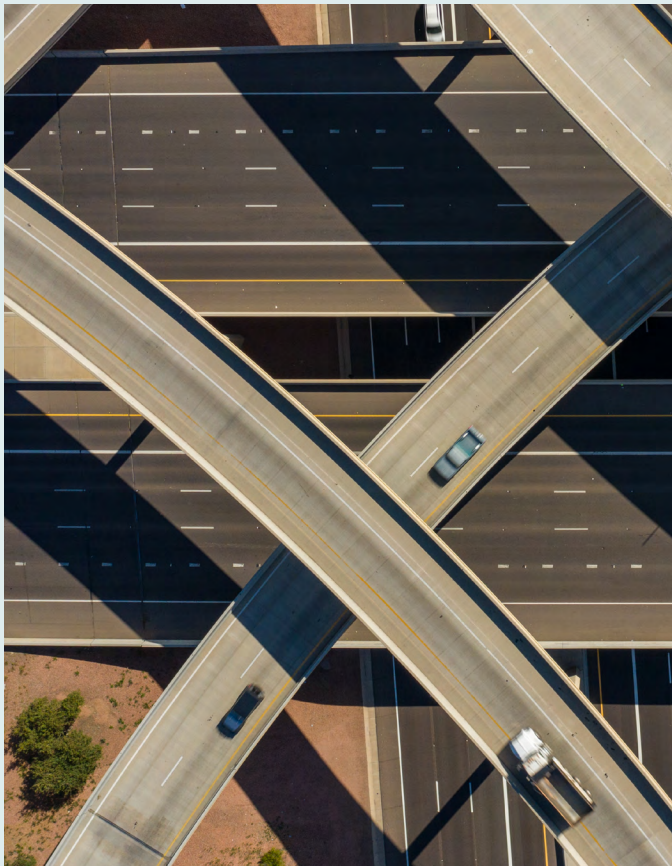


2024



# Global Investment Outlook





# A letter from Steve Peacher

There's almost always a difference between expectations and reality, and in 2023 we saw that ring true for investing just as it does for any other aspect of life. Market sentiment had suggested expectations of a U.S. recession for the past year, which did not happen – although for other economies, such as Canada, the United Kingdom and the eurozone, the growth picture has been less rosy. We also saw the broader market's interest rate projections shift throughout the last 12 months, sometimes even running counter to the statements from central banks themselves.

As we begin 2024, sentiment indicators and expectations continue to be a focus for investors, especially as discussions over potential peak interest rates heat up and impact market volatility. It's certainly valuable to monitor the financial news flow, but I believe it's just as important to not get too caught up in the daily bobbing and weaving of financial market projections, and view events through a more comprehensive lens instead.

As SLC Management passes its 10-year milestone, we're reminded how important it is to maintain this kind of longer-term perspective, one that we seek to pass on to our clients through our 2024 Global Investment Outlook. Since our company's inception we've been committed to providing quality solutions, service and insights. And a key part of that commitment is utilizing the expertise of our diverse investment specialists to offer a deeper dive into what the indicators are really telling us. We consider what today's economic developments could mean in a historical context and what the specific outlooks are for different asset classes and different investors – from public and private fixed income, infrastructure and real estate to pension plans and insurance asset management.

Our twice-yearly global outlook is when we get to garner all of these insights in one place, featuring views from SLC Management and our specialty asset managers BGO, InfraRed and Crescent Capital. In the following pages we tackle some of the tough questions we all might face in the year ahead. Are there going to be further economic slowdowns in 2024? Are central banks done with rate increases, and are rate cuts on the horizon? What direction are fixed income markets heading? Will we see a pickup in private credit volumes, regaining of ground in real estate, and/or further global expansion of infrastructure? And what strategic positioning should various institutional investors adopt for the months ahead?

Over the past decade, it's been a privilege to help our clients achieve their long-term investment goals, and we look forward to continuing to do so in the months and years ahead. We hope this outlook can help you see past the crowd, view the short- and longer-term implications of shifts in the economy and engage your own stakeholders with these insights as we head into a year of change, challenges and opportunity.

Regards,



**Steve Peacher**

President, SLC Management



# Macroeconomic outlook

A resilient 2023 shifts expectations to pockets of weakness over systematic challenges in coming year

## Global economy switching to lower gear

Over the last 18 months, most economists have been warning that a major global setback was right around the corner. The alarm was defensible. As central banks tightened at an historic clip, the reflex view has been that something will surely break. But the big surprise has been the resilience. Households and corporations are still in good shape. Jobs are plentiful and wages remain high. Rising rates are having little effect on companies that have locked in fixed rates years ago and on mortgage holders that are in the same camp.

The GDP outlook has now shifted from recession scenarios to one of modest growth. The lagged effects from rate hikes are expected to cool activity and pinch expansion plans. North America was a standout last year but is expected to downshift and deliver 1% GDP growth this year.

