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# 2024 Midyear Outlook

June 2024

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# Letter from the Partners

*2024 Midyear Outlook*

Canada became the first G7 country to cut interest rates in June, signaling the start of the long-awaited rate cuts investors have been anticipating. The biggest questions now on the minds of investors include: will there be further rate cuts, how fast and deep might they be, and will other nations, including the United States, follow suit.

But it is not just the monetary policies of central banks that are impacting investments. Ongoing geopolitical turmoil, energy transition and the movement of digital assets to the mainstream have also been driving forces in the first half of the year in alternative investing.

In this 2024 Midyear Outlook report, we attempt to address how these trends have impacted our investment decisions so far this year and what sort of impact they may have in the back half of 2024. The goal, as always, is to help ensure you have the right information and strategies in place to guide your investment decisions and build your portfolios for success through the next cycle.

We hope you find our insights helpful.

**James Fox**
**John Wilson**
*Managing Partners*
Ninepoint Partners LP

Mark Wisniewski, Partner, Senior Portfolio Manager & Head of Fixed Income
Etienne Bordeleau, Vice President, Portfolio Manager

# Fixed Income Outlook

Following the fastest and largest rate hike cycle since the 1980s, we now have the highest interest rates in over 20 years. Investors can earn very attractive returns in various fixed income securities without taking much risk. And monetary policy is sufficiently restrictive, so the odds of further increases, which cause mark-to-market losses in bonds, are extremely low. If, and when, the economy slows as inflation declines, rates cuts will then provide capital gains in bonds. There is clearly a compelling risk-reward opportunity for fixed income investors with bond yields at their highest point in 20 years, very low odds of further rate hikes and greater odds of rate cuts and attractive income. Investors that had been invested in high-interest savings accounts, money market funds and GICs are recognizing the higher income and return potential available in bonds.

*"There has undoubtedly been a renewed appetite for fixed income products. Risk adjusted returns relative to equities and other riskier assets are extremely compelling. Advisors that haven't touched bonds in the past 15 years are now actively investing."*

— Mark Wisniewski
*Partner, Senior Portfolio Manager & Head of Fixed Income*
Ninepoint Partners

## Big Questions Remain Around Rate Cuts

There are several questions fixed income investors will be looking to be answered in 2024. Will inflation decline to 2%? When will the Bank of Canada and the Fed cut interest rates? And how big will these rate cuts be? A series of modest rate cuts won't materially change the opportunity for fixed income investors, because interest rates will still be higher than they have been in the past 10 years. But, if the economy goes into a recession, central banks will cut rates more aggressively, and that would be very positive for fixed income returns. On the other hand, a resurgence of inflation is a possibility, particularly from energy costs moving up. This could force central banks to hold rates higher for longer, pushing medium- and long-term interest rates up and, with that, higher volatility in equities and corporate credit.

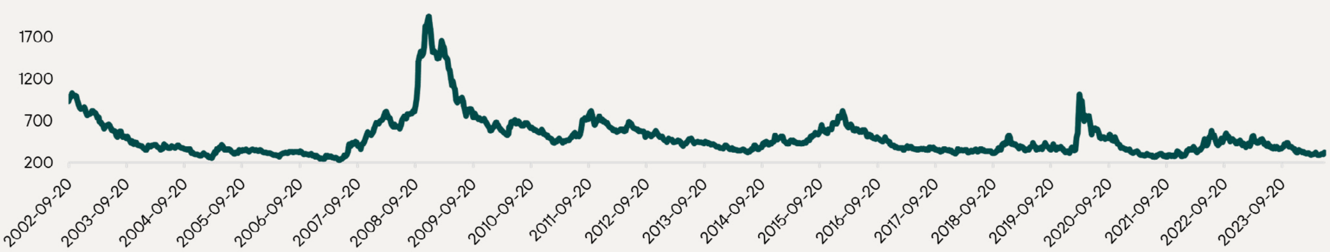
## What if Inflation Doesn't Come Down?

