Mackenzie Bluewater Team

Q4-2018 COMMENTARY

The fourth quarter of 2018 saw large declines in equity markets globally and a sharp upswing in volatility. There have been several large market pullbacks over the past decade and in each case markets gradually recovered and then went on to new highs. Each time, we have looked to answer the same set of questions, namely: is this the end of the cycle or simply another mid-cycle pause, and if so, what might that mean for equity markets, and what are we doing about it in the funds that we manage. Our funds are very global in terms of where our companies do business so we thought it would be useful to recap our views on the economic conditions in the three major global regions—Asia, Europe, and North America.

Recent data from China suggest that economic growth has slowed sharply because of the trade dispute with the United States. At this point it appears more likely than not that the trade friction will ultimately be resolved, which seems to imply that growth should rapidly snap back. This view may prove too optimistic. We believe that China's manufacturing base will continue to see longer term erosion regardless of a new trade deal. Many companies have highlighted that the cost of manufacturing in China has been increasing over the years. In our view, supported by recent conversations with several of our portfolio holdings, the trade friction has caused companies to re-examine their supply chains leading them to conclude that moving operations to other, less developed, emerging markets will ultimately be cheaper. As a result, even with a resolution of the trade dispute, we suspect that 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. For over a decade, the Chinese government has highlighted the need to increase local consumption by consumers, moving China's economic growth mix away from infrastructure construction and manufacturing. We will see if the policies the government choses to pursue will indeed move them in this direction, or if they will once again look to offset any slow down through accelerated infrastructure spending. At this point we are cautious on the economic growth prospect for China.

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. There have been occasional pick-ups in growth, followed by considerable market enthusiasm that Europe has "finally turned the corner". Each one has proved disappointing, as growth has subsequently slumped. In our minds, the issue is as much about forecasting as it is about the actual rate of economic growth in Europe. Growth, excluding inflation, seems stuck at around 1-2%. When growth rises above that level, as it did in late 2017, forecasters seem to react by ratcheting up their expectations for future growth rates. As European growth subsequently slows back to trend, markets are "disappointed". Once again, we are in a period of disappointment. As has been true for the past decade, Europe continues to have many large political problems that are a headwind to growth. At this point, the main ones in the 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 American economies continue to expand as we head into 2019, with the US economy outperforming Canada. Growth in the US 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 US than in Canada. We have repeatedly highlighted that nearly all recessions in North America are led by a significant slowdown in the housing sector, as housing is a significant component of consumer net worth and a major source of economic cyclicality. House prices in both Canada and the United States have moved up rapidly and as a result affordability is now stretched in both countries. As a result, it seems reasonable to assume that housing will not be a source of strength for either economy in the nearer term. Canada, in particular, has had a long period of rising prices, and certain regional markets are now showing clear signs of weakness. With the 2008-2009 global financial crisis centering around a collapse in the US housing market, it is worth contrasting the state of the housing markets pre-crisis versus today.

In the 2000's the US housing market entered a bubble, which was clear from several major economic data series, all of which remain fairly muted during this cycle. During the 2000's, the US saw a massive increase in real estate activity as measured by housing turnover, new homes built, and mortgages taken out. The housing market peaked in 2005 and then collapsed. By 2007, before major problems began to show up in the economy, housing related indicators were down 40%+ from the peak. This cycle, despite significant increases in housing prices, we simply have not seen the same excesses in housing markets, which suggests to us that any housing downturn is likely to be fairly muted. Existing home sales and new housing starts are at mid cycle levels, and mortgage

MACKENZIE Investments

lending conditions do not appear unusually lax. As a result, we suspect that any downturn in North American growth coming from the housing sector will be fairly mild, as, unlike 2007-2009, there does not appear to be large excesses that need to be worked though and absorbed over an extended period of time. Looking across the three major regions, it appears to us that the North American economies remain the best positioned at this point.

To some extent the large declines in equity markets globally were touched off by the US Federal Reserve, with Fed Chairman Jerome Powell stating on October 3rd that "Interest rates are still accommodative, but we're gradually moving to a place where they will be neutral" and "We may go past neutral, but we're a long way from neutral at this point, probably." Bond yields immediately spiked upwards and equity markets began to fall the next day. 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. As a result, moving rates back up to more "normal" levels will likely create a very large headwind to growth. Somewhat belatedly, the Fed Chairman appears to have recently reversed course, signaling that the Fed may not be accurately assessing the neutral rate and that future interest rate increases will be data dependent.

So where does all of this leave us? Well, we entered 2018 with global synchronized growth. Strong global growth with increasing inflationary pressures forced 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. But the flip side to all of this is better than the alternative. 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. We are braced for a slowdown but are not convinced that a major recession in the US is imminent. The businesses we have always been attracted to are those that are not dependent on a strong economy. In fact, we have a long consistent track record of underperforming in very strong economic growth environments. We believe there is nothing in our investment approach to change this record. We do not invest in deeply cyclical businesses that perform extremely well in strong economies, but falter when things start to slow. We don't invest in highly levered businesses that investors tend to shun when times get tough. We don't invest in concept stocks where valuations are based on some rosy endless outlook of great growth. What we do invest in are 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.

