2024 MID-YEAR MARKET OUTLOOK

MACKENZIE
Investments

BLUE BOOK

MARKET OVERVIEW

Adjusting bearings

A mid-year economic compass

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Summary points

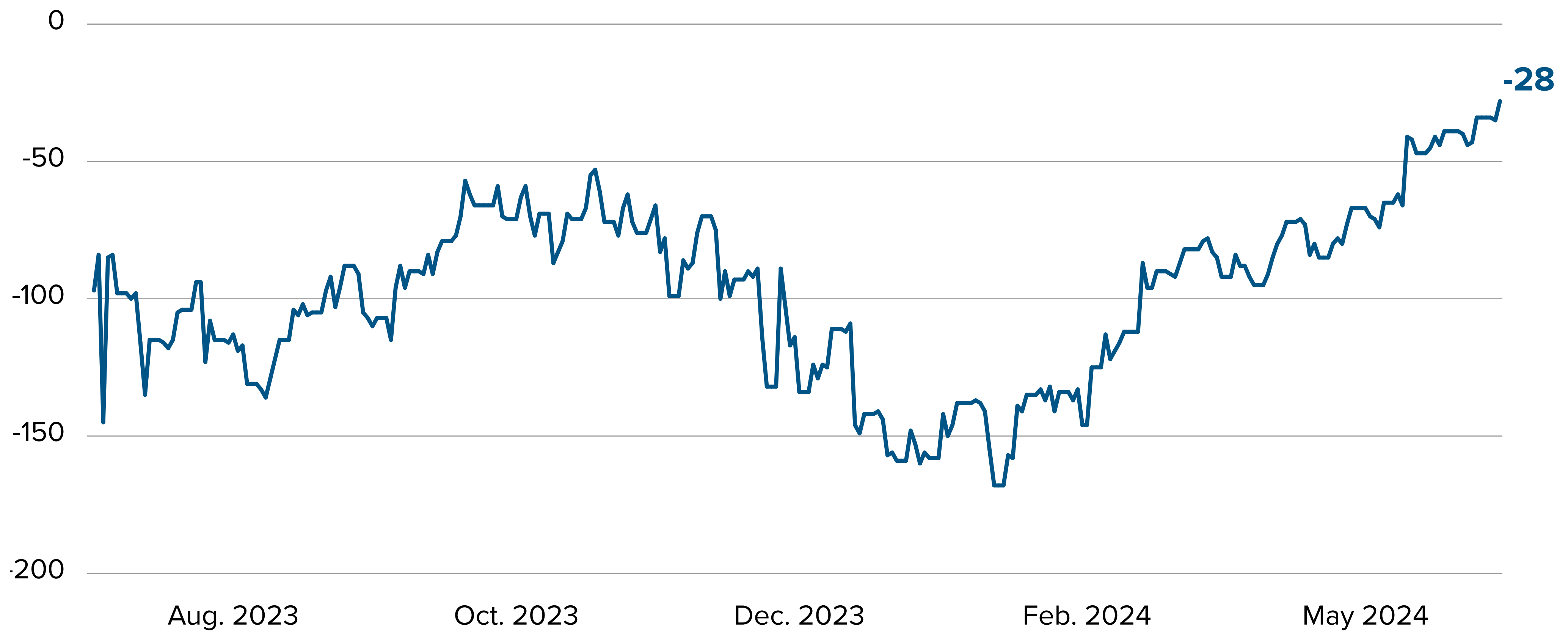
1. Positive real yields and strong corporate fundamentals continue to provide opportunity in the corporate bond sector.
2. Immense opportunities to support the energy transition exist across several sectors.
3. Investors are chasing the mega-cap stars of artificial intelligence (AI), overlooking many opportunities among the enablers of the technology.

Traversing the economic waters

Market expectations of interest rate cuts in 2024 changed direction as US growth and labour market data showed resiliency, and downward inflation trends did not show enough progress for policymakers to act early in the year. The implied quantum of Federal Funds Rate cuts for the year moved from 150 basis points at year-end to less than 50 basis points during the second quarter.

Markets rein in rate cut expectation

Market implied cumulative 2024 Federal Funds Rate cuts (bps)



Source: Bloomberg, April 30 2024.

Despite a weaker relative economic outlook in Canada, expectations for cuts to the overnight rate by the Bank of Canada were also reduced as some inflation components related to shelter remain uncomfortably high.

Canada's weaker growth outlook is in part due to a more interest rate sensitive household sector and lower productivity in Canada versus the US. Looking through the positive headline growth in Canada reveals a weaker profile when adjusting for our significant population growth: on a per capita basis, Gross Domestic Product (GDP) has fallen by about 3% over the last 18 months.