If inflation doesn't decline to 2%, or there is a surprise increase in inflation, central banks would be forced to raise rates further. This would inflict maximum pain on the economy and with that, volatility in equities and corporate credit. Although this isn't anyone's base case, it is still a slight possibility. Alternatively, if they cut rates too early, while the economy is too hot, they risk repeating the mistakes of the 1970s, when inflation became entrenched. That would be a significant challenge and difficult environment for investors.

## Corporates Still Compelling For Discerning Investors

Although we still prefer corporate credit, not everything is cheap, and investors need to be discerning. After credit spreads widened meaningfully in 2022, both investment grade and high yield credit are now back to very tight levels. So, while bond yields are attractive, investors need to be mindful of the risk of lower-quality credit. This is why Ninepoint is totally focused on higher quality issuers. And with the yield curve still inverted (short-term interest rates are higher than long-term rates), it is a logical decision to purchase shorter dated bonds, which are less volatile. These bonds, which trade at a discount, showcase the whole new world of tax efficiency that is now available in fixed income, a benefit that hasn't really existed for 40 years. Heavily discounted, low coupon bonds issued in 2020 and 2021 offered investors a small stream of income and the potential of attractive capital gains as they make their way back to par. This greatly enhances their appeal versus GICs, which are 100% interest or bond funds that do not have the flexibility to optimize for this opportunity.

## Risk Assets Are Priced to Perfection — U.S. High Yield Spreads Back to the 2021 Tights




Source: Bloomberg

Jeff Sayer, Vice President, Portfolio Manager

# Real Asset Outlook

As we reach the midway point of 2024, investors in the real asset class have had quite different experiences depending on where their capital was allocated. Investors in global infrastructure have generally experienced good performance as positive GDP growth, and investments, such as in the transition to clean energy, have acted as supportive tailwinds. However, investors in the global real estate category have generally experienced weaker performance with high interest rates continuing to act as a headwind, pressuring valuations and making new development more difficult. On a positive note, monetary policies should ease over the balance of the year, interest rates are likely to fall, bond yields should drop and both infrastructure and real estate assets should perform well on an absolute and relative basis.

## Slowing Economic Growth Could Create Hurdles

Slowing economic growth in certain geographies may act as a headwind but it is highly unlikely that the global economy will fall into a recession this year. Since GDP growth should remain positive, and may even reaccelerate at some point, infrastructure utilization and real estate occupancy should trend higher, boosting revenue, earnings and cash flow growth from our holdings.

## Infrastructure Investment Warranted

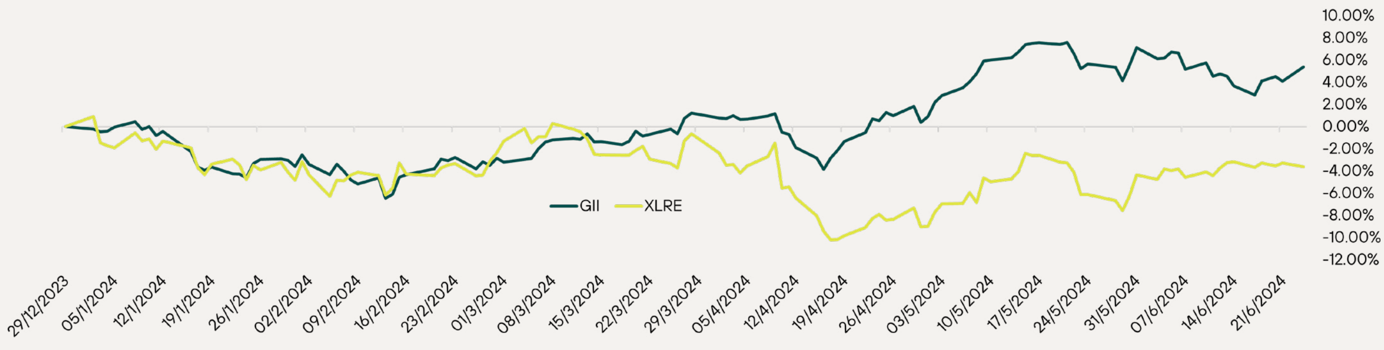
Both institutional and individual investors continue to add to their real asset class allocations in 2024. This has improved awareness and bolstered valuations in recent years. However, we believe that infrastructure, which has characteristics of both fixed income and equity securities, should be considered a core holding in a diversified portfolio and warrants a more significant weighting. We hold this view because the various infrastructure sub-industries or sub-sectors can be thought of as either GDP sensitive or interest rate sensitive and work differently depending on where we are in the economic cycle. Therefore, active management can add significant value irrespective of the macroenvironment. Because real estate is a more homogenous asset class that moves in tandem – but inversely to interest rates – a less significant exposure is more appropriate.