The market volatility has seen stock prices tumble for many companies. Are we interested in buying everything? No! But are there opportunities? Absolutely! Our investment criteria has not changed, we have simply been given an opportunity to find some new investments that were otherwise out of our reach.

During the quarter we initiated positions in several new companies, including Wolters Kluwer.

Wolters Kluwer is a Netherlands based firm providing data and systems for healthcare, legal, regulatory and accounting professionals. The company has undergone a long and steady evolution over the past 15 years, a transition which we believe highlights the importance of management to a business. In 2003, Nancy McKinstry was named CEO, a role which she continues in today. At the time, Wolters was a strong business that was in the process of being disrupted by technology. The company had a long profitable history as a provider of information and analysis to the healthcare and legal professions in the form of textbooks and journals; i.e. printed material. The rise of the internet was a clear disruptive threat, forcing the company to adapt or risk becoming obsolete. Wolter's major competitors, including Canada's Thomson Reuters Corporation, elected to engage in "transformational" M&A to combat the threat. Wolter's new CEO chose very differently, and the company began the slow, steady, and difficult work of transforming the business from within. Over the past 15 years, print has shrunk from over 50% of sales to less than 10% today, replaced with the highly recurring and steadily growing digital distribution of information. The company continues to provide data, analysis, and services to the same non-cyclical customer base: medical, legal, regulatory, and accounting professionals. But providing data in a digital format has clear advantages for Wolters, as digital distribution has higher operating margins and allows for the sale of data analysis tools. From a shareholder perspective, McKinstry's decision to face the challenges of disruption head-on has proven rewarding, with Wolter's stock materially outperforming their competitors over the past 15 years. In our view, the company's business is extremely well positioned to continue to perform steadily in the future.

PORTFOLIO MANAGEMENT TEAM:

Dina DeGeer, Head of Team, Senior Vice President, Portfolio Manager, Investment Management, Mackenzie Investments

David Arpin, Senior Vice President, Portfolio Manager, Investment Management, Mackenzie Investments

Shah Khan, Associate Portfolio Manager, Investment Management, Mackenzie Investments

Hui Wang, Associate Portfolio Manager, Investment Management, Mackenzie Investments

Commissions, trailing commissions, management fees, and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. The indicated rates of return are the historical annual compounded total returns as of December 31, 2018 including changes in unit value reinvestment of all distributions and do and not take into account sales, redemption, distribution, or optional charges or income taxes payable by any security holder that would have reduced returns. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.

Index performance does not include the impact of fees, commissions, and expenses that would be payable by investors in the investment products that seek to track an index.

This document includes forward-looking information that is based on forecasts of future events as of December 31, 2018. We will not necessarily update the information to reflect changes after that date. Risks and uncertainties often cause actual results to differ materially from forward-looking information or expectations. Some of these risks are changes to or volatility in the economy, politics, securities markets, interest rates, currency exchange rates, business competition, capital markets, technology, laws, or when catastrophic events occur. Do not place undue reliance on forward-looking information. In addition, any statement about companies is not an endorsement or recommendation to buy or sell any security.

The content of this commentary (including facts, views, opinions, recommendations, descriptions of or references to, products or securities) is not to be used or construed as investment advice, as an offer to sell or the solicitation of an offer to buy, or an endorsement, recommendation or sponsorship of any entity or security cited. Although we endeavour to ensure its accuracy and completeness, we assume no responsibility for any reliance upon it.

On November 10, 2006, the Mackenzie US Growth Class acquired the assets of another Mackenzie-sponsored fund in a merger that was considered a material change for the Fund. Therefore, the Fund's performance is provided from the date of the merger rather than its inception, as required under applicable securities laws.

Fund and Benchmark Performance as at: December 31, 2018	1 year	3 years	5 years	10 years
Mackenzie Canadian Growth Balanced Fund – Series F	-0.8%	5.9%	9.5%	8.3%
65% S&P/TSX Composite TR and 35% FTSE TMX Canada Universe Bond Index ($CDN)	-5.3%	4.9%	4.0%	6.8%
Mackenzie Canadian Growth Fund – Series F	-1.3%	8.0%	12.4%	11.0%
Blended Benchmark* ($CDN)	-4.9%	6.8%	7.3%	10.0%
Mackenzie Global Growth Class – Series F	0.5%	5.3%	8.4%	11.3%
MSCI World Index ($CDN)	-0.5%	5.7%	9.9%	10.8%
Mackenzie US Growth Class – Series F	5.9%	5.6%	10.2%	11.5%
S&P 500 Index**	4.2%	8.6%	14.1%	14.3%

*The Mackenzie Canadian Growth Fund's benchmark was changed in March 2017 from the S&P/TSX Composite Index to a blended benchmark of 60% S&P/TSX Composite Index, 30% S&P 500 Index, and 10% MSCI EAFE (Net) Index, in order to better reflect the long-term average geographic composition of the Fund. **The Mackenzie US Growth Class benchmark was changed in March 2017 from the Russell 1000 Growth Index to the S&P 500 Index in order to better reflect the long-term average geographic composition of the fund.

MACKENZIE Investments