2024 YEAR AHEAD OUTLOOK

"While conventional wisdom suggests that a rate cut boosts market performance, historical data ***shows investors could actually be rewarded the most in a pause period****, before easing begins."*

Gargi Pal Chaudhuri
Head of iShares Investment Strategy

KEY TAKEAWAYS

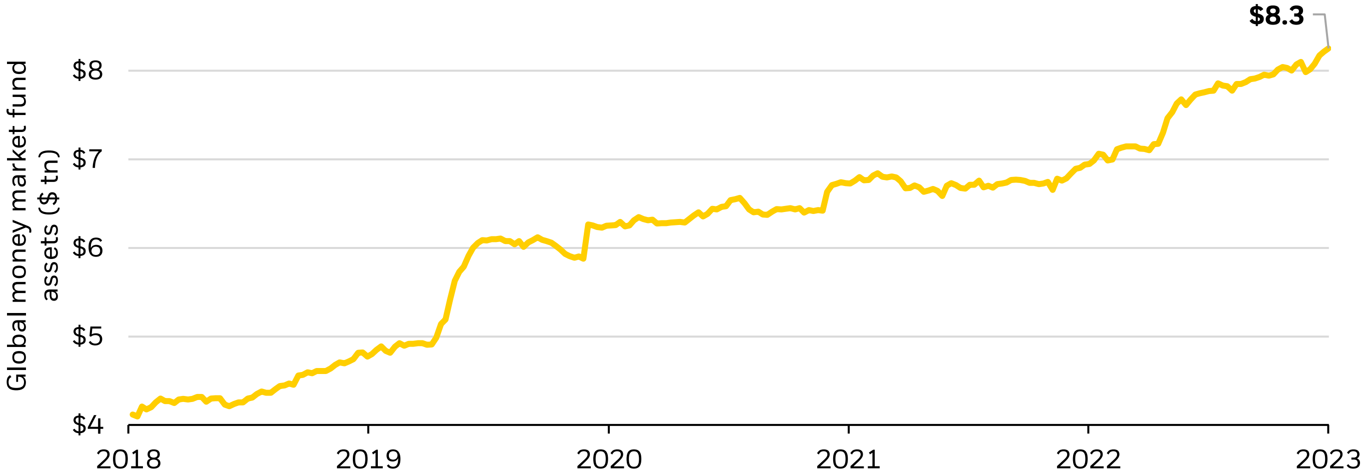
1. We are likely at the end of developed market Central Bank hiking cycles, but **don't anticipate rate cuts until the second half of 2024.** The shape of the yield curve and the trajectory of growth will be key drivers of returns.

2. Investors piled into cash in 2023. Staying there **risks missing the returns in stocks and bonds** during the 'pause period' between the last hike and the first cut.

3. 2024 will be a year to pick your spots. We see opportunities to deploy cash selectively across asset classes.

- **In fixed income,** we prefer pairing intermediate duration core holdings with income seeking exposures.
- **In equities**, we favour adding downside protection in core exposures while taking targeted risk in loveable laggards.

Figure 1: Investors have stockpiled cash in the face of macro uncertainty



Source: EPFR, Bloomberg. As of November 22, 2023.

