MACKENZIE
Investments

Mackenzie Call Series

Calming perspectives in uncertain markets

Economic updates and perspectives on high yield bonds and ETFs

On May 26, Mackenzie held a conference call featuring economic and market updates from **Todd Mattina** (Senior Vice President, Chief Economist, Team Co-Lead, Mackenzie Multi-Asset Strategies Team) and **Dan Cooper** (Vice President, Portfolio Manager, Mackenzie Fixed Income Team).

Conference call highlights

Current macroeconomic perspective (Todd Mattina)

- Stock markets have rallied strongly after the initial COVID-19 decline with U.S. and Canadian markets down by about 7% and 11% this year, respectively.[1] The market is predicting some improvement in corporate earnings in 2021 and lower interest rates for longer. These factors are helping to support equity fair values.
- The economic lockdown has helped contain the virus but has also led to "sudden stop" in a large portion of the global economy, leading to massive job losses. To help support the flagging economy, governments have increased budget deficits to levels not seen since the Second World War, and central banks have aggressively eased their monetary policies.
- The Canadian dollar has recently declined to roughly US$0.72, given that the Canadian dollar is typically a pro-cyclical and commodity currency that benefits from a strong market. We believe fair value for the Canadian dollar is higher. However, the U.S. economy is stronger and more diversified than the Canadian economy and appears better positioned to rebound following the pandemic. For now, we are keeping our currency hedges at their long-term target levels because cheap valuations for the Canadian dollar are offset by macro conditions supporting the US dollar.
- As a result of the pandemic-related slowdown, deflation is currently the greater risk while higher inflation could arise in the long term once the economy is in a firm recovery mode. Since many unknowns remain, we think diversification across asset classes and investment strategies (which leads to lower correlation and higher risk-adjusted expected returns) is important when preparing for a wide range of potential future economic environments.

Insights on today's high yield market (Dan Cooper)

- Valuations in the high yield bond market were already expensive coming into 2020, as indiscriminate buyers through 2019 had driven spreads to only 350 basis points over treasuries by the end of the year. The high yield market then repriced wider in March, as the escalating COVID-19 situation drove spreads to over 1,100 basis points over the course of an unprecedented 21-day stretch, as risk assets sold off and the price of oil fell to only $23 per barrel.
- Spreads have since tightened to 700 basis points as the Fed effectively removed the tail risk and stabilized the markets in March with two emergency rate cuts, as well as a massive asset purchase program. As part of the program, the Treasury announced that they would be directly buying bonds of investment grade and fallen angel issuers, as well as credit ETF's in both investment grade and high yield. The announcement was enough to get the credit markets functioning again, as it gave investors the confidence to lend to companies, and the new issue market re-opened to provide companies with the much needed liquidity they need to get through the crisis.
- The high-yield market had been down 20% at its recent low in mid-March, but has since rebounded to a 7% drop for the year. . The performance has been bifurcated, with higher quality issuers flat to down 7%, which the lower quality CCC segment is still down closer to 20%, pricing in more stress and uncertainty.
- The Fed actions have solved the immediate liquidity issues that companies faced, but insolvency remain an issue for many companies, which will result in a higher default rate in the coming year. The default rate already ticked up from 2% to 4% in the last couple of months, as many retailers have shutdown and high-cost oil producers have failed.

[1] U.S. and Canadian stock market returns are based on the year-to-date performance of the S&P500 and S&P TSX market indexes, respectively, as of May 26. Returns are expressed in local currency.

Defaults are a lagging indicator however, so we expect to see a 10% default rate by the end of the year, particularly in industries that are most sensitive to the impact of COVID-19 and those in more cyclical sectors.

- Accordingly, we've been underweight cyclical industries like energy, airlines and leisure, but overweight industries with less risk and reasonable valuations, such as health care, telecom, cable, and packaging. To gain exposure to cyclical sectors, we've recently favoured secured bonds issues and higher quality issuers with attractive yields and lower risk of failure or weakness.
- Overall, we believe the high-yield market is in better shape now than it was during the 2008-09 financial crisis, with an overall higher quality of companies, and better fundamentals as companies have opportunistically refinanced at low rates while pushing out maturity dates. Spreads are wider now, making the high-yield market look more compelling with better risk-adjusted return potential, although additional risks and volatility are still possible.
- As an alternative to investing directly in a high yield product in this volatile and uncertain environment, we're suggesting that investors consider a more defensive way to play the recovery with the Mackenzie Unconstrained Fixed Income Fund or Mackenzie Unconstrained Bond ETF (MUB). This is a tactical go anywhere strategy that aims to achieve an above average yield, but also limit downside with the objective of achieving a positive return through the market cycle.
- The Unconstrained mandates can be used as core components of most fixed income portfolios. The mandates are built with the flexibility to invest where we see the best risk adjusted return potential across the fixed income universe. Permeant downside mitigation is in place through the purchase of insurance in the form of put options to limit the downside in the high yield portion of the mandate, which paid off as the market selloff occurred this year.

Check out the conference call

To access the playback of this call, visit our website or dial-in to our instant replay below.

Toll-free: 1-800-408-3053
Passcode: 3315460

Please note that the dial-in number will only be available for 30 days after the event and will expire on June 26, 2020.

FOR ADVISOR USE ONLY. No portion of this communication may be reproduced or distributed to the public as it does not comply with rules for investor sales communications. Mackenzie disclaims any responsibility for any advisor sharing this with investors.

The content of this communication (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.

This communication may contain forward-looking information which reflect our or third-party current expectations or forecasts of future events. Forward-looking information is inherently subject to, among other things, risks, uncertainties and assumptions that could cause actual results to differ materially from those expressed herein. These risks, uncertainties and assumptions include, without limitation, general economic, political and market factors, interest and foreign exchange rates, the volatility of equity and capital markets, business competition, technological change, changes in government regulations, changes in tax laws, unexpected judicial or regulatory proceedings and catastrophic events. Please consider these and other factors carefully and not place undue reliance on forward-looking information.

The forward-looking information contained herein is current only as of May 26, 2020. There should be no expectation that such information will in all circumstances be updated, supplemented or revised whether as a result of new information, changing circumstances, future events or otherwise.

Your privacy is important to us. Please review Mackenzie Investments' Privacy Protection Notice at: mackenzieinvestments.com/en/legal/privacy-protection©2020 Mackenzie Investments, 180 Queen St W, Toronto, ON, M5V 3K1. All rights reserved.