2024 market outlook

2024

NEI

Contents

Introduction **3**

The outlook for fixed income **4**

- Guardian Capital on canadian fixed income 5
- Amundi Asset Management on global fixed income 6
- Wellington Management on global impact bonds 9
- Principal Global Investors on global high yield fixed income 12

The outlook for US and Canadian equities **14**

- AllianceBernstein on US equities 15
- QV Investors on canadian equities (large and small cap) 17
- Lincluden Investment Management on dividend equities (North America) 19

The outlook for global/international equity **20**

- Maj Invest on global equities 21
- Ecofin Advisors Limited on clean infrastructure equities 23
- Columbia Threadneedle on emerging market equities 25

Summary and opportunities snapshot **27**

Introduction

John Bai,
Senior Vice President,
Chief Investment Officer

It's been a tough few years for investors. Sure, the U.S. stock market has been on a tear in 2023, but it felt like only a select few stocks have participated in this rally. The rest of the markets were mired in the sluggishness resulting from one of the most aggressive central bank rate tightening cycles in recent memory. The good news is that it looks like we have witnessed a few peaks this year, like peak central bank rates and peak inflation. So, the biggest question for investors in 2024 is what happens after these peaks? Peaks are often followed by valleys.

Accelerating peaks and valleys have been a dominate theme of the pandemic and post-pandemic era. Equities markets have been difficult to navigate with two bear markets and two bear recoveries in just the past three years, bonds recently experienced the worst year in over two centuries, and three of the last four years have been defined by bearish investor sentiment. It's no surprise that we've seen record flows into money market funds as investors look to secure a return in the face of so much uncertainty, but keeping cash on the sideline isn't a viable long-term investing strategy.

I find this quote from author Spencer Johnson helpful in these sort of market environments: "Between peaks there are always valleys. How you manage your valley determines how soon you reach your next peak". Looking for opportunities in peaks and valleys is about looking for lower correlations, lower risk, and lower volatility asset classes. Using that lens we see lots of opportunities ahead.

The end of the unprecedented monetary tightening cycle is very near – if it isn't here already – and that potentially provides a great entry point for fixed income investors and those with balanced portfolios. Real yields are starting to make the income side of the equation for bonds very attractive, plus expectations for rate cuts later in 2024 will likely add capital appreciation in the years ahead. Within our own strategic asset allocation, we are favouring the High Yield segment of the market as over the next 10-year period it shows some of the highest return potential of any asset class. On a risk-return basis the Fixed Income universe is full of opportunity for patient investors who are willing to take a bumpy ride, and we are adding to our fixed income holdings in our own tactical asset allocation pool as well.

On the equities side we are cautious about the impact of slowing global growth on corporate earnings, plus the risks posed by increased geopolitical tensions. However, we prefer being selective about high quality companies that offer stability and growing dividends, especially in some regions and sectors where valuations are cheap on a relative basis. While 2023 was a difficult year in the renewables and clean infrastructure space, we don't think those long-term themes have gone away. The march towards a lower carbon world is still a huge opportunity and at current low valuations we believe this long-term secular tailwind will generate alpha.

We don't try to time the markets, but I do believe how we manage the valley is how we will get to our next peak. A disciplined active approach is a key component to success and our sub-advisors' investment philosophies and processes that tilt towards quality while focusing on defensive characteristics are well suited to outperform in this type of market that requires a more thoughtful and selective approach to constructing portfolios.

I hope this collection of views from a select group of our 19 sub-advisors helps you make informed decisions going into the new year.

The outlook for

fixed income

Following another difficult year for fixed income markets in 2023, our subadvisors see a better economic environment for fixed income investors in 2024.

With inflation continuing to trend in the right direction, it appears that the rate hiking cycle has come to an end. Rates will likely remain restrictive for the first half of 2024, but the second half should see the start of an easing cycle as central banks begin to cut rates due to slowing economic growth. While a new cycle of monetary easing should be supportive of fixed income assets, slowing economic growth also brings risks to the fixed income market, especially in areas of the markets that have higher risk of defaults. Growth is expected to slow in the U.S. and Eurozone, but certain emerging markets will remain resilient, meaning that investors will have to be selective about where they allocate their fixed income holdings. The "higher for longer" narrative will likely persist, and higher than average yields in most fixed income assets will continue to offer attractive opportunities to generate income. Our subadvisors are looking to take advantage of anticipated market dislocations and attractive entry points as they arise, as they see selective opportunities in corporate credit, investment grade bonds and sections of the high yield market.

Read more about the outlook for fixed-income from our subadvisors.

Guardian Capital on canadian fixed income

The Bank of Canada (BoC) paused their rate hiking cycle in January, signalling a willingness to observe the lagged effects of its extraordinary tightening over the prior year. Given this pause, markets were looking for some signal for the potential that the hiking cycle was close to peaking and took what appeared to be a banking crisis in March (failure of a few U.S. regional banks and a large Swiss global bank) as the sign that something had finally 'broken' in response to the policy tightening. Markets embraced a 'risk off' sentiment and interest rates declined markedly amidst a rush to price in a swift retreat by central banks later in the summer.

The decline in interest rates and swift actions by the Fed and the SNB to contain the banking crisis, in part, contributed to an easing in financial conditions. Adding to this concern, the high frequency data – consumption, employment and inflation – soon reaffirmed the ongoing resilience of the global economy. In Canada, retail sales were stronger than the consensus expectations in four out of the six reports since the Bank of Canada paused rate hikes, while reported employment figures were higher in six of the last eight reports over the same period. In the U.S., retail sales remained strong, with four of the eight reports released since January coming in ahead of expectations. Employment also followed suit, coming in higher than expected for five of the last eight reports over the same period.

Absent signs of a slowdown and the stickiness of core inflation raised concerns at both the Bank of Canada and the Fed that more tightening was still required to achieve their goal of 2% inflation. As a result, the Bank of Canada abandoned its pause and renewed its hiking cycle delivering an additional 50bps of tightening. Markets reversed its hope for an easing cycle this year and priced hikes into early 2024.

As we approach the end of the year, both central banks have eschewed forward guidance for data dependency as the preferred approach for monitoring the lagged effect of their respective monetary policy. Both central banks left the overnight rates unchanged in their most recent meetings but have maintained an asymmetric skew for further tightening if inflation remains stubbornly above their target. The Bank of Canada has outlined its checklist of four factors that it's monitoring to determine if inflation is on a durable and sustainable path to 2%. It has also suggested that it could ease before inflation gets to the target. Of these four, we see the evolution of the labour market and wages as most critical to its assessment that it has achieved a better balance between supply and demand. More recent surveys, such as the Business Outlook and vacancies, suggest that the demand for labour is already cooling and that wage gains are likely to be more muted and consistent with a 2% inflation rate going forward. This is consistent with a dour sentiment gauge of both businesses and consumers.

Going forward, investors should be conditioned to expect that the bulk of the fixed income portfolio returns will be coming from income *and less from* capital gains *(the reverse of the past 20 years).*

To be sure both the Bank of Canada and the Fed are modelling a growth slowdown but not a recession in their outlook. Both see a reasonable probability for a soft landing but a greater likelihood that the economy will have to adjust to higher nominal overnight rates going forward. This outlook, in part, stems from multiple factors – de-globalization, geopolitical risks, demographic trends, climate change and re-shoring are a few – and is further compounded by a significant surge in fiscal spending outside of a recession or a significant war effort. This would suggest an extended pause before both Banks adopt a change in policy.

After two years of negative returns, we are hopeful that investors will eke out a small positive return this year – a disappointment nevertheless. Our outlook is for much better returns in 2024 as we see the start of an easing cycle and the opportunity to earn a

reasonable income from the portfolio going forward. We would summarize our outlook as follows:

1. We believe the Bank of Canada hiking cycle is complete and the Bank will be on hold through Q2 '24.
2. We expect the first rate cut in Q3 '24 as the Bank responds to a continued rise in the unemployment rate
3. We see a persistent higher nominal neutral rate going forward as the Bank calibrates to a real neutral rate consistent with achieving its 2% inflation target
4. We expect the yield curve to normalize/dis-invert as the economy cools and labour markets loosen.
5. Going forward, investors should be conditioned to expect that the bulk of the fixed income portfolio returns will be coming from *income* and less from *capital gains* (the reverse of the past 20 years).

Guardian Capital is sub-advisor to NEI Canadian Bond Fund. Learn more about them and this Fund.

Amundi Asset Management on global fixed income

Focus quickly shifting from inflation to growth

Growth surprised to the upside in 2023, especially in the US. However, the effect of higher rates is being felt and the economy is now slowing. We expect US inflation to continue to drift lower towards target. Services inflation remains sticky but sequential inflation rates are easing. For now, oil prices have remained relatively subdued despite geopolitical escalation in the Middle East. This could pose some risk to headline inflation, but with monetary policy expected to remain restrictive, there is less risk of higher headline inflation spreading to core inflation. Financial conditions are very tight for the real economy, and higher bond yields will lead to even tighter lending conditions. Unemployment remains low, but the labour market is softening. A number of indicators point to further weakening: hiring rates and workers quitting jobs are now normalizing to pre-crisis levels, while layoffs are above pre-crisis levels. Similarly, wage growth has peaked and hours worked is falling. As a consequence, we expect demand to continue to weaken. Consumption has recently been rising more than disposable income, but as excess savings are now largely depleted, consumer spending will not be sustained at the levels of 2023. On the corporate side, revenues are already slowing and will weaken further with the impact of tighter lending conditions. Overall, we expect further slowing as higher rates continue to feed into tighter financial conditions, but real income growth should be resilient due to lower inflation. We expect this to translate into a mild recession in the US in first half of 2024, but still a positive growth rate overall in 2024.

