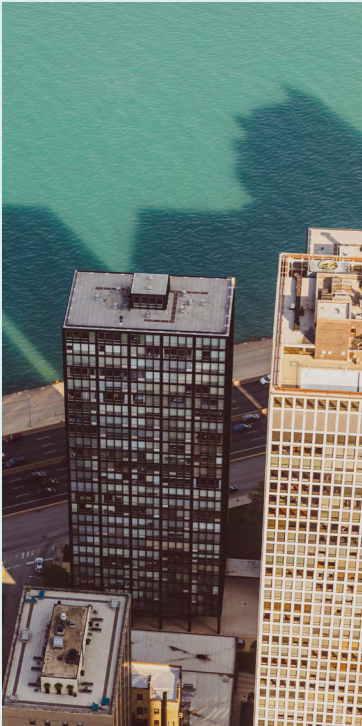


2024 MID-YEAR



# Global Investment Outlook



**SLC** | Fixed Income

**CRESCENT**

 **BGO**

 **InfraRed**  
Capital Partners



# A letter from Steve Peacher

I am pleased to present the 2024 Mid-year Global Investment Outlook, during a time that is proving to be pivotal for markets and the global economy. At the midway point of this year, the central banks of Europe and Canada took careful steps to make initial cuts to rates, while noting that these were not necessarily the beginnings of a cycle. Meanwhile, eyes are fixed on the U.S. Federal Reserve and other policymaking peers who have appeared cautious toward sustained easing activity until inflation and other indicators offer clearer signals on the best time to begin rate reductions. Whether or not the data will give central banks the ability to make substantial easing moves continued to be a source of uncertainty at the mid-year point of 2024.

It's widely expected that constant discussions over inflation, central bank signals and higher-for-longer rate environments will continue to fuel market sentiment for the remainder of the year and beyond. What I find particularly notable, however, is the impact that these possible divergencies in opinions, expectations and policy have had on the risks and opportunities faced by investors.

Within this comprehensive global outlook, you will find insights into these issues from our wide range of SLC Management investment specialists. In the following pages, we cover everything from fixed income to private credit, real estate and infrastructure, as well as the overall global economic backdrop and how it might affect the insurance and pension sectors. With global markets possibly at a turning point, the range of potential opportunities spans regions, asset classes and time horizons, as do the challenges that investors need to be aware of.

The 2024 calendar year has been one of remarkable shifts already, and I hope our mid-year outlook can provide perspectives into your own positioning for the months and years ahead. This is a rare opportunity to hear all at once from our investment specialists across SLC Management, BGO, InfraRed and Crescent Capital, and I consider this a key part of our ongoing commitment to provide insightful communications, thought leadership and engaging resources to our stakeholders.

Regards,



**Steve Peacher**  
Executive Chair, SLC Management





# Macroeconomic outlook

Policy pivots, moderation in consumer spending and geopolitical risk set tone for next half of 2024

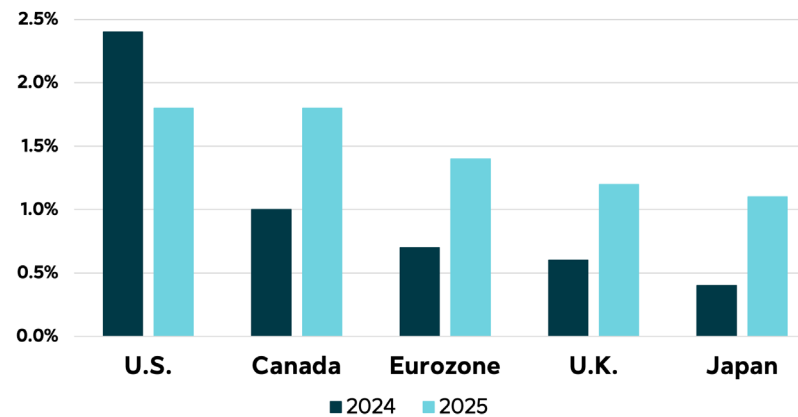


**Dec Mullarkey**  
Managing Director, Investment Strategy and Asset Allocation

## U.S. growth to outperform peers

The U.S. economy has been a standout over the last several years as it leads G7 peers in real GDP growth. The resilience of the American consumer has been the key engine. Backed by a surprisingly strong labor market, which held up in the face of gloomy predictions, consumers kept spending. As inflation drops, real wages remain strong. But activity is expected to slow in the second half of this year as consumer demand looks likely to cool.

## GDP growth outlook for major economies



Source: Bloomberg monthly survey, 2024. The above forecast is based on estimates and there is no guarantee that the estimate will be achieved.

The job market is also rebalancing as the number of job openings drop. And quit rates, which act as a proxy for the willingness to switch jobs, are also returning to pre-pandemic levels.

The job market has benefited from supply side gains. Immigration is up and labor participation rates for prime age workers, those 25–54 years old, are at decade highs. This has helped offset the wave of early retirements, from the over 54 crowd, that happened in the pandemic era.

## U.S. consumers turning cautious

Consumers are slowly dialing back demand as prices pinch and debt loads pick up. Many of the large banks commented on their most recent earnings calls that consumer credit is generally in good shape but that delinquencies are starting to tick up, albeit starting from near record low levels. For now, most banks have characterized this shift as a normalization to pre-pandemic levels, rather than material deterioration.

Meanwhile consumer-facing companies are starting to see a more discerning consumer hunting for value. In particular, some large food retailers have cut prices, looking to win back customers who switched to more affordable brands.

High prices have certainly made consumers cautious. And that pullback is a critical reason U.S. growth is expected to drop from 3% in the first half of this year to 2% in the second half.

## Central banks have shifted to cuts

While the U.S. Federal Reserve is still on hold at the mid-year point, other key central banks have already started cutting rates. The Bank of Canada (BoC) broke the ice in June with a 25 basis point rate cut, and right after that the European Central Bank (ECB) followed with the same move. But do not expect the flood gates to open. While both central banks feel inflation is heading in the right direction, they stressed they will continue to be data dependent and not commit to a prescribed pace of cuts.

Both banks needed to move ahead of the Fed as Canada and the eurozone are expected to deliver around 1% GDP growth this year, less than half of U.S. expectations. Fortunately, after months of plateauing, U.S. inflation is showing some renewed cooling, which has revived the prospects that the Fed will respond with rate cuts later this year.

Historically, when central banks end a long tightening cycle they have rushed to cut rates – mainly because they have waited too long, and a recession is in the works. But this has not been a typical cycle. The Fed in particular promised to learn from the past and looked to engineer a soft landing. With a reasonable combination of skill and luck that quest continues at a measured, data dependent pace.

