Empire Life webinar – 2024 Market Outlook
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PRESENTATION

Rob Popazzi
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Good day, everyone. I'm Rob Popazzi, Vice President of Retail Distribution for Empire Life and your host for today. On behalf of my colleagues at Empire Life, I want to welcome you to the 2024 Market Outlook Investment webinar. Today's date is February 8th, 2024. We've got something special planned for you today. We recently published our 2024 market outlook and today we have a panel of our Empire Life investment team portfolio managers who've contributed to that piece and they're here today to expand on their insights and perspectives for 2024. Joining us today are Ashley Misquitta, our Investment Strategist and Senior Portfolio Manager, who will share a macroeconomic overview and the outlook for US equities. David Mann, our Senior Portfolio Manager, unfortunately is ill today, but we're pleased to have Neeraj Khosla, our Senior Investment Analyst, to provide his insights on the global markets. Greg Chan, our Senior Portfolio Manager will take us through what's happening in Canada. And Ian Fung, our Senior Portfolio Manager will take us through the team's outlook for fixed income in 2024. Gentlemen, thank you for joining us today.

Now, before we move on, I need to remind everybody that this presentation reflects the views of Empire Life as of the date published and is subject to change without notice. The information in this presentation is for general information purposes only and is not to be construed as providing legal, tax, financial or professional advice. The Empire Life Insurance Company, and its affiliates assume no responsibility or any reliance on or misuse or emissions of the information contained in this document. Information obtained from and based on third party sources are believed to be reliable, but accuracy cannot be guaranteed. Please seek professional advice before making any decisions.

Now, with the legalese out of the way, let's get our webinar going. Now, there are many themes that have the potential to affect the markets in 2024. From an evolving interest rate environment as central banks globally try to fend off inflation, the continued and aggressive growth of AI and its effect on various industries and sectors, and geopolitical tensions that have yet to be resolved. Now our portfolio managers will do a quick review of the events of 2023 and the themes that may impact markets in 2024. We'll ask each of them to take us through their thoughts on their area of focus and then we'll go through some questions at the end that we've received from across the country. To get us started, let's hear from Ashley, who will highlight some of the macroeconomic themes he's observed and what they mean for the markets in 2024. Ashley, over to you.

Ashley Misquitta
Senior Portfolio Manager and Investment Strategist

Thanks, Rob. 2023 was kind of a Goldilocks year in a lot of ways in the economies around the world and in the markets. So, part of this Goldilocks effect came from an abating of inflation. Now it was different levels in different places. The US for example, I think peaked at nine-ish, nine point something percent in 2022 and it sort of declined through 2023. You saw that in other places as well. In different measures, it's sort of different rates. As that happened you started to see interest rate expectations start to abate as well and I think that had a fairly substantial impact on things. When I look back that was one of the key contributors and it was especially important towards the latter part of the year. So, in the October forward time frame, we saw real reductions in interest rate expectations or expectations maybe I should say of interest rate cuts coming in through 2024. Now since then we've seen strong inflation prints, we've seen some indications that prices in particular in places like the US are not, inflation is not abating quite as fast as people thought. And so, you know we'll see where that net shakes out, but it's probably not as fast as people might have perceived in December.

And at the same time, and this is where things get made, last year, a particularly complicated year, is you had this extrinsic effect of generative AI. The explosion on the scene of generative AI is maybe a better way to think about it. And that drove certain companies. You had the sort of picks and shovels, companies that really were beneficiaries. You saw the early applications of Gen. AI and now we're potentially going to be getting into the usage of Gen. AI and the implications of it for cost savings and for things like that. But last year was a big year where that basically burst on the scene.

Other contradictory kind of factors were that we saw employment in a lot of places actually quite strong and that's usually one of the things you would look to see, well, OK, so economies are maybe slowing, but it wasn't the case, you know, initial claims remained very, very well contained. We saw nonfarm payrolls and other measures showing levels of strength that were not associated with the broader weakness that was actually suggested by other indicators like leading economic index, PMIs and various other measures we use. Some of you will have heard me talk about those before. So, you saw this real contradiction there and simultaneously we saw retail sales reasonably strong. We saw the consumer actually in pretty good shape and probably some of that when we look back on this period of time, one of the things I think we're going to observe is that the flush bank accounts, the strength of the consumer came from having so much money deposited in those bank accounts through COVID and we're kind of in the carry over effect of that.

