2022 Outlook

The Blue Book

MACKENZIE
Investments

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Pandemic aftershocks: Challenging, not insurmountable

- Pandemic aftermath playing havoc with inventory cycle
- Equities should outperform bonds as inventory restocks and service sector returns
- Bond yields expected to rise on inflation fears
- Central bankers tread lightly, balancing recovery and inflation
- China growth to buoy the global economy

As the world continues to navigate the COVID-19 pandemic, the risk of variant outbreaks remains. However, we believe that the world is better equipped to handle outbreaks through effective and highly adaptable vaccines, expanding vaccine adoption and approval for children, booster shots, and an expanding range of therapeutics. Continued rollout of these measures beyond the developed world to developing nations remains critical – it is increasingly clear that COVID knows no boundaries.

We believe that each successive variant outbreak will have a diminishing impact on capital markets. The fear of the unknown is now greatly diminished. Markets will need to reprice expectations and the timing of a reopening depending on the severity of the variant's impact. However, if the economy stumbles, we now know what fiscal and monetary authorities are prepared to do in response.

If a return to normal stokes investors' fears of tighter financial conditions and higher inflation, a COVID setback removes the tighter financial risk and should dampen inflation fears, even if it doesn't eliminate them. COVID variants and the attendant government restrictions will weigh on economic activity, but that weight and the market's response should be smaller and more selective.

Lesley Marks, MBA, CFA
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Brent Joyce, CFA
Investment Strategist

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Chief Investment Officer, Fixed Income & Multi-Asset Strategies

Our asset class expertise

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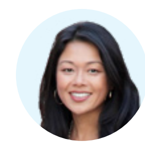

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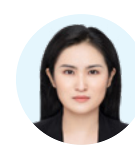


Wenjie Ding, Ph.D.

Benoit Gervais, MSc, CFA

Arup Datta, MBA, CFA

US inventory cycle: Orders are at a historical high, and supply is unpredictable

ISM manufacturing new orders less customers' inventory

Source: Bloomberg November 2021

As the risks ebb and flow, capital markets will experience gyrations as they always do, especially given pockets of extended valuations. As the world adapts to living with COVID, we see capital markets driven more by the fundamentals of earnings, inflation, interest rates and sentiment, versus a singular focus on case counts and R0 stats of the past.

The pandemic has created a historic shake-up in most global economic systems, causing distortions to the business cycle. What will become more important for investors in 2022 and beyond is how capital markets respond to these reverberating shocks. The collision of excess demand and restrained supply has triggered an outsized wave of inventory restocking. The timing and unwinding of supply and demand imbalances are challenging to forecast, but the pattern should prove to be typical of an inventory cycle, which has three stages – excess demand (production ramp-up, inventory upcycle), supply catches up to demand (inventory cycle peaks), and overshoot, supply exceeds demand (inventory cycle bottoms).

Until mid-2022, we expect we will see elevated production activity while manufacturers scramble to meet elevated demand. Equities do well at this stage, embracing the strong production and robust sales environment, while bond markets fret about inflation, sending yields higher.

Mid- to late-2022, or later, we expect production to remain high, while PMIs* slow, and sales lose momentum. At this point, equities may begin to discount a future slowdown.

In early 2023, we expect the inventory cycle to overshoot. The outsized price signals and supply challenges of today eventually lead businesses to over-order/over-produce, resulting in full inventories. Meanwhile, pent-up consumer demand and excess savings have run their course. Fiscal and monetary stimulus (despite sizeable fiscal spending continuing) are shrinking from the massive pandemic response of 2020-21.

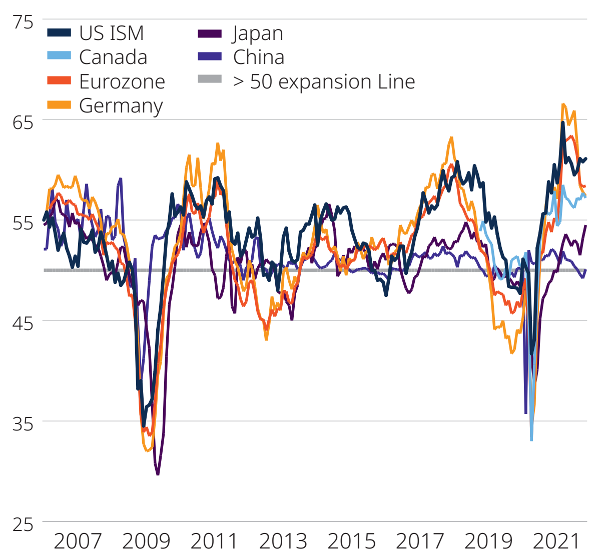
The overshoot stage typically triggers a slowdown, and that may eventually ensue. But, for our forecast horizon, we see the broader economic backdrop having enough momentum – with the resurgence of the services side of the economy – not only to stave off recession but to deliver reasonable growth.

A key assumption in this scenario is that central banks take a light-handed approach, such that financial conditions do not tighten to the point of causing a recession.

*PMI – Purchasing Managers Index – a survey of hundreds of manufacturers designed to capture a forward-looking view of business conditions.

Boom-times at factories should stretch into mid-2022

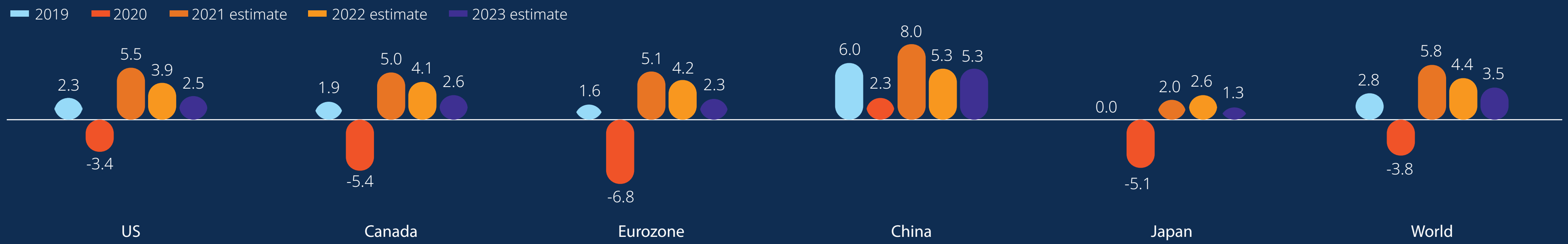
Global manufacturing Purchasing Manager Indices



Source: Bloomberg November 2021. For US, ISM. For Canada, Eurozone and Germany, Markit Economics. For Japan, Jibun Bank. For China, China Federation of Logistic and Purchasing

China and the return of the service sector will fuel positive global GDP growth

Real GDP growth (y/y % change)



Source: Bloomberg November 2021

In addition, the economic cycle in China is asynchronous with the rest of the world. We anticipate mid-to-late 2022 should see the Chinese economy exiting the current slowdown, providing timely ballast to the global economy and equity markets.

