Portfolios RE: Constructed with small caps

Event Summary

Key takeaways

- Small caps have shown an ability to outperform to the upside during market recoveries by adding alpha and a performance boost when markets regain their footing.
- We believe the bear market is coming to an end in Asia and while it is too early to add global cyclical exposure, the team has been adding quality growth to portfolios.
- Among Canadian small caps, US dollar exposure should provide nice tailwinds to many companies in the fund.

Why small caps?

Small caps have shown an ability to outperform to the upside during market recoveries by adding alpha and a performance boost when markets regain their footing. This is demonstrated when the MSCI ACWI Small-Mid Cap Index outperformed the MSCI ACWI Index during the period of 2003-2022. The message is clear: small-mid cap exposure brings a performance advantage.

This chart represents periods from July 1997 to September 2022 when the global equity market fell by at least 10%.
Source: Morningstar

What positioning changes have the Mackenzie Growth Team made on small and mid cap companies in the US given the Fed's aggressive action to tame inflation?

On the US macro front, we are seeing a slowdown, especially in areas like manufacturing and housing. We don't plan to increase our cyclical exposure given the foreseeable slowdown of the overall economy, but continue to see opportunities in beaten-down high-quality growth companies within the small and mid cap space. Examples of growth companies added include the following:

  - Alteryx: data preparation and analytics, well positioned, new management & sales forces
  - Charles River Labs: dominant contract research organization (CRO) in early clinical work, growing contract development and manufacturing in the cell/gene therapies area
  - CoStar: real estate information services – core is commercial, new entry into single family residential

There have been major world issues centred around Europe. What has been the impact on European currencies and what opportunities are in the European market?

With the euro at a historical low compared to USD, we believe the euro will improve competitively through exports, which far outweigh the higher-interest debt payment. Given the uncertainty of the overall economic environment, as well as the rising living costs, we are not increasing exposure to consumer discretionary, and in the meantime, maintain our underweight positions to more cyclical industries. We will continue to focus on fundamental trends in energy efficiency, rising health care costs, and increasing demand of productivity in food production.

- Some examples of investments focusing on these trends include:
  - NIBE: leading global producer of heat pumps
  - Munters: energy efficient building ventilation
  - Genus: world-leading animal genetics company
  - DiaSorin: global diagnostics company in fields of disease detection and preventative testing

How has inflation affected the Asian market?

Given mild inflation, Asia shows more policy independence compared to the rest of the world. The yen is very cheap, which makes Japanese companies attractive. We believe the bear market in Asia is finally coming to an end, and have noticed attractive opportunities appearing in Japan, Hong Kong, China and Australia. We still think it is too early to add global cyclical exposure but have been slowly adding quality growth to our portfolios.

- Some companies we recently added:
  - Mani: Japanese medical goods and equipment manufacturer
  - Kingdee: Chinese enterprise software developer with large addressable market
  - Cleanaway: leading waste management services provider in Australia

What's the benefits of adding Mackenzie Global Small Mid Cap Fund to client portfolios?

This fund has a naturally low correlation among three regions by incorporating a diverse range of high-quality small and mid cap businesses across the world.

What is an appropriate small and mid-cap exposure?

According to Morningstar, only 6% of assets are allocated to North American and international small and mid cap stocks. We believe there is an opportunity to increase small and mid cap exposures, and we found roughly 23% was the sweet spot for global small-mid cap inclusion, providing both enhanced return with only a marginal increase in risk.

Why Mackenzie Canadian Small Cap Fund?

- The team is focused exclusively on the Canadian small cap universe of stocks, with decades of experience. The team focuses on minimizing uncontrollable risks, such as market timing risk and sector exposure risk, and places a greater emphasis on selecting the best investment opportunities.
- A strong preference for stocks with quality attributes, that demonstrate steady growth, along with strong internal cash flows and solid balance sheets.
- Critical in the small cap space, the fund invests in companies with consistency of management and a demonstrated track record of outperformance.

What differentiates Mackenzie Canadian Small Cap Fund from other small cap funds?

The fund is more diversified than the benchmark and is systematically underweight volatile resource companies and is overweight exposure to industrial, financials, consumer discretionary and real estate. The portfolio is not just a collection of junior mining and unproven exploration companies that many generally associate with Canadian small caps.

What part of the Canadian small cap space are you most excited about?

- We are seeking to tap into a completely different set of growing, innovative small companies that we believe will one day become large companies.
- We look at companies with pricing power in the inflationary environment, such as insurance companies
- The following example demonstrates our process:
    - IBI group: one of the top holdings added in mid-2020. This is a stable building infrastructure business with a good balance sheet and has reduced days of sales outstanding (making faster collections) over the years. It was trading at a very attractive valuation when we bought it. It was recently acquired at a premium.
- We believe valuations have come down to a level which makes companies attractive again.
- In the current environment, US dollar currency exposure should provide nice tailwinds to many companies in the fund.

What weight should the fund have in a client portfolio?

We think this fund deserves a spot in your client's portfolio. With strong performance, any amount would have a positive impact so the more you add, the greater the return potential. The mix is at 50/50 with the S&P/TSX, but 10%, 15% or 25% of asset allocation may all be justified by improving the risk adjusted profile of your portfolios.

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