Enhancing portfolio outcomes through an unconstrained credit solution

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MAWER

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Overview

After decades of falling yields provided a tailwind for fixed income returns, rising yields over the past few years proved a nasty headwind. In fact, investors experienced two straight years of losses in their traditional bond portfolios in 2021 and 2022[1], the first back-to-back negative returns since 1997/1998. People don't expect to lose money in fixed income. While fixed income retains many of its key historical benefits, losses should lead to a critical examination of the type of fixed income an investor holds. We recommend an examination followed by a reformulation of one's fixed income exposure rather than outright elimination. Investors should consider a strategic allocation to an unconstrained global credit strategy because of the attractive risk-adjusted returns that are targeted by dynamically managing credit risk and interest rate risk throughout the investment cycle.

Key challenges for investors

- Risk of low expected real returns in most asset classes
- Growing late-cycle complacency in the credit markets
- Increased interest rate volatility

Mawer Global Credit Opportunities Strategy

- A long-only, absolute return focused credit strategy
- Bottom-up focused process, with individual credit decisions guiding the overall portfolio composition
- Unconstrained credit from AAA to unrated
- Unconstrained duration
- Designed to provide attractive, long-term risk-adjusted returns 6-8% over a full economic cycle

[1]ICE Global Bond Index

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Why invest in the Mawer Global Credit Opportunities Strategy?

Improve portfolio outcomes through the following potential benefits:

Attractive return profile: Flexible investment mandate leverages expertise across the Mawer global research platform to target equity-like returns with less risk.

Downside protection: Absolute return focus acts as a portfolio hedge.

Global exposure: Investment breadth across geography, sector, and rating. Reduces home country bias.

Effective Diversification: Helps lowers equity risk concentration in investors' portfolios and diversifies traditional fixed income exposure.

Duration Flexibility: Unconstrained duration targeting that aims to protect investors' portfolios in some environments while enhancing returns in others.

Our investment philosophy

Credit markets are inefficient because of the artificial segmentation of financial assets by often unreliable credit rating, geography, and other issuer characteristics.

We believe the way to maximize the return potential per unit of risk created by this inefficiency is to provide the flexibility to invest:

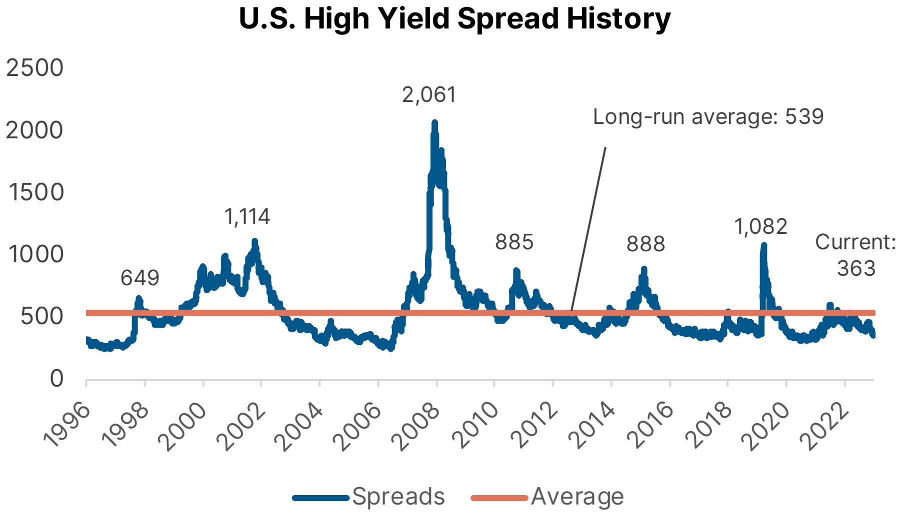
- in mispriced securities across the capital structure of issuers;
- across all rating categories;
- within major developed credit markets around the globe.

