MAWER
newsletter

Fourth Quarter 2013

Market Overview

Last quarter, U.S. Federal Reserve Chairman Ben Bernanke surprised markets when he announced that the Fed was not ready to taper their unprecedented level of monetary stimulus. Despite repeated signals to prepare for this outcome, the Fed ultimately concluded that the economy was not healthy enough to wean itself from this monthly injection of capital. Investors celebrated this extension as both bond and equity markets rallied on the news.

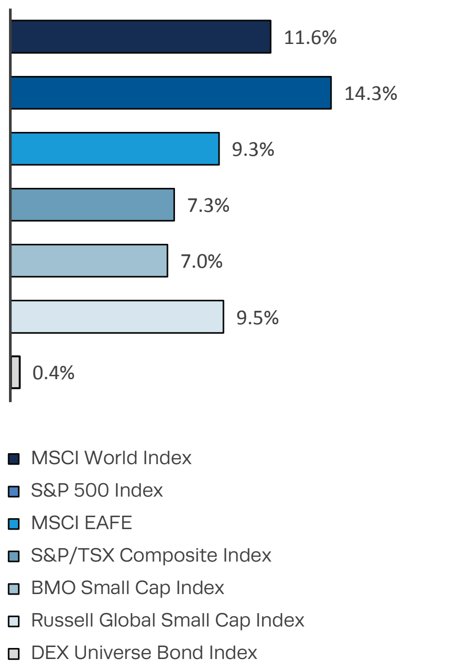
This quarter, additional economic data points validated the improving health of the U.S. economy. GDP growth topped 4% for the first time since 2011. Higher real estate prices boosted consumer confidence. Unemployment fell to a five-year low. These data points prompted the Fed to announce in December that they would soon begin tapering their massive bond-buying program.

Many market prognosticators believed that this inevitable reduction in stimulus would usher in higher interest rates and halt the remarkable rally in global equity markets. But the Fed delivered a reassuring message to market participants: tapering was not equivalent to tightening. They were merely scaling back their monthly bond purchase program, but otherwise maintaining an accommodative interest rate policy. They even offered forward guidance hinting that short-term rates may remain at ultra-low levels for a prolonged period of time.

This reminder to investors seemed to re-ignite enthusiasm for equities and sent prices rallying. Chart A illustrates the quarterly performance, expressed in Canadian dollars, of some of the notable indices around the world.

U.S. equity markets, yet again, outperformed all other major regions of the world this quarter. Low interest rates unquestionably aided this performance, but that should not lessen the fact that the U.S. economy continues to show steady signs of improvement.

Chart A
Q4 2013 Quarterly Index Performance (in C$)



Furthermore, U.S. companies have emerged from the recession with a renewed focus on cost cutting and boosting productivity. This discipline has helped companies enjoy a record level of earnings. Interestingly, eight of the ten major sectors of the S&P 500 posted returns in excess of 12%. This illustrates the breadth of the recent market rally, as only the defensive Utilities and Telecommunications sectors earned less than 12%.

The 9.3% return in the MSCI EAFE Index (Europe, Australia, Far East) was primarily driven by another quarter of exceptional gains within Europe. Overall, European equities gained 11.6%, with the influential German market climbing a phenomenal 16.9% in the last three months alone. The peripheral countries in the region are making progress in addressing their fiscal imbalances, although a stubbornly high unemployment rate increases the risk of societal and political tensions. The strengthening Euro also hampers the competitiveness of the region and threatens the sustainability of recent growth. In Japan, equity markets, as measured by the MSCI Japan Index (C$) gained 5.8% this quarter as authorities remain committed to aggressive monetary stimulus, while the rest of Asia, as measured by the MSCI Pacific ex-Japan Index (C$) posted gains of 3.7%.