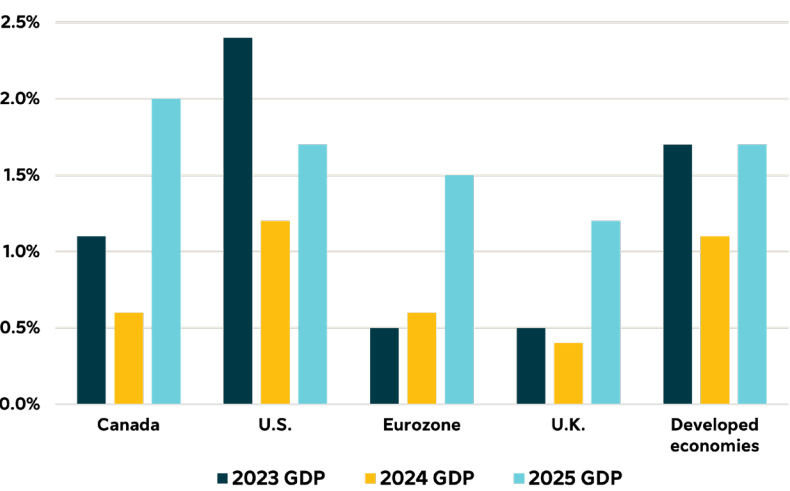
Meanwhile the eurozone barely avoided recession last year as it managed its energy supply dislocations well. This year will feature some of the same challenges but improvements in real wages and household incomes are expected to help deliver modest growth.

China suffered its worst housing downturn last year but still posted average growth as economic activity bottomed over the summer – and is entering 2024 with more momentum as government economic policy has turned more friendly.



Dec Mullarkey  
Managing Director, Investment Strategy  
and Asset Allocation, SLC Management

## GDP growth outlook for major economies



Source: Bloomberg monthly survey, SLC Management, 2023. The above forecast is based on estimates and there is no guarantee that the estimate will be achieved.

## Unsynchronized sector adjustments

As we look to understand and characterize the current economic cycle, particularly in the U.S., it looks more like a series of unsynchronized sector adjustments or a “rolling recession” – which is a version of a soft landing where you have pockets of weakness but not a systematic downturn.

For instance, after a major correction in 2022 within technology, firms trimmed staff but started to recover as AI enthusiasm picked up. Housing prices dropped from cycle highs but are recovering as inventory remains low. U.S. manufacturing has been in contraction territory for over a year but is edging up from last summer’s lows as supply chains heal and demand for goods stabilize.

Regional banks after recent failures have been shoring up their balance sheets as new regulatory capital requirements are proposed. Their stock valuations have taken a hit but seem to have reached a floor as markets cautiously assess risks from commercial mortgage holdings.

The biggest concern within real estate is the office sector. With the future of office still uncertain, office real estate investment trusts (REITs) are trading at significant discounts as the market worries about rent durability. High yield companies that pay floating rates are still performing relatively well. With the dramatic increase in rates over the past year, stress in this sector is still fairly contained with defaults rising slowly.



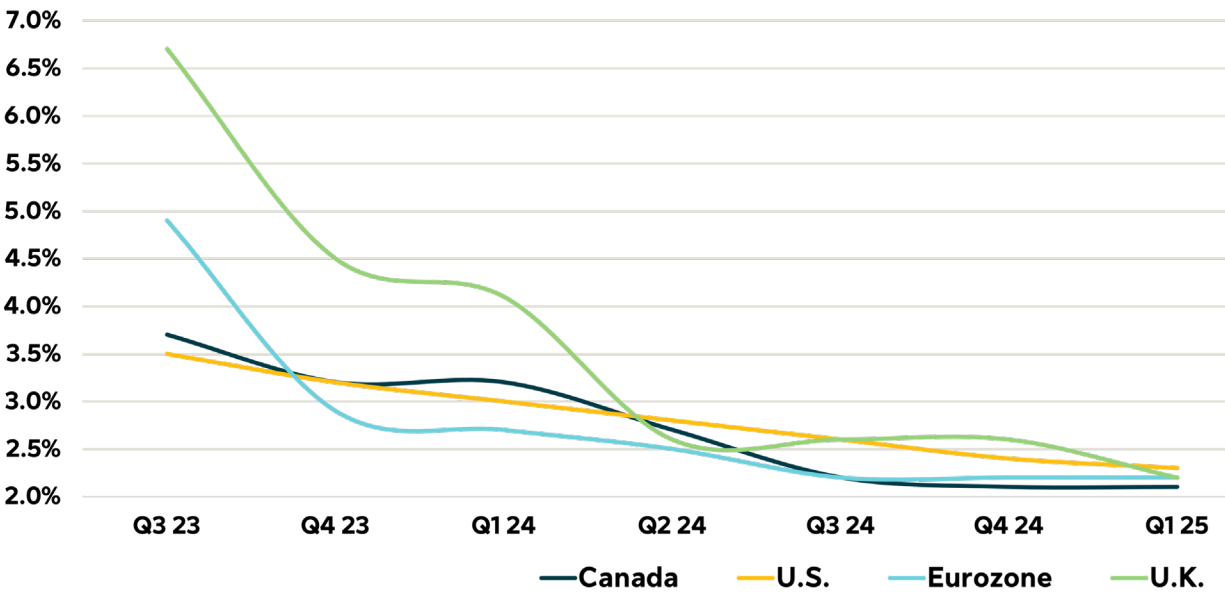
# Macroeconomic outlook (cont.)