# Macroeconomic outlook (cont.)

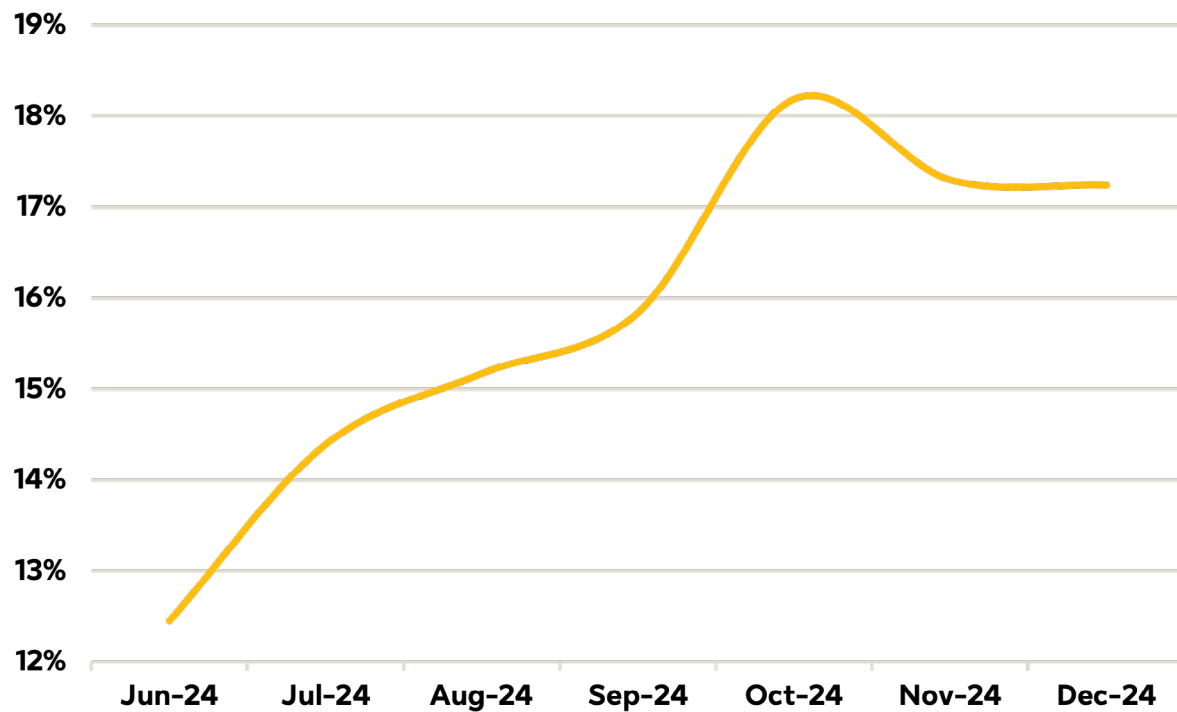


**Dec Mullarkey**  
 Managing Director, Investment Strategy and Asset Allocation

## Geopolitical risk is ticking up

Markets generally pay little heed to U.S. presidential elections until about three months in advance of the vote. As can be seen from the implied option volatility chart, markets are expecting volatility to peak right before the election but remain high through the end of the year.

**S&P 500 Chicago Board Options Exchange Volatility Index (VIX Index), implied forward volatility**



Source: Bloomberg, 2024.

This time, the big issues are likely to be taxes, tariffs and immigration. But regardless of what disruption the potential presidents promise, they can only deliver if they have agreement from the other two branches of government. And on that note markets generally like a divided government, which most forecasters expect to be the outcome, of a single party not controlling all branches of government and allowing for more checks and balances.

One area where there is bipartisan agreement is strategic tariffs and sanctions on China. And as election promises start to ramp up, markets will look to assess their impact. So, volatility around trade and geopolitical risk will likely increase. That type of uncertainty tends to support a stronger dollar, as the U.S. is perceived as a safe haven even if it is the cause of the geopolitical risk.

## Higher for longer

The Fed has also been upping its forecast of the eventual Federal Funds Rate, the short-term rate needed to keep the economy humming at a stable pace. In the past, 2.5% seemed about right. But recently the Fed has been nudging up its estimate and has it now close to 2.8%.

Persistent fiscal deficits, secular demand for capital and financial conditions that seem less sensitive to Fed rates have led to a rethink of the target or neutral rate. And varying research suggests something in the 3.25%–3.5% range may be needed.

Fed Chairman Jerome Powell has also commented that “rates will not go back down to the very low levels that we saw” over the last cycle. So, beyond rate cuts, the neutral rate is another important piece of the Fed picture, as this rate is a basic building block in deriving market yields and the cost of capital.

Sources: Bloomberg, U.S. Federal Reserve, 2024.

# Fixed income: investment grade



Randall Malcolm

Senior Managing Director, Portfolio  
Manager, Public Fixed Income

Following June's rate cut, eyes are on any policy differences between Canada and the U.S.

## First shot over the bow

With the backdrop of inflation trending lower into the top end of the 1%–3% range, the Bank of Canada (BoC) took the opportunity to lower overnight rates by 25 basis points in June to 4.75%. The elusive soft landing still seems to be playing out, with growth remaining mildly positive and the job market softening marginally from record low unemployment. In its press conference, the BoC noted that as its confidence in reaching inflation targets increases, it may be reasonable to expect further cuts. The market jumped on the potential for further cuts in the overnight rate, sending two-year Government of Canada rates lower, outperforming the U.S. and taking the implied year-end expected overnight rate very close to 4.00%.

In the second half of the year, investors will be watching to see how far the BoC can lower rates if the U.S. Federal Reserve is less inclined to do the same. While U.S. inflation has fallen, it seems to have settled in a new range just above 3% as economic growth and employment have been stronger in the U.S. than in Canada. Combine this with the more aggressive U.S. government deficit spending and we could see the Fed more reluctant to follow the BoC's rate cuts. This could mean further rate cuts by the BoC will put pressure on the Canadian dollar. In the second half of the year, we could see the Canadian yield curve continue to normalize (i.e., steepen) from its current inversion driven by yields moving lower in the shorter terms.



## Longer-term Canada/U.S. yield gap might continue

Further out on the yield curve, Canada yields have significantly outperformed and moved to record levels over U.S. federal yields as the U.S. has issued a disproportionately large amount of government debt in the longer terms. With both candidates in the U.S. election apparently willing to continue to spend and the U.S. more inclined than the Government of Canada to issue long-term bonds for funding, we could see this significant gap in long-term yields between Canada and the U.S. persist into the second half of 2024.

In Canadian credit markets, we have seen a very robust amount of issuance from both provincial and corporate issuers so far in 2024. With most provincial debt programs increasing in size to fund additional deficit spending, many provinces have moved aggressively in 2024 to issue debt. By the end of May, domestic Canadian-dollar provincial supply was running well ahead of 2023 levels as of the same month. However, the provinces were also making generous use of international markets to spread the additional supply around, which brought the total of all currency supply of provincials in 2024 year to date to more than double supply levels for the same point in 2023. The use of international markets

for additional funding has helped keep domestic provincial bond credit spreads relatively stable so far this year. With the expectation that supply was front-loaded in 2024, we may see lower supply in the second half combine with investor inflows into bonds, which would provide an opportunity for provincial credit spreads to tighten from current levels.

Corporate supply as of the end of May 2024 was C\$57B compared to a 10-year average of C\$48B. While very strong, it is notable that bank issuance is a lower share of supply as banks see more attractive levels to issue at in other markets. Despite the increase in supply, corporate credit spreads have tightened so far 2024, underpinned by strong fundamentals such as solid earnings and consistent investor inflows into fixed income markets. If the BoC continues to lower rates, we could see economic growth rise and credit fundamentals improve. Combine that with supportive investor flows into bonds, we could see Canadian corporate credit spreads compress and catch up to those of other major markets they have recently lagged.

Source: Bloomberg, Bank of Canada, 2024.