Canadian equity markets continue to be hindered by the dismal performance within the Materials sector, and more specifically, the sub-sector of gold and mining companies. Both the large cap S&P/TSX Composite Index and the small cap BMO Small Cap Index have a relatively large exposure to mining companies that have been plagued by falling commodity prices and questionable capital allocation decisions. Losses have been severe. Double-digit declines during this quarter were commonplace and annual declines have wiped away a substantial portion of the market value for many miners. Fortunately, every other sector within the Canadian marketplace was positive this quarter, resulting in healthy gains for both the S&P/TSX Composite Index and BMO Small Cap Index.

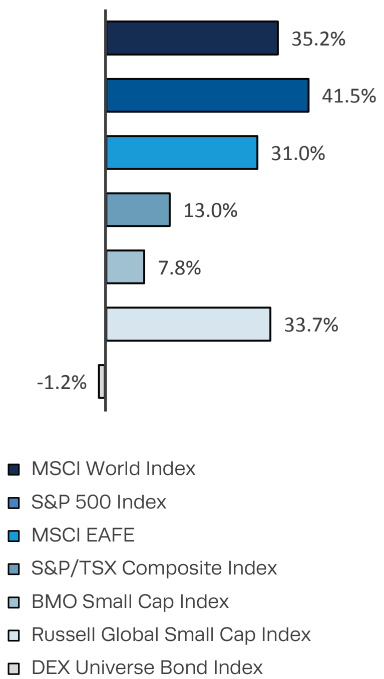
Global small caps enjoyed another stellar quarter with the Russell Global Small Cap Index (C$) rising 9.5%. Results were somewhat evenly distributed across the major sectors of the global small cap universe, but the gains from European and North American companies were noticeably higher than those from Asia and other emerging markets.

While equities across all asset classes enjoyed significant price appreciation, Canadian bonds had a relatively uneventful quarter. Canadian yields initially declined before gradually rising to end the quarter not far from where they began. The result was a modest gain of 0.4% with shorter-term bonds faring better than longer-term bonds, and both corporate and provincial issues outperforming the federal sector. Much of 2013 has followed this trend, with shorter-term credit issues performing better than longer-term federal bonds.

The performance of the major asset classes over the last 12 months, as noted in the chart below, illustrates the sheer magnitude of the gap between equity and bond returns in 2013. The chart also shows how poorly Canadian equity markets have fared relative to the rest of the world. This can be almost entirely attributed to Canada's relatively significant exposure to the troubled mining sector.

Chart B

Annual Index Performance (in C$)



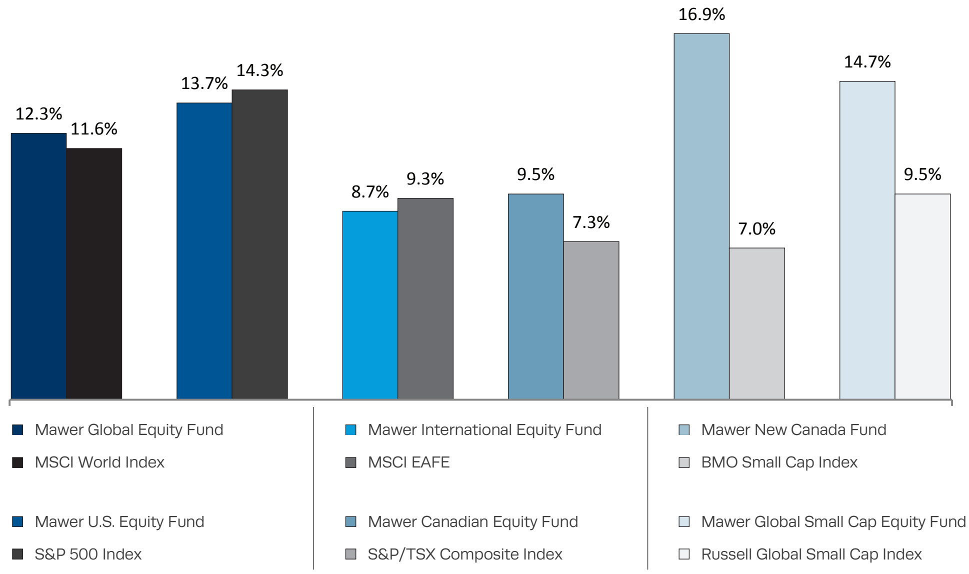
How Did We Do?