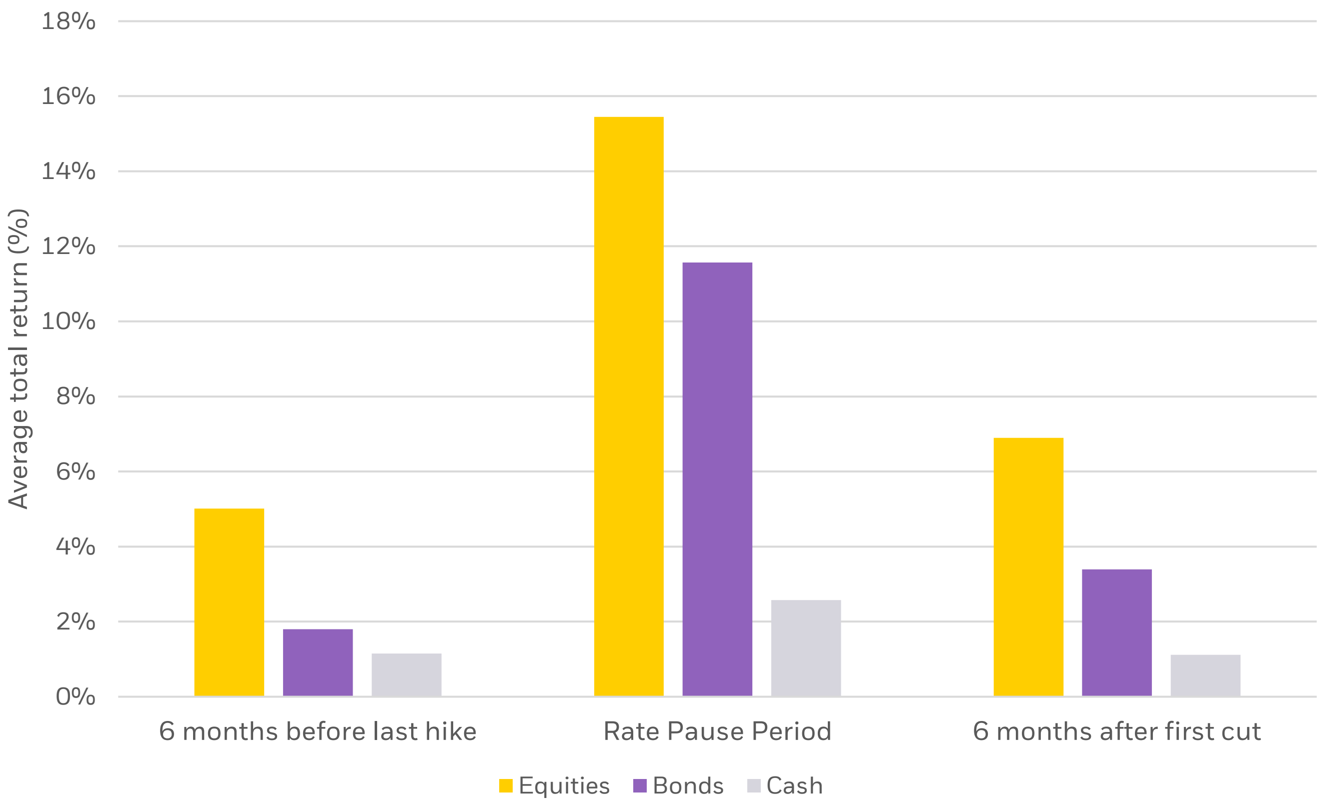
MACRO

We believe developed market Central Banks are likely done hiking, though the market overestimates the speed and scope of their easing in 2024. We generally don't see a rate cut until the second half of 2024 as inflation remains well above Central Bank targets of 2%. For investors, the focus will shift from "how high?" to "how long?" policy rates can remain tight. In our view, the pace of policy easing, the shape of the yield curve, and the trajectory of economic growth will be the key drivers of portfolio returns.

In 2024, sitting in cash risks missing out on bond and equity market returns. In the previous five hiking cycles since 1990, the Fed paused an average of 10 months between its last hike and its first cut.[1] On average, stock and bond returns have been higher during the pause period than in easing periods immediately following the first cut (Figure 2).

In 2023, global investors added a record $1.1tn to their cash holdings, the highest allocation since the pandemic.[2] While an overweight cash position made sense for some investors during rapidly rising rates, it is harder to justify now that the Fed has reached its likely terminal rate. Many investors appear to be waiting on the sidelines for more clarity around the path of policy rates; we caution that doing so now risks missing potential upside in other asset classes.

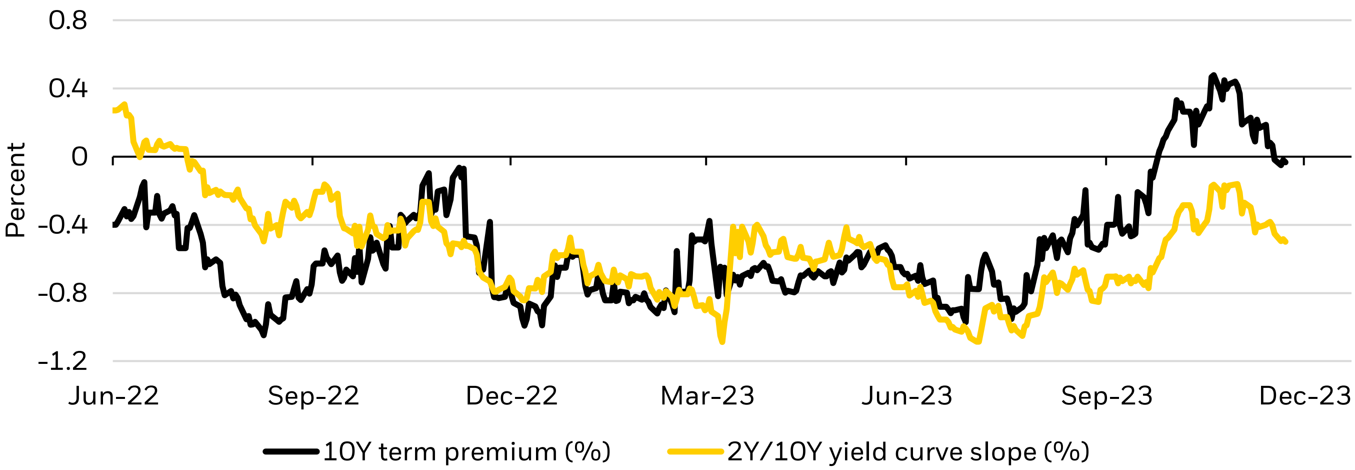
Figure 2: Pauses have paid off, even more than easing periods



Source: Bloomberg, as of November 16, 2023. Total return analysis produced by iShares Investment Strategy. Historical analysis calculates average performance of the S&P/TSX Composite Index (equities), the iShares Core Canadian Universe Bond Index ETF XBB (bonds) and the S&P Canada Tbill TR Index (cash) used in the 6 months leading up to the last Bank of Canada rate hike, between the last rate hike and first cut, and the 6 months after the first cut. The dates used for the last rate hike of a cycle are 4/15/2003, 7/10/2007, 9/8/2010, 10/24/2018. Dates used for the first-rate cut are: 7/15/2003,12/4/2007, 1/21/2015, 3/4/2020. Prior to 7/10/2007, cash return has been approximated by Bank of Canada policy rate. **The Index performance is for illustrative purposes only. Index performance does not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results.**

Cash was king in 2023 but changes in the shape of the yield curve signal the end of its reign. Over the past 2 years, the 10-year term premium has been negative most of the time. In other words, investors in 10-year notes have been paying to take the risk of uncertainty around the expected path of short rates instead of getting paid to do so. A negative term premium, combined with a steeply inverted yield curve, meant that cash and short maturities outperformed for most of 2023. Normalization in both has changed the incentive structure, and the shape of the yield curve is now signaling that it's time to consider allocating out of cash.

Figure 3: Changes in the yield curve make cash less appealing



Source: Bloomberg, as of November 21, 2023. 2Y/10Y yield curve slope as represented by USYC2Y10 Index. 10Y term premium as represented by ACMTP10 Index.