## Global Exposure Important in Canada

From a Canadian investor's perspective, having the ability to invest globally is important to generating solid returns over time. Certain types of real asset investments are simply not available in the country so Canadians are forced to look outside of our domestic market for these types of investment opportunities. A global mandate also allows investors to allocate capital where economic conditions are most favourable, whether this means regions with better GDP growth or lower and falling interest rates. Thankfully, after almost two and a half years of rising interest rates, rates are likely to begin to move in the right direction and GDP growth should remain firm, which bodes well for the real asset class going forward.

> *"Falling interest rates should be the most important tailwind driving performance."*
>
> — Jeff Sayer
> *Portfolio Manager & Head of Global Equity, Infrastructure and Real Estate*
> Ninepoint Partners

## Infrastructure v Real Estate - Total Return YTD




Source: LSEG Eikon, effective close June 24, 2024

# Precious Metals Outlook

Prices of gold and silver made notable gains in the first half of 2024 with both metals benefiting from the prospect of easing monetary policy, increasing geopolitical turmoil and central banks buying gold. Gold prices reached a new high in April at $2,432 per ounce, supported by emerging markets, like China, looking for an alternative to the U.S. dollar. Investor interest in physical gold and silver in the West remains muted but if the Fed signals a change to their monetary policy, we could see a resurgence in interest in precious metals. Silver is experiencing a boom of its own, driven in large part by its pivotal role in the green energy transition.

## Central Banks Driving Gold Prices

The driving force in gold prices in recent years has been central banks buying in emerging markets, specifically China, as they look to become less dependent on the U.S. dollar. Monetary authorities buying gold started to surge in 2022 and has continued through the first half of 2024. The trend was spurred by the Russian invasion of Ukraine and the subsequent freezing of Russia's foreign exchange reserves by Western nations. The result has been an effort by the central banks of several emerging markets to diversify away from the U.S. dollar and into gold bullion. This trend of de-dollarization is expected to continue in the back half of 2024 and will continue to support gold prices.

*"Central banks around the world are trying to diversify away from the U.S. dollar and buying gold is one of the ways they are doing that."*

— Maria Smirnova
*Senior Portfolio Manager and Chief Investment Officer*
Sprott Asset Management