Dec Mullarkey  
Managing Director, Investment Strategy  
and Asset Allocation, SLC Management

Therefore, through the lens of a rolling recession, technology and housing have seen stress and worked through it. Manufacturing is still in a prolonged but relatively mild contraction, and the outlook is improving. Regional banks have stabilized at a significant discount while markets assess how asset risks are evolving and how much consolidation may need to occur. In a similar fashion, the office sector is still in discovery mode on its ultimate level of utilization. Meanwhile companies with floating rate debt are holding up but could provide an early alert to the intensity of corporate debt stress.

### Headline CPI inflation



Source: Bloomberg, SLC Management. Consumer price index (CPI) measures for Q4 2023 and after based on Bloomberg survey of economists. The above forecast is based on estimates and there is no guarantee that the estimate will be achieved.

### Geopolitical risk remains a top concern

As the conflict between Israel and Hamas escalates and Russia’s war in Ukraine continues, geopolitical risk continues to rise. Notwithstanding the human cost of the conflict, for now the spillover to financial markets has been contained. Oil prices are still trading within a tight range. One of the biggest concerns is if other parties enter the Middle East conflict, which would complicate any quick resolution.

Beyond Israel and Ukraine, the other big geopolitical tension is between the U.S. and China. As the U.S. seeks to contain China’s technological sophistication, it is banning China’s access to advanced U.S. chips and encouraging allies to follow suit.

The global trading system is reordering around a “China plus One” policy. The U.S. and others that relied on China for significant supply chain support are more actively diversifying into alternatives like Mexico, Vietnam, India, Indonesia and the Philippines.

Right now, the moves are more about diversification than decoupling. China remains a top destination for U.S. exports, but Mexico and Canada have moved into the top two, with China now a distant third.

### Central bank policy to remain a critical market driver

While major central banks still warn the world that inflation is a threat, traders are ramping up their bets that rate cuts will be in vogue this year. It is surprising how quickly and consistently this shift has happened. Markets expect that the U.S. Federal Reserve, Bank of Canada, Bank of England and European Central Bank (ECB) will cut rates by 100 basis points or more this year.

After all, inflation is calming and central banks appear to be at peak rates as they stall and plan next steps. While most central banks suggest they are in no hurry, markets expect many will start cutting rates within the next six months. And the surprise in this outlook is that the ECB may lead the way should eurozone inflation recede to target much quicker than expected.

The market’s conviction is that the cumulative effects of central bank rate hikes will have fully kicked in this year. This should pinch activity, force hiring to cool and excite central banks to be accommodative.

The key question is how much slowing do central banks need to see before they cut? And the tricky maneuver is that economic setbacks rarely proceed at a linear pace. Sometimes things look fine until they are not. However, for now markets believe central banks will stay alert for shifts in the data and react quickly to weakness to prevent too much of a self-enforcing downward spiral.

# Fixed income: investment grade

Expectations of rate cuts could lead to normalization in the yield curve



Randall Malcolm

Senior Managing Director, Portfolio  
Manager, Public Fixed Income

## Is the tightening cycle truly over?

With Bank of Canada (BoC) rate hikes likely behind us, the timing and quantity of rate cuts will be the focus of 2024. Although at year end 2023 inflation remained above the BoC goal of 2%, the decline of the headline Consumer Price Index from its 6.3% start to 2023 has been encouraging. Not surprisingly, the largest contributors to inflation in 2023 were shelter, via higher mortgage interest costs and rent, along with food and energy, but after stripping out shelter inflation ran closer to the 2% target. This, along with the weaker economic backdrop, gives us confidence that we have reached the end of this tightening cycle.

So, when do we begin to feel some relief and see rates drop? The lag between the BoC's last 2023 raise (July) and its first cut has historically averaged about six months. Fitting with the "higher-for-longer" theme, the market is not expecting cuts to begin until June 2024, although these expectations often change. Interestingly, rate cuts are being priced in ahead of the BoC's expectation for inflation to return to 2% in the second half of 2025. After a hiking cycle that began in March 2022, and as we move toward rate cuts in 2024, we believe the inverted yield curve should finally begin to normalize, led by front end yields moving lower. The long end of the Canada curve could also see some pressure from additional issuance after the federal government's Fall Economic Statement in 2023 forecasted deeper deficits in the coming years, with Canada long bond issuance seeing the largest increase in issuance at +40%.

## 2%/2025

Canada expected to hit target  
inflation next year, but rate  
cuts could precede that.



## A strategic shift in CMB

The Fall Economic Statement also brought to light new strategies for the Canada Mortgage Bond (CMB) program. Instead of eliminating the issuance of CMB bonds, the annual issuance of the program will increase by C\$20B, but the federal government will now purchase up to C\$30B annually in the market, which will gradually reduce the tradeable portion of outstanding CMB bonds. By taking advantage of the positive spread between its CMB purchases and where it issues Canada bonds, the government can use the carry to fund its spending on items such as affordable housing.

Ontario also forecasted deeper future deficits in its fall update, which could be a prelude to deteriorating provincial economic fundamentals as previous rate hikes bite into economic growth. This could also result in additional provincial issuance upcoming in 2024, although provincial issuance is already so large it might be hard to detect. Year-to-date corporate supply has fallen short of 2022 supply largely due to the significant amount of funding from Canadian banks in 2022. While the banks have a significant amount of debt maturing in 2024, a substantial amount of that debt is already in U.S. dollars and senior debt, both of which tend to favor refunding at better levels in U.S. dollar terms. Combine that with a slowing economy, and we are unlikely to see a significant expansion in new corporate bond issuance in 2024.

