Market Outlook 2024

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Contents

03 Foreword
Sun Life Global Investments

05 Key themes for 2024
Sun Life Global Investments

OUTLOOKS FROM OUR SUB-ADVISORS:

07 Canadian equities
MFS Investment Management

08 U.S. equities
MFS Investment Management

09 International equities
MFS Investment Management

10 Canadian fixed income
MFS Investment Management

11 Fixed income: U.S. below investment grade
Crescent Capital Group

12 Private credit: investment grade
Sun Life Capital Management (Canada) Inc.

14 Private credit: below investment grade
Crescent Capital Group

16 Global dividend
KBI Global Investors

17 Global sustainable infrastructure
KBI Global Investors

18 Global fixed income
Wellington Management®

20 India & emerging markets
Aditya Birla Sun Life Asset Management Company Ltd

22 Featured mutual funds & solutions

23 Important information

Foreword

We are proud to present **Sun Life Global Investments' Market Outlook** for 2024. We've collected views from our Multi-Asset Solutions Team and sub-advisors on what's ahead to help inform how you construct your investment portfolios for the year ahead, and beyond.

Oricia Smith
President, SLGI Asset Management Inc.
and Senior Vice-President, Investment Solutions,
Sun Life Canada

Different market challenges ahead in 2024

Our Multi-Asset Solutions Team, the largest in Canada, believes that delivering better risk-adjusted returns this year will require different portfolios than in the past. Focused on being prepared to invest through a range of economic and market scenarios, they expect an increased dispersion of returns, new risks in portfolios driven by a new interest rate regime and equity market valuations requiring differentiated investment capabilities.

The impact of rising rates and geopolitical tensions is a stark reminder that designing risk-managed portfolios is not easy. With the right inputs, tools and investments you can construct more resilient portfolios for clients accumulating wealth, as well as generating income in retirement.

Desired client outcomes drive portfolio construction, but we acknowledge that every client is different. Our investment team uses a disciplined, consistent and repeatable process to enhance product offerings. We are committed to bringing our knowledge and expertise to you.

Sharing our sub-advisors' global experience

We leverage our breadth of managers and their insights as no one manager can do all things well. This is why we are bringing current and relevant market insights from world class asset managers to you.

One of our sub-advisors, **MFS Investment Management (MFS)** was launched in the U.S. 100 years ago, and its founders created North America's first mutual find in 1924. When thinking "long-term" and "a history of innovation," it's hard not to think of MFS. They continue to offer time-tested strategies to help grow assets for investors across the world. We bring this expertise to Sun Life MFS Funds in Canada.

We also provide our Canadian investors access to **SLC Management's** capabilities in the fixed income and alternative investment space. Diversification has always been key to balanced portfolios and increasingly savvy investors aim to diversify outside of traditional asset classes. In the fixed income space, alternative investment solutions can include investment grade options in public and private securities as well as below-investment

Foreword

grade credit options, a market trend we see value in, as a way to tap into diversified sources of return and yield.

As managers of capital, we can have a positive impact on the world. Our commitment to sustainability has never wavered as we strive to build a better tomorrow through responsible investment practices. **KBI Global Investors** is a sub-advisor focused on sustainability aiming to capitalize opportunities in the space across the globe.

Our purpose

Our purpose is to help people achieve lifetime financial security and live their most meaningful lives. We're continuing to ramp up our efforts to be a leader in retirement and estate planning. Robust planning for all life stages of a client's retirement journey is more vital than ever with five million Canadians set to retire in the coming years.

We are proud to offer holistic advisor support. This includes education, events, portfolio construction tools, and products to meet not only wealth accumulation, but also longevity and estate transfer needs. We offer mutual funds, segregated funds, annuities and guaranteed interest annuities designed to help you give impactful advice and build meaningful, lasting client relationships.

How we differentiate ourselves

- Learn more about our Practice management consulting
- Visit our Retirement Hub
- Discover our virtual xSpace
- Join our Women's investment community
- Meet our Tax & Estate Planning DAPs

What's next?

We all want to know what this new year holds. We'll soon find out if we achieve a soft landing, or if we enter a recession, whether the 60/40 portfolio makes a comeback, or if bond prices will continue to follow equities.

Although we can't predict the future, we hope that these insights give you a sense of confidence not only in what's next for markets, but also in how we're working to capitalize on new opportunities as market conditions evolve.

We are optimistic about the opportunities ahead and look forward to continuing to partner with you through 2024.

Key themes for 2024

Chhad Aul
Chief Investment Officer and
Head of Multi-Asset Solutions,
SLGI Asset Management Inc.

What's ahead this year?

- Soft vs. hard landing
- Economic divergence
- Systemic stress event
- Return of the 60/40 portfolio
- An environment for active management

1. Soft vs. hard landing

- In 2023, one of the major debates was whether economies would experience a hard landing (recession) or a more muted soft landing. In 2024, we will finally get the answer.
- The definition of a soft landing was a moving target in 2023. In our mind, a slowdown that reins in inflation without a significant spike in the unemployment rate would qualify as a soft landing.
- Economies were resilient to high interest rates in 2023 due to large accumulated household savings and loans that were locked into low rates during the pandemic. The supports continue to fade as excess savings are consumed, and loans continue to mature.
- We're cautious of a soft landing "goldilocks scenario" as it is rarely achieved. But, we're open to the idea that if inflation continues to normalize, policymakers could pivot to easing monetary policy. We will pay close attention to leading labour market indicators.