# Fixed income: non-investment grade

A possible pivot in monetary policy could further strengthen non-IG opportunities



John Fekete

Managing Director and Head of Capital Markets

## Credit returns robust irrespective of rate moves

As investors enter the second half of 2024, much of the focus continues to be on the possibility of rate cuts, a focus that we believe is myopic. With high base rates resulting in high-single-digit coupons in credit as of June 2024, investors don't need rate cuts to generate attractive returns, in our view. Recent U.S. economic data have been resilient. The Organisation for Economic Co-operation and Development forecasts U.S. GDP growth to be 2.6% in 2024, the highest of G7 economies and well above the 2.1% 20-year U.S. average. We believe we are in an environment in which clipping coupon income is sufficient for most investors to meet or exceed return requirements.

A strong labor market, combined with healthy consumer spending, underpins the U.S. economy. Post-pandemic earnings growth has helped to mitigate the impact of higher debt servicing costs. In the first quarter of 2024, leveraged loan issuer earnings before interest, taxes, depreciation and amortization (EBITDA) grew by 3%, according to Pitchbook/LCD. This was the 14th consecutive positive reading dating to the fourth quarter of 2020. Interest rates have stabilized while EBITDA continues to grow, resulting in 0.2-times improvement in the interest coverage ratio since Q3 2023. The ratio is at approximately 4.4-times as of June 2024.

## Inexpensive valuations in CCC-rated space

Credit stress and default activity have been modest, but there are pockets of the market in which the dominant sentiment is less than rosy. For example, CCC-rated bonds in the U.S. high yield bond market trade at a significant relative discount to BB- and B-rated bonds. According to Goldman Sachs, the spread ratio of the CCC index to the broader index, a measure of relative cheapness, stands at the 98th percentile rank as of June 2024, using a 20-year lookback window. The expensive cost of capital for CCC-rated borrowers has

caused this current gap, which is wider than 98% of the time in the past 20 years.

A recent surge in primary issuance has reduced the once looming debt maturity wall, pushing out maturities and making it less likely borrowers will stumble. This wall is often spoken about and makes for good headlines, but is rarely a driving factor for markets.

The U.S. Federal Reserve's signaling of no further rate hikes provides a green light for investors to take advantage of the carry trade in fixed income. We believe there may be select opportunities in floating rate assets. In addition, syndicated loans and collateralized loan obligation (CLO) debt might be in a "sweet spot," with yields high enough to attract capital but low enough to facilitate refinancing in a robust new issue market. Based on our analysis, a blended portfolio of high yield bonds, syndicated loans and CLO mezzanine debt currently could yield approximately 9%–11%, according to the expected returns of corresponding indices.\*

## An inflection point for fixed income

We appear to be in the midst of a great monetary pivot, in which interest rate policy could go from being a headwind to a tailwind at a time when recession risk is relatively low, leading allocators to find value across fixed income again. High base rates mean fixed income instruments can cushion portfolios against equity and growth volatility, something that couldn't be counted on when rates were near zero. There's room for growth for most allocators. According to Pensions & Investments, the allocation to traditional fixed income by the largest U.S. public pension plans was 20.3% of their total portfolio in 2023, down from 27.1% in 2008.

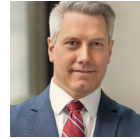
Market views on economic growth, inflation and interest rates have shifted over the past six months. However, we have observed revenue and EBITDA growth among the stronger issuers. Against this backdrop, we believe investors could benefit from disciplined sourcing, underwriting and portfolio construction processes that remain consistent and that can therefore help reduce costly errors. This can help position investors for more durable portfolios that generate high income with minimal default risk.

Sources: Bloomberg, Pitchbook/LCD, Pensions & Investments 2024.

\* Indices used as asset class proxies: Credit Suisse Leveraged Loan Index & JPMorgan CLOIE Index as of May 31, 2024. This information is based on combining 50% Credit Suisse Leveraged Loan Index and 50% JPM CLOIE yield. Public and private credit indices shown are widely used market benchmarks to generally assess the relevant risk profile of a particular investment strategy. Future fluctuations in valuations and performance may occur as a result of changing market conditions, among other variables. The comparison indices and asset classes presented set forth herein are provided for informational purposes only and should not be relied upon as an indication of Crescent's investment strategy or as an accurate measure of comparison, as there may be differences between the relevant Crescent fund and such indices due to varying fund vintages and strategies. The comparisons contained herein have inherent limitations and qualifications, such as limited sample size, imperfect access to information and other considerations. There are significant differences between the types of securities and assets typically acquired by a Crescent fund and the investments covered by the applicable index or benchmark. Certain indices may or may not reflect the reinvestment of dividends, interest or capital gains. Moreover, indices are unmanaged and are not subject to fees and expenses.



# Private credit: investment grade



**Andrew Kleeman**

Senior Managing Director,  
Co-Head of Private Fixed Income



**Elaad Keren**

Senior Managing Director,  
Co-Head of Private Fixed Income



**Nushi Kazemian**

Managing Director,  
Private Fixed Income

Market could be primed for steady growth in a competitive environment

## Increased certainty could strengthen volumes

Year-to-date volume for investment grade (IG) private credit issuances at June 2024 has shown a modest but steady growth compared to the similar period last year. Market activity started at a slower pace in January and February of 2024 but by March the number of issuances picked up materially and has continued since. With a backdrop of more stability in the economy, retreating fears of a material recession and now a firmer consensus that interest rates are likely to stay higher for longer than previously predicted, we are seeing an uptick in market activity versus last year.

## Shifts from previous year, and possible signals for 2024

At this mid-year point of 2024, we have identified a series of evolving trends that could impact IG private credit markets for the remainder of the year and beyond:

**Number of issuers** – A higher volume of issuers came to the market versus last year, with several financings and projects that were put on hold in 2023 due to an expectation of interest rate drops now moving forward.

**Deal size** – Several substantially sized deals (greater than US\$1 billion) were completed so far this year, an increasing trend since 2023, with the two largest issuances represented by an over US\$7 billion deal in the infrastructure-energy pipeline sector and US\$2.3 billion in a structured credit tenant lease financing in the industrial-manufacturing sector. We consider these illustrative of the growing demand in IG private credit markets, with a large diversified and ever-expanding investor base. It also underscores the ability of the market to execute complex large transactions. This is a trend we expect to continue in the near term.

**Currency** – So far in 2024, there has been a significant increase in non-USD volume compared with the same period in 2023, with nearly 50% more issuances from outside of North America; this highlights the diversification, flexibility and depth of current markets, in our view.

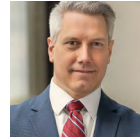
**Spreads** – Often the advantage of larger-sized deals for investors is that spread expectations are sustained without bids materially outpacing the available volume, providing attractive relative value opportunities. Notwithstanding the larger deals, we have seen material oversubscriptions on average- and smaller-sized deals this year, leading to more competition and at times putting downward pressure on spreads. Overall, the weighted average spreads have seen a compression so far compared to last year, following a similar trend seen in the public IG corporate bond markets. We believe relative value compared to the public market remains solid.

**Term** – Year-to-date new volume for 2024 has been more equally distributed along the duration curve with a material portion in the 20-plus year term bucket. This is in contrast to last year where we saw more shorter-term issuances and very little beyond 10–15 years. As more consensus has formed around higher interest rates in the short term and with the economy showing growth, we are seeing a slow gradual move to issuers locking in rates over longer terms where it makes sense, albeit still at lower levels than pre-interest rate hikes.