## The impact of greater issuance

Given the increase in supply of government issuance, with both federal and provincial borrowing programs moving higher, this could push yields higher in the longer end of the curve and potentially crowd out corporate issuance. The 2023 calendar year was relatively positive for credit markets in North America. As interest rates normalize, if we do see an unexpected rebound in corporate issuance or a more significant decline in the economy, we could see corporate credit spreads drift wider from their relatively tight levels. Canadian corporate credit spreads lagged the tightening of U.S. corporate credit spreads in 2023, which is typical in periods of significant credit spread changes. We would expect this relationship to eventually have some reversion, which would be supportive of Canadian credit spreads' relative performance.

Source: Bloomberg, 2024. Bank of Canada, 2023.

# Fixed income: below investment grade

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



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

## Below-IG markets pick up by end of 2023

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 are likely to realize high single-digit returns in 2024.



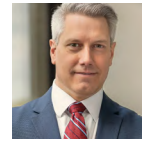
Sources: Bloomberg, JP Morgan, 2024.

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# Private credit: investment grade

IG private credit volumes poised for a strong 2024 opening



Andrew Kleeman

Senior Managing Director,  
Co-Head of Private Fixed Income



Elaad Keren

Senior Managing Director,  
Co-Head of Private Fixed Income



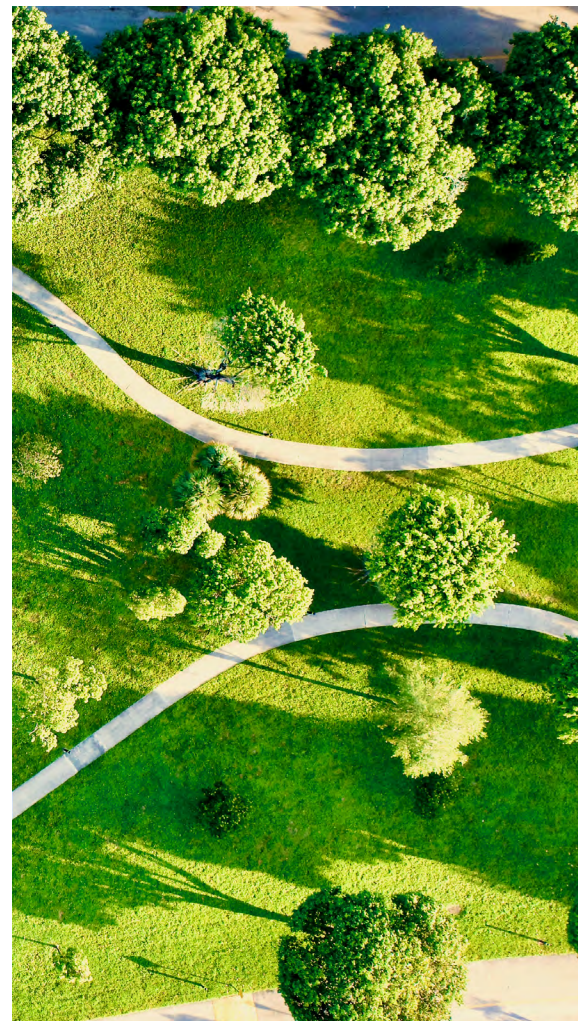
Gary Greaves

Managing Director, Private Fixed  
Income

## Capitalizing on opportunities

The total volume for investment grade (IG) private credit in 2023 was close to 2022's volume, a result of 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 the low interest rate environment of 2020 and 2021 to bolster liquidity.

When issuers did come to market it was often for short tenors, with a preference to not to lock in long-term rates. While overall volume was relatively steady in 2023 over 2022, the market in 2023 lagged 2022 for much of the year, but caught up with a strong final quarter. Q4 of 2023 was busy as issuers seemed to have come to terms with rates that could be "higher for longer." Steady supply was not bad news, however, because for much of 2023 the market experienced lower demand driven by investors who were either cash constrained or had lower product sales or higher redemptions, thereby tempering their demand. Despite lower market volume, many investors have been able to take advantage of reduced competition and to invest in IG private credit securities exhibiting attractive relative value and with good allocations.



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

We expect a solid start to 2024 for two reasons:

1.

A number of deals were postponed that had been scheduled to launch in Q4 but, given the strong fall calendar, these deals were delayed as issuers and bankers were concerned about "shelf space" (i.e., getting investor's attention).

2.

The annual Private Placements Industry Forum, which is usually scheduled for January, occurs later in 2024, resulting in some issuers coming to market in advance of the conference rather than waiting until mid-February.

As we enter 2024, the U.S. economy is still doing well, but shows signs of slowing and 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. The oft-used term "soft landing" comes to mind. With that backdrop, we expect the IG private credit market to be steady. Considering the uncertainties we

had in front of us 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 given the bulge of issuance in the past few years. 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 for much of 2023 was a bit muted due to the reasons mentioned previously. The stronger investor demand, as evidenced by price tightening and deal over-subscriptions we have seen at times 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 as the private market has been viewed by investors as a safe haven where issuers seek certainty of execution. During those times investors are often rewarded for proving liquidity. We believe that investors who retain a "steady-as-she goes" perspective might find it beneficial in such an environment.