Although some ongoing support for the Canadian economy may come from higher prices for our commodity exports, the Bank of Canada is likely to reduce the overnight rate to support the economy over the second half of the year. The relative economic growth trends between Canada and the US could necessitate different policy rates as the Bank of Canada cuts more aggressively than the Federal Reserve.

At the mid-point of the year, equity markets are navigating sticky inflation and rising bond yields across the curve. However, their response is more closely tied to the economic outlook and the implications for earnings, rather than disappointment with the prolonged period of higher interest rates.

The outlook for global GDP growth continues to be sustained, primarily driven by stronger-than-expected growth in the world's largest economy – the United States. While economies outside of the US (including Canada), faced anticipated headwinds due to tight monetary policies, the US economy defied the prevailing trend for a few reasons.

First, the government's "big fiscal" policy which included sustained domestic investment under the Inflation Reduction Act, the Chips Act and other onshoring initiatives, provided substantial stimulus to the economy. Secondly, the US experienced unparalleled productivity gains compared to other major developed countries over the same period.

Looking ahead to the remainder of 2024, these trends are expected to persist, offering continued support for earnings growth, a robust global economy, and an overall positive tailwind for risk assets such as equities.

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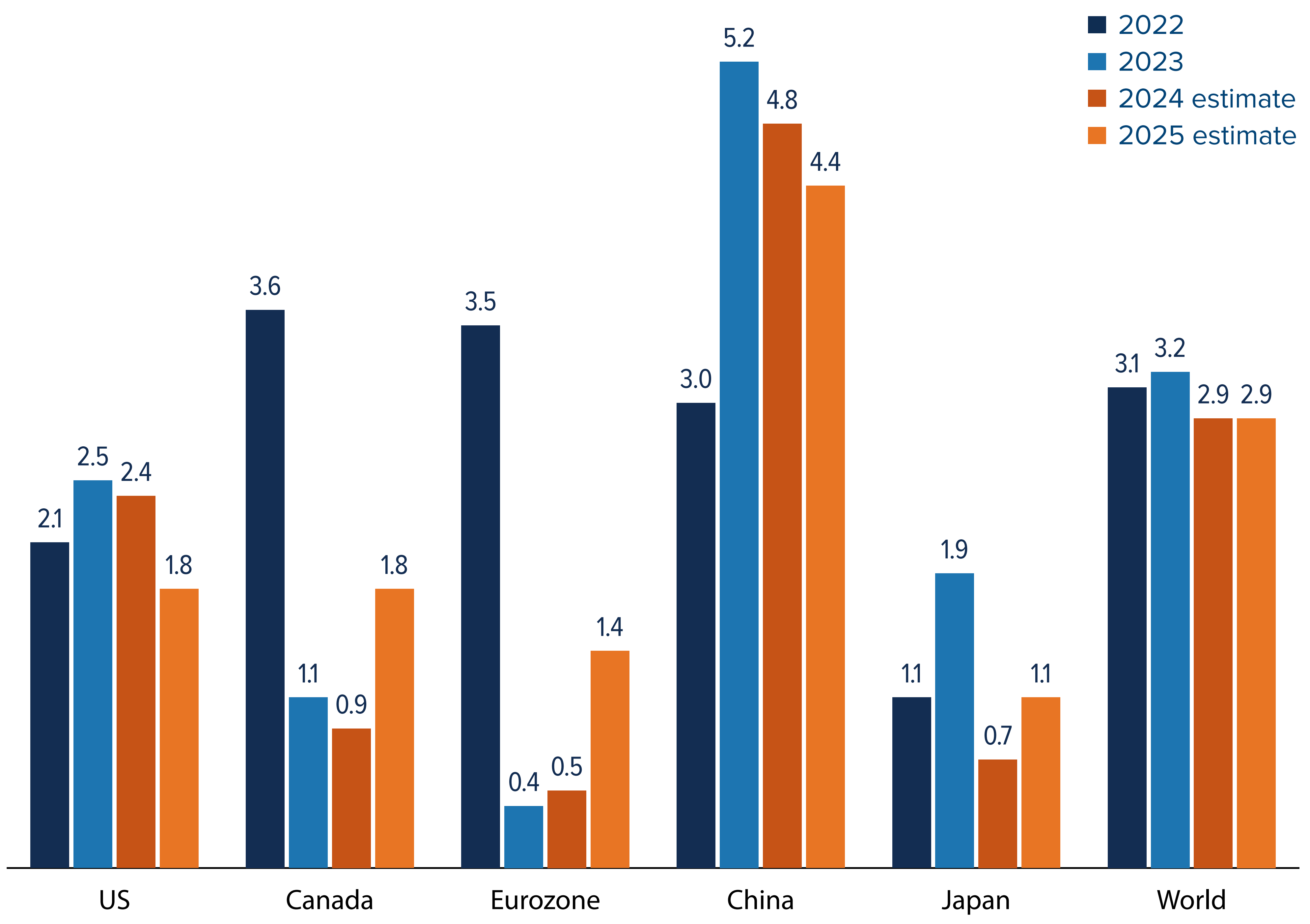
Global growth remains better than expected