On the other side of the Atlantic, the Eurozone proved resilient initially despite the energy crisis, but disappointed later in the year. The economy is slowing and most indicators are pointing to further weakening in activity. Financing conditions and lending standards have tightened significantly, resulting in higher

borrowing costs and falling demand for credit both from non-financial Corporates and from households. Fiscal policy will be less supportive as governments withdraw energy subsidies progressively. The outlook for investment will remain subdued given monetary policy is expected to remain restrictive for an extended period. As in the US, there has been steady progress on inflation, notwithstanding some sticky components. We expect inflation to continue declining toward the ECB target by end 2024. We believe the Euro Area can avoid a recession, thanks to continuing increases in real wages, which together with low unemployment, will limit the downside to consumption, but we expect very low growth.

In Japan, we expect above trend growth to continue and inflation to moderate, but to remain positive and higher than during the past decades. This should translate in the end of the negative interest rate policy in 2024, but authorities will likely remain very gradual and cautious.

Moving to EM, China's economic rebound and reopening boost was very short lived, and we believe we are entering a phase of structural shift, with a recalibration of the economy towards lower growth sectors. However, we expect Asia to remain resilient, in particular India, where we expect 6% growth in 2024 thanks to the support provided by structural factors. We expect a supportive environment for EM, with the EM-DM growth differential at its highest in 5 years, although with high fragmentations between countries.

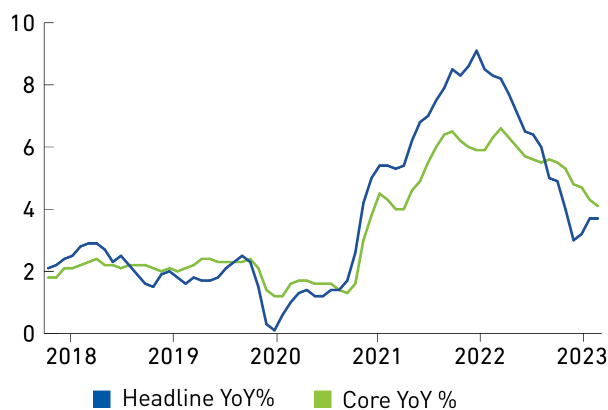
2024: adding duration and more global relative value opportunities

As it stands, we believe monetary policy is entering a new phase and that the global monetary policy tightening cycle is mostly behind us. In the very short term, some uncertainty remains as central banks are data dependent and keep a somewhat hawkish rhetoric, as they want to keep optionality. In the US, the market expects no further hikes and is now pricing in significant easing by mid-2024.

In Europe, the ECB has turned slightly more dovish in the face of the weak economy. We expect the ECB to be done with rate hikes, but to keep rates in restrictive territory for the time being, as it indicated it was premature to discuss rates cuts. In the short term, we expect rates rallies to be limited and look for steeper curves at the long end; hence, we remain tactical and slightly underweight for now. We believe 2024 will be a good environment for rates, as yields are back at historically attractive levels. After staying underweight duration to varying degree for the last four years, which was very beneficial for the portfolio in 2022 and 2023 year to date, we are likely to look to add duration gradually in 2024, although we do not expect a full dovish tilt in 2024 and will remain flexible to adjust to the environment.

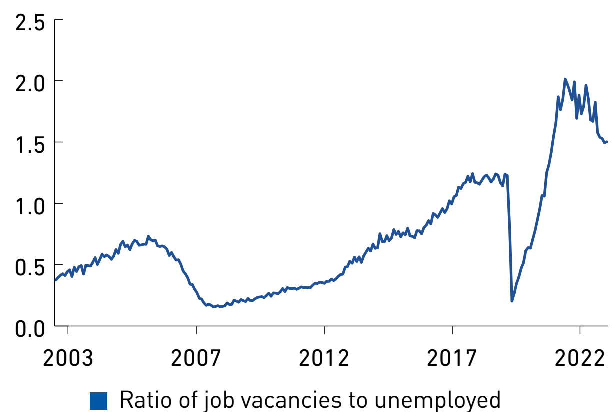
In Japan, we expect upward pressure on yields through 2024. The BOJ appetite to keep buying JGB's to defend target is waning. We expect Yield curve

US inflation moving in the right direction



Source: Amundi Asset Management as of September 30, 2023

US labour market has started to cool



Source: Amundi Asset Management as of October 31, 2023

control to be relaxed further and potentially the end of the negative interest rate policy in 2024, and hence we remain underweight in Japanese duration.

On the other hand, we hold an overweight duration position in New Zealand, as we are relatively more negative on the economic prospects there and we believe the Central bank may cut sooner than the market is currently pricing. We also have an overweight duration position in the United Kingdom, where we have a negative economic outlook and we believe the rate adjustment has been overdone.

China's economic rebound and reopening boost was very short lived, and we believe we are entering a phase of structural shift, with a recalibration of the economy towards lower growth sectors. However, we expect Asia to remain resilient, in particular India, where we expect 6% growth in 2024 thanks to the support provided by structural factors. We expect a supportive environment for EM, with the EM-DM growth differential at its highest in 5 years, although with high fragmentations between countries.

On the EM Local rate side, we are still bullish on Brazil, Mexico and South Africa duration, as we expect further progress on the inflation front, moderate rate cuts, and a shift to moderate growth.

In credit, we still like Investment Grade. Fundamentals remain resilient, although management guidance is starting to be lowered. Investment Grade Companies still benefit from the very low cost of funding they enjoyed for a number of years. Despite the move tighter in spreads post SVB and Credit Suisse, spreads still remain relatively cheap from a historical perspective and offer more compensation for the potential downside risk ahead. We currently prefer the belly of the EUR Investment Grade curve on valuation grounds. We expect Investment Grade spreads to remain range bound in 2024. High Yield corporates look expensive in our view, in the face of the deteriorating growth outlook, and we remain cautious in that segment.

In FX, recent US developments have opened a window for USD weakness. However, US exceptionalism still lingers, with the rest of the world on more tenuous footing. We expect another year of a relatively resilient Dollar. However, we still find some pockets of attractive valuations, for instance on the AUD, which we believe is relatively undervalued and should benefit from the strength of the Australian economy and the still hawkish stance from the Reserve Bank of Australia. On the other hand, we are negative on GBP, as we believe the growth outlook will weigh on the currency, and on CAD, on weak economic fundamentals and rich valuations against other commodity currencies. In EM, we still favour Latin America, where policymakers have been careful to preserve real carry. We still expect a very gradual policy normalization and little real carry erosion over the first half of next year. We remain cautious in Asia, where we expect lower growth, in particular from China, and greater geopolitical uncertainty. We use some low yielding Asian currencies to fund long position in Latin America. We will need to become more selective in carry trades, if and when the carry buffer reduces later in the year.

We remain agile in the face of rising political uncertainty. The election agenda is heavy in 2024, including election in the US, which could bring about some volatility. We expect these factors, combined with the lagged impact of divergent monetary and fiscal policies across economies, will bring about a number of relative value and tactical opportunities to generate outperformance in 2024, in addition to the directional strategies implemented in the portfolio.

Amundi Asset Management is sub-advisor to NEI Global Total Return Bond Fund. Learn more about them and this Fund.

