MACKENZIE Investments | CONFIDENCE IN A CHANGING WORLD

Webcast – Market Outlook 2019

Summary Notes – January 15, 2019
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2019 Outlook – Risks becoming more apparent

Growth is decelerating globally.

- U.S. was last major economy to experience deceleration in growth, after emerging markets and European and Asian developed markets
- Until recently, U.S. resilience was underpinning of outperformance of U.S. assets relative to the rest of world
- As Federal Reserve's tightening campaign is now more advanced, interest rate-sensitive sectors of the economy have begun to slow
- Housing sector activity has decelerated considerably
- Indicators of growth in manufacturing sector also coming back down to earth, indicating U.S. growth is joining the rest of the world in moderating.

Another break from 2018 trends has been the recent fall in inflation expectations.

- Most of reduction in bond yields in the fourth quarter of 2018 was explained by falling inflation expectations.
- Collapse in crude oil prices, led markets to anticipate a more subdued inflation outlook.
- Market expectations for further Federal Reserve rate hikes are now much more muted than they were a few months ago.

Canadian assets have been under pressure, as Canada's energy woes have been compounded by a lower price for Western Canada Select (WCS) crude.

- While decision by Alberta government to curtail production helped close some of the gap between WTI and WCS, oil prices are falling and Canadian oil continues to trade at a low price compared to global benchmarks.
- In this environment, Canadian dollar lost about 7% against the U.S. dollar in Q4, as the market began to doubt the likelihood of further immediate Bank of Canada rate hikes.

Barring further fiscal stimulus, we expect slower U.S. growth in 2019.

- The "sugar rush" experienced by U.S. economy, following an unusual, late-cycle fiscal stimulus, is disappearing. Interest rate-sensitive sectors of the economy are also slowing.
- Corporate capital expenditures, an area of strength for the U.S. economy one year ago, are now softening considerably.
- Suggests interest rate normalization process is beginning to be felt in the real economy.
- We expect U.S. economy growth in 2019 will be much slower than 2018.
- That said, the consumer side of the economy remains strong and wage inflation is present. This means that: 1) we don't see a contraction in 2019, and 2) there is scope for a Fed hike in Q4.

We also expect Canada to slow down.

- Canadian economy has already begun this process.
- Particularly evident in Canadian consumer spending, which has come back down to earth from the elevated levels of growth reached in 2017.
- Coincided with a topping out of housing markets in Toronto and Vancouver, suggesting interest rate hikes by Bank of Canada have begun to work their way through the system.
- In our view, this likely will continue into 2019.
- The Bank of Canada seems intent on bringing interest rates back to neutral. This means they could still hike later this year.

China already has slowed down abruptly and is now considering applying stimulus—this will be something to watch in 2019.

- Chinese economy responded negatively in 2018 to policy efforts to de-risk and de-leverage the financial system.
- Government cracked down on the shadow banking system, leading to much slower credit growth.
- Historically, after sharp economic slowdowns, government has tended to stimulate to avoid a hard landing of the economy and maintain job and income growth, two key factors ensuring social stability in China. This would suggest that stimulus is now imminent.
- Chinese government has cut taxes in recent months, with a view to bolstering consumption.
- Results of tax cut have so far been muted. Efforts to de-leverage and de-risk financial system are somewhat constraining the government's ability to stimulate.
- Will be watching evolution of this tension in China in early 2019. For now, does not appear China is re-accelerating meaningfully.
- Markets have begun to price in some Chinese stimulus. We are watching closely for announcements in the next few weeks. So far, we haven`t seen anything.

Europe remains stuck in the slow lane.

- Market participants hoped 2018 could build on robust 2017 for Europe, with stronger footing for more sustainable expansion.
- Markets disappointed again, as European growth underwhelmed.
- Global trade tensions hurt export-driven European economies such as Germany, while political instability in Italy and U.K. undermined domestic confidence.
- Several European equity market indices in bear market territory.
- Forward-looking expectations for the region are much lower than beginning of last year.
- It is unlikely that the European Central Bank will be able to raise interest rates meaningfully this year.

Investment Views for Q1 2019

Mackenzie's Multi-Asset Strategies Team's key tactical views:

- Asset mix: underweight position on equities relative to cash and underweight position in bonds relative to cash.
- Foreign exchange: slight overweight in the U.S. dollar relative to the G5 basket of currencies.
- We see some opportunities in emerging market currencies which were hurt badly last year, such as TRY, MXN and BRL.