Equities expected to remain buoyant, while rising bond yields weigh.

We see equity markets remaining buoyant but with much shallower gains through the first half of 2022. This period would correspond with rising bond yields.

Equity markets could begin discounting a future slowdown in the mid to back half of next year. We feel this timing could be conservative. If anything, we see pandemic disruptions elongating the period of inventory restocking and thus extending the cycle.

In the past decade, equity markets had slowdowns coinciding with inventory cycle bottoms in 2012, 2015 and 2019. These periods typically featured increased volatility and a sideways trading pattern. Valuations absorbed much of the slowdown in earnings, waiting patiently for profits to resume their uptrend.

Our macro view: Medium-term, we see the environment as constructive, but some risks make us cautious enough to warrant a neutral stance.

A policy error by central bankers is a risk as they begin to remove accommodative policies. Equity valuations are generally elevated, with Canada and emerging markets the exceptions. Rising costs also present a headwind for corporate earnings in 2022.

However, many positives remain. Monetary policy is only beginning to tighten. New fiscal spending is expected to flow, although the overall government sector contribution to GDP growth is expected to decline. Unshackled from the pandemic, businesses and households step up. Households have accumulated savings, are seeing rising wages and positive wealth effects. Businesses are flush with cash; tight labour markets and rising costs should be a catalyst for capital investment spending that can unlock productivity gains.

Our base case scenario features upward pressure on bond yields. Equity gains that flatten out into 2022 are accompanied by volatility as recession and stagflation scares swirl, but don't materialize. This environment can present short-term tactical opportunities, but the best approach is, as always, diversification across asset classes and a long-term time horizon to ride out any short-term turbulence.

Equities often pause after inventory restocking before resuming climb

MSCI World Equity Index

Source: Bloomberg November 2021

Theme 1

Inflation reset, not revolution

After a decade of inflation below 2%, we believe inflation will shift to a higher level but won't spiral out of control. It's a reset, not a revolution.

Inflation has the power to impact the outlook for all asset classes. That impact depends on the *source* of inflation (cost-push or demand-pull), the *nature* of the inflation (transitory or structural), and the *growth environment*.

In the current environment, both demand and supply forces are at play, and the data continues to be heavily distorted by the pandemic.

Demand-pull inflation is due to a surge in demand. This type of inflation is a sign of the good times and includes wage growth that fuels further consumption. The key for equity investors lies in companies continuing to pass along price increases that keep all-important corporate earnings protected.

Cost-push inflation arises when there's tight supply of inputs and labour. Supply chain disruptions, often transitory, don't worry us as much as the pre-pandemic trends lingering in the labour market – an ageing workforce, declining labour market participation and skills mismatch. Impaired immigration flows have also impacted labour force growth. One counter to the impact of the tight labour market is the continuous rise in automation.

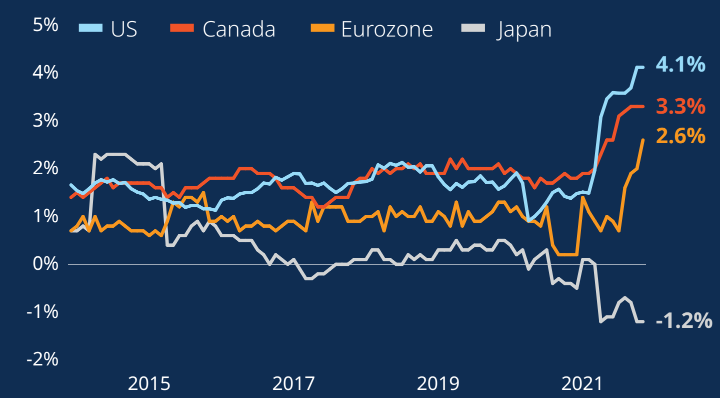
Supply and demand are out of sync. While consumption has skyrocketed, labour and supply chain disruptions caused by rolling lockdowns have not yet eased. This pandemic-induced disequilibrium marks a significant misalignment of supply and demand. How long this will last is on the mind of every central banker who has bet on the current inflation trend being transient.

Stagflation is a non-starter. If costs stay elevated due to long-lasting shortages (such as the 1970s oil embargo), inflation could send bond yields and prices so high that economic growth gets choked off, and stagflation is a risk. But to be in stagflation, the economy needs to be stagnating. With robust demand, rising employment, rising wages and well above potential GDP growth, we believe the economy remains firmly in boom mode.

Our view on inflation: We are experiencing a reset to a new base level, but not a revolution. Inflation will reset at a level higher than the sub-2% range of the last decade. Global deflationary forces, productivity gains, and fading medium-term transitory factors are expected to keep inflation from spiralling out of control. Of course, there are still central banks to consider. They may take a lighter hand on the wheel, but they're not asleep.

Inflation hits in a perfect storm of surging goods demand and supply disruptions

Global core inflation (y/y % change)



Source: Bloomberg October 2021

We believe inflation will reset to a new normal, but won't spiral out of control.

Lesley Marks, MBA, CFA
Chief Investment Officer, Equities

Theme 2

A sustainable China is good for investors

After decades of growth at all costs, China seeks a stable and sustainable growth path that we believe will benefit investors and the world.

As the world's second-largest economy, China remains a key driver of global growth. Naturally, investors worry about policy changes that may seem, on the surface, to be anti-free market. However, after decades of embracing capitalism, China's private sector accounts for 60% of its GDP and 80% of jobs. Economic growth remains of utmost importance. Policymakers are aware that China cannot grow without a vibrant private sector.

