

# A Fragile Peace

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Investment Strategist  
February 2021

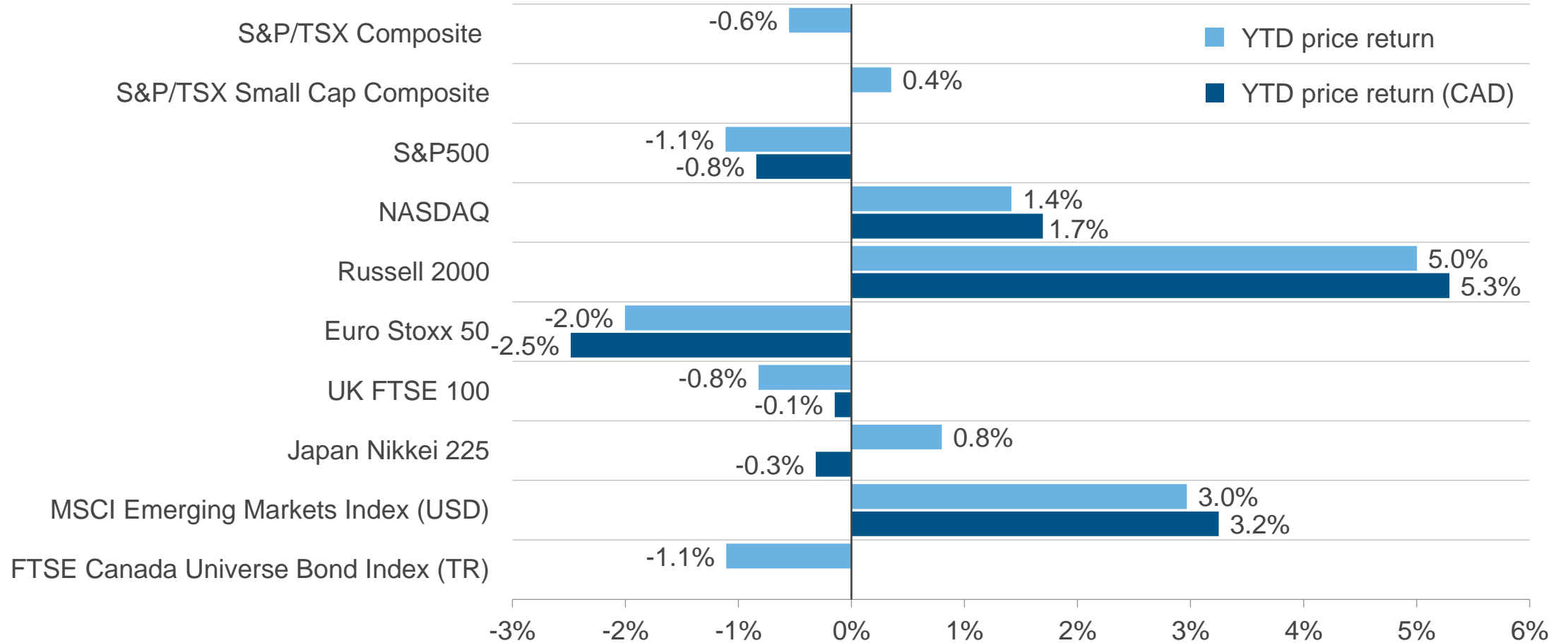


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That's better together



# Capital market YTD price return



Source: Bloomberg January 29, 2021 - local currency unless noted, equity price only returns, bonds total return

# Agenda

**Outlook**  
Equity forecast  
Fixed income  
forecast



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# Market themes

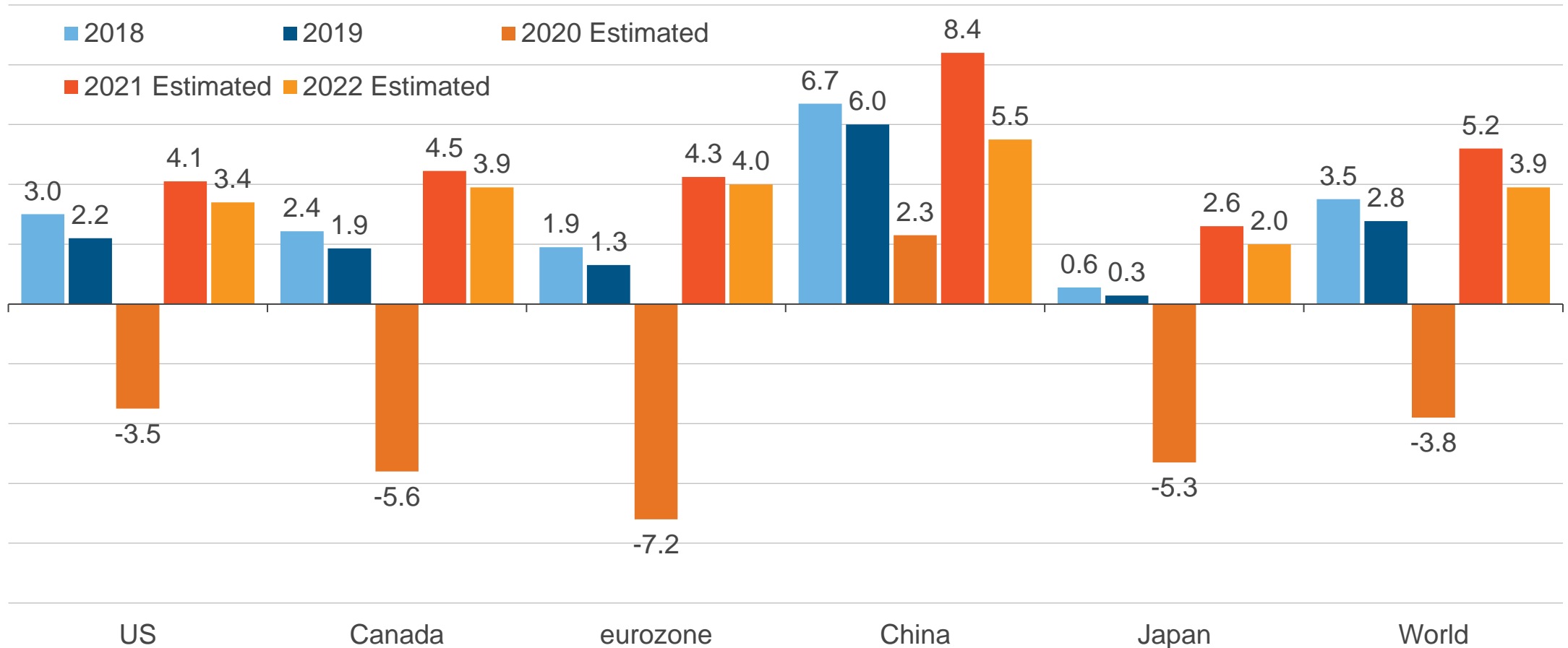


- 1 Global economy is recovering from recession. Second-wave is upon us, second shutdowns may be less damaging, but behaviours may not.
- 2 Monetary and fiscal authorities flooding the system. How will markets react if the battle against the virus improves and these supports wane?
- 3 Equities expensive, risk-reward skewed to the downside. Growth to Value rotation is key.
- 4 Bond yields are rising, is a taper-tantrum possible?
- 5 Return outlook is muted.
- 6 **Asset mix:** Neutral equities vs. fixed income.



# Global GDP growth

## Real GDP growth (y/y % change)

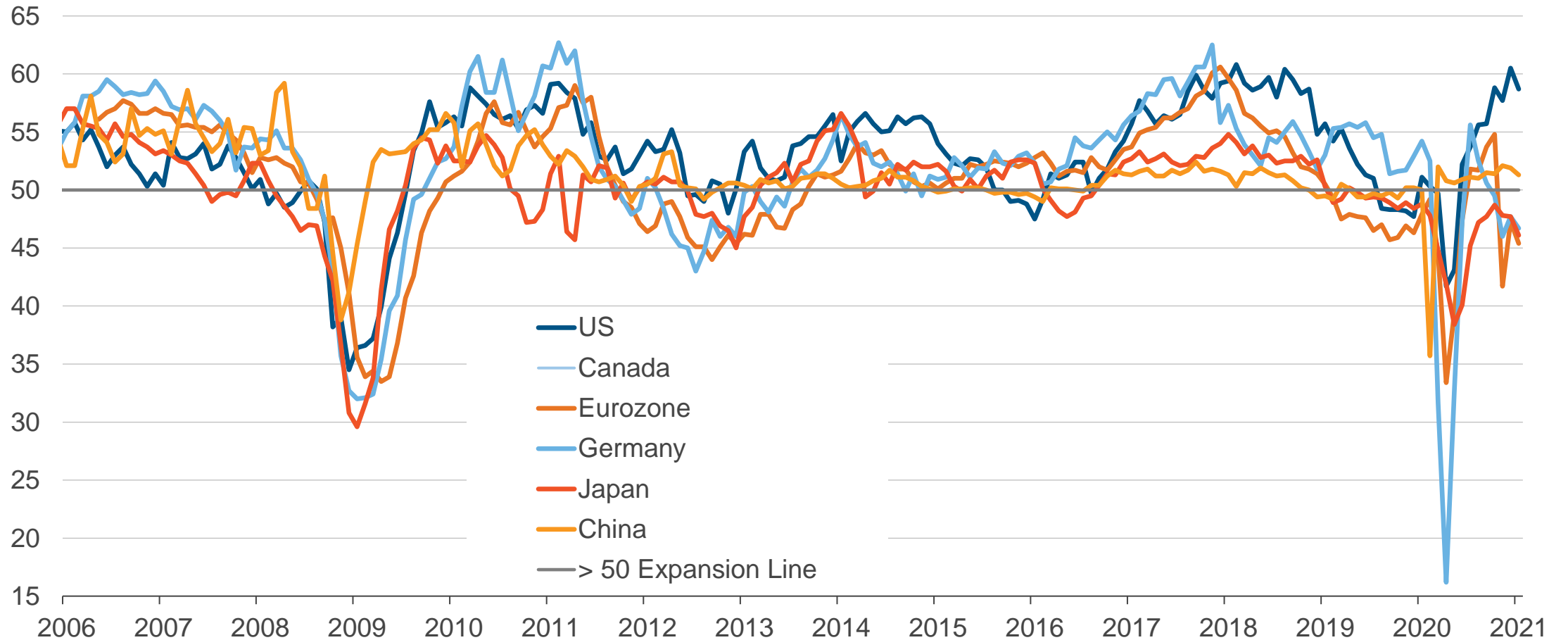


Source: Bloomberg January 31, 2021



# Global PMI surveys – manufacturing

## Global manufacturing purchasing manager indices

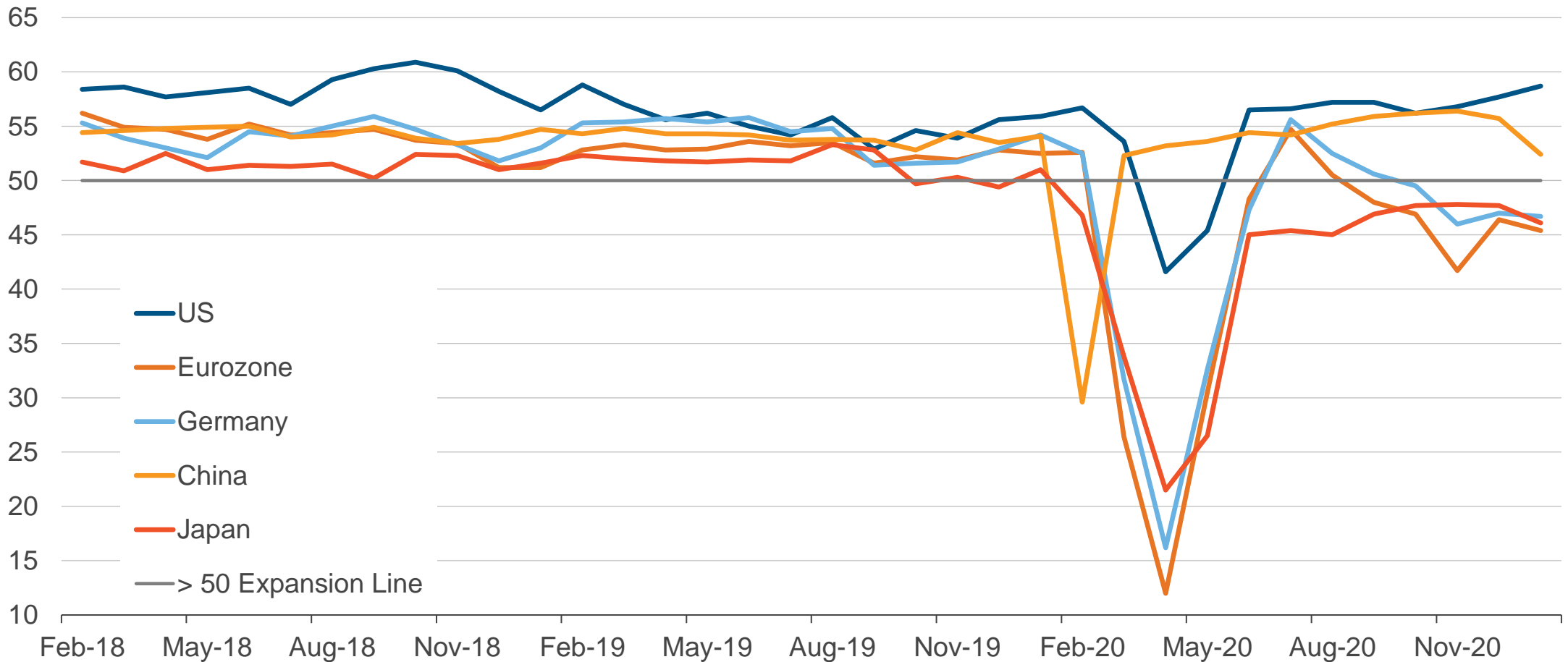


Source: Bloomberg January 2021; US - ISM, Canada, Eurozone, Germany – Markit Economics, Japan – Jibun Bank, China – China Federation of Logistics and Purchasing