2. Economic divergence

- Even if we achieve a soft landing, it may not occur evenly across global economies.
- The U.S. is most likely to achieve a soft landing as its growth is still strong, compared to Canada and Europe that are showing some signs of struggling.
- If U.S. bond yields remain higher for longer, global yields may also move higher and elevate borrowing costs in weaker economies (like Canada and Europe), exacerbating economic divergence. This would be positive for U.S. dollar assets.

3. Systemic stress event

- 2023 saw little in the way of systemic stress in the market. The failure of several regional banks in March provided a bit of a test; however, policy makers moved quickly to contain the issue.
- Market consensus is that a systemic stress event is unlikely in 2024. By their very nature, these are low probability tail events.
- After the historic rate-hiking campaigns of 2022/2023, is a systemic risk event possible? Could it be a "known unknown" like regional banks, commercial real estate or a series of high-profile credit events? Or could it be an "unknown unknown"? We remain vigilant and continue to assess.

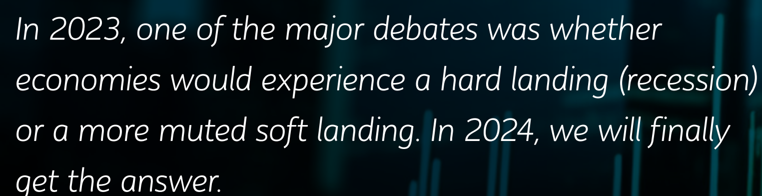
Key themes for 2024

4. Return of the 60/40 portfolio

- The 60/40 portfolio has been challenged in the past two years of higher inflation. When high inflation is the main driver of yields, bond prices and equities tend to be correlated.
- As inflation continues to cool, economic growth becomes the predominant driver of bond yields and the diversification benefit of bonds against equities typically reasserts itself.
- Importantly, if markets are wrong and we experience a hard landing, stocks will fall as earnings expectations are marked down. But bonds stand to perform well as interest rates drop.
- In the rare occurrence of systemic stress, the 60/40 construct can expect to also provide strong diversification.
- Cash is earning a decent yield for the first time in many years. But investors with a large cash allocation face reinvestment risk, as central banks may decide to cut interest rates soon. As cash rates fall, these investors are likely to miss out on some strong performance from more balanced portfolios - now is the time to plan for redeployment of cash into a more broadly diversified portfolio.

5. An environment for active management

- 2023 was marked by exceptionally low breadth within markets. Seven U.S. stocks popularly called the "magnificent seven" were responsible for virtually all the gains of the S&P 500. The remaining members of the benchmark were essentially flat for the year.
- With this narrow leadership, particularly among the largest stocks in the market, it's very difficult for active managers to add value above and beyond market-cap based passive indexes.
- In 2024, we believe market breadth will expand. In an economic soft landing scenario, broader sections of the market could rally and relative 2023 laggards may catch up. On the other hand, if a hard landing unfolds, high-quality companies with strong balance sheets and resilient earnings could outperform their risker counterparts.
- Both scenarios provide an ideal backdrop for disciplined active managers to outperform.



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Canadian equities

MFS Investment Management

Canadian equities, as measured by the S&P/TSX Composite Index, grew more than 11% through 2023, but lagged the S&P 500. While the first half of last year was marked by resilient economic growth and strong jobs and wage growth, equities experienced a sell-off in the third quarter as Canada's economy contracted, inflationary pressures persisted and higher rates started to take a toll on consumers. Canadian consumers have one of the highest levels of household debt among the G7 countries and are starting to feel the pain of higher mortgage payments and borrowing costs. We are starting to see consumer spending soften, particularly on discretionary items, which will likely continue to persist in the coming months - a headwind for profitability. While we anticipate that a slowing economy will put downward pressure on equities through the first half of 2024, expectations of declining inflation and potential rate cuts in the second half of the year will likely be constructive for equity markets in the latter part of the year.

Canadian companies' revenue growth and profitability will likely remain challenged over the next several months in the "higher for longer" regime. Companies on average have reported negative earnings since the end of 2022 and forward-looking earnings appear muted. The materials sector, which has been struggling due to weak demand from China, is likely to continue to feel pressure as slower economic activity in China weakens demand. The consumer discretionary sector may underperform in 2024 amid diminishing excess demand and curbed discretionary spending. Furthermore, several major Canadian banks, which make up a large share in the Canadian equities space, are expected to have stagnant to negative growth in 2024. As companies navigate the current economic landscape, there has been a dry spell in new IPO deals, with only one company issuing an IPO in 2023, the lowest since 1993. This signals emerging struggles for companies to grow and expand in this environment that is likely to remain an obstacle for the equity market for the foreseeable future.

A more positive outlook for Canadian equities is in the growing technology sector, which returned around 60%[1] through mid-December. In a bid to enhance the country's tech ecosystem, Canada has welcomed an influx of tech-oriented immigrants over the past few years and is on track for strong growth in the industry with revenue for several tech companies projected to continue to grow. While Canadian equities have had relatively low exposure to technology, the sector's weight has substantially increased over the past 10 years.[2] We believe the energy sector, equipped with improved production capacity and reasonable capital expenditure, is well positioned to potentially have stronger earnings in 2024. Another bright spot we see for Canadian equities is valuations, which are below long-term averages and appear relatively cheap versus the United States. We believe this is making them an attractive asset class for Canadian investors.

