2024 MARKET OUTLOOK

MACKENZIE Investments

BLUE BOOK

GLOBAL MACRO OVERVIEW

There is safety in numbers

SUMMARY POINTS

1. Modest year for equities
2. Quality is critical in 2024
3. Pick your spots in today's markets

Steve Locke
CIO, Fixed Income & Multi-Asset Strategies

Lesley Marks
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GLOBAL MACRO OVERVIEW

A time for reflection

As we reflect on this past year, we are reminded that getting the big trends mostly right will not always lead to the outcome that you anticipate.

Our investment thesis was based on the belief that fighting the last mile of inflation would prove more difficult than expected, forcing central banks to continue with their tightening bias, and that geopolitical risks would remain elevated. As the year progressed, this thesis largely played out and we became more concerned about the outlook for economic growth, which caused us to adopt a more cautious approach towards equities in our mid-year update, modestly favouring the relative safety of shorter-term bonds.

Our decision to moderately underweight equities in 2023 was based on the view that a rapid and sustained monetary tightening cycle and declining fiscal stimulus would lead to an economic slowdown that would ultimately result in corporate earnings weakness and, in turn, equity prices. Economic fears would then start to weigh on central bankers, causing them to move to a less hawkish stance and helping to level off the upward trend in yields.

The Canadian and to some extent, European economies followed our playbook with a weakening consumer, a slowing economy and weaker equities. The one major outlier was the U.S. economy, which proved to be much more resilient, as evidenced by the strong labour market, robust consumer spending and stubborn inflation. This fuelled Treasury yields higher. With stability appearing late in the year, the bond market narrowly avoided negative returns (as measured by the FTSE Canada Universe Bond Index). While the S&P 500 did fade in the third quarter due to the impact of ‘higher for longer’ interest rates, big price movements in the “The Magnificent Seven” (Apple, Microsoft, Alphabet, Amazon, Nvidia, Tesla and Meta) resulted in healthy year-to-date gains. Investors sought refuge in these names – also the most crowded trade of the year – pushing up these seven stocks by an average of over 80% by the end of October.

We adopted a more cautious approach towards equities in our mid-year update, modestly favouring the relative safety of shorter-term bonds.

GLOBAL MACRO OVERVIEW

Outlook for 2024

As we turn the page on another calendar year, we revisit our investment thesis to formulate our outlook for 2024 with the view that elevated risks imply "safety first" as our investing motto. Given the dominance of interest rates in the macroeconomic outlook, we can start there.

The Bank of Canada (BoC) has likely finished raising its policy rate for this cycle. The effects of the cumulative rate hikes are beginning to be felt in the Canadian economy. While inflation is now well below its peak level, it remains above the BoC's target. It appears, however, that interest rates are at high enough levels to restrain interest-rate sensitive areas of the Canadian economy like real estate. Our central bank is likely to keep interest rates at this level until more material signs of lower inflation appear. As a result, a slower economic growth trajectory for Canada is most likely in the cards for 2024. Should Canada show signs of a mild recession, the BoC could modestly lower rates during the year, irrespective of policy rate movements by the U.S. Federal Reserve.

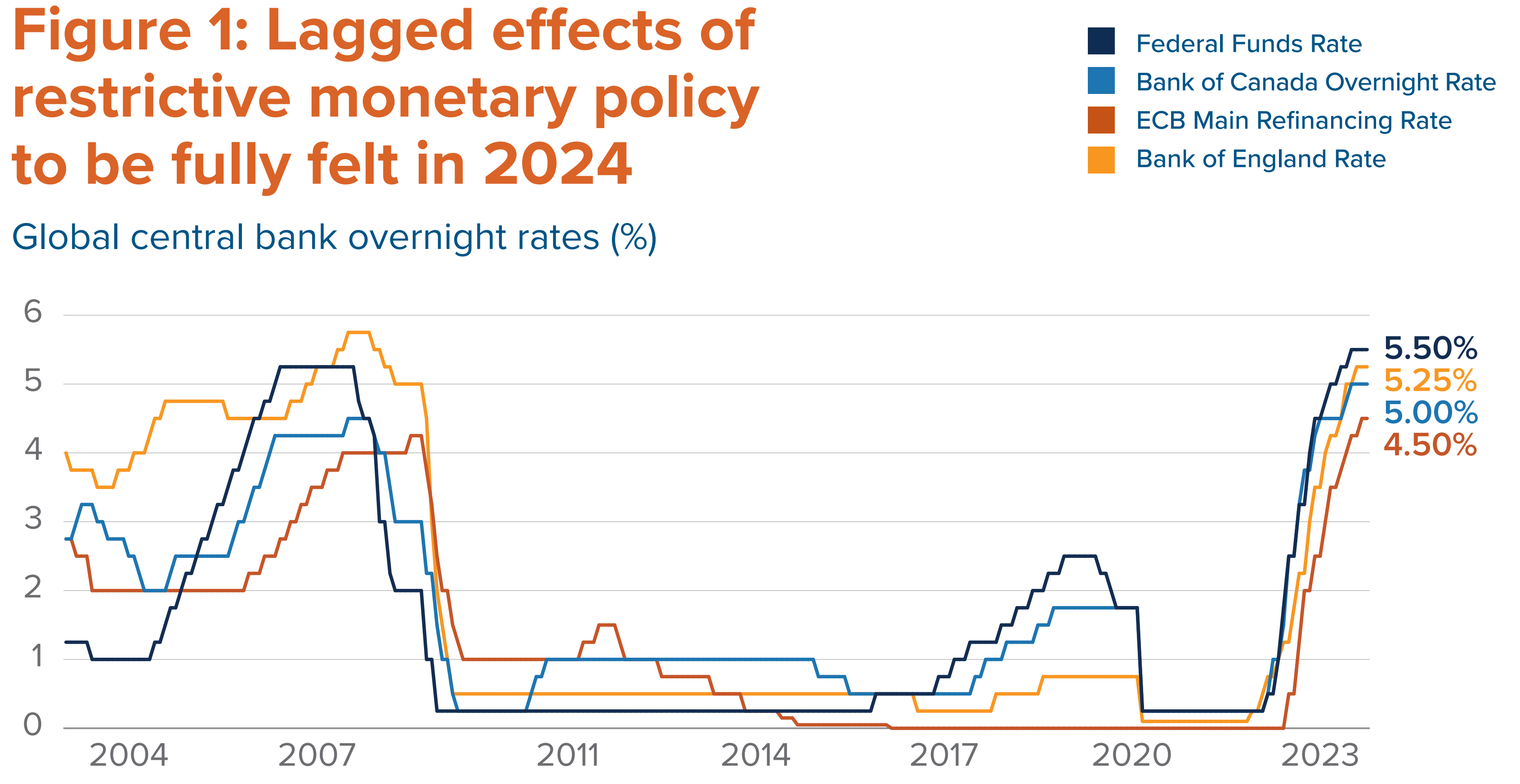
The resilient U.S. economy has withstood the tightening of financial conditions well. The U.S. housing market is less interest rate sensitive than Canada's due to the prevalence of long-dated, fixed-rate mortgages. A very low percentage of U.S. residential mortgages are scheduled to reset to higher mortgage rates in 2024. Household consumption has held up well, in part, due to wage growth and a drawdown of savings. There are some signs that economic momentum is slowing, but without a sufficient weakening of inflation or GDP, the Fed is unlikely to lower its policy rate from 5.5%. The market is currently pricing in expectations of approximately 100 basis points of Fed Funds Rate cuts in 2024, but if the U.S. economy only slows slightly it is more likely that the Fed will keep the policy rate steady through the year.