# Global PMI surveys – services

## Global services purchasing manager indices

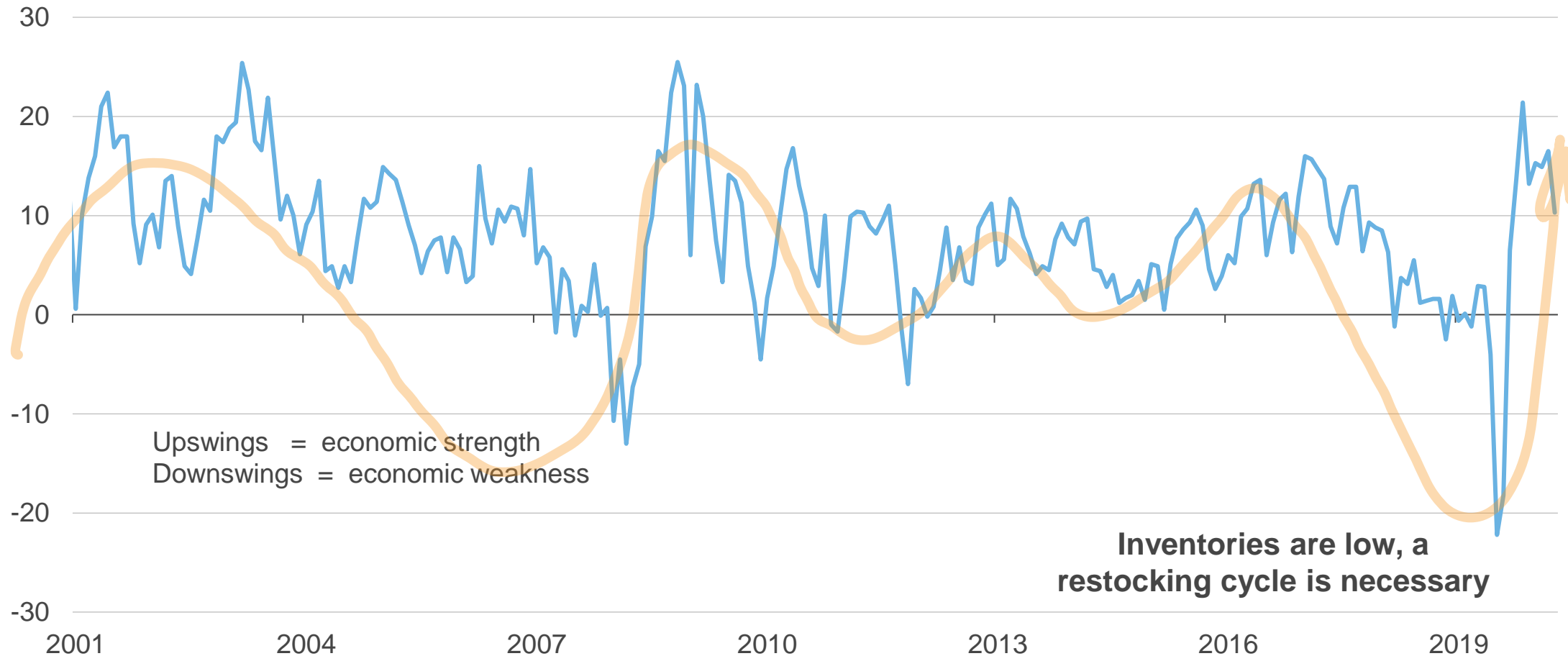


Source: Bloomberg January 2021



# US inventory cycle

## ISM manufacturing new orders less inventory

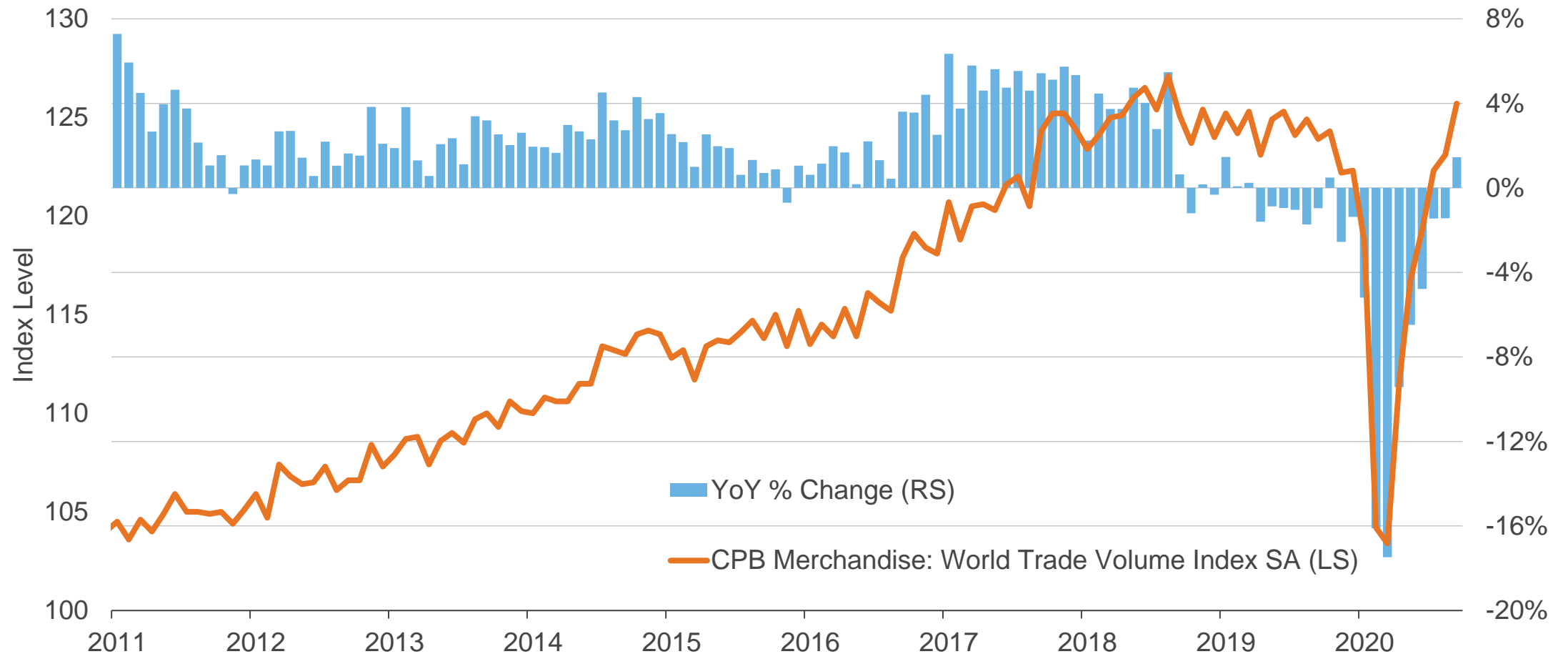






# Global trade by volume

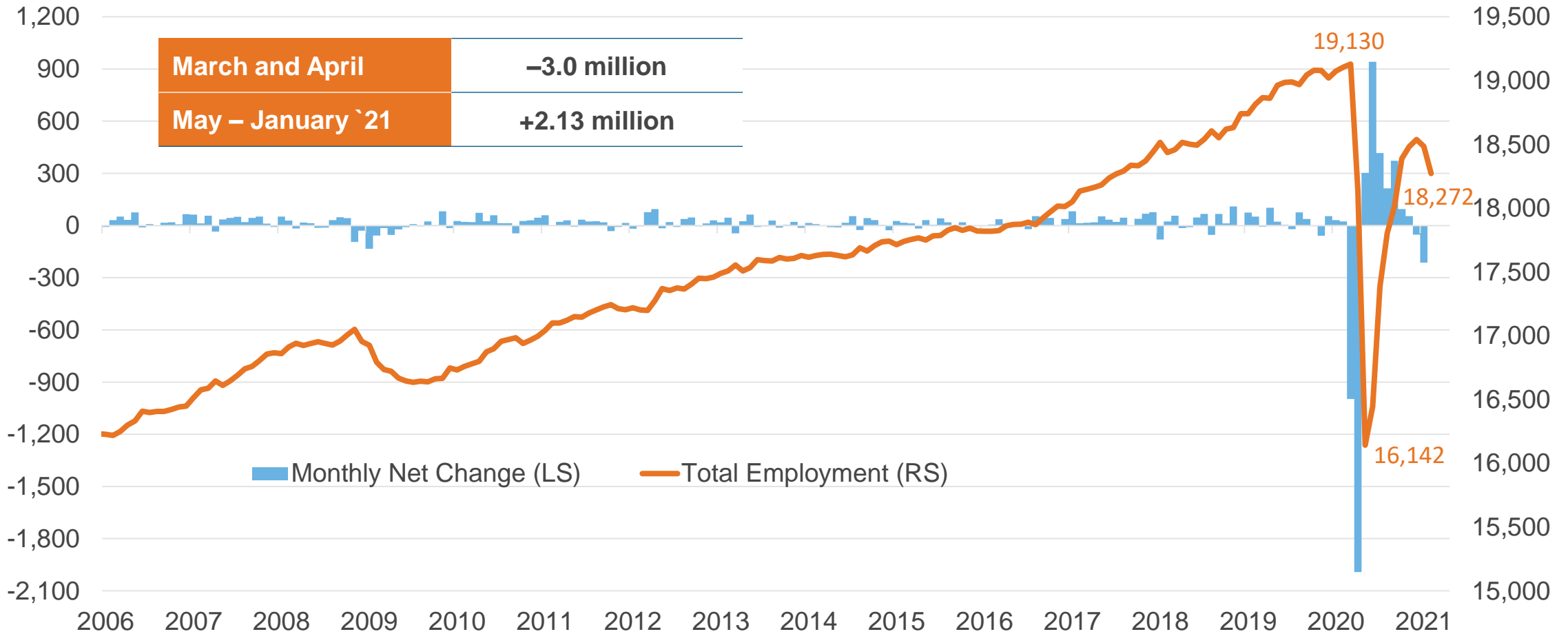
## CPB Merchandise Trade Volume Index





# Canada – employment picture

## Canadian employment (000's of persons)

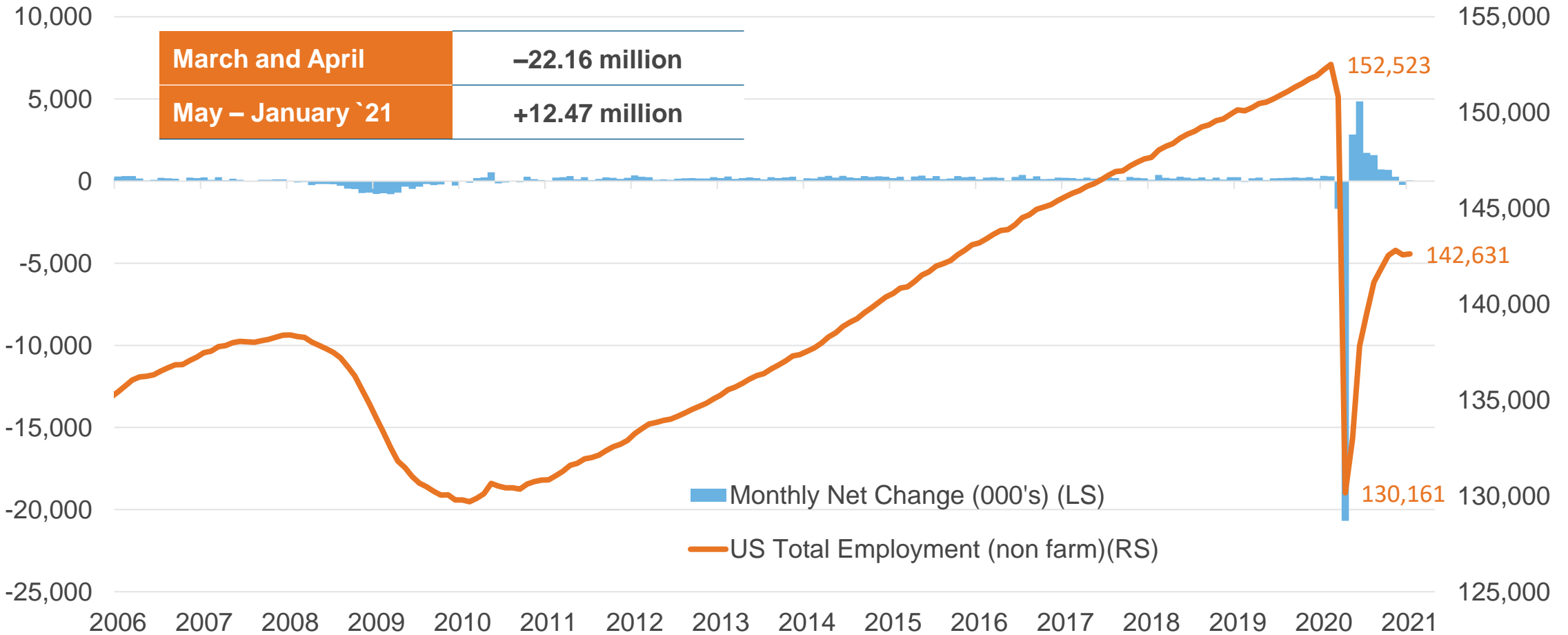


Source: Bloomberg January 2021



# US – employment picture

## US employment (000's of persons)

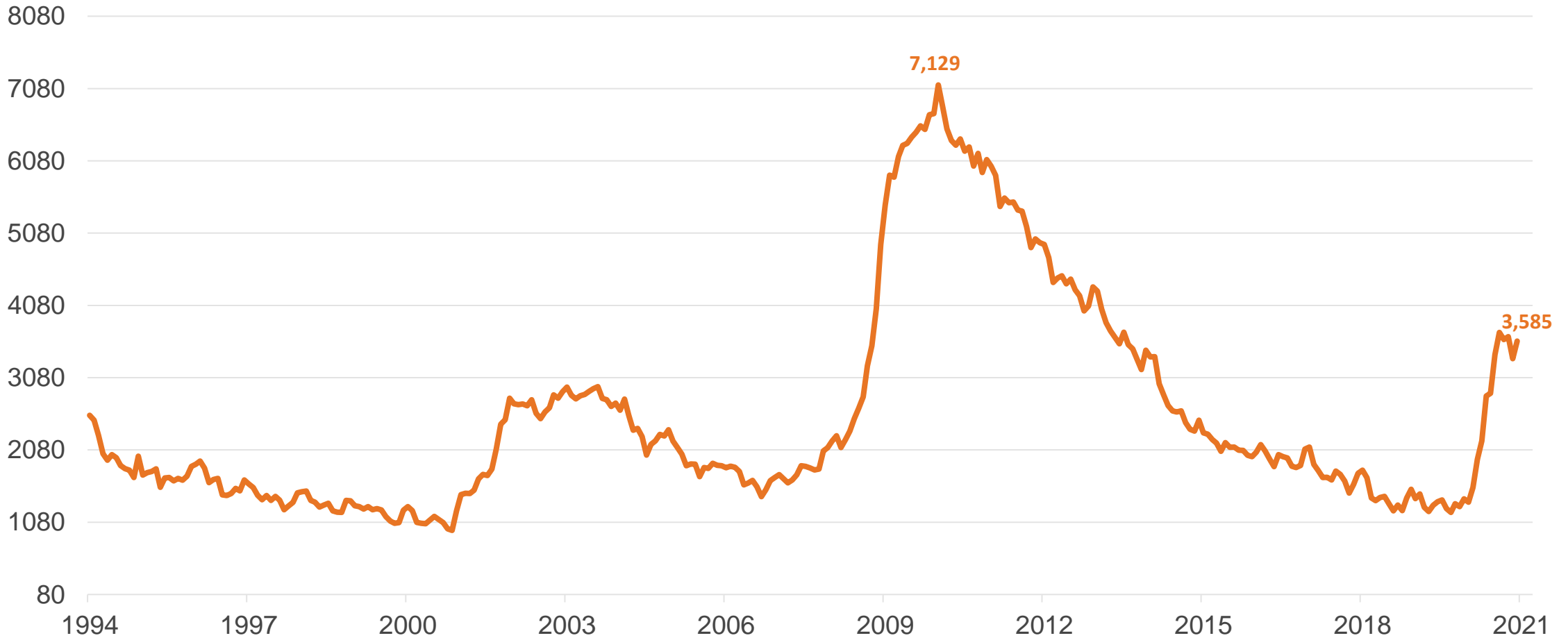


Source: Bloomberg January 2021



# US – employment picture

## US unemployment – permanent job loss (000's of persons)

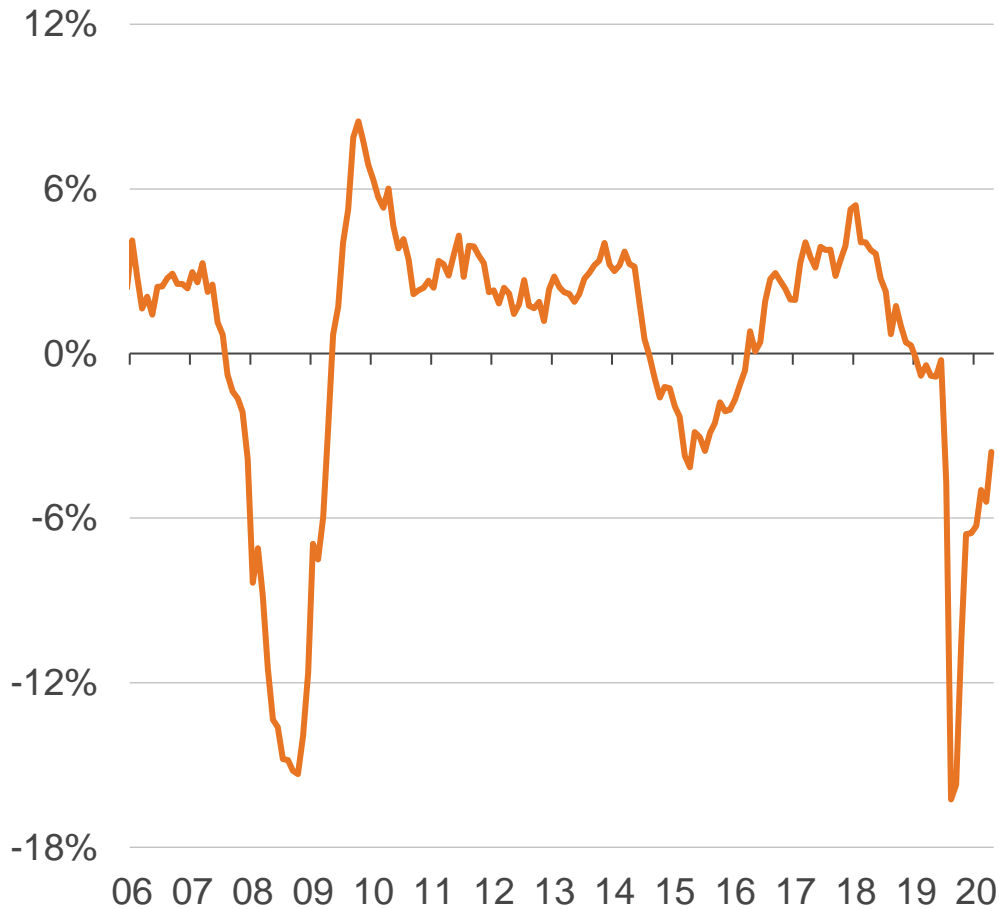


Source: Bloomberg January 2021

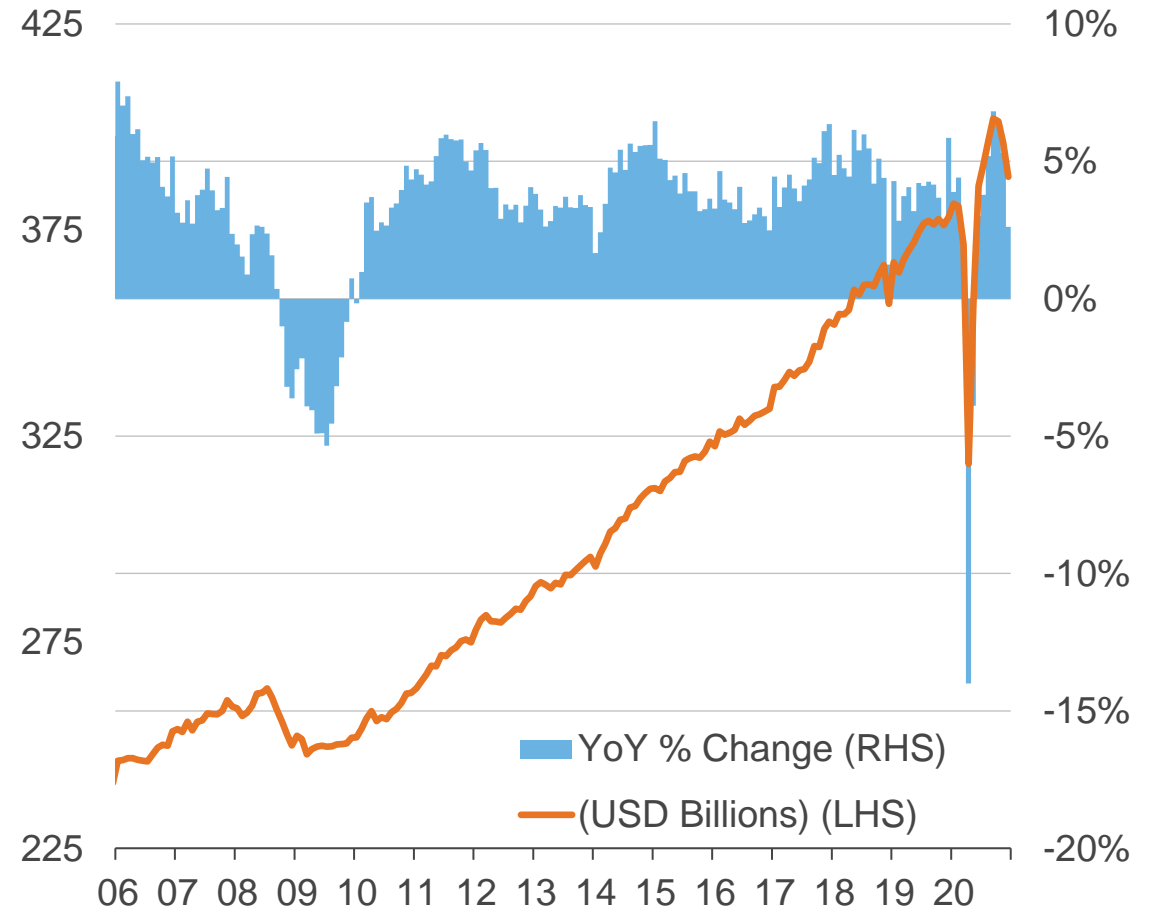


# US – economic picture

## Industrial production YoY% change



## Retail sales less autos and gas

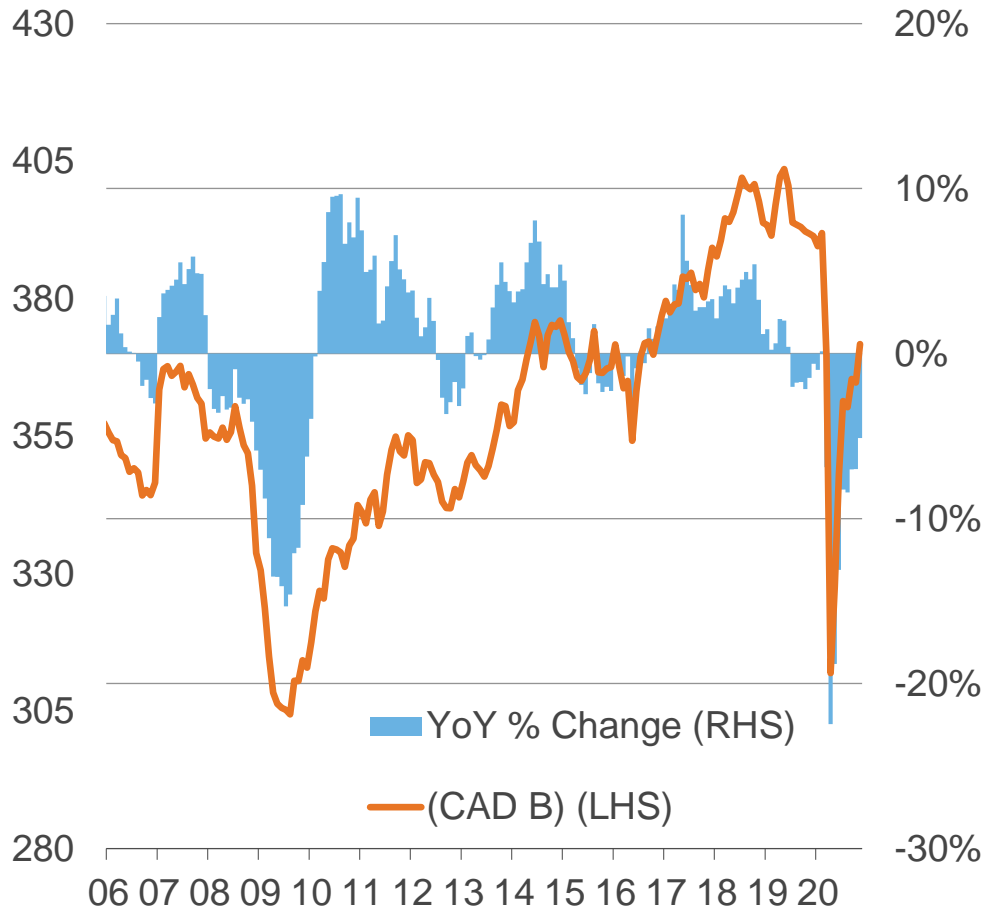


Source: Bloomberg IP December 2020, Retail Sales December 2020

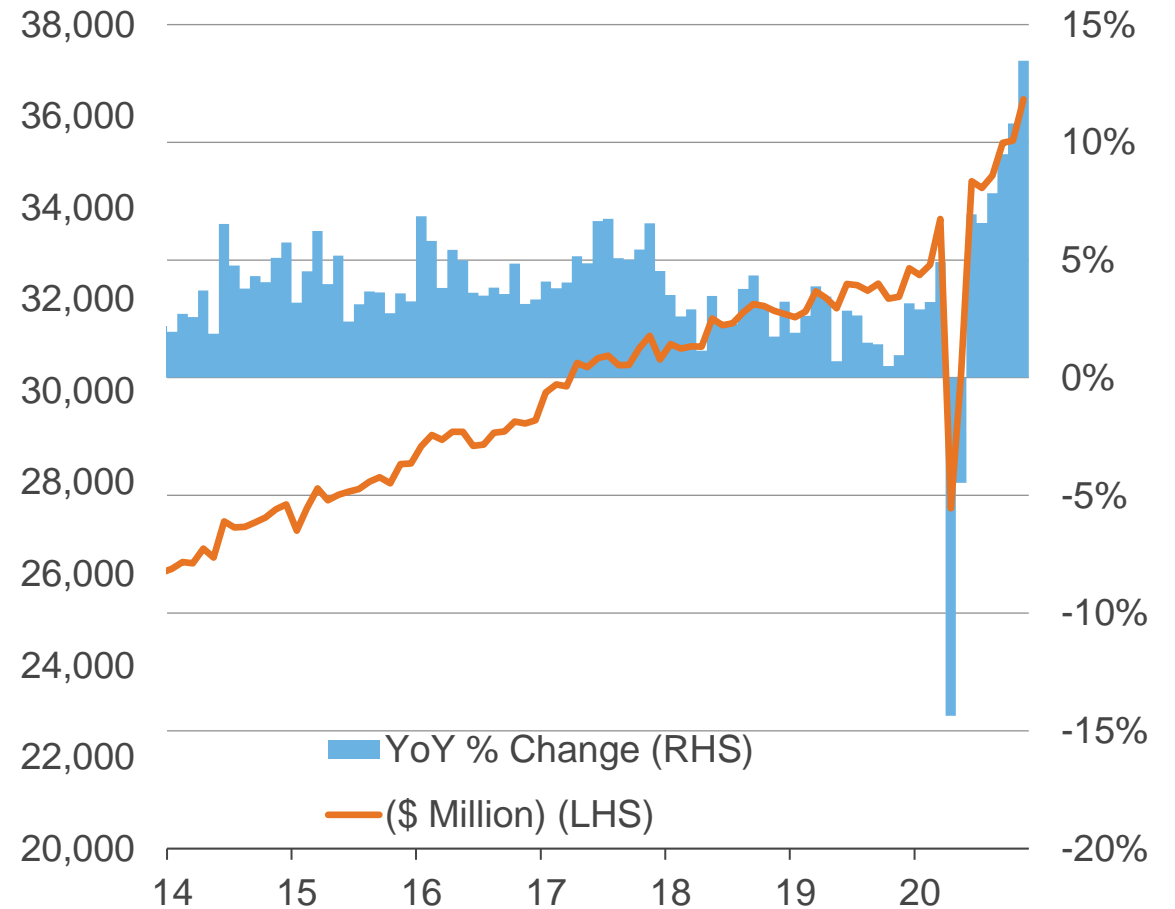


# Canada – economic picture

## Industrial production



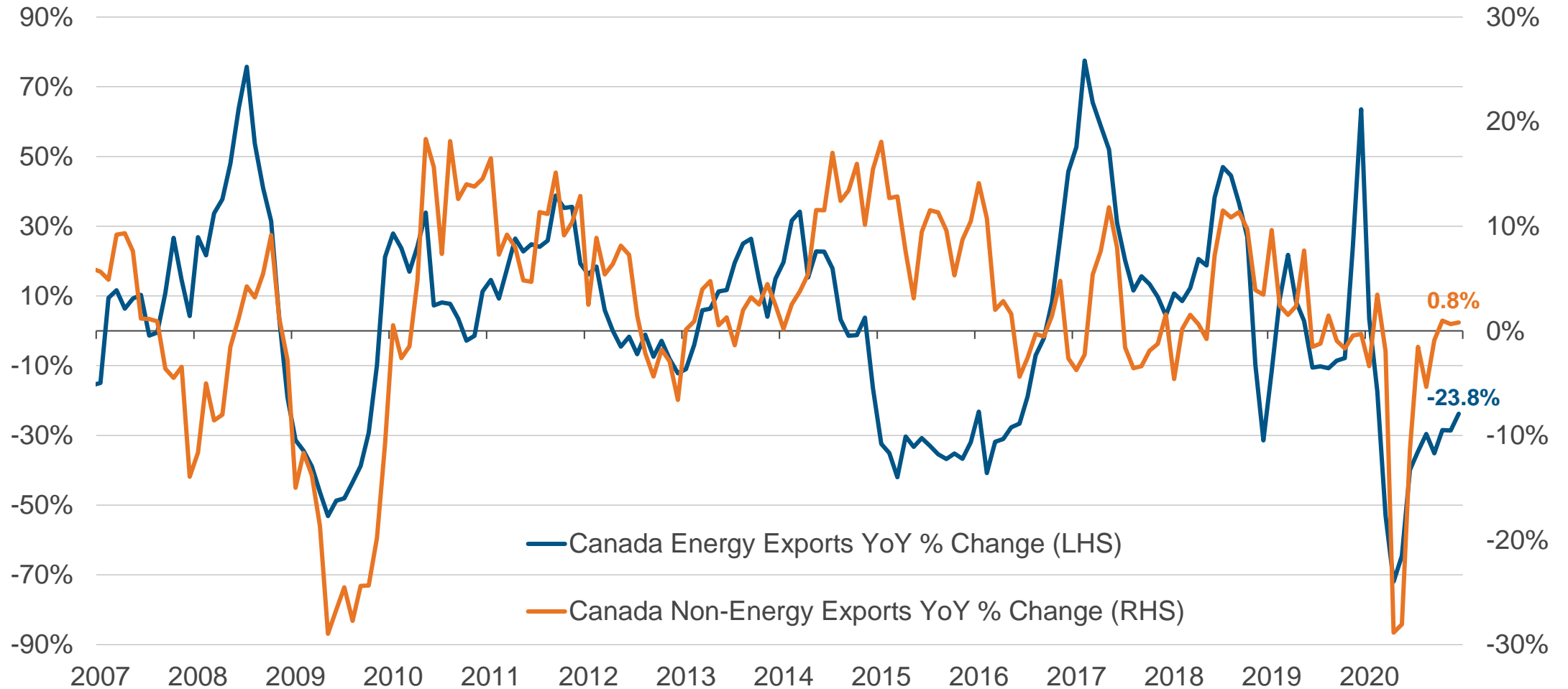
## Retail sales less autos and gas





# Canadian exports

## Canadian energy and non-energy exports (YoY % change)

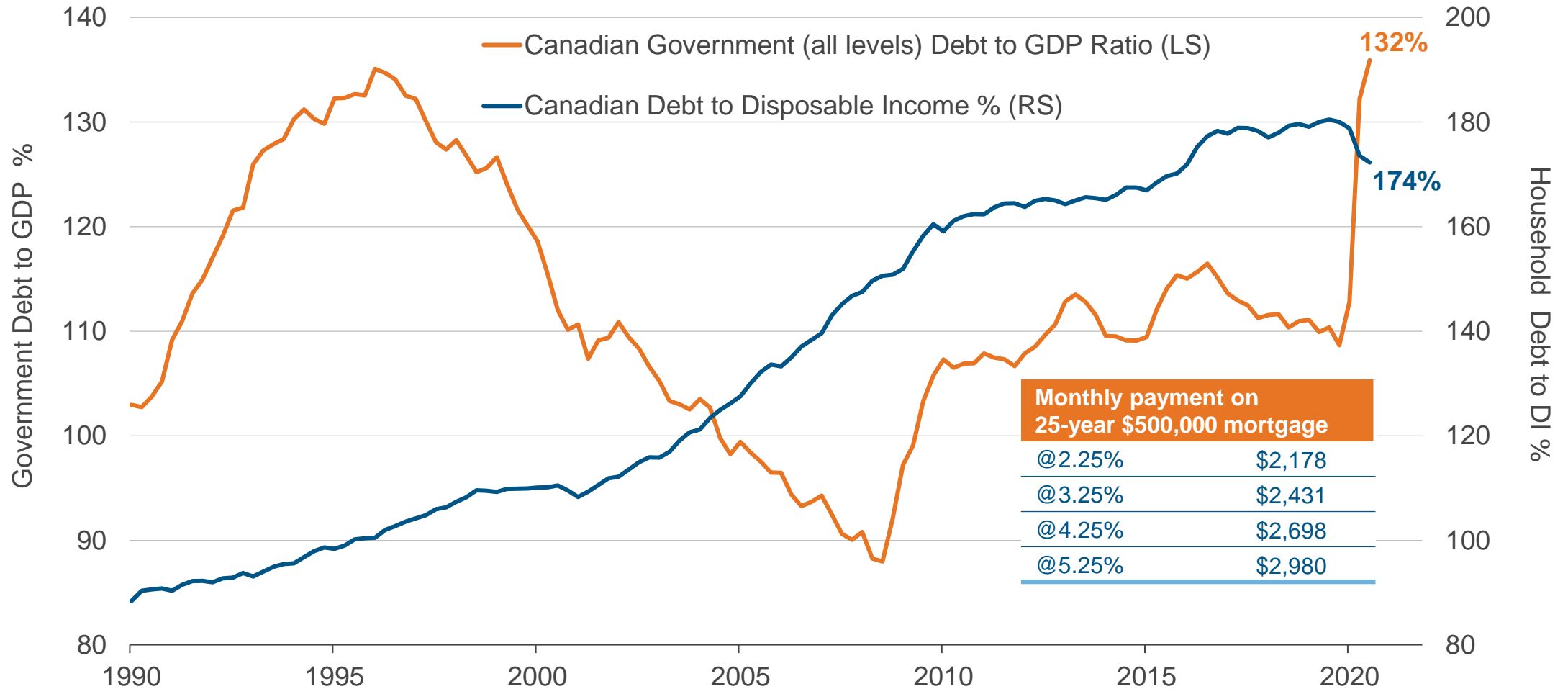