For equity allocations, **managing macro risks in a slowing growth backdrop will be key.** While we are not calling for a recession, a downshift from above-trend growth could present challenges for segments of the equity markets. We see three key risks to consumers – and, by extension, earnings (see table below). In a shifting macro environment, remaining invested can be paramount, but adding downside resiliency to core equity holdings could make sense for many investors.

But where there are losers, there are also winners. We think reducing risk in core equity holdings allows investors to **steer portfolio outcomes toward potential opportunities** on the margin by deploying cash selectively within styles, industries, and geographies.

Geopolitical risks, election cycles, a worsening U.S. fiscal backdrop, and shifting central bank narratives may result in rapidly shifting equity leadership and require more frequent portfolio adjustments in 2024. ETFs can be a useful tool to efficiently adjust to rapidly changing realities.

Figure 4: Risks to the consumer outlook

Growth Factor	Outlook
Disposable income	• While historically low, the unemployment rate in the U.S. has risen 0.5% from its cycle lows.[3] In Canada the unemployment rate has increased by 0.9%.[4] • The 6-month annualized change in real disposable personal income in the U.S. is at its lowest two years. [5]
Borrowing	• The 6-month average change in U.S. consumer credit has slowed to its weakest pace since October 2020.[6] U.S. auto loan delinquencies have reached their highest level in 13 years.[7] U.S. 90-day credit card delinquency rates are at their highest level in two years.[8] • In Canada, almost 50% of mortgages have had their payments increase with the expectation this share will rise to nearly all mortgages over the next three years. [9] • Canadian household debt service ratios at 15.2% are at the highest level on record. [10]
Savings	• The personal savings rate in the U.S. has fallen to 3.4% versus its long-term average of 5.7%.[11] • While estimates vary, research suggest that pandemic-era excess savings are now completely exhausted.[12]

FIXED INCOME

iShares Investment Strategy Views: Fixed Income

	Short Term	Medium Term	Outlook
Cash	↓	↓	Developed market central banks have likely reached terminal policy rate
Intermediate duration	↑	↑	Utilize 'belly' of the curve to lock in higher rates
EM Hard currency	↑	↑	EM central banks ahead of DM and already easing
Investment Grade	↑	↑	IG provides more portfolio resilience relative to HY
High yield	↓	—	Spreads too tight to adequately compensate for rising default risks
TIPS	—	↑	Diminishing upside inflation risks

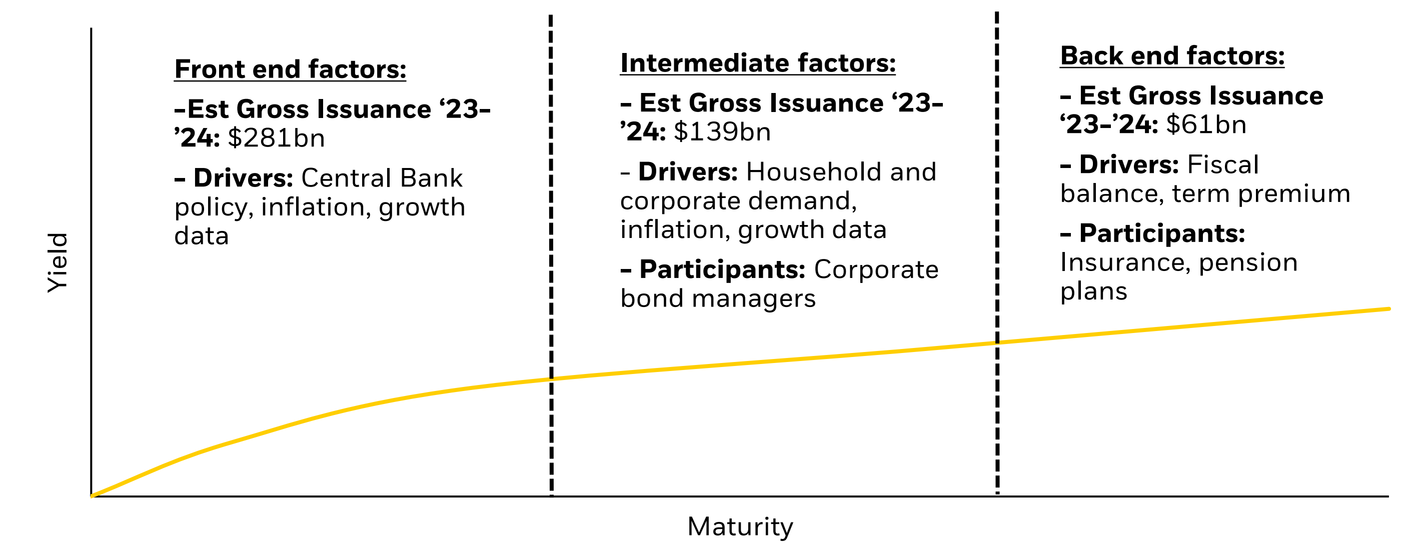
As of November 28, 2023. Views are subject to change.

2024 will be a year to pick your spots in fixed income. We see opportunities to do so along the yield curve, within spread products, and outside of Canada.

Cash cannot benefit from falling rates like bonds can. With inflation continuing to normalize, we believe developed market central banks' next move is likely a cut. In a regime of declining interest rates, current bond yields would no longer be viewed as the best expectation of total returns, but instead something closer to a floor. As rates fall, bond prices rise and provide investors with returns from price appreciation in addition to interest income. However, to capture the potential upside of price appreciation, investors would need to own duration, which is a measure of a bond's sensitivity to changes in interest rates. As the duration of cash is close to zero, it cannot participate in such a rally.