[1] Bloomberg S&P/TSX Index 31 Dec 2022 to 12 Dec 2023
[2] FactSet. Data as of 11 Dec 2013

U.S. equities

MFS Investment Management

U.S. equities head into 2024 having largely reversed the losses posted in 2022. From a high level, the culprits behind the volatility of recent years are easy to pinpoint: inflation and interest rates. Markets struggled in 2022 as inflation skyrocketed due to COVID-inspired supply chain disruptions and extraordinary levels of monetary and fiscal stimulus. In 2023, most supply chains normalized while monetary policy continued to tighten through the middle of the year as inflation maintained the decline begun in mid-2022. Toward the end of 2023, investors grew increasingly confident that the U.S. Federal Reserve was on course to achieve an economic soft landing, setting the stage for easier monetary policy by the middle of 2024. The resulting rally in U.S. Treasuries helped fuel an equity rebound which took share prices within a few percentage points of the all-time highs set at the start of 2022.

One of the factors propelling cap-weighted indexes higher in 2023 was the market's embrace of the promise of artificial intelligence (AI). A late-2022 breakthrough in AI led to the wide scale availability of large language models to businesses and individuals. What appears to be the dawn of an AI revolution sparked a strong (but narrow) rally, concentrated mainly in large-cap technology stocks, the so-called "Magnificent Seven." However, as the drag from higher interest rates lessened late in 2023, even the neglected 493 or so "other" members of the S&P 500 Index began to tentatively participate in the rally, a trend investors hope will persist in 2024.

Looking ahead to 2024, in the current market environment we like higher-quality large cap stocks that are less cyclically sensitive, as well as exposure to lower beta and growth-at-a-reasonable-price strategies. Should the lagged effects of higher interest rates eventually result in an economic slowdown, we would prefer defensive companies in aerospace and defense, food and beverage and electrical power to more cyclical value companies.

Given the divergent makeup of the U.S. and Canadian equity markets, Canadian investors may benefit from exposure to U.S. equities. This is because the Canadian market offers investors much lower exposure to the information technology, health care and consumer discretionary categories than the U.S., while the U.S. market has lower relative exposure to sectors that make up the lion's share of Canada's market cap, such as financials and energy.

Looking ahead to 2024, in the current market environment we like higher-quality large cap stocks that are less cyclically sensitive, as well as exposure to lower beta and growth-at-a-reasonable-price strategies.

International equities

MFS Investment Management

Developed international equities outperformed Canadian equities through December 2023 but have lagged the mega cap tech-dominated U.S. markets. Regionally, Japan's Nikkei index performed exceptionally well for the calendar year with a combination of corporate governance reforms, monetary easing, fiscal stimulus and strong earnings acting as a tailwind. The Eurozone fared even better as a previously anticipated energy crunch never materialized in the early part of the year. The UK lagged the rest of the developed world. The country's value-heavy orientation and lack of technology exposure led to underperformance in the midst of the artificial intelligence (AI) frenzy during the year.

We expect regional divergence in outcomes in developed markets to persist. The UK, with its equity market trading at around 11 times[1] 2024 earnings, continues to see elevated inflation despite unemployment trending upwards. This implies that the Bank of England may need to keep rates higher for longer, increasing the risk of a recession and posing further headwinds for UK equities. Within the Eurozone, recession risks remain high, and growth is expected to continue to be slow into 2024. Eurozone inflation has been falling rapidly, and the primary downside risk to equities is the European Central Bank being too slow to begin cutting interest rates. Japan is likely to see growth slow in 2024. Despite this, we believe Japanese equities are poised to continue outperforming their developed market counterparts for many of the reasons previously stated as well as due to ongoing governance improvements. In addition, a weakness in the yen should provide Japanese exporters with an earnings tailwind. International developed market equities offer historically attractive valuations relative to their U.S. counterparts, which should provide some cushion to investors in the event that regional recessions materialize.

Emerging markets

Emerging markets equities have lagged developed markets with Chinese stocks dragging down performance the most. Emerging markets performance dispersion by country was wide in 2023 as India and other Southeast Asian countries continued to benefit from the shift of manufacturing supply chains away from China. South Korea and Taiwan, countries with substantial exposure to the semi-conductor industry, have also experienced strong results with the AI rally driving returns in some of the large technology stocks that dominate their markets. Additionally, unlike their developed market counterparts, most central banks in emerging markets have already begun their monetary easing cycles, providing an environment for growth.

Similar to developed markets, we expect this divergence in country and regional performance in emerging markets to persist into the first half of 2024. China remains slightly below 30%[2] of the MSCI Emerging Markets Index and may continue to cause emerging markets equities to lag given the ongoing issues with China's property sector, the consumer, and ongoing geopolitical issues. Stimulus measures put forth by Chinese authorities have left investors wanting and many foreign and domestic investors have shifted assets towards other countries. India, now approximately 15%[3] of the index, has been, and is likely to continue to be a major beneficiary of this. A continued slowdown in global growth is a potential headwind for Indian equities and may put pressure on export demand; however, the domestic economy has shown resilience. On a valuation basis, emerging markets equities are trading at around 11x forward earnings, in line with their long-term averages.

