MAWER
newsletter

Third Quarter 2015

# Market Overview

Volatility increased across asset classes in the third quarter of 2015. China's economy, weak global commodity prices, and anxiety around if, and when, the Federal Reserve will raise interest rates weighed on investors' minds. This anxious sentiment was matched by weak, global investment returns across equity markets. (See Chart A).

Fears around China's economic health grew. In August, China devalued its currency peg against the U.S. Dollar by approximately 4%, triggering a wave of concerns surrounding China's economic growth and stoking fears of a currency war. Chinese equity markets dropped further while capital outflows intensified, forcing the Chinese to sell foreign exchange reserves to preserve the yuan's lower peg against the U.S. Dollar. In August, for example, China sold just under $100 billion of its nearly $4 trillion in foreign exchange reserves due to this pressure. Some worried that this would have a negative impact on the U.S. Dollar and U.S. Treasury prices.

We have mentioned China as a core risk in the investment landscape for the last several quarters. While we continue to see the country's slowing growth and fragile financial system as areas of potential instability, these risks now seem to be more widely acknowledged and better reflected in asset prices.

Meanwhile, the theme of weak global commodities continued. Oil prices remained low, as did the prices of other commodities such as copper and aluminum. Slower Chinese growth has contributed to lower commodity prices, but oversupply appears to be the dominant reason behind the weakness. We have seen the negative impact of these prices on a number of asset classes including the currencies of commodity-oriented economies such as Canada.

Unsurprisingly, the focus on the Federal Reserve and its decision concerning interest rates was a focal point of the quarter. In September, the Federal Open Market Committee (FOMC) opted to leave rates unchanged, attributing their decision to a lack of visible inflation. However, it was clear from reports of clashing data and disagreement amongst FOMC members that the decision had been contentious.

The intense focus of the market on the Federal Reserve this quarter brought to mind something Warren Buffett once said, "If (Federal Reserve Chair) Janet Yellen came up and whispered in my ear what she was going to do for the next two years, it wouldn't make any difference to what we do."[1]

We agree. Markets are chaotic and unpredictable so even if you knew how the Federal Reserve was going to behave, you would not be able to know with certainty how all the other market participants would react to the news. Buffett's commentary is a good reminder of the absurdity of focusing so heavily on something that does not guarantee investment success (like predicting rates) instead of a practical, long-term strategy.

## How did we do?

*(All performance is expressed in Canadian dollars and net of fees.)*

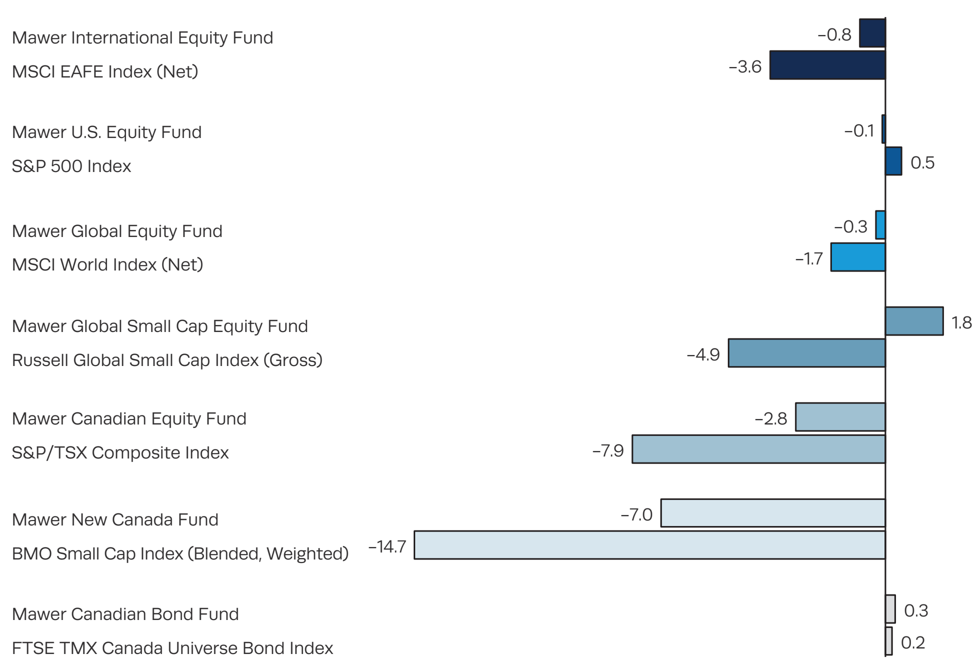
The Mawer Balanced Fund ended the quarter slightly down at –0.4%, but outperformed the benchmark return of –3.1%. A weak global environment for equities led to this second consecutive quarter of negative performance, although the bond and cash components of the fund tempered its decline. Year-to-date, the Fund has posted a 5.6% return, over twice the benchmark return of 2.4%.