1. We think it is time to extend in duration, but do not yet think the risk-reward justifies a move to the long-end of the curve. We believe the intermediate portion of the yield curve represents the 'sweet spot,' optimizing potential price appreciation, liquidity, and current yield. In our view, rates at the long end of the yield curve are not yet attractive at current levels. Before taking a significant exposure to the long end, we would prefer to see the yield curve return to a more normal shape, with an upward-sloping term structure and a positive term premium more consistent with levels before the Global Financial Crisis.

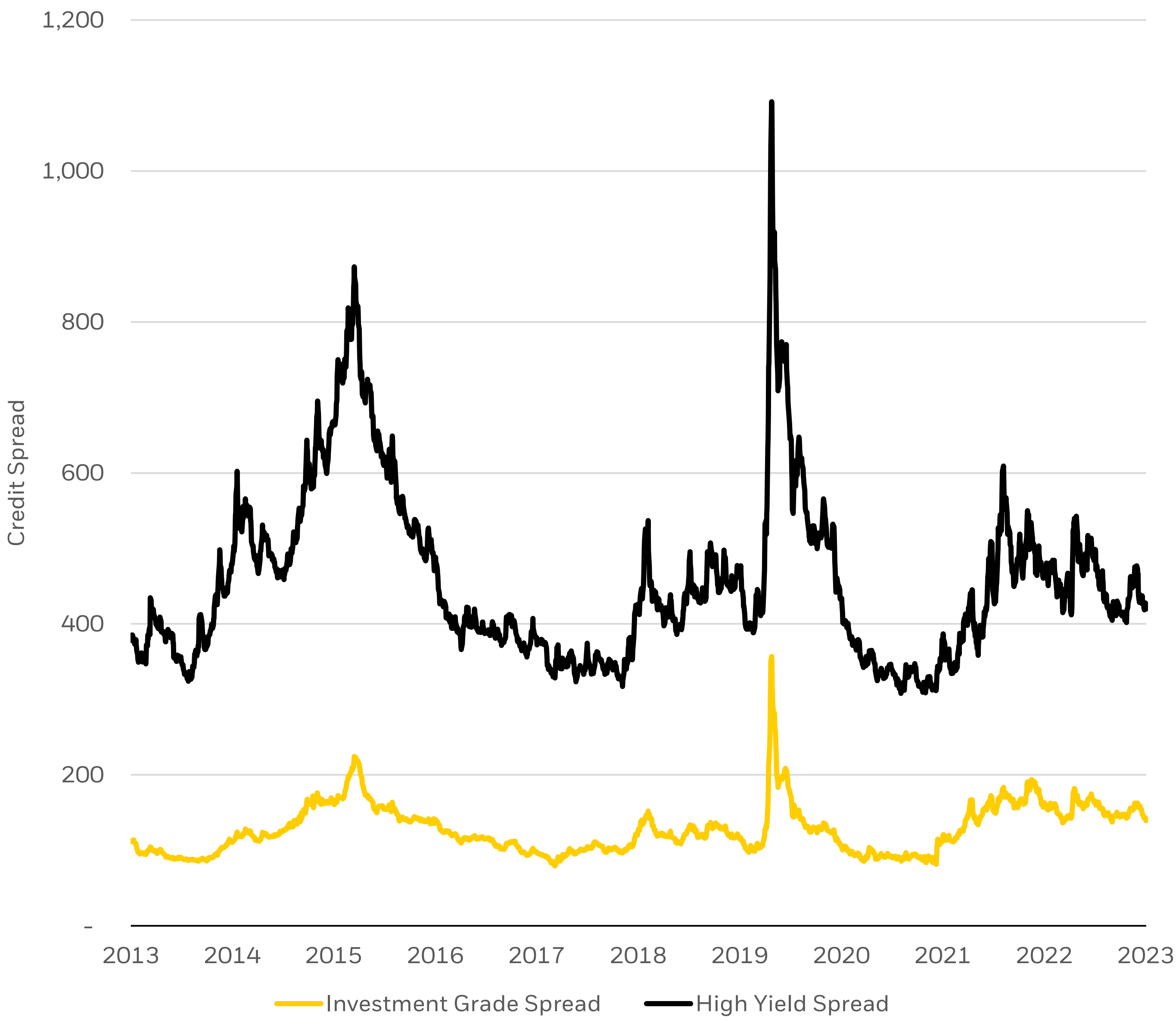
Figure 5: What we believe will drive the shape of the yield curve



Yield curve depiction is for illustrative purposes only.
Source: BlackRock, Bank of Canada. Figure by iShares Investment Strategy. Factors determined by iShares Investment Strategy. Factors listed not comprehensive. Supply as represented by the Bank of Canada's Fall 2023 economic statement – Annex 2: Debt Management Strategy. As of November 21, 2023.

2. Investment grade corporate bonds may deliver portfolio resilience relative to high yield in times of stress. With uncertainty around the economic outlook following the fastest central bank tightening cycle on record[13], global investment grade credit can deliver high quality, attractive yields that may help better insulate portfolios against risk-off markets compared to high yield credit. Additionally, in the U.S. credit market, rising stars, or issuers that have been upgraded from high yield to investment grade have outpaced falling angels this year.[14] This is a trend that may persist into 2024 if global developed market central banks are successful in engineering a 'soft landing scenario'. While investment grade credit spreads remain tight, there is no a clear catalyst for widening in the near term, yet in the event of a selloff investors may be better insulated with an 'up in quality' stance within the portfolio.