[1] Bloomberg: MSCI UK PE ratios. Data as of 31 Dec 2023
[2] As of December 31, 2023
[3] As of December 31, 2023

Canadian fixed income

MFS Investment Management

We are constructive on Canadian fixed income. Historically, high interest rates have provided an attractive entry point for the long-term fixed income investor and Canadian interest rates have reached multi-decade highs after the Bank of Canada raised its policy rate to 5.0% in July 2023, 475 basis points higher than the start of 2022.

In the past, correlation between starting yields and subsequent expected return has been strong. Should this relationship hold, as a broad asset class, Canadian fixed income in our view, could be near an attractive entry point. High interest rates have also historically proven to be a great opportunity to add duration exposure, as many rate-hiking cycles have been shortly followed by interest rate reductions to restimulate slowing economies. Given the magnitude and scope of the central bank's current tightening cycle, they certainly have the ability to cut, should the need arise. Furthermore, carry is also back in fixed income, providing income for investors to collect, reinvest or redeploy. In addition, Canadian spreads are trading at attractive levels in relation to other international markets, potentially offering value to select international investors, thus increasing demand.

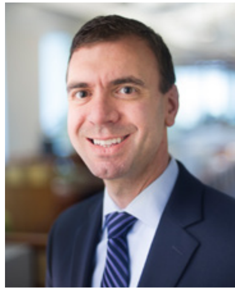
As the Bank of Canada has remained on hold in the second half of 2023, there has been a significant dis-inversion of the Canadian two and 10-year yield curve, rising from a low of around negative 130 basis points in July, suggesting the likelihood of a soft landing has improved for 2024. This path to dis-inversion has coincided with the futures market no longer pricing in rate hikes from the Bank of Canada. Instead, it is now pricing in rate cuts starting in the first quarter of 2024, with around five cuts expected as estimated by the futures market at year end 2023. This came at a time when real economic growth has been cooling with the latest third quarter annualized real GDP reading of -1.1%, which was a surprise to the downside.

Supportive of the soft-landing narrative is the deceptive strength of the Canadian labour market. While the unemployment rate has risen from the low of 5% in January 2023 to 5.8% in December 2023,[1] according to Statistics Canada, this has been driven by working age population growth that has exceeded the growth in employment, not the elimination of jobs that typically occurs as economic prospects dim, as record immigration has grown the size of the workforce. Immigration has also supported one of the most widely viewed areas of risk within the economy, housing. Demand for housing from the growing population, combined with low levels of housing inventory have supported rising house prices, despite the record rise in mortgage rates. The threat from higher mortgage rates is real, as many consumers are up for mortgage renewals in 2024 and 2025 which could further pressure affordability; a concern that is already at the forefront following an inflation spike in 2022. As we move throughout 2024, should inflation come down to target, it could pave the way for a reduction in the central bank's policy rate and alleviate some of this risk.

While there is no shortage of challenges facing the Canadian economy, we believe that as long as the Bank of Canada does not resume its tightening cycle, Canadian fixed income is likely to perform strongly in the period ahead. The combination of the attractive level of rates, the favourable spread valuation backdrop, and a resilient macro environment, may favour a gradual downward move in local rates.

[1] Source: Statistics Canada. Data as of December 31, 2023

Fixed income: U.S. below investment grade



John Fekete
Managing Director and
Head of Capital Markets,
Crescent Capital Group

CRESCENT

End of the rate-hiking cycle leaves credit poised for stronger results

Inflows to credit were light by volume throughout 2023, though they did see some pickup in the latter stages of the year as it became more apparent that a U.S. recession was not happening in the near term, giving way to expectations of a mild recession or soft landing in 2024 instead. A more sanguine outlook on the rate environment also helped drive volumes, with market sentiment reflecting the belief that central bank tightening may be at its peak.

We began to see more constructive below investment grade public markets in the final months of last year, particularly with respect to single-B-rated credits. That has resulted in some tighter pricing in high-yield and bank loan new issues, and there remains considerable potential for the market to further benefit from these tight conditions given the still-light volumes and significant demand from the collateralized loan obligation market.

Possible impacts of higher-for-longer rates

The high-yield market itself has experienced some headwinds from rising rates, given the fixed rate nature of these bonds, but we expect returns from the asset class to improve in an eventual rate decline. One space in below investment-grade public markets garnering interest is that of broadly syndicated loans, which offer the benefits of floating rate structures. The debt securities in this sector that have been coming to market since late 2023 have been of higher quality and feature more conservative leverage structures, according to our analysis, amid a high-rate environment.

Solid ground ahead, but caution still required

In our view, the environment for credit in 2024 looks to be constructive. Credit fundamentals remain positive heading into early 2024, although some of this strength is expected to moderate as U.S. economic growth cools. We continue to expect most borrowers to exhibit revenue and cash flow growth going forward, resulting in stable leverage ratios. Coupons, or the rates borrowers pay, are likely to be at or near their peaks with the rate-hiking cycle concluding in the U.S. While still-high interest rates may pressure certain borrowers, many have adequate liquidity and would benefit from private equity sponsor support, if needed. Credit defaults are relatively low and are likely to hover around their long-term average in 2024. With low recession risk, defaults at or below historical average and monetary policy leaning toward rate cuts rather than additional hikes, high-yield bond and bank loan investors could see positive returns in 2024.