Brighter outlook for bonds

We believe that most developed economies have moved past peak inflation, which is allowing other major central banks to pause or end rate-hike cycles while their inflation rates normalize, although this may take some time. Elevated geopolitical tensions will remain a constraint on energy pricing for some regions and, more generally, will inhibit trade in some critical goods. A slower global growth outlook, combined with higher interest costs on debt, will increase fiscal pressures gradually for many countries in 2024 (see Figure 1).

Figure 1: Lagged effects of restrictive monetary policy to be fully felt in 2024

Global central bank overnight rates (%)



Source: Bloomberg, October 31, 2023.

GLOBAL MACRO OVERVIEW

With slowing economies and tight monetary policies in place, Canadian and U.S. yield curves should remain flat or inverted but then stabilize after almost two years of volatility. Stability at these yield levels makes bonds an attractive asset for income-oriented investors for the first time in over a decade. Canadian investment-grade corporate bonds offer yields in the range of 5.50 to 6%, and diversified high-quality bond portfolios are in a better position now to provide balanced portfolios with negative correlation to equities if a market correction materializes. Corporate bond spreads are expected to be relatively stable for higher-quality issuers because these companies are entering 2024 with fundamental strengths, such as high-interest coverage ratios.

Earnings growth moderate

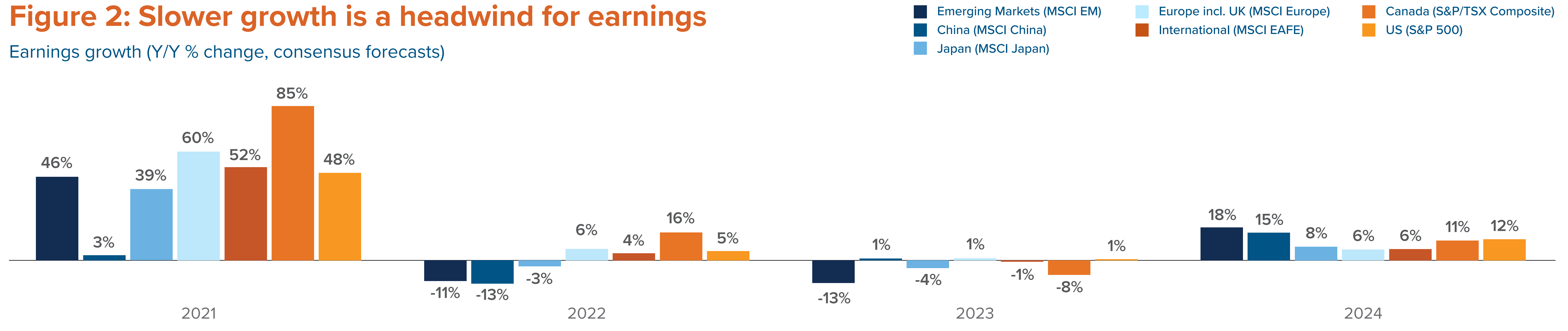
Of course, the impact of the macroeconomic outlook is not isolated to bonds. The outlook for equities is based on the expectation for earnings and the price or multiple you are willing to pay for those earnings.

In the short term, earnings growth can be harvested from cost discipline, deferred capital expenditures and price increases, but sustainable earnings growth can only be derived from a backdrop of economic growth (see Figure 2). We continue to believe that several headwinds exist on this front.

Interest rates being at a 16-year high will eventually have a dampening effect on just about every large expenditure for businesses and consumers. Inflation, and specifically wage inflation, will temper earnings growth in 2024. The higher prevalence of labour strike activity portends future upward pressure on wage growth. There is also a bounty of less obvious headwinds to earnings growth, such as the drawdown in pandemic savings (a post-pandemic phenomenon with a limited shelf life), resumption of payment of student loans in the U.S. and declining or diverted fiscal expenditures, are just a few examples. We are skeptical of the 8% to 10% consensus earnings growth expectations for next year. The picture is more mixed when we consider the second driver of stock prices: the price paid for earnings. The two primary factors that impact multiples are interest rates

Figure 2: Slower growth is a headwind for earnings

Earnings growth (Y/Y % change, consensus forecasts)



Source: FactSet, October 31, 2023.

(due to the usage of a discount rate to value future cash flows) and sentiment (the level of optimism or perceived risk level).

With interest rates peaking in the near-to-medium term, this could create the positive market conditions that equity investors look for, as they did when equity markets bottomed in late 2022. But this could also be negative for equities if the prospect of a decline in interest rates is associated with the onset of a meaningful recession. Although a favourite area of speculation is whether the recession will be shallow or deep, that becomes difficult to predict ahead of an actual recession.

Shifting sentiment

If we've learned anything from this past year, it is to never under-estimate the role of sentiment in determining market outcomes. Although we saw a persistent increase in interest rates and weak earnings momentum, bullish sentiment towards high beta, high price momentum stocks pulled markets higher resulting in a multiple expansion led rally at precisely the time that multiples should have been contracting. Sentiment is also a mixed picture as it can be easily swayed, based on the geopolitical events of major conflicts in Europe and the Middle East. There is also an election in the U.S. in 2024, and the uncertainty around the outcome may add to further risk aversion for equity investors.

Despite the recent short-term sentiment-driven rallies, the safest time to invest in equities is when valuations are low and negative earnings momentum is bottoming. While it is premature to bet on these trends, we believe an opportunity will present itself later in 2024, where equities will truly reflect the lower earnings backdrop and a buying opportunity will ensue. In the meantime, portfolio risk should be aligned with your risk tolerance, focus on quality in your investments and find protection in safe havens while you wait.

If we've learned anything from this past year, it is to never under-estimate the role of sentiment in determining market outcomes.

Investment roundtable

Tight financial conditions persist around the globe and yet so do compelling investment opportunities.

Rajan Bansi
VP Investment Strategy & Portfolio Solutions

The Mackenzie Investment Roundtable is an opportunity for fixed income and equity portfolio managers from around the world to share how they are positioning their portfolios for clients at a time when many global central banks prepare to end their historic tightening cycles. These views not only highlight opportunities they're finding by asset class and geography, but also by style and sector.