Figure 6: U.S. investment grade and high yield spreads

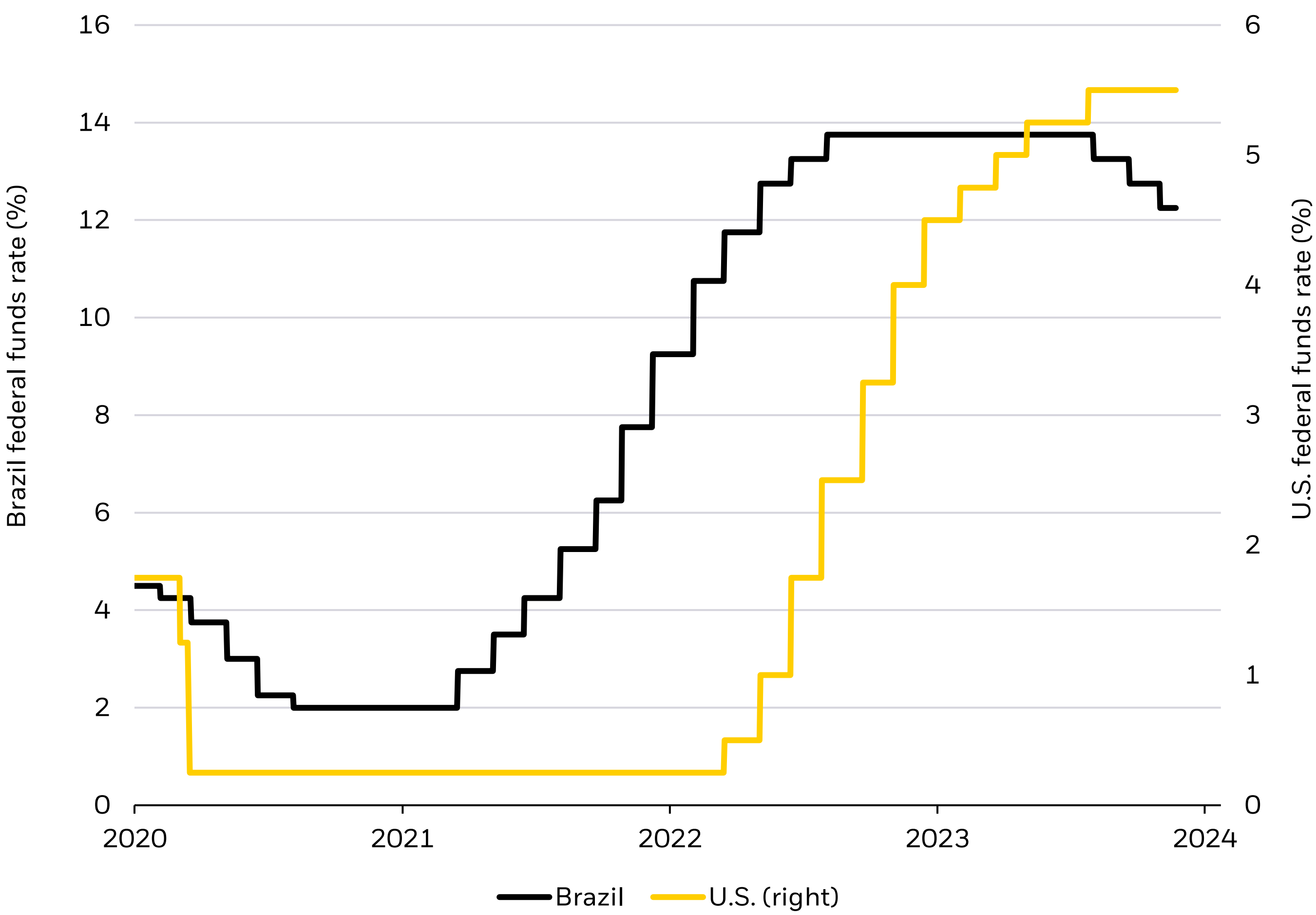


Source: Bloomberg. Investment Grade spread as represented by USD IG All Sectors OAS Index, High Yield spread as represented by USD HY All Sectors OAS Index. As of November 30, 2023.

Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results.

3. Emerging Market (EM) debt is inexpensive as EM monetary policy has been more proactive than in developed markets (DM). For example, the Brazilian central bank started hiking rates a year before the developed market Central Banks and is already in the easing stage of its monetary policy cycle. This monetary policy easing can help support the performance of high coupon EM bonds, particularly as U.S. and other DM rates are set to remain on hold in the first half of 2024. Importantly, this EM easing is occurring without a decline in forecasted growth. The IMF forecasts emerging market GDP growth of 4% in 2024, the same as last year.[15] Given widening rate differentials, we now prefer hard currency bonds over local currency.

Figure 7: Brazil vs. U.S. policy rates



Source: Bloomberg. Brazil rates as represented by BZSTSETA Index, U.S. rates as represented by FDTR Index. As of November 23, 2023. Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results.

4. A selective approach may be helpful as investors extend from cash and seek diversified income opportunities. In a regime of elevated macro and market volatility, being nimble and selective with portfolio exposures across duration, credit quality and regional allocations may benefit portfolio returns. Investors can utilize broad market exposures via highly liquid fixed income ETFs or alternatively can seek to target specific points on the curve with Target Maturity Bond ETFs.

Related funds

XBB	**iShares Core Canadian Universe Bond ETF**
XCB	**iShares Core Canadian Corporate Bond Index ETF**
XEB	**iShares J.P. Morgan USD Emerging Markets Bond Index ETF (CAD-Hedged)**
XGB	**iShares Core Canadian Government Bond Index ETF**
XIG	**iShares U.S. IG Corporate Bond Index ETF (CAD-Hedged)**

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EQUITIES

iShares Investment Strategy Views: North American Equities

	Short Term	Medium Term	Outlook
DM equities	—	▲	Recognize need for downside resiliency
Large-cap growth	▲	—	Low financial leverage
Quality	▲	—	Preference for strong balance sheets
Small-cap	▼	—	Cautious due to unclear funding backdrop

As of November 28, 2023. Views are subject to change.

