Mawer Tax Effective Balanced Fund, Series A

Q2 2024 | Performance Commentary

Market Overview

The second quarter of 2024 saw a continuation of the key themes from the first quarter as strength in public equity markets was led largely by artificial intelligence related companies. Even the utilities sector enjoyed an AI-related boost given expectations that more data centres should lead to increased electricity demand.

Regionally, emerging markets equities led the advance given heavy exposure to semiconductor-related businesses, most notably via Taiwan's stock market. Similarly, U.S. growth stocks surged lifting the results of the broader U.S. market while performance was more modest in Europe, and negative in Japan after adjusting for the depreciating yen.

The Canadian equity market also faced headwinds from a more challenging growth outlook. The Bank of Canada diverged from the U.S. Federal Reserve and began reducing policy interest rates during the quarter. In Canada, a surprise move higher for inflation near the end of the quarter makes the job of the Bank of Canada harder given the stagnating economy; even so, their messaging to market participants has stressed that policy action will be measured and data dependent. Market participants reduced expectations for U.S. interest rate cuts this year as the Federal Reserve remains on pause as it grapples with stubborn inflation that has yet to be fully tamed.

Canadian bonds had positive returns this quarter as the short end of the yield curve moved lower and long-term yields remained mostly unchanged.

Performance Commentary

This quarter's portfolio return was flat as positive returns for bonds and money market securities offset the slight decline from many of our equity strategies. The portfolio underperformed the blended benchmark, largely driven by the relative underperformance of the portfolio's U.S. equity strategy. A primary source of relative underperformance for our U.S. equity strategy came from our large underweight to semiconductor stocks and not owning Apple, the sum effect of which accounted for approximately half of the strategy's negative relative performance in the period.

During the last quarter several equity markets reached new highs driven by a narrow segment of the market, notably technology-focused companies that either form the supply chain for semiconductors or are positioned to develop/benefit from AI-related advancements.

- Our semiconductor holdings continued to enjoy tailwinds including manufacturer **TSMC**, single wafer atomic layer deposition technology company **ASM International**, and EUV lithography machine manufacturer **ASML**. These companies have robust competitive advantages largely tied to technological know-how, reputation, high barriers to entry, and significant market shares.

- Companies that may benefit given their competitively advantaged position of access to large amounts of proprietary data and information also performed well including provider of insurance underwriting data **Verisk Analytics**, and reference data providers **RELX** and **Wolters Kluwer**.
- Global technology mega companies such as **Microsoft** and **Alphabet** also continued on their incredible runs.

However, Consumer weakness has been a growing concern as the eroding of purchasing power from high inflation has the potential to impact spending.

- Stock prices for our holdings in **Sleep Country Canada** and premium pet store **Pet Valu** were lower given concerns around the strength of consumer demand for their products.
- Luxury goods company **LVMH** faced headwinds similar to many consumer discretionary companies, as did apparel company **Nike** which is also losing market share to competitors.

Consumers trading down can have a different effect depending on the business model: **Dollarama** had another strong quarter as their product assortment and price points continue to drive a differentiated value proposition for consumers.

Regionally, our holdings in France were impacted by investor sentiment around the election and increased uncertainty. Industrial gas supplier **Air Liquide**, voucher solution provider **Edenred**, and research company **Ipsos** were amongst many of our French holdings that lagged this quarter.

The underperformance of our U.S. equity strategy was in part reflective of the challenges to keeping pace with a market that is driven by a few high-flying technology stocks. Amongst a period of such narrow market leadership, we continue to closely monitor the high momentum stocks like Nvidia. The range of outcomes for these types of companies are very wide and current valuations reflect market assumptions that earnings growth rates and margins will stay at elevated for many years to come. While of course possible, we find these sorts of scenarios hard to envision with high probability. This reduces our confidence that these stocks are trading below intrinsic value and ultimately reinforces our belief that sticking to our philosophy and process, despite the temptation to chase the current trend, is a sound strategy.

From an asset mix perspective, we modestly added to our bond weight to account for drift and as of quarter end we remain underweight bonds. At the beginning of June, we also reallocated an additional portion of our U.S. equity weight to U.S. mid cap equity as we believe this improves the diversification of the U.S. equity portion of the portfolio. This change has little effect on our overall U.S. equity exposure, and we continue to be overweight one of the stronger economies globally.

Looking Ahead

Though we are very much bottom-up investors, the juxtaposition of the current macroeconomic and geopolitical backdrop with many equity markets at or close to all-time highs is increasingly puzzling. Beneath the surface of the headline performance of many global indices, there is a noticeable lack of breadth in the markets' recent advance. Consumer-related stocks and more traditional industrial bellwether segments point to potential underlying weakness. While global economic growth remains positive, it has slowed and we note that the word "deflation" has started to occasionally creep into conversations with company executives, a shift relative to the last few years.

In 1989, the fall of the Berlin Wall was an inflection point that served to catalyze more inclusive global economic growth, increased productivity, trade, and formidable stock market returns over the ensuing three decades. We worry that current trends (more protectionist policies, less globalization, more conflict, and a multi-polar world), along with a higher cost of capital, may imply lower real returns from equities moving forward.