Mawer's returns this quarter stand out as some of the strongest in the Firm's history. While our Money Market and Canadian Bond Funds posted modest gains, our six equity funds gained between 8.7% and 16.9%. These would be very healthy annual returns, let alone quarterly results. Chart C highlights the quarterly performance (net of fees) of each of Mawer's equity funds relative to their benchmarks.

While the Mawer Global Equity, U.S. Equity, and International Equity Funds generally kept pace with their surging benchmarks, the results in the Mawer Canadian Equity, New Canada, and Global Small Cap Funds were particularly impressive.

Chart C

Q4 2013 Quarterly Fund Performance relative to Index (in C$)



One of the contributing factors to the outperformance in each of these three asset classes was our investment in Paladin Labs. Paladin is a Quebec-based pharmaceutical company that Mawer initially invested in during 2009. It adopted a unique business model within the pharmaceutical industry. Instead of investing heavily in the research and development of new drugs, Paladin waited for other pharmaceutical companies to complete this often lengthy and costly process. Often these drugs were developed by U.S. firms that did not have an established distribution network in Canada and were content to sell the Canadian distribution rights to Paladin, who would then reap the rewards from the revenue generated. The business model made sense to us, the valuation was compelling, and we came to admire the management team at Paladin and considered them to be among the best in the world. Paladin's shares have generated excellent returns since 2009 and we would have been delighted to continue to entrust this company with our investment capital for years to come. But in November the company agreed to a takeover offer by a U.S. rival. Paladin shares gained approximately 90% during the quarter and we considered it prudent to redeploy this capital to other opportunities. It's bittersweet to see Paladin disappear from the Canadian landscape, but this sizeable return was certainly a welcome compensation for the loss of this company.

Our strong performance this quarter was also driven by our relatively insignificant weight in Canadian mining companies, both in our large cap Canadian Equity Fund and small cap New Canada Fund. Instead, our emphasis on companies in the Financials and Industrials sectors was particularly beneficial as it was in these sectors where we enjoyed some of our strongest results. The large cap Canadian Equity Fund benefitted from Manulife Financial's gain of almost 24% this quarter, resulting in overall returns of approximately 10% from our large cap Financials. Industrial companies such as CN Rail and CP Rail had gains of over 16% and 26% respectively. The Financial companies within our small cap New Canada Fund earned nearly 15% this quarter, with a gain of more than 25% in Canadian Western Bank among the more notable performers. Stantec, an Edmonton-based engineering firm also gained more than 25% this quarter while Canadian Energy Services, a Calgary-based oilfield services company delivered returns of approximately 36%.

In addition to the strong performance of Paladin, our Global Small Cap Fund benefitted from our rigorous security selection, particularly among companies in Asia and North America. Our large allocation to Western Europe also proved favourable given the strong performance in Europe relative to Asia.

From an asset allocation perspective, the positioning of the Balanced Fund and other client portfolios added a significant amount of value this quarter. Based on our muted outlook for bonds and more favourable outlook for equities, we have maintained an overweight position in equity and underweight position in bonds for some time now. With the remarkable gap between equity and bond returns this quarter, this positioning proved beneficial once again. Within equities, we have been consistently reducing our allocation to Canada in recent years and building more exposure to U.S. companies, to the point where U.S. equities now represent the largest regional exposure within our portfolios. The strong relative performance in U.S. equities has certainly helped portfolios, as has the depreciation in the Canadian dollar relative to the U.S. dollar. This currency impact alone enhanced the return on U.S. assets by over 3% this quarter and over 6% throughout 2013. Finally, although we have trimmed our exposure to Canadian and Global small caps on several occasions this year, our combined exposure to small cap companies represents approximately 15% of our Balanced Fund. This positioning has added considerable value given our positive performance in both asset classes.