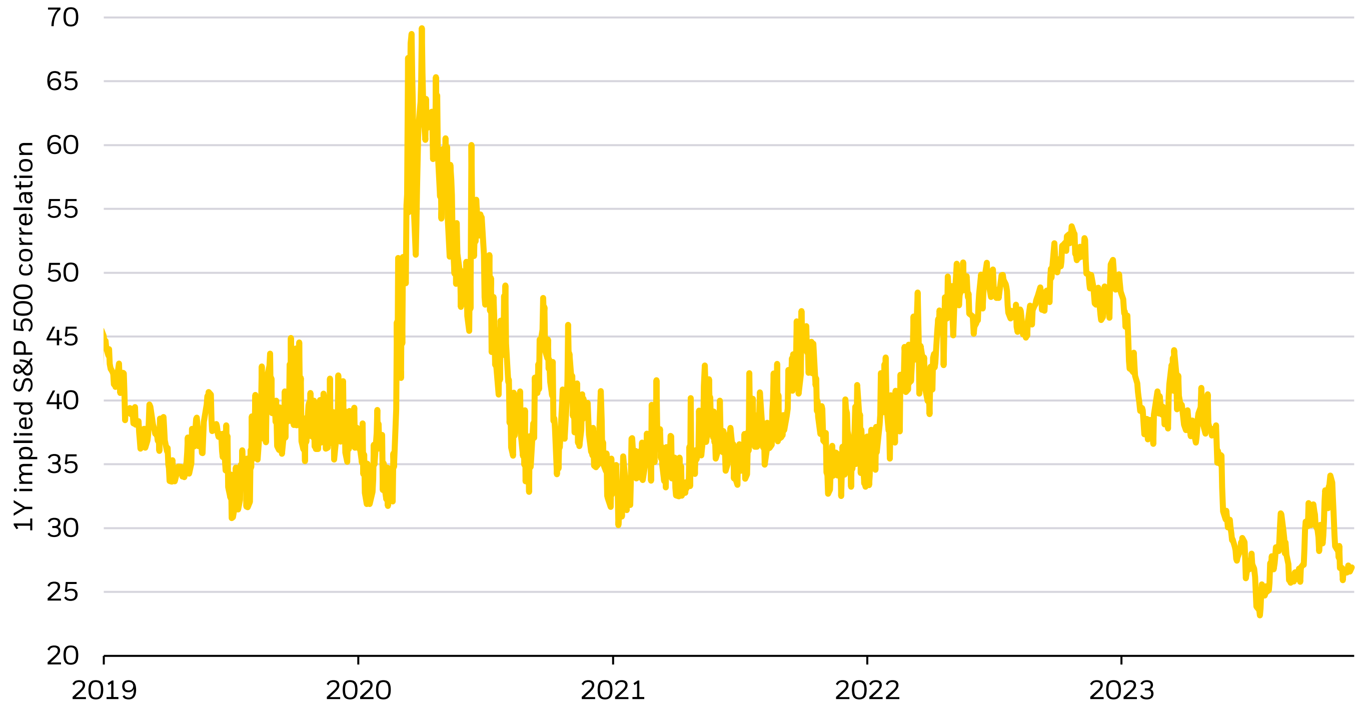
Our expectations are for positive, but slowing, economic growth in 2024. We believe that can translate to modestly positive equity index returns – albeit with significant event risk over the course of the year, and with significant differentiation under the hood.

2024 holds a variety of macro crosscurrents that can cut in different directions: receding inflation, the path of interest rates, domestic elections, and mounting geopolitical tensions. That points to a choppy path forward for equity markets and the potential for leadership to change frequently.

We therefore believe investors would be well-served to be in risk-management mode in broad U.S. and Canadian equity exposures, enabling them to take deliberate risk where, and when, opportunities arise.

Investors can strive to reduce market risk in their core equity allocations by moving up in quality across sectors. Incorporating a sector-neutral quality factor or high dividend approach can help investors focus on companies with strong balance sheets.

Figure 8: 1-year implied S&P 500 correlation



Source: Bloomberg. Implied correlation as represented by CBOE 1Y Implied Correlation Index. As of November 27, 2023.

Reducing risk in the core of a portfolio can allow investors to lean into upside opportunities, both now and as macro conditions evolve over the course of the year.

- **For now, we believe large-cap growth can continue to power the market.** Large-cap growth names screen strongly on low financial leverage – a well-rewarded theme in 2023's market rally – while boasting margin resilience and stable earnings.[16] Despite the rapid pace of the Fed's historic rate-hiking campaign, we don't expect policy rates to be as quickly unwound. This delivers a backdrop that can continue to reward low leverage. On the horizon, there are multiple catalysts that could cause equity leadership – and our preferred exposures - to change over the course of the year.
- **On the horizon, there are multiple catalysts that could cause equity leadership – and our preferred exposures - to change over the course of the year.**
  - A steeper yield curve and the potential for modest developed market central bank easing in H2 2024 creates a favourable macro backdrop for large-cap financial services. A normalizing yield curve could boost net interest margins while a rally in rates may drive trading revenues at large broker-dealers and exchanges. Although regional banks earnings are slated to contract next year, consensus 12-month forward earnings for the U.S. financial sector are expected to rise 6.2% in 2024, driven in large part by financial services and insurance sub-sectors.[17]
  - In another scenario, a dovish Federal Reserve or Bank of Canada surprising markets with rate cuts earlier than expected could spur a cyclically driven rally.
    - Under those circumstances, we could see small-caps, which currently sit at cheap valuations and underweight allocations, outperform the broader market.[18]
    - A comeback in 'loveable laggards' could also play out in sector performance. Healthcare sector ETF outflows totaled $8.7bn this year, the sharpest unwind since pre-GFC.[19] Under-owned and potentially poised for an earnings upswing, healthcare exposures, especially medical devices and pharmaceuticals, could reap rewards in a catch-up trade.