In relative terms, our equity funds beat their respective indices in five of six cases although only the Mawer Global Small Cap Fund posted a positive return. (Refer to Chart A for quarterly performance of various Mawer Funds relative to their benchmarks.)

The Mawer Global Equity Fund lost –0.3%, but outperformed the MSCI World Index decline of –1.7%. Our better relative performance came from our security selection, primarily in the Consumer Discretionary and Information Technology sectors. In particular, two U.K. companies, Markit and NCC, were strong performers. Markit, which provides data to financial services companies, was up over 21%, and NCC, which provides independent escrow and information security assurance to companies, was up over 32%.

More than 80% of the outperformance of the Mawer Global Small Cap Fund (1.8%) over the Russell Global Small Cap Index (–4.9%) can be attributed to stock selection primarily in the Industrials and Information Technology sectors. Given its position as a top 10 holding, Paypoint

Chart A
Q3 2015 Fund Performance relative to Index (C$)




Source: For Index information see disclaimer†

[1] Source: www.reuters.com/article/03/31/2015

PLC (+6%) was a significant contributor to quarterly fund performance. This U.K.-based multi-channel payments company is growing through the application and development of technologies that offer alternative payment options for retailers and their customers. One recent example is a mobile application that allows people to pay for parking using their Apple Watch. Their multi-channel approach is also evident in Nice, France where PayPoint platforms handle payments for bicycle and electric vehicle hire, public transport and taxi payment options through a city-wide payments passport.

The Mawer International Equity Fund was down -0.8% this quarter, but well ahead of the MSCI EAFE Index return of -3.6%. Relative outperformance was driven by our zero weight in Energy and overweight in Consumer Staples while stock selection accounted for over 60% of the performance difference. Our top performers include Cineworld Group, a U.K.-based company operating over 77 multiplexes (+25%), and Tsuruha Holdings Inc. a Japan-based holding company mainly involved in the operation and management of drugstores (+18%).

Underperformance from the Mawer U.S. Equity Fund, which fell -0.1% compared to the S&P 500 return of 0.5%, can be evenly attributed to security selection and sector allocation. Our security selection suffered from our holdings in Financials from Blackrock (-7%) and in Industrials from United Technologies (-13%). Resiliency of the portfolio was bolstered, however, by the decision to sell spin-off Chemours Co. (See Discussion Box: Building Resilience in Portfolios). We were also underweight the two strongest performing sectors in the index, the Utilities sector (+13%) and Consumer Staples (+7%).

Both Canadian equity funds beat their respective benchmarks this quarter, despite posting negative returns. The Mawer Canadian Equity Fund saw a quarterly drop of -2.8%, ahead of the -7.9% return for the S&P/TSX Composite Index. Key names adding to the resiliency of the portfolio were Loblaw, CCL Industries and Onex. CCL is a Canadian-based specialty packaging company and the world's largest label company through the Avery brand. Likewise, the Mawer New Canada Fund was well ahead of the index drop of -14.7%, but still down at -7.0%. Strong performances from New Flyer Industries, FirstService Corporation and Descartes Systems Group helped cushion the overall fall.

A combination of lower all-in yields, a flatter yield curve and weaker credit spreads drove the differences in performance between the Mawer Canadian Bond Fund (0.3%) and the index (0.2%). Diligent security selection remains a theme across the portfolio; our preference is to find high quality corporate issuers that are durable throughout the entire business cycle.

### Building Resilience in Portfolios

Building resilient portfolios is a long-term goal we strive for and is a result of risk-based decision-making. As an example, when Chemours Co. became a spin-off from E.I. du Pont, our Research team sold the spin-off stock based on a thorough analysis of Chemours as a standalone company. We chose to exit the position immediately due to its high risk profile (high debt load, cyclical earnings, unsustainable dividend). The stock has since dropped approximately 70%. While Chemours had attractive upside potential, we are unwilling to venture far out on the risk curve to achieve those potential returns.