So now looking forward, 2024 is going to be an interesting year. We've got elections in a variety of places. We've seen Taiwan already happen. Which didn't hit kind of either of the extreme worrisome cases or potentially worrisome cases, maybe you think about it. We've got Indonesia coming. We've got India coming, we have a variety of European countries where they have different levels of elections. And then finally, of course, as most of us will probably have heard by this point, is the US election coming this year. Twenty, sorry, I say something like 65% of people polled will tell you this was not the outcome they wanted. But it looks like where we are today, there's a very high probability we're going to get a Biden Trump election. Like I said, most people didn't want that, but that's probably what we're going to end up with. It's really consequential though, you know every cycle, people are like “This is the most important election ever” and they aren't, usually. This one actually is when you think about the divergent in views on economic policy, on immigration policy, on national security, decisions that have to be made around Ukraine and support for Ukraine, support for different countries in the Middle East. What do we do? What is the long-term plan around China and engagement, reduced engagement, what is that plan? And so, this is a really important election. So, it's something to keep an eye on. Geopolitics, I would say have been a thorn in investor sides, wow, for like call it four years now, and assuming you wouldn't count COVID as a geopolitical event. And I think that that's an appropriate way to think about it. So, you've had COVID, you've had the Russian invasion of Ukraine. You've had October 7th in the Middle East. You just had all of these things emerging. I remember I was in talking to clients back in November and talking about, well, you know, there's this missile that was fired from Yemen. We weren't sure if it was going into Israel or targeting a US destroyer in the Red Sea. And it was kind of like one of those, what's going on here? How is this going to affect things? Next thing you know, where we are today, it's a regular occurrence and the Suez is basically closed. The Red Sea is basically closed to shipping. And we're going to start to see some of the impacts of that. Geopolitics also takes in, contemplates China, right. So, the relationship between the US and China has become hotter and colder, warmer and cooler, I guess I would say through 2024. We did see some high level meetings in San Francisco partway through the year, simultaneously we've seen fairly aggressive action from the Chinese Navy towards the Philippines, a US ally. And so even though we're seeing calming in some regards, we're seeing continued action in others. And then of course semiconductors and supply chains are a topical issue where we've seen the export bans and things like that. Companies like Apple moving their supply chains to places like India, trying to move some there and other companies as well. It's not like a mass exodus, but on the margins, people are making those choices.

Happier news, renewables are going to be a very big stimulus for the, I think for a while now. We've seen, we've got infrastructure spending to do. We're going to be, you know based on the COP 28 commitments, we're going to see three times the production of nuclear energy, very positive zero carbon emission. Small footprint. The energy transition overall is going to be great news for Canada. On the less, more concerning, less happy side, we're seeing EV demand growth slowing in a variety of places, actually not just the US but I've seen some early data on slowed EV demand in Germany and South Korea. And so, we'll see what that turns into. Of course, Gen. AI is a huge tailwind. The timing of when that goes from the nascency and infancy of it into broad proliferation, broad impact, that remains to be seen. India is a, is gonna be a big tailwind. I think I try to think about the heuristic of what are historians going to talk about when they look at today in our period of time versus what journalists are talking about today. And I think India is going to be an important one. So, there's a lot of exciting, important stuff going on. There's lots to be cautious about. I'll wrap the macro component of it there. And with that, I'll hand over to Neeraj. Over to you.