WELLINGTON MANAGEMENT®

Wellington Management on global impact bonds

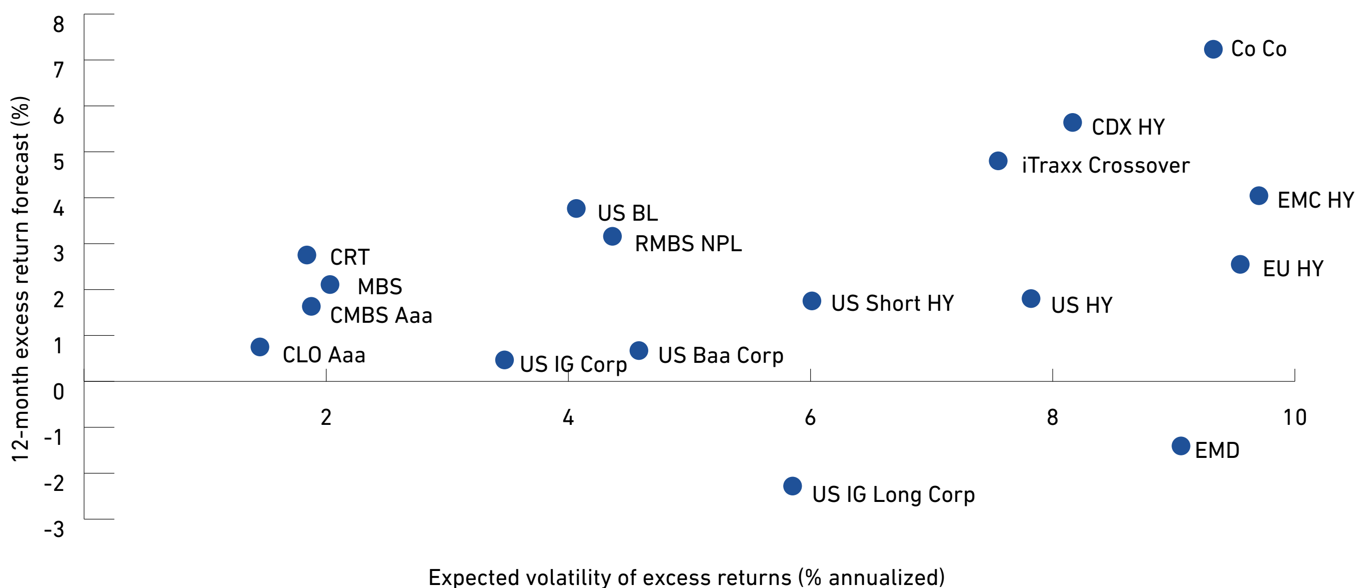
Despite just over a year having passed since the US Treasury yield curve inverted,[1] the resilient consumer appears to have delayed a slowdown in US economic growth. We still expect US economic growth to slow meaningfully sometime in 2024, and, thus, advocate a defensive credit risk posture. But we observe some dispersion across fixed income sectors and still see opportunities to add value through sector rotation and security selection.

The Federal Reserve has heightened monetary policy aggressively over the past 18 months to bring down inflation, but while financial conditions have heightened, this has not yet broadly flowed through the economy as consumers maintain above-trend spending patterns. We expect, however, this will change in 2024 as the lagged impacts of tighter monetary policy take hold.

The sharp increase in nominal rates has occurred against a backdrop of elevated inflation, so real rates are not currently very restrictive. However, if inflation pressures continue to abate, keeping real rates elevated should slow economic activity significantly. Alternatively, if inflation remains elevated, the Fed will need to resume hiking policy rates. While this action may postpone a credit crisis, we believe it would make it more severe. Under either scenario, we expect credit sectors would underperform government bonds.

Evidence is beginning to emerge of cycle indicators turning negative. Default rates for bonds and loans have been rising recently, suggesting that restrictive monetary policy is impacting corporate balance sheets. Consumers are still spending but are starting to show some cracks. Despite looming (and growing) economic recession risks, we see several potential opportunities in higher-yielding credit sectors. While these excess return forecasts assume that spreads will revert to their historical medians, our slightly more bearish forecast incorporates some degree of spread widening given my expectation for an economic slowdown.

Expected credit sector excess returns and volatility (12 month forward)



Sources: Bloomberg, BofA Merrill Lynch, Morningstar/LSTA, JP Morgan, Wellington Management as of October 31, 2023. Expected returns vs volatility of credit sectors in excess of duration-equivalent US Treasuries based on historical valuation relationships.

[1] As measured by the difference in yield between the 10-year US Treasury note and 3-month US Treasury bill.

Having observed meaningful spread compression across fixed income sectors, both in terms of the level of spreads and in the magnitude of relative value dislocations, we are finding attractive opportunities to add potential alpha through security selection. Corporate fundamentals are likely to deteriorate, albeit from strong starting points, as softer demand, higher financing costs, and sticky cost pressures conspire to pressure profit margins. However, we believe that bouts of volatility in 2024 could generate greater idiosyncratic dispersion and create attractive entry points to add credit exposure.

Select central banks might slow/pause policy normalization cycles driven by financial instability and slowing growth, risking an incomplete move lower in inflation toward policy targets. On the other hand, persistently high inflation and a potential energy price spiral highlight the risk of more outsized rate hikes by other central banks. We continue to manage duration tactically with an emphasis on country differentiation.

Despite economic and monetary policy uncertainty, we expect the potential upside from earning today's historically high yields and being ready to take advantage of credit market dislocations as they arise outweigh the possible risk from rates moving higher. We believe it is prudent to maintain defensive credit positioning, because "higher for longer" monetary policies ultimately could be more negative for medium-term credit returns. We also expect that there are likely to be more attractive entry points over the course of 2024 to add credit risk at potentially wider spreads, and we are ready to move quickly when those entry points arise. In the meantime, portfolios invested in spread sectors continue to earn attractive yields – even for those maintaining a relatively defensive stance – and we still see attractive market opportunities in this space.

Corporate

Global investment grade

Major global central banks are, in aggregate, net sellers of assets, and the reduction of major central bank balance sheets has material implications for corporate credit spreads. In this new environment, we expect the volatility of global investment grade corporate bond spreads to increase. As we anticipate that credit spread dispersion will increase, we are selectively prioritizing issuers with high-quality free cash flows and strong liquidity, to retain the flexibility to make additional changes to the portfolio's credit exposures in the event of further credit spread volatility.

Global high yield

We are cautious on the high yield sector and maintain an up-in-quality tilt to our holdings but will look to take advantage of any dislocations that arise from tighter global monetary policy. While we expect the macroeconomic backdrop to deteriorate further, we do not anticipate a deep recession or full-scale credit default cycle. Rising input costs contribute to weaker corporate fundamentals, but they also lower the cost of debt in real terms over time. The new issue market is reopening for issuers willing to pay higher borrowing costs, but given the lack of refinancing needs, few chose to take advantage. Tail risks are rising in an environment of evaporating market liquidity, and we expect some of the excesses in the markets and economy created by a prolonged period of low rates will be sources of volatility as they are unwound.

Municipal

We remain positive on municipal fundamentals due to conservative financial policies and federal fiscal stimulus, though we recognize the sector has been challenged by market volatility and rate volatility this year. Municipal fundamentals are broadly positive based on a bounce-back in economic activity and generous direct and indirect Federal support in response to COVID-19. While the sector is not immune to a broader credit sell-off related to geopolitics, it is more insulated than other fixed income sectors, leaving inflation and the Fed as larger risks.

Mortgage-backed securities

Agency MBS

MBS market fundamentals and, especially, valuations have improved amid rising rates, but technicals are now the biggest driver of performance. These factors had supported mortgages for almost two years but have since reversed as Fed and bank sponsorship for MBS has peaked. The natural pain point for mortgages remains in the origination coupons where the net organic supply is concentrated. Meanwhile, lower coupons (2.0% and 2.5%), which comprise more than 60% of the index, have seen support from investors who are structurally underweight and are majority-owned by the Fed and banks, enabling these coupons to have performed better. As housing activity slows given high mortgage rates, the supply of mortgages will likely be lower. While volatility may remain elevated in the near term, it is now better priced in the markets and could be supportive of MBS spreads, as uncertainties around Fed policy diminish, as well as attractive relative value opportunities.

CMBS

We have become more negative on CMBS, though we are still finding pockets of opportunity. The performance of commercial real estate (CRE) is closely tied to the strength of the US economy, and the softness we are seeing in CRE will likely continue as economic growth weakens. We anticipate that asset valuations are set to decline off their peaks which will likely result in an uptick in collateral defaults, though the low loan-to-values on CMBS loans (~50-60%) provide ample cushion against potentially strained asset values. Still, results will vary greatly by property type and submarket. Multifamily property values have likely peaked though they are still supported by strong net operating income. We are most concerned about the longer-term outlook for office as work-from-home has structurally changed the demand for office space. We believe higher-quality, new/renovated, green office buildings are poised to outperform lower-quality, dated buildings as borrowers take advantage of the weakness to upgrade their space. With this dispersion across and within property types, security selection will be critical.

Government & related

Central bankers have continued to signal a willingness to sacrifice jobs and growth to avoid the risk of inflation expectations becoming untethered. However, there will be increased differentiation among regions based on policymakers' ability to credibly restore price stability. Select central banks might slow/pause policy normalization cycles driven by financial instability and slowing growth, risking an incomplete move lower in inflation toward policy targets. On the other hand, persistently high inflation and a potential energy price spiral highlight the risk of more outsized rate hikes by other central banks. We continue to manage duration tactically with an emphasis on country differentiation. As a reminder, we do not hold general-purpose debt from sovereign issuers.

Emerging market debt

Over the medium term, we expect inflation will begin to plateau and growth will cool as central bank tightening and easing bottlenecks begin to take hold. In the near term, we expect EM growth to continue to be challenged, though country differentiation will remain critical as varied starting points in fundamentals and access to financing mean that some countries are better positioned to weather the challenges than others. Signals we are assessing to turn more constructive include an easing of geopolitical tensions, in turn moderating inflationary impacts and sanctions, monetary policy reaching terminal rates, and/or supply pressures beginning to abate. This would reduce the volume of tightening needed and moderate the impacts to growth.

Wellington Management is sub-advisor to NEI Global Impact Bond Fund. Learn more about them and this Fund.

Principal℠

Principal Global Investors on global high yield fixed income

As we reflect on 2023, we recognize that global economies have demonstrated remarkable resilience amidst a complex backdrop marked by elevated inflation, higher interest rates, and geopolitical headwinds. As we turn to 2024, we anticipate a macroeconomic environment that, while potentially challenging, offers a unique opportunity for investors.

