MAWER
quarterly

Fourth Quarter 2017

President's message

I have always found the beginning of a new year to be a good time for reflection. As we head into 2018, and I look back on my ten years at the firm, I am struck both by how much has changed, and how much has stayed the same since I first started writing this message.

Ten years ago, the firm managed $5 billion on behalf of individuals and institutions across Canada. We now manage over $45 billion on behalf of investors across Canada and the U.S. Our team has also grown considerably. We now have 150 employees—including 55 owners—across our three offices. A significant part of this growth has been in our research team where we have added considerable depth, growing from 11 to over 30 people, and opening a dedicated research and trading hub in Singapore to better identify investments from more countries around the globe.

If there's one thing I've learned over the years, it's that consistently delivering value-add investment performance over time and across asset classes is hard—especially in an increasingly complex and rapidly changing world. We realize that to meet the high standards we set for ourselves, and that you rightfully expect from us, it is imperative that as a firm we must continue to evolve and adapt.

One area that is a focal point in this regard is technology. It is one in which we have noticeably accelerated and over time it has moved from a supporting role in the firm to one that is mission critical with regard to cybersecurity, risk management, operations, client service, and parts of the investing process. And while we don't expect technology to fully replace fundamental, bottom-up investing, we do expect that thoughtfully integrating data, analytics, and machine learning into our investment process—a "human plus machine" approach—will be paramount going forward.

But while we continue to evolve as a firm, there are some necessary constants: the core of who we are and what we do. We have stayed true to our values, we have remained independent, we have protected our unique culture, and we have consistently followed our disciplined investment process. I am proud of our ability to stay grounded and continually add value for our clients. It's a privilege to work alongside my dedicated colleagues every day to earn the considerable trust you place in us to manage your money.

We wish you all the best for 2018.

Michael Mezei

Market overview

Markets continued their year-long upward trajectory in the final quarter of 2017. As depicted in Chart A below, synchronized growth in advanced economies, strong corporate earnings, and positive sentiment contributed to a quarter of stellar performance in most global asset markets.

Chart A	4Q17	YTD
MSCI ACWI (net) Index	5.9	15.8
S&P 500 Index	6.8	13.8
S&P/TSX Composite	4.5	9.1
FTSE TMX Canada Universe Bond Index	2.0	2.5

Mawer Balanced portfolios benefitted most from the strength of non-Canadian equities with these asset classes posting double-digit gains for the year and strong fourth quarter returns. All asset classes within Balanced strategies were positive for the fourth quarter: the Mawer Balanced Fund Series A posted an 10.0% gain for the year and a 4.2% result in the last quarter.

Despite steps that central banks took to gradually tighten monetary policy, volatility in equities, for the most part, remained low. After a rocky third quarter, Canadian Bonds rebounded in the fourth quarter to post positive gains for the year.

Some of the key themes in the fourth quarter included:

- Central bankers in many advanced economies managed to prepare investors for a tightening path without spooking them. In October, the ECB extended its asset purchase program until September 2018 but halved its monetary purchases. In November, the Bank of England raised its policy rate by 25 basis points to 0.50% and in December, the Federal Reserve increased its target benchmark rate range by 0.25%. Meanwhile, the Bank of Canada maintained its benchmark rate at 1.0%, having already hiked interest rates in Q3. And the Bank of Japan did nothing: Japan is one of the few advanced economies not on some sort of tightening path.

- The yield curves in both Canada and the U.S. flattened (near-term rates got closer to long-term rates) through the quarter, which may limit the ability for policymakers to continue hiking rates. Flat yield curves can be a sign that either monetary policy is out of sync with the economic cycle or that market participants' inflation expectations are incorrect. Without greater inflation or growth expectations, long-term yields are unlikely to move higher, which may put market expectations in conflict with policymaker plans.

- Chinese leaders were more vocal this quarter in naming financial stability and debt as areas they will seek to control, as concerns have mounted over the quality of credit to local governments and large corporations (primarily property markets and industries with overcapacity). Credit growth has supported overall economic growth in China over the last few years, as the growth burden has shifted somewhat from China's export market to domestic markets.