Sources: Bloomberg, JP Morgan, 2023.

Private credit: investment grade

Andrew Kleeman
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Elaad Keren
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Gary Greaves
Managing Director, Private Fixed Income, Sun Life Capital Management (Canada) Inc.

IG private credit volumes poised for a strong 2024 opening

The total volume for investment grade (IG) private credit in 2023 was close to 2022, resulting from lower financial sector issuance (asset managers, business development companies and real estate investment trusts (REITs) being offset by strong corporate and utility issuance. We believe that issuers came to market in 2023 because they had a reason to raise capital (an acquisition, capex or refinancing a debt maturity) and that higher coupons discouraged some "opportunistic" issuers who had taken advantage of low interest rates in 2020 and 2021 to bolster liquidity.

When issuers came to market, it was often for short tenures, with a preference to not lock-in long-term rates. While overall volume was relatively steady in 2023 compared to 2022, the market in 2023 lagged 2022 for much of the year, but caught up with a strong final quarter. The fourth quarter (Q4) of 2023 was busy as issuers seemed to come to terms with rates that could be "higher for longer." Steady supply was not bad news, however, because for much of last year the market experienced lower demand driven by investors who were either cash-constrained or had lower product sales or higher redemptions, which tempered their demand. Despite lower market volume, many investors took advantage of reduced competition and invested in IG private credit securities exhibiting attractive relative value.

2024's market outlook: "Steady as she goes"

We expect a solid start to 2024 for two reasons: 1) a number of deals that were scheduled to launch in Q4 were postponed, given the strong fall calendar. These deals were delayed as issuers and bankers were concerned about "shelf space" (i.e., getting investors' attention); and, 2) the annual Private Placements Industry Forum, usually scheduled for January, will occur later in 2024. This resulted in some issuers coming to market in advance of the conference rather than waiting until mid-February.

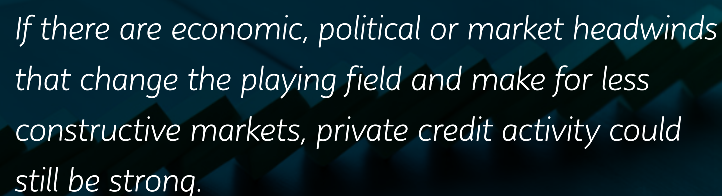
Private credit: investment grade

As we enter 2024, the U.S. economy is still doing well, but shows signs of slowing. It appears that the U.S. Federal Reserve and central banks are inclined to be accommodative in order to stave off any more tempering of economic growth from the 2022/2023 rate hikes. With a "soft landing" backdrop, we expect the IG private credit market to be steady. Considering the uncertainties at this time last year, when we prepared our 2023 "cautiously optimistic" outlook (high inflation, midway into aggressive rate hikes and a chance of a recession), combined with the U.S. bank turmoil led by Silicon Valley Bank in March 2023, our outlook for 2024 is no less constructive. While we do not expect the financial sector to drive volumes as it did in 2020 and 2021, we do expect that it will anchor new issuance and provide ample refinancing opportunities in the near term. More stable interest rates should benefit all asset classes, from infrastructure and structured finance to corporates. REITs and real estate issuance are still in search of a bottom.

A wild card on the demand side is investor appetite, which was a bit muted for much of 2023 due to the reasons mentioned previously. Stronger investor demand, evidenced by price tightening and deal over-subscriptions we have seen in the fall of 2023, could signal a more competitive market in 2024.

If there are economic, political or market headwinds that change the playing field and make for less constructive markets, private credit activity could still be strong. Some investors view private equity as a safe haven that can provide certainty of execution. Investors could also be rewarded for proving liquidity in uncertain times. We believe that investors who retain a "steady-as-she goes" perspective might find it beneficial in such an environment.

Source: Private Placement Monitor, 2023.



Private credit: below investment grade

Chris Wright
Managing Director &
Head of Private Markets,
Crescent Capital Group

Chris Wang
Managing Director,
Crescent Credit Solutions,
Crescent Capital Group

CRESCENT

Attractive yields and conservative structures may create a compelling vintage in private credit

We believe private credit will continue to deliver tangible value to both investors and borrowers. Today, investors have benefited from the higher returns, consistent cash flows and steady income distributions that private credit can provide while delivering lower volatility. At the same time, borrowers have appreciated the partnership that a private credit manager can provide with certainty of execution and no market risk for the borrower due to the committed capital and contractual commitments that underlie such financings. These factors increasingly make private credit borrowers' lender of choice.

Capital formation is changing and shifting to private credit

In our view, private credit continues to benefit from favourable market dynamics and secular tailwinds. Capital formation is changing, and it is shifting toward private credit on a secular basis.

Banks continue to retrench from middle market lending with private capital providers filling the void. Record levels of investible capital amassed by private equity sponsors, as well as the growing volume of refinancings, growth capital and dividend recapitalizations, continue to drive demand for private credit. Finally, we have observed that borrowers have increasingly turned to private credit for refinancing solutions to help solve the upcoming maturity wall of loans and bonds that were underwritten in a zero-rate environment. This includes seasoned public issuers that have utilized the private credit markets to address their pending maturities.

