Mawer Global Small Cap Fund, Series A

Q3 2024 | Performance Commentary

Market Overview

In the third quarter of 2024, under the weight of previous central bank interest rate increases, global growth continued to slow. But in September, the U.S. Federal Reserve made its first interest rate cut this cycle, joining the Bank of Canada and other central banks who had already begun reducing rates due to retreating inflation. This has provided some relief for certain households and businesses who have been struggling with a higher interest rate environment. While the path of inflation and interest rates are never certain, it does seem we are now on the easing side of this cycle.

Equity market performance remained strong while broadening out over the third quarter with interest rate sensitive sectors such as real estate, financials, and utilities performing well, propelling several stock market indices to all-time highs. The technology sector lagged, however, as investors questioned higher valuations for companies benefiting from artificial intelligence spending. Though performance was strong overall in the quarter, we did see bouts of volatility and market drawdowns, particularly in the late July/early August when the U.S. posted weaker economic data and the Bank of Japan hiked interest rates. Despite the volatility, tighter credit spreads and all-time highs for several equity markets may suggest that investors have priced in a low probability of a recession.

Performance Commentary

The portfolio underperformed its benchmark this quarter.

A few of our European value-added resellers (**Atea, Softcat,** and **SoftwareOne**) and IT consultants (**Endava**) were impacted by a weaker discretionary spending environment where clients remain cost conscious. Companies have observed slower decision-making around smaller projects—which are more discretionary in nature—and hardware, especially across SMEs and public-sector entities. Conversely, the demand for large projects remains healthy while customers have been shifting their spending towards software. Notable growth drivers have included AI, data management, and cybersecurity, which ultimately lead to a more complex IT environment that necessitates more advice and expertise from the industry.

Notable performers included steady, resilient portfolio stalwarts such as branded consumer goods company **Orkla** and pharmaceutical company **Hikma**. The latter has benefitted from successful new products development in its core injectables segment (think: intravenous fluids used in surgeries) which have high regulatory driven barriers around quality and reliable supply in part due to their complexity and criticality. Elsewhere, Swiss financial institution VZ and provider of regulatory filing and deal solutions **Donnelley** reported strong results driven by rising capital markets activity and performance. Finally, distributor of industrial products **RS Group** has continued to gain market shares across most of its product categories as it benefits from clear scale advantages against competitors.

Since 2020, the global economy—and small businesses who have been hit hard by higher interest rates—has been surprisingly resilient and has primarily surprised to the upside versus expectations. Our investment style focuses on profitable, recurring businesses and naturally steers us away from those parts of the market that benefitted the most during periods of market euphoria. And regionally, these periods of economic surprises have been substantially more pronounced in the U.S. compared to Europe and has amplified headwinds for the portfolio due to its underweight to the U.S. These factors have led to the meaningful return deviations from the benchmark over the past few years.

More recently, we have made some improvements to our process that we believe will generate alpha over time, notably with respect to idea generation, which has led to recent initiations in the portfolio. We remain confident in our positioning as portfolio KPIs that have historically driven alpha are now particularly strong. In terms of valuation, the portfolio is in a very healthy spot and trading better (i.e., cheaper) than it has in the past eight years while maintaining a sustained gap in return on invested capital compared to the benchmark and having a larger portion of the portfolio invested in businesses with engaged owners. The latter being a characteristic the team feel is especially important in the small-cap world given the potentially outsized impact of management.

Looking Ahead

While corporate earnings remain on an upward trajectory, many of the world's economic engines such as the U.S. and Europe are slowing with PMI data declining across the globe. Further, there are both top-down and bottom-up signals that the world's 2nd-most impactful economic force given its size and purchasing power—the U.S. consumer—might be facing headwinds. (*Editors' note: the Fed is likely #1*). As an example, a meaningful slowdown in the auto sector, which is a significant driver of manufacturing activity and jobs in the West, doesn't portend well for aggregate demand. While central banks should be commended for their handling of the economy over the last two years, investors may be placing too high a probability on a "no landing" scenario.

On the other hand, speaking of central banks, the denominator impact of lower rates and the start of the easing cycle should generally be supportive of risky assets on the assumption that inflation is falling for the right reasons and not due to more worrisome deflationary forces. The most recent stimulus in China is a great example of the impulse and impact to sentiment that this denominator effect can provide. "Don't fight the Fed" has been a rather prudent mantra historically.

Looking ahead, there will undoubtedly be no shortage of events to preoccupy markets; war and the upcoming U.S. election spring immediately to mind. But to paraphrase former U.S. Defense Secretary Donald Rumsfeld, it's the "unknown unknowns" that often produce the largest surprises … much like a global pandemic to the vast majority of market prognosticators prior to 2020.

This is why "Prepare, don't predict" is such an important mindset at Mawer and lies at the heart of our investment process. Investing in a diversified portfolio of real businesses with strong competitive advantages, that generate recurring revenues, that have flexibility in their cost base, that maintain dominant industry positions, that are run by competent managers, and that refrain from taking undue risk from a leverage perspective, should lead to genuine wealth creation. While market sentiment can shift quickly and unpredictably in the short run, attractive risk-adjusted returns over the long term are the real prize.

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Performance Summary[1] (%)
As of September 30, 2024

	YTD	3 Mo.	1 Yr.	3 Yrs.	5 Yrs.	10 Yrs.	Since Inception[2]
FUND	1.3	2.0	9.6	-2.6	4.5	8.3	10.0
BENCHMARK	14.0	7.4	24.5	4.8	9.8	9.8	7.6

Calendar Year, as of December 31:

	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
FUND	13.9	-17.7	4.8	14.8	24.4	-2.6	20.8	-0.7	29.1	12.1
BENCHMARK	13.7	-12.8	15.1	14.3	18.4	-6.7	15.7	8.3	18.3	9.1

[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 Global Small Cap Fund Series A Inception: October 2, 2007

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

Quarterly Update | Q3 2024 | EP168
Portfolio Manager Crista Caughlin discusses the economy and factors that drove markets in the third quarter of 2024.

Marbles and Billiards: Navigating the Highs and Lows in Global Equity | EP162
In this episode, Portfolio Manager Manar Hassan-Agha discusses how the Global Equity Team navigates an exuberant market environment while staying true to Mawer's disciplined investment approach.

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.

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Benchmarks:

FUND	BENCHMARK
Mawer Global Small Cap Fund	Oct 2007: Russell Global Small Cap Oct 2016: MSCI ACWI Small Cap (net) Total Return index

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