Related funds

XDIV [iShares Core MSCI Canadian Quality Dividend Index ETF]

XQLT [iShares MSCI USA Quality Factor Index ETF]

XUS [iShares Core S&P 500 Index ETF]

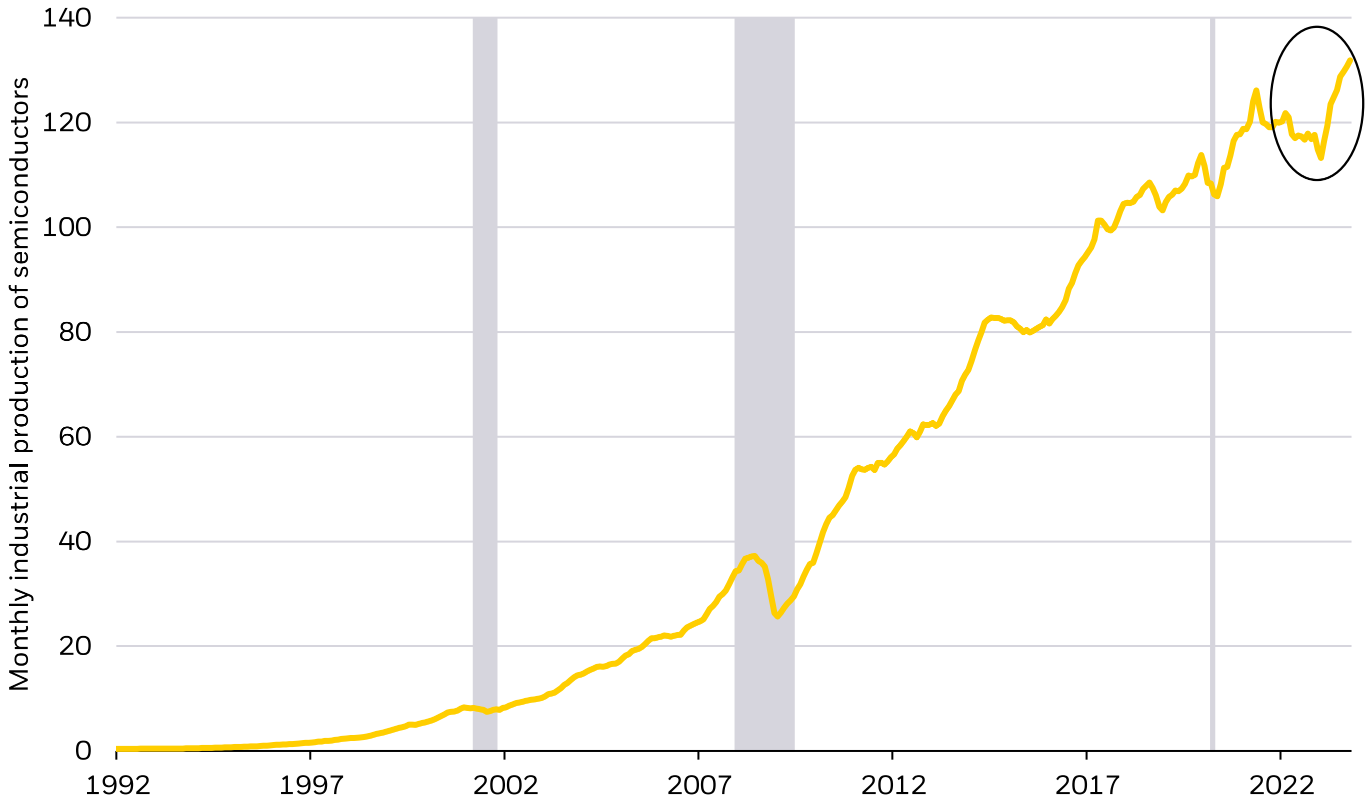
XQQU [iShares NASDAQ 100 Index ETF]

Investors looking to the future can lean into select structural trends that may help diversify returns relative to cash and other assets. With the rapid adoption of ChatGPT's generative AI and GLP-1 weight-loss drugs, 2023 has given investors no lack of evidence on how long-term trends with near-term catalysts have the potential to generate differentiated outperformance. Stepping into 2024, investors may want to continue to assess the potential impacts of AI and medical innovations, while also paying close attention to other trends such as the rewiring of globalization and future of financing.

The success of OpenAI accelerated global understanding and adoption of generative AI, but we are still in early days. In the coming years, we could see tremendous amount of growth in product integration and enterprise level implementations, driven by an expansion of use cases and cost saving potentials.

Semiconductor companies take centre stage at every step of AI adoption, from chip design to increased production and sales. In 2023, growing demand triggered an earlier cyclical recovery in the semiconductor industry. The ongoing support for domestic semiconductor research and manufacturing from the $52bn CHIPS Act in the U.S. could lead to a geographical realignment of manufacturing capacity.[20] While semiconductor valuation remains elevated, we believe the medium and long-term growth trajectory justifies an increased allocation, especially when entry level valuations become attractive.