Neeraj Khosla
Senior Investment Analyst

Thanks, Ashley. And just for clarity, I will focus on all the regions outside of North America. And today I'm going to provide a recap of 2023 and the outlook on Europe, Japan and China for 2024. We don't invest directly in a lot of companies in China, but I think the country is just so important for the rest of the world. So, coming to Europe, there's no Magnificent 7 which you may have come to know, that have driven the returns for S&P 500 in 2023, and all these businesses are classified as growth companies. So, growth significantly outperformed value in the US in 2023. In Europe, however, there's no real difference between the growth rates of growth and value companies and it was more of the macro factors that drove the returns for companies. So, for example, banks and financial institutions, they benefited significantly from high interest rates and consumer discretionary did pretty well as well because of resilient consumer spending. On the other hand, sectors such as resources did not do as well, and they underperformed the market because of exposure to China. So, Speaking of China, Chinese equity markets actually had a really tough year in 2023 and there are a multitude of reasons for that underperformance. Firstly, the geopolitical tensions led to significant contraction of the trading multiples and a spike in the country's risk premium. The economy itself slowed down quite dramatically post what you would describe as quite a tepid recovery post COVID. And then finally and most importantly, there's a big crisis in the residential property market. It's an over levered sector where you know the demand from developers as well as the users dried up. The sales actually declined in mid-teens and there was very minimal property, new property construction and this is critical because it contributes about 25% of GDP. Used to be something like 30% of GDP, but it has come down due to lack of activity and this is usually an area of stimulus from the government, but in so far, we haven't really seen anything on that front. Coming to Japan, Japan actually performed quite well in 2023, both in local currency as well as Canadian dollar terms and there were two big drivers of equity market performance there, the depreciation of the yen and corporate governance reforms. So, the cheaper yen actually helps exports and also the inbound tourism into the country. And these two are very critical for Japan because the Japanese economy is very export oriented and it depends heavily on inbound tourism to drive consumer spending. Corporate governance reform is a little bit more complicated topic. So, we have talked about this before that there's a lot of Japanese companies who have high cash balances, low ROEs and therefore they trade at low price to book multiples. And in many cases these institutions are not even run with shareholders being in mind. The TSE has openly commented that any company that is trading at less than one times price to book would have to justify what that, why that may be the case and they're also encouraging more shareholder returns. So, this combined with a lot of record levels of activism in the Japanese companies is leading management teams to react and focus more on running their enterprises with keeping shareholders in mind. So, I think these two factors will, are driving a lot of buybacks as well as corporate actions in Japan. Coming to our outlook, we have a conservative view on Europe. The higher interest rates that benefited the financial institutions in 2023 will not impact or have a positive effect on the European economy as much as in 2023. China is still struggling and there are early signs that higher interest rates are having a material impact on consumer spending. So, we think that the earnings expectations broadly need to come down. We have a similar cautious view on Chinese companies as well. The difference here is that on the macro front. But the difference here is that there's a lot of high quality businesses in China where we have taken exposure and we feel that there's a lot of value that can be unlocked in these companies. And should there be any stimulus or let up of the geopolitical tensions, we believe that there's a lot of upside in these companies.

And finally on Japan, we are very positive on Japan. Aside from the yen depreciation that we saw in 2023, we believe that a lot of other factors will continue to persist in 2024. Most notably the corporate governance reform that I talked about is a structural change in Japan. And you know in the past foreign investors have not had big exposure to Japanese companies and that's for a very good reason. But we believe that will change as corporate governance improves, the balance sheets of these companies become more reasonable and the shareholder, these companies become more shareholder friendly and poor governance and returns is less and less of a reason to not allocate capital to Japan going forward. So, with that I will pass it on to Greg who will talk about Canadian equities. Over to you, Greg.

Greg Chan
Senior Portfolio Manager

Thanks, Neeraj. I'll start by providing some highlights from 2023 and then I'll talk about some key themes for 2024. Canadian equities had a decent 2023. The TSX was up around 12%. However, we did underperform both the S&P 500, which is up 26% and MSCI World, which is up 24%. Last year, growth investing was in favor of value investing with technology leading the way. This is a reversal of 2022, where the TSX was one of the stronger markets worldwide. We were down 5 1/2%, but did outperform both the S&P 500 and the MSCI World, which were both down 18%. And in 2022, value investing was in favor of a growth investing. Last year the technology sector was the big winner and in Canada and south of the border. The TSX technology sector was up around 69%, which was mainly driven by one stock, Shopify which was up close to 120%. The stock had a big re-rate in its multiple along with many growth stocks around the world. But also, fundamentally the company did a great job. They improved revenue 27% in the first nine months of the year and also put a greater emphasis on free cash flow and profitability. Canada's GDP growth decelerated considerably in Q3 of last year. We actually shrank 1.1% despite positive growth in both Q1 and Q2. Official Q4 numbers come out later in February. It's the expectation that we're going to see modest growth in Q4 and if this is the case, Canada would nearly avoid a technical recession. And another side of the slowdown, the unemployment rate went up from 5% in Q1 to 5.5% in Q3. While inflation is moderating, it's still above the Bank of Canada's 2% target. The Bank of Canada has now raised interest rates 10 times since March of 2022 and increased the overnight lending rate from a current level of 5% versus 0.25% at the beginning of the hiking cycle. Now shifting gears to our 2024 outlook. We are expecting growth to continue to slow. Higher interest rates are likely to impact the Canadian consumer more heavily and the reason is twofold. One, Canadians have a lot of debt currently. Right now, our household debt to net disposable income is at 187%, amongst the highest of all OECD countries. And secondly, our mortgage market has a shorter duration, so a typical fixed rate mortgage in Canada could be five years. Which compares to the typical fixed rate mortgage in the US, which could be 30 years. The Bank of Canada may cut rates in April of this year. However, we think that's a bit optimistic and we're expecting the first cut likely in the middle of this year.