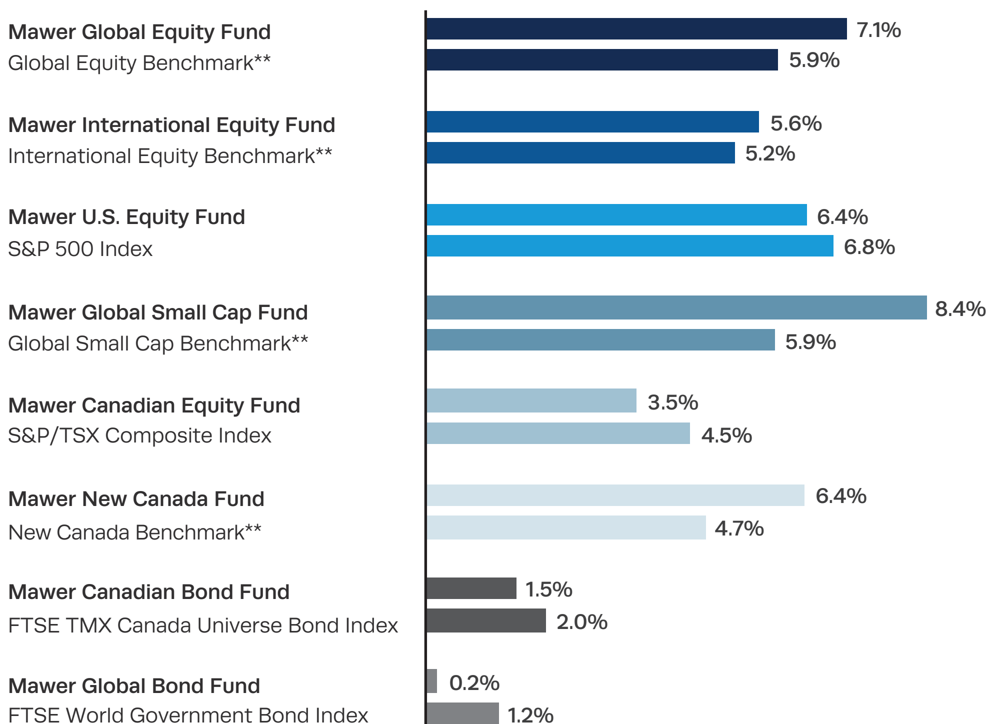
- Many investors—who had been anticipating this all year—were relieved when the new U.S. tax bill made its way through Congress which will bring the corporate tax rate to 21%.

- Global oil prices rose, with WTI trading near $60 and Brent surpassing that level. While the recovered oil price was good news for OPEC, the IEA estimated that U.S. shale producers are staging a comeback. If U.S. shale producers ramp up their drilling programs again and overall supply is increased, it could mean a cap on the recently increasing oil prices. Shale production was one of the biggest contributing factors to the supply glut that has plagued oil markets in recent years.

How did we do?

(All performance is for Series A Funds, net of fees and expressed in Canadian dollars for the period of October 1 — December 31, 2017)

Chart B – Q4 2017 Fund performance relative to Index (C$)
(A Series, Net of Fees)



Mawer Global Equity Fund: 7.1%

Overall, global equity markets have been performing well, led by some of the more cyclical components such as energy, materials, technology, and discretionary consumer stocks. Sector-by-sector, our Fund's holdings outperformed those of the benchmark virtually across the board, with particularly strong contributions in the industrials segment. U.S. railroad operator Union Pacific had a strong quarter in an environment of heightened economic activity and increased its dividend. Wolters Kluwer and Verisk delivered solid returns and are examples of a business model we like: companies that provide critical information and data to the professional industries that they serve, such as reference material for legal, tax, and medical professionals. Because of the importance of the information and the need for it to be updated regularly, this results in sticky customers, recurring revenues, pricing power, and what we believe will be wealth-creation for shareholders.

An oft-quoted aphorism in investing is to "win by not losing." We had sold our position in industrial conglomerate GE mid-2016 when the stock was worth approximately $30/share in light of concerns around capital allocation. Since then, the company has announced significant restructuring and divestitures, but the latest weakness has stemmed from two of GE's core businesses – power and oil & gas—which have been a key focus of management's M&A activities over the past few years. In the latest quarter, GE cut its dividend by 50% and the stock ended the year near $17.50/share. As long-term investors, we care deeply about management's ability to effectively deploy capital in value-creating endeavours on behalf of our clients. We won't always get it right, but we generally tend to react when we lose confidence in this ability.

Mawer International Equity Fund: 5.6%

The Fund outperformed its benchmark during the quarter, largely on the back of strong contributions from technology companies and especially those in China. We believe Chinese companies enjoy two advantages that many of their peers do not. First, the country has often created barriers to outside firms entering the market which gives Chinese players a chance to develop into more competitive entities. Second, China's huge population base gives any business enough scale to compete globally once it's ready.