In our view, this secular shift is occurring against a backdrop of more conservatively structured loans with lower leverage levels, higher equity cushions and greater lender protections in credit agreements.

Private credit: below investment grade

Flexible capital to deliver sought-after solutions

We expect borrowers to increasingly look to private credit to provide flexible capital solutions across both senior and non-senior structures to meet their specific financing needs in today's market.

For example, creative senior solutions and non-senior structures could be critical in helping companies transition and right-size their capital structures, which may have been put in place during a significantly lower interest rate environment. Non-senior debt has the flexibility to be structured with cash or non-cash (payment-in-kind) returns, allowing borrowers to access incremental growth capital without increasing their cash interest burdens. This growth capital can be used to generate liquidity, retire cash-paying debt or make accretive acquisitions. Non-senior debt can also be a cost-efficient tool for sponsors to raise capital without repricing existing senior debt or triggering existing most-favoured-nation (MFN) provisions, whether such debt is structured with a cash or non-cash return.

Finally, we believe flexible capital solutions represent a compelling value proposition to borrowers and can subsequently provide investors with the opportunity to earn higher risk-adjusted returns.

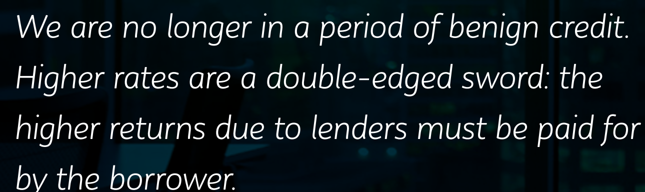
Implications for investors considering private credit

In a benign credit environment, there are low default rates and little dispersion in returns among managers. In fact, managers that took on more risk have been typically rewarded with more return. But we are no longer in a period of benign credit. Higher rates are a double-edged sword: the higher returns due to lenders must be paid for by the borrower. And the risk of a recession is top of mind for investors and managers alike, with concerns over earnings pressure and a potential increase in defaults.

Investors considering private credit today should consider a manager's experience investing across multiple credit cycles (including through prior high interest rate environments and periods of economic weakness), strength of sourcing platform, consistent discipline in underwriting and portfolio management expertise.

We believe that with the right manager, the attractive yields and conservative structures today should create the conditions for a compelling vintage in private credit for 2024.

Sources: Bloomberg, Private Placement Monitor, 2024.


We are no longer in a period of benign credit. Higher rates are a double-edged sword: the higher returns due to lenders must be paid for by the borrower.

Global dividend

Gareth Maher
Lead Portfolio Manager,
Global Dividend Equity Strategy,
KBI Global Investors

The unprecedented macro environment of quantitative easing, free money and negative yields which began in 2017 drove the risk appetites of equity investors to all-time highs. The ensuing "everything rally" reflected investor preferences for speculation over fundamentals. At KBI Global Investors, we believe this period in markets is firmly over and a new, more "normal," structural framework of higher yields and higher rates remains our central thesis, as it has done since autumn of 2021.

This macro "regime change" has continued through 2022 and 2023. Broadly speaking, value has outperformed growth in Europe, Japan, Asia and emerging markets. The exception is North America where the artificial intelligence wildcard created huge excitement and expectation among investors in the early part of 2023. A handful of mega cap technology stocks now account for almost 30% of the U.S. stock market, which accounts for ~70% of the MSCI World Index.[1] Such intense concentration has never lasted, historically.

Yield trends matter for equity investors. The lower the yield, the greater the appetite for future earnings speculation. The higher the yields, the greater importance of valuation discipline and near-term, cash-based, earnings delivery (as opposed to the promise of earnings sometime in the future). Of course, other macro challenges affected the market in 2023, including persistent inflation, a banking crisis, geopolitics, supply chain bottlenecks and stagnant Chinese growth. We would have expected strategies with strong fundamentals in the form of earnings cashflows and quality to do well, but the market has been slow to adjust from old preferences.

As we look into 2024, we retain our belief of a regime change and a rotation in market leadership. We believe the economy will slow down more than consensus expectations. We also note that much of the government fiscal spending packages of recent years that helped boost economic growth, will likely lead to a sustained rise in real yields. So, we remain relatively cautious. Volatility is likely to persist with market consensus diverging over the direction of interest rates and inflation.

Our view is that fundamentals will start to matter and will become more important this year. While the broad market has seen relatively resilient company earnings, this may change in the first half of 2024. Company earnings may be challenged and lead to downgrading of aggregate expectations.

We expect more modest returns and believe that now is the time for quality to matter with free cash flow cover, positive payout ratios and healthy debt profiles becoming increasingly important. We believe that "dividend signalling" in 2023 has been positive. Companies, which announced increased dividend payments, could be positioned to do well since they are producing earnings today (to cover these increases), as opposed to speculative earnings in the future. 2024 may bring muted returns for investors with income growing increasingly important.

[1]Source: MSCI World Index as of December 31, 2023

Global sustainable infrastructure

Colm O'Connor
Lead Portfolio Manager,
Global Sustainable Infrastructure Strategy,
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Since autumn 2021, the world has faced an upwards trajectory of interest rates and government bond yields. This has been driven by the desire for global policy makers to normalize their monetary policy, as well as tackling inflationary pressures that have emerged post-pandemic.