**Credit quality** – So far in 2024, IG private credit volume has seen a shift to the lower end of the IG curve (i.e., the BBB range), rather than the same period last year where the volume was more equally distributed across the risk curve (i.e., the BBB to A range). This shift in 2024 can provide attractive spread and relative value opportunities on good quality transactions, but also requires more diligence, plus discipline in credit underwriting.

**Sectors** – Volume has been anchored by issuance in the industrial sector followed by financials, utilities and transportation. Real estate investment trusts and utilities saw an uptick compared to the previous year, though spreads and relative value remain constrained for these sectors. We have seen a general slowing in the pace of financials compared to the growth seen a couple of years ago. Infrastructure volume has been robust so far this year with a number of energy, transportation and digital infrastructure (mainly data center) transactions anchoring the volume. Real estate continues to face major headwinds resulting from sustained high interest rates and inflation, lower investment activity and fundamental shifts in sectors such as office after the pandemic. However, we see robust volume activity in more niche commercial real estate sectors, such as credit tenant lease financings and government-funded housing (e.g., social housing, homeless shelters and seniors' care). In addition, fund financing and private asset-back securities are two of the growing segments of the IG private credit market that continue to provide solid volume and robust relative value and quality, further diversifying the IG private credit portfolio for investors who have the asset class expertise and a wide origination platform.

## Private credit: investment grade (cont.)



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**Elaad Keren**  
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**Nushi Kazemian**  
Managing Director,  
Private Fixed Income

### Volatility could create opportunities

The evolving trends we've seen thus far keep us optimistic for a solid investment year in 2024, with the caveat that the last quarter of the year remains uncertain as U.S. elections take place. While we expect the market to be resilient, it remains to be seen whether it would experience significant volatility in price and/or investor liquidity. It is worth noting that such periods of volatility could also serve as fertile ground for larger experienced investors who are well-positioned to take advantage of favorable pricing dislocation or to undertake attractive bilateral or smaller club transactions.



Source: Private Placement Monitor, 2024. Investment grade credit ratings of our private placements portfolio assets are based on a proprietary, internal credit rating methodology that was developed using both externally purchased and internally developed models. This methodology is reviewed regularly. More details can be shared upon request. There is no guarantee that the same rating(s) would be assigned to portfolio asset(s) if they were independently rated by a major credit ratings organization.



# Private credit: non-investment grade

Capitalizing on compelling private credit opportunities in a high interest rate environment

## Attractive market conditions for cycle-tested investors

While headlines this year have been dominated by the talk of the revival of banks, the reality is that yields, structures and documentation in private credit continue to offer what we view as compelling opportunities for a proven, cycle-tested manager to capitalize on in this high interest rate environment.

We believe the ingredients for a return of merger and acquisition activity are in place: there is a significant amount of private equity dry powder waiting to be invested, pressure from limited partners to return capital, a deep private credit financing market and the expectation of eventual rate cuts. While we expect some continued choppiness in the market for the remainder of this year due to the U.S. election, geopolitical concerns and the wait for the U.S. Federal Reserve to pivot, pressure is building to deploy capital and realize investments. We have already seen a pickup in activity this year as leveraged buyout activity grew year over year for the first time since Q1 2022.

Private credit continues to be the financing choice for companies and sponsors with private credit accounting for an 85% share of buyout and M&A activity this year. Even if this elevated level of private credit financing is not sustained, private credit's value proposition and permanent role are clear, and we look at this as the new era of capital delivery to companies.

## Market segmentation matters

Significant amounts of capital have been raised by asset gatherers in private credit, creating an immense pressure to deploy capital in upper middle market and large cap financings where it can be done so in size and scale. Due to this dynamic and competition with the



**Chris Wright**  
President and Head of Private Markets



**Chris Wang**  
Managing Director

newly reinvigorated banks, we have increasingly seen a convergence in this market segment with the broadly syndicated markets. Terms increasingly look alike with tighter yields, looser documentation, lax covenants and decreased access to information. Furthermore, portfolios focusing on the upper middle market and large cap financings typically look similar and lack differentiation as they are pressured to participate in every jumbo transaction that comes to market, lest they fall behind in their deployment targets.

While larger managers have moved upmarket to replace banks, the core middle market and lower middle market remain less competitive where financings are satisfied by one or a small number of lenders and borrowers are relying on a value-added partner to help grow their businesses. Here, lenders have more influence and control over structure, pricing and a greater ability to build protections and rights into documentation.

## Value of incumbency and rise of portability

Incumbency provides a proprietary pipeline of investment opportunities, as the incumbent lender is typically the first call for any additional capital needs. The incumbent lender also has unique insights into the historical performance of the company and capabilities of the management team, and as such can efficiently re-underwrite the business with speed and conviction.

Today, incumbency may be hardwired into transactions for the highest quality credits, due to the growing use of portability provisions. Portability allows the existing debt package to remain in place through a change of control transaction and leaves the incumbent lender invested in a well-known credit. Portability provisions have increased in prevalence as borrowers refinance or amend their existing debt structures in advance of upcoming maturities but are planning for a short-to-medium term exit.

## The importance of staying disciplined

There are many compelling opportunities in private credit today for those who have the experience and know-how of investing through multiple cycles and a track record of staying disciplined. Yet there are also many pitfalls waiting for less-experienced and less-disciplined managers who may not have the experience of investing through cycles or who may simply be prioritizing gathering and deploying assets.

We expect today's higher-for-longer rate environment to reveal which managers have been doing the hard work of staying disciplined in underwriting, negotiating stringent documentation and actively monitoring their portfolio, and which managers have not. This is a market environment where manager selection is vital, and we should see a growing dispersion of returns among asset gatherers and true credit investors in private credit.

Sources: Leveraged Commentary & Data (LCD), PC & MM Q1 2024 Quarterly Stats, as of March 31, 2024.

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# Real estate

## Optimism builds for Canadian commercial real estate

### June brings some interest rate relief

The Bank of Canada's (BoC's) June decision to lower interest rates is a positive sign for the commercial real estate market, in our view, providing much-needed clarity that peak rates are in the rear-view mirror. As of the mid-year point of 2024, inflation continues to cool, the labour market is softening and weaker than expected first quarter GDP growth cemented the start of the BoC's interest rate easing cycle.

The pace of cuts is expected to be gradual as the BoC takes it "one meeting at a time," in its own words, citing that "upside inflation risks remain." Consensus expectations are for a cumulative 75 basis points of cuts for 2024. While interest rate relief is welcome news, it will take time for rates to become "stimulative" and impact the real economy and real estate fundamentals. One cut isn't going to significantly reduce the interest burden that many consumers and businesses are facing. And real estate valuation cap rates are more closely aligned to longer-term interest rates, which won't experience the same magnitude of declines as the yield curve's inversion normalizes.

We anticipate that income growth from the execution of business plans at the property level will drive forward-looking returns. Nonetheless, the prospect of lower rates is a boost to occupier and investor sentiment in commercial real estate, which should gradually improve leasing and transaction activity.