Source: Private Placement Monitor, 2024.

# Private credit: below investment grade

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

## Delivering value to both investors and borrowers

We believe private credit will continue to deliver tangible value. 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 favorable 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.



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



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

## 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-favored-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.

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# Real estate

Beyond the tightening cycle: greater clarity on interest rates is welcome news for commercial real estate

## Growth downshifting, policy pivot on the horizon

A contraction in economic activity in the third quarter of 2023 that was well below consensus expectations may have signaled the end of the Bank of Canada’s (BoC’s) tightening cycle. The economy avoided a technical recession after Q2 2023 GDP was revised significantly higher into positive territory, but the impact of previous interest rate hikes is becoming clear. These data, combined with slowing inflation and a softening labour market, suggest that the next move for the BoC may be to cut interest rates. While the central bank will be wary of cutting too soon for fear of reigniting inflation, a policy pivot will be a key theme for investors in 2024.

## Short, shallow downturn key to preserving property income

The consensus continues to be for a brief and shallow economic downturn. As a result, occupier demand is expected to remain healthy, and well-balanced property fundamentals should continue to support rent growth. However, leasing activity in the office market remains well below pre-COVID levels, hampered by remote work and corporate layoffs. Uncertainty around office won’t be resolved any time soon, but what’s clear is that the divide between high quality, amenitized spaces and undifferentiated, commodity office is growing wider.



**Phil Stone**  
Managing Director, Head of Canada Research, BGO

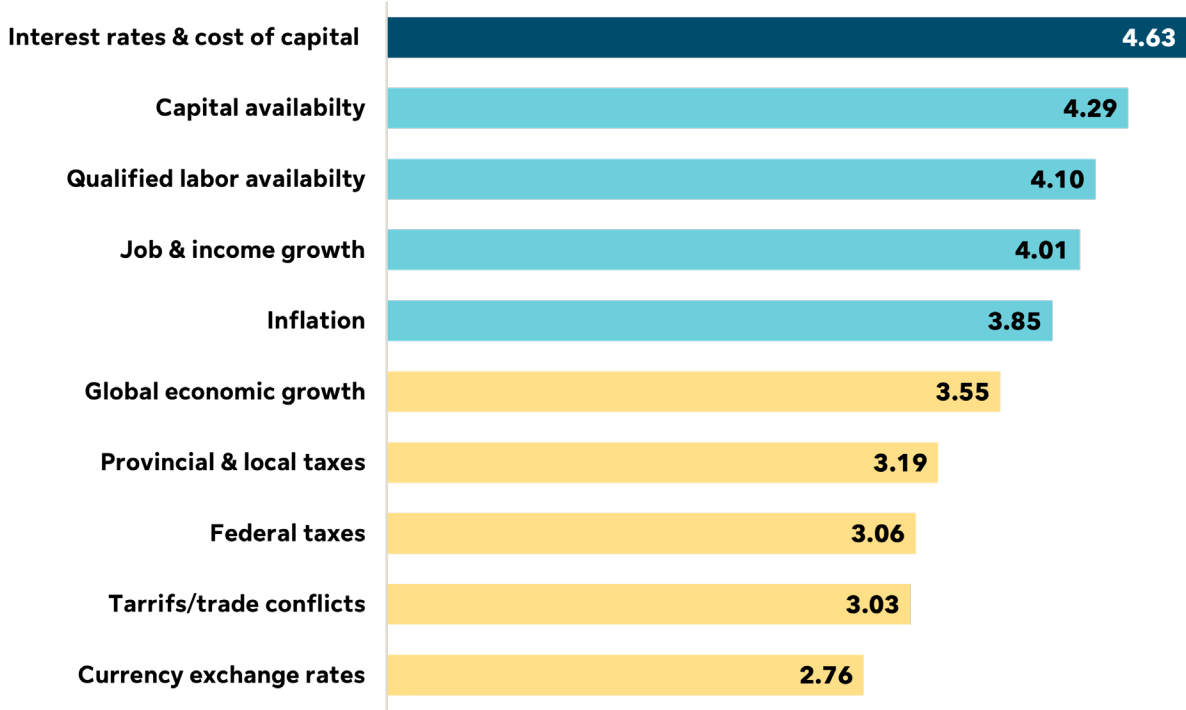
Refinancing risk continues to be one of the most significant near-term risks for commercial real estate (CRE) as floating rates, combined with maturing fixed rate debt, continue to cycle into significantly higher interest rates and stressing cash flows. Lenders remain somewhat cautious with credit standards and loan structures in the face of uncertainty, as evidenced by the importance placed on cost of capital issues in a 2023 PwC/Urban Land Institute (ULI) survey of Canadian real estate companies and other industry experts.

On a sector basis, we believe industrial and multifamily assets continue to be a clear favorite for lenders where the lowest spreads are being offered. We continue to see a wider spread differential by asset type and quality relative to what we’ve historically seen.



**Michael Andrews**  
Managing Partner, Portfolio Manager, BGO

## Rating the importance of economic/financial issues for real estate in 2024



Source: PwC/ULI LEmerging Trends in Real Estate 2024 Survey. Ratings: 1 = No importance; 5 = Great importance.