Steve Locke, MBA, CFA

Head of Mackenzie Fixed Income Team

- Market sensitivity to higher U.S. interest rates, and more generally monetary policy tightening, showed through strongly in the fourth quarter of 2018. The Federal Reserve's tightening path continued through the fourth quarter as the policy rate was increased a ninth time since late 2015, to 2.50%. Chairman Powell's slight increase in hawkishness as Q4 began, when combined with the slowing global growth projections, expectations of slowing growth in U.S. corporate profits, and the by-then significant declines in many emerging market equities and bonds, caused a sharp revaluation of U.S. equities and high yield debt.

- For the U.S. economy, no immediate signs of economic recession, some areas of domestic economy have begun to feel pressure from the higher interest rates and yields ushered in by the Federal Reserve policy hikes over the past two years. For example, as mortgage rates moved higher through the middle of 2018, applications for mortgages fell as affordability became more challenging for a greater number of households.

- Even though some leading indicators of growth, in-particular some of the well-observed sentiment surveys, have recently come off their highs, labor indicators for the U.S. economy are expected to remain supportive of growth in 2019. Chiefly, low unemployment and higher wages should keep consumer sentiment somewhat buoyant in the face of the fractured U.S. political environment, and uncertainty emanating from the U.S.-China trade war. So, the underlying support that drives consumption, which the most significant component of U.S. GDP, should have growth somewhere in the 2% range for 2019.

- The market volatility of Q4 caught the attention of the Fed. As 2019 began, the Fed signaled that it will pause additional rate hikes, effectively removing the hawkish bias embraced just three months ago. Future rate movements are now dependent on emerging data evidence as to inflation trends and labor market conditions. Thanks in part to the recent drop in many commodity prices, headline inflation rates are likely to be quite subdued until much later this year, when base effects may kick in to boost price indices. The bond market, which has generally lagged the Fed's dot plot on pricing in future rate hikes, began 2019 with no rate hikes priced-in. It serves to keep-in-mind that the Fed intends to keep reducing its balance sheet throughout 2019 by allowing $50 billion of maturing bonds to roll-off. This is effectively a form of policy tightening, just as the purchase of these bonds was a form of easing after the financial crisis.

- The Bank of Canada appears likely to follow or lag the Fed on potential monetary policy hikes this year. In general, the Bank of Canada faces a more rate-sensitive economy, given the greater amounts of household leverage in Canada as compared to the U.S.

- Corporate credit spreads widened swiftly in Q4 as the risk-off tone was exacerbated in the low liquidity days typical around year-ends. Valuations remain reasonable for this stage of the credit cycle, which may be prolonged by the Fed pausing its rate hikes for a while. Corporate fundamentals have only weakened modestly, and do not appear threatening, given continued growth in the U.S. Any truce in the trade war and a complacent Fed will likely ensure that profitability remains high and debts manageable. Nevertheless, we will be approaching this stage of the credit cycle with a degree of cautious optimism, and an expectation that additional market volatility will be a part of the valuation picture we need to discount.

Portfolio positioning

- Over the past couple of years, we've been running shorter duration in the portfolios. As we went through 2018 the curve started to reflect where we are going to end up with government bonds, and we were a buyer of duration in October when the 10 year U.S. treasury went from 3–3.25%. We are currently neutral on duration. It may turn out that October was the high point of the 10 year at 3.25%... duration is something we can put in and take out very quickly.

- Credit view - dialing back our credit beta but still more over weight credit vs a passive index - but dialing it back - added loans and HY in all our portfolios

EM Debt

- We see some potential upside for EM debt - the issue is if the Fed will bring a soft landing - some tail risks in EM assets.

- We have added a small allocation to EM assets with our eye on USD and Macro Risks.

Biggest risk in 2019

- With the reset in credit valuations at the end of 2018 and beginning of 2019 - there is upside available in HYBs - but end of cycle moment is the biggest risk.

Dina DeGeer, MBA, CFA

Portfolio Manager and Head of
Mackenzie Bluewater Team

David Arpin, MA, CFA

Portfolio Manager, Mackenzie Bluewater Team

"The Canadian economy can no longer be viewed in isolation of the global economy."

Global macro trends we are paying attention to across our Canadian, U.S. and Global Funds:

- Globalization has created irreversible economic interconnectedness. Things aren't regional anymore.
- Interest rates around the world have dropped from double digits to near zero a few years ago.
- In our view, the significant build up in debt globally over the past decade has made the global economy more sensitive to interest rates than in the past.
- An important lesson learned during 2018 is that when global growth rises beyond the central bankers' comfort zones, central bankers are not hesitant to raise rates to slow the economy down.