### Valuations bottoming; property fundamentals are healthy

Despite the fact that Q1 2024 had the lowest volume of transaction activity since the pandemic began in Q2 2020, several benchmark transactions provided more clarity on asset pricing. Property valuations appear to have bottomed in most sectors, with the exception of the office market, which continues to face structural and cyclical headwinds. While bid-ask spreads remain wider than usual, recalibrating seller expectations and the prospect of lower interest rates should help to close the gap in the second half of the year.



**Phil Stone**

Managing Director, Head of Canada Research



**Michael Andrews**

Managing Partner, Portfolio Manager



**Christina Iacoucci**

Managing Partner, Head of Canada and Canadian Chief Investment Officer

Property fundamentals remain exceptionally healthy when compared to previous cycles. There is little evidence of overbuilding, except in the downtown Vancouver and Toronto office markets. However, both markets are nearing the end of their development cycles, which should help to stabilize fundamentals.

The office sector continues to face a slowdown in office-using job creation, as well as headwinds from remote work and AI, which are expected to limit new leasing activity in the medium term. Bifurcation by asset quality remains the main theme, as "prime" or "trophy" assets remain well-leased while owners of obsolete "B/C class" assets consider major renovations or conversion to other uses. Although multifamily and industrial rents are softening as vacancy rates rise from historic lows, construction starts have fallen significantly in the last year, indicating tighter conditions in the coming years as demand recovers.

### Lenders signal increased activity

The risk sentiment and appetite for commercial mortgages have improved. Loans secured by office properties are an exception, as liquidity remains severely constrained, resulting in a higher risk premium. The market's capital availability remains strong, as lenders, particularly insurance companies and investment managers, have increased their origination budgets this year (source: Intellifi, 2024). Lending spreads are narrowing with more capital than opportunities, owing to lower transaction volumes. Institutional-quality conventional mortgage spreads have fallen 20–30 basis points since the start of the year, but all-in coupons have remained stable as underlying base rates have risen by roughly the same amount.

We believe lenders will need to continue to carefully navigate the commercial mortgage market's near-term risks, which include refinancing risk, collateral valuations, asset-specific risks (such as the office sector) and general economic uncertainty. Intellifi data indicate an estimated C\$203 billion (45%) of Canadian commercial mortgage debt will mature between 2024 and 2026. Regardless of the risks identified, in our view this represents a significant opportunity to invest capital in attractive debt yields.





# Real estate (cont.)



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 Managing Director, Head of Canada Research



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**Christina Iacoucci**  
 Managing Partner, Head of Canada and Canadian Chief Investment Officer

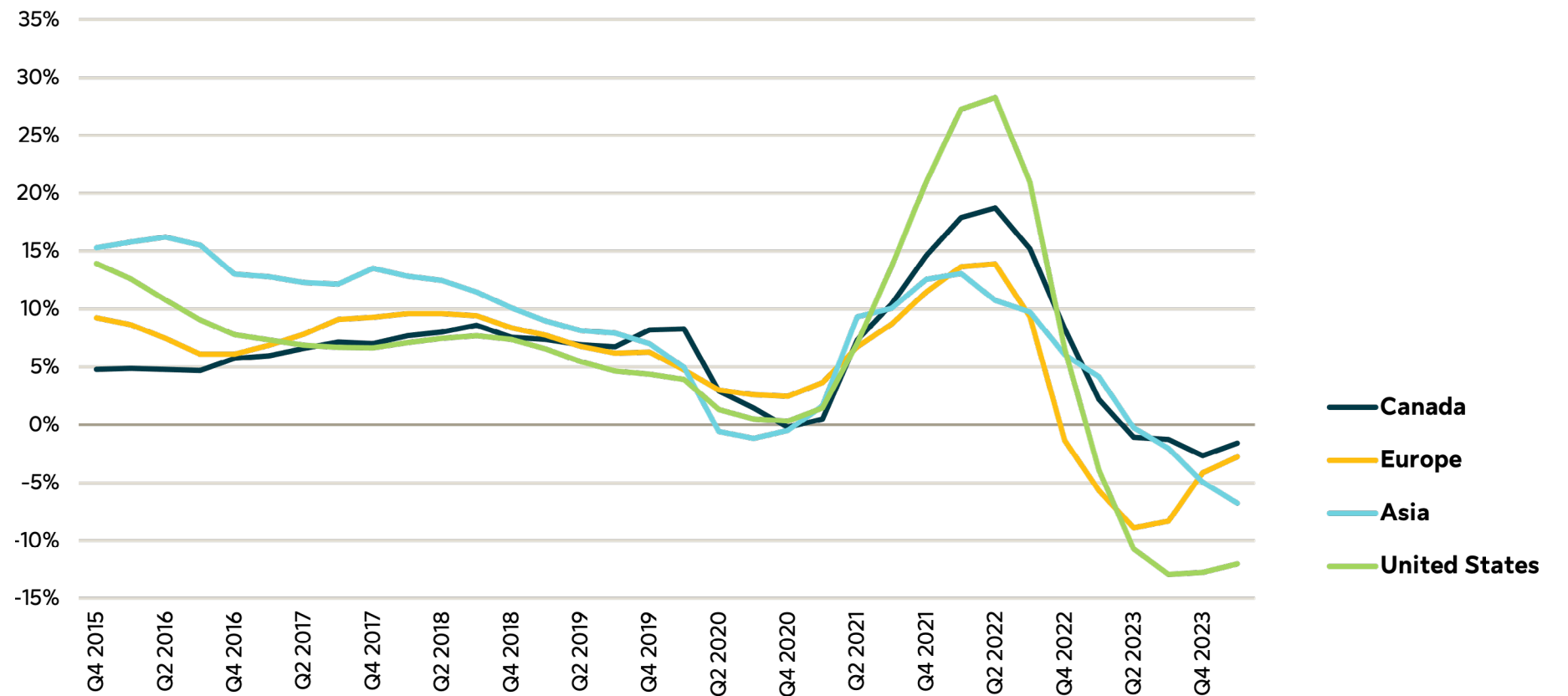
## Canada outperforming its global peers

Like prior down cycles, Canadian private commercial real estate equity returns continue to outperform other regions of the world (source: ANREV, MSCI, REALPAC, 2024). Healthy property fundamentals, more conservative use of leverage, institutional ownership and liquid debt markets all contributed to the stability of returns. In times of heightened economic and geopolitical volatility, we believe Canadian markets can serve as beacons of stability.

Despite weak overall transaction activity in 2023, foreign investment in Canadian commercial real estate from all regions of the world totaled nearly C\$11 billion, accounting for 13% of total investment activity (source: Altus Group, 2024). Sophisticated institutional and private capital recognizes not only the Canadian market's stability, but also the opportunity for consistent income growth created by strong demographics and barriers to developing new supply. Despite lower valuation drawdowns in Canada compared to global peers, 2024 remains an attractive entry point, in our view, because asset values have fallen more than any period since the 1990s. We expect more opportunities in core and value-add strategies to emerge in the second half of the year as market participants adjust to the current capital market dynamics.

## Canadian private real estate returns outpace global markets

Rolling 12-months net total returns, core commercial real estate category, as of Q1 2024



Source: ANREV, MSCI, REALPAC, 2024.

Sources: Bank of Canada, CBRE, Intellifi, Altus Group, 2024.