Ultimately, this produces into an "unconstrained" portfolio.

Dynamic investment approach

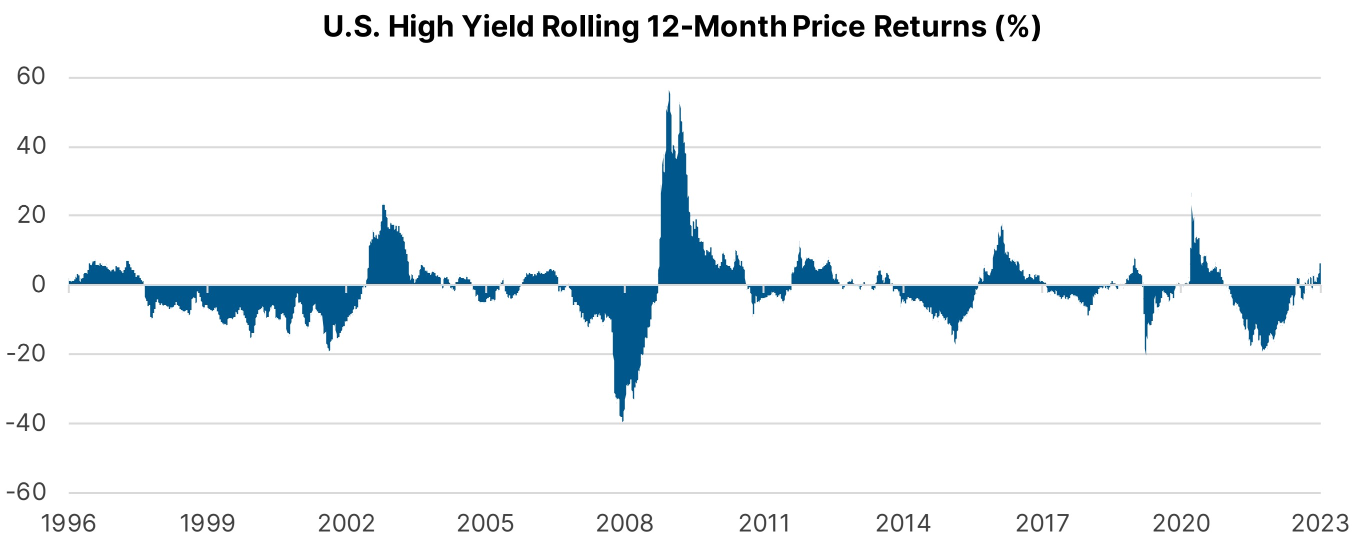
Active management acknowledges and respects credit spreads can stay tight, and yields low, for long periods. Shifting to higher credit quality and shorter duration mitigates risk in these expensive markets. When markets are cheap or distressed, a dynamic approach calls for taking advantage of the opportunity, rapidly and decisively shifting into lower credit quality positions.

Chart 1: Valuations are highly cyclical in credit markets



Source: ICE BofA data as of December 31, 2023

Chart 2: Capital appreciation is highly cyclical as well



Source: ICE BofA data as of December 31, 2023

For example, high yield credit spreads—the compensation for assuming credit risk embedded in yield— exhibit cyclical patterns and are currently well below historic averages. This suggests a more conservative approach to high yield is warranted at this stage of the cycle. Retaining the flexibility to move into and out of fixed income sectors as valuations fluctuate is a structural advantage of an unconstrained investment mandate.

Our investment process

The analytical work for possible issuer inclusion in the Global Credit Opportunities Strategy follows a bottom-up, fundamental research process.

The credit investment process derives the following:

- **Mawer credit rating.** An independent internal assessment of an issuer's creditworthiness. This assessment is used for valuation purposes. If we view an issuer as BBB, and the external rating agencies and the market view the same issuer as BB, we may establish a large position in the issuer's securities.