Source: Bloomberg December 2020



# Canadian debt

## Canadian household and government debt ratios



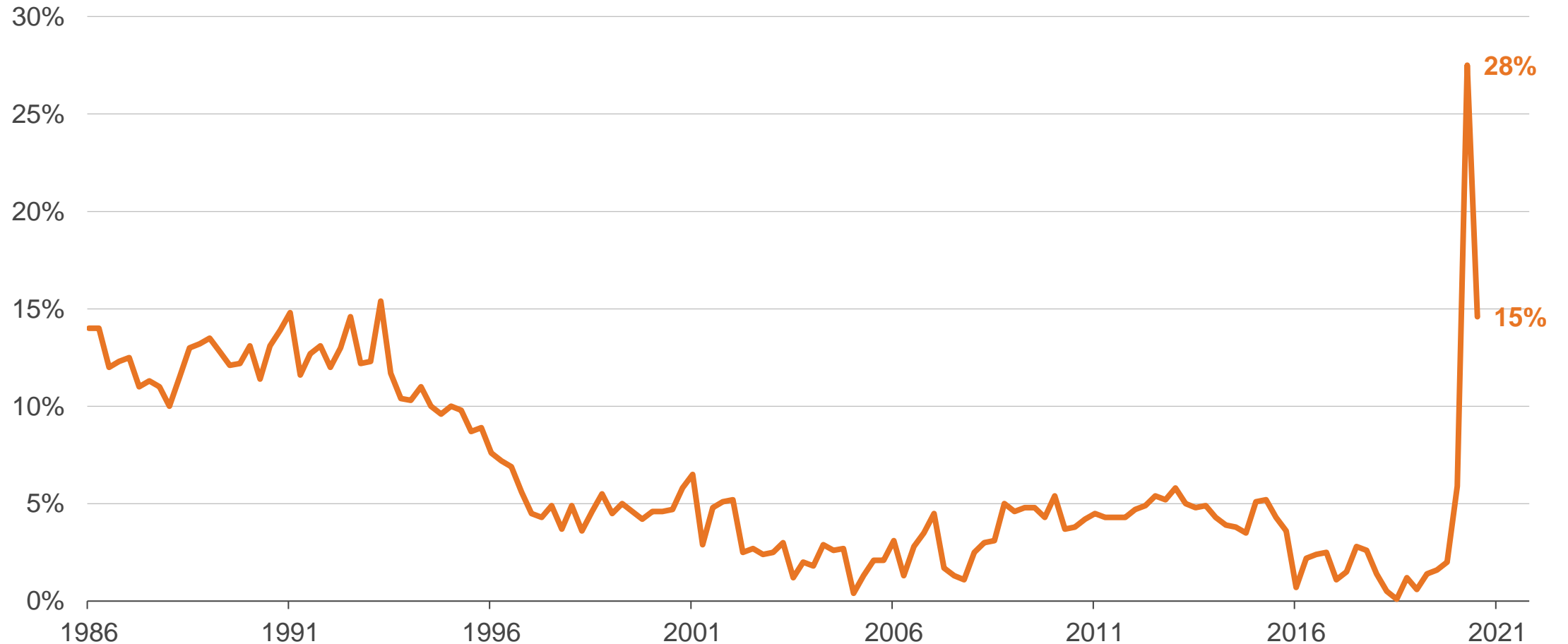
Source: Bloomberg September 2020





# Canadian savings rate

Canadian household savings rate (quarterly, % of disposable income, SAAR)



Source: Bloomberg September 2020



# Canadian corporate debt

## S&P/TSX debt to equity ratio

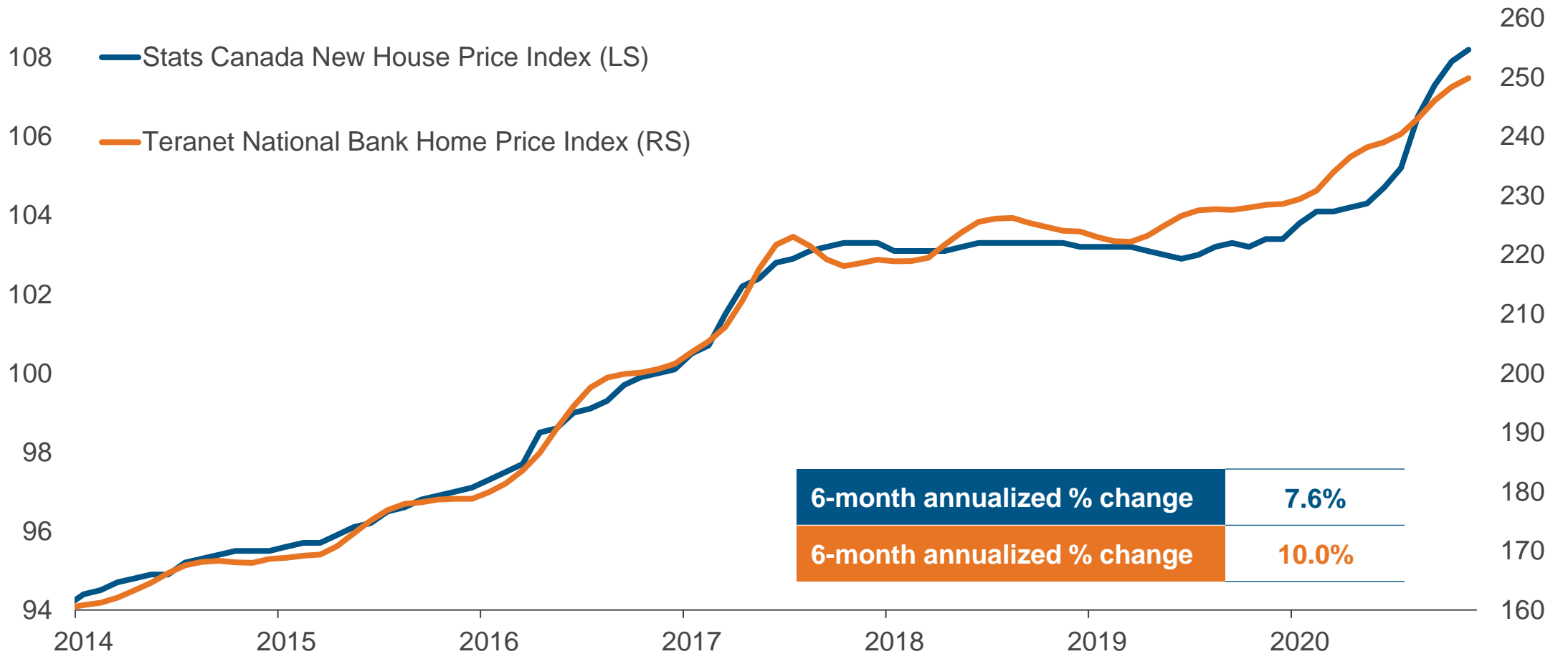


Source: Bloomberg January 2021



# Canadian housing market

## Canadian housing prices

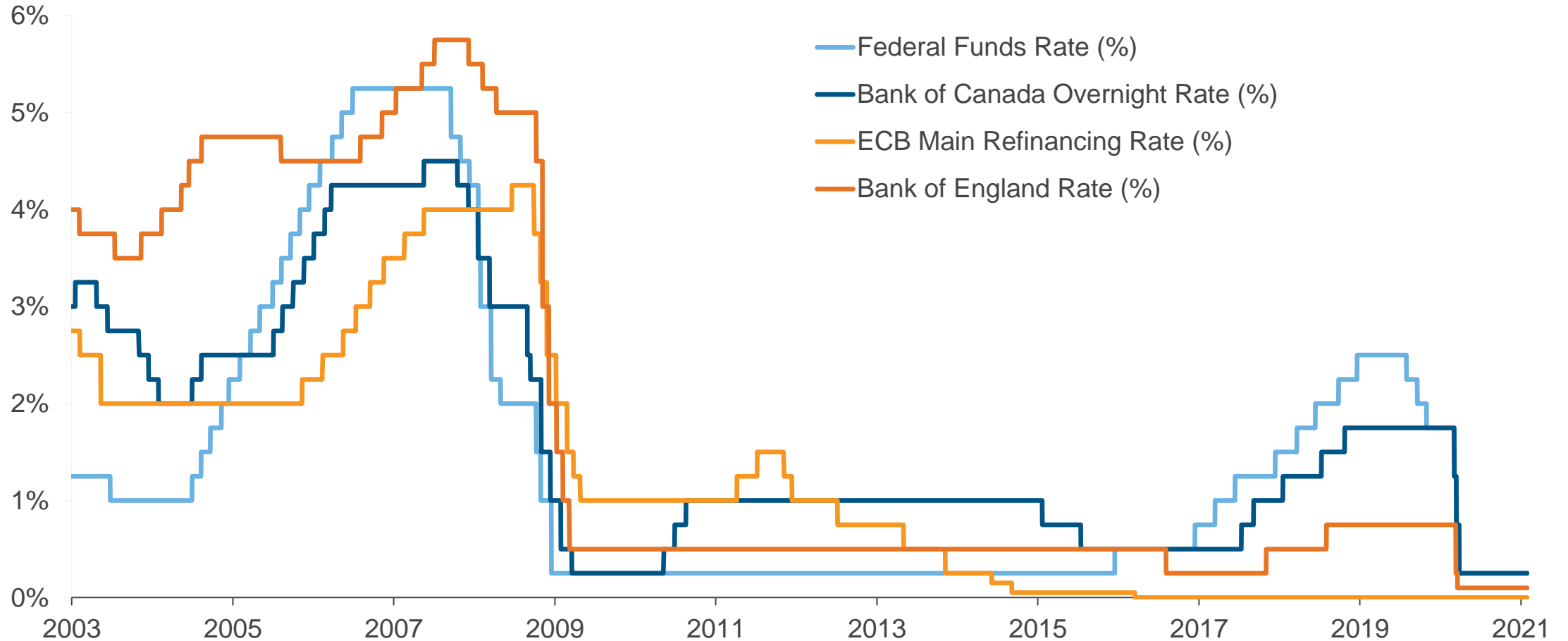


Source: Bloomberg; Teranet December 2020, StatsCan December 2020



# Central bank stance

## Global central bank overnight rates

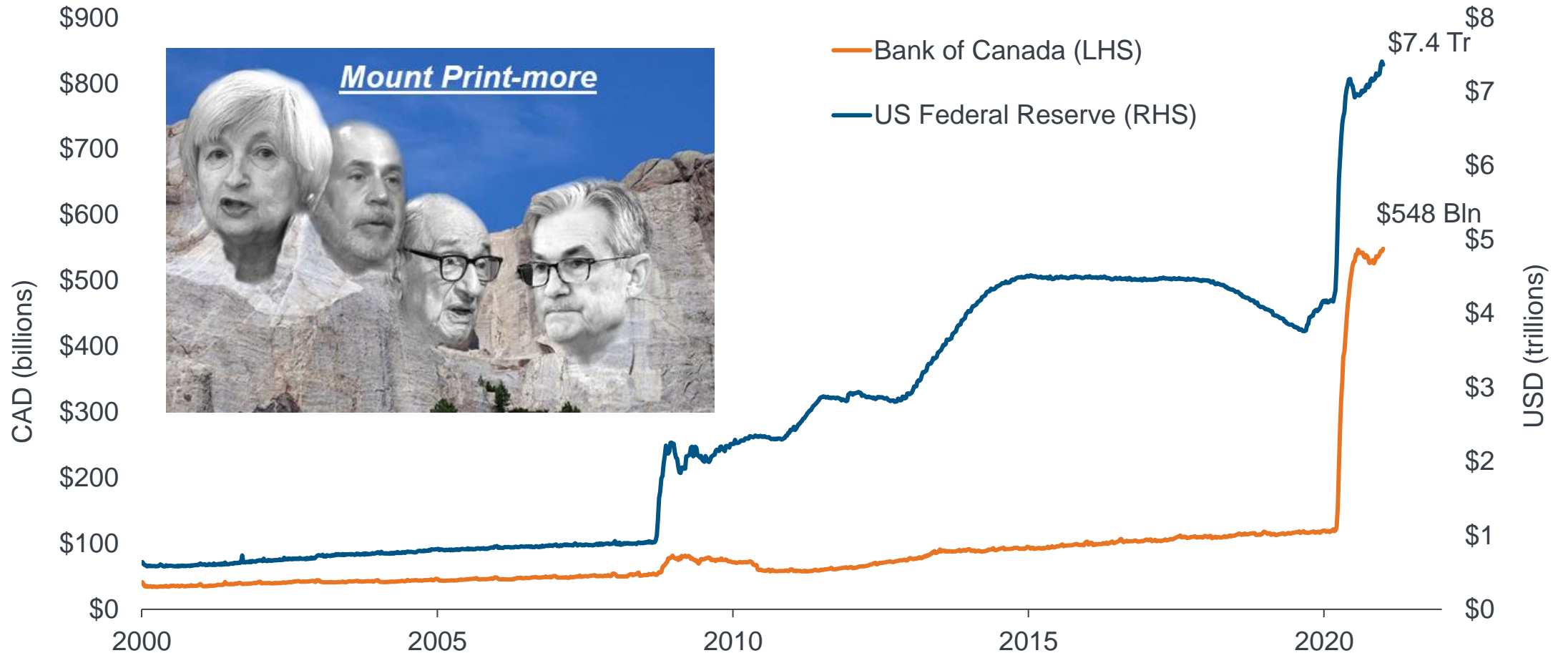


Source: Bloomberg January 29, 2021



# Curves markets won't want to see flatten

## Total assets: Bank of Canada and US Federal Reserve

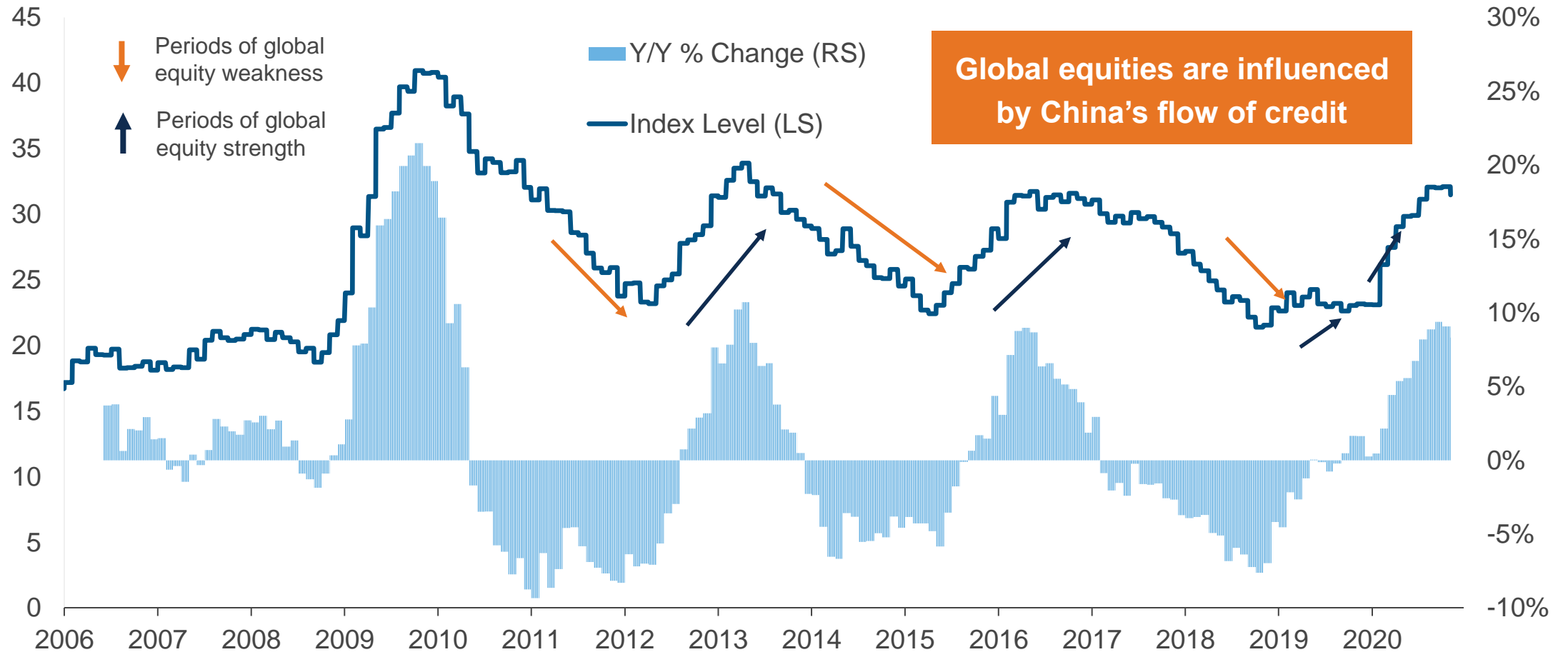


Source: Bloomberg December 30, 2020



# China's credit impulse

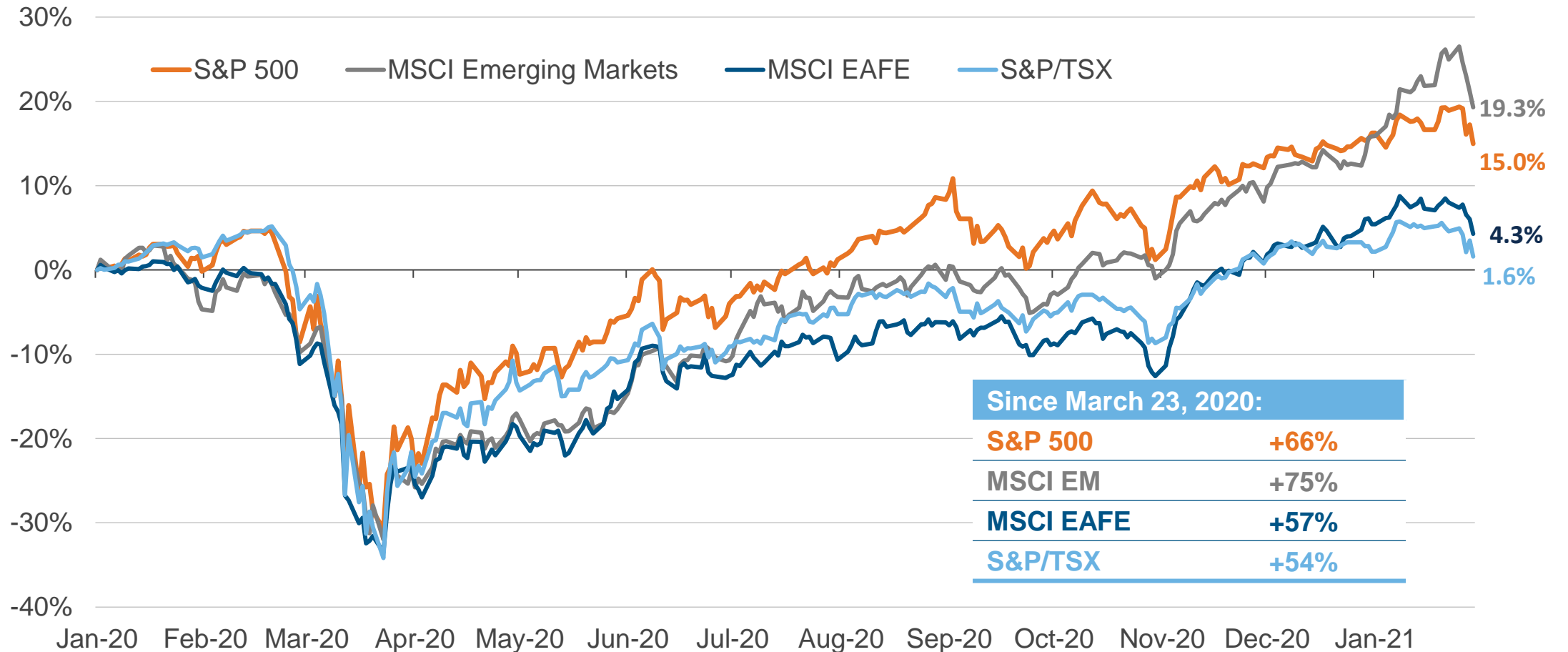
## Bloomberg Economics China Credit Impulse Index





# Too far, too fast

## 2020 annual return of major equity indices



Source: Bloomberg January 29, 2021 price only, local currency

# Agenda

Outlook  
**Equity forecast**  
Fixed income  
forecast  
Oil & currency  
forecast



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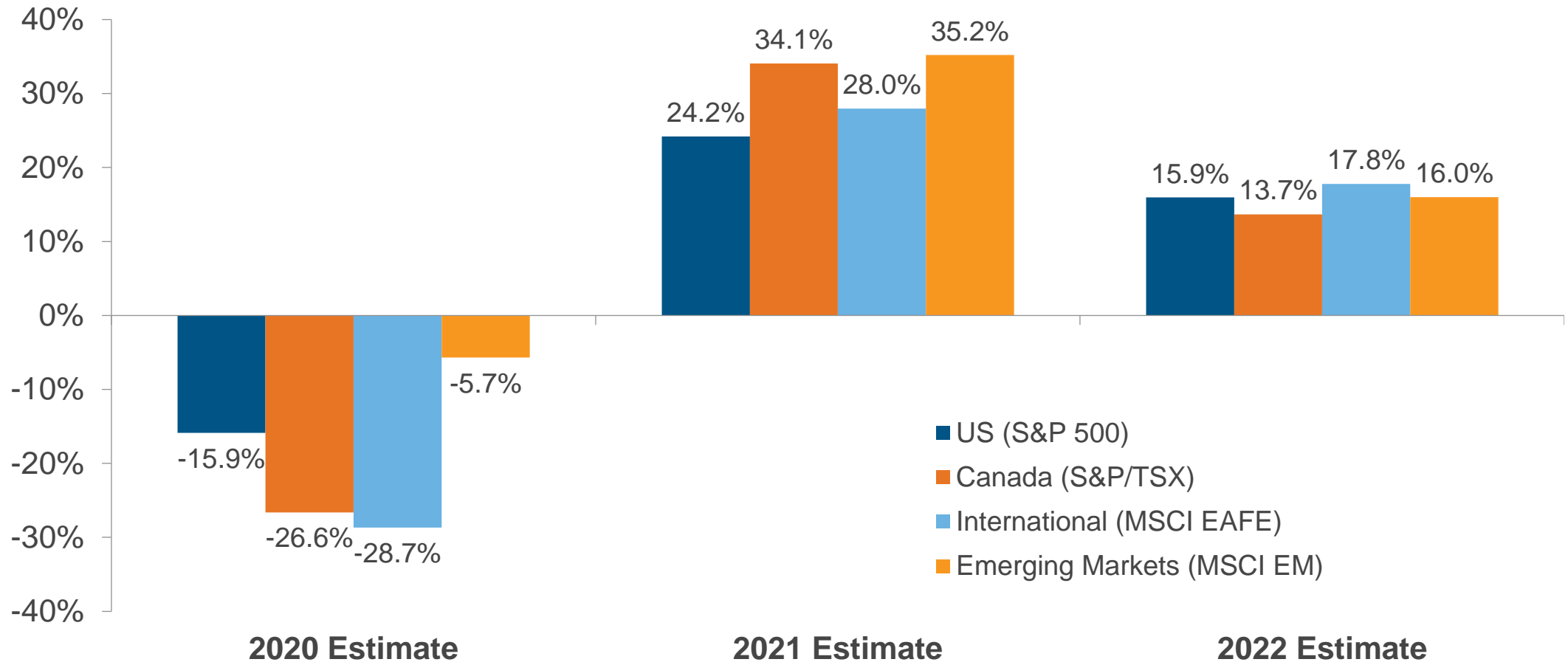