Tencent is a good example of this first advantage. Tencent is the Facebook of China...and more. It offers a wide range of internet-based activities such as social networking, in-store payments, flight bookings, money transfers, etc. Tencent currently earns most of its revenue from online games, but much of its potential value lies in its platforms that have captured nearly all Chinese internet users. As an example, the monthly active user base for the company's WeChat messenger application is nearing one billion users. The company has reported

exceptional revenue and profit growth over the past year, and its dominance implies continued positive momentum in monetizing its competitive advantages.

Hangzhou Hikvision Digital Technology is a good example of the second advantage. Hikvision is a Chinese manufacturer of video surveillance equipment, including cameras, back-end components, and analytics software. While the company is already dominant in China, the business has a long potential growth runway stemming from upgrading older systems and international expansion. Hikvision's competitors abroad have trouble competing on product quality, cost, and innovation given the company's labour cost and scale advantage.

There are obviously risks to both investments including, but not limited to, potential government intervention in capital allocation decisions and that a lot of growth is already priced into each stock. But we believe that the growth runways for both companies are quite substantial and that their competitive advantages are robust. Should they continue to execute as they have been, we believe it will be fruitful for shareholders.

Mawer U.S. Equity Fund: 6.4%

Our U.S. Equity Fund capped off the year with a quarter (and year) in which it modestly lagged its benchmark. Health care was a sector that delivered diverging performances, with medical equipment manufacturer Becton Dickinson one of the top contributors and branded pharmaceuticals company Allergan one of the biggest detractors.

Big picture, since the last U.S. election cycle, there has been intense pricing pressure in the U.S. pharmaceutical industry. By some estimates, generic drug prices in aggregate have been deflating at about 8–15% per year over the past two years. During the quarter, Allergan lost a patent challenge on one of its major dry-eye treatments which opens it up to generic competition. Investors are expecting Allergan to lose volume to new generic drugs and seem no longer willing to pay as much per dollar of Allergan's earnings, causing the stock to fall. However, it isn't all negative with Allergan, there are still a significant amount of recurring revenues from existing drugs, and their aesthetics business is exposed to an industry that is growing by double digits. Though we're disappointed with the stock's recent performance, we have maintained our position as the valuation at these levels appears compelling.

Becton Dickinson, on the other hand, makes medical equipment such as needles, catheters, and reagents for laboratory equipment. It has dominant market shares in most of its segments and, while it is certainly not immune to deflationary pressure, the intensity has not reached the same level as in the pharmaceutical industry. The company has delivered strong results thanks to management's ability to extract synergies from the company's past acquisition of CareFusion, and the market seems to be anticipating a successful integration of recently acquired CR Bard, a leading manufacturer of consumable surgical products. We continue to view management and the stock favourably: it is one of the largest weights in our U.S. Equity Fund.

Mawer Global Small Cap Fund: 8.4%

We wrote about Softcat in our last quarterly update, and the IT reseller posted another positive quarterly return—and was the largest contributor to the portfolio's performance during a quarter in which the Fund outpaced its benchmark. Softcat advises its customers as to which software or hardware product should be chosen given their customers' needs, existing infrastructure, and budget. In our opinion, customers tend to be very sticky given Softcat's strong reputation and the asymmetric payoffs that customers face when switching from a capable operator as IT disruptions can be extremely costly.

Softcat typically earns a margin on the software and hardware sold to customers. Just as a travel agency won't book an airline ticket until their customer buys a vacation package, Softcat only buys a piece of hardware or software to deliver to a customer once the customer agrees to a purchase. As a result, Softcat holds minimal inventory and carries little price risk on the underlying goods being sold. The company is therefore asset-light and has the potential to earn high returns on capital thereby creating wealth for shareholders.

Mawer Emerging Markets Equity Fund[1]

As an asset class, emerging markets equities had a banner year in which they outperformed developed market stocks and the fourth quarter was no different. In the last three months of the year, the Fund more than fully participated in this rise as our holdings eclipsed those of the benchmark across the majority of regions in which we're invested.

Country risk is important to evaluate when investing in emerging markets companies, and it can swing both ways. During the quarter, South Africa's ruling party elected a new leader to replace Jacob Zuma, and investors cheered with the expectation that the trend of worsening corruption would reverse. We're somewhat skeptical that the road ahead will be an easy one, but many South African stocks jumped on the news, including life insurer Discovery Ltd.