## Looking Ahead

Central banks continue to hold a safety net under the world economy. Globally, interest rates remain accommodative and this doesn't seem likely to change any time soon. Deflationary forces like overcapacity, technology advancements and China seem to be keeping a lid on monetary policy tightening. The one major exception to this trend is the U.S.; however, a strong U.S. Dollar and deflationary trends seem to be muting U.S. inflation, keeping the Fed on the sidelines for the time being.

Valuations for equities appear full by historical measures. That being said, we acknowledge that exactly how expensive equity valuations may be at this point depends on how long interest rates remain at these low levels. Realistically, no one knows how far along we are in this ballgame. On the one hand, there are signs that we are in a later inning; on the other, the many disinflationary forces in the world and the actions of central banks suggest that this game could go on a lot longer than previously anticipated. This underscores the need to build portfolios that will be resilient regardless of the scenario that unfolds.

Looking forward, we have some concerns over what seem like large, "tectonic" trends in the global economy that could trigger instability or dislocations in the market. For example, China is slowing down at the same time that commodity prices are weak and the Federal Reserve looks to raise interest rates. The confluence of these events creates risk for companies and countries with significant U.S. Dollar-denominated debt and commodity exposure including many in South American economies. Similarly, capital is flowing out of China at the same time as some Chinese banks may need to recapitalize. This increases the risk of China having to sell U.S. Treasuries or let its currency devalue further. If either of these events occurs at a substantial level, or if they happen unexpectedly, it would be like a large stone dropped into the investment pond: a significant devaluation of the Yuan would likely be destabilizing to competing export nations and could trigger a currency war, while a rapid selling of U.S. Treasuries could trigger a U.S. Dollar crisis.

These risks must be taken in the context of current central bank commitments, however. Central banks seem intent on providing liquidity to markets at the sign of any economic hiccup. For now, this appears to be keeping investors relatively calm. How long investors will rely on this soothing is unknown. This quarter's reaction to the Fed does make us wonder if we're reaching the end of the effectiveness of monetary policy.

Ultimately, our strategy and process have not changed. While we guard against the risks noted above at both the portfolio and asset mix level, our team is focused on buying "boring" companies—businesses that can endure. And to echo Buffett, our strategy would not change whether the Federal Reserve raises interest rates next month or in three because, unlike a sensible long-term strategy, this kind of prediction is not what we believe puts the odds of investment success in clients' favour over time.

From an asset mix perspective, we maintain a neutral weight in equity, keeping cash and bonds on hand to provide cushion should any difficult environment unfold, while remaining exposed to the upside. This hasn't really changed over the quarter. What is noteworthy is our addition of the Mawer Global Bond Fund into our strategic asset mix. The Mawer Global Bond Fund—the "shock absorber"—has the goal of preserving global purchasing power for clients and serving as a cushion during times of negative investor sentiment.

Mawer Investment Management

### Mawer Notes

**Focus Elite**
Mawer is pleased to be recognized for the third time in a row as one of Focus Consulting Group's "Focus Elite" for top cultures in asset management. Mawer was identified as one of eight firms having a strong culture based on surveys and interviews conducted with hundreds of asset management firms worldwide.

**Insight Event: The Currency Conundrum**
Calgary: November 26th
Edmonton: November 19th

Please join us for Mawer's annual Insight Event. Key speakers from Mawer's Research team will be providing commentary that focuses on the complexity of navigating currency in our current investment environment. For more information, please visit our website: www.mawer.com

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# Total Net Returns (Series A)