# Global earnings growth expectations

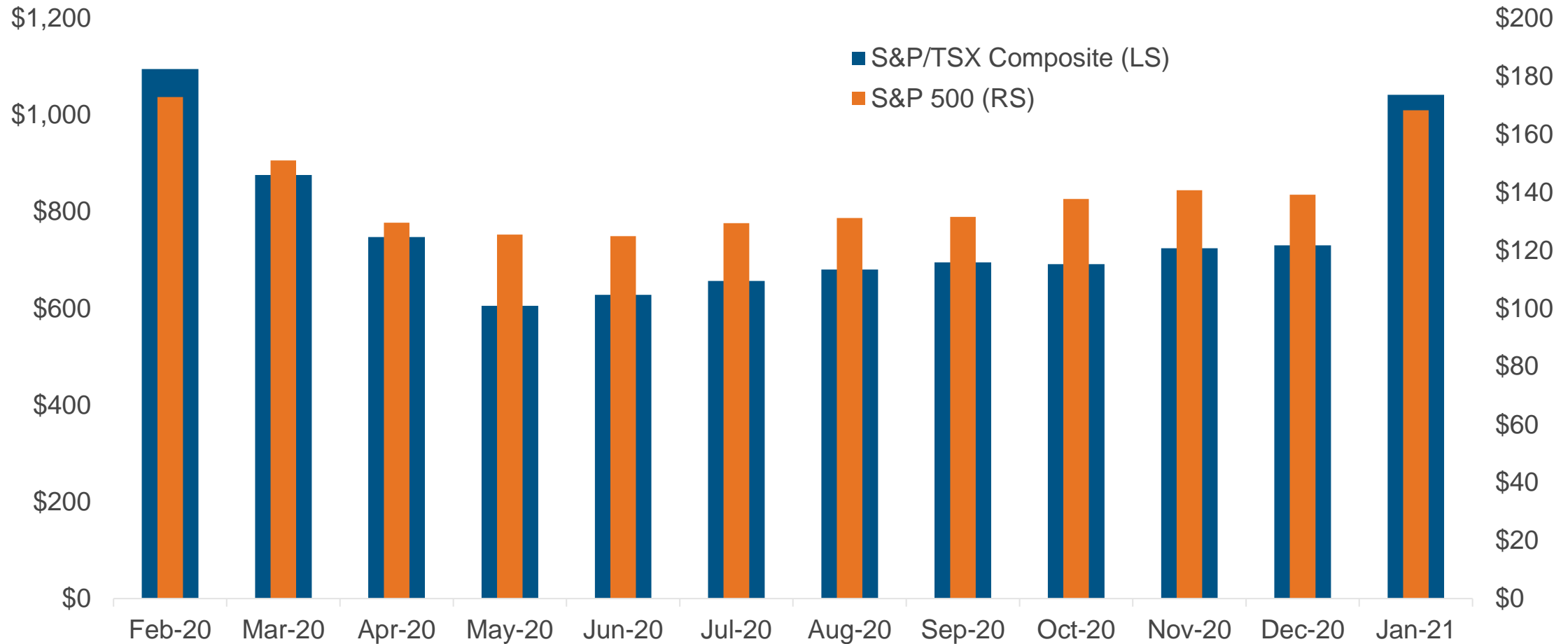
Earnings growth Y/Y % change (consensus forecasts)





# Canadian and US Earnings Estimates

## S&P/TSX Composite vs. S&P 500 Earnings Estimates

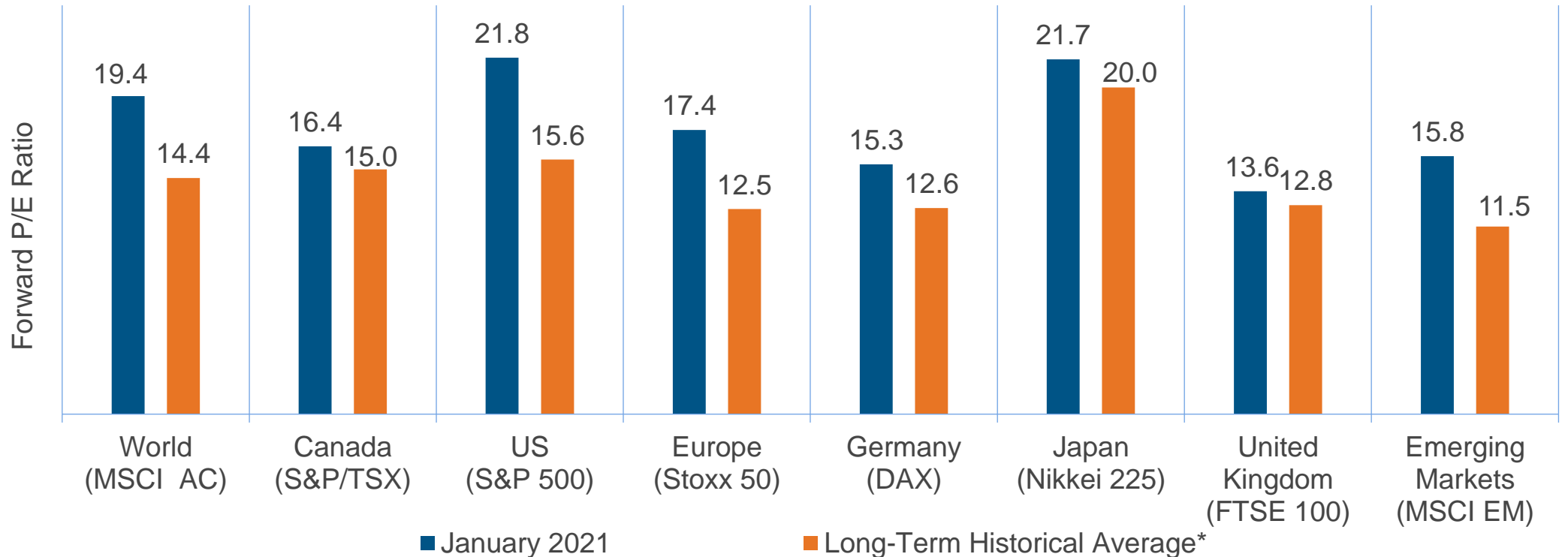


Source: Bloomberg, January 29, 2021



# Global equity valuations

## Forward P/E ratios

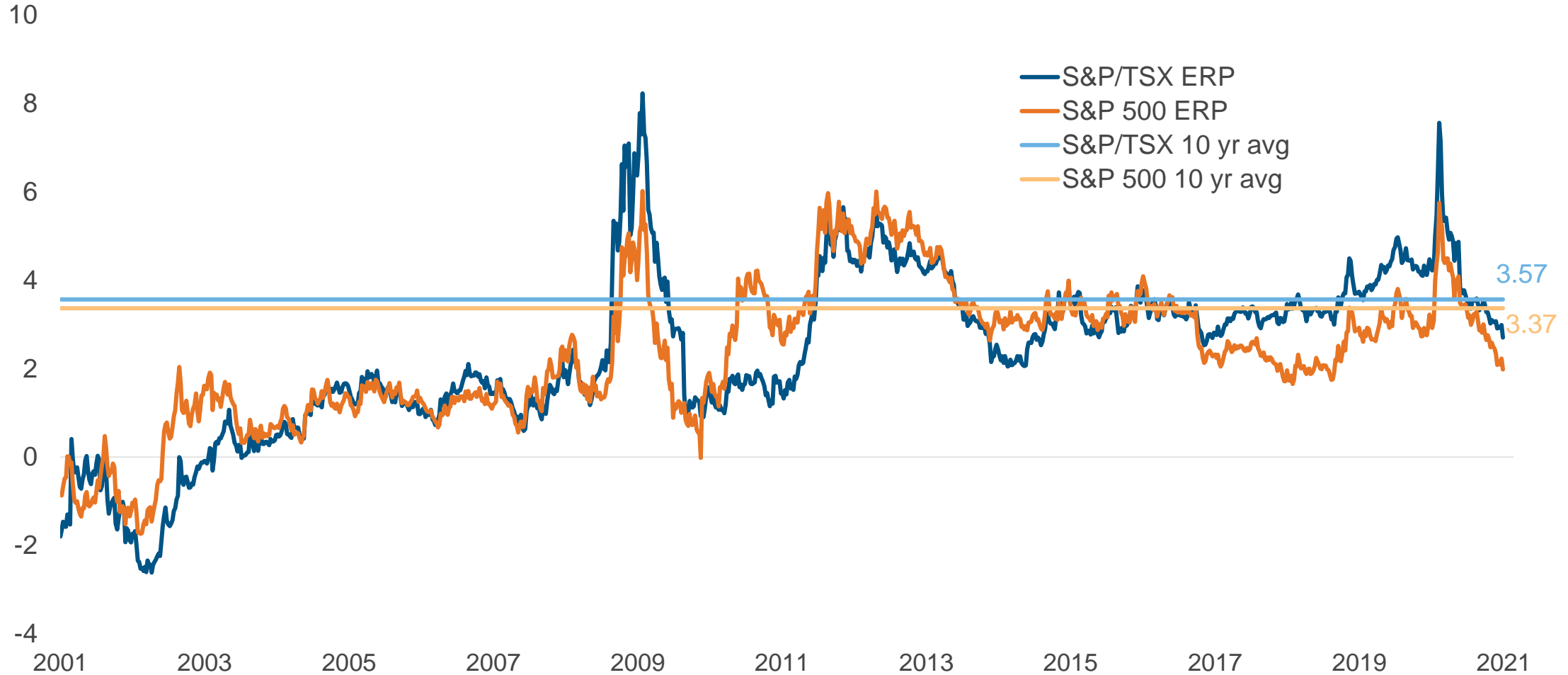


Source: Bloomberg, January 29, 2021 \*Historical Averages: S&P 500, S&P/TSX, Nikkei 225, MSCI AC 15 years; EuroStoxx 50, DAX, FTSE 100 & MSCI EM since 2005



# North American equity risk premiums

S&P 500 & S&P/TSX earnings yield less 10-year gov't bond yield



Source: Bloomberg January 29, 2021



# Valuation scenarios

## S&P 500

Implied TTM Multiple at Year End	10-YR bond yields	Earnings Yield*
25.6	0.90	3.90%
24.1	1.15	4.15%
22.7	1.40	4.40%
<b>21.5</b>	<b>1.65</b>	<b>4.65%</b>
20.4	1.90	4.90%

\*based on ERP of 3%

## S&P/TSX

Implied TTM Multiple at Year End	10-YR bond yields	Earnings Yield*
22.5	0.95	4.45%
21.5	1.15	4.65%
<b>20.2</b>	<b>1.45</b>	<b>4.95%</b>
19.4	1.65	5.15%
18.7	1.85	5.35%

\*based on ERP of 3.5%



# Return scenarios S&P/TSX

		Trailing Price to Earnings Multiple at end 2021							
		18.7		19.4		20.2		21.5	
2021 EPS		Level				% change from current level of 18,458			
	\$900	16,830	-9%	17,460	-5%	18,180	-2%	19,350	5%
<b>base case</b>	<b>\$975</b>	18,233	-1%	18,915	2%	19,695	7%	20,963	14%
<b>consensus</b>	<b>\$1,031</b>	19,280	4%	20,001	8%	20,826	13%	22,167	20%
	\$1,050	19,635	6%	20,370	10%	21,210	15%	22,575	22%

Current forward P/E multiple = 16.4x  
 Current trailing 12-month P/E multiple = 27.4x

Estimated 2020 dividend yield = 2.9%



# Return scenarios S&P 500

		Trailing Price to Earnings Multiple at end 2021							
		20.4		21.5		22.7		24.1	
2021 EPS		Level				% change from current level of 3,910			
	\$160	3,264	-17%	3,440	-12%	3,632	-7%	3,856	-1%
	\$165	3,358	-14%	3,539	-9%	3,737	-4%	3,967	1%
<b>base case &amp; consensus</b>	<b>\$169</b>	3,448	-12%	<b>3,634</b>	<b>-7%</b>	3,836	-2%	4,073	4%
	\$175	3,570	-9%	3,763	-4%	3,973	2%	4,218	8%

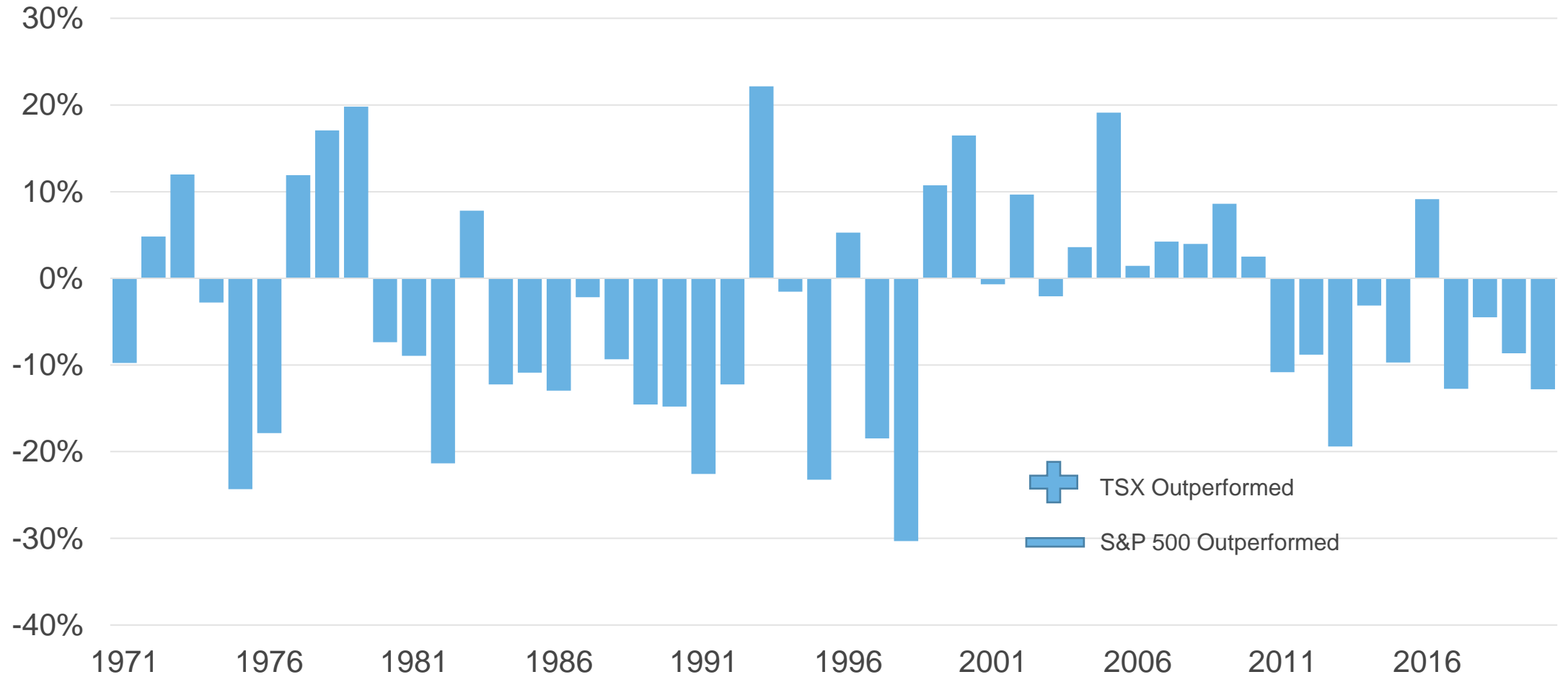
Current forward P/E multiple = 21.8x  
 Current trailing 12-month P/E multiple = 32x

Estimated 2020 dividend yield = 1.5%



# Canadian and US equity performance

## Total Calendar Return Difference: S&P/TSX Composite vs S&P 500



Source: Bloomberg January 29, 2021





# S&P 500 growth vs. value

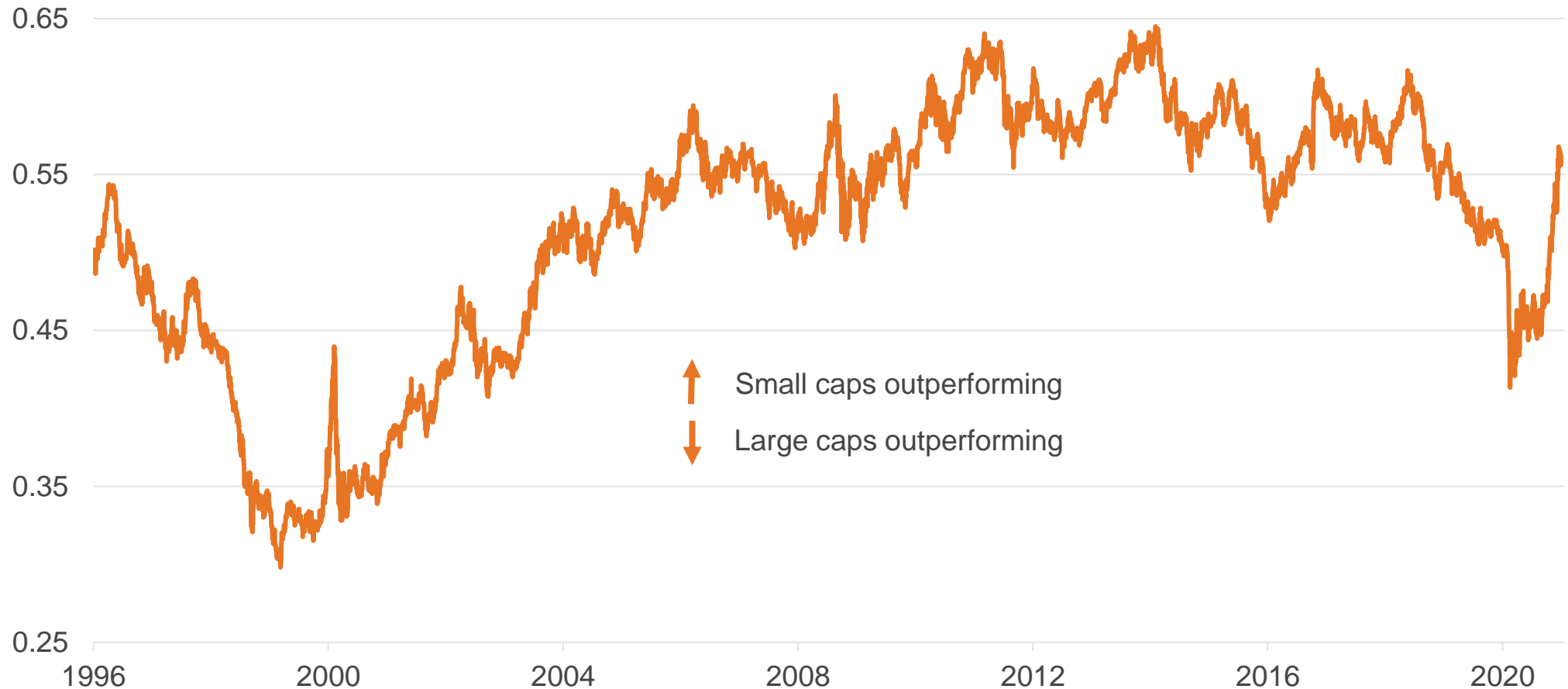
## S&P 500 Value Index / S&P 500 Growth Index





# US small cap vs. large cap

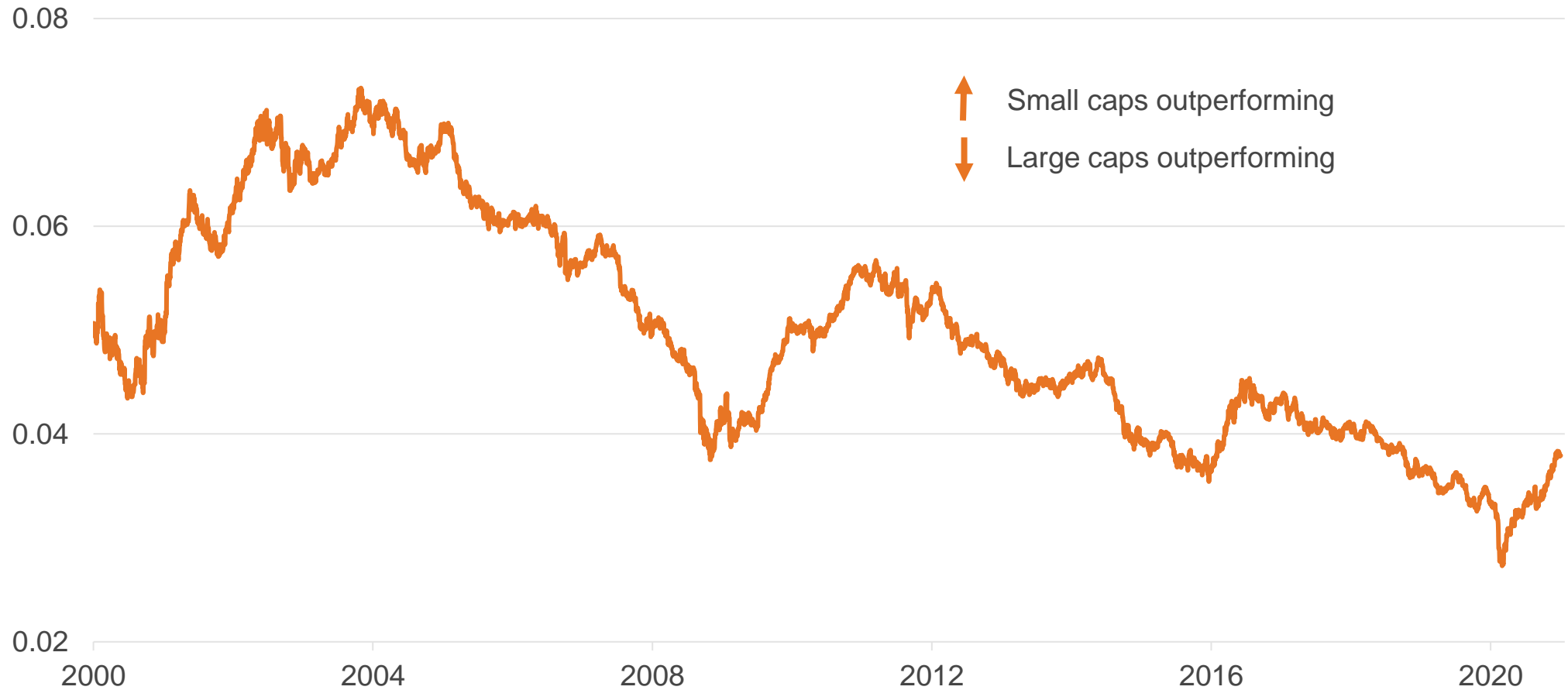
## Russell 2000 Index / S&P 500 Index





# Canadian small cap vs. large cap

## S&P/TSX Small Cap Index / S&P/TSX Composite



## Agenda

Equity forecast

**Fixed income  
forecast**

Oil & currency  
forecast

Asset mix  
recommendations



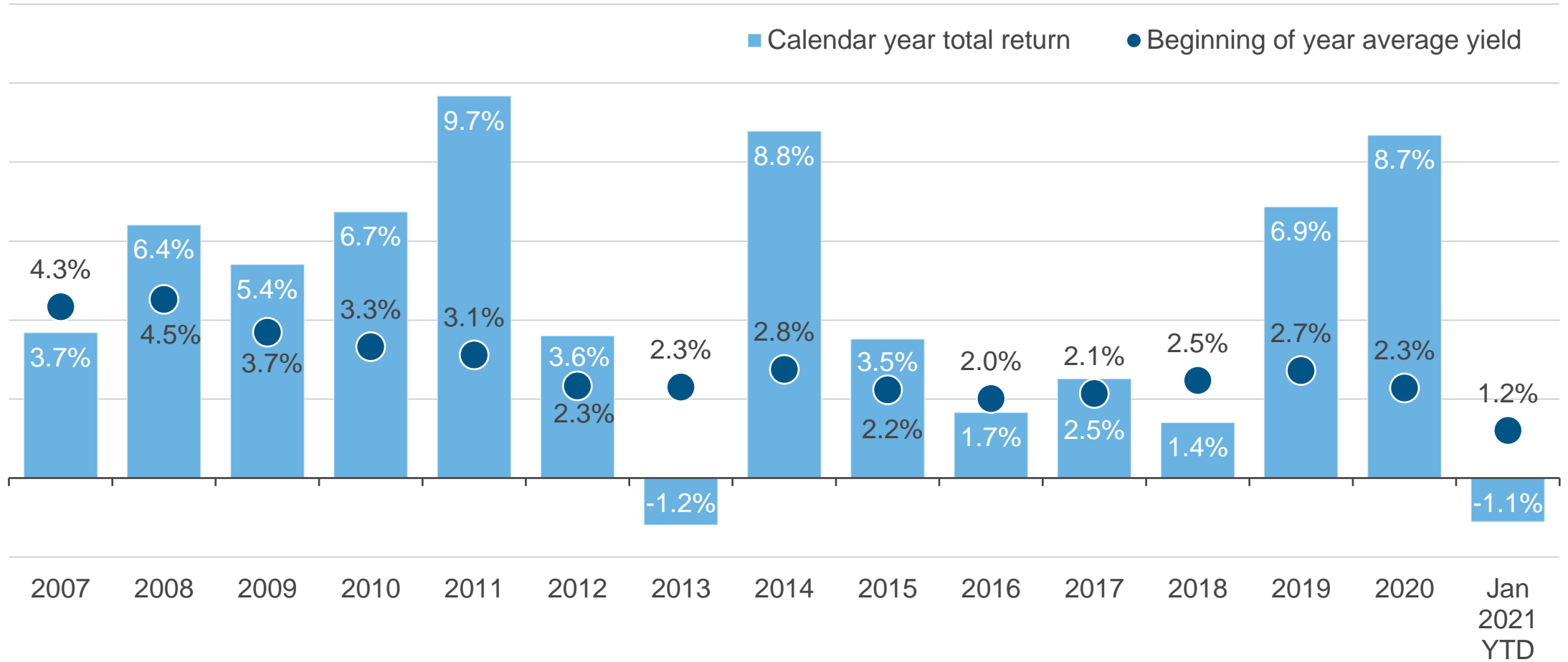
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# Canadian fixed income