## Real estate (cont.)



**Phil Stone**

Managing Director, Head of Canada Research, BGO



**Michael Andrews**

Managing Partner, Portfolio Manager, BGO

### Re-pricing and clarity on the outlook for rates are key to lifting CRE out of recession

The market continues to reprice assets according to current market conditions. Due to low sales volumes, price transparency has been difficult to achieve. Two factors should help boost investment volume in the coming year.

#### 1.

We anticipate more motivated sellers because of either capitulation to higher interest rates or valuation markdowns that adjust seller expectations and narrow bid-ask spreads.

#### 2.

A possible peak in interest rates should provide more clarity and draw institutional buyers off the sidelines. This feedback loop of greater price transparency should help normalize investment activity.

### Opportunities in the year ahead

Notwithstanding a challenging economic backdrop for Canadian real estate in 2024, we view the select opportunities in this market along three key themes:

- **Attractive risk-adjusted debt yields:** Despite pullbacks in base rates at the end of 2023, all-in coupons for high quality commercial mortgages remain attractive. We expect to see more opportunities to capitalize on market dislocation, particularly for office and retail assets that may offer exceptional risk-adjusted returns.
- **A great vintage for value-add equity:** We are anticipating more distressed sales than in past down cycles due to the impact of higher interest rates and refinancing challenges. We see opportunities to move up in quality (reducing risk) while still seeking to achieve value add returns, particularly in housing (multifamily and student rental) and last-mile logistics. In a higher interest rate environment, executing asset-level business plans to grow income should be the key driver of returns.
- **Back to core values:** For investors focused on income, we believe core strategies should continue to offer diversification and resilient income even through a slower growth environment. As 2024 progresses, there should be more opportunities to deploy core capital.

Historically, the dispersion of core real estate returns among managers has been relatively narrow, compared to value-add strategies. We believe there's likely going to be a much wider variance among core managers in the future. For starters, there is no longer a "rising tide lifts all boats" low-interest-rate environment. Second, rapidly evolving technologies, shifting consumer preferences and sustainability goals are changing how real estate is consumed. Managers who use data-driven strategies and that have local market knowledge to navigate the changing landscape should be able to deliver strong returns.

### ESG is key to driving long-term value

Regardless of a given strategy, we believe that evaluating how assets align with environmental, social and governance (ESG) goals, particularly reduced emissions targets, will be critical to managing existing portfolios and deploying new capital. We expect tenant and investor demand for assets that support ESG goals will continue to drive up rents and prices. ESG could increasingly be a competitive advantage for managers who can deliver measurable results to tenants, investors and community stakeholders.



Sources: Bloomberg, 2024. PwC, Urban Land Institute, 2023.



# Infrastructure

Shifting long-term thematic support the case for infrastructure investment



**Jack Paris**  
Chief Executive Officer,  
InfraRed



**Richard Crawford**  
Partner, Head of Energy  
Income Funds, InfraRed



**Edward Hunt**  
Partner, Head of Core  
Income Funds, InfraRed



**Stephane Kofman**  
Partner, Head of Capital  
Gain Funds, InfraRed

## Characteristic resilience in times of volatility

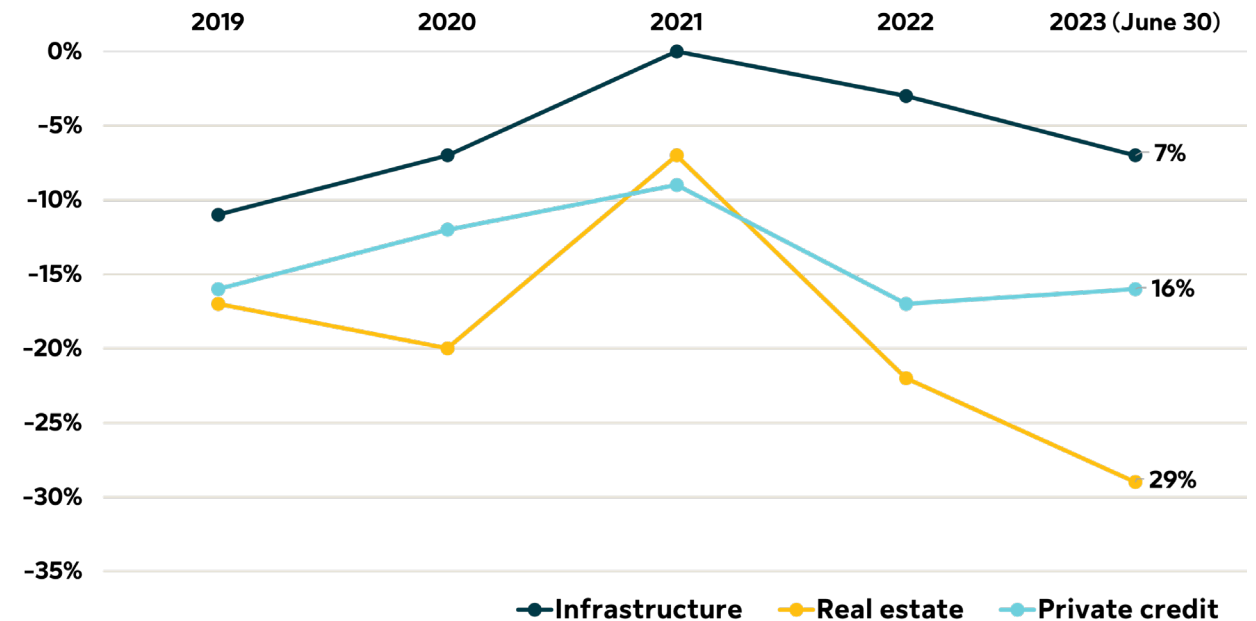
Looking at the infrastructure asset class, either in the context of the past year or for the outlook ahead, might be best done through two distinct lenses. Both the near- and long-term perspectives offer their own set of insights into the potential risks, opportunities and challenges ahead for infrastructure investors.