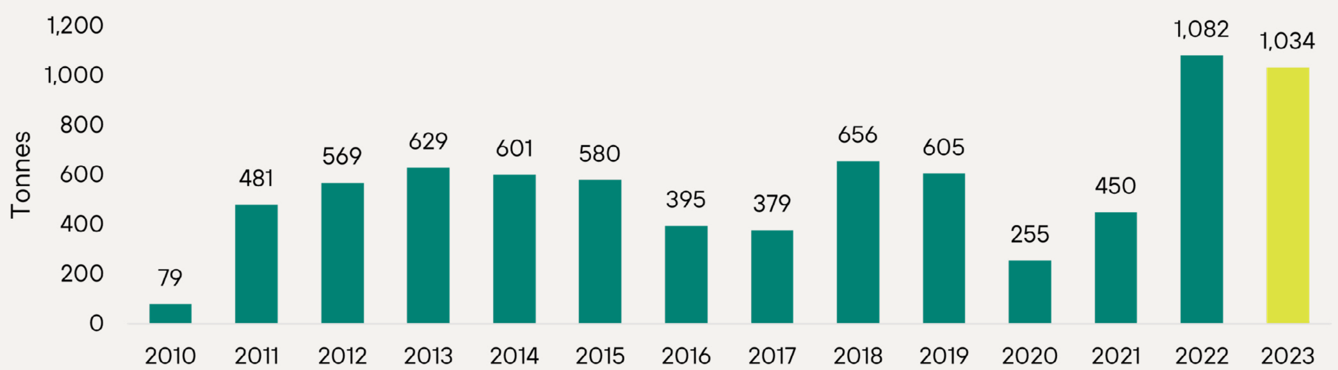
## Robust Demand Driving Silver Prices

Silver prices formed a new base at about $30 per ounce as the metal was buoyed by similar factors to gold, but also silver's exposure to the green energy transition. Looking ahead, silver prices are expected to improve, driven by lower interest rates, more robust physical investment, ETF purchases and increased industrial demand. The global energy transition is a major driver of silver prices with the metal playing a pivotal role in the manufacturing of solar panels and electric vehicles, for example. It is also important to the booming AI industry. Historically, demand for silver has been split evenly between industrial use and investment purposes, for example in silver bars or coin investment. This has shifted in recent years and industrial use of silver now accounts for 55% of the total demand. Supply, on the other hand, has been stagnant for a decade and the silver market has been in a supply deficit for the last three years. This trend is expected to continue in 2024 and beyond.

## Fed Pivot Will Benefit Bullion and Miners

In the West, interest in precious metals has been slim to none with outflows continuing in gold and silver bullion ETFs in 2024. Should there be a reversal in the Federal Reserve's interest rate policy, this could all change. The market is already anticipating this will happen – it's just a question of timing. On the equity side of gold, prices remain cheap, and the stabilization of inflation has helped improve labour and energy costs for miners. In the back half of 2024, investors will be looking for further proof of this in margin expansion, dividends, share buybacks and improved profits for mining companies. Once general investors move back into the sector, valuations will improve from their lows. The first half of 2024 showed very early signs of emergent interest from the generalist investor pool.

## Gold Balance — Central Banks & Other Institutions




Source: Bloomberg

# Energy Outlook

Entering the second half of the year, the oil market sits on the cusp of seasonal inventory draws. Given demand continues to exceed expectations and supply constraints – both voluntary and involuntary – global oil inventory levels are expected to hit all-time lows by year end. This is both supportive of prices and for allowing OPEC+ to slowly return curtailed volumes. Natural gas prices have strengthened on the recent warm weather, which is good for cooling demand, as well as producer discipline in curtailing volumes to help normalize very bloated storage levels. With continued curtailment, a normal summer and LNG projects in both Canada and the United States to begin consuming gas, there is a potential for normalized inventory levels this winter. With a significant increase in North American LNG production – roughly doubling from now to 2030 – the price for natural gas will have to increase to levels that allow more marginal basins, like the Haynesville, to increase production to satisfy demand growth. This price is roughly $4/mcf.

## Momentum Depends on the Fed, China

There are a few things that may derail the momentum in energy. If the Fed does not cut rates like most are predicting this year, the strength in the U.S. dollar may impact global demand growth, because a strong U.S. currency makes energy consumption more expensive. At the same time, if Chinese manufacturing data shows weakness, it may signal some trouble ahead, because the country is an important consumer of crude. While Chinese demand growth this year has been underwhelming, global demand continues to exceed consensus expectations.