# Infrastructure

Monetary policy at an inflection point, as longer-term megatrends continue to shape this growing market



**Jack Paris**  
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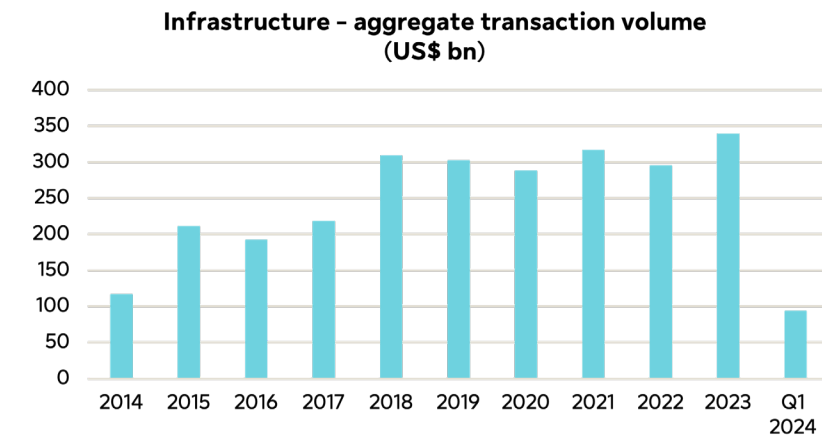
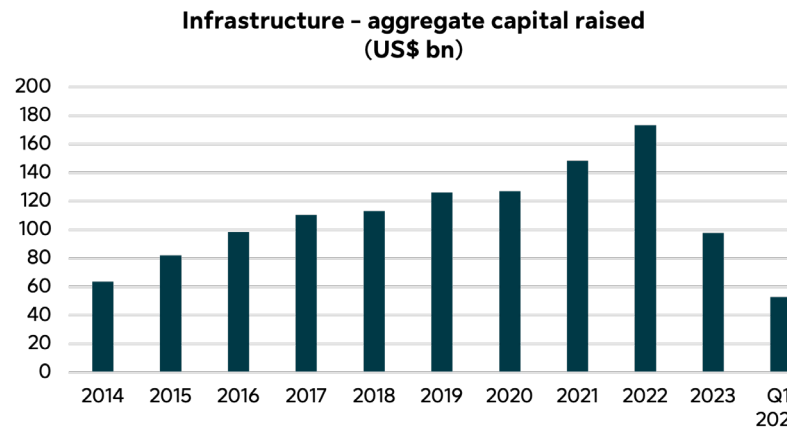
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## Rate pressures continue as near-term influences on infrastructure

The dominant short-term theme in infrastructure has been a degree of price adjustment and dislocation in the market, largely driven by the sharp increases in interest rates of the recent past. While there were some policy pivots in June 2024, with the central banks of Europe and Canada taking tentative steps toward rate easing, continued pressures from high rates in the United States and United Kingdom still have the capacity to affect asset valuations and deal flow. Having said that, infrastructure continued to prove resilient compared to other alternative asset classes, particularly with GDP-linked sectors such as energy and transport – supported by the resilient growth environment – and with digital infrastructure thriving as well amid an unprecedented acceleration in data demand driven by AI.

In terms of deals flow, higher rates led to a greater investor focus on value-add strategies over core. With investors already receiving higher income from traditional bonds amid elevated rates, interest in infrastructure has gravitated toward the higher end of the risk/reward spectrum. Furthermore, the short-term uncertainty on policy has led to a widening in bid-ask spreads, with a discerning buy-side, placing a greater emphasis on testing asset prices, coupled with a sell-side less incentivized to put assets on the market. At the mid-year point of 2024, the volume of infrastructure transactions, particularly for core assets, had moderated somewhat when compared with recent years, with certain deal processes also taking longer as well.

## Capital raises, transaction volumes moderating in early 2024

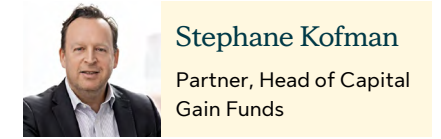
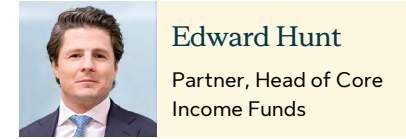


Source: Preqin, InfraLogic, as of June 2024. Aggregate transaction volume includes deals labeled as “Greenfield” and “M&A.”

However, it is important to note that the pricing environment for high quality assets continues to be strong, supporting transaction volumes. Similarly, after a very challenging past 18 months in terms of the fundraising environment, positive momentum can now be observed for established managers with a differentiated and proven investment proposition.



# Infrastructure (cont.)



## Global monetary policy at the crossroads

While high rates continue to be a potentially disruptive market force, we may also be at a possible inflection point in monetary policy. As previously mentioned, some central banks, such as the European Central Bank, have enacted rate cuts, and policymakers in the U.S. and U.K. have also signaled greater confidence that inflation is increasingly under control. This suggests that these two major economies could now be beyond peak interest rate levels and could possibly move to easing mode in the second half of 2024.

This could serve as a catalyst for infrastructure investment, as increased macroeconomic confidence could help move investment capital off the sidelines. We expect this to also provide stronger structural support to valuations in the sector.

## Investing in “4-D” megatrends

The longer-term picture for infrastructure continues to be promising, in our view, with the capacity for growth driven by the “3-Ds” of thematic megatrends we have discussed in our previous outlook statements:



**Decarbonization** - with continued efforts to decrease fossil fuel reliance and support electrification of heat and transport in addition to pushing for increased roll out of renewables.



**Digitalization** - including the expanded development of AI and the significance of cloud computing and other technological initiatives, boosting the volume of data and demand for digital infrastructure and data centers in particular.



**Demographic changes** - with ageing populations in major developed economies and increased migration to urban areas reshaping infrastructure demand patterns and investment needs.



We would note, however, the emerging importance of a “4th D” in the equation, that of “deglobalization,” with rising trade barriers leading to a reshuffle of supply chains and a reshoring of production capacity, and policy, such as the Inflation Reduction Act (IRA), aimed at stimulating investment in new infrastructure in the areas of clean energy, transportation and the environment to drive economic growth, job creation and a modernization of ageing infrastructure, which in many cases has been in decay for some time and is in urgent need of reinvestment. That these four megatrends continue to grow in importance, along with the capital outlays needed to fund them, means greater opportunities for infrastructure investors to participate in a long-term secular growth story. The opportunity set becomes more pronounced in the post-COVID era, in which government balance sheets have become strained due to increased public spending, which in turn opens the door wider for private investors.

Risks remain in the infrastructure space, from uncertainty around the growth outlook, to the possibility of greater geopolitical turmoil in the Middle East, Ukraine and other regions leading to increased market volatility and supply chain disruptions leading to construction delays and cost overruns for new infrastructure projects. However, given the pivotal role that the asset class plays for the energy transition and a widening investment gap, we anticipate continued support from policymakers and interest from investors in this rapidly evolving universe.

Sources: Preqin, InfraLogic, 2024.