Despite its resiliency this past year, we anticipate that in 2024 the U.S. economy will begin to feel the cumulative effects of such ongoing pressures. We project a modest deceleration in U.S. real GDP growth, expecting a leveling off at around 0.2% year-on-year by mid-2024. This forecast is underpinned by the early indicators of a slowdown that have been evident throughout 2023, including the steady decline in non-farm payroll figures, which have decreased from 4.3% in July 2022 to 1.9% in October 2023. These figures suggest a cautious outlook for employment trends in the coming year.

While some sectors like construction, healthcare, and education, continue to demonstrate robust hiring and earnings' growth, others are beginning to show signs of weakness. In traditionally pro-cyclical sectors, such as leisure and hospitality, we are seeing a slowdown in hiring as well as pressured earnings. This sector divergence is important to note as it provides insight into where the economy may be heading. We view these sectors as likely drivers of an increased U.S. unemployment rate in 2024. Consequently, we project a moderate increase in U.S. unemployment rates, from an estimated 4.0% at the end of 2023 to approximately 4.4% by mid-2024. This uptick, while moderate, indicates a shift in the employment landscape that warrants close monitoring.

An additional concern is the growing pressure faced by the American consumer heading into 2024. This past year, the number of households with multiple jobholders reached a 20-year high. Coupled with alarming highs in U.S. credit card debt, car loan defaults, and mortgage payments, this trend paints a concerning picture of the consumer's strength heading into 2024.

Despite these headwinds, the corporate sector remains a beacon of strength. Across various industries, companies have been surpassing earnings estimates, and key metrics like corporate leverage and interest coverage are at some of their strongest levels in recent history. Such strength in corporate fundamentals, juxtaposed against the backdrop of a slowing economy, gives us confidence that businesses are well-equipped to navigate potential challenges ahead.

Looking at the broader market, the confluence of a slowing economy and strong corporate fundamentals presents a compelling opportunity for investors, particularly in the High Yield asset class. With starting yields hovering near 9.0%, and the potential for added momentum from a decrease in the Fed Funds rates in the latter half of 2024, we believe this opportunity is particularly attractive for investors willing to weather short-term turbulence.

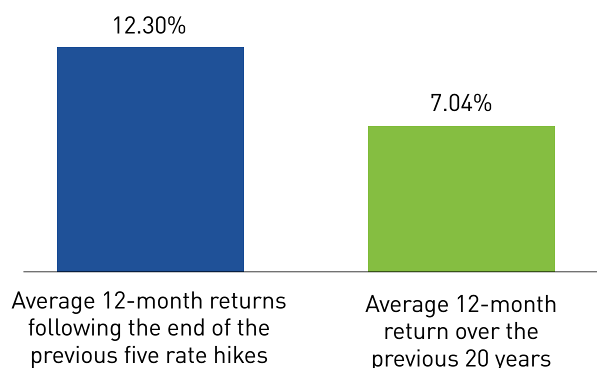
High yield outlook

High Yield investors have much to consider as they navigate the current landscape, including the future direction of the economy, the trajectory of interest rates, and escalating conflict in the Middle East. Our view is that the High Yield market is in a fundamentally very attractive place. The relative quality of the market is at historically high levels, and issuer fundamentals, including leverage ratios and interest coverage, are also at very strong points. With starting yields in the 9.0% area, the asset class provides a substantial income buffer which allows it to weather adverse economic or geopolitical events.

Amidst the current higher interest rate regime, corporate earnings may not be as robust as previous quarters, something we witnessed in the second quarter. In that environment, it's our view that spreads will widen slightly from current levels. We project High Yield spreads to widen from current levels to 475 basis points in 2024. However, a slowdown and expected spread widening should not scare investors away from high yield, as starting yields are well above the 10-year average.

We believe that corporate earnings will find their footing and rebound in 2024. At the same time, it's the consensus view that the Federal Reserve has reached its peak federal funds rate for this hiking cycle. Historical data suggests that following a peak in the fed funds rate, the High Yield market, on average, realizes a 12.3% average return over the following 12-month period. This historical perspective provides further basis for optimism in the High Yield market's performance post-interest rate hikes.

Attractive historical returns following a peak in interest rates



Source: Principal Global Investors

Despite potentially challenged corporate earnings, we view the asset class as positioned to potentially provide equity-like returns with bond-like volatility over the next year. This unique combination of characteristics makes the High Yield market an attractive proposition for investors, especially in an environment marked by uncertainty and fluctuations.

Turning to portfolio construction and positioning heading into 2024, we're positioned slightly inside the index in terms of spread and yield and are focused on overall higher quality bonds. Our relatively defensive positioning should give investors comfort as the economy begins to slow in 2024. Additionally, using bottom-up fundamental credit analysis, we've positioned the portfolio in names that we believe have enhanced risk-reward profiles compared to that of the broader index. We're also keenly focused on avoiding cyclically challenged industries, and primarily aim to outperform through superior credit selection.

In terms of sectors, we've maintained the positioning we've had mostly throughout 2023, with larger overweight's in Metals and Mining, Independent Energy, and the Healthcare Insurance sectors. Our biggest underweights continue to be in Media and Entertainment, Wirelines, and Technology. This sector allocation reflects our ongoing assessment of market conditions, potential risks, and opportunities. By maintaining a strategic focus on these sectors, we aim to leverage the unique opportunities they present, while also mitigating risks associated with more volatile industries.

As part of our evolving high yield investment process, we continue to incorporate our dynamic environmental, social, and governance (ESG) and data science initiatives into our fundamental research. These proprietary tools have been instrumental in testing our investment biases, highlighting investment opportunities, and expanding efficiencies across the high yield team. Using our internal ESG scores, we have improved the overall portfolio's exposure to these factors. Moreover, we maintain our focus on reducing the portfolio's overall carbon footprint. This commitment to ESG considerations is not only about aligning with global sustainability trends but also about recognizing that companies with strong ESG profiles often exhibit lower risk and potentially higher returns.

In summary, as we navigate through these complex market conditions, our approach remains rooted in a disciplined, research-driven strategy that emphasizes quality, diversification, and active management. We believe this approach positions the portfolio well to navigate the challenges and capitalize on the opportunities that 2024 may bring.

Principal Global Investors is sub-advisor to NEI Global High Yield Bond Fund. Learn more about them and this Fund.

The outlook for

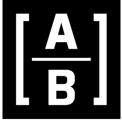
US and Canadian equities

The U.S. economy defied expectations of a bear market and its resilience was buoyed by better-than-expected earnings on the back of strong consumer spending, which helped propel U.S equity indices through 2023.

However, the strong performance from the S&P 500 and Nasdaq were largely driven by a handful of tech mega-cap companies that surged on the promises of an AI revolution. Outside of that small group of richly valued tech firms, most sectors struggled. 2024 will bring new headwinds as growth slows and monetary policy remains tight in the first half of the year. U.S. equities still offer opportunity in 2024, but investors will need to be more selective, focusing on high quality holdings that offer stability. Especially in undervalued names in defensive sectors like healthcare, utilities, consumer staples as well as financials and energy.

The Canadian economy didn't fare as well as the U.S. as higher policy rates and higher bond yields weighed on growth, resulting in an equity market that traded in a narrow range without much upside. 2024 will likely be challenging for Canada equities as indebted consumers and small businesses face higher borrowing that will slow growth. There are still pockets of opportunity as, some parts of the Canadian market like oil and gas producers, as well as some technology stocks will continue to thrive in this era of higher inflation and interest rates. Discounted valuations for some quality franchises that have sustainable competitive advantages and durable earnings streams also present attractive opportunities to generate returns.

Read more about the outlook for US and Canadian equities from our subadvisors.



AllianceBernstein on US equities

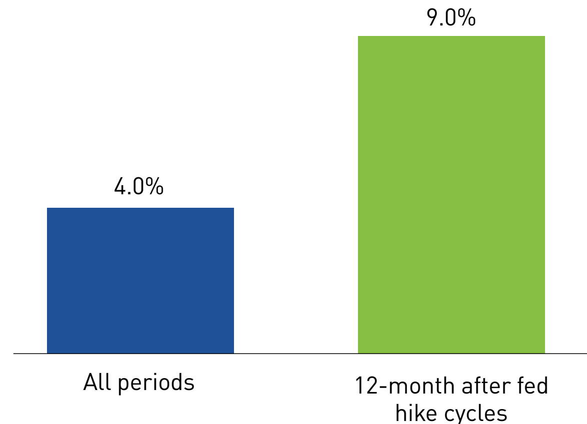
We believe that quality, stability and price (QSP) are the three key attributes in navigating the current market environment.

The current market concentration also creates risks; investors who pile into a small group of Artificial Intelligence (AI)-fueled names could get burned if valuations stretch too far, sentiment shifts and returns rapidly reverse. With the rally in the mega-caps this year, we believe valuation risk for investors who are exposed to the group is greater than the earnings risk. High valuations can end in a painful correction, as we saw in the 2022 bear market. Higher interest rates warrant a greater focus on valuation. But it will take time to know which companies and products have a competitive edge in the race for AI. Beyond the AI darlings, the rest of the market may offer more opportunity than widely perceived, when comparing the bottom-up earnings outlook of individual companies to top-down economic concerns.