A couple of key sectors that were playing close attention to include both the financials and energy. They're both the two largest sectors in Canada. Financials are just over 30% of the TSX benchmark and energy just under 20%. So combined they represent about half the TSX benchmark. First on Canadian banks, we're expecting tepid loan growth this year. I talked about the over levered consumer, I talked about the slowing macro and all this likely translates into modest EPS growth this year. Provisions for credit losses are likely to continue to increase this year and likely peak later this year. And despite mortgages that get all the attention in the news, these increases in provisions for credit losses are actually driven off a non-mortgage book, so areas such as credit cards and auto loans. We feel that mortgages will become a bigger issue in 2025 and beyond and the reason is there was a lot of cheap debt at the beginning of COVID. So back in 2020-2021 debt was very cheap and as these five year fixed rate mortgages start to renew at higher rates it could put pressure on the consumer. Importantly, in times of distress or economic uncertainty, the bank's capital ratios or balance sheets become more important. And luckily for us, the big six banks have healthy capital ratios, all above the minimum ratio of 11 1/2%. Shifting gears to energy, oil prices were relatively flattish last year. We remain constructive on supply side. There's been a general underinvestment in the oil industry over the last several years and we also feel that OPEC plus is doing a good job curtailing production in order to support oil prices. Offsetting these pauses supplies side dynamics is a weakening macro environment, which could put pressure on the demand side. We feel that Canadian energy companies are well positioned. Valuations are really attractive in Canada and there's a lot of E&P [exploration and production] companies training in mid-teens free cash flow yield in Canada. In addition, as the Trans Mountain pipeline gets completed later this year, it should narrow the WCS [Western Canadian Select] heavy oil discount relative to WTI [West Texas Intermediate].

So, in conclusion, while there are several economic headwinds facing the Canadian economy, we feel that continued moderating inflation, eventual interest rate cuts will help offset some of these headwinds. In addition, the valuation levels of Canadian equities are very attractive in our opinion. The TSX is currently trading at 14 times forward earnings, which compares to its five year historical average of 14 1/2 times earnings, so slightly at a slight discount. It also compares to the S&P 500 which is trading at 21 times earnings versus its historical five year average of 20 times. And with that, I'll turn it over to my colleague Ian Fung from our Fixed Income team.

Ian Fung
Senior Portfolio Manager

Thanks, Greg. 2023 was a volatile year last year in bond markets as markets gyrated between pricing and cuts during the year to hiking further in both Canada and the US and then return, a return to pricing cuts for 2024. Bond markets finished the year on a positive note as we saw inflation continuing to decelerate from the highs that we saw in 2022 in both Canada and the US and we saw the Fed and the Bank of Canada appear to have reached their terminal rates. We had quite the rally to finish the year as we saw interest rate markets began aggressively pricing rate cuts for 2024, speculating that cuts would begin as early as Q1 in 2024 in both Canada and the US. At its peak, the US had six cuts priced for 2024 and Canada had five entering this year. Fixed income started out a bit on the back foot. The market began pushing back on the notion that the Bank of Canada and the Fed would cut rates in the first quarter and began pushing cuts further or pushing the pricing of cuts further up into the year. Cuts in the first quarter again seem pretty aggressive and we expect that cuts will likely take longer than the market thinks to materialize for a number of reasons. One, inflation remains too high. Even after we moved off the high rates in 2022, inflation remains higher than central bank targets in both Canada and the US.