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Canadian equities

Will, within Canadian equities, how are you positioning the portfolio?

Will Aldridge: We always look to balance quality and valuation. Today we're seeing a lot of high-quality Canadian companies on sale. Valuation multiples are low. Canadian stocks are looking very attractive. Consider our Canadian banks like TD Bank, RBC and BMO, our energy companies like Canadian Natural Resources or our consumer companies like Alimentation-Couche Tard, Loblaw and Canadian Tire – these companies are all focused on managing growth, driving margins and distributing capital to shareholders. And we don't have to pay up for this quality, which is unique to Canada at the moment.

Let's move to the Canadian consumer. Is this a space you're avoiding given all the headwinds?

Aldridge: We always ask ourselves – what is priced into stocks? And today we are seeing a lot of negativity priced in, particularly in the consumer discretionary space. We think the Canadian consumer will be resilient. Yes, there will be challenges the consumer will have to navigate. But we are optimistic, particularly over the medium term, and think consumer stocks are pricing in a fairly dire outcome. Canadians will certainly be watching their spending more closely, and looking for value in areas like private label and discounted offerings. But our well-managed domestic retailers are positioned to continue to cater to Canadians' needs while benefitting shareholders as well.

Richard, how would you characterize the investment landscape as a value investor?

Richard Wong: Heading into 2024 the cost of capital is very relevant. We've left a 13-year period where central banks had suppressed interest rates. This in turn drove down the cost of capital and served as a tailwind to growth strategies. The environment now is very different. Fundamentals are important again and so are valuations. As value investors, we try to identify businesses that are cheap based on our estimation of intrinsic value.

You're a global manager – what's an example of a name you like given this approach?

Wong: UBS is a name we like. The company bought Credit Suisse in 2023 at a distressed valuation and they're in the process of taking out a lot of costs. It's already a major player in Asia and Europe and they bank with 50% of the world's top billionaires. They're simplifying the operating model and they should grow market share and cement their status as a leader in global wealth management. The stock trades under book value, which is a significant discount to its relevant peer group.

Bonds

How should we position Canadian fixed income given the current macro forces?

Konstantin Boehmer: Bonds at the front end of the curve typically thrive following the final rate hike by a central bank, and the Bank of Canada (BoC) is either there or very close to getting there. Yields compensate investors well at current levels. If the economy goes south, we'd expect these bonds to rally as the market prices in rate cuts. The base case seems to favour "longer" as opposed to "higher" at current levels as the BoC tries to engineer a soft landing.

Caroline Chan: The short end will remain attractive because it's driven by policy rates. We'll continue to look for opportunities in corporates, but on the shorter end of the curve because of the volatility we expect on the longer end. Right now, I particularly like the safety and yield pickup that regulated utilities provide.

What's the risk/return profile within investment grade bonds given these cross currents?

Mark Hamlin: It's about opportunistic trading in and out of specific names given spreads. We're overweight credit risk versus the index, but at the same time our allocation to high yield remains at the lower bound just given tightness. Should tightness of spreads widen from current levels we'd use liquidity in high-quality bank paper to take advantage of lower rated credits where we have confidence in the name and its operators.

U.S. equities

Katherine, 2023 was all about the "Magnificent Seven" in U.S. equities – how are you positioning for 2024?

Katherine Owen: We are clearly in a new macro environment and that's a tricky transition for investors. This is the time to own quality companies that have the financial muscle to invest in the business, increase their moat, extend their leadership position, and extend their competitive advantage.

What's an example of a company that fits this profile?

Owen: Motorola Solutions is an under appreciated gem. The company provides the communications network for first responders. They're the dominant player and they have a mission critical role in emergency response. The company also makes the handsets that enable first responders to speak to each other. It's a resilient operation, but they're using their strengths to further invest in the business. They're drawing on their trusted reputation to provide the software for 911 command centres, but they're also investing in capabilities to provide video cameras for surveillance at hospitals and schools, as well as body cams for police officers.

What should investors make of the artificial intelligence (AI) tailwind some names enjoyed through much of 2023?

Owen: Our thesis, which played out in Q3 earnings, was that companies really need to demonstrate that AI is a real business driver through their top line growth. Companies who can't show these benefits are at risk of the valuation re-rating they enjoyed in 2023 dissipating in the coming quarters.

INVESTMENT ROUNDTABLE

Asia

Nick, what's your outlook in Asia for equities?

Nick Scott: The macro considerations we're seeing in North America are not the same given that Asia didn't go down the route of extreme monetary policy, so the inflationary snapback has been very different. Inflation has been an issue for Japan, but that's a function of its approach to managing rates through yield curve control.

You've compared the investment landscape in Japan to America in the 1990s – why?

Scott: It's taken 30 years to run off the impact of the Japanese asset bubble. But return on capital employed for the average Japanese corporate has now caught up to its U.S. peers and we are seeing shareholder friendly approaches to governance and capital allocation.

What's an example of this?

Scott: Azbil is a Japanese manufacturer of air conditioning systems installed in commercial buildings, factories and data centres. The company has reduced the total number of board directors, made independent directors the majority, and set up nomination and remuneration committees chaired by independent members. The business can generate rich cash flows and does not require a large investment to grow. The company has increased shareholder return, and now distributes most profit through dividends and buybacks.

Hussein, why is the Ivy team also drawn to Japan?

Hussein Sunderji: As Nick said, in addition to the quality and strength of many business platforms in Japan, a lot of companies have really strong balance sheets after a multiple decade deleveraging process. We regularly compare Japanese companies with their European or North American peers, but oftentimes the Japanese have healthier balance sheets. We are also seeing more share repurchases, progressive dividend policies and an articulation of return on capital goals. Look at Seven & i Holdings Co., Ltd., which operates 7-Eleven globally. They have a dominant share in a concentrated Japanese market and a number of tailwinds in its U.S. operations. More recently, it's accelerated improvements to corporate governance, developed focused policies around capital allocation among its holding companies, and sharpened its approach to shareholder returns.

INVESTMENT ROUNDTABLE

Europe

Seamus, how are inflation, higher rates and geopolitical risks impacting your positioning in Europe?

Seamus Kelly: Our view is expressed through a barbell strategy. We like select eurozone banks, with strong capital positions. The higher interest rate environment offers a strong earnings and capital return profile, which is a significant change from the aftermath of the global financial crisis. Against financials, we are overweight healthcare as our preferred defensive sector where we have held Novo Nordisk for some time, given its attractive diabetes and obesity franchise.

It sounds like you're favouring the larger cap names within Financials?

Kelly: Yes, we like the bigger names, such as BNP and ING. These are the most resilient with the strongest balance sheets. They're also cheap from a valuation perspective right now, so you don't have to go down the quality curve to gain exposure.

What's another long term theme you're positioned for in 2024?