## FTSE Canada Universe Bond Index – annual returns

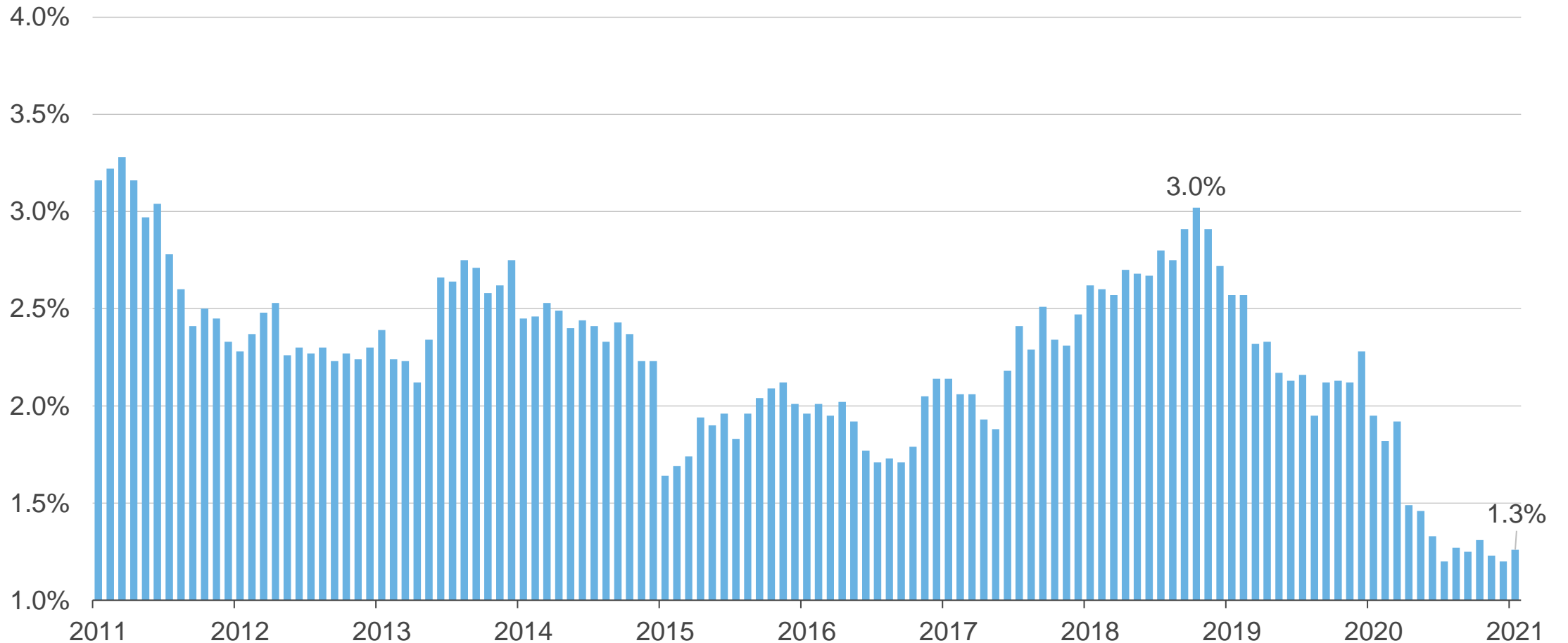


Source: Bloomberg, FTSE Canada January 29, 2021



# The 'income' in fixed income

## FTSE Canada Universe Bond Index – annualized yield (beginning of month)

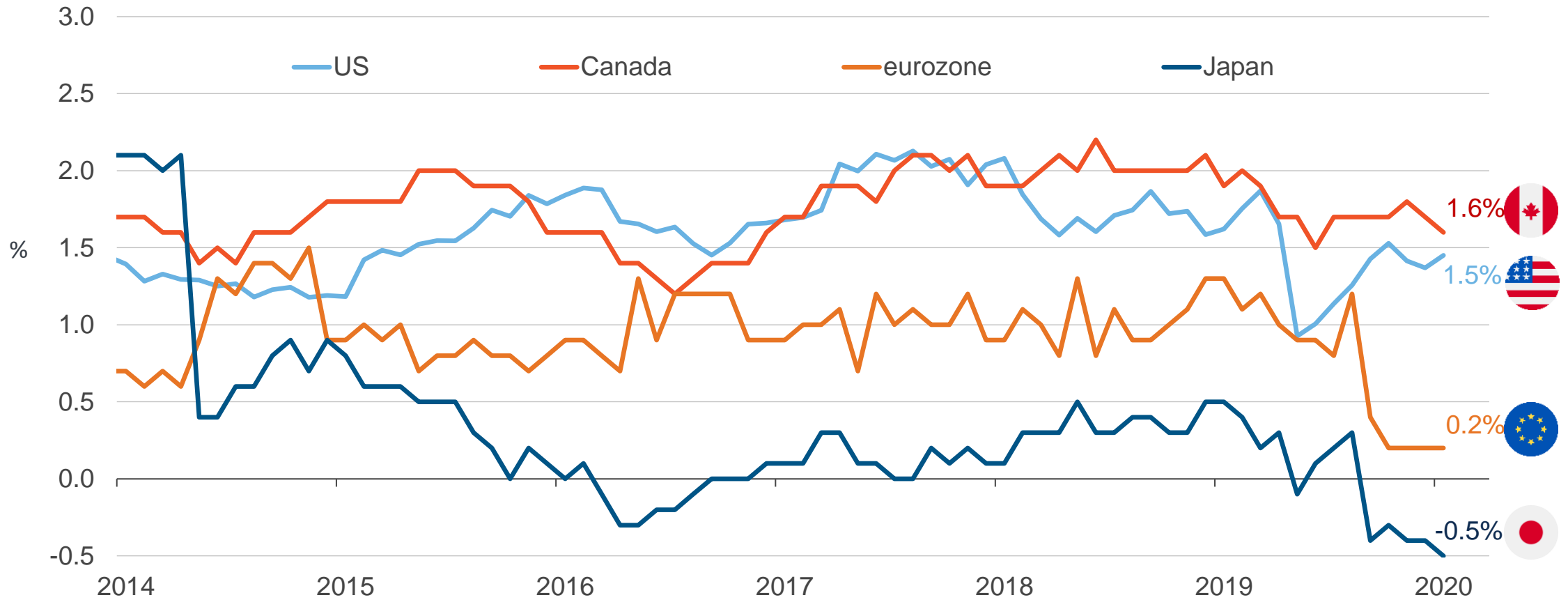


Source: Bloomberg, FTSE Canada January 29, 2021



# Global inflation

## Core inflation rates (YoY %)

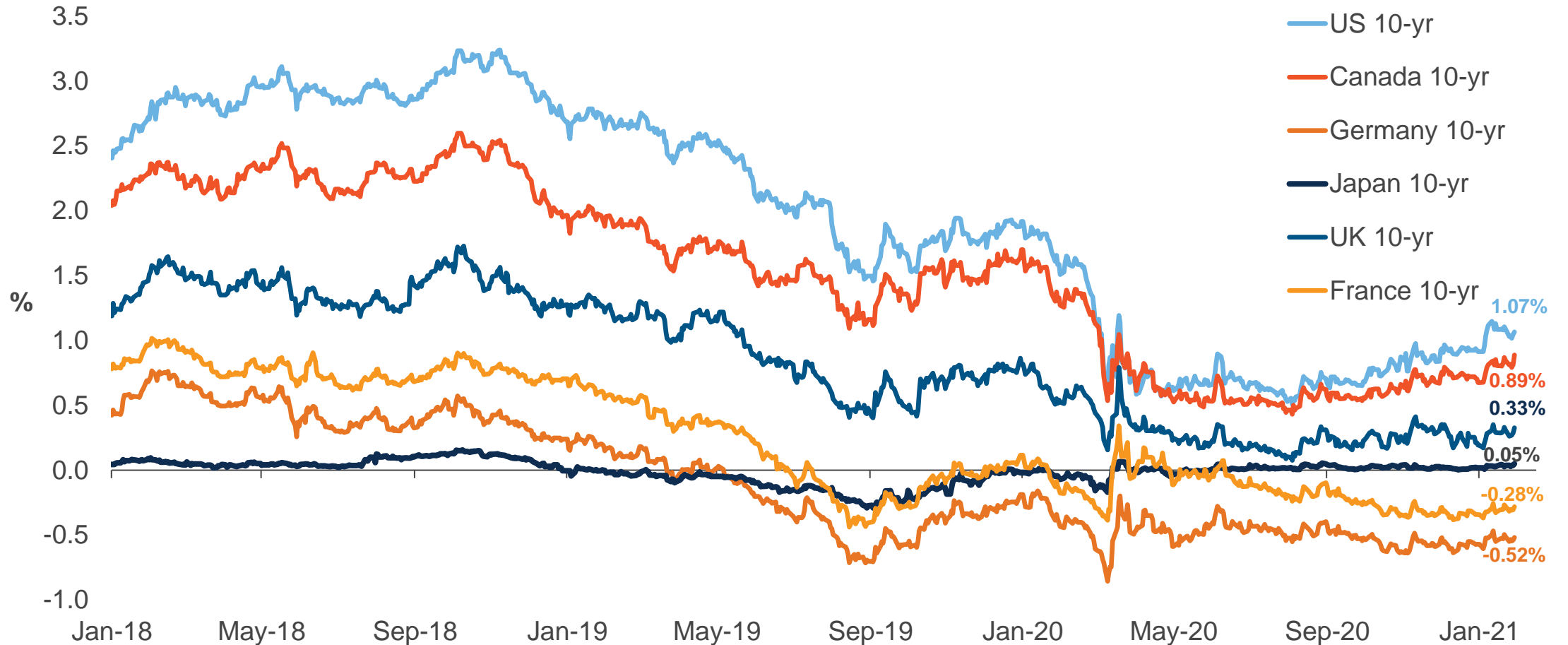


Source: Bloomberg December 2020



# Global bond yields

## 10-year bond yields



Source: Bloomberg January 29, 2021

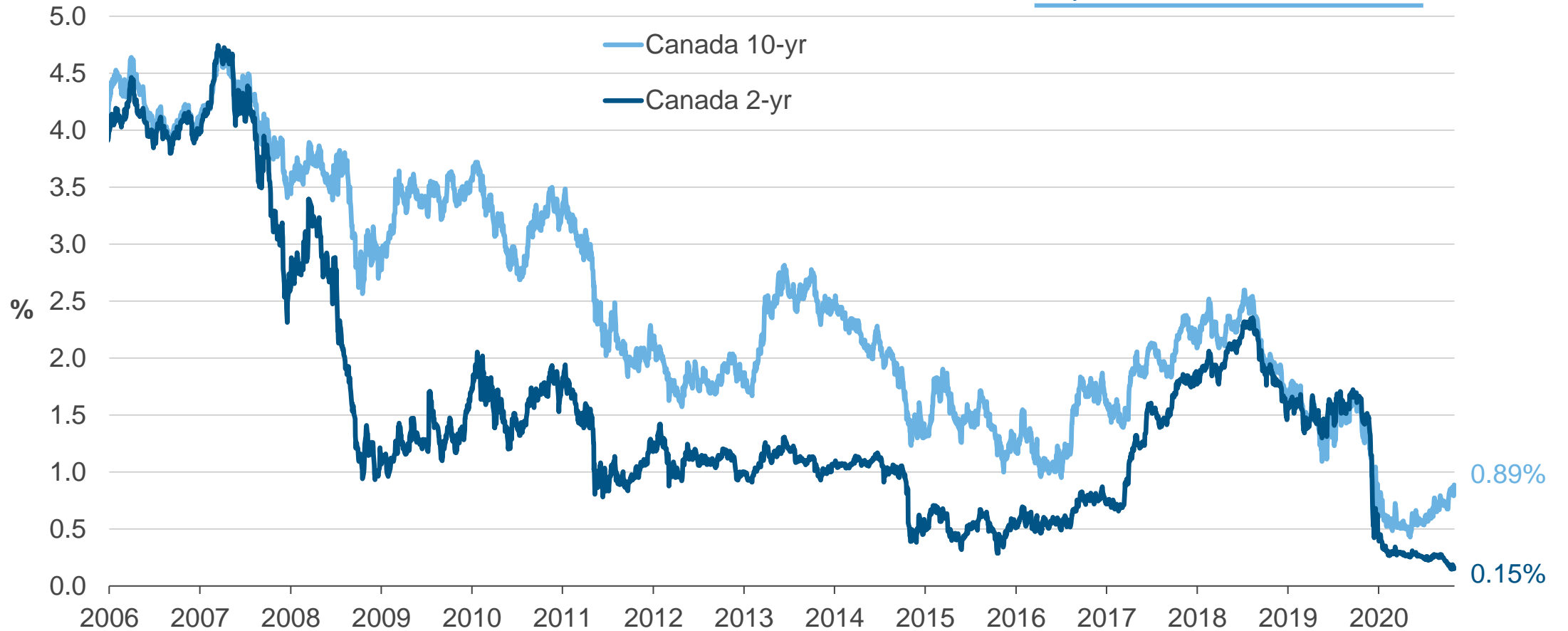




# Canadian yields

## Government of Canada bond yields

2021 year-end targets:	
10-year	1.45%
2-year	0.35%

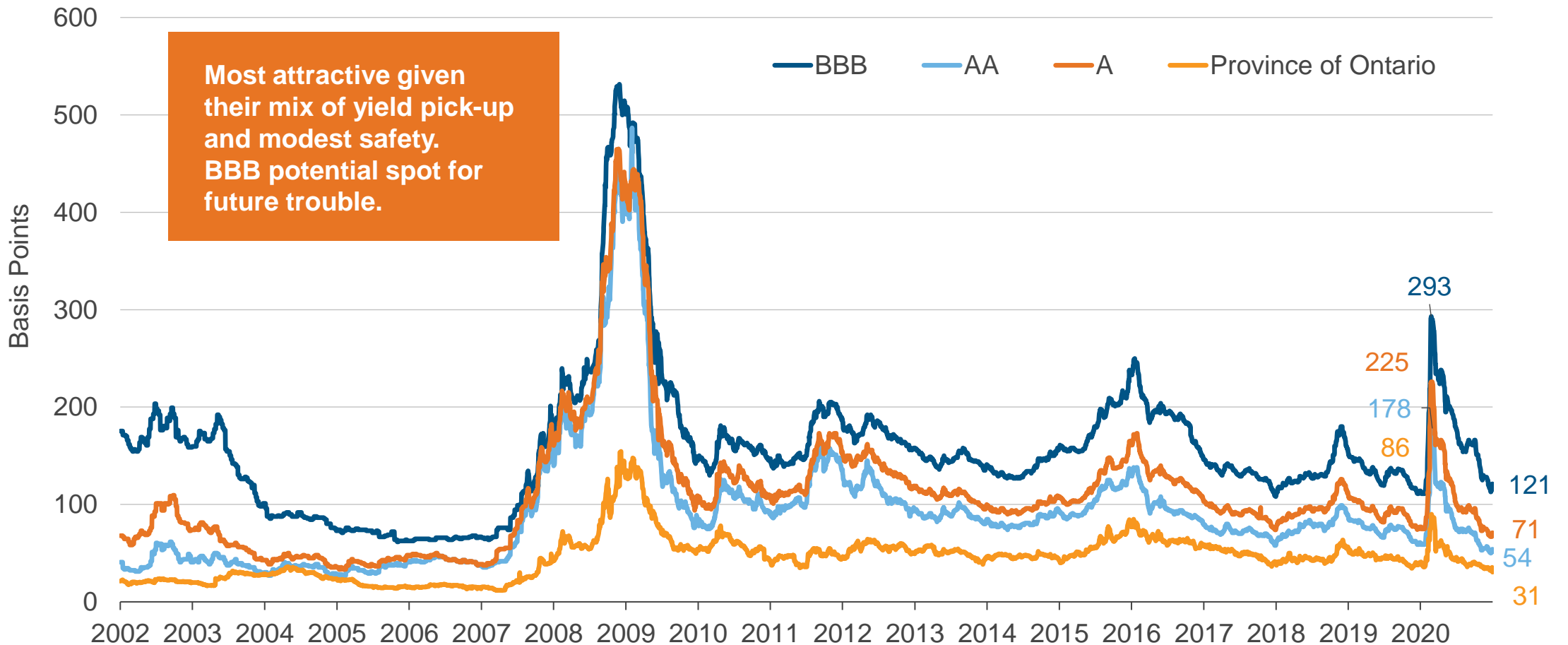


Source: Bloomberg January 29, 2021



# Canadian investment grade credit market

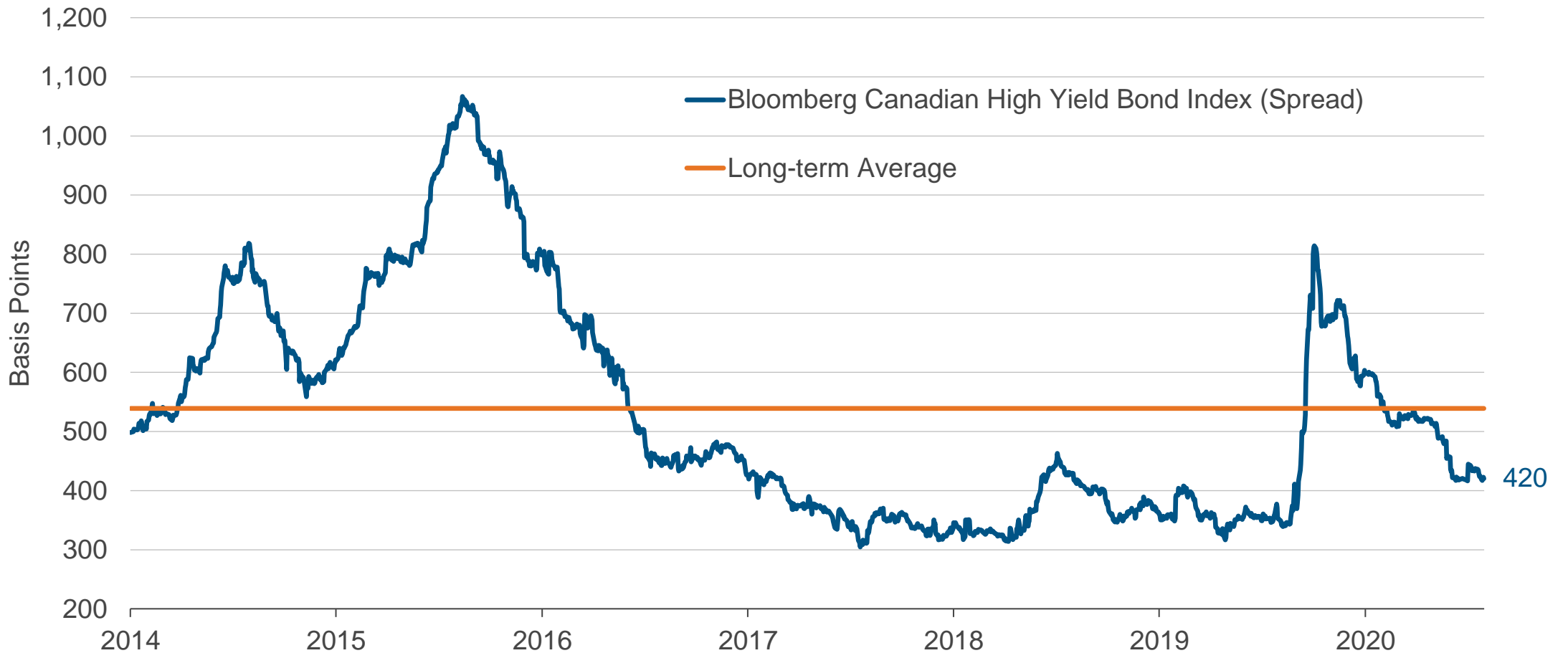
## Canadian investment grade yield spreads





# Canadian high yield credit market

## Canadian high yield bond credit spreads



Source: Bloomberg January 29, 2021



# US high yield credit market

## US high yield bond credit spreads



Source: Bloomberg January 29, 2021

## Agenda

Fixed income  
forecast  
**Oil & currency  
forecast**  
Asset mix  
recommendations



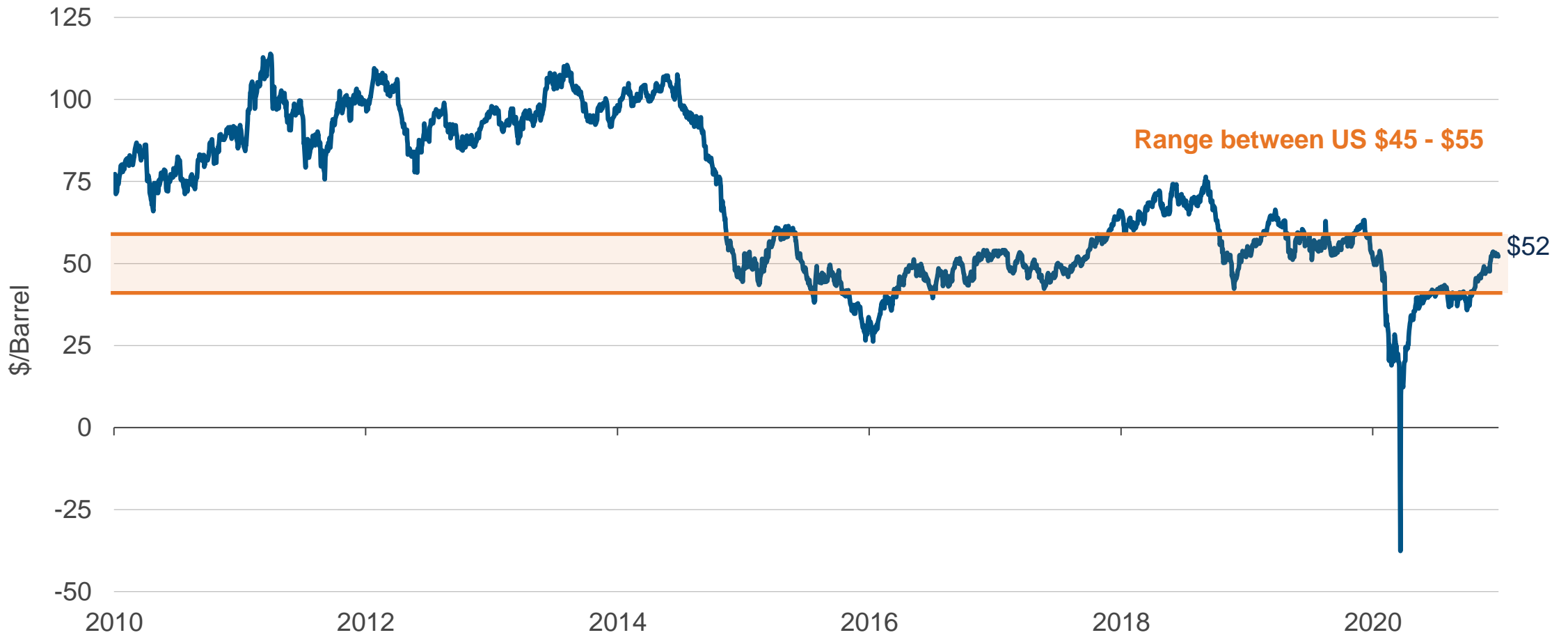
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# WTI Oil