The transition from *quantity* growth to *quality* growth is the path to sustainable growth. In the early 2000s, China added 12 million new workers a year; this has fallen to 1-2 million new workers a year. China no longer needs to pursue high growth at a high cost to the environment, financial stability and inequality.

China and the West face similar concerns. "Common Prosperity" is not a negative. Social agendas that prioritize social equality, access to healthcare/eldercare and education, and housing affordability are also being pursued in the West. Similarly, many Western governments are looking to address privacy issues and monopolistic practices in big tech/platform technology companies.

Policy tightening in the real estate sector aims to avoid future market corrections by reducing the outsized exposure of the Chinese economy and financial system to excess leverage and moral hazard. There is also a fear the property sector is crowding-out resources and capital from important investments in manufacturing upgrades, green initiatives and innovation.

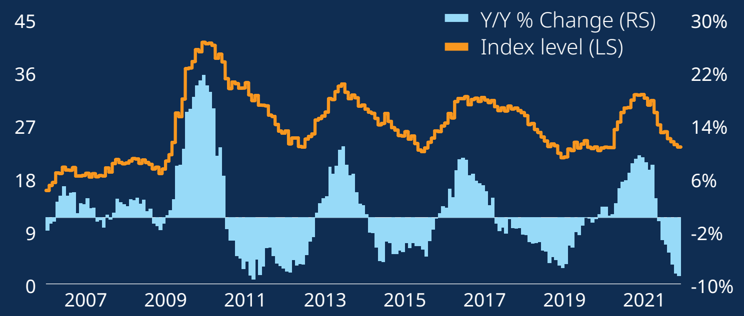
We believe fears over regulatory tightening are overblown. Policy reforms in China are not new. There have been four episodes of regulatory tightening in the past decade alone. In our opinion, the concern that the government will take control of the private sector or that regulatory reform will stifle entrepreneurship has historically been overblown in the markets, creating an investment opportunity.

Our view on China: A stable and sustainable growth path for China is beneficial for the world and vital for global growth. A more equitable Chinese economy with social safety nets will lower precautionary savings and boost demand for domestic goods and imports.

In 2022, China will convene its 20th National Party Congress. Prior Party Congress years (one every five) have corresponded to periods where the Chinese authorities have steered the economy toward an upswing. We see 2022 as a year where the slowdown in Chinese GDP growth bottoms and regulatory headwinds attenuate, leaving China in a position to improve global growth.

China's stimulus bottoming leaves the pump primed to reflate

Bloomberg Economics China Credit Impulse Index



Source: Bloomberg October 2021

We believe China is primed for growth and that Common Prosperity is a medium- to long-term positive for investors.

Brent Joyce, CFA
Investment Strategist

Theme 3

Central banks, mind the brakes

Global central banks are in a tricky spot. Inflation persists, but any over- or under-reaction will risk derailing a fragile post-pandemic recovery. We believe central banks will take a light-handed approach.

The typical response to higher inflation would be for central bankers to increase interest rates, but the current environment carries special considerations:

- Raising interest rates too soon or too aggressively could push a still-fragile, post-pandemic economy into recession
- The world economy is saddled with massive debt due to fiscal spending to support economies during COVID-19. Total global debt has ballooned to 353% of world GDP[1]. Any increase in interest rates would drive up the borrowing costs on this debt

A new policy of "watch and wait – and fix it all". The US Federal Reserve has adopted a new policy of "average inflation targeting" to provide more flexibility to not act on interest rates, even when inflation runs above its 2% upper band. By letting inflation run too hot, the Fed risks needing to increase interest rates faster and higher than if they start earlier, triggering an early recession. Additionally, pressure is growing on central banks to go beyond traditional price stability and full employment goals and incorporate social equality and the climate crisis into their purview.

These changes in policy response are untested, raising the risk for policy to misfire. Market volatility could come simply from the perception that a large, globally significant central bank might make a policy mistake.

We believe rising rates increase uncertainty for all asset classes. For nominal bonds, rising yields would be universally painful in the short term, regardless of the factor driving the move (rising real yields, inflation expectations or term premia).

We believe equities could perform well as long as rates rise due to an improving economic environment. Fast and furious rate hikes to combat runaway inflation is a different story. Equity values would likely suffer from contracting price multiples due to recession fears and funds flowing away from equities into bonds.

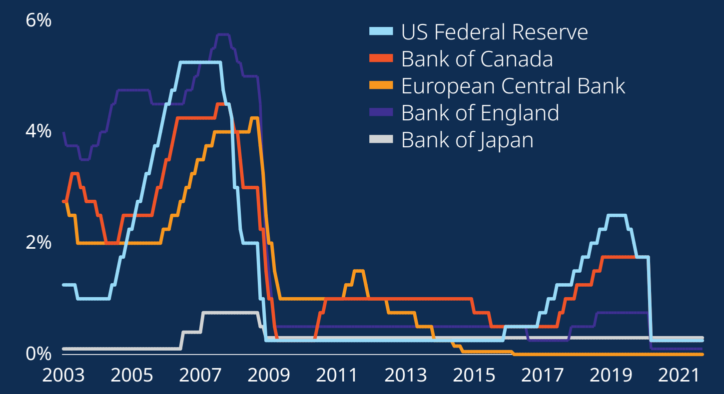
Our view on central banks: We believe global central banks will take a light touch on interest rate policy, and we see inflation fears abating. This should provide central banks with the leeway to remove stimulus and accommodative monetary policies in a gradual and orderly fashion.

For years, asset prices (equities and housing, in particular) have benefitted from low interest rates to the point that low real yields now underpin them. A disorderly move to higher yields could trigger repricing across multiple asset markets that could undermine financial stability.

[1] Institute of International Finance: Global Debt Monitor Q2 2021 estimate

The need to lift rates off the floor will bring uncertainty to stocks and bonds

Global central bank policy rates



Source: Bloomberg November 2021

The typical response would be to raise interest rates, but the current environment is anything but typical.