- **Mawer margin of safety.** For lenders, understanding what happens if something goes wrong is imperative. The downside risk of an investment is managed through understanding capital structures and covenants. The legal remedies afforded lenders surface through a review of terms and conditions contained in credit agreements, offering memorandum, and trust indentures. This analysis results in a "Mawer margin of safety" and is expressed as a numerical percentage estimating the likely recovery value of a security in the event of a default or distressed sale.

A robust process identifies what to buy and permits investing with conviction. Investments are sized to be impactful based on our informed credit judgments. If our analysis identifies an undervalued security, we will take a significant weight. That said we won't deploy all our risk in any one security, but we won't diversify away return potential either.

Our fixed income team

Brian Carney is the portfolio manager of the Mawer Global Credit Opportunities Strategy.

Brian joined the firm in 2023. He has over 30 years of experience in the investment industry, including roles with responsibilities spanning portfolio management, corporate research, counterparty risk management, rating agency advisory, syndication, and trading.

Mawer Global Fixed Income Team	
Canadian Core Universe	**Global Unconstrained Credit**
Portfolio Manager: Crista Caughlin	Portfolio Manager: Brian Carney

Shared Resources		
Macro Analyst and Trader	**Quantitative Analyst**	**Credit Analysts**
Max Moore	Stefanie Wei	Brian Carney Curtis Elkington Sandro Morassutti

All members of the fixed income team contribute to managing the strategy. However, the “team” as we think about it is the entirety of Mawer’s investment research group. The conclusions, insights, and observations of every team member on specific companies, and markets more generally, are all valuable to the credit selection process.

What is our competitive advantage?

1. **Investment Professionals.** Our research team executes bottom-up, fundamental research across the capital structure of companies around the globe. Our credit team plugs directly into the broader investment team, accessing their conclusions, insights, and knowledge facilitated by our open, non-hierarchical culture which encourages candid communication and fosters trust.

2. **Installed Knowledge Base (M42).** Insights on thousands of companies worldwide are catalogued and shared with the entire research team through our proprietary M42 database. M42 contains information on over 1,000 issuers that are included in the ICE Index, representing more than half of the market value of the investable universe for the strategy. This provides differentiated global connectivity and coverage. Our credit team will benefit from, and continue to contribute to, the M42 library.

3. **Screening Process.** We’ve developed a proprietary screening tool to screen and isolate potential investments of interest from the investable universe of over 3,600 issuers, and 30,000+ bonds. The process helps us to identify interesting situations from all the major credit markets—USD, €, £, CAD, ¥ and AUD.

4. **Unconstrained Investment Parameters.** The strategy’s unconstrained credit and duration parameters maximize the likelihood our process will successfully preserve capital in expensive markets and opportunistically deploy capital in periods of chaos and dislocation. We buy securities we believe are trading cheaply to their intrinsic value based on our proprietary insights and security selection abilities. We seek to exploit inefficiencies and illiquidity across the capital structure and in all markets.

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Place in investors portfolios

The Mawer Global Credit Opportunities Strategy attempts to solve investors' fixed income challenge—improving returns while better navigating risks compared to traditional strategies. Investors may want to consider migrating to actively managed fixed income where credit risk and interest rate risk are managed depending on stage in the investment cycle.

A core fixed income substitute: Some investors commonly see unconstrained global credit as a substitute for a large portion of an existing traditional fixed income allocation. This strategy can target a more attractive expected return profile than traditional fixed income without a commensurate increase in risk.

A fixed income satellite: For investors that want to maintain a traditional core fixed income exposure (for example pensions that want duration exposure to hedge liabilities), a satellite allocation to this strategy can be a return-seeking credit focused compliment.

An equity substitute: Some investors use unconstrained global credit strategies to reduce the equity concentration risk in their portfolios without materially sacrificing return potential. The strategy also targets a smoother return profile than equities. In other words, the long-term destination may be very similar but the experience along the way can be more comfortable in an unconstrained global credit strategy.

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