## WTI crude oil spot (US\$/bbl)

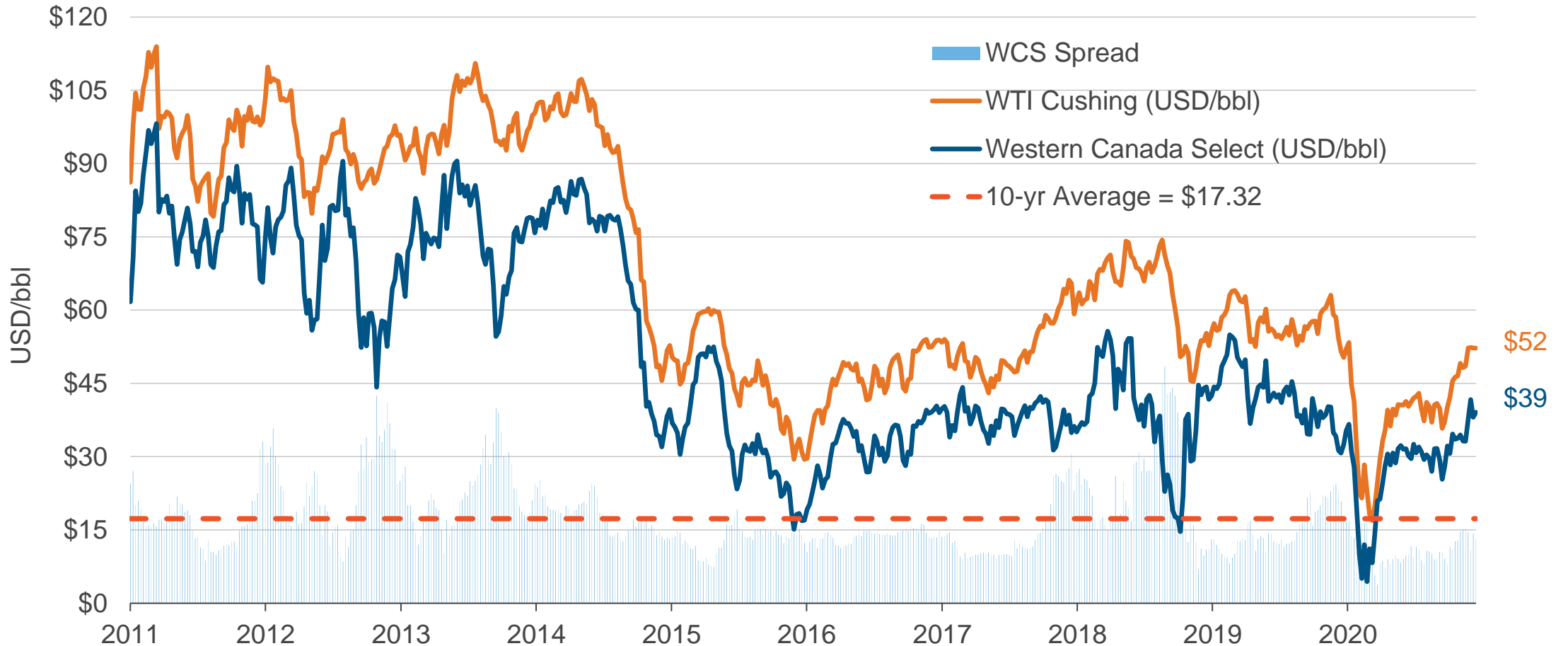


Source: Bloomberg January 29, 2021



# Canadian heavy oil pricing

## WTI vs Western Canada Select crude oil (US\$/bbl)

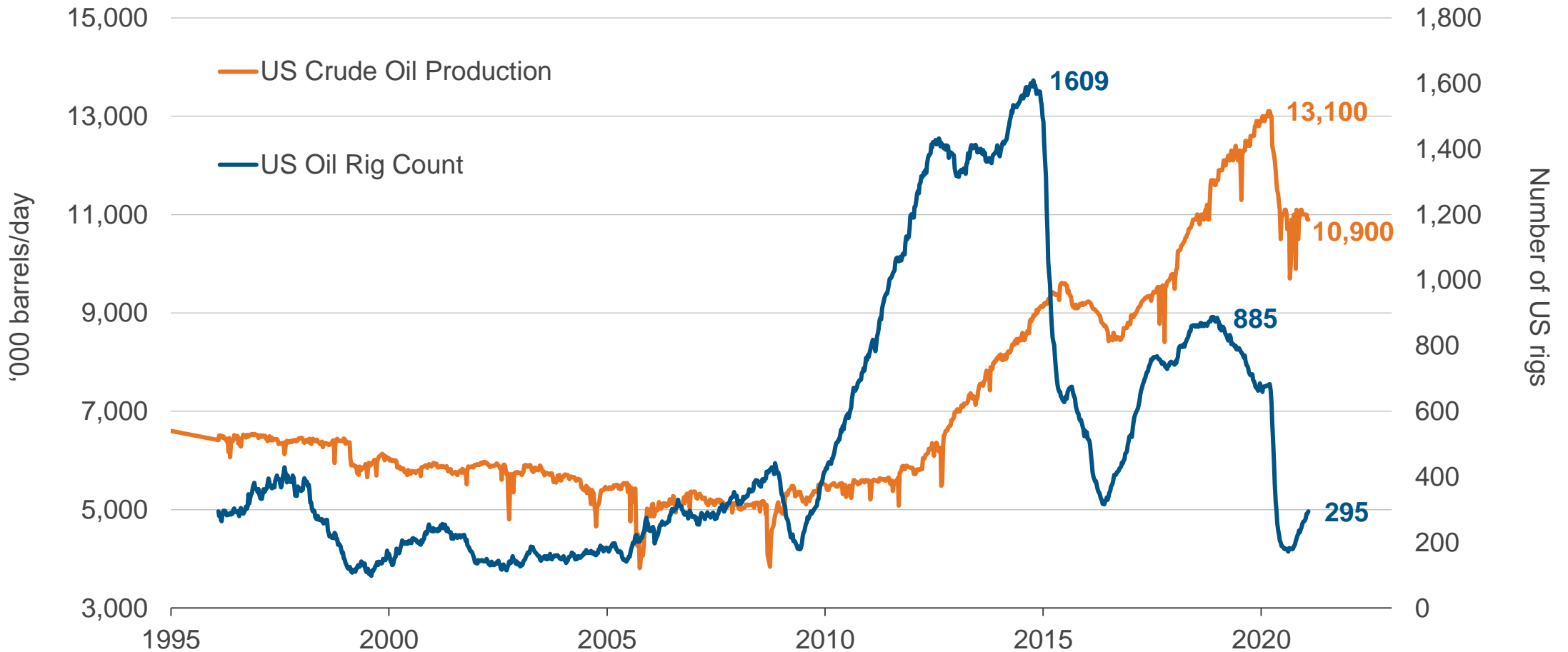


Source: Bloomberg January 29, 2021



# US oil supply

## US crude production vs rig count



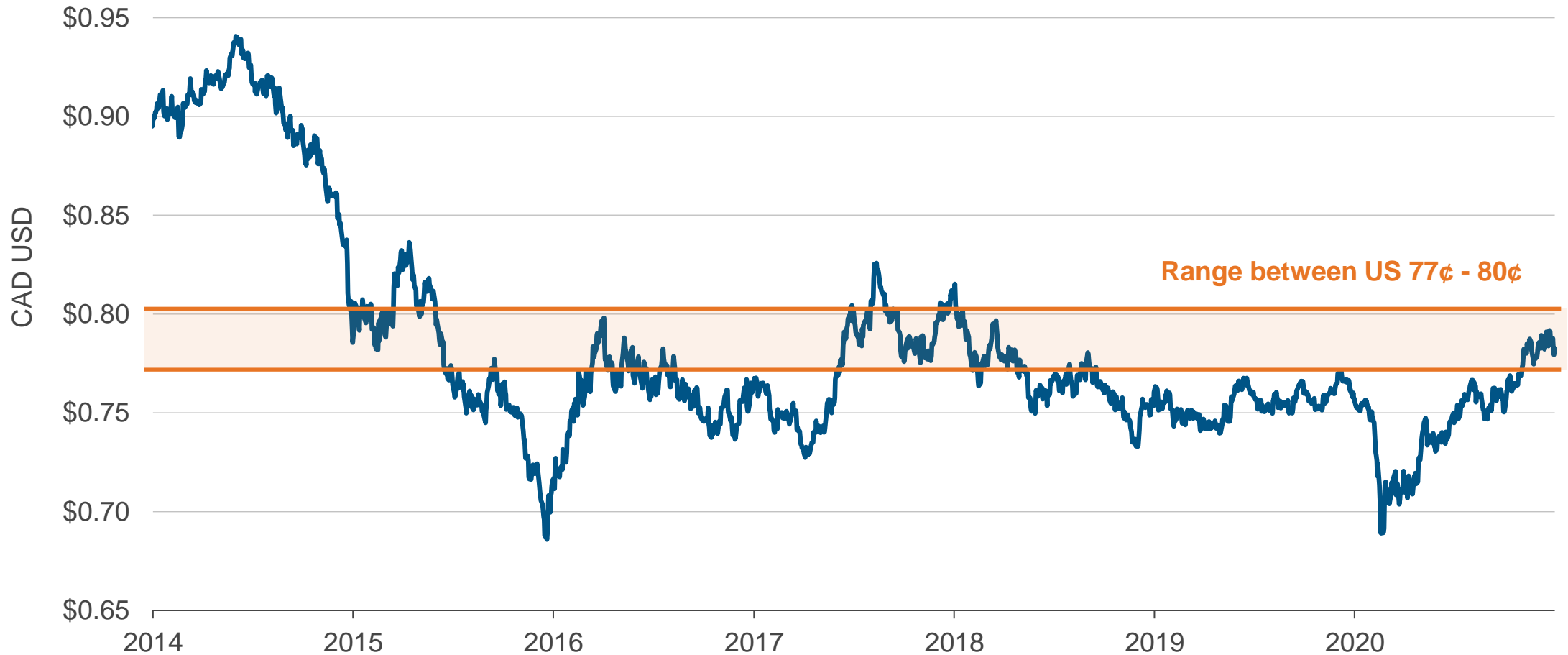
Source: Bloomberg January 29, 2021





# Canadian dollar

## CADUSD

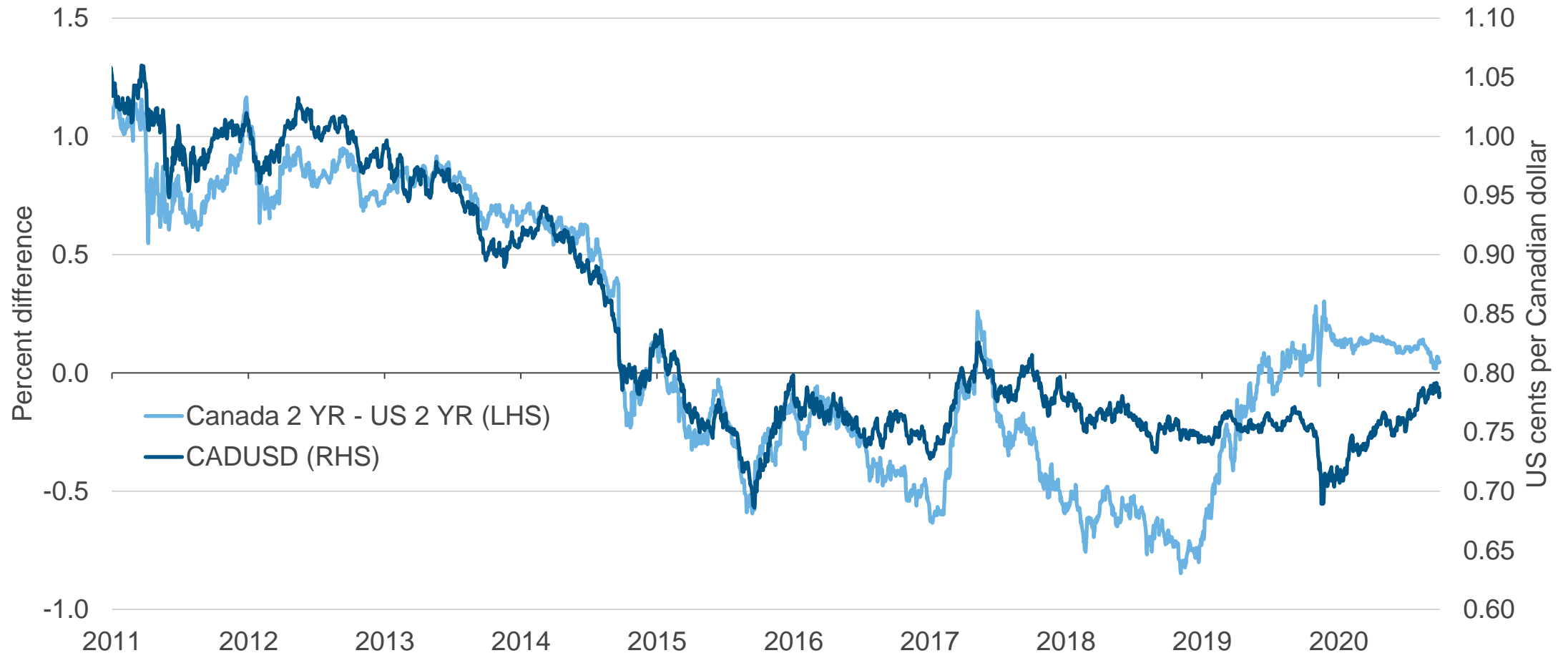


Source: Bloomberg January 29, 2021



# Loonie & yield spreads

## Canadian – US 2-yr yield spread vs Canadian dollar

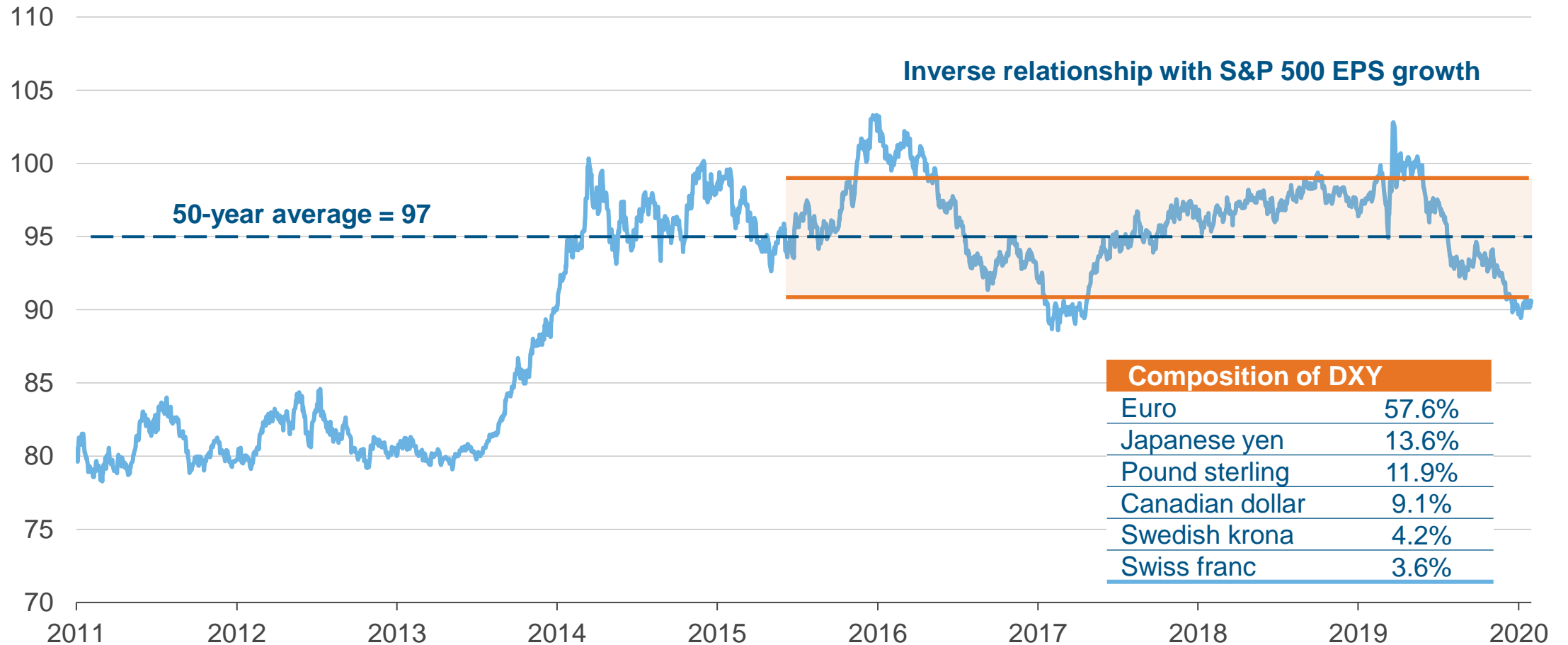


Source: Bloomberg January 29, 2021



# US dollar

## US Dollar Index (DXY)

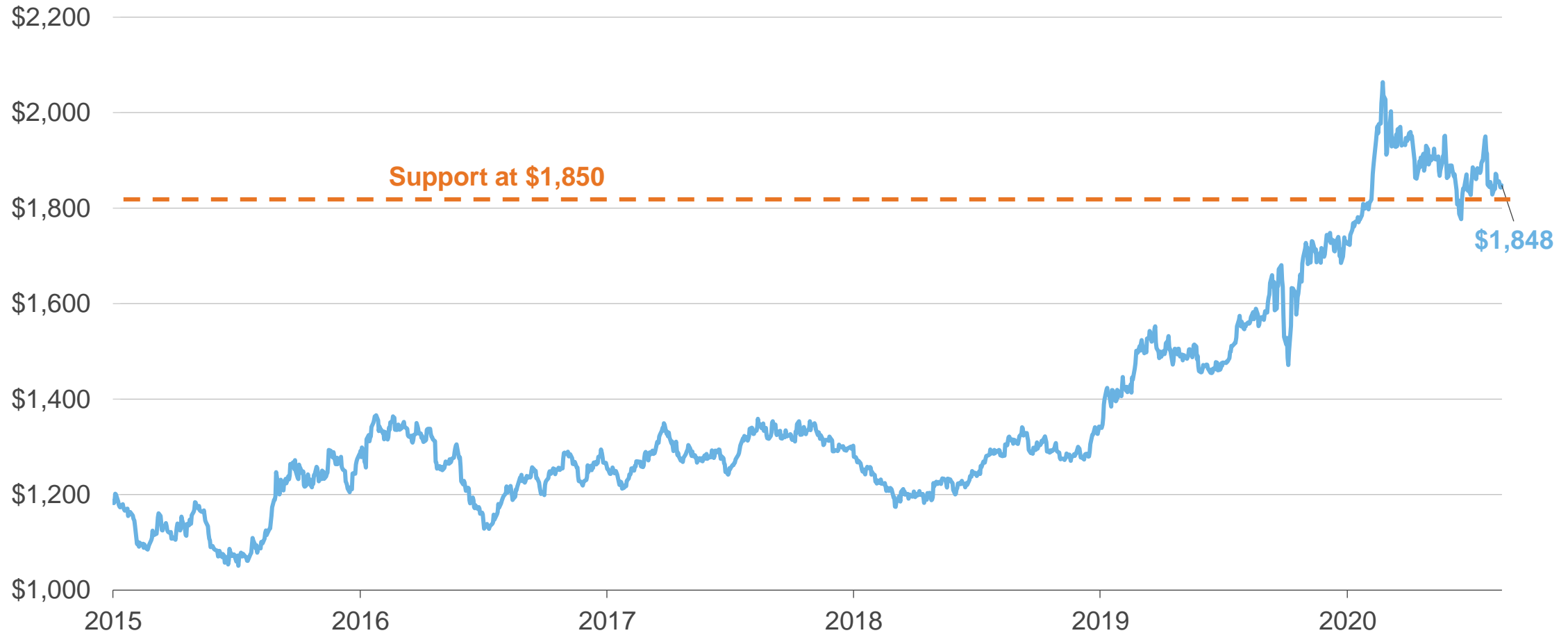


Source: Bloomberg January 29, 2021



# Gold

## Gold spot price (US\$/oz)



Source: Bloomberg January 29, 2021

## Agenda

Oil & currency  
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**Asset mix  
recommendations**

Appendix



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# Investment Strategy Team asset mix recommendations

## Fixed income

	Change in view <sup>1</sup>	Under			Neutral			Over		
Fixed Income	▼	○	○	○	○	●	○	○	○	○
Government bonds	▼	○	○	●	○	○	○	○	○	○
Investment grade corporate bonds	▼	○	○	○	○	○	○	○	●	○
High-yield corporate bonds	▲	○	○	○	●	○	○	○	○	○

● As at February 10, 2021

○ <sup>1</sup>From November 2020



# Investment Strategy Team asset mix recommendations

## Equity

	Change in view <sup>1</sup>	Under			Neutral			Over		
Equity	▲	○	○	○	○	●	○	○	○	○
Canada	▲	○	○	○	○	○	○	○	●	○
U.S.	▼	○	○	●	○	○	○	○	○	○
International	▼	○	○	●	○	○	○	○	○	○
Emerging Markets	▲	○	○	○	○	○	○	○	●	○

● As at February 10, 2021

○ <sup>1</sup>From November 2020



# Investment Strategy Team asset mix recommendations

## Fixed income

	Change in view <sup>1</sup>	Under	Neutral	Over
<b>Fixed Income</b>	▼	○ ○ ○	○ ● ○	○ ○ ○
Bond yields are trending higher but remain historically low. Credit spreads have narrowed substantially, now trading through longer-term averages. Central bank responses (yield curve control), muted inflation and risk aversion will keep bond yields low, however a near-term rise in yields will cause some pain. We recommend a neutral weight to fixed income, with an emphasis on credit over sovereign bonds.				
<b>Government bonds including cash</b>	▼	○ ○ ●	○ ○ ○	○ ○ ○
While a general headwind exists, with bouts of risk-off volatility expected, government bonds are attractive for their superior risk-mitigation qualities. We see 10-year sovereign yields rising toward 1.45% by year end.				
<b>Investment grade corporate bonds</b>	▼	○ ○ ○	○ ○ ○	○ ● ○
We see investment-grade (I.G.) corporate bonds as attractive given their mix of yield pickup and modest safety. I.G. spreads widened materially and have retreated with the aid of expansive policy backstops. There is limited room for price appreciation through time on narrowing spreads, meanwhile there is attractive relative running yield versus the risk.				
<b>High-yield corporate bonds</b>	▲	○ ○ ○	● ○ ○	○ ○ ○
High-yield spreads have narrowed meaningfully, fueled by ample liquidity and reach for yield. Additional running yield is attraction in an overall low yield environment. However, current spread levels leave high yield vulnerable to rising defaults and debt rollover at higher 'all-in' yields.				

● As at February 10, 2021

○ <sup>1</sup>From November 2020





# Investment Strategy Team asset mix recommendations

## Equity

	Change in view <sup>1</sup>	Under	Neutral	Over
<b>Equity</b>	▲	○ ○ ○	○ ● ○	○ ○ ○
The global economy continues to heal with the aid of substantial ongoing government support measures. A second wave is enveloping large parts of the world. Equity markets are priced for the most sanguine outcomes. We see the risk as asymmetric with potential downside outweighing further upside. Valuations are elevated. We recommend a neutral weight.				
<b>Canada</b>	▲	○ ○ ○	○ ○ ○	● ○ ○
Canadian equities trade at more favourable valuation multiples than their global peers. Their sector composition favouring financials, cyclicals and value has them poised to see an outsized rebound on improving sentiment and a value-rotation. The hefty 2.9% dividend yield is attractive.				
<b>U.S.</b>	▼	○ ○ ●	○ ○ ○	○ ○ ○
U.S. equities trade at a premium valuation relative to peers, leaving return prospects muted. The S&P 500's sector composition and top-heavy concentration that were tailwinds in 2020 turn to headwinds in 2021. The growth bias of US large-cap faces potential underperformance in a rotation to value trade. The 1.5% dividend yield is modest relative to other markets.				
<b>International</b>	▼	○ ○ ●	○ ○ ○	○ ○ ○
Europe and Japan face longer-term structural issues that impede growth. This low growth/low productivity/deflation scenario is kryptonite for stock markets. There are some trade and tourism stocks that will benefit from the 'reopening trade.' There is the prospect of a more friendly US trade environment under a Biden administration. Financials face a headwind as monetary policy choices continue to be oppressive. Valuations are elevated but cheaper than US equities. The 2.8% dividend yield is attractive.				
<b>Emerging Markets</b>	▲	○ ○ ○	○ ○ ○	● ○ ○
EM equity market sector composition and geographic market ties make it well-positioned for continued outperformance. Benefits include: the prospect of a better (at least no escalation) U.S-China relationship; the new Regional Comprehensive Economic Partnership agreement; abundant global liquidity; accommodative global financial conditions; and a weakening bias for the US dollar. A more contained virus in parts of Asia is allowing economic activity to resume with fewer economic setbacks. The valuation gap to developed markets is attractive. The sector composition is well positioned for a rotation to cyclicals, while maintaining meaningful exposure to growth stocks.				