Whereas we certainly incorporate country risks into our analysis of individual companies and our portfolios, we never view a company's country of domicile as the central

[1] Due to regulatory requirements, performance information may not be published until the Fund has completed a financial year.

pillar to any investment thesis. For Discovery, our thesis resides principally with management; we believe the company's management team is strong and are notably struck by their disciplined, long-term perspective. For example, they are comfortable deploying 5% of their profits into new ventures that may not pay off for a decade.

One of these ventures that is now bearing fruit is a wellness rewards program called Vitality. Vitality is a system that tracks physical activity and nutrition over a person's life. Data is inputted by members both directly and indirectly, through their credit cards, gym visits, and wearable technologies. In addition, the program incents healthy behaviour, offering discounts on products and services that promote a healthy lifestyle. As a life insurance company, the benefit to Discovery is huge: Vitality allows the company to price their insurance policies more accurately at the time of underwriting and to dynamically adjust premium pricing based on their members' engagement. Given the breadth of the Vitality network that Discovery has built, this provides them with a major advantage over their competition.

Mawer Canadian Equity Fund: 3.5%

Among developed markets, Canadian equities lagged globally during the quarter and our portfolio underperformed its benchmark. Weakness among our financials holdings—notably private equity investment firm Onex—as well as lackluster returns from two cable companies we own (Shaw and Cogeco) were the main culprits. The common thread between all three businesses is that they are sensitive to higher interest rates and operate in industries that seem to be becoming increasingly competitive. We trimmed our positions in all three during the quarter in light of these concerns.

One stock that has been an important contributor to the Fund's return since we initiated our position in 2009 (and that continues to perform well) is Constellation Software. The company acquires, manages, and grows software businesses that provide mission-critical services to their clients, e.g., by providing billing software to fitness clubs.

Given its strong performance, we've been trimming our position in Constellation Software, but it remains a top 10 holding in the portfolio. Its current valuation indicates that investors seem to be anticipating that the company will deliver organic growth and continue to add meaningful value for shareholders through acquisitions, which becomes more difficult as the company has grown bigger. In a letter to shareholders earlier this year, CEO Mark Leonard wrote: "In the last couple of years, a number of journalists and analysts have hinted that [our] historical performance is too good to be true. They frequently conclude, in the best case, that our performance will revert to the mean. [...] I don't disagree with their observation. Our goal, however, is to have our return on Total Capital revert to the mean as slowly as possible."

In theory, companies that earn a return on capital greater than their cost of capital—like Constellation Software—should attract competition that drives down their returns to meet their cost of capital. And it is this difference between the return on capital and cost of capital that creates wealth for shareholders. If in fact a reversion to the mean is inevitable, it is also true that slowing this mean reversion could have a very significant impact on future wealth creation and the intrinsic value of the company. If they can execute on this effectively, shareholders may continue to do well with Constellation Software.

Mawer New Canada Fund: 6.4%

Canadian small-cap stocks performed roughly in-line with their larger-cap peers, though our portfolio outpaced its benchmark during the quarter. Companies with significant U.S. revenue exposure rebounded as the loonie gave back some of its gains versus the U.S. dollar earlier in the year and tax reform was successfully passed in the U.S. Examples include commercial real estate advisory services provider Altus Group, collision repair shop operator Boyd Group, and bus manufacturer New Flyer—the top three positions in the portfolio.

Partially offsetting these positives, the absence of any companies in the metals & mining sector was a headwind to relative performance, not surprisingly given the recent rally in commodity prices and the industry's heavy representation in the universe of small-cap Canadian stocks. Elsewhere in the materials sector, Winpak suffered a pullback after offering weaker guidance around margins. The company manufactures plastics-based packaging materials, used primarily in the protection of perishable foods and with applications in health care. As a result, its margins are sensitive to input costs. We believe the company is still well-positioned to gain share in the U.S. and we added to our position following the pullback on more attractive valuation.

Mawer Canadian Bond Fund: 1.5%

The Canadian bond market had a strong end to the year driven primarily by longer-dated maturities as bonds with remaining term-to-maturity greater than 10 years generally experienced declining yields. This stood in contrast to shorter-dated maturities whose yields rose moderately. As we've discussed, this flattening of the yield curve was a key theme during the quarter. Relative to the benchmark, the Fund underperformed slightly during the fourth quarter, largely due to where the portfolio was positioned along the yield curve and notably the portfolio's underweight exposure to bonds with maturities greater than 10 years.