Looking at the US, when we look at core CPI, the last year over year print in December was at 3.9%. Even when we look at the, look at it on a momentum basis over the last three months we're at 3.31% annualized, which again is too high. However, when we look at the Fed's preferred measure, the PCE deflator, we're seeing a similar story. It came in at 2.9% year over year for December, but the three month annualized rate was 1 1/2%. So, there's a little bit of positive momentum there, but again, overall level seems, appears too high. When we flip to Canada, the Bank of Canada looks at a variety of measures for core CPI. There's the vanilla core CPI, which is just CPI less food and energy. They use a version that uses only the median values and they use a trim version that takes out the outliers. Across all three methodologies, we're seeing year over year inflation anywhere ranging from 3 1/2 to 3.9% as of December. When we look at the three month annualized rates, we're not seeing much improvement either across the three measures. They're coming in at 3.5 to 3.8%. So again, relative to the 2% target, we're pretty elevated. What's a bit more concerning here in Canada is the breadth of inflation components. As of the last print, over 50% of the components making up CPI came in annualizing at a 3% rate or greater. So again, the breath is concerning in Canada. Again, we could see some upside risks to inflation due to geopolitical risks or supply chain issues or even from the service sector. So again, inflation remains too high. Two, we have a similar story for inflation expectations. Survey based measures in both Canada and the US are again, have come down from their highest seen in 2022, but again still remain elevated relative to target. Lastly, economics, the economies are still pretty resilient. In the US economic strength is evident given the last GDP print for Q4 came in at 3.3%. Labor markets remain robust, continuing to show strength from a hiring perspective as evidenced in payrolls and from an unemployment perspective as evidenced by low initial claims and continuing claims. Wage growth continues to remain a problem area as it remains elevated and as a result, consumer spending has continued to remain robust in the US. In Canada, we've seen a little bit of a different story as the economy has begun down shifting. Three of the last four GDP prints came in flat, so 0% growth. That would be August, September and October. And in November we saw growth of .2%, so signs that an economy is not super strong at the moment. The labor market is a bit closer to balance here, but again, wages, wage pressure and wage growth remain an issue here. Consumer spending should likely be a little more restrained than what we're seeing in the US, given the interest rate sensitivity in Canada. Of note, the Bank of Canada has mentioned that they think the economy is now in a state of excess demand. So, we should start to see spending slow down and see some downward pressure on inflation. And so, if we don't think cuts are happening in Q1, we're still positive on fixed income for the rest of the year. Even if we think it's too early for them in Q1, there are positive things to look for. Number one, inflation is likely to continue working lower as the economy should continue to decelerate given the tightness of policy right now. Second, if we look at things on a real rate basis, real, real rates would likely continue to increase. Assuming inflation continues to move lower and no action from central banks, real rates would continue to rise further, which would tighten policy. Recall real rates are the nominal overnight rate less inflation. And so said differently, if policy is tight enough now to begin slowing down the economy at current levels of inflation, doing nothing as inflation moves lower would actually serve to tighten policy. So intuitively it leads to some cuts further out in the year to maintain the current restrictive stance. And lastly, if economic data continues to soften more aggressively, particularly hitting employment, this would likely bring forward cuts and if we get cuts we should likely see the curve re-steepen for the rest of this year.

Moving quickly to credit, we saw credit spreads widen last year, begin the year tighter and then we widen pretty aggressively when we saw the regional bank failure in March. But over the rest of the year we saw them tighten for the balance. Opening into 2024, it's been the busiest January on the books for both the Canadian market and the US credit markets. We saw credit spreads start this year in the same vein as 2023 tightening further. However, our base case is that spreads will finish the year modestly wider, not significantly but just a little bit, on the back of tighter policy continuing to slow down the economy. Investment grade spreads will likely outperform high yield spreads given the nature of the issuers. Investment grade issuers tend to be companies who are larger, more diversified economic models to better withstand slow, economic slowdowns. But in high yield we should, we are expecting to see an increase in default rates concentrated in the triple C and below bucket. So that should continue to put some pressure on corporate spreads. As a result, we continue to take action to high grade the portfolio and increase the credit quality. So, all in all, I think we're in for another volatile year in fixed income. And with that I will turn it to Ashley to talk about US equities.

Ashley Misquitta
Senior Portfolio Manager and Investment Strategist

OK. Thanks, Ian. Another exciting year in US equities, US economy, US markets. We started out the year with, not started out, in the first quarter, we saw some of the biggest bank failures we've ever seen in the US. We saw Silicon Valley and Signature and First Republic and even though it's not a US domicile Bank, Credit Suisse, for Credit Suisse, First Boston CSFB was folded into UBS. And that CS has had a pretty big US presence as well. So, there was an impact to that as well. As it turns out, there wasn't the contagion that I think everyone was sort of concerned about. And that was obviously a very positive thing for the market longer term. You can't talk about 2023 in the US without talking about the Magnificent 7. And so, the clear impact on those and that you know, you had effectively two markets. You have the Magnificent 7 and you have the S&P 493, the other ones. And of course, the Magnificent 7 is Apple, Microsoft, NVIDIA, Amazon, Meta, Tesla and Alphabet, which owns Google. Quietly, gold actually did pretty well last year as well and from the end of November forward gold basically stayed over $2000. So that was, that's something that's kind of interesting and kind of worth paying attention to if you look at major purchases from global central banks, it's something to keep an eye on and sort of file away in the back of your head. I think it's something to consider. There was no recession in the US, most people or many people, I guess I should say, myself included, were kind of expecting one. And yet GDP came in around 2.1%. And so, I think that was a little bit of a surprise as well. So now as we look forward to another exciting year, I think ahead of us, I touched on inflation earlier on and then the importance of this set of inflation, of this set of elections. What else is coming up? So, Ian and others have alluded to inflation. We're in the three to 4% range in the US right now. And so, I think a very important question is do we come back to that 2 1/2, two to 2 1/2 level that the Fed is desirous of, and my personal take is it’s hard to see them aggressively cutting if we're in the three to 4% range without real evidence of it, of it coming forward, coming down rather. And so, we know there's pushes and pulls on that. We'll see how it all plays out. The US debt is starting to become more and more of an issue, particularly the deficits that are being run and the degree of new issuance of U.S. Treasuries and bonds and notes that are required in order to finance that. We saw around 2 trillion in deficit last year. The first quarter of the US government year, it's September to December that is the first quarter for the US government's fiscal year. That was on track for a two-ish trillion dollar deficit again this year. And so, my suspicion is like some things that we've seen in the past, it won't be an issue until it's an issue and then it'll become an issue, which is not a great answer to the question of what happens with the US debt. But it's one of those things where markets will, are basically ignoring it as an issue. And so, it is something that I think that is very worthy to pay attention to, particularly as you see with rates where they are, with debt levels continuing to ratchet upwards, the dollar expenditure on interest is continuing to grow. And you know most of us don't know the exact number of the US federal spending on defense, but we know it's really big. Interest payments have now ballooned past that. So that's something that obviously is very important. You can probably tell I'm sort of cautious in near term.