Steve Locke, MBA, CFA
Chief Investment Officer, Fixed Income & Multi-Asset Strategies

Canadian equity

William Aldridge, MBA, CFA
VP, Portfolio Manager, North American Equities Team

We hold a positive view on Canadian equities, anticipating attractive capital returns to shareholders through dividends and share buybacks, particularly from the banks and energy companies.

We believe the outlook for Canadian financials is strong as we anticipate robust capital returns, good expense management and reasonable earnings growth. In our view, financial stocks are trading at relatively attractive valuation levels.

For the energy sector, higher commodity prices have generated adequate cash flow enabling companies to repair balance sheets and fund ongoing production. Investors have been less interested in production growth and more interested in a return on their capital.

Inflation is a concern; however, as savings dwindle and consumers become more thoughtful about purchase decisions, this could lead to slower growth. Companies may face margin pressure if unable to pass on rising costs. We would not be surprised to see earnings growth slow in 2022 relative to current expectations. While rising input costs are generally negative for companies that lack pricing power, the Canadian stock market is more highly levered to companies that benefit from rising prices, such as energy and materials companies. Large financial companies, like the banks and insurers, should be able to offset labour cost increases through attrition and managing other expenses. Within the industrials sector, the railways have historically been able to raise prices to offset cost pressures. We also see consumer staples as attractive, given valuations and reasonably strong pricing power along with their defensive properties at a time when stocks feel fully valued in general.

We expect all our portfolio companies to be increasingly focused on environmental, social and governance (ESG) factors and their carbon footprints. Though carbon intensity is an obvious consideration for energy companies, we are spending more time speaking with management teams across all sectors about ESG and anticipate a continued focus on these principles as companies seek to ensure they are awarded the social license to operate. We cannot ignore that this may make it more challenging for certain companies.

We hold a positive view on Canadian equities, anticipating strong capital returns to shareholders through dividends and share buybacks…

Valuations in Canada are attractive, as is the 2.8%* dividend yield

S&P/TSX Composite valuations & earnings growth

Calendar year earnings growth estimates

2020	2021	2022	2023
-29.2%	88.5%	6.6%	-6.1%

*2022 Bloomberg estimate
Source: Bloomberg and FactSet November 30, 2021

US equity

Katherine Owen MBA, CFA
VP, Portfolio Manager Global Equity & Income Team

US economic growth is expected to slow in 2022 but remain at a historically rapid pace, supporting a solid earnings outlook for corporations. COVID-19 remains the most significant risk to this optimism as the US vaccination rate is below peer countries.

With US inflation running high, rising interest rates and higher discount rates could be the most important market influences on share prices. The US Federal Reserve (Fed) will likely start a new interest rate hiking cycle that may pressure valuation multiples and drive continued rotation within the equity market among value/growth, cyclicals/defensives and reopening/stay-at-home stocks. Investors need to balance the positive impact of a more widespread global reopening, pent-up demand and infrastructure stimulus with potential headwinds of tighter monetary conditions, peaking economic growth and higher taxes. Tight labour markets likely remain a challenge with companies facing elevated wage growth.

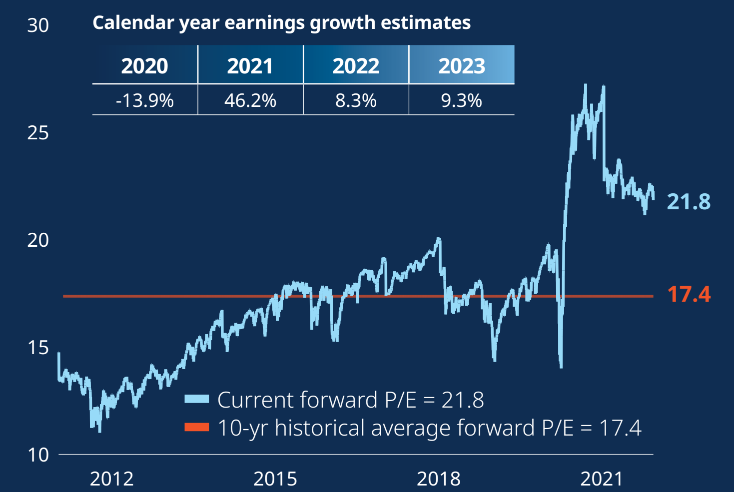
With pressure on valuations, companies generating and sustaining high current earnings face less pressure than those dependent on cash flows in the distant future, which are harder to predict with confidence. This represents a changing paradigm from the falling interest rate environment of the past decade. This shift should benefit companies with higher quality franchises and earnings streams, as well as cyclical recovery investments while putting at a disadvantage the more speculative growth companies and those that depend on cheap financing.

US equity valuations remain relatively elevated, and thus we expect overall US equity returns to be positive but moderating. We continue to believe that some companies will emerge stronger from the pandemic and others weaker, and this bifurcated recovery lends itself to adept security selection. We see opportunities in traditional value sectors like financials and reasonably valued secular growth companies in the consumer and technology sectors.

We continue to believe that some companies will emerge stronger from the pandemic and others weaker, and this bifurcated recovery lends itself to adept security selection.

Valuations elevated, reasonable earnings growth drives a positive but moderating return outlook

S&P 500 valuations & earnings growth



Calendar year earnings growth estimates

2020	2021	2022	2023
-13.9%	46.2%	8.3%	9.3%

Source: Bloomberg and FactSet November 30, 2021

European equity

Martin Fahey, MBA, CFA
SVP, Portfolio Manager,
Head of European
Equity Team

A renewed outbreak of COVID-19 across Europe is starting to concern financial markets, especially given the increasing likelihood of further lockdowns, against the backdrop of some countries' health systems beginning to reach capacity. The countries most negatively impacted are Eastern European as well as Austria, Germany, Ireland and the Netherlands. Europe likely has a tough winter ahead, trying to manage COVID-19 as well as the flu season.

Like the rest of the world, Europe is also grappling with supply chain issues and an increasing proportion of companies reporting labour shortages. However, pressure on corporate bottom lines isn't as acute as in some other jurisdictions. Wage growth in Europe is running at just under 1.4%[1] year over year, lagging significantly behind the US (closer to 5%[2]).

