Mawer Tax Effective Balanced 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. 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. While the path of inflation and interest rates are never certain, we are now on the easing side of this cycle.

Equity market performance broadened out over the third quarter with interest rate sensitive sectors performing well, helping to propel several stock market indices to all-time highs. The information technology sector lagged, as investors questioned higher valuations for companies benefiting from artificial intelligence spending. Continued exuberance across several equity markets may suggest that investors have priced in in a low probability of a recession.

Regionally, Chinese stimulus announcements provided an end of period share price rally for the country, despite lingering longer-term economic challenges. Canadian bonds also rallied this quarter as interest rates declined.

Performance Commentary

The portfolio underperformed the benchmark in the quarter driven primarily by the underperformance of the Global Small Cap strategy relative to the MSCI ACWI Small Cap Index (Net).

The interest rate sensitive area of the market such as real estate companies benefited this quarter from falling rates. **Colliers International Group**, a diversified service provider for commercial real estate, performed strongly due to an improved outlook for the industry and lower interest rates. Industrial REIT, **Granite Real Estate Investment Trust**, similarly benefited from an improving real estate outlook. Elsewhere, financial exchange operators **Intercontinental Exchange** and **CME Group** were businesses that did well as heightened volatility experienced during the period tends to increase trading volume.

Some of our companies based in Japan also did well this quarter. Management consultant **BayCurrent Consulting** and B2B maintenance, repair, and operations distributor **MonotaRO**, enjoyed significant bumps after lagging earlier in the year. BayCurrent continues to hire to take advantage of a long runway in IT consulting in Japan and the market rewarded the stock as the company reported higher-than-expected revenue per consultant. In addition, North American investors further benefitted from the significant appreciation of the Japanese yen.

Unlike previous quarters, holdings with AI-related exposure did not keep up with the market including advanced lithography machine producer **ASML Holding** and single wafer atomic layer deposition technology company **ASM International**. **Samsung Electronics** a semiconductor manufacturer also did not keep pace with the advancing market.

Outside of AI, **Novo Nordisk** pulled back due to increasing regulatory risks and a potential rise in competitive intensity in obesity pharmaceuticals. Households facing financial strain under a rising cost of living has impacted our holding in **Dollar General,** as its lower-income customers have been disproportionally affected by higher inflation.

Over the past year, the relative performance of the balanced portfolio has been driven by the underperformance of the U.S. Equity strategy compared to the S&P 500. Overall, we would characterize the current market as exuberant with the S&P 500 rising 25% this year—the best performance of the index in the first three quarters since 1997—and 36% over the past twelve months. This type of outlier performance in the market with extremely narrow leadership and strong momentum is typically an environment where our quality at the right price investment style is challenged to keep pace. Insurance broker **Marsh & McLennan's** performance of ~18% over the past year is an example of a "boring" company that has done well, but not kept pace with the market leaders. The more recent performance of our U.S. Equity strategy in the quarter is aligned with our expectations: we outperformed in late July/early August where the macro-economic situation appeared more precarious and underperformed later in the quarter as the market started pricing in a no-landing scenario.

From an asset mix perspective, we adjusted our target weights deploying cash into bonds, moving both asset classes closer to their strategic target weight. The incrementally higher allocation to bonds provides a degree of downside protection to a slowdown or recession scenario, while also recognizing the current lower expected return on cash holdings.

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 signals that the U.S. consumer might be facing headwinds. 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. 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 is the real goal.

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

	YTD	3 Mo.	1 Yr.	3 Yrs.	5 Yrs.	10 Yrs.	Since Inception[2]
FUND	10.4	5.7	18.9	3.5	5.7	6.8	7.7
BENCHMARK	13.0	6.2	21.8	5.6	7.4	6.8	7.8

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 | Q3 2024 | EP168

Portfolio Manager Crista Caughlin discusses the economy and factors that drove markets in the third quarter of 2024.

Looking Past the Pitfalls: Focusing on Managing Risk in the Balanced Portfolio | EP169

In this episode, Steven Visscher, lead manager of the balanced strategies, discusses the impact of rising interest rates and inflation on the balanced portfolio in recent years, Mawer's disciplined and collaborative approach to portfolio construction, and the importance of having a long-term perspective. He spoke about recent changes and additions to the balanced portfolio and provided an update on the performance of the balanced portfolio thus far in 2024.

Recession Fears and Credit Spreads: A Comprehensive Fixed Income Update | EP164

In this episode, Crista Caughlin, lead Portfolio Manager of the Canadian Bond Strategy, and Brian Carney, lead Portfolio Manager of the Global Credit Opportunities Strategy, provide their thoughts on recent economic data releases, a shift in central bank language, and recent market volatility. They delve into new issuance activity in the U.S. and Canada, widening spreads in the investment-grade and high-yield markets, and current portfolio positioning. The conversation concludes with an update on the growth and expansion of Mawer's fixed income team.

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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)

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