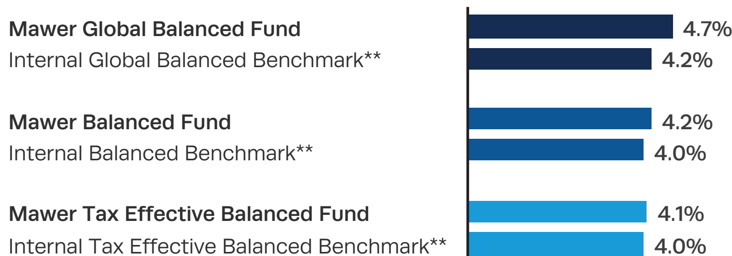
Mawer Global Bond Fund: 0.2%

During the quarter, the Canadian dollar weakened relative to some of the world's key reserve currencies including the Euro, the U.S. dollar, and the Japanese Yen. This generally helped to bolster the returns of foreign securities denominated in those currencies when translated back into Canadian dollars. While the Fund had a sizable allocation to bonds denominated in Euros, the benchmark has an even larger one and this was the main contributor to the portfolio's underperformance relative to its benchmark during the fourth quarter. An overweight position in Mexico detracted from relative performance but to a lesser degree due to potential trade disruption, ongoing political challenges, and increasing inflation.

Mawer Global Balanced Fund: 4.7%
Mawer Balanced Fund: 4.2%
Mawer Tax Effective Balanced Fund: 4.1%

2017 was a strong year for our balanced portfolios, both in absolute terms and relative to their benchmarks. The fourth quarter was no different. As highlighted above, strong stock selection in the foreign equity and the small-cap components was a strong driver. Our asset mix positioning also had a favourable effect, notably our overweight in equities and preference for stocks outside of Canada.

Chart C – Balanced fund performance relative to Index (C$)
(A Series, Net of Fees)



Asset mix

In this environment, we have kept the overall exposure to equities at a modest overweight position relative to its neutral weight (the neutral weight for the standard balanced portfolio being 60%). After a strong performance by equities this quarter, the overall weight of equities had crept up, so a decision was made to sell some equity to bring the drift back in line. While the upwards cycle in equities may continue for longer from here, with the mounting risks and steep valuation in markets, we were unwilling to take on additional equity risk. This modest reduction in equities was taken from the U.S. position, where there had been the biggest drift. It should be noted, however, that the U.S. market remains one of our largest overall equity weights. This positioning reflects the quality of U.S. companies and the historic strength of the U.S. dollar in times of market crisis. Overall, our positioning is consistent with our outlook for markets and approach to managing risk.

Looking ahead

If investing were a ballgame, we might categorize this as a later inning. Exactly how late or how many innings this ballgame will have, however, is unknown at this point. But while there are risks accruing in the system—with equity valuations in particular—there are also positive forces keeping the momentum going such as synchronized global growth, still-low interest rates, and increasing yet mild levels of inflation. And although the odds of an equity market correction have increased in the medium term, we may remain in this supportive period for some time yet. This bull market cycle has already lasted longer than many expected, and it may continue to surprise.

When cycles end, the closing signals are usually seen in the credit market. At the time of publishing this newsletter, we are still not seeing many signs from the credit market that we are in the final inning. We watch global credit markets closely for these signs, but for the most part, investor psychology has remained bullish and credit markets continue to function. Moreover, it is worthwhile to note that, historically, the length of time between the initial signals of distress in credit markets and an actual market correction differs. In some periods, like 1987, the correction is swift (weeks). In others, like in 2007, it can take as much as a year for the music to stop. This reminds us that even when there are some signs, there is no one rule that necessitates the timing for these events.

This begs the question: how to manage through the current environment? There are really two choices for any investor when it comes to managing market corrections: either try to time the storms or seek to ride through them. Our philosophy at Mawer is to build resilient portfolios of exceptional businesses that can ride through storms. We do not believe in market timing. Not only is the track record of market timing poor, but given that markets are complex adaptive systems, there is no compelling or logical reason to believe that market timing as a strategy can be consistently and successfully applied over time. Moreover, market timing often moves the focus of the investor to the short-term instead of playing the long game. As an example, the global financial crisis of 2008/2009 was among the worst in recent memory. Yet investors who stayed invested through this period ultimately experienced a great rebound in 2009 and nearly a decade of strong stock returns.

