal Balanced Benchmark ***	2.6	7.3	18.1	13.9	9.7	10.5	9.6	6.6
Mawer Tax Effective Balanced Fund	**2.1**	**6.6**	**19.7**	**17.2**	**12.1**	**13.2**	**12.1**	**7.9**
Internal Tax Effective Balanced Benchmark***	2.6	7.3	18.1	13.9	9.6	10.3	9.5	6.5
Income Funds								
Mawer Canadian Bond Fund	**1.8**	**4.6**	**4.7**	**1.9**	**4.2**	**4.2**	**4.5**	**4.7**
FTSE TMX Canada Universe Bond Index	2.0	4.8	5.3	2.6	4.8	4.8	5.2	5.6
Mawer Canadian Money Market Fund	**0.1**	**0.2**	**0.4**	**0.4**	**0.3**	**0.3**	**0.3**	**1.2**
FTSE TMX 91 Day T-Bill Index	0.2	0.4	1.0	1.0	1.0	1.0	0.8	2.0

† Mawer Fund returns are calculated after management fees and operating expenses have been deducted. In comparison, Index returns do not incur management fees or operating expenses.

* Due to regulatory restrictions, we are unable to report performance of the Fund during its first year. The Mawer Global Balanced Fund was launched July 2, 2013.

** 5% FTSE TMX 91 Day T-Bills Index, 35% FTSE TMX Canada Universe Bond Index, 60% MSCI World Index (Net)

*** 5% FTSE TMX 91 Day T-Bills Index, 35% FTSE TMX Canada Universe Bond Index, 15% S&P/TSX Composite Index, 15% S&P 500 Index, 15% MSCI EAFE Index (Net), 7.5% BMO Small Cap Index (Blended, Weighted) and 7.5% Russell Global Small Cap Index (Gross)

Mutual funds are not guaranteed, their values change frequently, and past performance is not indicative of future performance. Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. (Money market fund: Mutual fund securities are not covered by the Canada Deposit Insurance Corporation or by any other government deposit insurer. There can be no assurances that the fund will be able to maintain its net asset value per share at a constant amount or that the full amount of your investment in the fund will be returned to you.) Please read the prospectus before investing.

Performance returns for the Mawer Mutual Funds 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. They include 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.

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