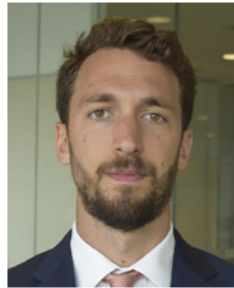
Infrastructure is a "real asset" and hence, the protection it affords investors during inflationary periods is one of its key features. This benefited listed infrastructure in 2022, but investor sentiment towards the asset class waned in 2023. A primary driver of this was the perceived interest rate sensitivity of infrastructure business models, but as we assess the prospects for 2024, we see that valuations have de-rated while listed infrastructure fundamentals are largely unchanged. We pose the question as to whether this affords an attractive entry point for investors looking to access secular growth markets like renewable power generation, the digitization of the global economy, electrification of everything, water supply and sanitation and smart cities.

As we assess the macro-outlook for 2024, we are of the view that interest rates will remain higher for longer. We do not envisage any further material moves upwards from current levels, with the economy more likely to experience a slowdown. Inflation pricing mechanisms have already started to kick in for many of our companies, and hence, the headwinds that have dragged on the asset class in 2023 are unlikely to persist in 2024.

As such, we believe the strong fundamentals of the strategy will result in improving sentiment.

For those looking to make a sustainable investment, we believe that infrastructure offers one of the more compelling solutions. We invest in infrastructure opportunities that offer a diversified source of return in addition to stable and predictive cash flows. Our companies are high quality, are often monopolies and operate within industries and sectors that have high barriers to entry. With long-term regulatory support and multi-year secular tailwinds, we believe our global infrastructure investments will deliver attractive income combined with positive earnings growth, trading at a valuation discount compared to most risk assets. With minimal cyclical or commodity price exposure, we look for sustainable infrastructure companies that are built to be resilient to whatever economic influences 2024 has to offer.

Global fixed income



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U.S. and Europe potentially diverging

Given growing concern about avoiding a deep recession, we believe central banks may take weak economic growth (or a recession, no matter how shallow) as a cue to cut rates, particularly as monetary policy appears to be achieving its objective of bringing inflation sustainably down toward 2%. While the first half of the year may see the U.S. Federal Reserve (Fed) setting the trend for cuts among global central banks, we could witness growing divergence between countries later in the year.

Europe has experienced a persistent drop in inflation over the course of 2023, albeit to a lesser degree in the UK. Growth has flatlined and some countries - most notably Germany - are flirting with a technical recession.

While markets are pricing in rate cuts, we could, in fact, see the European Central Bank keep rates where they are unless there is significant deterioration in labour markets. The Bank of England may also be forced to pause after a few cuts. We expect a continuation of the steepening trend, either through rallies at the front end or through moves up in long-end yields as economies withstand more persistent inflation in the long term.

Japan remains the exception

The notable exception to cooling inflation in developed countries is Japan, which is seeing significant reflation as the Bank of Japan (BOJ) has been unfazed in shifting away from accommodative policies at its own pace, rather than joining global central banks in their hiking cycles. While yield curve control has been significantly adjusted, we will still start 2024 with negative BOJ rates and markets having so far been unsuccessful in putting pressure on policymakers. While the direction of travel is clear – abandonment of yield curve control and exit from negative rates – the question remains as to how and when policy normalization will occur.

Global fixed income

Emerging markets in a more comfortable position

In emerging markets, central banks have been successful in front-loading hikes during this cycle, putting them in an enviable (from other policymakers' perspective) position where they can gradually bring down rates without the risk of entrenching inflation in the system. In this context, emerging markets' currencies could struggle, not only because of reductions in interest rates, but also because end-of-cycle dynamics generally favour the U.S. dollar, Swiss franc and Japanese yen, which markets perceive as safe-haven assets. However, the carry trade could continue for some time.

China's systemic challenge

Chinese policymakers were slow to respond to a disappointing reopening in the first half of 2023 but are now more engaged in combatting the domestic slowdown, as they seek to shift the economic model toward consumption and manufacturing of higher-value-add goods for export. The slowdown observed so far is multifaceted, as issues in the property market have combined with deteriorating balance sheets and a surprisingly high unemployment rate among younger cohorts. The People's Bank of China has taken a number of steps so far to address liquidity concerns, but we believe monetary policy alone will not suffice to resolve these more systemic challenges.

Continued normalization, but beware potential surprises

In summary, 2023 has shown that economies can withstand higher interest rates for longer, and may continue to see positive growth. Yield curves may steepen further, especially if inflation shows any signs of reaccelerating, while we note an increased potential for policy errors as central banks and markets navigate a treacherous trade-off between inflation and growth. Tracking these potential developments closely will be crucial for portfolio positioning in 2024.

Yield curves may steepen further, especially if inflation shows any signs of reaccelerating, while we note an increased potential for policy errors as central banks and markets navigate a treacherous trade-off between inflation and growth.

India & emerging markets

Vikas Gautam
Chief Executive Officer,
Aditya Birla Sun Life Asset Management Company Ltd.

India

We believe India has the conditions in place for an economic boom. Investment in manufacturing, offshoring opportunities, energy transition and the country's advanced digital infrastructure are fuelling the economy; India's share of the world economy is on the rise.

