2022 Mid-Year Outlook

Event Summary

Mackenzie co-CIOs Steve Locke and Lesley Marks, and Portfolio Managers Paul Taylor and William Aldridge, offered their predictions for the remainder of 2022, including shifting trends, inflation, central bank policy and China.

Global macro overview

- While society has been learning to live with the pandemic without economic lockdowns, and many people have returned to their normal lives, inflation has hit record highs not seen in decades.
- The **Russian invasion in Ukraine** has further contributed to global commodity price increases.
- With **China remaining the second largest economy**, we expected that 2022 would be a turning point after a difficult year in 2021. However, the Chinese zero COVID-19 policy has not only impacted its domestic economy, it has also created pressure on the global economy and supply chains.
- **Don't fight the Fed**: we should be cautious when the Federal Reserve tightens monetary policy.
- Acting as an effective hedge, **commodities proved to be a safe haven**. Strong demand coming out of the pandemic and tight supply conditions have supported the outlook for commodities. This has benefited countries like Canada, which experienced upward revisions in corporate earnings.
- We believe that North America will avoid a recession this year: we're more worried about the potential recession in Europe.
- The environment presents short-term tactical opportunities, but we still believe a focus on **diversification** and the **long-term horizon** is the best approach to survive short-term turbulence.

Theme 1 - Recalibrating for an economy with higher inflation

- **Inflation trends proved to be even stronger than expected**
  - War in Ukraine and a negative supply shock on commodities.
  - Input costs, strong demand and upward pressure on wages were driven by tight labour markets.
- **There's no quick fix for many commodities**
  - Ongoing conflict in Ukraine, sanctions on Russia, curtailment of energy exports from Russia to Europe and the interruption of grain supplies.
  - China's temporary lockdowns crimped the global supply.
- **Passing costs on to consumers is no sure thing**
  - Climbing borrowing costs with the expectation of rate hikes.
  - Wage increases are not keeping up with inflation.
- **Many central banks are focused squarely on reducing inflation**

   - The possibility of stagflation has been raised, due to central banks' pace of tightening monetary policy and on-going global supply issues.
   - Expect inflation to come down but remain above target by the end of 2022.

Our view: inflation has hit growth-oriented markets but has provided a relative boost to producer economies with rising commodities prices.

Theme 2 - China faces persistent headwinds

- **This is an important year in terms of political history**
   - China will convene its 20th National Party Congress and it will be critical to set the stage this fall.
   - A modest response to inflation has triggered the call for more aggressive policy easing to boost credit demand and supply.
- **Policy-makers may well be chasing an impossible trinity**
   - It will be crucial to accelerate credit to stabilize growth if China won't give up its growth target of 5.5% or relax pandemic control measures.
- **A Chinese downturn would be another drag on the global economy**

Our view: the slowdown in Chinese GDP growth will bottom this year and regulatory headwinds will diminish. China will provide a positive boost to global growth.

Theme 3 – Fed turns aggressive against inflation

The Fed was late for rate hikes and labelled the inflation as transitory for too long. It's now attempting to get demand- and supply-induced inflation under control.

- **We expect the Fed and other central banks to follow a hawkish path throughout the second half of 2022**
   - The Fed and other central banks might need to induce a near-recessionary environment to achieve their inflation mandates.
- **Tighter financial conditions are needed**
   - To stamp out high inflation and curtail a frothy labour market.
   - Rising wages undermine central banks' low and steady long-term inflation expectations
   - The Fed put is likely further away.
- **Hawkishness is now widespread**
   - We believe there is a strong possibility that markets are underestimating central banks' resolve to stamp out inflation, and the terminal rate could be higher than is currently priced in.

Our view: many central banks are now playing catch-up in fighting inflation, and investors may be underestimating how high policy rates may rise.

Asset mix recommendations

- Underweight in US equity and sovereign bonds.
- Neutral on equity and fixed income, international equity and high yield corporate bonds.
- Overweight in Canadian equity and investment-grade corporate bonds.