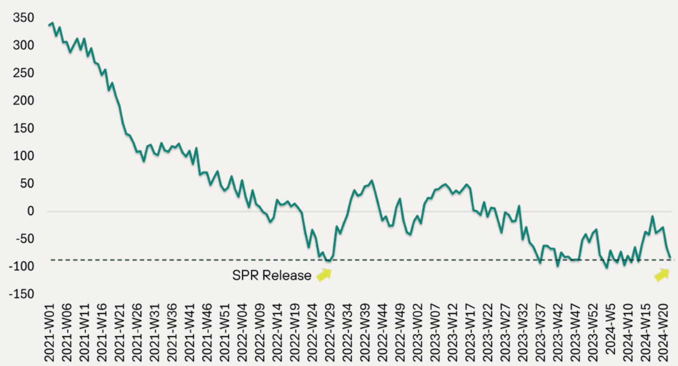
## Peak Oil is Decades Away

There continues to be significant misconceptions around the energy sector. The notion that peak oil is just around the corner, or that the oil and gas sector are a sunset industry that has stranded-asset risk or is facing a rapidly decarbonizing world is patently false. Goldman Sachs recently estimated that peak demand is at least a decade away, after which point oil demand will only very slowly and gradually decrease. The expectation is that global demand will not fall below current levels until around 2040. There is a need for more Canadian oil and natural gas production, not less, and therefore the value of long-duration assets is much higher than what the market currently believes. Sentiment remains challenged and the sector generally is experiencing outflows. Energy ignorance fuelled by a chronically negative media and heightened volatility due to macro concerns or sector rotation has resulted in impaired sentiment. Typically, strong share price performance is beneficial to sentiment but year-to-date the opposite seems to be true.

## The Canadian Opportunity

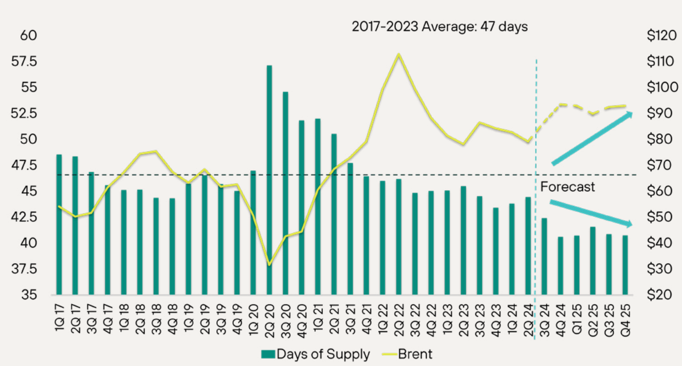
Canadian energy companies have some of the longest-dated inventories anywhere in the investable world, trade at a discount to their U.S. peers and have their strongest balance sheets in history. They are also generating record amounts of free cashflow and are returning that cash back to shareholders in the form of share buybacks and dividends. Free cashflow yields and trading multiples compare extremely favourably to other subsectors. The Canadian energy sector is trading at a forward free-cash-flow yield of 14%, is in the strongest financial position in history and is committed to low-to-no growth in order to maximize returns to shareholders. This meaningful buying power, in our view, will eventually rerate trading multiples from still too-low levels.

## Global Observable Oil Inventory*




*(onshore + oil-on-water) Surplus/Deficit to 2017-2019 Baseline Average (MM Bbls)
Source: Kpler

## Global Oil Days of Supply: Oil Price




Sources: Kpler (inventories), Cornerstone Analytics/Energy Aspects (demand), Ninepoint Partners

# Digital Assets Outlook

Digital assets have managed a remarkable recovery during a period of higher-than-normal interest rates, dispelling an early criticism that they could only perform well in a zero-interest-rate environment. Investors are, as a result, less concerned with sticky inflation and high rates than they once were. The world is learning to live with higher rates – as a result, the go forward driver of growth for Web3 will be continued improvements in utility of the technology and innovation at the application layer. However, the asset class is still not immune to global macro factors. For example, if inflation reaccelerates, requiring central banks to raise rates once again, this would be a headwind for the digital asset complex.

## Regulatory Headwinds Turning into Tailwinds

Over the past year, the regulatory headwinds facing the digital assets industry have started to turn into tailwinds as the likelihood of future 'catalysts' began to lean more favourably and as several key milestones were reached, including:

- The successful and historic launch of spot Bitcoin ETFs in the U.S., which have gathered more than $13.7 billion in net assets since launching in January 2024 and now hold over $50 billion in assets under management.[1]
- In April 2024, Bitcoin underwent its fourth-ever halving network upgrade. While prior halvings have led to new all-time highs in the following 12 months, this halving reached an unprecedented milestone as Bitcoin reached a new all time high before the halving unlike all other previous halvings, which have marked cycle bottoms.
- In May 2024, the U.S. House of Representatives passed the Financial Innovation and Technology for the 21st Century Act (FIT21) with a bipartisan majority, a crucial milestone that provides regulatory clarity and consumer protections for the digital assets ecosystem.
- Finally, the SEC's surprising approval of Ethereum ETFs in late May now paves the way for ETH ETFs to begin trading this year (more on this below).