The country is different from what it was 10 years ago. India's position in the world order has improved and this has helped its macro and market outlook.

Factors driving India's growth

Supported by its demographic tailwind, India's terminal growth is higher than the rest of the world.[1] Key metrics suggest strong economic growth in the years ahead. Financial markets are experiencing a virtuous cycle. Investor participation, liquidity and fundamental coverage have grown. Besides structural promise, factors such as easing oil prices and rising international capital flows are likely to support equity markets in the short term. These developments continue to support a combination of elevated valuations and low volatility.

Secondly, India's upward growth cycle could encourage strong earnings growth for the next three to four years. This type of environment has historically been positive for the domestic economy and we expect strong growth alongside benign inflation. India's economy is likely to be driven by growth in capital expenditures and improved credit availability. We expect financials, real estate, consumer and industrial sectors to outperform with the peak in interest rates.

Thirdly, the cost of capital is falling as markets are more confident about future cash flows, which are growing faster for Indian companies. Further, as future cash flows become more reliable, the cost of capital to discount them is also falling. This should benefit both cyclical and secular businesses.

India & emerging markets

2024 could be volatile

We expect equities to rise as India heads into general elections in 2024. Markets are pricing in a majority for the current ruling government and expect continuity in economic policies. The fundamentals are underpinned by:

1. Strong macro stability as a result of improving terms of trade, flexible inflation targeting and stable foreign direct investment.
2. Earnings forecast to grow at about 20% annually over the next four to five years, led by an emerging private capital expenditure cycle, re-leveraging of corporate balance sheets and a structural rise in discretionary consumption.
3. A reliable source of domestic risk capital.

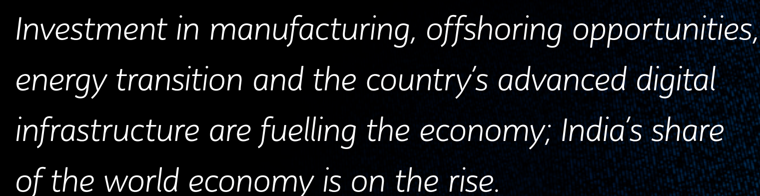
These factors have reduced correlations and volatility of Indian stocks relative to emerging markets (EM). Further, India's rate spread with the U.S. has also declined. Both these factors support India's rich headline multiple.

Asia ex-Japan

EM saw multiple swings driven by shifts in the U.S. macro narrative and uncertainty around China's policy outlook. We think returns will be frontloaded in 2024 for MSCI Asia (excluding Japan) considering challenges from last year. Returns could also be buoyant as investors downplay near-term recession risks, inexpensive valuations and an expected turn in monetary cycle. However, as we progress into 2024, we think a host of challenges such as moderating growth and a strong USD will reassert in the first half of 2024. Further headwinds could come from a restrictive or measured policy stance, domestic political and geopolitical uncertainty and structural issues in China.

EM should become more attractive through 2024 as growth differentials become favourable for EM over developed markets (DM). In addition, demand for diversification away from the U.S., low investor positioning and cheaper valuations and a weak USD in the second half of 2024 could help EM. China, which has lagged meaningfully this year, could perform better if its growth delivers on the upside and the geopolitical risks stay contained. We see a more positive setup for Latin America equities helped mostly by lower inflation and a fall in financing costs.

[1]Sources: CEIC, UN Forecasts, Morgan Stanley Research forecasts, 2023



Sun Life Global Investments featured mutual funds and solutions

Sub-advisors	Mutual funds	Guaranteed Investment Funds (GIFs)
MFS Investment Management	• Sun Life MFS Canadian Equity Fund • Sun Life MFS U.S. Growth Fund • Sun Life MFS U.S. Value Fund • Sun Life MFS International Opportunities Fund • Sun Life MFS Canadian Bond Fund	**Sun Life MFS Diversified Strategies** • Sun GIF Solutions Sun Life MFS Cdn Equity Investment Series* • Sun GIF Solutions Sun Life MFS US Growth Investment Series* • Sun GIF Solutions Sun Life MFS US Equity Investment Series* • Sun GIF Solutions Sun Life MFS Intl Opportunities Investment Series* • Sun GIF Solutions Sun Life MFS Canadian Bond Investment Series*
Sun Life Capital Management (Canada) Inc.	• Sun Life Core Advantage Credit Private Pool	• Sun GIF Solutions Sun Life Core Advantage Credit Private Pool Investment Series* • Sun GIF Solutions Enhanced Balanced Investment Series*
Crescent Capital Group LP	• Sun Life Crescent Specialty Credit Private Pool	–
KBI Global Investors Ltd.	• Sun Life KBI Global Dividend Private Pool • Sun Life KBI Sustainable Infrastructure Private Pool	**Sun GIF Solutions Private Investment Pools** • Sun GIF Solutions Sun Life KBI Global Dividend Private Pool Investment Series* • Sun GIF Solutions Sun Life KBI Sustainable Infrastructure Private Pool Investment Series
Wellington Management Canada ULC	• Sun Life Wellington Opportunistic Fixed Income Private Pool	–
Aditya Birla Sun Life Asset Management Company Pte. Ltd.	• Sun Life Aditya Birla India Fund	–

*Also available in the Sun GIF Solutions – Estate Series

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