As for the AI-related market darlings, the late Roy Amara once said: "We tend to overestimate the effect of a technology in the short run and underestimate the effect in the long run." Put differently, there's a risk of over-exuberance in markets extrapolating today's pace of AI-related demand, with many companies lacking the data or infrastructure to deploy generative AI widely within their organizations. Return on investment is also unknown. But the mismatch between the timing of investment and returns may create significant future opportunities, particularly where competitive advantages are strongest.

As always, valuation is the great equalizer and both axes of our Matrix—quality and valuation—are important. AI-related or not, companies with strong, recurring revenues should benefit from continued economic growth while providing a measure of defensiveness should the macroeconomic environment deteriorate. Purchasing such securities at a discount to their intrinsic value should offer greater upside in a bullish scenario yet better downside protection should markets correct. We aim to get the balance right. While not a formula for avoiding benchmark-relative underperformance or negative returns in the short run, we believe this approach should minimize the probability of permanent impairment of capital while leading to long-term compounding of wealth.

Tax Effective Balanced Fund

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Performance Summary[1] (%)
As of June 28, 2024

	YTD	3 Mo.	1 Yr.	3 Yrs.	5 Yrs.	10 Yrs.	Since Inception[2]
FUND	4.5	-0.1	9.9	2.0	4.8	6.3	7.6
BENCHMARK	6.3	1.5	12.1	3.5	6.3	6.2	7.7

Calendar Year, as of December 31:

	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
FUND	10.1	-12.4	9.2	10.7	14.9	-0.3	9.9	3.3	10.2	12.2
BENCHMARK	11.2	-9.6	10.0	10.7	14.2	-2.7	8.4	7.4	6.2	9.5

[1]Performance figures are net of management fees and operating expenses. Periods greater than one year are annualized. Performance figures are in Canadian dollar terms.
[2]Mawer Tax Effective Balanced Fund Series A Inception: January 8, 1988

Selections from Mawer's Art of Boring blog and podcast:

Quarterly Update | Q2 2024 | EP161
Portfolio Manager Crista Caughlin discusses the economy and factors that drove markets in the second quarter of 2024.

Navigating the U.S. Mid-Cap Landscape: Resilience Amid Uncertainty | EP160
In this episode, Portfolio Manager Jeff Mo makes the case for investing in U.S. mid-cap equities, highlighting the country's strong business environment, large domestic market, and GDP growth. He discusses current market trends, including artificial intelligence, and his team's risk management evaluation, especially with a pivotal U.S. election looming on the horizon.

From Buy to Bye: Sell Discipline and Overcoming Behavioral Biases | EP159
Portfolio Manager Jeff Mo discusses common behavioral biases that can hinder clear sell decisions, and the tools, such as checklists and trigger points, that can help slow down emotional thinking.

Disclaimer

Opinions and Forecasts:
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All opinions contained in forward looking information are subject to change without notice and are provided in good faith and are based on the estimates and opinions of the portfolio advisor at the time the information is presented. The portfolio advisor has no specific intention of updating any forward looking information whether as a result of new information, future events or otherwise, except as required by securities legislation. Certain information about specific holdings in the Fund, including any opinion, is based upon various sources believed to be reliable, but cannot be guaranteed to be current, accurate or complete and is subject to change without notice.

Benchmarks:

FUND	BENCHMARK
Mawer Tax Effective Balanced Fund	Jan 2012: 5% 91 Day Treasury Bill, 35% FTSE TMX Canada Universe Bond, 15% S&P/TSX Composite, 15% S&P 500, 15% MSCI EAFE (net), 7.5% BMO Weighted Small Cap (Blended), 7.5% Russell Global Small Cap Aug 2013: MSCI EAFE (net) returns is used to calculate the blended benchmark from inception. Previously, MSCI EAFE (gross) was used. Oct 2015: 5% 91 Day Treasury Bill, 30% FTSE TMX Canada Universe Bond, 5% FTSE WGBI, 15% S&P/TSX Composite, 7.5% BMO Small Cap (blended), 15% S&P 500, 15% MSCI EAFE (net), 7.5% Russell Global Small Cap Oct 2016: 5% 91 Day Treasury Bill, 30% FTSE TMX Canada Universe Bond, 5% FTSE WGBI, 15% S&P/TSX Composite, 7.5%

	S&P/TSX Small Cap, 15% S&P 500, 15% MSCI ACWI ex-USA (net), 7.5% MSCI ACWI Small Cap (net) Jun, 2021: 5% FTSE Canada 91 Day TBill Index, 35% FTSE Canada Universe Bond, 15% S&P/TSX Composite, 7.5% S&P/TSX Small Cap, 15% S&P 500, 15% MSCI ACWI ex-USA (net), 7.5% MSCI ACWI Small Cap (net)

Performance Disclosure and Requirements:
Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the fund facts and the prospectus before investing. The indicated rates of return are the historical annual compounded total returns including 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. Mawer Funds are managed by Mawer Investment Management Ltd.

The Funds mentioned in this document are not registered with the United States Securities and Exchange Commission and they are sold in the United States only in reliance on exemptions from registration.