Corporate Europe also doesn't face as tough a road ahead for tightening financial conditions. Although the run rate of quantitative easing is expected to decline in Europe, the European Central Bank has pushed back against market expectations for interest rate increases. Nevertheless, the risk from COVID variants and global central bankers removing accommodation has sent bond yields lower with yield curves flattening and financial markets have become increasingly concerned about some leading economic indicators deteriorating (China and Germany for example).

With rising inflation (in the US in particular), our central case is that global bond yields will rise. Given that equity markets have performed very well over the past 15 months, risks are currently higher against a backdrop of higher inflation and potentially higher bond yields. Our view remains constructive as European equities, with their overweight toward value sectors such as financials, mining and energy, historically have outperformed global equity markets in periods of solid global growth and rising bond yields.

[1] Source: Bloomberg, as at September 30, 2021
[2] Source: Bloomberg, as at October 31, 2021

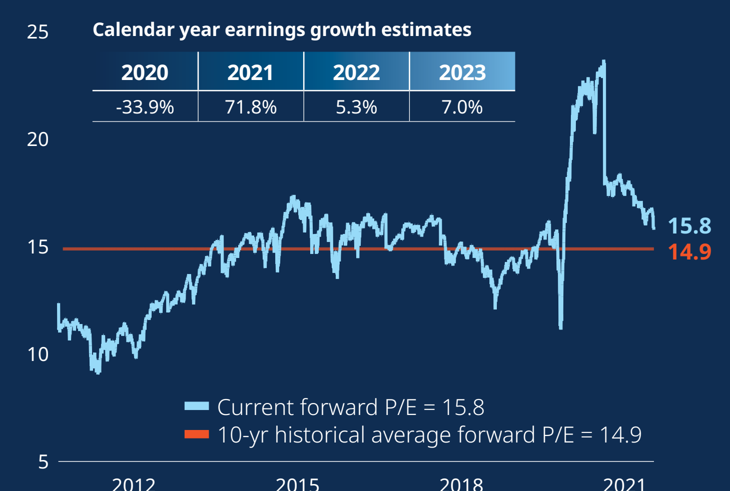
Our view remains constructive as European equities, with their overweight toward value sectors such as financials, mining and energy, historically have outperformed global equity markets in periods of solid global growth and rising bond yields.

Reasonable valuations and the cyclical orientation drive a positive outlook for European equities

STOXX Europe 600 valuations & earnings growth

Calendar year earnings growth estimates

2020	2021	2022	2023
-33.9%	71.8%	5.3%	7.0%



Source: Bloomberg and FactSet November 30, 2021

Asian equity

Nick Scott,
SVP, Portfolio Manager,
Head of Asian Equities

Asian equities peaked in February 2021 and have been on a slight downtrend since, mainly due to issues emanating from China. China's economy has slowed from its pre-pandemic pace of growth. Overall, we believe 2022 is likely to be a better year for Asian equities than 2021.

Government orchestrated deleveraging in the Chinese real estate sector has weakened the Chinese property market. There is a risk that this weakness will spill over to consumer confidence and the overall banking system. Increased regulation and the "Common Prosperity" policy have also weighed on Chinese equities. The "Common Prosperity" agenda could mean extra labour-related costs, reduced pricing power, and increased taxes and excise duties. However, Chinese exports have been very strong and the renminbi is the best performing Asian currency this year. The outlook for Chinese equities is slowly improving. We believe Chinese equity valuations are at attractive levels, the worst of the internet regulation is probably behind us, and the government has begun gradually introducing some pro-growth policies.

We prefer Japan and Australia in the region. Japan has structurally rising return on equity. Earnings revisions should remain positive as they are highly correlated to the global manufacturing cycle, with semiconductors and technology hardware being particularly strong. Japan's domestic consumption recovery should remain robust following a high vaccination rate and political reluctance to go back to stringent lockdowns. The financial sector looks attractive as bank credit costs should remain low, and loss-provisions are abnormally high. Financial sector stock prices are strongly correlated to rising US bond yields.

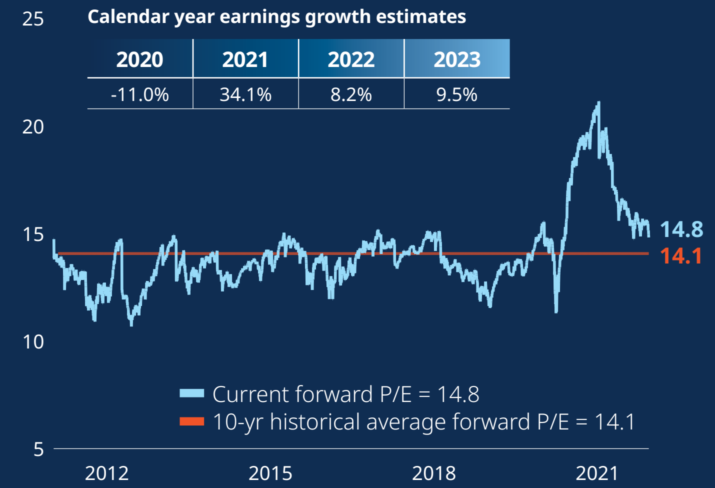
We particularly like the Australian banks that have over-provisioned during the COVID pandemic. They are beneficiaries of rising short-term rates. The energy and material sectors have a more transparent and strategic view on ESG related issues; natural gas companies should benefit from China's need to reduce coal in its energy mix.

Reasonable valuations and solid earnings growth drive a positive outlook for Asian equities

MSCI AC Asia Pacific valuations & earnings growth

Calendar year earnings growth estimates

2020	2021	2022	2023
-11.0%	34.1%	8.2%	9.5%



Source: Bloomberg and FactSet November 30, 2021

Chinese equity

Wenjie Ding, Ph.D.
Investment Strategist,
China Asset
Management Inc.

China's economic outlook continues to face a variety of challenges heading into 2022. COVID-19 remains a problem in many countries around the world as well as in China. At this time, China continues to have a zero-COVID tolerance policy to help ensure the safety of the Winter Olympics set for February. We expect this will change.