In the near term, throughout 2023 we saw a continuation of several macroeconomic themes that have been playing out over the course of the year: higher inflation, elevated interest rates and the resultant market volatility. Infrastructure assets are historically more resilient to these factors than other types of alternative investments, and infrastructure's performance during bouts of pressure in 2023 were consistent with this characterization.

It is important at this point to be reminded of the characteristics of infrastructure investments that help them maintain their resilience amid uncertainty. We expect that high-quality infrastructure investments may be more insulated from the broader economy and policy landscape given both their long-term and conservative debt structures, which are generally less sensitive to rate fluctuations, and often contracted revenues, that may be correlated to inflation.

The following graph shows that the discount to net asset value (NAV) in the private secondary market for infrastructure held up better in the volatile first half of 2023 compared to other alternative asset classes.

**Infrastructure holding up well during volatility**  
*Discounts to NAV in the private secondary market*



Source: Greenhill Secondary Market Review, H1 2023. Market data based on Greenhill transactions and other known transactions as reported in the source. For more information, visit [www.greenhill.com](http://www.greenhill.com).

# Infrastructure (cont.)



**Jack Paris**  
Chief Executive Officer,  
InfraRed



**Richard Crawford**  
Partner, Head of Energy  
Income Funds, InfraRed



**Edward Hunt**  
Partner, Head of Core  
Income Funds, InfraRed



**Stephane Kofman**  
Partner, Head of Capital  
Gain Funds, InfraRed

## Macro concerns could lessen, but likely to remain

We have seen some stabilization in the macroeconomic environment, though we also caution that some risk factors remain, such as further escalations in geopolitical conflicts. Moreover, market volatility and underlying inflation and rate uncertainty could continue to affect asset pricing and investor demand in 2024.

With respect to inflation, our observations of market sentiment suggest some confidence that we are at, or perhaps even past, the point of peak rates. However, we also see evidence that even if inflation comes off its highs, it will likely remain sticky and range-bound for the near term.

## An evolution in thematic

Shifting to the longer-term lens, while we believe the thematic megatrends that we have identified in previous discussions (such as decarbonization, digitalization and demographic changes) should continue to drive markets, 2023 saw some changing dynamics that could further shape infrastructure demand. The greater role of public policy within megatrends such as decarbonization – through initiatives like the Inflation Reduction Act in the U.S., the European Green Deal and the COP 28 agreement on transitioning away from the use of fossil fuels – had an increasing impact in the past year and into 2024.

These policies have created an environment of intensified competition between countries for infrastructure investment capital and expertise. Coupled with numerous geopolitical security concerns around the world, we are seeing evidence of a “deglobalization” effect around infrastructure investment. A growing number of distinct regions are seeking to attract more of what may be a finite amount of available capital in a given thematic sector, for example, in opportunities arising from onshoring the supply chain in logistic facilities, intermodal transportation and other operational enhancements. This represents a considerable tilting of the demand–supply balance, and we expect such developments to serve as a medium- to long-term positive driver of infrastructure investment.



Source: Greenhill, 2023.



# Insurance asset management

Opportunity continues to exist to lock in reliable, income-driven returns despite pullback in rates

## Ongoing market volatility underscores insurers’ need for reliable income

In most years, investment income is the largest and most important component of earnings for an insurance company, and the importance of that stable source of earnings is amplified when underwriting and when investment markets are volatile. As a result, insurers are increasingly looking to build more resilient fixed income portfolios that can generate attractive risk-adjusted returns in changing market conditions.

One approach insurers are taking is to allocate a portion of their portfolio to alternative fixed income asset classes, which can help insurers diversify their existing fixed income portfolio while still aiming to generate steady income streams. The fixed income space has evolved significantly over the last few years, providing insurers with more tools to craft allocations that are tailored to their objectives and risk constraints. Some alternative fixed income asset classes insurers are allocating to in this regard include investment grade private credit, U.S. structured credit and below-investment grade securities.

More generally, the current higher interest rate environment continues to provide investment income growth opportunities in both the core and alternative fixed income markets. A careful selection of assets providing reliable income streams might benefit insurers seeking to enhance their long-term earnings potential in the current macroeconomic environment.



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Managing Director, Head of Canadian Client Solutions



**Steve Guignard**  
Senior Director, Client Solutions

## Federal government reverses tax change for preferred shares

In its latest fall economic statement, the federal government exempted “taxable preferred shares” (TPS) from a previous budget measure that would have taxed dividends on such shares held by financial institutions. That earlier budget announcement had represented to many investors a significant challenge to preferred shares, an asset class that Canadian insurers held a significant portion of.