Kelly: As part of Europe's energy transition, electrification is an important secular theme. The capital expenditure required across renewable energy, building renovation, and mobility will benefit our portfolio holdings in Schneider Electric and Prysmian.

Hadiza, you have a global view of fixed income. We opened with Canada and have just spent time on Europe. What are some forward looking insights into these markets not yet surfaced by the group?

Hadiza Djataou: Europe is an interesting case of contrast, because on the one hand inflation is showing to be more persistent but on the other hand growth is slowing down. For exporting economies like Germany and France, I think you can liken that pain to the economic slowdown in China and the European Central Banks delayed start to its hiking cycle.

Canada is highly sensitive to interest rates owing to the consumer's balance sheet. We already have some deterioration in consumer data. Debt service costs for households has increased tremendously thanks in part to variable rate mortgages. From that perspective, as we look to 2024 and beyond, the BoC would likely have to be the first to cut rates among central banks in the G10.

What's in store for 2024?

There are plenty of trends and issues to pay attention to in any given year, but we're keeping a close eye on three areas in particular.

The energy transition, the return of fixed income and increased attention on growth and innovation will all influence markets in 2024 and beyond. Here's what you need to know about each area.

1. **The great energy transition**
2. **Bonds return**
3. **Growth & innovation**

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THEME 1

The great energy transition

This transition has left the station. While 2022 and 2023 necessitated a pragmatic approach of transitioning to low carbon sources of energy, they've also highlighted the importance of diversification and accessibility. Through Mackenzie's boutique structure, we're able to provide diversified perspectives to investing in this global transformation. Our experts believe that 2024 will bring continued investment and advancement in solar generation and storage, electric vehicle manufacturing and infrastructure, and a more prominent place for natural gas with carbon capture technology in our ability to meet climate targets.

Renewables are central to the energy transition, but alternatives like wind and solar still face some significant challenges. What are the issues?

John Cook: Wind is currently facing several headwinds – pun not intended. Let's categorize these challenges as financing costs, input cost inflation, and connectivity costs. It takes a longer time to install wind farms versus solar utilities or rooftop solar. This is where higher interest rates come into play because wind projects have higher overall construction financing costs. Second, wind turbines are massive pieces of machinery, with some offshore wind turbines almost rivalling the height of the Eiffel Tower. These turbines require tremendous amounts of steel, concrete and epoxy, not to mention precious and rare earth metals. All these materials are more expensive than they were three to four years ago. The final piece is connectivity. It's presently costing more to connect wind generation to the grid. All these factors play into the economics for wind.

Solar is the cheapest way in the right regime to produce an electron. It's cheaper than coal, natural gas, and significantly cheaper than new nuclear, or hydro. According to the 2023 Lazard Levelized Cost of Energy+ (LCOE+) comparison, utility-scale solar can now be sold economically for as low as US2.4 cents/kWh, which compares to the combined cycle natural gas average of US6.2 cents/kWh. Like wind, it's still intermittent, but the intermittency is more predictable. Storing solar energy produced during peak daylight hours for consumption in the evening reduces demand from other non-renewable sources.

What's an example of an investment in renewables that brings your approach to life right now?

Cook: French power utility ENGIE is a large integrated generator that is itself on an energy transition journey. They are one of the largest developers of renewable energy in the world. It is not a pure play, however. They still have some natural gas and coal represents about 5% of its generation output. They have announced a hard termination date for all coal by 2027. The company's stock valuation is significantly more attractive than many pure renewable players, with far less ambitious renewable development pipelines.

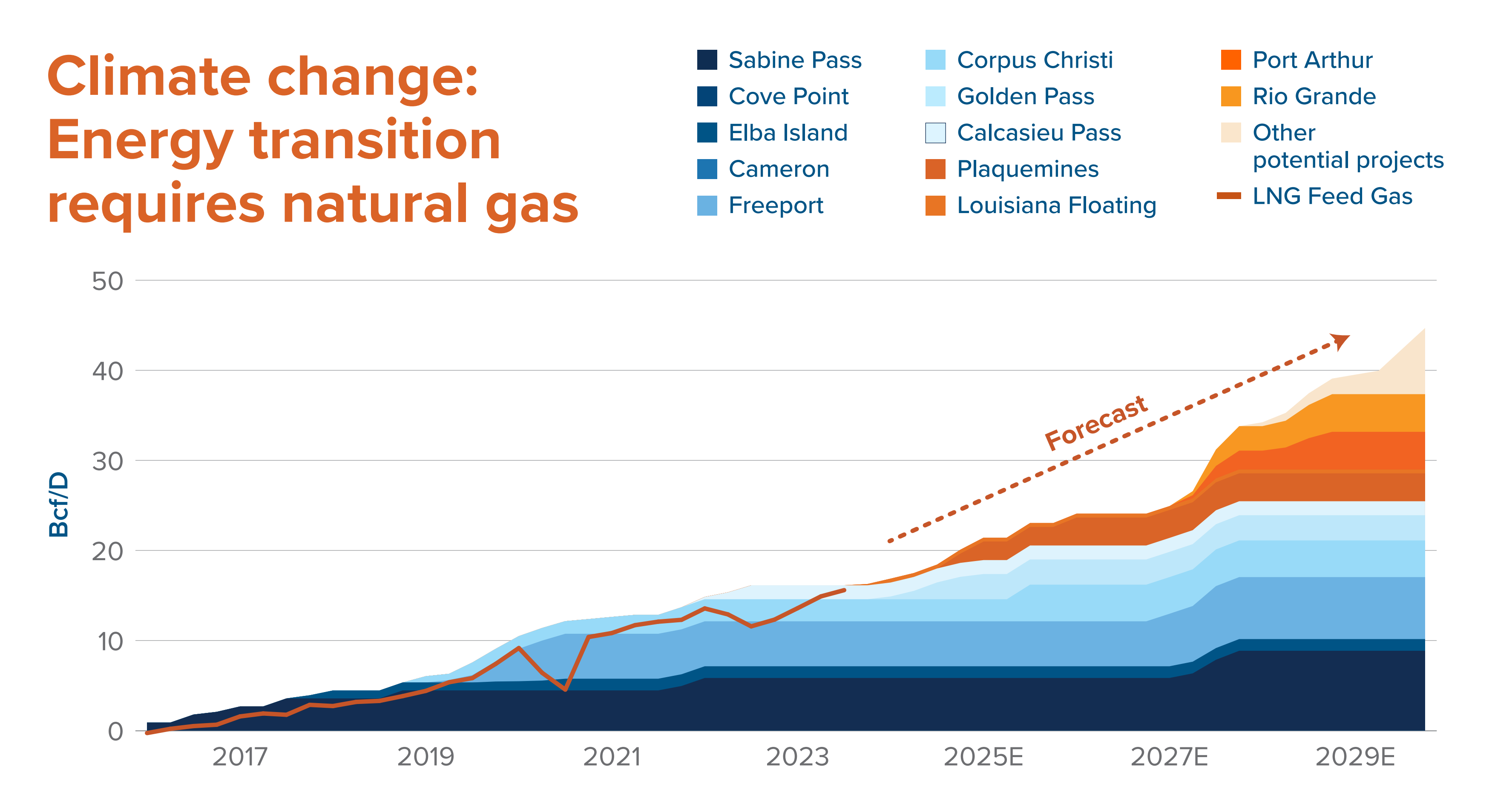
What's the role of the resource sector in the energy transition?