Another significant factor affecting economic growth is an energy shortage due to a lack of investment in coal from policy initiatives toward more renewables. This left coal in short supply in China, so when energy demand increased, prices got pushed to impossibly high levels, causing rolling blackouts and brownouts in certain provinces. While acute, the energy shortage can be solved, even if it means a step in the wrong direction by temporarily increasing coal usage. We believe that China remains committed to its carbon neutrality goals, by reducing fossil fuel reliance in favour of renewables.

The other significant challenge for China is how it emerges from the economic slowdown and high debt levels in its very important real estate sector. We believe that the government has the tools to keep the situation contained while at the same time discouraging bad habits that led to this difficult moment.

A positive for investors is that Chinese equity valuations sit below peak levels reached early in 2021 and at a wide gap to developed market valuations. China continues to innovate and deliver solutions that the world needs – in particular, in renewable energy. Regulatory crackdowns, which have been a key source of equity market uncertainty, are seen as waning. We expect risk appetite for Chinese equities to remain subdued over the near term, but overall, we see 2022 as likely to be a better investment experience than 2021.

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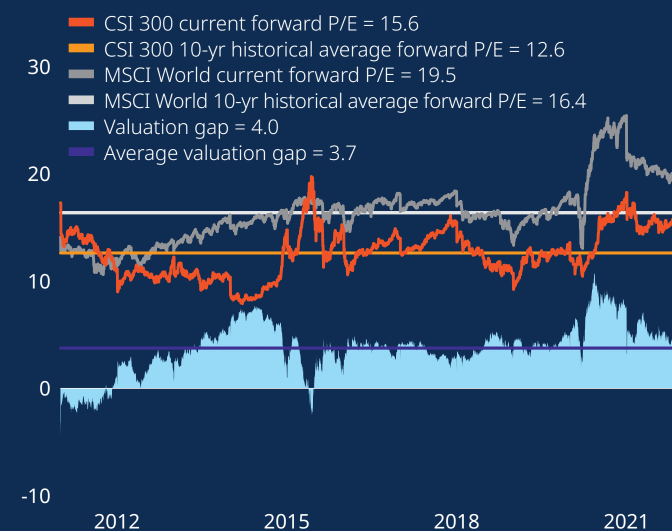
Chinese equity market valuations offer an attractive discount to developed market valuations

Equity valuations: China CSI 300 vs. developed markets



Source: Bloomberg November 30, 2021

EM equity

Arup Datta, MBA, CFA
SVP, Head of Global
Quantitative Equity Team

We believe that emerging markets equity (EM) is well-positioned for growth over the next decade. We continue to see the benefits of diversification within emerging markets. While China brought down the returns in 2021, India's strong performance helped offset this. We believe the benefits of diversification in EM will continue going forward as several of the leading economies in the emerging markets are rapidly developing.

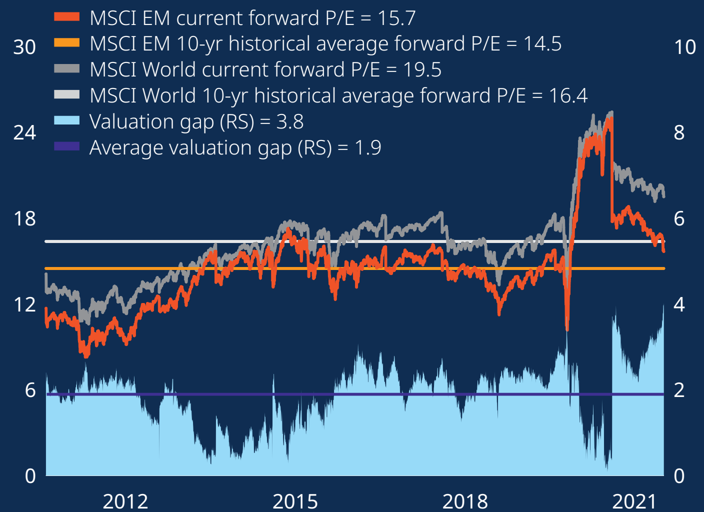
We continue to see EM valuations at a steep discount relative to developed markets. However, uncertainty remains. Emerging economies have had varying degrees of setback and success battling COVID-19. The majority are seeing a recovery in economic activity. We are keeping a close watch on the potential for China to expand their regulatory crackdown in and beyond technology, digital and for-profit education firms, and pollution-emitting industries. Or China may begin to loosen up if they believe current actions have gone too far. In addition, we continue to keep a close watch on trade policy between China and the US.

Overall, the length of the pandemic, varying degrees of recovery across countries and central bank actions around the world are our biggest concerns in emerging markets. Heading into 2022, we continue to believe in the long-term benefits of emerging markets equities within a diversified portfolio. EM equities are levered to a global expansion scenario and contain many exciting new economy and technology companies. The investment team's quantitative approach constructs the portfolio with a "core" focus, balancing growth and value characteristics and seeking to outperform in various market environments.

We believe that emerging markets equity is well-positioned for growth over the next decade. We continue to see the benefits of diversification within emerging markets.

Emerging markets provide attractive valuations and diversification benefits

Equity valuations: emerging vs. developing markets



Source: Bloomberg November 30, 2021

Global fixed income

Konstantin Boehmer, MBA
SVP, Co-Lead of Fixed Income Team,
Head of Global Macro,
Portfolio Manager

Global fixed income has endured a challenging year with most developed markets' bond yields rising substantially in 2021. The initial rise has been primarily driven by expectations of future rate hikes. Thus far, policy rate hikes in developed markets have been very limited (mainly smaller countries like New Zealand and Norway). We expect more countries and rate hikes to follow. However, we believe base effects will likely bring inflation down aggressively next year. There are many possible paths ahead. Unexpected events can occur and we believe capital markets remain fragile, as plenty of risk assets trade at rich valuations. Moreover, in countries with significant household debt, paired with short debt maturities, interest rate sensitivity will likely play a large role: how far can bond yields rise before negatively impacting growth?