I'm very optimistic long term, very optimistic. And here's some of the reasons. I think there's some real structural tailwinds for the US, one of which is innovation. The US is an innovation machine and it's not just Gen. AI, it's not just that, it's in medicine, in science, in health, in tech, in energy production, think about the last 30 years, think about all the innovations in the world. I think you'll find many of those came from the US and it's such a tailwind because it's great for economic growth, but it's also great because it gives us a lot of companies that are, that are innovative and developing the technology of the future that allow us to invest in those. So, I think that's an important tailwind. I touched on energy a second ago, the US is the largest producer of oil and natural gas globally. This is important for I would say a couple of reasons. One is obviously it's good from a jobs and revenue perspective, it's the more that you produce the better it is for your country economically. Secondarily, because the US has so much natural gas and the energy production structure has a decent component of Nat Gas in it. And the cost of Nat Gas is really relatively low especially compared to the global markets. That's a real tailwind because electricity costs are a lot lower in the US. Industrial electricity costs particularly are a lot lower than they are in most places globally. Then you're sitting there going well, where do I want to build my new factory? Where do I want to build my new plant? Combine that with the low cost of Nat Gas, which is an input for refining and input for cement production, input for steel production and a lot of other places, that is a tailwind for you, for the US. And then you layer further on top of that onshoring. And where we're seeing, we've seen US construction and manufacturing spending very strong in the past 12 to 18 months, give or take and that's, I think all part, sort of part of the same package of tailwinds.

Demographics, I'll touch on this briefly. Demographics are a real tailwind for the US, the working age population, people 15 to 64 years old, that's expected to grow in the US in the coming decades, plural decades. And that is a very different story than China, than Japan, than Russia, than many parts of Europe, which doesn't mean you can't invest in those places, but you have the demographic tailwind in the US and I'd be awfully cautious about buying companies that are levered selling infant diapers in Japan. And so, when you think about what are the tailwinds for the different economies, this is one that's going to help the US.

Finally, I'm going to touch a little bit more on India because I think it's so important both from a macro perspective globally and driving global growth, but also as an important and growing trade ally with the US. And so, India is doing this transition from an agricultural economy to an industrial economy. And when you take someone, a person and say, first I'm going to take the output that you can produce on a farm just with the strength of your back paired with whatever technology we have there. And I'm going to take you and move you to a city and I'm going to pair you with machines. The output growth is, and the productivity growth is massive, is massive. And as a result of that you get this almost productivity free lunch as economies transition that way. BCG did a study, I'll wrap it up on this, BCG did a study and it concluded that post everyone born after 2000 in India is going to spend in the neighborhood of $240,000 in their lifetimes. Multiply that by like 1.4 billion people. That is a very large economy. I think it's going to be really important globally. That more or less wraps up what I'd like to say about the US, so with that, I'm going to hand things back over to Rob. Over to you, Rob.

Rob Popazzi
Vice President, Retail Distribution

Thanks, Ashley. And again, thank you to all of the presenters so far today, some great insight and again really good information for us to walk through and be able to translate for the end consumer and I know many of the advisors on the call have been taking notes, I'm sure thinking about what are the areas they want to have those conversations with their clients about to help them with their confidence as they continue to invest with Empire Life and with that particular advisor. So, thank you for your thoughts.

We've got some time. Let's dive into a few questions and Ashley, since we just had you on the stage, let's bring you back up on the stage and maybe dive a bit more into the election commentary. And since they're happening all over the world this year, it seems, what are some of the most important ones that are on your radar and maybe a bit about why?