● As at February 10, 2021

○ <sup>1</sup>From November 2020



# World at large

## A vaccine tomorrow, doesn't mean complacency today!

- The economy has begun to heal with the aid of substantial ongoing government support measures. A second-wave is enveloping large parts of the world. Equity markets are priced for the most sanguine outcomes. We see the risk as asymmetric – with potential downside outweighing further upside.
- The recession is likely over from a technical perspective. This doesn't change the fact that recessions of any kind bring some level of business failures, defaults, restructurings and longer-term damage. A double-dip due to the second wave remains a possibility.
- Government support measures are masking the impact to household and business income, consumer and business sentiment. Government support is meant to be temporary, how will the economy respond when it comes time for supports to be removed?
- Larger debt burdens across households, businesses and governments will restrain economic growth.
- Equities are exuberant on the prospect of a vaccine. Virus mutations, vaccine distribution, safety, public adoption and lasting efficacy all remain significant unknowns.
- Monetary and fiscal authorities are flooding the system with money that's fueling prices of all assets, both risky and safe, leaving equity markets expensive and sovereign bond yields low, but also rising. This combination delivers a muted return outlook.



# Capital market views

## Our base-case scenario:

- Markets experience a euphoric ‘melt-up’ on easing of risks, fueled by generous fiscal and monetary supports, and upward revisions to earnings growth estimates. Bond yields rise mildly and equities overshoot to the upside. Select opportunities are presenting themselves in the growth to value rotation trade.
- Rising bond yields pave a difficult road for fixed income.
- Equity markets must strike a delicate balance between rising bond yields and inflation being viewed as positives; and the tipping point where inflation and higher yields rise too much and flip to a negative. Earnings continuing to deliver positive surprises is sustaining the upward momentum. However, as earnings expectations rise and stock prices climb higher, so does the hurdle for success.
- Markets will eventually need to cope with the winnowing, or removal of, government support measures, and an economy that is required to stand more on its own.
- There is also the bruising reality that all the efforts and emergency measures to bridge the gap come with costs – higher taxes, lower spending and heavier debt burdens.
- Economies are learning to cope. Inventories need re-stocking and pent-up demand is real if successful vaccination allows it to release.
- Even in a post-COVID world, consumer and business tastes and behaviours at a minimum will take time to normalize and some behaviours may be long-term or permanently altered.

# Agenda

# Asset mix recommendations Appendix



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Investments



# Global economic data

Region	Real GDP YoY % Change					Consumer Price YoY % Change					Unemployment Rate %				
	2018	2019	2020E	2021E	2022E	2018	2019	2020E	2021E	2022E	2018	2019	2020E	2021E	2022E
US	3.0	2.2	-3.5	4.1	3.4	2.5	1.8	1.2	2.2	2.1	3.8	3.6	8.1	6.0	5.0
Canada	2.4	1.9	-5.6	4.5	3.9	2.0	2.1	0.7	1.7	1.8	5.8	5.7	9.5	7.9	6.3
UK	1.2	1.5	-10.6	4.6	5.7	2.3	1.4	0.9	1.5	1.9	4.0	3.8	4.6	6.6	5.5
Germany	1.3	0.6	-5.4	3.5	3.8	2.2	1.2	0.4	1.3	1.4	5.0	5.0	6.0	6.1	5.6
France	1.8	1.5	-9.0	5.8	4.0	2.2	1.2	0.5	1.0	1.1	8.8	8.2	8.3	9.9	9.2
China	6.7	6.0	2.3	8.4	5.5	2.1	2.9	2.5	1.5	2.3	3.8	3.6	3.8	3.8	3.6
Japan	0.6	0.3	-5.3	2.6	2.0	1.0	0.5	0.0	0.0	0.5	2.4	2.3	2.8	3.1	2.9
<b>World</b>	<b>3.5</b>	<b>4.2</b>	<b>-3.8</b>	<b>5.2</b>	<b>3.9</b>	<b>3.6</b>	<b>3.5</b>	<b>2.2</b>	<b>2.7</b>	<b>2.9</b>					



# Regional summary



## Canada

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- Economic growth faces headwinds due to COVID-19 global shock and slow vaccine rollout. Economy continues to require government support measures.
- The Bank of Canada has cut interest rates to their effective lower bound and continues with quantitative easing of \$4 billion per week. Domestic credit growth, housings share of the economy and rising home prices are concerns being ignored by the central bank until uncertainty over the outlook clears.
- Wide-ranging fiscal support remains in the form of direct income payments to households, wage and rent subsidies, and loans to businesses both small and large aimed at addressing the slowdown and disruptions to the economy. These are meant to bridge the economy to recovery.
- Elevated household and corporate debt continue to be a concern, along with ballooning government deficits; but low interest rates help to soften the blow.



# Regional summary



## Europe

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- Economic growth was weak prior to COVID-19 impact. Economy continues to require government support measures. Tight 2<sup>nd</sup> wave lockdowns. Fiscal spending coming, coordination issues likely impact efficacy.
- Political risks abating, U.K.–E.U. trade deal completed.
- Monetary policy to be supportive of economy, but punitive for financial sector.
- Less potential for trade frictions with the U.S. under Biden.



## US

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- Economy continues to require government support measures. Fed acting and prepared (and able) to do more. Fiscal response late, but massive amounts likely coming soon.
- Trade/foreign policy uncertainty ebbing under Biden, but not eliminated.



## China

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- Solid economic growth rebound, led by large manufacturing and export footprint. Domestic spending weak on more muted consumption.
- Authorities are injecting fiscal and monetary stimulus to offset COVID-19 impact, but it may be nearing its peak.
- Debt is a potential pitfall



# What's inside your bond funds?

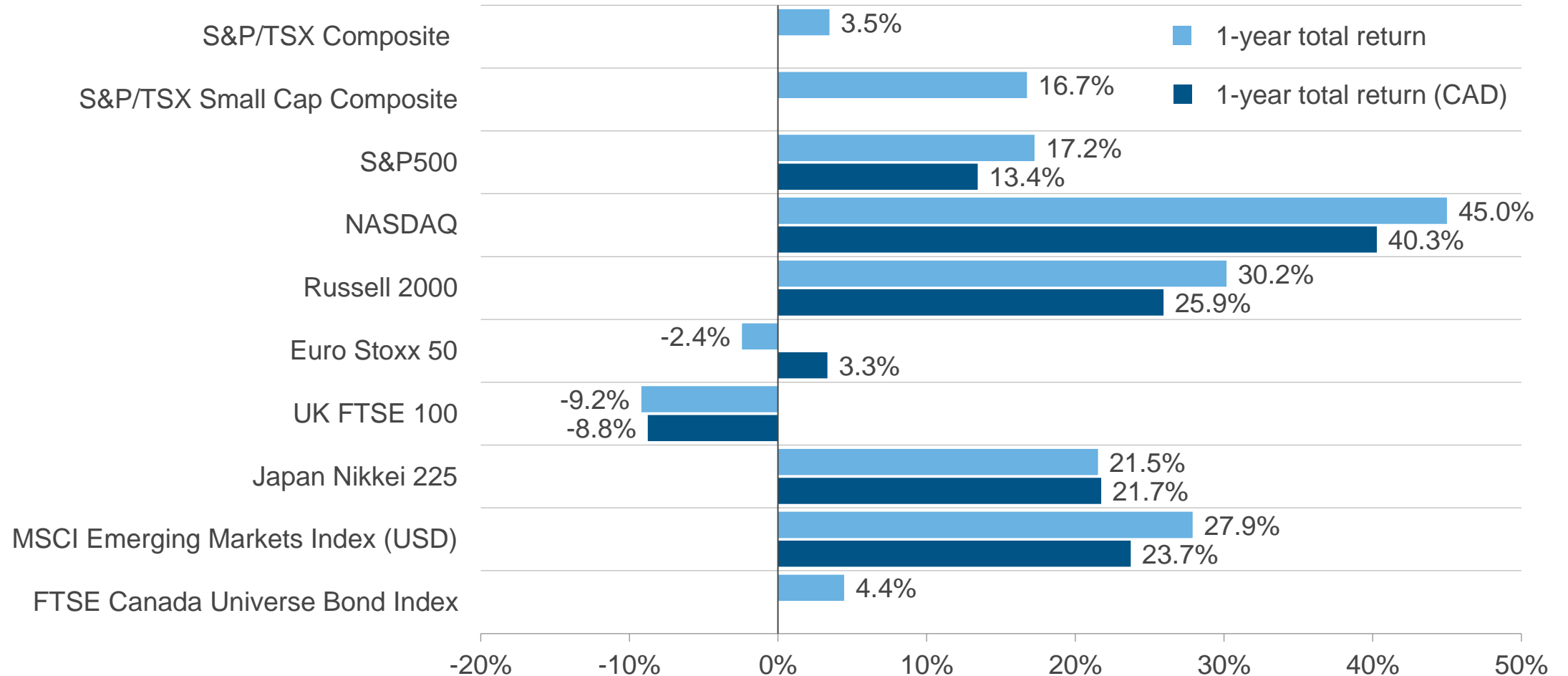
Steep decline periods for Canadian equity	S&P/TSX Composite Index TR	FTSE Canada Universe Bond Index TR	FTSE Canada Corporate Bond Index TR	FTSE Canada High Yield Bond Index TR
Sep 1, 2000 – Dec 21, 2000	-24.2%	3.1%	2.5%	1.9%
Jan 30, 2001 – Apr 4, 2001	-20.4%	1.3%	1.5%	2.0%
May 22, 2001 – Sep 21, 2001	-22.0%	5.0%	4.7%	4.2%
Mar 7, 2002 – Jul 23, 2002	-22.1%	4.5%	3.4%	3.9%
Jun 18, 2008 – Mar 9, 2009	-48.5%	4.7%	0.3%	-16.3%
Apr 5, 2011 – Oct 4, 2011	-20.6%	8.3%	6.5%	-7.8%
Apr 15, 2015 – Jan 20, 2016	-21.5%	0.1%	-0.3%	-6.6%
Feb 20, 2020 – Mar 23, 2020	-37.2%	-1.6%	-5.8%	-9.8%

High quality bonds, not high yield bonds, should form the core component of a fixed income portfolio. Source: Bloomberg, FTSE Canada.





# Capital market one-year total return



Source: Bloomberg January 29, 2021 - local currency unless noted, total returns



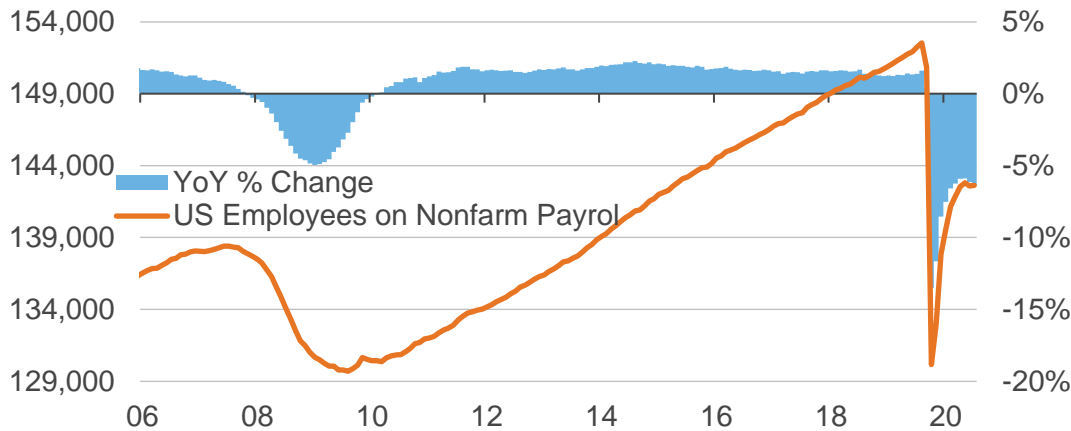
# North American sector weights & performance

S&P/TSX Composite			S&P 500	
YTD Return	Weight	Sector	Weight	YTD Return
3%	12%	Energy	3%	4%
-3%	13%	Materials	3%	-2%
-3%	12%	Industrials	8%	-4%
-3%	4%	Consumer Discretionary	13%	0%
-1%	12%	Info Technology	28%	-1%
35%	2%	Health Care	13%	1%
-1%	30%	Financials	11%	-2%
-5%	4%	Consumer Staples	6%	-5%
0%	5%	Communication Services	11%	-2%
3%	5%	Utilities	3%	-1%
1%	3%	Real Estate	2%	0%



# US – economic picture

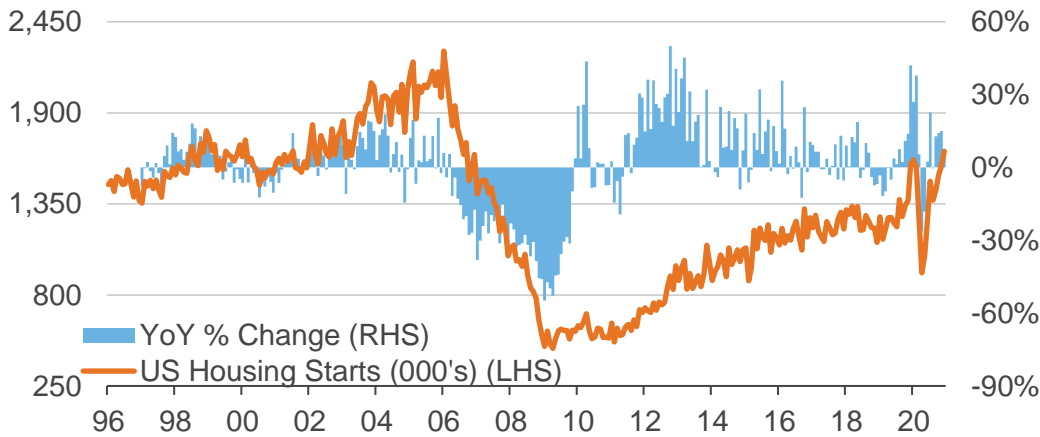
## US nonfarm payrolls (000's)



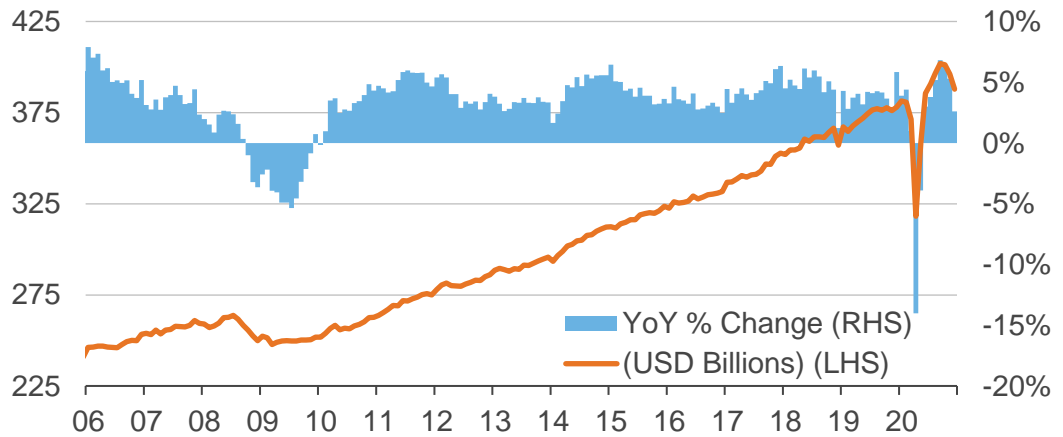
## US industrial production yoy% change



## US housing starts



## US retail sales less autos and gas

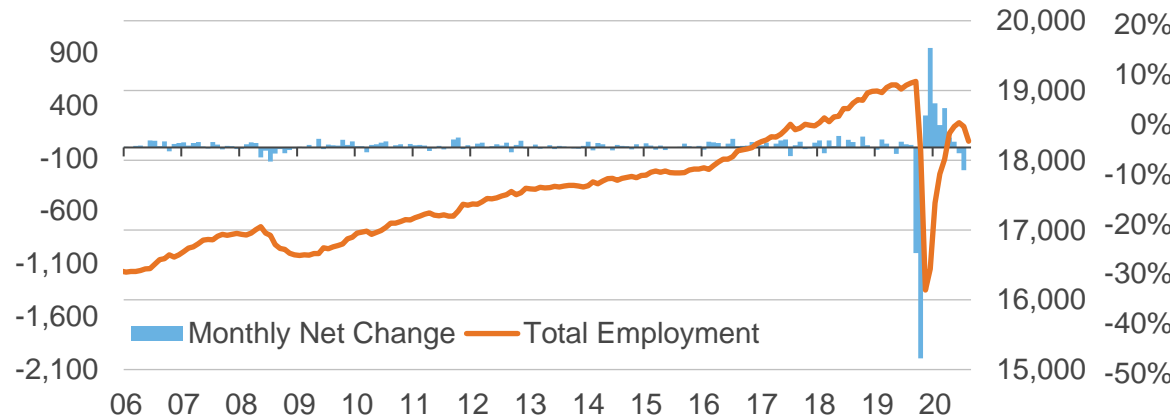


Source: Bloomberg Payrolls January 2021, IP December 2020, Retail Sales December 2020, Housing December 2020

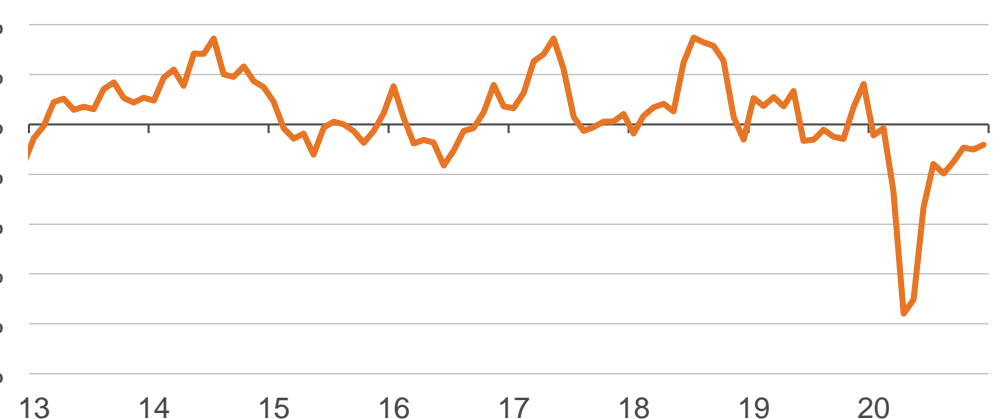


# Canada – economic picture

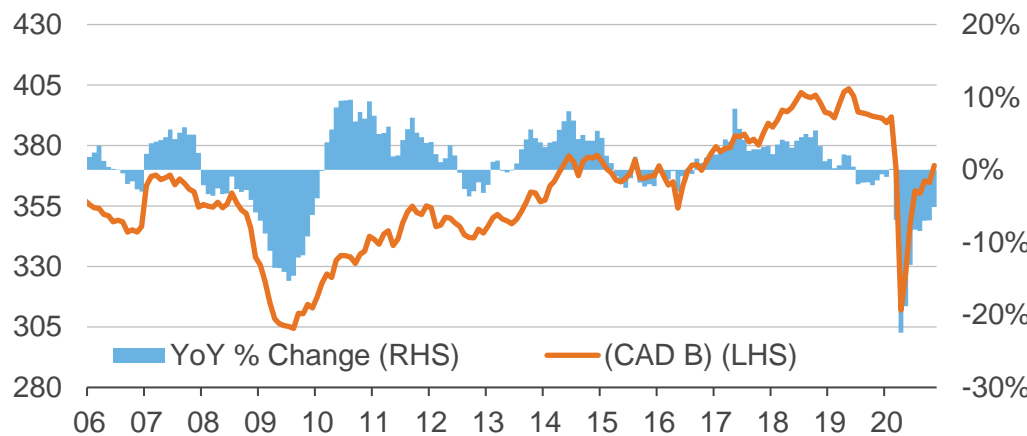
## Canadian payrolls (000's)



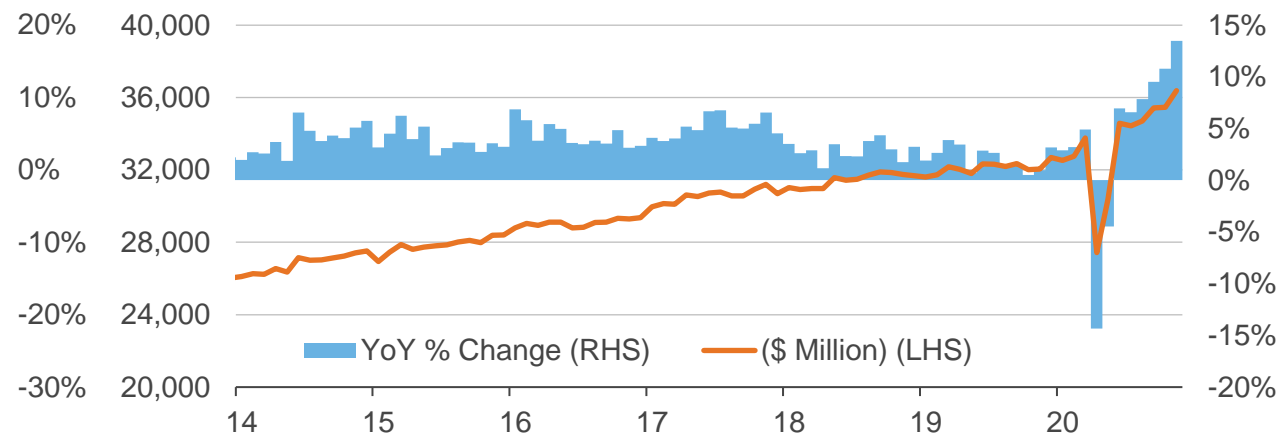
## Canadian exports yoy % change



## Canadian industrial production



## Canadian retail sales less autos and gas

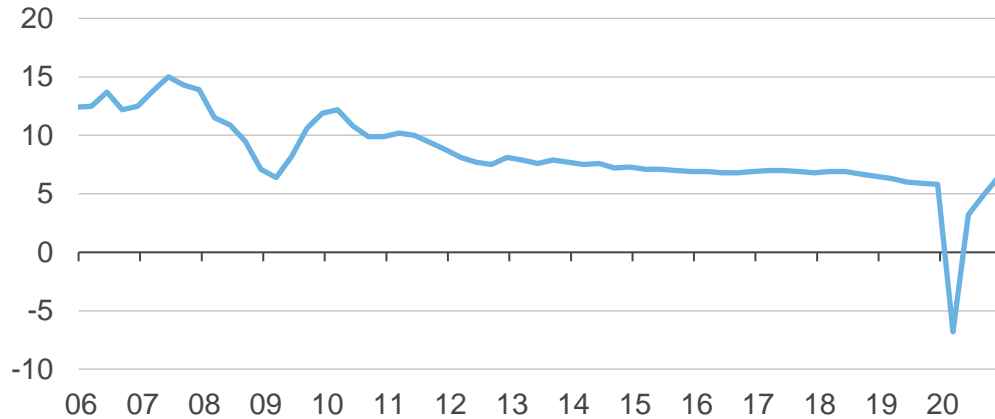


Source: Bloomberg, Payrolls January 2021, Exports December 2020, IP November 2020, Retail Sales November 2020