Fueled by strong performance in numerous asset classes, and the advantageous positioning from an asset allocation perspective, the Mawer Balanced Fund delivered a 7.6% return (net of fees) this quarter, which ranks as one of our best quarterly returns in years. The annual return of 20.2% stands out as the highest calendar year return since the inception of the Balanced Fund 25 years ago. In fact, four other Mawer funds posted their highest annual return since their inception; the Mawer Tax Effective Balanced Fund (20.1%), the Mawer U.S. Equity Fund (41.8%), the Mawer Global Equity Fund (34.3%), and the Mawer Global Small Cap Fund (47.0%). This was certainly a fantastic quarter to end a fantastic year.

Managing Risk

After such strong gains, it can be easy for investors to become complacent. We are wary of this and spend a great deal of time and effort identifying potential risks, and reviewing strategies to mitigate their impact on portfolios.

Currently, the risk of rising interest rates remains one of the most worrisome in our opinion. Now that the Fed has finally embarked on an exit strategy with respect to their stimulus efforts, there is uncertainty regarding how bond markets, and interest rates, may react to this withdrawal. Should rates rise, not only could economic activity wane or potentially recess, but the slightest change in the interest rate environment could also have a significant impact on asset valuation. Our strategy to mitigate this risk has not changed. We continue to maintain a relatively low allocation to bonds, and with the bonds we do own, we are emphasizing those that are less sensitive to rising yields. Screening our equity positions to emphasize companies that can either benefit from, or better withstand, a rising rate environment is yet another tool to mitigate this risk.

Another risk that has emerged in recent months is that low interest rates may be encouraging speculative behavior and contributing to a bubble in asset prices. Those most worried about a speculative bubble typically note how equity benchmarks have nearly doubled in the last five years, with many companies rising notably more than this during that period. Other warning signs include real estate prices in some markets that have risen much more than household incomes, and even auction houses like Sotheby's fetching record prices for art and other collectibles. Are investors taking advantage of easy access to cheap capital and bidding up asset prices? Have we become irrationally exuberant?

One of the ways that we assess the validity of these concerns is through a review of the valuation models that we have constructed for the companies in our portfolios. This exercise, in which we forecast future cash flows and discount them to current values, accounts for an important variable in the discussion: the cash flow generating ability of many companies is significantly higher today than in the past. With that in mind, we've found that the companies in our portfolios are generally trading at higher valuations today than in the years immediately following the 2008/2009 crisis, but these valuations are not alarmingly high relative to historical levels. That said, we continue to reduce or eliminate companies that appear more fully valued relative to their peers, and redeploy this capital to companies that appear more reasonably priced. In this way, we are managing the risk that valuation multiples contract from current levels.

Looking Ahead

The returns in the last five years have been strong. The global economy continues to march forward, with the U.S. economy demonstrating particular signs of strength. But economic imbalances persist, and the restoration of balance can disrupt the growth trajectory. The Fed's intention to restore balance by embarking on an exit strategy for their stimulus endeavours is of particular importance to the interest rate environment and the underlying health of the economy. Though we remain vigilant to mitigate certain risks and increase the resiliency of our portfolios, it's paramount for individual investors to also review their own tolerance for downside risk. Though cash equivalents and bonds have not posted superior results of late, they offer far more downside protection than equities and should not be abandoned at this stage of the cycle.