Benoit Gervais: The resource sector is involved in both old and new sources of energy. The old sources are fossil-fuels with a carbon footprint. The new sources are renewables, though materials still play an important role in the production, transmission and storing process. Society is slowly moving out of coal, which has a high carbon footprint, to a combination of renewable energy sources and natural gas. The latter is still a fossil fuel, but it has a much smaller carbon footprint.

THEME 1 THE GREAT ENERGY TRANSITION

Expand on the role of natural gas.

Gervais: Cheap coal is currently powering the schools and hospitals in developing countries, such as India and China. The world's energy needs must be met with solutions that are reliable, affordable, feasible, and acceptable. China is in a league of its own with respect to solar energy production, but the need for energy and cost considerations still leaves a place for fossil fuels. Natural gas could serve as a toggle to meet energy demands and it has a much lower carbon footprint than coal.



Sources: Company reports, EIA and Peters & Co. Limited estimates.

What policy initiatives in 2024 could spur investment in Canada?

Gervais: In 2022, the U.S. passed the *Inflation Reduction Act*, which has incentives in the hundreds of billions of dollars to support renewable power and reduce pollution. This includes generous incentives to companies that operate in the carbon capture and storage, or CCS industry. We own one company that has superior technology for capturing carbon at very low concentration levels in an economical manner.

We have not seen this type of policy framework yet in Canada. We have to implement the right carbon policy that has incentives that will spur companies to act and invest.

How should investors think about the resource sector and the electric vehicle (EV) industry?

Gervais: EVs and batteries are part of a broader theme – electrification. Extracting enormous amounts of copper and lithium are critical in the electrification journey. We need to see the price of copper move higher to support greater levels of extraction. Meanwhile, lithium is one of the most common elements in the Earth's crust and the extraction is economical depending on the grade.

THEME 1 THE GREAT ENERGY TRANSITION

Why are private markets in some ways better positioned to fund the energy transition?

James Cowan: Much of the energy transition involves investing in infrastructure that deliver essential services. The owners of these privileged assets typically operate within a highly regulated environment where there are other significant barriers to entry and/or operation. These assets also have a long capital life, with stable, predictable long-term cash flows linked to inflation. Entering 2024, we believe private markets are well positioned to fund these assets because you're investing for the next 20 to 30, even 50 years, not the next quarter. This type of investment requires patient capital that is close to management and has a strong understanding of the business.

Right now, are there parts of the EV market better suited for private investing?

Cowan: Currently, there are private operators capable of building out the infrastructure of EV chargers in homes or commercial properties, similar to how the electric water heater business model works. A private company will install the technology in the home or at a commercial property and then collect long-term rental income from the user. With a transition away from gasoline powered automobiles to electric vehicles, these stand to be sticky, long-term revenue streams. EV adoption is held back by "range anxiety" among prospective buyers. EV chargers at home or the office are a logical solution, but it's not economical for everyone due to the cost. The solution is a great example of how patient private capital is best suited to fund many opportunities as part of the energy transition. The other reason I'm excited about EV chargers is that a fully charged car could download power onto the grid, providing energy for others. That makes sense for the car owner. EV chargers are an example of how modern communities are able to distribute energy – everybody is a bit of a power generator in the future.

THEME 2

Bonds return

Yields have breached highs not seen since the 2008 financial crisis, which means there is now an abundance of opportunity for investors seeking income from bond exposures. This new paradigm has forced asset allocators to rethink strategic positioning as there are once again merits in balanced portfolios. But risks abound as we enter a higher-for-longer interest rate regime. It is imperative to have a clear view on global fixed income, to understand the potential drivers of performance within rates and credit markets and be aware of any hazards moving forward.

We expect bonds to return to the forefront of asset allocation decisions in 2024. What are some of the considerations facing the Bank of Canada right now given the influence of policy on the curve?

Dustin Reid: The BoC is determining policy as several powerful forces simultaneously push and pull. Core inflation remains relatively sticky. The labour market is running relatively hot, albeit not as hot as in the U.S., and wages remain elevated. But juxtapose that with recent economic activity. Beginning in Q2 and stretching into Q3 we saw clear evidence of a slowdown and I think the central bank is mindful of a scenario that creeps towards stagflation. Our view since the first half of 2022 is that getting inflation from 8% to 5% is one thing but getting from 5% to 2% is quite another. The BoC has to weigh hiking rates further to get inflation back down to 2% as that will increase the burden on consumers in general and mortgage holders in particular.

Let's talk portfolio construction – what are the primary reasons investors should pay more attention to bonds in 2024?

Konstantin Boehmer: First, when we look back at history, one of the best times to buy fixed income is when central banks complete their final hike of the cycle. Shorter term bonds are primarily influenced by policy rates. We know the heavy lifting by the BoC, the U.S. Federal Reserve, and European Central Bank is done. Investors are compensated well on the short end of the curve and will benefit from a rally in rates if growth falters. Second, negative correlations between stocks and bonds are back in play from a portfolio perspective. Bonds are an excellent ballast in multi-asset portfolios at current yield levels and the diversification benefits should not be overlooked. Our strategies allow us to source high-quality bonds with yields north of 6%. That's incredibly attractive if you're managing portfolios for clients and you have a target return in the mid- to high-single digits.

How do you think liquidity in the bond market will play out at the start of the year?

Boehmer: Tactical asset allocation will be important in 2024. Financial markets are processing a series of powerful cross currents including geopolitical crises, sticky core inflation, and uneven economic growth. Nothing on the radar right now suggests we'll see dislocation in fixed income markets in 2024. As we enter the new year, I would emphasize liquid positions within fixed income allocations such that liquidity is available to take advantage of opportunities as they arise. Bond funds are advantageous from that perspective as they are not only liquid, but they also allow for faster execution because an investor does not have to haggle over odd-lot pricing on individual bond holdings.

THEME 2 BONDS RETURN

Conditions in private markets have changed remarkably in the last 24 months. How does Northleaf feel about the current investment landscape?