Ashley Misquitta
Senior Portfolio Manager and Investment Strategist

Yeah, absolutely, Rob. There's a few of them obviously, as I was mentioning the ones that spring to mind. So, for sure the US is a really important one and that's one we all talk about, we all hear about. So, we all know about it. Let me touch on Indonesia. Indonesia's a very large and fast growing economy. It's an important economy globally. It's done really quite well in recent years. The current president is term limited and sort of without getting into the gory details of it all, he was one of the first outsiders not part of the sort of the ruling families. And so, it'll be really interesting and important to see who takes over and what sort of policies they put in place. So, Indonesia's one I'd be paying some attention to. India for sure. I mean, you're probably sick of hearing me talk about India. I just think it's very important. And I really think India is the one historians will talk about, but journalists are not quite there yet. That's the example. And so, Modi is up for election again this year and, you know, it looks like he's going to come back in. We'll see what happens. That looks probable. From a European perspective, really I'm most paying attention for outlier outcomes. I think it was Poland recently that had an election that was more sort of EU favorable and so which you know, what you're looking for to some degree is very anti EU parties coming into place. And so those are like the kind of outlier things that could cause some levels of stress. Those would be the ones that I would highlight and of course the US is very, very important, but those are the ones I would highlight.

Rob Popazzi
Vice President, Retail Distribution

Absolutely. Thanks Ashley and it'll be interesting all the political machinations that are going to happen, of course, consuming so much of our daily media time. Fascinating to get your perspective on the ones that we don't necessarily hear about on a daily basis. Let's shift to Canada. And Greg, let's bring you up and let's talk a bit about the Canadian equity valuation levels. You mentioned that they're at a discount relative to historical levels and why do you think that is?

Greg Chan
Senior Portfolio Manager

Sure. Thanks, Rob, for the question. I think there's probably two reasons why Canadian equity valuations are cheaper than historical trading ranges. And the first, it's pretty simple. As interest rates have gone up over the past couple of years, not just in Canada, but globally, this makes sense that not just Canadian equities, but equities in general should be trading at a discount. And the reason is because future free cash flow is discounted back to present value at a higher discount rate, which lowers the intrinsic value. So that's the first reason. I think secondly as it relates more to Canada is like I mentioned earlier, the Canadian market, it's considered a cyclical market. So, we have financials and energy like I said represent about half our benchmark. Both of those are cyclical markets. So, you know there's obviously a lot of macro uncertainty out there. If growth is expected to slow down, you can see a lot of Canadian companies have lower top line growth, lower bottom line growth and all else equal investors are likely to pay a lower valuation multiple when growth is slowing down. So, I'd say probably those are the two big reasons at a discount right now.

Rob Popazzi
Vice President, Retail Distribution

Fabulous. Thanks, Greg, for adding that insight to it. Let's do a bit of a global perspective here. And so, Neeraj, let's bring you up here and aside from the markets you've already talked a bit about, what are some of the other markets that you're starting to see potential opportunity in?

Neeraj Khosla
Senior Investment Analyst

Thanks, Rob, for the question. I think from a long term perspective, I would like to highlight two important countries, one is India and one is Indonesia. And aside from the political comments that Ashley made, I think both these countries have a lot of commonalities. You know, first of all, both these countries have large populations, so India over 1.4 billion people, Indonesia close to 300 million people, very favourable demographics as well, with a large working age population and high, increasing urbanization rates in both these countries, and all these factors kind of lead to a secularly high GDP growth rates in both these countries. So, India typically grows in 6 to 7% range, in the last decade, it has grown that, at that pace and there are signs to show that growth is only going to sustain if not get better over the long term. And Indonesia grows consistently above five, 5 1/2% as well. And apart from these factors, both these countries are also benefiting greatly from US China relations where a lot of supply chains are actually moving down to these countries. So, for example, India is attracting a lot of investments in the manufacturing space from companies like Apple. So, I believe that all these elements would lead to large, good businesses in these countries to continue to grow at high growth rates for a very long period of time.
Back to you.

Rob Popazzi
Vice President, Retail Distribution

Fantastic, Thank you. And it's always fascinating from a geographical perspective to think about countries that aren't often in the news as much, Indonesia being a great example of that. And being sort of one of the top 10 economies in the world and one of the most populous countries as well. So great to have it on the radar. Thank you. Let's shift to fixed income and Ian. You gave us some great insight. I'm wondering if you could sort of bucket that into some key themes that you're going to keep watching and monitoring this year.