Therefore, in the absence of unique portfolio requirements such as an immediate need for liquidity or changes in personal circumstances, we would discourage investors from trying to front run a downturn. Identifying any inflection point (top or bottom) is very difficult to do and somewhat dangerous to try: doing so could mean missing out on positive performance if a downturn does not materialize, or not timing your re-investment into the market after a downturn and therefore missing out on the rebound. What's more, it isn't guaranteed that a correction is imminent even if the probability of one has increased. One alternative scenario is that a meaningful downturn fails to materialize in the medium-term, and we simply experience lower, but still positive, returns than we've enjoyed for the better part of the past decade

Now is the time to evaluate your adherence to your current investment policy statement. Current conditions warrant a re-visit of your total equity weight, which may have drifted higher than what you are comfortable with given the strong returns experienced over the past year and ensuring your liquidity needs are well understood to ensure risk is managed in compliance with your strategy.

Similarly, our investment teams haven't been making wholesale shifts within asset classes, but rather incremental adjustments to portfolio weights in individual names based on changes in our evaluation of a company's business fundamentals, management team, and valuations. Our stance, as always, is to ensure our portfolios are resilient to a downturn. We do this by investing in real businesses which can weather and even improve through difficult market conditions. This doesn't mean we're immune to the temporary pain of negative returns, but we do keep the bigger picture in mind. We encourage our clients to do the same.

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Total Net Returns (Series A)*

For periods ending December 31, 2017	3-Mo	YTD	1 yr	3 yr	5 yr	10 yr
Equity Funds						
Mawer International Equity Fund	**5.6**	**22.6**	**22.6**	**12.6**	**13.8**	**6.8**
International Equity Benchmark**	5.2	18.8	18.8	11.1	13.2	4.5
Mawer U.S. Equity Fund	**6.4**	**12.8**	**12.8**	**12.4**	**19.5**	**10.2**
S&P 500 Index	6.8	13.8	13.8	14.4	21.2	11.1
Mawer Global Equity Fund	**7.1**	**17.5**	**17.5**	**12.5**	**16.9**	**–**
Global Equity Benchmark**	5.9	15.8	15.8	12.4	17.0	–
Mawer Global Small Cap Fund	**8.4**	**20.8**	**20.8**	**15.7**	**20.6**	**14.2**
Global Small Cap Benchmark**	5.9	15.7	15.7	14.0	16.7	8.4
Mawer Emerging Markets Equity Fund* **	**–**	**–**	**–**	**–**	**–**	**–**
MSCI Emerging Markets Index	–	–	–	–	–	–
Mawer Canadian Equity Fund	**3.5**	**8.7**	**8.7**	**7.9**	**12.8**	**8.1**
S&P/TSX Composite Index	4.5	9.1	9.1	6.6	8.6	4.6
Mawer New Canada Fund	**6.4**	**3.9**	**3.9**	**8.1**	**16.2**	**11.1**
New Canada Benchmark**	4.7	2.8	2.8	6.3	5.3	3.9
Balanced Funds						
Mawer Global Balanced Fund	**4.7**	**11.0**	**11.0**	**8.2**	**–**	**–**
Internal Global Balanced Benchmark**	4.2	9.9	9.9	8.2	–	–
Mawer Balanced Fund	**4.2**	**10.0**	**10.0**	**7.8**	**11.1**	**7.6**
Internal Balanced Benchmark**	4.0	8.4	8.4	7.3	9.2	6.1
Mawer Tax Effective Balanced Fund	**4.1**	**9.9**	**9.9**	**7.7**	**11.0**	**7.5**
Internal Tax Effective Balanced Benchmark**	4.0	8.4	8.4	7.3	9.2	6.0
Income Funds						
Mawer Global Bond Fund	**0.2**	**-1.1**	**-1.1**	**–**	**–**	**–**
FTSE World Government Bond Index	1.2	0.4	0.4	–	–	–
Mawer Canadian Bond Fund	**1.5**	**1.3**	**1.3**	**1.8**	**2.1**	**3.9**
FTSE TMX Canada Universe Bond Index	2.0	2.5	2.5	2.6	3.0	4.7
Mawer Canadian Money Market Fund	**0.1**	**0.1**	**0.1**	**0.0**	**0.2**	**0.4**
FTSE TMX 91 Day T-Bill Index	0.2	0.6	0.6	0.6	0.7	1.0

* Mawer Funds are managed by Mawer Investment Management Ltd. Mawer Fund returns are calculated before management fees and operating expenses have been deducted. In comparison, Index returns do not incur management fees or operating expenses.

** Refer to http://www.mawer.com/our-funds/performance/ for Benchmark History.

*** This information is not available because the Fund has not yet completed a Financial year.

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

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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. 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.