This momentum is likely to continue building, especially as the U.S. is in an election year in which crypto's future is top of mind for many voters. In fact, a recent survey from Digital Currency Group revealed that 20% of voters in swing states consider 'crypto' a major issue, highlighting the increasing importance of the broader Web3 world in the political discourse.[2]

## Huge Demand Expected for Ethereum ETFs

In May, the SEC announced it was approving eight Ethereum ETFs that will bring industry heavyweights into the space, including BlackRock, Fidelity, Invesco and others. These ETFs, while approved, will likely not start trading until the second half of 2024. It was always a matter of when they would be approved, not if. That said, it is a big step forward for the asset class and will also accelerate the adoption of Web3 and crypto by making it easier for institutions and everyday investors to own the asset class. How significant could an Ethereum ETF be? Canadian Ethereum ETFs, when launched in 2021, grew to nearly $1 billion in less than a year, so the U.S. market could grow 10 to 15 times that.[3] Standard Chartered estimates that Ethereum ETFs, if approved, would gather $15 billion to $45 billion of inflows in their first 12 months.[4]

> *"The change of tone from the SEC could signal a broader shift in the U.S. towards a more accommodating and open approach to the digital assets industry."*
>
> — Alex Tapscott
> *Managing Director, Digital Asset Group & Portfolio Manager*
> Ninepoint Partners

## Investors Still Cautious on Crypto.... But That's Likely to Change

The biggest misperception investors have is that somehow Web3 is only about cryptocurrencies. While digital money is an important test case, there's a lot more to the story than that. The Web3 era is really about the convergence of several technologies, including blockchain, AI, extended reality and the internet of things. Despite the fact that most investors still do not have exposure to Web3 in their portfolios, the tide is quickly beginning to turn in Canada. For instance, KPMG and CAASA's 2023 Institutional Adoption of Cryptoassets Survey has already indicated that Canadian investors are increasingly embracing crypto assets as 39% of institutional investors have exposure to crypto assets, up from 31% in 2021. In addition, roughly 50% of financial service firms already offer crypto asset services now, up from 41% in 2021.[5] Canada has been a global leader in Web3 for years and was the first to enable closed-end crypto asset funds, crypto asset ETFs and Ether staking ETFs. With a total of 64 Web3 businesses trade on our public markets, the opportunities ahead for investors in the market only continue to grow.[6]

Arif Bhalwani, Chief Executive Officer & Managing Director,
Third Eye Capital - Sub-Advisor
David Sum, Managing Director, Alternative Income

# Private Credit Outlook

We are entering a period where the role of private credit, in our view, is more critical than ever. The rise in financing costs over the past two years, combined with slowing economic growth, has posed significant challenges for several businesses and created a sizable demand for flexible and creative financing solutions that traditional banks are often unable to provide. Private credit has shown its resilience and adaptability in these conditions. While publicly listed companies might benefit from fixed-rate bonds with longer maturities, small- and medium-sized businesses, which form the backbone of the economy, often rely on demand-based, floating-rate bank loans and face more immediate financial pressures. The recent surge in business insolvencies, particularly among small businesses, underscores the urgent need for specialized financing solutions.

## Demand for Private Credit Surging

The rise in financing costs over the past two years, combined with slowing economic growth have posed significant challenges for many businesses. The number of businesses in Canada filing for insolvency, which had been unusually low during the pandemic, has now surpassed pre-pandemic levels by a large margin. Business insolvencies in Canada surged by 87.2% in the first quarter of 2024 compared to the same period last year, marking the sharpest increase in the 37-year history of records from the Office of the Superintendent of Bankruptcy.[7] Demand for private credit has increased as traditional banks tighten their lending standards and more businesses are turning to private credit for financing, creating opportunities for private credit funds to fill the gap with bespoke financing solutions. Companies seeking flexible and creative financing options, particularly those in distress or undergoing restructuring, are driving this demand. The private credit market has proven to be resilient through various economic cycles. Experienced managers can navigate market volatility and identify attractive investment opportunities, leveraging their expertise in turnaround investing and restructuring strategies to capitalize on market dislocations and distressed opportunities, potentially generating outsized returns.