Ian Fung
Senior Portfolio Manager

Yeah, for sure, Rob. Thanks. Just to distill that into a few themes. One would be core inflation and inflation expectations. I mentioned that when we talked about it a bit earlier. But again, we want to see inflation continue to moderate and move lower on a sustained basis. So, we're close, keeping a close eye here for any inflections here and any signs of a pivot point for inflation to move lower. But I'll just touch on why inflation expectations are important to watch. Because we all know that inflation is important. Inflation expectations, we've talked about this in the past, but basically inflation expectations, if they rise, they get more inflation. So, it can be a self-fulfilling loop just feeding on itself, i.e. if you think that things will get to be more expensive later, you're going to buy something now and push the price higher. And then someone else might think the same thing and it ends up with a higher level of inflation that gets realized as more people think this way. So that's why inflation expectations are important to watch and so we're keeping an eye on that. Second, we're keeping an eye on consumer credit and any early signs of consumer delinquencies. This could throw some doubt into the ideas of soft landing if we see, if we see delinquencies and consumer stress move up higher on a dramatic basis. We've talked about the difference in interest rate sensitivity in both Canada and the US. Greg mentioned it in his remarks as well, but that's something we're keeping an eye on because Canada again is much more sensitive to interest rates given the higher level of indebtedness and the mortgage structure that we've seen in Canada. But again, we're looking, keeping an eye on that in the US as well.

Lastly, we're looking at wage growth in the employment outlook. Wage growth, as mentioned earlier, has been a trouble spot for both Canadian and the US economies in that it has remained relatively robust. We want to see wage growth kind of recede a little bit, so it eases the pressure on inflation. And again, from the employment side, we want to see the employment strength moderate a little bit. And so, when we see all of those factors put together, we should be able to see, put together a good, good read on inflation and the outlook for the economy going forward. Back to you.

Rob Popazzi
Vice President, Retail Distribution

Fantastic. Thanks, Ian. I appreciate it. And let's close out the questions, maybe cycling back to the US a bit. Ashley, if I could bring you up. And really wondering if you can give us a bit more insight into your thoughts around the US consumer and why that consumer has been so resilient.

Ashley Misquitta
Senior Portfolio Manager and Investment Strategist

Yeah, it's a really good question actually. And I think there's a couple things I'd point to. So, one, employment has just been so much stronger, I think than almost anyone would have predicted. And part of it is because companies had such a hard time hiring. We started to hear kind of midway through last year that even though rates were up and there's a lagged effect of increases in interest rates on corporate decision making. Even though that was the case, because it had been so hard to hire people, they were reluctant to fire people. So that's probably one of the things that contributed. I mean, even today you look at both the high frequency [weekly] data which is something that comes out every Thursday. There's what's called initial claims, how many people filed for unemployment that previous week. It's at really quite low levels relative to sort of what we would expect from history. In addition to that if you look at sort of more backward looking stuff, the employment print was, the prints have been really quite strong even till recently and so that's one contributor. The second contributor is just the robust bank accounts that consumers have had, the amount of money that was put in their bank accounts as a stimulus measure through COVID. Those are, you know it takes time for those to diminish and deplete, I guess. And then the final thing I would say is, unlike in Canada and unlike prior to the financial crisis in '08, the US consumer is much less leveraged than they used to be. So, it used to be that the debt to disposable income, let's say this was the trend line, debt to disposal income pre '08 went up into these levels, went way high and we're actually down well below trend line now. And so, the consumer in the US is just in a better shape than they have been historically. So, I think if you combine all those things that, those are kind of the key things I would point to that have contributed to the consumer strength. So over to you, Rob.

Rob Popazzi
Vice President, Retail Distribution

Fantastic. Thanks, Ashley. And it's such an interesting position for us to be in at this point in time. And I was with a group of advisors today. And again, so much energy and so much excitement around the time that we're in. And there's never been a better time to be in our business helping people with their investment planning, with their protection. It's just a great, a great time that we're in right now. So, thank you all for your insights. I'm going to conclude our webinar today. I want to thank the panel for joining us. And I want to thank you for taking the time to join us as well. And I do want to leave you with a couple of action items to help you grow your business. So, if you haven't had a chance, I would encourage you to read the Empire Life 2024 market outlook you can find on empire.ca/advisor or as part of the resources available here in the webinar. Remember that the GIF Growth Commission Bonus campaign, that's been extended for 2024. But that's not all. And until April, get twice the reward with our 2024 RRSP Season Commission Bonus. If you have any questions about today's webinar, our industry-leading product choices, please contact your Empire Life sales team. They'd love to talk to you. They're waiting for your call, as the saying goes. Watch your inbox for the next couple of days for an email blast that will include a replay of today's webinar. You can share that with your colleagues that missed it. In addition, there's lots of great fund resources that can be found on the advisor site. Again, empire.ca/advisor. With that, I want to wish you a wonderful day and thank you very much for joining us.

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