We believe that identifying companies with quality businesses can help position portfolios for higher interest and inflation rates. Features such as pricing power, competitive advantages, innovation and management skill will define the companies that can overcome the profitability headwinds created by inflation and higher interest rates. Cash flows are an essential indicator of quality. Companies with high free cash flow have historically performed better through economic slowdowns and recessions. Healthy balance sheets and low debt levels offer some risk mitigation from rising interest rates.

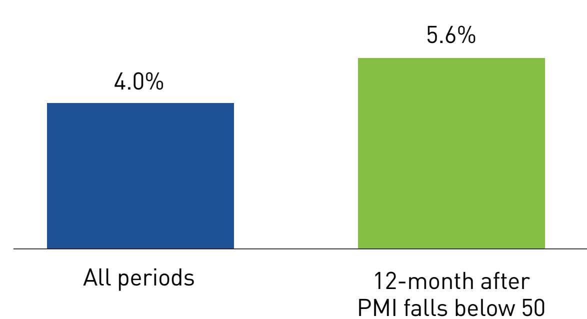
Investors can also offset slowing growth with stability. Stable companies can cushion on the downside across a broad array of sectors and industries. Firms like these are often seen in traditional defensive sectors such as healthcare, utilities and consumer staples, but can also be found in traditionally less defensive sectors like technology, financials and energy.

After fed rate hikes: average annualized relative return of QSP (percent)



Sources: FRED Economic Data, Russell, and AB. Results are for the period from January 1970 through December 31, 2022. Universe: Russell 1000 (largest 1000 US stocks in AB research universe prior to Russell inception) and identification of 10 12-month periods after FED hike cycles. Average forward 12-month USD returns of QSP (equally weighted returns of stocks with 1Q AB QSP score start of each month [(1/3) Quality {ROA Z-score} – (1/3) Stability {AB Adaptive Beta Z-score} + (1/3) Price {Earnings/Price Z-score}] relative to equally weighted universe return.

Economic growth decelerates: average annualized relative return of QSP (percent)



Sources: FRED Economic Data, Russell, and AB. Russell 1000 (largest 1000 US stocks in AB research universe prior to Russell inception) and identification of 17 12-month periods after US Manufacturing PMI crosses below 50. Average forward 12-month USD returns of QSP (equally weighted returns of stocks with 1Q AB QSP score start of each month [(1/3) Quality {ROA Z-score} – (1/3) Stability {AB Adaptive Beta Z-score} + (1/3) Price {Earnings/Price Z-score}] relative to equally weighted universe return.

But why should investors want to own equities at all in a world with cash deposits offering more than 5%? We believe that investors need equity returns to beat inflation. Equities are also a source of income. While the free-cash-flow yield of equities is below short-term yields, equities provide cash-flow growth. We believe investing in stocks will generate real returns above inflation to reach long-term financial goals. Current short-term interest rates are expected to

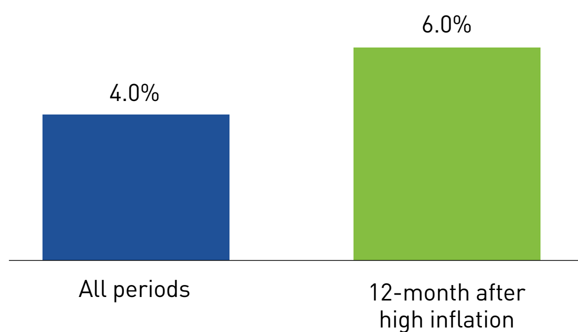
decline, so investors will struggle to maintain returns when reinvesting. Cash hasn't beaten inflation for any of the past 12 years.

We believe that equity portfolios designed to smooth volatility are especially appealing in the current market environment. We continue to look for companies that offer a combination of quality and stability at attractive prices, the three core elements that underpin our investment philosophy in good and bad times. For long-term, outcome-oriented investors, we believe that companies with these features are best positioned to deliver strong returns through changing environments.

US outlook

Growth remains resilient, albeit tepid in most regions outside the US. The US economy once again defied expectations in the third quarter, accelerating when most had expected slower growth. Again, the explanation comes down to the consumer: with the labor market staying strong, households reached deep into their wallets and kept spending. Headwinds are mounting, however, with slower growth expected. A mild recession can't be ruled out even if a sudden stop appears unlikely. Despite the resilience of the global economy to date, we forecast a protracted period of below-trend growth through 2024 and likely beyond.

High inflation: average annualized relative return of QSP (percent)



Sources: FRED Economic Data, Russell, and AB. Results are for the period from January 1970 through December 2022. Universe: Russell 1000 (largest 1000 US stocks in AB research universe prior to Russell inception) and identification of periods where Inflation (12-month change in Consumer Price Index) is in top tercile. Average forward 12-month USD returns of QSP (equally weighted returns of stocks with 1Q AB QSP score start of each month [(1/3) Quality {ROA Z-score} – (1/3) Stability {AB Adaptive Beta Z-score} + (1/3) Price {Earnings/Price Z-score}] relative to equally weighted universe return.

Beyond the AI darlings, the rest of the market may offer more opportunity than widely perceived, when comparing the bottom-up earnings outlook of individual companies to top-down economic concerns.

Major central banks have raised rates aggressively and are increasingly emphasizing that the persistence of tight policy is more important than the terminal rate. We expect tight policy for several quarters to come. The Fed and the ECB have both indicated that the terminal rate is likely to be higher than they expected.

Inflation is generally moving lower, but the pace of deceleration is variable both within and across regions. Rising commodity prices pose an unwelcome upward risk. We believe the recent rise in yields is unlikely to be sustained as growth and inflation slow and rate hikes end.

AllianceBernstein is sub-advisor to NEI US Equity RS Fund. Learn more about them and this Fund.

QV
INVESTORS

QV Investors on canadian equities (large and small cap)

Higher policy rates and higher bond yields result in restrictive borrowing costs that hinder economic growth through slower investing activity and compressed valuations. The policy rate hammer wielded by central banks is a proven tool in stemming inflation, but it can take up to 24 months before its full effect is felt across the economy. If history is a guide, we may begin seeing the long lags of policy start to bite sometime by the spring of next year, considering that initial rate hikes from the Fed and the Bank of Canada were announced in March 2022.

Another leading indicator, the yield curve, remains deeply inverted despite some of the recent steepening. Historically, the yield curve inverts approximately 6 to 24 months before the onset of an economic slowdown. Both the U.S. Treasury and Government of Canada yield curves, as measured by 10-year yields minus 2-year yields, inverted in July of 2022. Should history rhyme, as it typically does, this suggests an economic slowdown by the summer of 2024.

Inflation, as measured by the Consumer Price Index (CPI), peaked at 9.1% in the U.S. and 8.1% in Canada in June 2022. Price pressures have since trended down between 3% to 4%. The improvement is notable but remains above the central bank target range of 1% to 3%. The final push lower lies with the labour market as wage growth of 4% to 5% in North America is simply too high to achieve price stability. Chairman Powell and Governor Macklem both openly support the linkage that labour market rebalancing is required to help rein inflation back within their targeted range.

Labour market strength has been evident as the unemployment rate has held steady at multi-decade lows for over 18 months. But a decelerating trend in new job hires is now visible. U.S. nonfarm payroll growth has slowed from the strong numbers seen in the post-COVID recovery phase and is now closer to the key level of 100,000 monthly new jobs (which is considered the breakeven level that prevents the unemployment rate from rising). A further deteriorating trend would indicate labour market weakness and softer wages.

A painful reversal in the unemployment rate may be necessary in the name of price stability. Wage inflation is stubbornly high, and central bankers have set their sights on a rebalancing of the labour market to carry out their inflation-targeting mandate.

The twin engines of the Canadian economy – the consumer and small businesses – are facing more headwinds than in the past, with rapidly rising borrowing costs reducing discretionary cash while inflationary pressures continue to increase costs like rent and energy.

We remain cautious of consensus earnings estimates as they continue to reflect an optimistic growth scenario next year, exposing investors to de-rating risk should economic growth decelerate. Equity market valuations, while not at unreasonable levels, are also at risk should earnings revise lower, highlighting the importance of maintaining a valuation advantage in our respective strategies.

Within Canada we continue to see select notable areas of weakness within the economy and the market. This includes accelerating weakness for consumer discretionary, financials and select industrials businesses. However, some parts of the Canadian market continue to thrive in this era of higher inflation and interest rates. This includes oil and gas producers and select technology stocks such as Shopify. We emphasize that we currently do not expect continued resilience in these areas should there be a significant pullback to global economic growth.

Looking ahead, while the economic visibility on a soft or hard landing is not obvious, it is clear the economy and the market are facing increasing downward pressures. The twin engines of the Canadian economy – the consumer and small businesses – are facing more headwinds than in the past, with rapidly rising borrowing costs reducing discretionary cash while inflationary pressures continue to increase costs like

rent and energy. The upcoming months should reflect the lagged effect of higher interest rates; however, historically low unemployment levels are so far supportive of a significant component of Canadian GDP, consumer spending. It seems likely consumers will shift their demand profiles and tighten their belts to focus on essentials. Corporate Canada seems cautious as it navigates tight labor conditions and shifting or slowing demand.