# Insurance asset management

Ongoing market volatility, new insights from IFRS 17 refocusing strategies toward more resilient portfolios

## IFRS 17 prompts re-evaluation of strategic asset allocation

As expectations for aggressive rate cuts in 2024 have diminished, the higher-for-longer interest rate environment has prolonged the opportunity for insurers to add attractive yields and income opportunities to their portfolios. Furthermore, the experience gained since the transition to International Financial Reporting Standards 17 (IFRS 17) has provided new insights from an investment perspective and prompted many insurers to reassess their strategic asset allocations. This has led insurers to spend 2024 refocusing on their fixed income exposures and increasingly turn to alternative investments that can help build more stable and diversified portfolios.

Insurers have spent the last six quarters adapting to the new reporting standards of IFRS 17. While implementing the standard required substantial effort and resources, it has provided valuable lessons for capital management going forward. From an investment perspective, a key insight from transitioning to IFRS 17's approach of delinking assets and liabilities is that that past investment strategies may not succeed under the new framework. With maintaining balance sheet strength still a top priority, insurers are carefully re-evaluating their strategic asset allocations in response to IFRS 17, but also in light of rapidly changing and volatile market conditions.

## The shifting attractiveness of fixed income

A key takeaway from these strategic asset allocation reviews is that the rapid rise in interest rates has significantly impacted the relative attractiveness of fixed income compared to return-seeking investments. Many fixed income asset classes now offer equity-like return potential, especially when factoring in regulatory capital requirements.

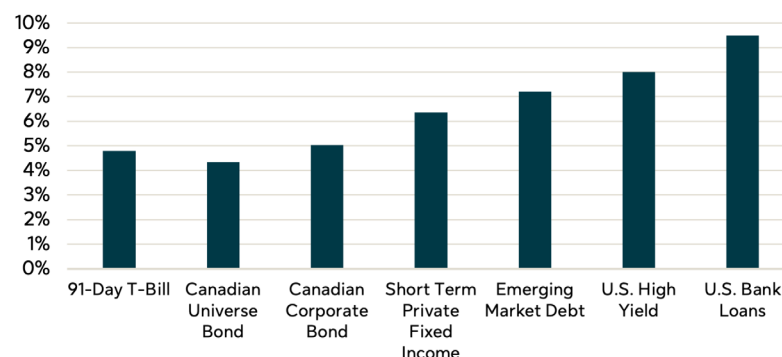


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## A review of the current opportunity set in fixed income – yield by asset class



Source: Bloomberg, as at May 31, 2024. The following representative indices were used for each asset class; FTSE Canada 91-Day T-Bill (yield = yield to maturity), FTSE Canada Universe Bond Index (Canadian Universe Bond, yield = yield to maturity), FTSE Canada All Corporate Bond Index (Canadian Corporate Bond, yield = yield to maturity), FTSE Canada Short Corporate A Bond Index (Short Term Private Fixed Income, yield = yield to maturity + illiquidity premium), Bloomberg Emerging Market USD Agg Index (Emerging Market Debt, yield = yield to worst), Bloomberg US High Yield Bond Index (U.S. High Yield, yield = yield to worst) and Credit Suisse Leveraged Loan Index (U.S. Bank Loans, yield = yield to maturity). Past performance is not a guarantee of future results. It's not possible to invest in an index directly.

As such, many insurers have refocused on constructing more resilient fixed income portfolios that can generate stable returns and income. Where portfolios were once concentrated in traditional Canadian instruments, the fixed income universe is expanding. Insurers are increasingly looking to allocate to alternative fixed income asset classes like private credit, structured credit and non-investment grade assets, a multi-faceted credit approach that allows more flexibility to navigate periods of uncertainty.

## Looking to alternatives for long-term stability, resiliency

Insurers are increasingly turning to alternative investments to build more resilient investment portfolios that can withstand economic downturns and market volatility. According to a recent survey from Mercer and Oliver Wyman, the vast majority (73%) of insurers either currently invest in private markets or plan to begin doing so by 2024.

While subject to their liquidity requirements in the short term, insurers have long-term investment horizons that position them well to capitalize on the risk-adjusted returns offered by alternative assets like real estate, infrastructure and private credit over the long run. It is worth noting that insurers now have access to a wider range of capital-efficient investment vehicles and structures to choose from when implementing their investment strategies, providing more flexibility to how insurers invest according to their return and risk preferences.

These alternatives also provide diversification benefits to traditional stocks and bonds, helping to stabilize portfolio performance. As a result, many insurers have been strategically increasing their allocations to alternative investments that offer exposure to steady income streams and inflation hedges.

## Navigating market uncertainty

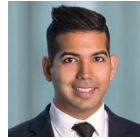
The coming months pose challenging uncertainties that could impact financial markets and insurers' balance sheets. Ongoing geopolitical conflicts, the upcoming U.S. election and central banks' difficult task of lowering inflation without causing a recession all present potential risks. During such volatile times, insurers would be well served to thoroughly review their investment strategy. A diversified strategy that also aligns with IFRS 17 standards can help insurers navigate continued turbulence in financial markets with greater resilience.

Sources: Bloomberg, Mercer and Oliver Wyman 2024 Global Investment Outlook For The Insurance Industry, 2024.



# Retirement plan solutions

Plan sponsors look to lock in higher rates as funded statuses remain strong and markets stabilize



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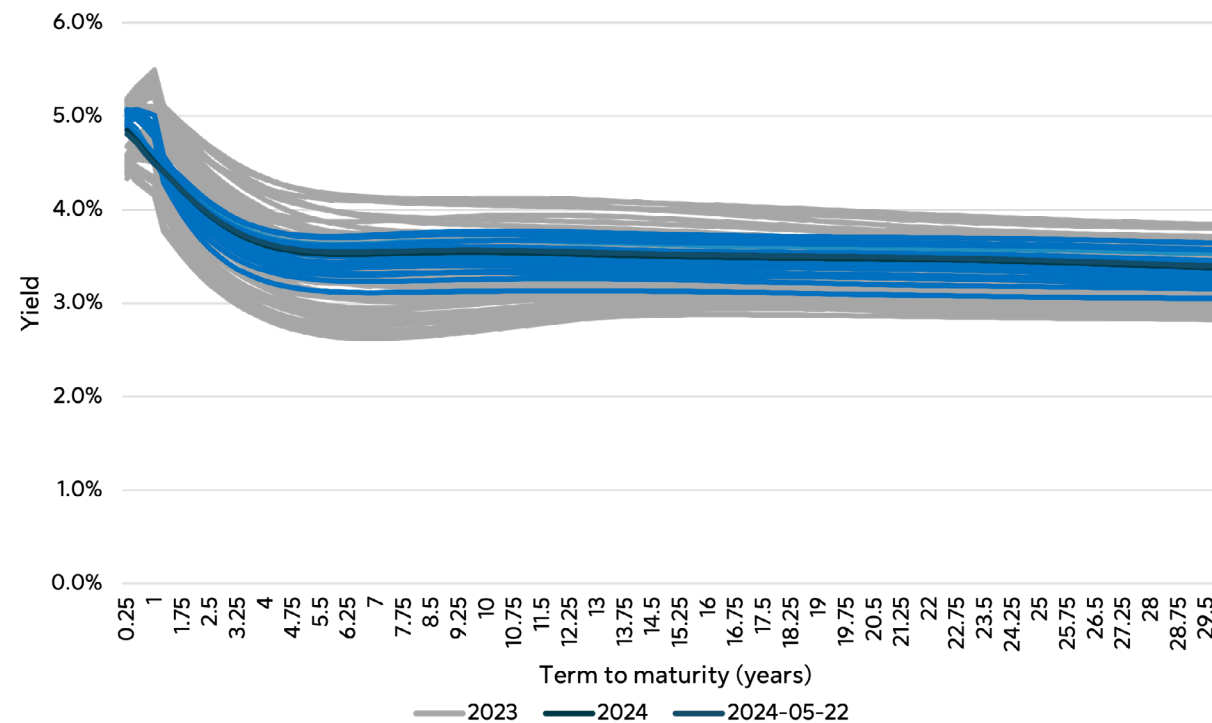