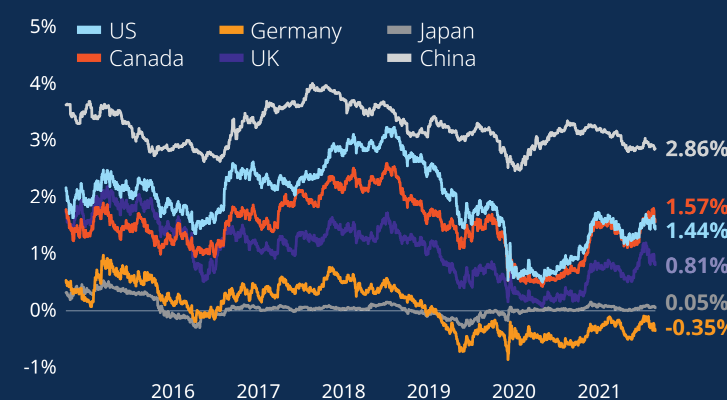
Inflation pressure is being felt globally, and most acutely in North America. This increases the risk of a central bank policy error. The risks are the possibility that a central bank is too aggressive and could stifle growth; or too loose, allowing inflation to become entrenched. This uncertainty is causing interest rate volatility and unusual yield curve divergence between the two interlinked bond markets of the US and Canada. China has been an outlier in the global trend of interest rate hikes – our expectation is for more rather than less Chinese policy accommodation.

Emerging market (EM) economies have already had to respond to inflationary pressures and the prospect of tightening financial conditions emanating from the US (higher US yields and stronger US dollar). With an array of countries sitting at various stages of the hiking cycle, we expect quite a few opportunities to arise. However, US dollar strength and rising US bond yields are two major obstacles for a sustained EM rally.

We are likely to see upward pressure on interest rates. The question is, how far can bond yields rise before negatively impacting growth?

Solid growth, normalizing monetary policy and inflation put upward pressure on global bond yields

Selected global 10-year bond yields



Source: Bloomberg November 30, 2021

Credit market

Dan Cooper, CFA
SVP, Head of Credit,
Portfolio Manager,
Mackenzie Fixed Income Team

We are constructive on the credit markets for 2022, as the yields on corporate bonds look attractive in this low yield environment relative to other fixed income alternatives. Companies endured a severe profit recession but were largely able to survive (and many prospered) on significant government monetary and fiscal support. Fast forward almost two years from the onset of the pandemic, and there is a strong tailwind from the recovery and re-opening. Companies have access to capital and liquidity, and profits and credit fundamentals have rebounded to pre-crisis levels. The default rate sits at a multi-year low.

Although this backdrop represents a supportive environment for credit, we expect the majority of returns in the coming years to come from interest income, as there is limited spread-tightening potential given the massive rally since March 2020. We see this total return opportunity as attractive. Credit spreads can remain low and rangebound for an extended period, evidenced by the mid-cycle environments of 2004-2006 and 2017-2019.

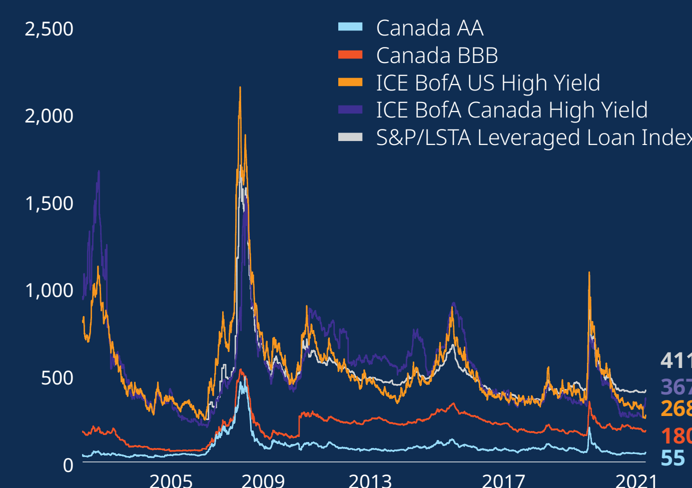
The main risk to our outlook is the threat of higher inflation and rising government bond yields, which may pressure areas of the credit market with greater duration sensitivity. As a result, we favour lower quality segments of the credit markets, such as high yield bonds and especially leveraged loans over higher-rated investment grade corporates with limited spread buffer.

Outside of the traditional markets, we also see interesting opportunities in the non-syndicated private debt market. Given that some economies are at different points in the economic cycle, we believe the global high yield market also presents attractive valuation opportunities. We continue to believe that it's essential to have the flexibility in this environment to move up/down the capital structure, across rating categories, and across different markets to seek out strong risk-adjusted returns in this challenging low-yield environment.

The total return opportunity is attractive, especially in lower rated segments. Credit spreads can remain low and rangebound for an extended period, evidenced by the mid-cycle environments of 2004-2006 and 2017-2019.

Credit spreads are narrow – total return opportunity is attractive in an overall low-yield environment

Select North American credit spreads



Source: Bloomberg November 30, 2021; S&P/LSTA Leverage Loan Index: S&P Global Intelligence November 30, 2021

Currency

Todd Mattina, Ph.D
SVP, Chief Economist,
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Multi-Asset Strategies Team

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Economist, Multi-Asset
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We expect the US dollar (USD) to depreciate relative to other "G5" major currencies, including the Canadian dollar, euro, British pound and Japanese yen.

US dollar

Numerous forces are expected to weigh on the USD, including large US budget and trade deficits as well as the USD's current overvaluation relative to long-term economic fundamentals. Capital flows were attracted to the liquidity and relative safety of US financial markets during the spring of 2020, and more recently by the prospect of tighter Fed policy. However, we expect portfolio flows to shift next year toward international markets in search of higher expected returns as the global economy continues to recover, global vaccination rates rise, and our expectation that many foreign central banks start hiking interest rates.