We continue to invest in quality franchises that we believe have sustainable competitive advantages and durable earnings streams. Bottom-up security selection remains our bread and butter and we are not abandoning the compounding abilities of our businesses. We continue to own opportunities that offer attractive risk and reward in a variety of scenarios. Our emphasis towards durable free cash flow, balance sheet strength, and proven management teams has helped clients preserve and grow their wealth through prior cycles. Long-term returns and risk management go hand in hand and so we remain committed to these key characteristics.

With greater options, market participants may focus more on the fundamentals of risk and reward rather than a reflexive "buy the dip" mentality in equities. This shift could be favorable for our portfolio holdings that demonstrate above-market revenue and cash flow profiles going forward. We believe that focusing on fundamentals and risk-adjusted return frameworks is the most appropriate way to allocate capital. While our investments may not be immune to all challenges that lie ahead, their underlying characteristics suggest an ability to navigate all weather conditions.

The Canadian Small Cap Equity RS portfolio currently reflects a 10%+ valuation discount to the benchmark and lower balance sheet risk. Quality-wise, the portfolio's longer-term return on equity (ROE) of 12% represents a 50% advantage over the benchmark's 8%, supporting the objective of consistent growth over the long run.

The Canadian Equity RS portfolio continues to demonstrate stronger compounding characteristics, including a higher ROE, lower payout ratio and similar yield relative to the benchmark. The portfolio also boasts lower debt levels.

We believe both strategies are prepared for a weakening economy and equity market.

Within the Canadian Equity RS strategy, we are starting to see incrementally more opportunities for capital deployment. While it is not surprising that cyclicals may be weak as the market continues to worry about the economic cycle, the rise in interest rates has also contributed to meaningful weakness in the more traditionally stable parts of the market. We are seeing opportunities for capital deployment across the economic spectrum. We intend to manage exposures with a balanced approach; with a higher level of cash on hand, we are ready to take advantage of any market volatility.

Market sentiment on small caps seems weak due to concerns of a slowing economy, rising borrowing costs, and less diverse businesses. While this sentiment may be true broadly, it creates pockets of opportunity in some quality companies that are swept up within the space. The portfolio doesn't represent the entire market, some companies with sound balance sheets and good business models are trading at below-average valuation levels. In the short term, the portfolio may lag on a relative basis in a soft landing scenario, as lower quality companies tend to lead recoveries. If a tougher landing scenario materializes, the portfolio's balance sheet and lower reliance on cyclical earnings streams should help it navigate adverse conditions reasonably. Over the medium term, we anticipate sound execution of business plans and healthy capital structures to drive portfolio outcomes.

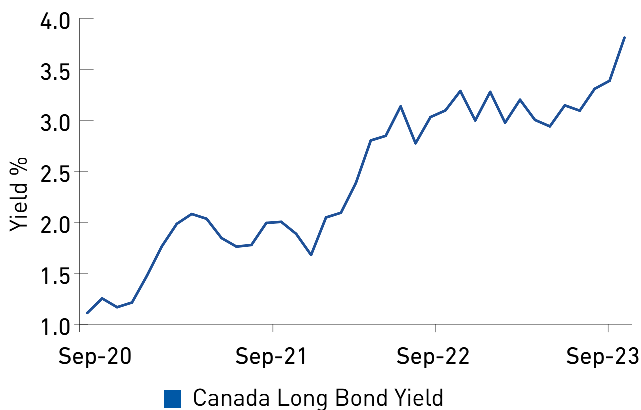
QV Investors is sub-advisor to NEI Canadian Equity RS Fund and NEI Canadian Small Cap Equity RS Fund. Learn more about them and these Funds.

Lincluden

Lincluden Investment Management on dividend equities (North America)

With administered rates having increased further and, faster than at any point in our careers, yield stocks have faced a greater headwind than much of the market over the last 18 months.

Rates Rise Extremely Rapidly



Source: Lincluden Investment Management as of September 30, 2023.

As is often the case the market appears to have overly negative sentiment for many of the companies in this area providing in our view a strong opportunity.

	NEI Canadian Dividend Fund	80% TSX, 20% MSCI World
Price/Earnings	12.2x	15.0x
Price/Book	1.5x	1.9x
Price/Sales	1.0x	1.5x
Price/Cash Flow	5.8x	12.6x
Weighted Avg. Mkt. Cap.	$123.5B	$171.5B
Dividend Yield	4.4%	3.1%

Source: Bloomberg as of October 31, 2023

The combination of attractive yields, strong profitability, and depressed valuations speaks to a very robust return opportunity over a 3-year horizon with highly attractive yields while you wait.

With pre-tax yields of 5.7% the portfolio is attractive in comparison to the current bond yield of 3.5%. Many of our solid dividend paying companies tend to be in oligopolistic or regulated industries where the ability to pass on the increased cost of capital to customers is easier in uncertain times indicating continued strong profitability. Further, we are now of the belief that most if not all of the medicine to combat inflation has been administered and that the Fed and the Bank of Canada will look to pause. Further, we believe that while rates will stay higher for longer the next year or three will likely see moderate declines in yields as the economy slows. Hence a headwind turns into a tailwind.

The combination of attractive yields, strong profitability, and depressed valuations speaks to a very robust return opportunity over a 3-year horizon with highly attractive yields while you wait.

Lincluden Investment Management is sub-advisor to NEI Canadian Dividend Fund. Learn more about them and this Fund.

The outlook for

global/international equity

The general outlook for global equities is cautiously optimistic as a projected soft landing in the U.S. and the end of monetary tightening should be a tailwind for the global economy.

Pandemic savings and spending by the baby-boomers should continue to drive consumption and support demand. The outlook for the Eurozone is less positive due to weakness in manufacturing, while emerging markets look promising due to expectations for continued positive GDP growth and attractive valuations. China's willingness to stimulate the economy should also be supportive of China's GDP and surrounding Asian economies. However, heightening geopolitical risks still warrant some caution and investors should focus on quality businesses trading at a discount to their fair value.

Following a challenging year due to rising interest rates, the Clean Infrastructure sector is at an inflection point. Stable or falling interest rates and attractive valuations should support the sector where companies are more focused on consistent cash flows and growth. With the cost differentials between renewable electricity and traditional fossil fuel alternatives becoming increasingly attractive, robust policy support and increasing electricity demand should all continue to support the sector more broadly. The sector offers opportunity for investors to capture structural growth amid a slowing global economy.

Read more about the outlook for global/international equities from our subadvisors.

MAJ
INVEST

Maj Invest on global equities

Looking at 2024 from a macro perspective, we are cautiously optimistic regarding the global economic outlook.

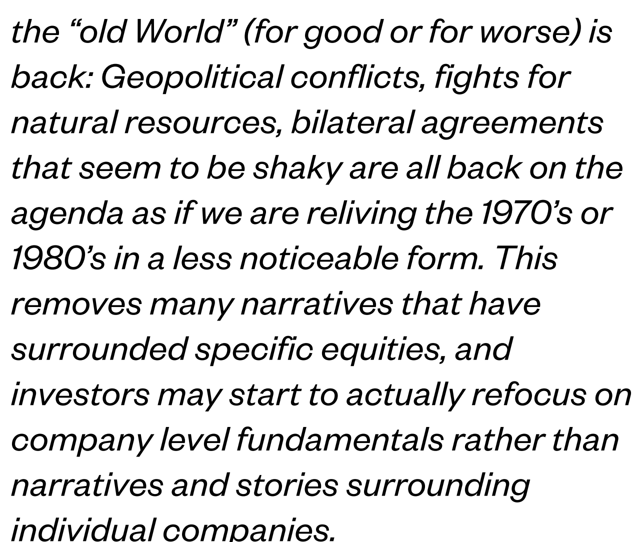
Given the weight of the US economy in the global context, our outlook is primarily based on the US and its role as the main driver of the global economy. The transmission of the monetary policy conducted by the Fed has cooled the main inflation drivers so far without causing too much damage to other aspects of the economy i.e., private consumption and the labor market. As a result, we still expect that the Fed will manage a soft landing.

Inventories have been cut at a rapid pace throughout the year and this has weighed on manufacturing activity. With inventory reduction now gradually being pared back, the manufacturing cycle is set for a rebound, and we expect the PMIs to reflect this fully once the strikes among car manufacturers have been resolved.

Despite notable monetary tightening, private demand has so far proved remarkably resilient. To some extent, this can be credited to the excess savings accumulated during the COVID-19 lockdowns. This has enabled consumers to maintain their consumption despite the sharp increases in inflation. However, we also view the strong consumption pattern as a reflection of the changing demographic composition. As they have approached retirement age, the baby boomer generation appears to have increased their savings considerably. Given the relative size of this generation, this has lowered demand and inflationary pressures significantly for several years. Now the trend is reversing as the baby boomers are increasingly entering retirement and therefore starting to spend out of savings. We believe that these demographic effects will continue to be a strong consumption driver for 2024 and the following years.