**Neil Tai-Pow**  
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## Rate markets stabilize, plan sponsors reassess LDI portfolios

The 2024 calendar year thus far has exhibited much more stability in rate markets compared to 2023. With inflation easing, central bank rate cuts have begun in Canada and Europe, and are anticipated later this year in the U.S. This is resulting in the inversion of the yield curve becoming less pronounced. While rates were at historic highs in 2023, volatility of rates and the potential continued upward movement, coupled with a hot equity market, made it difficult for plan sponsors to adopt a change in their pension plan strategy. As rates stabilize, the potential of a drop in rates becomes more likely and consensus builds that the stock market rally can't continue, we've seen heightened interest from plan sponsors in de-risking to lock in the higher yields while they last. As long as these economic factors continue to hold sway, we expect this trend to persist.

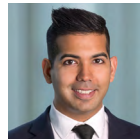
**Yield curve volatility has eased, although inversion persists**



Source: Bank of Canada, weekly yield curve data for zero-coupon bonds, as of May 22, 2024. Dispersion between curves within each data series reflects the degree of yield curve volatility in the corresponding year.

Continuing from trends seen in 2023, plan funded statuses have improved in 2024 to date, driven by yield increases combined with strong equity performance. Furthermore, as of the end of the first quarter of 2024, annuity purchase discount rates continue to be elevated, close to peak levels last seen at year end 2022 (based on the Canadian Institute of Actuaries' methodology for medium duration liabilities). As a result, plan sponsors have shown increased appetite for either increasing allocation to liability-hedging fixed income or lengthening duration of existing fixed income portfolios to protect their funded status gains and capitalize on the higher-yield environment.

# Retirement plan solutions (cont.)

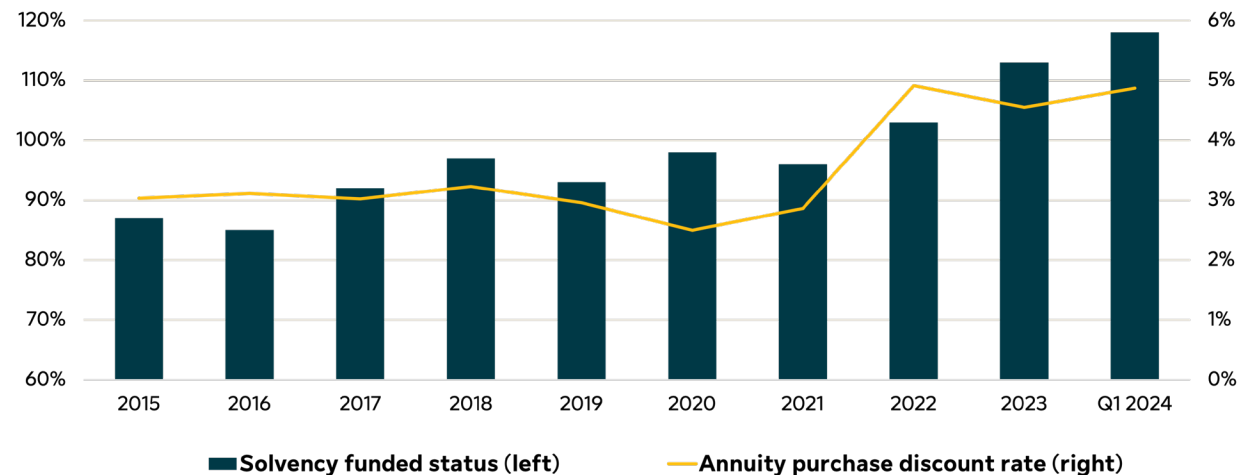


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Head of Retirement Solutions



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Senior Director, Client Solutions

## Strong financial positions and high discount rates suggest an opportune time to reduce risk



Sources: Solvency funded status based on Mercer Pension Health Pulse (as of Q1 2024), which tracks the median solvency ratio of the DB pension plans in Mercer's pension database. Annuity purchase discount rate based on the Canadian Institute of Actuaries methodology and shown for the medium duration liabilities.

## Diversification, yield enhancement in focus for fixed income portfolios

As fixed income portfolios grow in defined benefit plans, we expect plan sponsors to look for ways to generate higher yields to keep pace with liability growth, and to sufficiently diversify exposure to credit downgrades and defaults. Consequently, plan sponsors are increasingly looking outside of traditional credit to help meet these needs. U.S. long corporate bonds and private credit (both traditional and investment grade [IG]) can fit the bill and have garnered interest among many plan sponsors. U.S. long corporate bonds can alleviate the sector, name and quality concentration inherent in the Canadian long corporate bond market, and cross currency swaps can help mitigate foreign interest rate and foreign exchange risks.

In our view, skilled managers can adopt this strategy in meaningful allocations while still seeking to outperform the same Canadian index benchmarks that are used to price Canadian liabilities. IG private credit can improve a plan's fixed income diversification profile without detracting from interest rate hedging by introducing medium and long-dated fixed exposure to issuers and sectors not found in public corporate markets, in addition to potentially higher yield due to complexity and illiquidity. Traditional private credit has surged in popularity as a return enhancer for less liability-oriented investors such as public pension plans, some of whom have recently introduced new long-term strategic allocations to the asset class within their portfolios, or as a component within a liability-driven investing (LDI) strategy to generate additional yield and income with reduced volatility compared to equity.

## Yield curve inversion increasing leverage financing costs

Many plan sponsors are looking to use leverage to extend the duration of their fixed income portfolios. However, yield curve inversion has made leveraged strategies more costly to employ, as short-term financing costs currently exceed long-term yields. As such, we have observed some resistance to the use of leverage. Furthermore, we have seen plan sponsors consider options for mitigating this impact, such as lengthening duration of their physical fixed income portfolios to allow for lower leverage ratios. As long as rate cuts continue and financing costs fall, we expect to see plans consider increases to the leverage in their portfolio.

## Troubled waters ahead?

There are no guarantees that the balance of 2024 will herald the same good fortunes seen in the first six months, as the potential headwinds are numerous. From ongoing global conflicts and the upcoming U.S. election to the success of central banks, particularly in the U.S., at curbing inflation while staving off a recession, there are number of pitfalls that market actors will need to manage carefully. In times of higher risk, the benefits of derisking and diversification are at a premium, and we expect increased activity in areas that support plan sponsors in these objectives, such as LDI and real assets.

Sources: Bank of Canada, Canadian Institute of Actuaries, Mercer, 2024. Investment grade credit ratings of our private placements portfolio assets are based on a proprietary, internal credit rating methodology that was developed using both externally purchased and internally developed models. This methodology is reviewed regularly. More details can be shared upon request. There is no guarantee that the same rating(s) would be assigned to portfolio asset(s) if they were independently rated by a major credit ratings organization.



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