Consensus estimates real GDP growth (y/y % change)



Source: Bloomberg, April 30 2024.

Bonds: let's get real

Bond yields adjusted to reduced rate cut expectations by reversing some of their downward course that began last October. Importantly, however, the credit markets were undaunted as financial conditions tightened.

Bond market volatility has continued its downward trajectory this year, and new corporate bond issuance was well received in both investment grade and high-yield markets. Corporate credit spreads narrowed, reflecting not only good investor demand for credit, but also that strong corporate fundamentals are supporting credit quality at this point of the cycle. Real (inflation adjusted) yields on high-quality corporate bonds are looking attractive at mid-year.

Investors today can look into the corporate bond market and find some of the best yield opportunities at 2–10 year maturities that we have seen in about 15 years. Beyond the available yields, investors seeking more specific types of sustainable debt have seen record primary issuance early this year. Spanning sovereign, supranational, and corporate issuers, global issuance of green bonds hit a record in the first quarter, and the trend continued into Q2. Many investors recognize the enormous, cumulative needs for energy transition financing over the years ahead. The good news for investors: many different types of sustainable debt are offering attractive yields and plenty of choice.

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The great energy transition in transition

The energy transition remains a compelling theme for investors to incorporate into their portfolios. Governments and businesses around the globe continue to emphasize its significance through policy and investment. But, like any transformational trend, the trajectory is not a straightforward upward path.

Many early transition measures were adopted in a context of lower inflation, reduced costs, and lower interest rates. Additionally, geopolitical conflicts in regions such as Ukraine and the Middle East have diverted fiscal resources and attention away from energy transition efforts, as defense spending takes precedence over other expenses. Consumers are also experiencing fatigue due to the inflated costs associated with supporting this transition, especially amid an inflationary environment.

Despite these temporary headwinds, the world remains aware of the converging challenges of economic growth, resource scarcity and ecological constraints, including climate change. In 2023, investments in cleaner energy reached a record $1.7 trillion USD, surpassing traditional fossil fuel investment by a significant margin. Adjacent opportunities remain for efficiency technologies, transportation, water and agriculture. Building sustainable infrastructure and capital goods will support demand for traditional materials. In addition, copper, nickel, catalytic metals and lithium production must keep pace with an increasingly electrified economy.

Meanwhile, a new trend — the AI revolution — is poised to strain an already overburdened global electricity system. Generative AI searches consume more than 10 times the energy of traditional search methods, highlighting the associated risks of decades of underinvestment in power infrastructure.

In summary, we remain optimistic about the immense opportunities within the energy transition theme across various asset classes and sectors of the economy.

Building sustainable infrastructure and capital goods will support demand for traditional materials.

Navigating the economic future of growth and innovation

While AI has a decades-long history, its true watershed moment emerged with the proliferation of generative AI. This paradigm shift facilitated seamless human interaction, harnessed vast amounts of data, achieved unprecedented mass adoption and unlocked multiple use cases.

The productivity gains from AI applications defy precise quantification today, yet their directional significance is undeniable. Much like the internet and smartphones revolutionized our lives, AI has the potential to usher in a step change in productivity.

Investors, keenly aware of this seismic shift, are fervently pursuing the stock market successes of tech giants like NVIDIA and Microsoft. However, the canvas of opportunity extends far beyond these behemoths. It spans software, hardware, services and the enabler industries that underpin AI's transformative journey.

It is hard to imagine an industry or sector of the economy that will be immune to the impact of AI, machine learning and large language models. From health care to finance, logistics to entertainment, AI's fingerprints will be indelibly etched across the landscape.

Yet, as investors, we tread with both excitement and caution. History teaches us that disruptive technology yields both winners and losers. Our collective objective is to carefully evaluate opportunities, devise sound strategies, and estimate the potential of innovation-driven businesses. In doing so, we aim to create enduring value within our investment portfolios — a prudent participation in one of the most extraordinary growth opportunities of our generation.