Another consequence of an increase in the retired cohort of the population is the effect on the job market. So far, the increases in the fed funds rate have not affected job openings to the initially expected extent because the underlying demand has been too strong. Pairing that with a shortage in the supply of qualified workers, companies have both been reluctant to let go of employees and the wage increases for new hires particularly have been significant in the last year. With easing inflation pressures, real wages began increasing in June 2023.

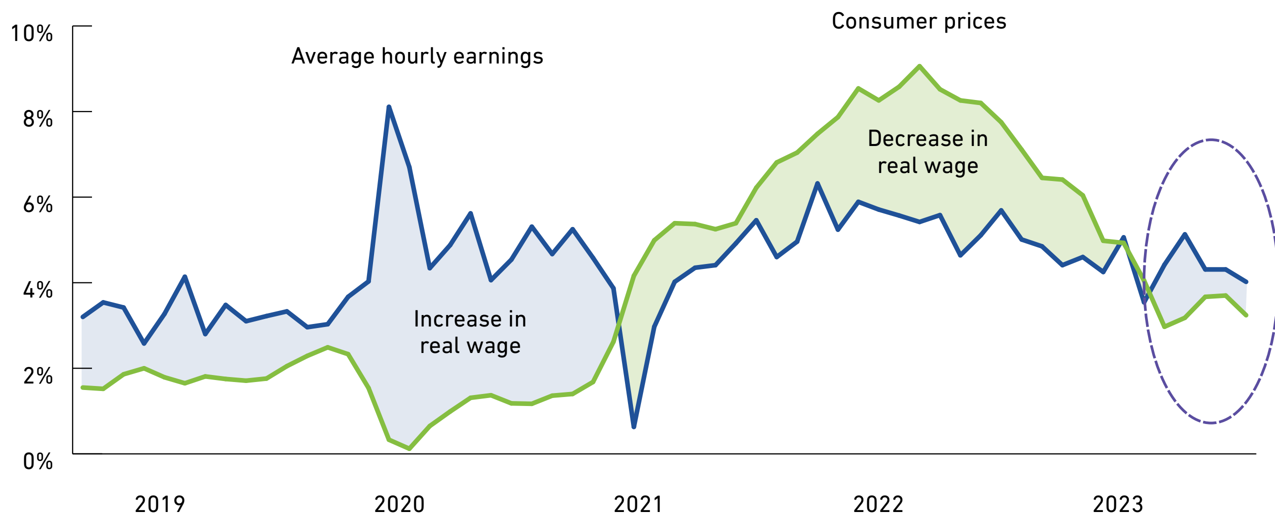
We believe that these trends in the labor market will remain due to baby boomers retiring and this will allow for real wages to continue increasing in 2024.



Combining the effects of the demographic trends with recent US fiscal policies such as the IRA and the CHIPS Act as well as the turn in the industrial cycle, we expect that US real growth will be at 2% for 2024. However, these effects also mean that the inflation pressures will not subside sufficiently to accommodate the Fed's goal. Therefore, we expect a couple of further 25 basis points rate hikes in 2024.

Expanding our view beyond the US, we are not quite as positive regarding the near-term outlook for the Euro area economy due to continued weakness in the manufacturing sector. However, Euro area countries also benefit from relatively strong labor markets that will help sustain real wage increases and help drive the economy forward. We expect real Euro area growth at 1.5% in 2024.

Year-Over-Year changes



Source: Bureau of Labor Statistics. Note: NSA data. Avg. hourly earnings for the private sector.

As we enter into 2024, we believe that there are several positive drivers for the Value strategy.

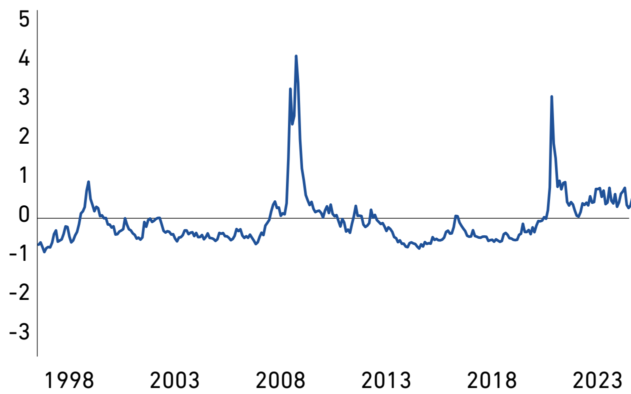
First of all, the zero-rate environment that lasted for more than 10 years is over. This environment, which can probably best be called a "great monetary experiment" had created its own demise, as warped valuations penetrated almost all markets in the world. As inflation came back with a vengeance, this environment is now behind us, and we believe it will not resurface anytime soon. Consequently, this is good news for value stocks and for any reasonable investment strategy that actually focuses on valuation along other parameters.

A second important factor, which should provide tailwind for the strategy is, that value stocks in general have had a rough time over the last 10+ years. The valuation gap between i.e., value stocks and growth stocks have been exacerbated by the large popularity of ETF index funds. Index funds "have to buy" what is in the index, and as long as it is a one-way positive inflow to these funds, large companies become larger and small companies becomes smaller – simply because valuation has no say during the purchase phase. The effect of this phenomenon is, that the US now stands at a record high 70 percent weight of MSCI World – which it has never done before. If we look at the index members it looks even more distorted: Apple weighs almost as much as all of Japan, and the 10 largest members of the MSCI World are all American. This has usually been a harbinger of a more rational and equalized market to come. If and when this happens, it usually bodes well for value strategies in general, and should also bode well for this strategy.

A third point to make is that in many ways, the "old World" (for good or for worse) is back: Geopolitical conflicts, fights for natural resources, bilateral agreements that seems to be shaky are all back on the agenda as if we are reliving the 1970's or 1980's in a less noticeable form. This removes many narratives that have surrounded specific equities, and investors may start to actually refocus on company level fundamentals rather than narratives and stories surrounding individual companies. This would be a healthy development for the market, which we believe should be good for fundamental value investors.

A final point is, that valuation spreads are high measured as the difference between the 95th and 5th percentile EY across all sectors globally. This spread indicates, that there is ample room for valuation dispersions to come down, which translates directly into to excess return for the strategy.

Sector neutral Valuation spreads for Russell 1000



Source: Maj Invest as of October 31, 2023

The chart above clearly illustrates, the valuation spreads are as high now, as during the dotcom bubble and the crash of 2008. They have been elevated since the outbreak of covid 19, and we believe they will eventually come down. Historically speaking, the strategy's excess return has been strongly negatively correlated with these spreads, which should bode well for the coming years if we are right in our prediction about the direction of these spreads.

Despite all these positive drivers, there are naturally risks which need to be addressed as well. We believe the best way to address any risk is by focusing on quality businesses that trade at a discount to fair value. By focusing on these two cornerstones of investment, we believe we impair risks to the business (via the quality component) as well as risks to the share price (via the low valuation component). Although risks can never be removed completely, it is our profound view that this is the best way to minimize them over time.

Maj Invest is sub-advisor to NEI Global Value Fund. [Learn more about them and this Fund]().

Ecofin Advisors Limited on clean infrastructure equities

Electrification Trends Remain Robust

Fundamentally, demand is strong as we see more evidence that electrification is happening, be it due to the large amount of electricity needed for datacentres, AI, or electric cars, to name a few. Demand for electricity worldwide is expected to more than triple by 2050 as electricity is more widely adopted for use.

Further, electricity will increasingly be generated using renewables. Renewables' attributes intersect government policy and economic preference with strong customer demand. Renewables offer security of supply and energy independence, decarbonization benefits, and relative affordability, as renewable electricity cost differentials provide attractive levels compared to traditional fossil fuel alternatives. In terms of costs, declining solar panel and other technologies point to improving cost formation within renewables. Further, contracted power prices for new projects, have by-and-large adjusted upward to reflect the higher cost of capital and overall equipment costs to maintain project returns.

Policy Catalysts

From a macro perspective, we see robust policy support for our sector looking into 2024. We believe we will see full benefits stemming from the US IRA starting to be reflected within companies' financial statements. We also expect clarity on broader European and German pro-renewables policies and Canada's response to the US IRA.

Attractive Valuations

Valuations for the stocks in our investment universe have come down relative to history and relative to the broader market. The sharp increase in long-term interest rates has created a larger headwind to

valuations and capital formation of new projects, overshadowing other drivers as the market questions the value of actual cash flows and the value of growth for companies in the sector. We believe these doubts surrounding growth are likely overly pessimistic.

Delving deeper into attractive valuation levels; the PE of the U.S. utilities index is trading about one standard deviation below its 2010-2023 average and below where it was trading before the IRA was announced, despite an expected acceleration in EPS growth in the next few years relative to the past 5 years. The sector is therefore declining or derating while the broad market multiple has expanded relative to history, creating an attractive set-up for our space. This is perhaps not entirely unexpected given the rate sensitivity of our fund investments, but we believe the mean-reverting aspects of utilities and infrastructure have been historically compelling. Over-time, in our sector, share prices will tend to correlate with earnings. We anticipate these dynamics in 2024.

we see more evidence that electrification is happening, be it due to the large amount of electricity needed for datacentres, AI, or electric cars, to name a few. Demand for electricity worldwide is expected to more than triple by 2050 as electricity is more widely adopted for use.