While we believe some insurance companies will welcome the news, and the clarity that comes from the statement, we anticipate that insurers will continue to re-evaluate their allocations to preferred shares given the long line of challenges faced by the asset class. From a capital-adjusted return perspective, preferred shares compare favorably to many other asset classes due to their favorable capital treatment and tax advantages. However, some alternative options may provide higher risk-adjusted returns depending on an investor’s risk tolerance and objectives.



“... we anticipate that insurers will continue to re-evaluate their allocations to preferred shares given the long line of challenges faced by the asset class.”

It is worth noting that the remainder of the proposed tax change impacting dividends on non-TPS shares, including common shares, has been effective since January 1, 2024. As a result, we expect that some insurers that relied on this favorable tax treatment may consider alternate asset classes to non-TPS shares that may provide a more favorable capital adjusted return. Such alternatives can include core and value-add real estate.

## Alternatives screen well from a long-term strategic asset allocation view

With the rise in rates over the past couple of years, income-oriented alternative investments such as real estate and infrastructure can now potentially offer private equity-like returns over the near term, with significantly less volatility, according to our analysis. However, uncertainty surrounding the timing and pace of possible rate cuts has led to quickly changing market views on all asset classes, including alternatives, and can result in suboptimal long-term asset allocation decisions.

Fortunately for insurers, these types of decisions tend to proceed at a measured pace due to the accounting, tax and capital rules they are subject to. Consequently, asset allocations are less likely to be based on market timing and more likely based on which asset classes offer the best risk and/or capital adjusted expected returns over a long-term horizon. As we proceed into an uncertain 2024, many areas within private and public below investment grade credit, real estate and infrastructure offer attractive long term risk/return potential, can improve overall portfolio diversification and come with negotiated downside protection features.

Sources: Bloomberg, Office of the Superintendent of Financial Institutions, SLC Management, 2024.

# Retirement plan solutions

Important decisions face pension plan sponsors as interest rates test lower levels

## Rate impacts on liabilities could mean challenging choices ahead

The 2023 calendar year was a volatile period for interest rates, with historical highs and a significant rise in rates capped by a swift fall. We saw significant de-risking during the year, either in the form of increased interest rate hedging using fixed income and derivatives, or risk transfers to insurance companies.

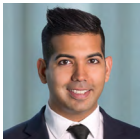
We believe plan sponsors with remaining liabilities, hedged or unhedged, now face some important decisions to help ensure that their hard fought pension gains do not disappear due to higher liability accruals that come with increased rates and the price impact of falling discount rates.

## Rates begin to subside after historic highs

The average yield on Government of Canada long-term bonds rose above 4% at the beginning of the fourth quarter before declining sharply by over 100 basis points (bps) by year end. This steep decrease in interest rates over the final three months of the year can serve as an important reminder for pension plan sponsors that de-risking opportunities to protect recent funded status gains may be temporary given shifting and volatile market conditions.

100+ bps

A sharp decline in LT Government of Canada bond yields in Q4 2023.



**Ashwin Gopwani**  
Managing Director, Head of Retirement Solutions



**Steve Guignard**  
Senior Director, Client Solutions

Overall, annuity purchase discount rates ended 2023 approximately 10–30 bps lower than the previous year end, according to the Canadian Institute of Actuaries’ methodology. However, positive returns on return-seeking assets allowed many pension plans to continue experiencing funding improvements in 2023 despite the reduction in solvency discount rates over this period. In such a context, we continue to believe that this is an opportune time for plan sponsors to re-evaluate their investment strategy and consider taking risk off the table. From our perspective, based on industry-level data many pension plans still carry too much interest rate risk.

## Higher fixed income returns needed to keep up with growing liabilities

With fixed income increasingly making up a larger portion of pension plans’ asset allocations, it is becoming even more important to ensure that plans can expect assets to grow at least at the rate of liabilities so that plans retain their current funding levels. For instance, a traditional universe fixed income mandate yielding a little less than 4% at year end no longer keeps up with solvency discount rates. Within fixed income portfolios, we believe that growth is increasingly being sought through “LDI plus” or “enhanced LDI,” a strategy that retains the liability hedging characteristics of liability driven investing (LDI) alongside a higher credit allocation and some higher yielding fixed income asset classes like high yield bonds, bank loans, commercial mortgages and private fixed income.

## Plan sponsors turning to new tools for hedging and diversification

Increased levels of funding and a volatile and more complex market environment have led to an increased interest in leverage as a solution to some of the challenges that pension plans face.

Large pension plans and insurance companies have been using leverage as a liability management tool for decades. Over the past few years, we’ve seen a marked increase in the number of small- to mid-sized plans actively seeking to extend duration, using such vehicles as 3x bond overlay funds, plus an increase in the number of mid-sized plans considering more bespoke leverage strategies to achieve a more targeted form of hedging. One reason for these increases is the greater risk posed by high inflation on plans with indexed benefits and the decision by the federal government to cease issuance of real return bonds. The former has increased the interest of plan sponsors in inflation protection overlays and the latter is incentivizing plan sponsors to consider gaining this protection using foreign instruments, which could typically include U.S. Treasury inflation-protected securities (TIPS) and U.S. inflation swaps.



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