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Equities

	UNDERWEIGHT	NEUTRAL	OVERWEIGHT	CHANGE*
Equities		●		↑
Canada		●		—
US		●		—
International		●		—
Emerging markets		●		—

With looser monetary policy conditions and a more constructive outlook for corporate earnings growth, we anticipate equities will continue their upward trajectory. Although stocks can be sensitive to fluctuations in interest rates, we expect earnings and forward guidance to play more dominant roles in driving equity performance. Corporate earnings have exceeded expectations this year and we foresee this positive trend continuing. As indications of a soft landing become clearer, we anticipate a broadening of the existing market rally.

Canada

Canadian equities stand to gain from widening market breadth. Although the higher concentration of cyclical stocks in Canadian equity indices could make them more susceptible in a slowing growth environment, this risk is already reflected in current valuations, potentially presenting an appealing entry point. Canadian equities offer exposure to the commodity sectors which are benefiting from resilient economic growth and attractive supply and demand fundamentals. Overall, a relatively dovish Bank of Canada is expected to act as a tailwind for Canadian equity valuations.

US

We expect the current rally in US equities to further broaden into lagging sectors as bond yields stabilize and corporate earnings improve. However, the overall performance of US indices will remain dependent on the heavily weighted mega-cap tech stocks and the ongoing excitement around artificial intelligence. A stronger-than-anticipated start to 2024 for the US economy could complicate the Federal Reserve's ability to ease monetary policy this year, potentially exposing highly valued stocks to valuation multiple compression.

International

The outlook for European equities is looking brighter, buoyed by better-than-expected economic data, a significant deceleration in core inflation towards the European Central Bank's (ECB) 2% target, decreasing energy prices, and a pickup in global manufacturing activity. The European economy should benefit from the ECB's upcoming campaign to cut interest rates, which could begin as early as June. Corporate earnings expectations in Europe are quite conservative, which could lead to positive surprises if global growth picks up.

We remain constructive on Japanese equities amid ongoing regulatory reforms and shifts in corporate behaviour that have boosted corporate efficiencies and profitability. Japanese equities are also poised to benefit from the Bank of Japan maintaining its highly accommodative monetary policy stance.

Emerging markets

Green shoots are emerging in emerging market (EM) economies, which should support EM equities moving higher. Despite challenges such as a strong US dollar and higher interest rates, economic growth in these regions has been resilient. Additionally, inflation is moderating from elevated levels, which should allow EM central banks to reduce interest rates further from today's elevated levels. While China continues to grapple with its structural issues domestically, increased support from policymakers is anticipated to buoy economic growth and some positive signs are emerging. Geopolitical tensions remain a risk and could lead to short-term volatility. However, attractive valuations in these markets may provide an appealing opportunity for long-term investors.

* Representing change of allocation recommendation from Mackenzie's 2024 Outlook, published in November 2023.

	UNDERWEIGHT	NEUTRAL	OVERWEIGHT	CHANGE*
Fixed income We maintain a positive outlook on fixed income. As inflationary pressures ease and growth projections moderate, some major central banks have already begun lowering interest rates. We expect more central banks to follow suit in the second half of the year. Consequently, bond yields are likely to decline, leading to modest price appreciation. Elevated and more stable bond yields present an attractive opportunity for investors seeking income generation. Additionally, portfolios of high-quality bonds are now better positioned to offer a negative correlation to equities, providing a buffer in the event of a market correction.		●		↓
Sovereign bonds We believe interest rates have peaked and expect them to begin moderating as inflation gradually falls towards central bankers' targets. Consequently, we have tactically extended our duration relative to the benchmark, finding duration particularly appealing in economies where high real rates are dampening economic growth, such as Canada. In emerging markets (EM), we are selectively overweight in countries like Brazil, Mexico and South Africa, anticipating a decrease in real interest rates in these regions.		●		—
IG corporate bonds We anticipate spreads for higher-quality corporate bond issuers to remain relatively stable in a soft-landing scenario. Yields available to investors are attractive considering corporate fundamentals are strong. The potential for lower central bank policy rates supports a positive view of this high-quality credit sector. Investment-grade corporate bonds should continue to offer investors attractive risk-adjusted returns moving forward.			●	—
HY corporate bonds Lower quality or more highly levered companies may experience deteriorating fundamentals as their coupons reset higher, particularly in 2025. We expect this to lead to a gradual increase in default rates and a consequent widening of credit spreads in the lowest-quality segments of the high yield bond market. However, by maintaining a high-quality bias while collecting the additional carry, investors can generate excess returns through exposure to high-yield bonds.		●		↑

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