In 2024, we will likely see interest rates stabilize, and we believe that would be very supportive for the sector and the fund in the future. In the US, history shows that the sector does very well 12 months after the last Fed rate increase. Stability in interest rates should help reduce volatility by offering more consistent net present values of operating cash flows and growth. This is unfortunately an exogenous factor, but equally is not fundamental to operating earnings before interest and taxes (EBIT).

It has been a challenging environment to be a larger user of capital for growth. In the coming months, as the cost of equity might constrain the attractiveness of some companies' renewables projects, and share prices are not reacting to strong dividend yields, we expect some companies may cut their dividend to retain more cash and maintain some ability to grow. Any dividend cut would simply be a re-direction of cash flows internally to fund growth or to de-risk balance sheets for a period of potential upcoming 'defence.' We see almost no fundamental (EBIT deterioration) rationale for dividend cuts in the sector.

Through 2023 many companies have reset priorities among growth, credit rating, and dividend. The sector will therefore enter 2024 offering a clearer picture with potentially less volatility and a focus on execution.

On balance, moving into 2024, and considering valuations, strength in demand, and where we are in the inflation and interest rate cycles, we believe that we are approaching an inflection point and are in an attractive spot within our universe looking ahead. Our sector captures structural growth in a slowing global economic environment. Portfolio companies deliver more stable, and more predictable non-cyclical earnings, and the portfolio is positioned to protect better in falling markets while also participating in rebounds.

Ecofin Advisors Limited is sub-advisor to NEI Clean Infrastructure Fund. Learn more about them and this Fund.

COLUMBIA THREADNEEDLE INVESTMENTS

Columbia Threadneedle on emerging market equities

The Emerging Markets (EM) forecast estimate for GDP growth was 4.3% for 2023, heading into 2024 we're expecting a GDP growth rate of 3.9%. Many were pointing to an earnings recovery in the second half of 2023, which we're witnessing now.

The big catalyst to the earnings recovery narrative in the near term has been rate cuts with lower inflationary pressure in Mexico, Brazil, Indonesia, India and Poland. EM central banks are ahead of the Fed in their hiking cadence. Markets are predicting the Fed to begin cutting rates between December 2023 – May 2024. We would expect EM easing before this given recent inflation blips in-line with the Fed. EM Central Banks in Mexico and India may err on the prudent side and sync rate cuts to Fed easing; and while in countries like Chile and Brazil the easing cycle could be shallower and develop more slowly than expected.

The Value rally since Q4-2021 has clearly been a headwind for the Columbia Threadneedle style and it feels we are certainly close to or just past the inflection point. The 2024 debate will be characterized by the speed and depth of easing. Either way rate cuts will be a tailwind for the equity market. Analyzing the last 20 years, EM equities witnessed strong front-loaded returns in the first 6 months following easing (avg. 7% local returns). The biggest question is whether risk appetite will come back once the global tightening cycle has reached its peak. In previous decades we saw:

- **2000s:** Strong growth and Foreign Direct Investment (FDI)
- **2010s:** Favorable monetary policy by developed markets
- **2020s:** Capital will be less available

With the availability of capital being scarcer, we believe bottom-up investing is more important than ever. In addition, markets with strong fundamentals and a structural story behind them (i.e., Brazil, Mexico, GCC, India and Indonesia) are what we favor. Possible dollar weakness may be on the horizon and is often a good signpost to get aggressive on EM. Valuations are attractive and significantly below long-term averages and cheap relative to global equities – 10% discount to history and a 28% discount to Developed Markets.

Valuations are attractive and significantly below long-term averages and cheap relative to global equities – 10% discount to history and a 28% discount to Developed Markets.

Looking around the regions there are reasons to be more constructive. The team has recently returned from China, and the woes of the property sector along with a weak consumption recovery post-covid are the main topics of discussion. Clearly both are related, as household saving as a percentage of disposable income is 30%, which is 50% higher than historical levels. There is also pent-up demand and excess savings, but sentiment is impacted by the property sector, given the large allocation in personal investments. Nonetheless, Q3 GDP was higher than expected (+4.9%) due to improving policy visibility around State Owned Enterprises reforms that ended regulation and directed capital to key sectors. The market was also buoyed by China-US dialogue ahead of the potential Xi-Biden meeting in November and the APEC summit in San Francisco. China recently announced more fiscal stimulus, raising the central deficit from 3% to 3.8% via more bond issuance. China rarely adjusts the budget mid-year and is a strong signal from the central government that it is willing to use their balance sheet, instead of local government to stimulate growth. This action is worth around 0.7% of GDP.

North Asian economies are also benefitting from China's re-opening. South Korean semi exports are projected to improve, with the memory cycle likely bottoming. In addition, the demand outlook for AI servers account for 90% of high bandwidth memory demand. Taiwan is in a cyclical recovery as semis have suffered from weaking global demand.

Indonesia is also benefitting from structural tailwinds due to reform agendas in the green energy transition and EV ecosystem. This has resulted in increased FDI and a current account surplus. The economy has been very resilient due to a ban on exports of cheap raw commodities like nickel ore which is a key component of EV batteries and the power grid. Their policy is focused on bringing the value chain home so they can export more finished products rather than raw materials.

India is also in a new structural growth cycle thanks to Modi's reforms around tax, bankruptcy, labour and real estate that are designed to make it easier to do business in the country. There is also a massive investment in infrastructure and manufacturing underway to encourage more foreign direct investment. Favourable growth demographics are also propelling a new credit cycle as loan growth is picking up. It's projected 100 million households will move from lower income into the middle class, which supports a new property cycle.

Brazil looks to be set up well now that political issues and inflation appear to be in the review mirror thanks to new fiscal policy frameworks that balance fiscal responsibility with social responsibility. Inflation has been surprising to the downside and there is plenty of room for rate cuts that will support higher revenue for companies and provide a broader tailwind to equities. Brazil's equities currently offer the cheapest valuations across EM with the PE ratio around 7x relative to an average PE Of 11x, representing a 35% discount.

Mexico also has a strong growth outlook thanks to its proximity to the U.S. with recent trade agreements supporting nearshoring to solve the supply chain fragility in Asia. This is generating jobs, pushing up real wages and investment is picking up momentum as a result. We see attractive valuations with strong potential for EPS compounding. However, the risk of a U.S. recession could dampen some of this activity.

There are however a few key risks we are watching across EM, including heightening geopolitical risks with China and Taiwan. We will be closely watching the elections in Taiwan in early 2024, as the incumbent Democratic People's Party may lose to the Taiwan People's Party or Kuomintang who are both more favourable to Beijing. Likewise, U.S.-China relations remain strained following the spy balloon incident earlier in 2023.

Columbia Threadneedle is sub-advisor to NEI Emerging Markets Fund. Learn more about them and this Fund.

Summary and opportunities snapshot

As we look past peak rates, 2024 will likely usher in the beginning of a new monetary policy regime that should be generally supportive of both equities and fixed income. However, slowing global growth, the possibility of a recession and heightened geopolitical risks warrant a cautious approach. Our subadvisors remain focused on taking a selective approach with a focus on finding opportunities in high quality names with attractive valuations on a relative and historical basis. Below are a few key opportunities outlined by our subadvisors:

1. **High Yield Bonds:** is positioned to potentially provide equity-like returns with bond-like volatility over the next year. The relative quality of the High Yield market is at historically high levels, and issuer starting yields in the 9.0% area, provides a substantial income buffer which allows it to weather adverse economic or geopolitical events.
2. **Investment Grade Bonds:** remain resilient as large companies are still benefiting from the very low cost of funding they enjoyed in previous years. Spreads still remain relatively cheap from a historical perspective and offer the potential for real returns given the downside risks ahead.
3. **Credit:** corporate fundamentals are likely to deteriorate, albeit from strong starting points, as softer demand, higher financing costs, and sticky cost pressures conspire to pressure profit margins while providing attractive entry points to add credit exposure.
4. **U.S Equities:** despite projections for slowing growth there are opportunities in quality businesses with pricing power, competitive advantages, innovation and management. These types of companies can overcome the profitability headwinds created by inflation and higher interest rates.
5. **Canadian Equities:** parts of the Canadian market can continue to thrive in this era of higher inflation and interest rates. This includes oil and gas producers and select technology stocks. Businesses with durable free cash flow, balance sheet strength, and proven management are key.
6. **Value:** the end of the zero-rate environment, a gap in the valuation between value stocks and growth stocks, geopolitical conflicts, and high valuation spreads are potential drivers for the Value strategy in 2024.
7. **Clean Infrastructure:** more evidence that electrification is happening due to the large amount of electricity needed for datacentres, AI and electric vehicles. Attractive relative and historical valuations create opportunities in this space as demand for electricity is still expected to more than triple by 2050.
8. **Emerging Markets:** have strong projected GDP growth in 2024 and equities are set to benefit from rate cuts. Equity valuations remain cheap on a historical and relative basis across emerging markets generally. Key countries are entering new cycles of structural growth while others are enacting policy changes designed to increase direct foreign investment.

For more information about the NEI Market Outlook or the investment opportunities set out in this report, please visit www.neiinvestments.com.

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