## Investor Demand

Positive market sentiment further supports the private credit market. Institutional investors continue to show strong interest in private credit, with many planning to increase their allocations this year. This influx of capital supports the growth and stability of the private credit market. The fundamental need for private credit remains strong. As traditional banks pull back from lending due to tighter regulatory requirements and increased risk aversion, private credit funds can step in to fill the financing gap. This dynamic allows private credit investors to negotiate higher yields, better collateral and stronger creditor protections. Moreover, many companies will face refinancing challenges as their existing debt matures or gets called in at a time of higher interest rates. Private credit can provide the necessary capital for these companies to manage their debt obligations, often at attractive terms for the lender. This creates a win-win situation where companies gain access to much-needed liquidity, and investors benefit from enhanced yields and improved risk-adjusted returns.

> *"Private credit is not just about taking on more risk; it is about managing risk effectively to achieve uncorrelated long-term returns."*
>
> — Arif Bhalwani
> *CEO & Managing Director*
> Third Eye Capital

## The Illiquidity Advantage

The biggest misperception investors have about the private credit sector is the belief that it is excessively risky due to illiquidity and higher default rates. While private credit is inherently less liquid than public fixed income due to the underlying nature of the investment and lack of well-developed secondary market, private credit benefits from the robust risk management practices, strong deal structures and active value creation strategies employed by experienced private credit managers. Private debt has real structural advantages like security, customizable terms and covenants. A private debt manager is directly engaged with the management teams, business and assets of its borrowers, allowing it to track idiosyncratic risks and adjust and recalibrate as necessary. Public market managers do not have that ability – a corporate bond could be held by hundreds of investors who will have little or no ability to influence terms or amend credit or security documentation. A public debt manager might be able to sell a bond to exit, but they have to take the market price, which in times of dislocation, can lead to a major disconnect between prices and fundamentals. During these periods, the liquidity that investors seek from fixed income investments can paradoxically become a liability, as the rush to liquidate positions exacerbates price volatility and erodes value. In contrast, the illiquidity inherent in private credit becomes an asset, shielding investors from the need to sell at market troughs and thus preserving the capital integrity of their investments.

## The Canadian Opportunity

The Canadian private credit market represents a significant white space with untapped potential. Canada arguably has the most inefficient business lending markets among advanced economies, with 80% of business financing coming from banks.[8] This heavy reliance on bank lending is due to the concentrated nature of the Canadian banking system, which is dominated by a handful of major banks operating as an oligopoly. The concentration of the banking sector in Canada, coupled with stringent regulatory requirements, has led to less competition and reduced risk-taking. This conservative approach disincentivizes banks from engaging in riskier lending activities, resulting in credit tightening. The inefficiency of the Canadian business lending market, combined with limited competition, creates a fertile ground for private credit. Alternative lenders can generate returns by providing much-needed liquidity and capitalizing on opportunistic lending opportunities. Proven managers with long track records are uniquely positioned to leverage their expertise and experience to unlock value in the Canadian private credit market, driving growth and innovation while delivering the potential for attractive returns for investors.

> *"Private credit as an asset class has gradually advanced, and now represents a core component of a well-diversified investment portfolio. Year to date, traditional bank lending remains tight and presents an opportunity for private credit to continue to fill the lending gap for companies seeking capital to grow their businesses."*
>
> — David Sum
> *Managing Director, Alternative Income Group*
> Ninepoint Partners

[1] The Block
[2] Digital Currency Group Survey
[3] YCharts
[4] The Block
[5] KPMG Survey
[6] TSX Crypto Listings
[7] Insolvency statistics in Canada
[8] Biannual Survey of Suppliers of Business Financing, Statistics Canada, April 2024

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