Regional viewpoints:

Global

- Recent data from China suggest that economic growth has slowed sharply because of the trade dispute with the United States.
- We believe that China's manufacturing base will continue to see longer-term erosion regardless of a new trade deal.
- China's growth rate may be slower than generally expected, while that of other emerging countries that gain manufacturing at China's expense may be somewhat faster.
- At this point we are cautious on the economic growth prospect for China.

Europe

- Economic growth in Europe appears to be continuing to follow the path that it has been on since the global financial crisis of 2008-2009. Growth, excluding inflation, seems stuck at around 1-2%.
- As has been true for the past decade, Europe continues to have many large political problems that are a headwind to growth.
- The main headlines are Brexit and Italy's debt issues. We do not see a simple resolution of either issue as particularly likely, suggesting that growth will likely continue to be anemic.

North America

- North American economies continue to expand as we head into 2019, with the U.S. economy outperforming Canada. The successful renegotiation of NAFTA will continue to give Canada preferential access to the U.S. market.
- Growth in the U.S. in 2018 was enhanced to some extent by the Trump Administration's tax cuts and wider deficits, and as a result, we expect a slower pace in 2019.
- The North American economy is dominated by consumer spending and consumer fundamentals remain strong with low unemployment and rising wages. Once again, this data is stronger in the U.S. than in Canada. In our Canadian funds we are tilted away from Canada with only a 28% exposure to Canada based on where businesses generate their revenues. Our largest regional exposure is the U.S. at 38%.

Current view on markets

- We entered 2018 with strong global synchronized growth that came with increasing inflationary pressures forcing the Fed's hand to continue raising rates.
- Emerging market debt issues, Italy's financial debacle, Brexit and trade wars started to impact growth globally. Global economies ended the year on a much weaker note.
- With slowing global growth, there is far less upward pressure on interest rates and it is possible that the economic cycle gets elongated, albeit with slower growth.
- This economic environment is preferred for our investment style.

Portfolio positioning

- We are braced for a slowdown but are not convinced that a major recession in the U.S. is imminent. The businesses we have always been attracted to are those that are not dependent on a strong economy. We have a low level of cyclical businesses across all the funds we manage. We have a very narrow focus in Canada. We are attracted to sectors in Canada that are global leaders.
- We are invested in businesses that have been around for a very long time, which have been much more resilient when economic growth is slower and have always taken market share and are ready to seize on opportunities when things do slow down when others do not have the financial luxury to take advantage.
- Valuation discipline is core to our philosophy and has been one of our hallmarks for decades. Our investment approach has successfully insulated us through market downturns through three major crises over the last twenty years. We believe there is nothing in our investment approach to change this record.

Phil Taller, CFA

Portfolio Manager and Head of
Mackenzie Growth Team

Markets through Q4 2018

- Q4 was a difficult quarter and the month of December was the worst since the Great Depression but it created a lot of opportunity – we added to existing positions and bought a few new names.
- We continue to maintain an overweight in the Technology sector and we added to our holdings in Health Care during the fourth quarter weakness. We believe that the secular growth available in those sectors will serve us well.

Cyclical vs non-cyclical and secular growth companies

- Cyclical companies are levered to the economy. Secular growth companies can grow regardless of where GDP goes; they have a long-term trend in a product or service that drives the business beyond just GDP growth.

  Example: WorldPay, a company we own, gives merchants electronic methods to access payments networks. They take away all the complexity and merchants can then tie into VISA Mastercard, Google Pay, Apple Pay, etc.

  - The great secular trend is the move from cash and cheque to digital; for example, many shops and restaurants in NY are no longer taking cash.
  - In 2009, WorldPay grew its revenues to high single digits; slightly lower growth rates but it grew through the worst recession in our lifetime.

Businesses owned in typically cyclical sectors

- Some people view Technology and Industrials as cyclical sectors but we've made a shift in the last few years to be less cyclical within those sectors.
- For example, within Technology you can get cyclical exposure by investing in sub-sectors like semiconductors, hardware and cyclical software businesses or you can be very low beta by owning more services businesses (business process outsourcing, consulting, more stable software, etc).

Exposure to potential U.S./China trade war

- There are a lot of mid cap companies that do global business and you could build a portfolio this way but we tend to focus on the mid cap businesses that are domestic based.
- Most of the businesses we own are focused on services or intellectual property. We only have a few companies that manufacture goods. We are less directly exposed to trade wars.
- Nobody can escape a global economic slowdown – it still filters down.