Mawer Notes

2013 Morningstar Awards

Mawer is proud to have been recognized as a top-performing investment organization in multiple categories at the 19th annual Morningstar Awards—one of the investment industry's premier investment awards programs, recognizing the year's most exceptional funds and fund managers. Mawer received the prestigious Analysts' Choice Fund Company of the Year award and Mawer's Deputy Chief Investment Officer, Paul Moroz, was named Foreign Equity Fund Manager of the Year. In addition to these top honours, the following Mawer funds won in their respective categories: Mawer Canadian Equity Fund, Mawer Canadian Equity Pooled Fund, Mawer Balanced Fund, Mawer Balanced Pooled Fund, and Mawer Global Small Cap Fund.

Happy 40th!

We are delighted to announce that 2014 marks Mawer's 40th anniversary. Since the first day Mr. Chuck Mawer opened the doors in 1974, we at Mawer have made a commitment to follow our founder's example of always doing the right thing. We are proud to say that the first client of the firm in 1974 is still with us today. On behalf of everyone at Mawer, we thank you for your ongoing support and we look forward to our continued partnership in 2014 and beyond.

We thank you for your continued support. If you have any questions, please don't hesitate to contact us at info@mawer.com.

Mawer Investment Management

Total Net Returns

For periods ending December 31, 2013*

	3–Mo	YTD	1–Yr	3–Yr	5–Yr	10–Yr
Equity Funds						
Mawer International Equity Fund	**8.7**	**22.6**	**22.6**	**10.7**	**12.9**	**7.5**
MSCI EAFE ND	9.3	31.0	31.0	10.6	9.1	4.8
Mawer U.S. Equity Fund	**13.7**	**41.8**	**41.8**	**18.4**	**12.4**	**5.1**
S&P 500	14.3	41.5	41.5	18.8	14.7	5.3
Mawer Global Equity Fund	**12.3**	**34.3**	**34.3**	**17.4**	**–**	**–**
MSCI World ND	11.6	35.2	35.2	14.0	11.6	4.9
Mawer Global Small Cap Fund	**14.7**	**47.0**	**47.0**	**24.1**	**25.4**	**–**
Russell Global Small Cap	9.5	33.7	33.7	11.0	15.5	7.5
Mawer Canadian Equity Fund	**9.5**	**25.4**	**25.5**	**12.9**	**16.2**	**10.2**
S&P/TSX Composite	7.3	13.0	13.0	3.4	11.9	8.0
Mawer New Canada Fund	**16.9**	**49.4**	**49.4**	**20.7**	**26.9**	**15.4**
BMO Small Cap (Blended, Weighted)	7.0	7.8	7.8	–1.8	18.1	7.2
Balanced Funds						
Mawer Balanced Fund	**7.6**	**20.2**	**20.2**	**11.3**	**12.0**	**7.8**
Internal Balanced Benchmark **	5.9	14.6	14.6	7.8	9.3	6.3
Mawer Tax Effective Balanced Fund**	**7.6**	**20.1**	**20.1**	**11.0**	**12.1**	**7.6**
Internal Tax Effective Balanced	5.9	14.6	14.6	7.6	9.1	6.2
Income Funds						
Mawer Canadian Bond Fund	**0.2**	**–2.2**	**–2.2**	**3.3**	**4.0**	**4.4**
DEX Universe Bond	0.4	–1.2	–1.2	3.9	4.8	5.2
Mawer Canadian Money Market Fund	**0.1**	**0.4**	**0.4**	**0.3**	**0.2**	**1.3**
DEX 91 Day T-Bills	0.2	1.0	1.0	1.0	0.8	2.1

* 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.

** 5% DEX 91 Day T-Bills, 35% DEX Universe Bond, 15% S&P/TSX Composite, 15% S&P 500, 15% MSCI EAFE ND, 7.5% BMO SCI (Blended, Weighted) and 7.5% Russell Global Small Cap

All foreign equity indices are net of withholding taxes.

Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing.

The indicated rates of return are the historical simple returns for the 3 month, YTD and 1 year periods, and annualized returns for the 3, 5, and 10 year periods. 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. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.

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