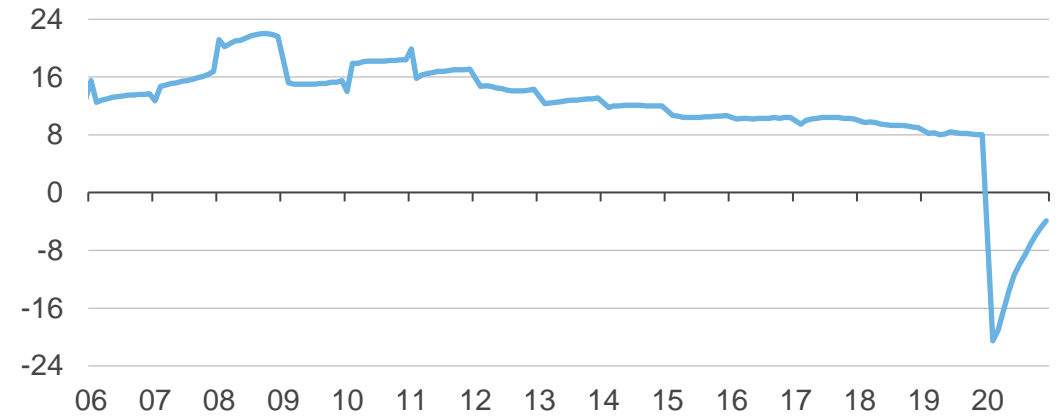


# China – economic picture

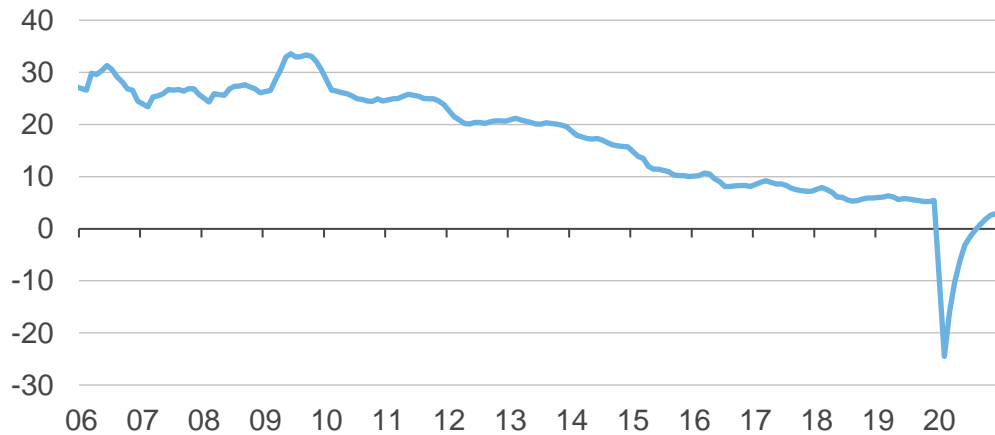
## China GDP yoy % change



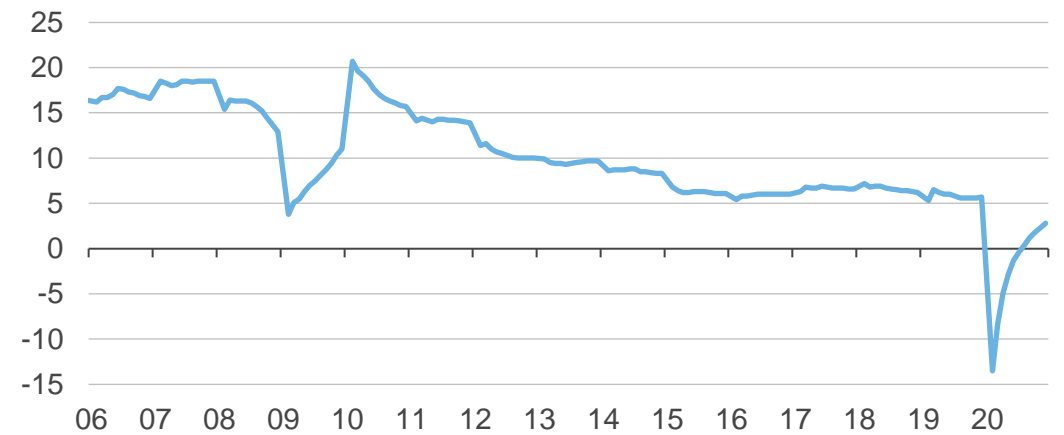
## China retail sales yoy % change



## China fixed asset investment yoy % change



## China industrial production yoy % change

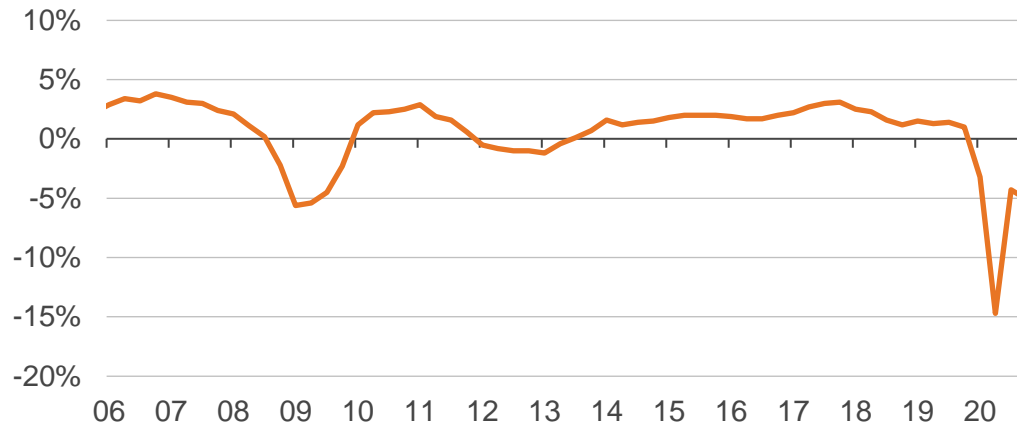


Source: Bloomberg GDP December 2020, Retail Sales December 2020, FAI December 2020, IP December 2020



# Eurozone – economic picture

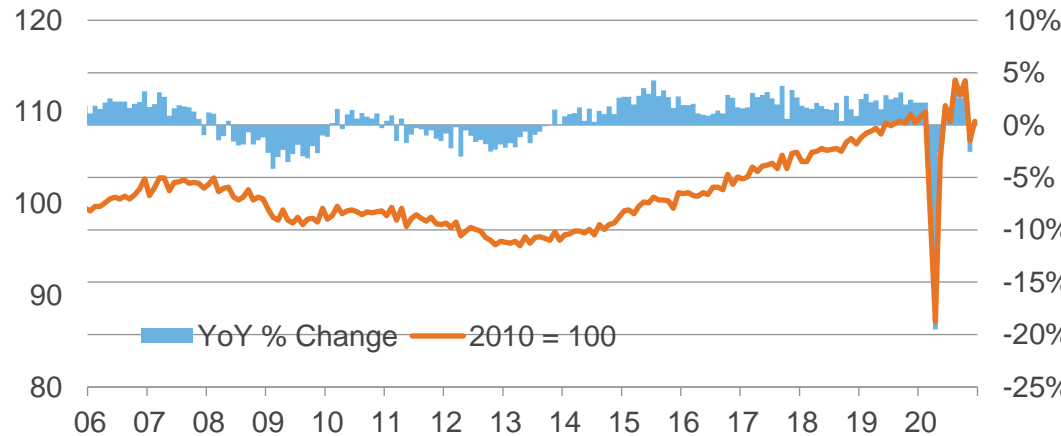
## Eurozone GDP YoY % change



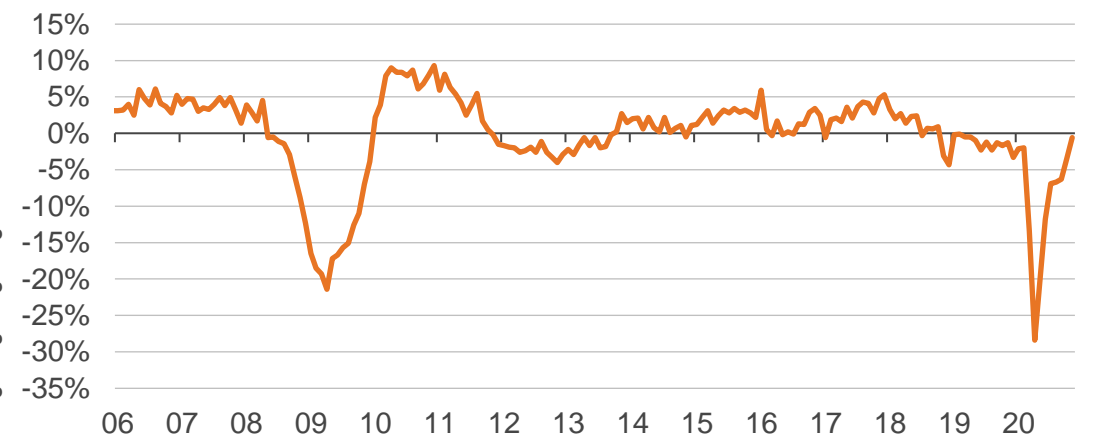
## Eurozone CPI yoy% change



## Eurozone retail sales index



## Eurozone industrial production yoy % change

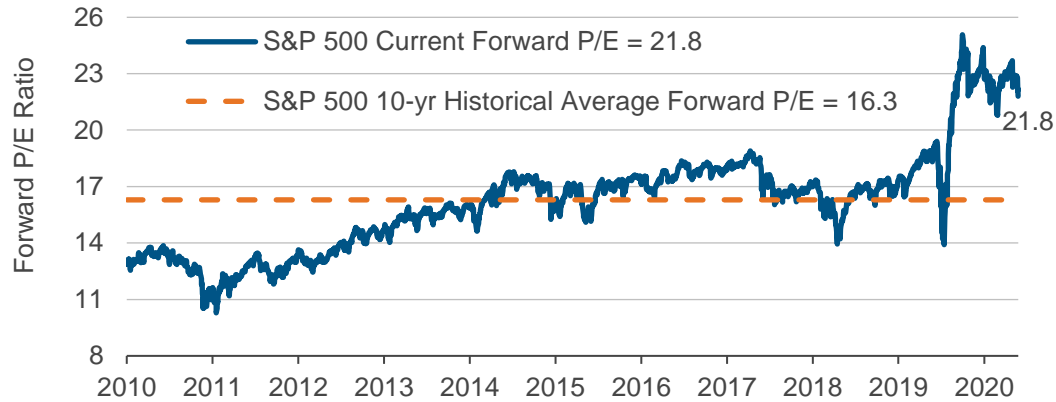


Source: Bloomberg GDP December 2020, CPI January 2021, Retail Sales December 2020, IP November 2020

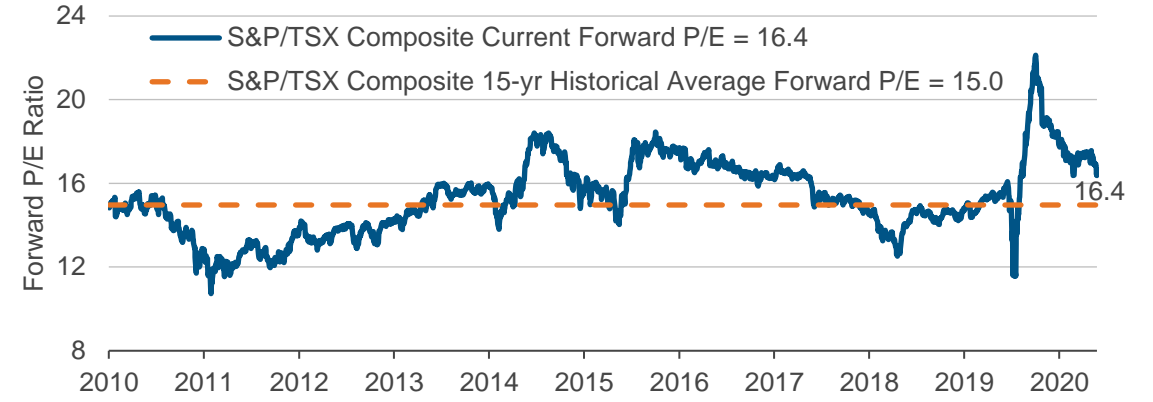


# Global equity valuations

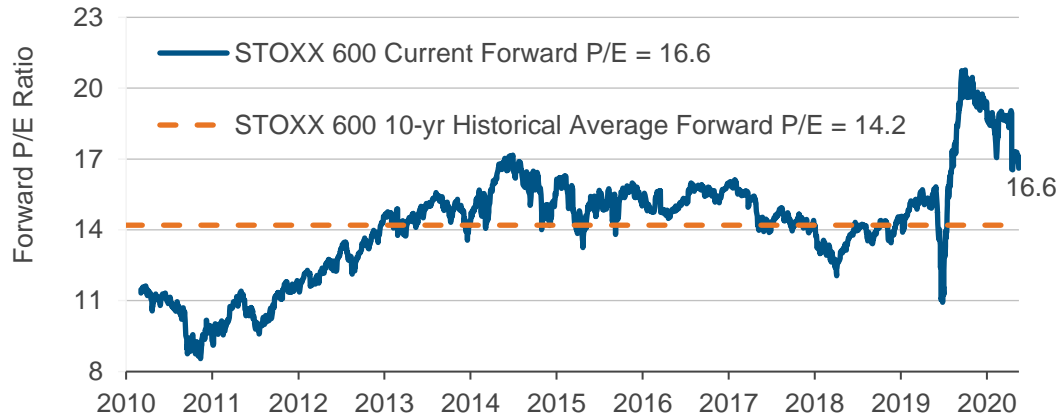
## S&P 500



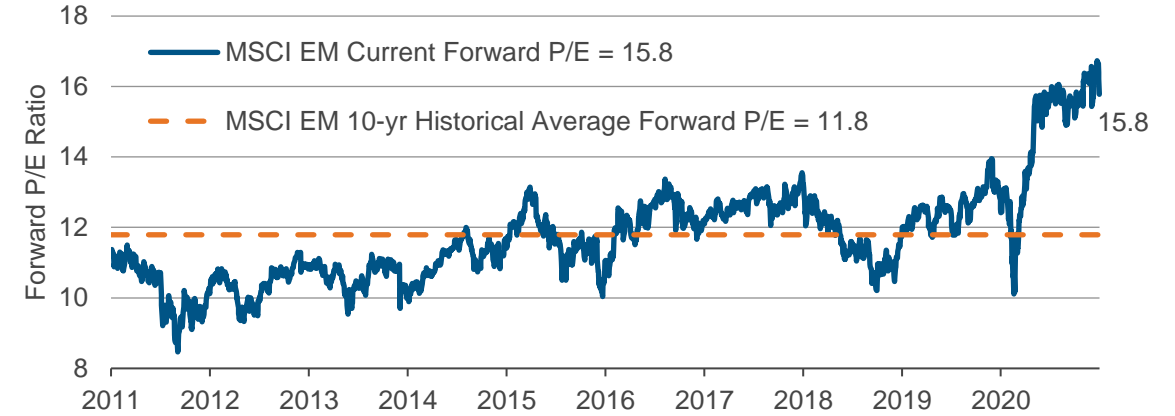
## S&P/TSX



## Euro Stoxx 600



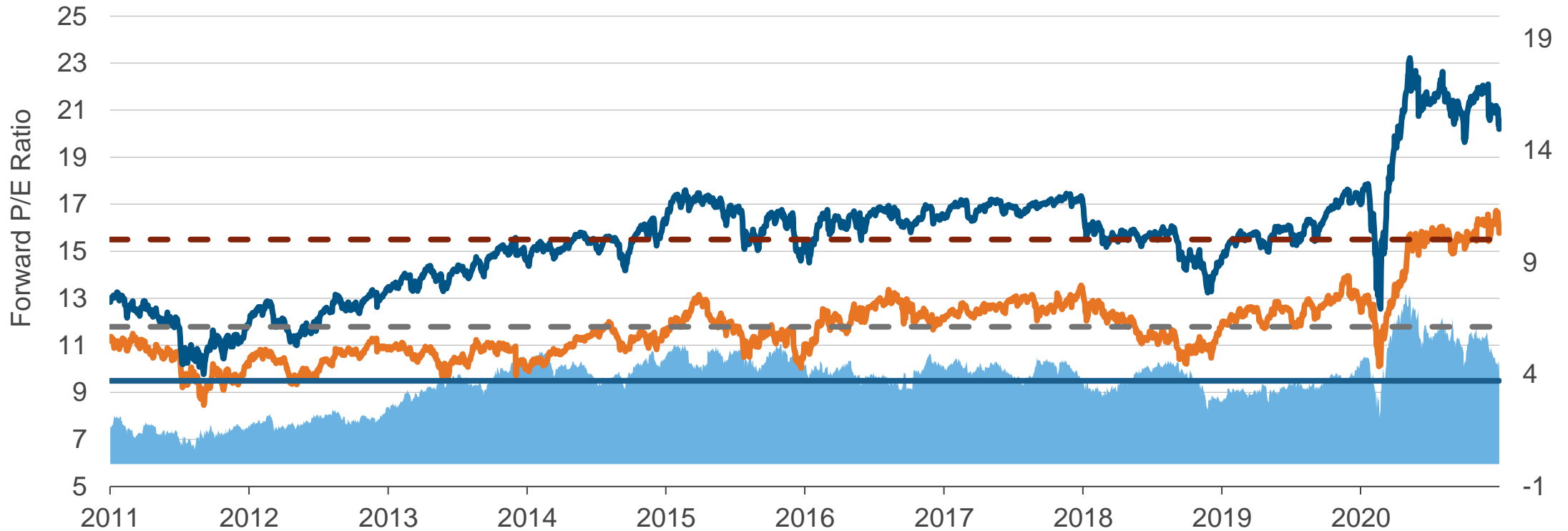
## MSCI Emerging Market





# Emerging markets valuation

## Emerging markets vs developed markets forward P/E ratio



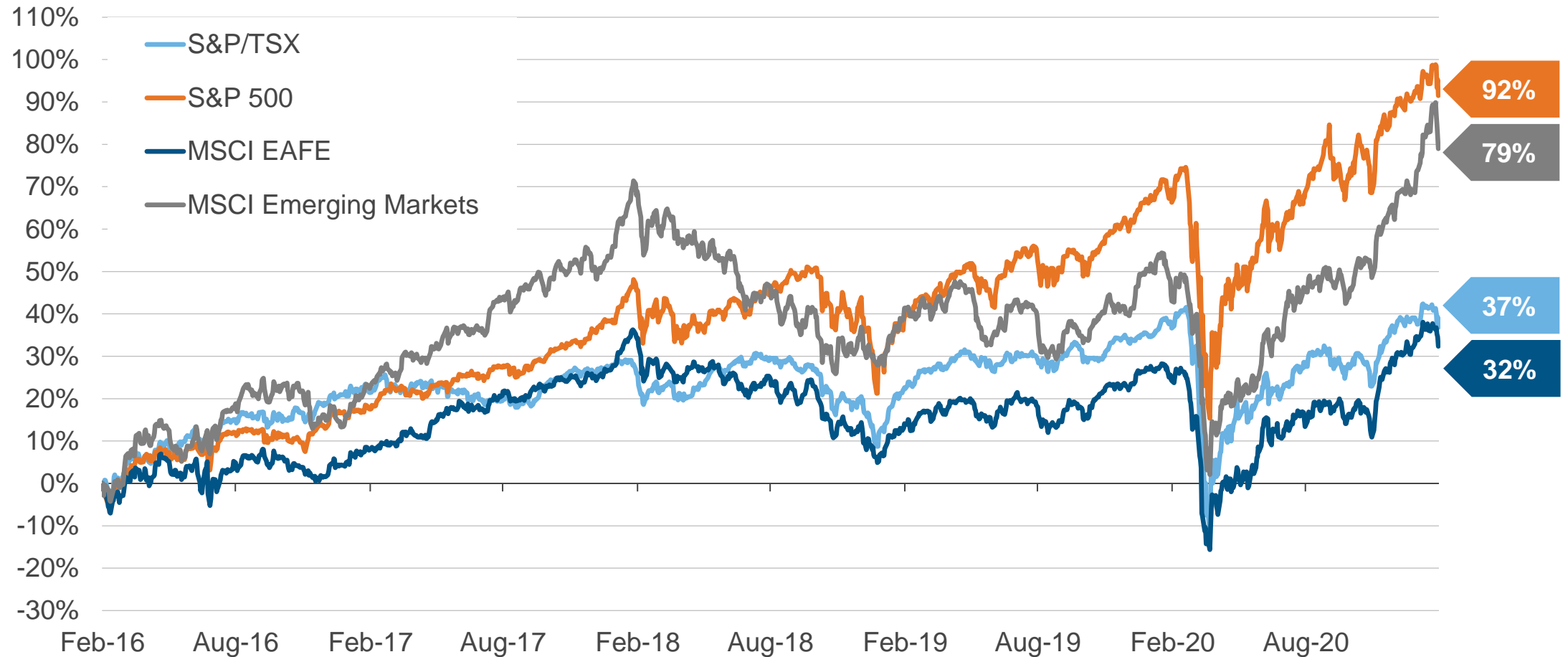
- Valuation Gap = 4.4 (RS)
- MSCI World Current Forward P/E = 20.2
- MSCI World 10-yr Historical Average Forward P/E = 15.5
- MSCI EM Current Forward P/E = 15.8
- MSCI EM 10-yr Historical Average Forward P/E = 11.8
- Average Valuation Gap = 3.7 (RS)





# Global equity returns

## 5-year cumulative return of major equity indices

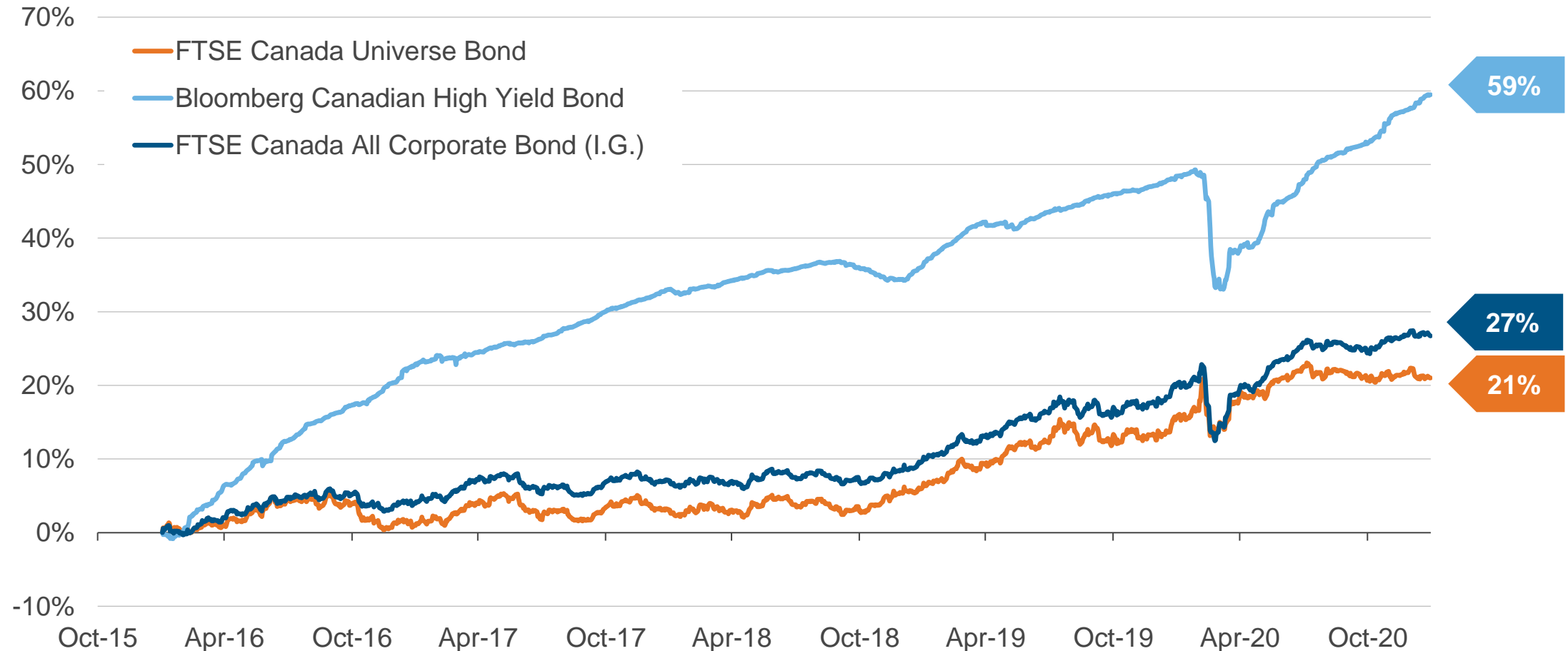


Source: Bloomberg January 29, 2021 price only, local currency



# Canadian fixed income returns

## 5-year cumulative return Canadian fixed income



Source: Bloomberg January 29, 2021 total return



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