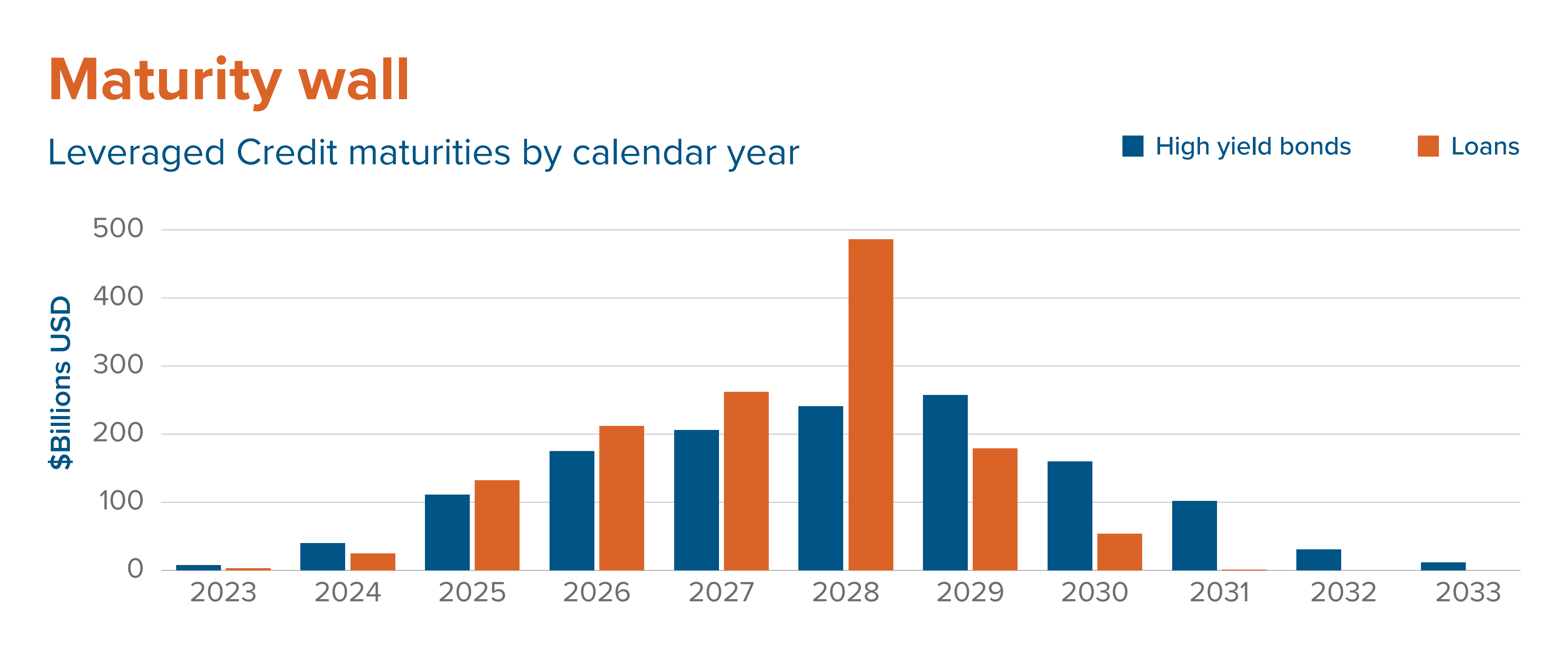
David Ross: We have found the investing environment over the last 24 months to be highly favourable and we are excited for 2024. The rise in interest rates has led to senior secured loans generating gross asset yields of around 12%. Given the evolving macro environment, lenders are also benefitting from favourable terms, including lower leverage and higher equity contributions from sponsors. Global M&A volumes and deal flow will remain muted so sourcing opportunities will be a priority. In our core geographies of North America and western Europe we expect to provide follow-on growth capital to existing portfolio companies.

In addition to positioning on the curve how will a professional money manager deliver value to investors in 2024?

Boehmer: Fixed income is not a single market where all securities move in the same direction in response to the news or exogenous factors. Yes, you need to be positioned for a rally on the short end in early 2024, but you also need to be positioned for action on the long end. We are money managers in Canada, but our team is always looking to uncover opportunities in the U.S., Europe and Asia, so our sources of value are global. 2024 is going to be a big year for credit. Interest rates have dialed up and the pot is hot for a lot of issuers. This is a fantastic time for managers who make active credit decisions. You want dispersion and you want to have differentiation between companies, because it's through skill and discipline that you'll win.

That's an appropriate segue to credit. What should we make of the "maturity wall" in the high yield market?

Dan Cooper: We look at it as more of a maturity mountain or hill versus a wall and it ultimately comes down to the ability and willingness of corporations to borrow. The ability exists, which is to say the markets are open and accessible. But, from a willingness perspective, most issuers don't need to access capital at these expensive levels with any immediate urgency. Overall, fundamentals are in decent shape for these companies. Remember, the BB segment of that market, which is the higher quality end of the high-yield spectrum, represents over 50% of the market. From a historical perspective that's a high level of representation. I think refinancing activity will occur relatively smoothly over the next 24 months as companies come to grips with the fact that we're not in that low yield environment anymore.



Source: Bank of America Global Research, ICE Data Indices LLC, September 2023.

THEME 2 BONDS RETURN

How is this theme playing out in the private credit space?

Ross: The refinancing wall is a concept that rears its head every five or six years as access to capital dries up to some extent. Whether you're a mid-market investor or a large cap investor, this concept is certainly very real. Generally, with private equity backed borrowers, we find that the owners are able to find creative solutions much earlier on. These borrowers are proactively looking for maturity extensions. They're bringing in new capital in the form of junior debt or preferred equity with payment-in-kind (PIK) coupons in order to conserve cash and de-risk the senior debt. For our investors this has created an opportunity because our borrowers are performing. We're able to get more duration on our existing loans, as well as higher fees and spreads as a result of working constructively with the owners.

Closer to home in public markets – where do you see value in the Canadian corporate market?

Cooper: Utility credits illustrate how there are pockets of value in the market, but you need skill and discipline to maximize risk adjusted returns. In general, we like utility credits, but risk adjusted returns differ across the capital structure. For example, investors can capture 8% to 9% yields in the hybrid subordinated debt of these high quality, regulated utilities in Canada. These are well run, stable businesses that are less sensitive to changes in economic cyclicality. The yields an investor can capture in these bonds are similar to those available in automotive names, which are actually highly cyclical and sensitive to consumer spending and weakening consumer balance sheets. Same yields, but very different exposure to economic cyclicality. We think, right now, you want to allocate a little bit more to a defensive sector like utilities because you're well compensated and able to avoid sectors that could see spreads potentially blow out.

One year from today, will we have an upward sloping curve and how do we get there?

Reid: Yes, we will have upward sloping yield curves in major economies in 2024, including Canada. We are going to get there through a bull steepener, which describes a change in the curve when short rates fall faster than those on the long end. In Canada, specifically, I think investors need to be positioned for a material bid on 2-year yields in 2024.

But the yield curve will still be a major theme in 2024 despite this rally because of what is going to transpire on the long end. The ability of the market to absorb supply was a developing theme in the third quarter of 2023 and I think this could carry over into 2024. Supply dynamics in the U.S. matter and it remains to be seen what yield levels the market will be willing and able to absorb through new issuance.