For periods ending September 30, 2015*

| | 3-Mo | YTD | 1-Yr | 3-Yr | 5-Yr | 10-Yr |
|---|---|---|---|---|---|---|
| **Equity Funds** | | | | | | |
| **Mawer International Equity Fund** | **-0.8** | **10.8** | **15.3** | **16.8** | **11.4** | **6.9** |
| MSCI EAFE Index (Net) | -3.6 | 9.7 | 9.6 | 17.1 | 9.7 | 4.5 |
| **Mawer U.S. Equity Fund** | **-0.1** | **8.4** | **21.6** | **24.0** | **18.5** | **8.1** |
| S&P 500 Index | 0.5 | 9.6 | 19.2 | 24.6 | 19.6 | 8.4 |
| **Mawer Global Equity Fund** | **-0.3** | **9.8** | **17.1** | **20.6** | **16.3** | **-** |
| MSCI World Index (Net) | -1.7 | 8.8 | 13.9 | 20.4 | 14.2 | 6.3 |
| **Mawer Global Small Cap Fund** | **1.8** | **19.3** | **23.7** | **28.6** | **22.5** | **-** |
| Russell Global Small Cap Index (Gross) | -4.9 | 9.2 | 14.5 | 18.7 | 12.2 | 7.1 |
| **Mawer Canadian Equity Fund** | **-2.8** | **-0.4** | **3.3** | **15.0** | **12.1** | **8.4** |
| S&P/TSX Composite Index | -7.9 | -7.0 | -8.4 | 5.7 | 4.5 | 4.8 |
| **Mawer New Canada Fund** | **-7.0** | **-1.5** | **-5.4** | **20.1** | **17.0** | **12.2** |
| BMO Small Cap Index (Blended, Weighted) | -14.7 | -13.9 | -20.2 | -2.9 | -0.5 | 2.8 |
| **Balanced Funds** | | | | | | |
| **Mawer Global Balanced Fund** | **0.2** | **7.3** | **12.9** | **-** | **-** | **-** |
| Internal Global Balanced Benchmark ** | -0.9 | 6.2 | 10.2 | 13.2 | 10.2 | 5.8 |
| **Mawer Balanced Fund** | **-0.4** | **5.6** | **10.3** | **13.8** | **11.2** | **7.6** |
| Internal Balanced Benchmark *** | -3.1 | 2.4 | 4.2 | 9.4 | 7.8 | 5.7 |
| **Mawer Tax Effective Balanced Fund** | **-0.5** | **5.4** | **10.1** | **13.8** | **11.1** | **7.5** |
| Internal Tax Effective Balanced Benchmark *** | -3.1 | 2.4 | 4.2 | 9.4 | 7.7 | 5.7 |
| **Income Funds** | | | | | | |
| **Mawer Global Bond Fund ****** | **-** | **-** | **-** | **-** | **-** | **-** |
| Citi World Government Bond Index | 9.2 | 13.0 | 15.4 | 7.7 | 5.3 | 4.9 |
| **Mawer Canadian Bond Fund** | **0.3** | **2.2** | **4.6** | **2.6** | **3.8** | **4.3** |
| FTSE TMX Canada Universe Bond Index | 0.2 | 2.5 | 5.3 | 3.4 | 4.5 | 5.0 |
| **Mawer Canadian Money Market Fund** | **0.0** | **0.0** | **0.1** | **0.3** | **0.3** | **1.1** |
| FTSE TMX 91 Day T-Bill Index | 0.2 | 0.5 | 0.8 | 0.9 | 0.9 | 1.8 |

* 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.

** 20% FTSE TMX Canada Universe Bond Index, 20% Citi World Government Bond Index, 60% MSCI World Index (Net).

*** 5% FTSE TMX 91 Day T-Bill Index, 5% Citi World Government Bond Index, 30% FTSE TMX Canada Universe Bond Index, 15% S&P/TSX Composite Index, 15% S&P 500 Index (CAD), 15% MSCI EAFE Index (Net, CAD), 7.5% BMO Small Cap Index (Blended, Weighted) and 7.5% Russell Global Small Cap Index (Gross, CAD).

**** Due to regulatory restrictions, we are unable to report performance of the Fund for 1 year. The Mawer Global Bond Fund was launched on May 28, 2015.

† Index returns are supplied by a third party – we believe the data to be accurate, however, cannot guarantee its accuracy. MSCI EAFE Index (net) – MSCI; S&P 500 Index – Factset; S&P/TSX Composite – TD Securities; BMO Small Cap Index (weighted, blended) – BMO Global Asset Management; Russell Global Small Cap Index (gross) – Russell Investments; FTSE TMX Canada Universe Bond Index, FTSE TMX 91 Day T-Bill Index – PC Bond; Citi World Government Bond Index – Citigroup.

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. (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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