Canadian dollar

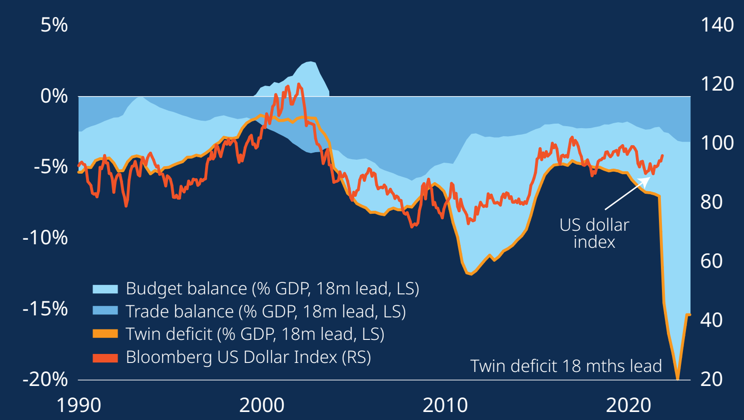
The strongest performer in 2021 among G5 currencies is expected to benefit from USD weakness. Building on the positive sentiment of past quarters and firmer commodity prices, higher Canadian interest rates could attract portfolio flows to Canadian markets in 2022. The yield pick-up after inflation to investing in a 10-year Canadian real return bond compared to its US equivalent is very wide at +0.5%, representing the 96th percentile of its distribution since 2008.[1]

Outside of North America, we expect the **euro** and **British pound** to gain relative to the USD in coming quarters. The euro and pound are undervalued relative to our fair value estimates, and both currencies should benefit from shorter-term macro trends. European growth has been solid recently, with Q3 eurozone GDP growth exceeding expectations and leading indicators for EU economies indicating positive economic momentum, although the new Omicron COVID variant could reverse this trend. In the UK, the hawkish turn by the Bank of England caused a surge in short-term government yields and could trigger the pound's convergence towards fair value in the coming quarters.

We expect the US dollar to depreciate relative to other "G5" major currencies, including the Canadian dollar, euro, British pound and Japanese yen.

US dollar: Weighed down by the large US "twin deficits"

US dollar vs. US deficits



Source: Bloomberg November 30, 2021

[1] Bloomberg, November 30, 2021

Commodities

Benoit Gervais, MSc, CFA
SVP, Portfolio Manager,
Head of Mackenzie
Resource Team

After a very strong 2021, 2022 will likely be a year of consolidation for commodities as many digest the recent price gains. However, we do not expect protracted declines. Rather, it is likely that commodities will establish new levels in 2022, with very few retreating to the mid-cycle prices of the last 10 years.

Lumber, a key ingredient to the North American housing sector, is an example of our thesis. The second quarter of 2021 saw the two-year advance in lumber prices hit a new all-time high, averaging US$1,300/1000bf. Prices have since retreated, establishing a new US$500 - US$800 range, a level that we believe will prove sticky and a significant departure from the lower average price of ~US$350 between 2010 and 2020[1].

Most commodities languished in bear market territory for 10 to 14 years after the 2008-2011 peaks. The weak prices forced producers to continually restrain capital investment, which is impacting today's supplies/reserves. While the latest price recovery has been impressive, it has done little to convince companies and shareholders to change their preference for dividend increases, share buybacks and debt reduction.

China was the main driver for commodity demand in the 2000s. We believe the next decade or two will be about infrastructure and climate action. This handover should allow prices to stabilize at much higher levels than expected. Few investors seem convinced that commodity prices can stay near current levels. Likewise, few, if any, companies are priced for growing demand. To incentivize resource companies to meet society's environmental aspirations, capital markets will need to price these businesses as part of the long-term solution. That should be reflected in higher earnings multiples, the ultimate signal, in our opinion, for company executives to redeploy capital and address climate change.

To incentivize resource companies to meet society's environmental aspirations, capital markets will need to price these businesses as part of the long-term solution.

Commodity bust erased, green revolution establishes a new level

CRB Commodity Index

Source: Bloomberg November 30, 2021

[1] Source: Bloomberg, November 30, 2021

Asset mix recommendations

Equity*

Equity

We hold a constructive outlook but see enough risks to warrant a neutral stance. Equity valuations are generally elevated and face downward pressure on rising bond yields. Solid global growth sees earnings deliver, but that represents a normalization back to single-digit levels. We see equity markets remaining buoyant but with much shallower gains.

Canada

Canadian equities are levered positively to global growth. We anticipate strong capital returns to shareholders through dividends and share buybacks. The value and cyclically oriented sector composition is favourable against a backdrop of rising yields and commodity prices. Valuations are attractive, as is the 2.8% estimated dividend yield.

US

We expect solid S&P 500 earnings reflective of strong GDP growth. Downward pressure on margins is likely from rising input costs and on elevated valuations from rising bond yields. We expect overall US equity returns to be positive but moderating. The 1.4% estimated dividend yield is modest relative to other markets.

International

International developed market equities with more value, cyclical, industrial and global trade-oriented exposure should perform well against a backdrop of solid global economic growth that includes inflation and rising yields. Financial conditions in Europe and Japan remain easier than in North America. Valuations are moderate and the MSCI EAFE Index 3% estimated dividend yield is attractive.

Emerging markets

EM equities are levered to a global expansion scenario along with many exciting new-economy and technology companies. We expect present headwinds to turn into tailwinds, with the US dollar weakening, China's growth stabilizing (with the potential for stimulus) and tempering of regulatory reform. In our opinion, the weak performance in 2021 leaves valuations attractive.

Fixed income

Fixed income

We expect bond yields to rise mildly in 2022. The move higher in 2021 has gone a long way; some further upward adjustment remains – keep duration short. We see yields being restrained by excess global savings, central banks' desire for an orderly move toward normalization and the sheer volume of global debt.

Sovereign bonds

We expect that sovereign yields should move higher as central banks taper asset purchases and raise overnight rates. Nominal yields face upward pressure from rising inflation risk premia, and real yields rising within a solid economic backdrop. Flows from ultra-low yield jurisdictions (Europe and Japan) temper global yield increases. Some exposure is prudent, as a hedge against any short-term bout of risk-off sentiment.

IG corporate bonds

We are constructive on credit markets amid a robust economy delivering solid earnings growth, falling defaults and credit rating upgrades outpacing downgrades. Demand is strong from yield-hungry investors. We acknowledge that credit spreads are tight, providing minimal buffer from rising government bond yields. We see credit positioned to deliver attractive carry.

HY corporate bonds

We expect high yield and leveraged loans to outperform investment grade, given the additional spread buffer to higher rates. However, we expect some flow-through of higher rates to impact high yield bonds and thus currently prefer leveraged loans, which benefit from rising rates and have virtually zero duration.

* All dividend yield estimates are Bloomberg consensus. As of November 30, 2021

Underweight Neutral Overweight

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