THEME 3

Growth & innovation

Growth and innovation occur in every stage of the business cycle. Today's environment of higher interest rates and stickier inflation means it isn't enough for investors to just identify the most compelling growth narratives. Instead, to determine long-term winners, investors must scrutinize the health of a company's balance sheet, assess management's ability to prudently invest for growth while competitors retrench, and ensure the business can navigate volatile financing conditions. From artificial intelligence to the experience economy and more, our panel of experts shares their thoughts on how investors can participate in some of the most compelling and durable investment themes of 2024.

What might the investment landscape look like in 2024?

Tyler Hewlett: It looks like another shaky year for the global economy with consumers under pressure and continued trade conflict between the major economic regions. The biggest change in the macro environment over the past 18 months is that interest rates and inflation have risen substantially. But, if one thing has become clear over that time, it's that elite companies can pass through inflationary pressures to their customers with greater success than an average company can. Regardless of the economic environment, we focus on a subset of structurally and competitively advantaged companies that are global leaders in attractive industries and generate significant free cash flow.

Greg McCullough: We're clearly in an interest rate regime that is very different from what we've been accustomed to since the financial crisis. Higher rates will push down market multiples and companies with high leverage on the balance sheet may feel acute pain. But we think our approach to investing in the growth space – seeking durable growth companies that can outperform in a variety of market conditions – holds up well when growth becomes scarcer in the economy because that's when you really see the benefit of investing in businesses with strong competitive positions, high barriers to entry, healthy balance sheets, and a high margin structure.

Ian Carew: We'll continue to be in this painful process where funding and valuation expectations in the private markets move back into alignment with public markets. We expect to see a continuation of deal structuring that has seen the inclusion of liquidation preferences or convertible structures to push the valuation issue down the road because people don't want to reprice their companies and crystalize a write-down. This creates an opportunity to participate in the secondary markets. We've been active here and this should remain an opportunity in the near-term if conditions aren't ripe for IPO launches and/or M&A activity dries up. But great companies are started at every part of the cycle. This part of the cycle is more difficult, but that is when you find true entrepreneurs. These entrepreneurs are very careful with their dollars, and you should get more rigorously built startups in this environment.

THEME 3 GROWTH & INNOVATION

How should we think about artificial intelligence (AI) as an investable theme?

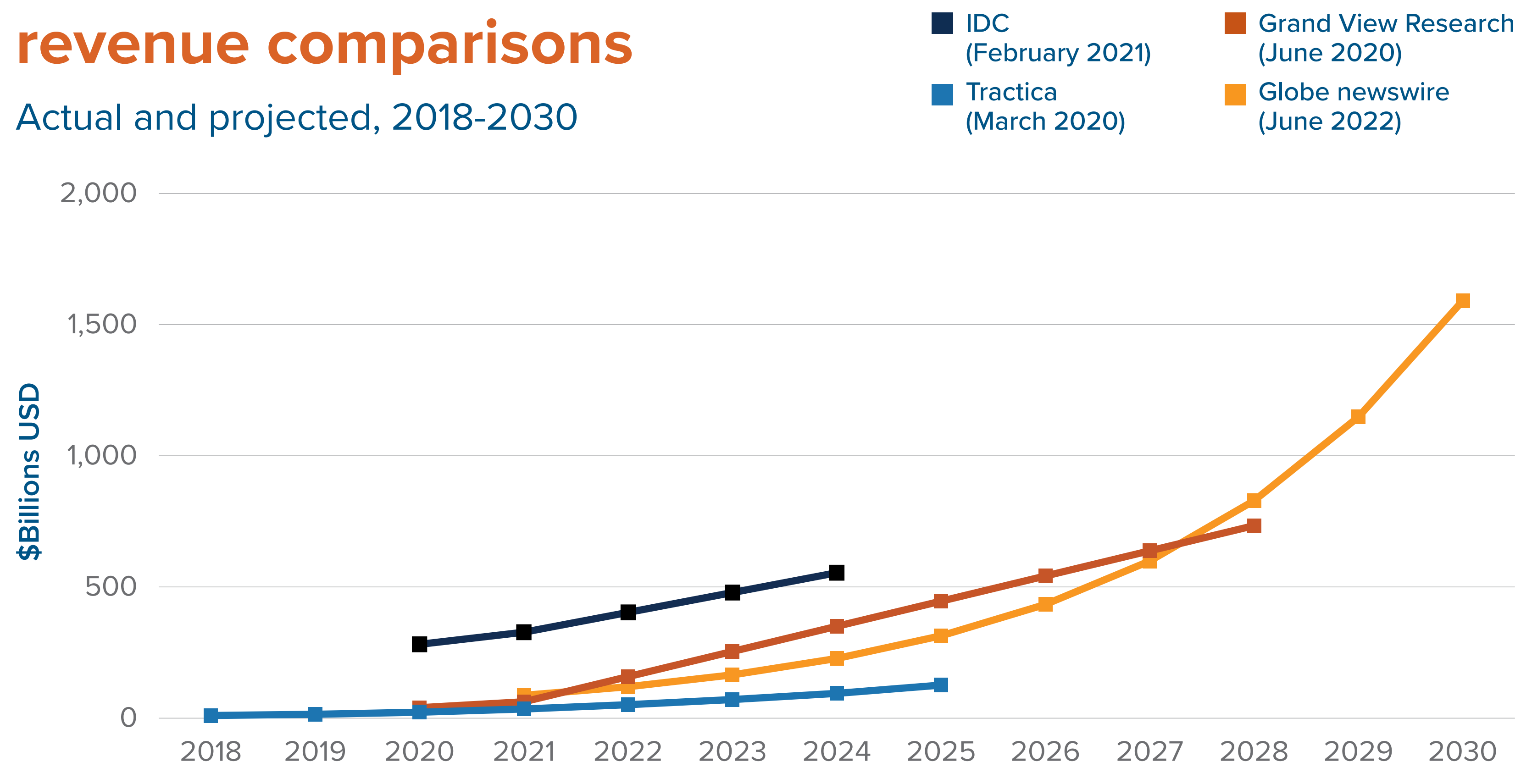
Richard Bodzy: AI, broadly speaking, is a concept that's been around since the 1950s. By and large, the progression of AI technology has been slow. But in the last 12 months we've seen it take a pretty marked leap forward in both its technology and commercial ability. We are at this exciting point where the cost of computing power will fall rapidly, and commercial generative AI applications will become ubiquitous. We see a lot of winners, and the winners will come in waves, but clearly the early winners are the chip companies like NVIDIA and AMD. We think the next layer of winners wil come from the enterprise software space. If you think about enterprise software names like Microsoft or Salesforce, their huge installed user base provides an advantage to monetize AI-powered applications. Additionally, we see meaningful potential for future applications of Generative AI across most other sectors - notably in healthcare, consumer, and industrial end markets.