U.S. political situation

- We do pay attention to the political situation but the U.S. is one of the highest growth economies in the developed world because it's the freest economically and that is what has driven the growth.
- The U.S. has a unique culture that drives their ability to innovate: the best educational institutions in the world, a culture of entrepreneurialism and established venture capital markets available to fund them.

U.S. dollar

- Last year we had no hedge on the Fund. USD is the lowest beta currency in the world; it helps with the Fund's volatility so we're sticking with no hedge for now.
- The U.S. is still the strongest in the world and when you're worried about slowing growth we believe the U.S. is the best place to be.

Concerns in markets today

- We spent the last few years making the Fund less cyclical in preparation for the economic softness we're seeing now. Leading indicators have rolled over a bit (the PMIs, housing, auto sales) which could lead to some deceleration in the economy.
- The companies we speak with are reporting increasing wages. We think companies are trying to be more productive than they currently are as wages continue to grow. We own companies that can help with productivity gains.

Growth investing over next 3, 5, 10 years

- We believe that the U.S. economy, like many others, faces structural challenges in the form of high debt levels and slow growth in the working age population. Across the globe, governments have too much debt to be able to boost growth in a major way. With that macro-economic backdrop, we believe that in the long term the world may continue to proceed in a lower growth environment compared to history.
- We believe the reason growth investing has done so well is that in an environment of less robust economic growth, investors will continue to place a premium on companies that can grow faster than GDP.

Darren McKiernan, CFA

Portfolio Manager and Head of Mackenzie Global Equity & Income Team

Global equity valuations

- In late 2017 and the start of 2018 the world was experiencing synchronized global growth, had generational low unemployment numbers in many developed markets and healthy levels of inflation, interest rates were edging up slowly and valuations reflected the improving economic conditions. There was a fairly positive bullish sentiment.
- Over the course of 2018, this situation changed. Chinese authorities took the positive global growth environment as an opportunity to address some of the challenges they had in the shadow banking industry by starting to tighten credit. Global trade concerns also flared up, specifically between the U.S. and China.
- These changes compounded and moved the economic outlook from a rosy growth story to a less-rosy, lower-growth story. And the uncertainty around future growth drove market valuations down, with most major markets coming off by 20% or more.
- This market correction was viewed as a signal to authorities that perhaps some policies were too aggressive. The Chinese authorities reduced interest rates and cut taxes on corporations and individuals. The U.S. Federal Reserve that had been more aggressive in moving rates higher, became more dovish and softened their position.
- And while it doesn't feel like it at the time, when you have less positive sentiment, lower valuations and less aggressive central bank rate-hike policy, this means that risks have come down for equity investors and valuations are naturally more attractive.
- Over the last 3-4 months we have taken advantage of these lower valuations to adjust the Fund.

Managing Mackenzie Global Dividend Fund in a rising rate environment

- Owning dividend-paying stocks has always been a great way to compound capital. That hasn't changed. Reinvested dividends will continue to be a material component of total returns over time, across all markets.
- However, as investors managing a dividend-focused mandate we do have to be aware of where we are in the rate cycle. Although the Fund has historically had a yield above its benchmark, we are never stretching for yield by overweighting bond proxies when the valuations are not attractive or when the environment for such businesses is not attractive.
- Because we take a very balanced approach to investing in dividend-paying companies, owning a mix of dividend-yielders and dividend-growers across industries and geographies, we have been able to navigate the Fund to achieve attractive returns, despite being in a rising rate environment since the end of 2015.

Portfolio positioning

- One type of business that fits well with our investment philosophy are stock exchanges. These function like local-monopolies and are low capital-intensity businesses.
- As they are not capital intensive, exchanges are able to pay out a significant portion of their cash flows as dividends. And, despite being able to pay out a significant portion of their cash flows as dividends, they are not viewed as bond proxies.
- We have been wary about owning certain types of retailers or businesses that are centered around distribution/delivery of goods. Advertising business are another industry we have stayed away from in recent years. This is an industry that is in rapid transformation with challenged revenues. For this reason, we have removed advertising companies from our Dividend Dream Team watch list.
- Additionally, we will typically be underweight price-taking industries, commodity-oriented industries for example. When we do hold a company involved in the commodity space, it will generally be a high margin, high recurring revenue, service-oriented business.

Talk to your Mackenzie representative for more information.

302117

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