Dave Taylor: AI has been around for decades, and we own companies that have used the technology for years. We will continue to focus on enablers instead of making a speculative bet on what may or may not be the next hot thing. Every company should be exploring how AI can help generate additional revenue streams and/or optimize cost structures. While the economic environment looks tougher in 2024, we've definitely picked up a new growth tailwind for companies like Synopsys, Microsoft, Accenture and ServiceNow as AI begins to roll out at scale.

Carew: It's hard to ignore AI. It's a very broad technology and every company needs to consider how their business might be impacted. Finding companies with AI-powered capabilities that can help other businesses better serve their customers will be a theme that continues in 2024. We currently own a company that is basically a tech-enabled bookkeeping or accounting platform. The company has identified a market of small business customers who do not want to take on all of the accounting function in their operations, so they're looking to AI to automatically categorize a higher percentage of the bookkeeping entries coming through their platform. We'll continue to look for opportunities like this where a company can use AI to bolster the productivity of its workforce and improve its operating leverage.

AI market size and revenue comparisons

Actual and projected, 2018-2030



Sources: IDC, Tractica, Grand View Research, Statista, GlobeNewswire.
As of September 30, 2023, NVIDIA represented 6.14% and Cadence Design Systems represented 1.87% of Putnam Large Cap Growth Fund assets.

THEME 3 GROWTH & INNOVATION

What's an area of opportunity that may not be top of mind for investors?

Bodzy: The 'experience economy' and I'll lean on Taylor Swift and The Eras Tour to illustrate. As one of the hottest tickets on the planet right now, we're seeing a lot of innovation in the ticket market. Live Nation, which put on Swift's tour, not only has strong relationships with major venue across the globe, but its Ticketmaster business is at the forefront of the transformation towards digital tickets. These technological capabilities allow tickets to be shared and resold, but also to ensure ticket authenticity for the paying consumer. Artists trust the company to organize the complex logistics necessary for a global tour and this complexity can only be addressed through technological leadership.

Taylor: One area that we are particularly excited about is the energy transition, which we see as one of the most significant developments we'll experience in our investment careers. Most companies are in highly competitive industries with rapid and significant technological change, making them highly risky investments. Instead, we have focused on companies that can enable this important change and are likely to benefit by being global leaders in areas that are essential to the transition. One company that fits this mold is Schneider Electric. The company sells components, software, and systems that are crucial to upgrading the world's electrical system as it transitions to a more sustainable model. It is difficult to imagine an energy transition scenario where the global electrical grid does not need to be upgraded and modernized, giving Schneider a significant growth tailwind in 2024 and beyond.

Carew: We would stay with the healthcare theme. In the venture and growth space we have seen the biotech IPO market come back a little bit quicker than in tech. That's been a robust segment of the market where we've witnessed a lot of activity and we think that has the legs to continue.

Asset mix recommendations

Mackenzie Investments Global Investment Committee

ASSET MIX RECOMMENDATIONS

UNDERWEIGHT NEUTRAL OVERWEIGHT

Equities

Sticky inflation will likely curtail the ability of central bankers to pre-emptively ease financial conditions, creating a bumpy road ahead for equities. The high interest rate environment is anticipated to continue whipsawing equity prices in the short term. However, corporate earnings results and forward guidance are beginning to play a more significant role. We believe 2024 earnings expectations are likely too optimistic in a backdrop of decelerating economic growth. Although we are tactically underweight equities, we anticipate an opportunity will present itself later in 2024 where equities will truly reflect the lower earnings backdrop and a buying opportunity will ensue.

Canada

Canadian equities trade at significantly lower valuations than their US peers, presenting an attractive proposition for investors with longer time horizons. However, cyclical stocks are more prevalent within the Canadian equity indices (more closely linked to the business cycle). This characteristic renders them more vulnerable in a slowing growth environment.

U.S.

Given that the 'Magnificent 7' (Apple, Microsoft, Alphabet, Amazon, Nvidia, Tesla and Meta) constitutes about a third of the S&P 500, the performance of U.S. equities will remain heavily dependent on the behaviour of these stocks. Although the U.S. economy has proved to be the most resilient in the developed world, this will likely keep the Federal Reserve committed to tighter policy for longer as well, keeping interest rates elevated. At the broad index level, earnings forecasts for 2024 are also likely too optimistic, introducing potential downside risk to prices if corporate earnings fall short of expectations. Themes like Artificial Intelligence have been a boom for U.S. equities but if this proves to be overhyped, some of the winners of 2023 will reverse trend.

International

European equities appear poised for weakness, as recent data indicates that the region is on the brink of recession after the multiple rate hikes undertaken by the European Central Bank. While international stocks offer attractive valuations for longer-term investors, we see the short-term downside risks outweighing the potential upside. Challenges currently plaguing the region (e.g. energy security and geopolitics) are likely to persist, which should hamper economic growth and, in turn, corporate profits. The outlook for Japanese equities will likely hinge on the Bank of Japan's ability to maintain its accommodative monetary policy. The weaker Japanese yen will be positive for export growth, helping to offset headwinds to European equities for EAFE investors.

Emerging markets

Emerging markets trade at cheaper valuations relative to their US counterparts. However, challenges such as a strong US dollar and a sluggish recovery in China pose significant headwinds. The presence of increasing geopolitical tensions and generally higher levels of volatility historically associated with this asset class necessitate a more cautious approach in the short term.

Fixed income

	UNDERWEIGHT	NEUTRAL	OVERWEIGHT
We remain constructive on our outlook for fixed income. It appears that central bankers are approaching, if not already at, the end of their tightening cycle, which should limit further substantial increases in bond yields while paving the way for a peak in rates. The anticipated stability in rates makes bonds attractive for investors focused on income generation. In addition, high-quality bond portfolios are now better positioned to offer a negative correlation to equities in the event of a market correction.			●
Sovereign bonds We believe interest rates have hit or are close to approaching their peak. As a result, we are tactically positioned at a neutral duration. Economies that are more sensitive to interest rates, such as Canada, are already showing signs of slower growth. Should these economies exhibit further weakness, their central banks could begin to lower rates, allowing for modest price appreciation.		●	
IG corporate bonds We expect spreads for higher-quality corporate bond issuers to remain relatively stable, reflecting the fundamental strength many of these companies are carrying into 2024. As economic growth downshifts, there is potential for a some widening in spreads. This underscores the importance for investors to stick to higher quality companies with strong balance sheets. Investment grade corporates should provide investors with an attractive risk-adjusted return.			●
HY corporate bonds We anticipate that realized total returns will underperform yields for high yield bonds and leveraged loans as economic growth slows. The high yield bond market is looking at increasing levels of maturing debt beginning in 2025. Lower quality, or more highly levered companies could see deteriorating fundamentals as their coupons reset higher. As we move through 2024 we expect to see a gradual rise in default rates in the lowest quality market segments, and a widening of credit spreads.	●		

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