Figure 9: Semiconductor production picked up from the cycle bottom



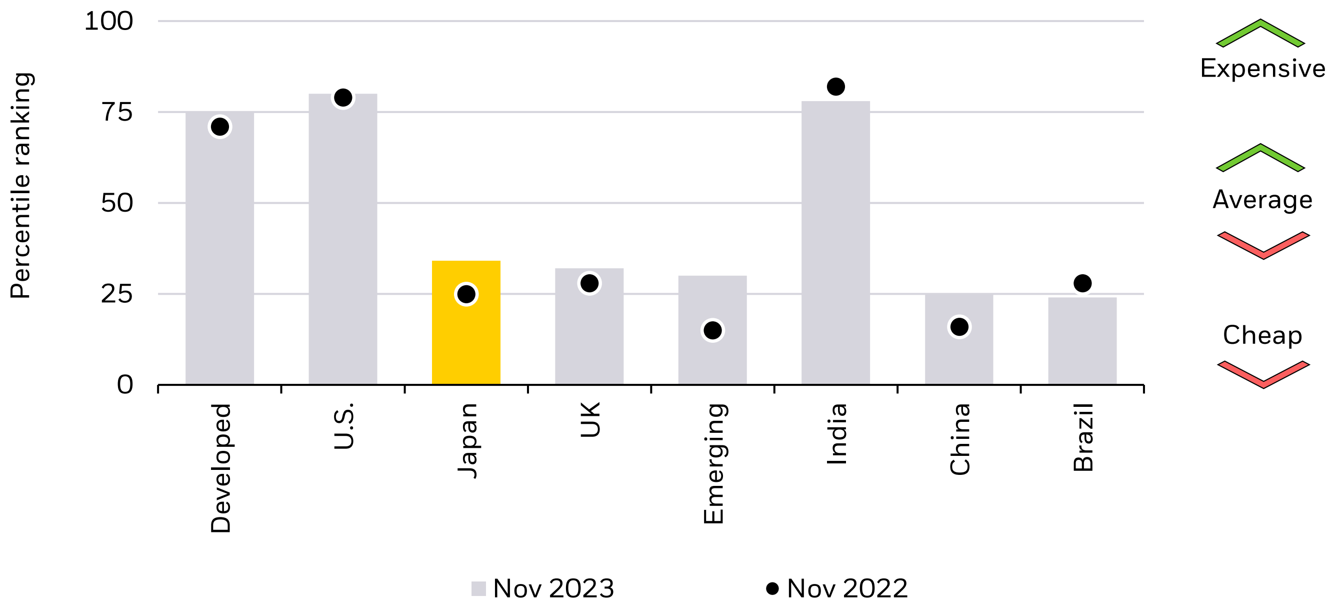
Source: Industrial Production: Manufacturing: Durable Goods: Semiconductor and Other Electronic Component, FRED, Federal Reserve Bank of St. Louis. Grey areas represent U.S. recession as defined by National Bureau of Economic Research. As of November 21, 2023.

While some mega forces take longer to manifest, we see investors starting to modify strategic allocations to capture upcoming investing trends, particularly in international markets. Rising geopolitical fragmentation means investors may need to take a more granular approach in international investing, we expect this to continue in 2024 and see opportunities in the following:

1. Over the past few years, investors have increasingly taken a modular approach in emerging markets, separating China from the broader region as China grew to be more than a third of the EM index. This trend accelerated into 2023, as the structural slowdown in Chinese economy and on-going geopolitical tensions with the U.S. weighed on investor sentiment. Since the beginning of this year, global investors have added $4.3bn into emerging market ex-China focused ETFs, as many expect the headwinds to persist.[21]

2. Japan's recent exit out of three decades of deflation amid the Bank of Japan's looser monetary relative to other developed markets has sparked investor interest. While the end of yield curve control and return of positive interest rates may cause volatility, renewed inflation and wage growth is promising for the Japanese market. Outside of the BOJ incentivizing investing, the Tokyo's Stock Exchange corporate reforms aim to create shareholder-friendly corporate behavior for both domestic and international investors. Beginning January 2024, new tax-free measures may boost flows into risk assets, putting to work some of the $7tn of household savings currently being held in cash.[22] While Japanese equities are more expensive than last year, valuations are lower than they've been for 66% of their history, despite the large rally in 2023.[23]

Chart 10: Despite strong performance this year, Japan's valuations remain attractive



Source: BlackRock Investment Institute, with Data from Refinitiv Datastream, as of October 31, 2023. Japanese equities represented by the MSCI Japan Index. Valuations an average of percentile ranks versus available history of earnings yield, cyclically adjusted earnings yield, trend real earnings, dividend yield, price to book, price to cash flow, and forward 12-month earnings yield. Historical range begins in 1986.

3. In India, globalization and demographics trends go hand in hand. India may be a beneficiary of trade rewiring to "friendlier" countries where costs are lower than developed markets. As the world's fifth-largest economy, India is focused on expanding and taking on a larger role in global supply chains. As India became the most populous country in 2023 with a labour force participation rate of only 32.5%, we expect millions of people to join the formal labour force as the economy expands, solidifying the Indian consumer and contributing further to economic growth.[24]

Related funds

XCHP	**iShares Semiconductor ETF**
XEMC	**iShares MSCI Emerging Markets ex China ETF**
CJP	**iShares MSCI Japan ETF**
XID	**iShares MSCI India ETF**

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1. Source: BlackRock, Bloomberg. As of November 22, 2023. The previous five hiking cycles in reference the dates of the last hike since 1990: 2/1/1995, 3/25/1997, 5/16/2000, 6/29/2006, 12/19/2018.
2. Source: EPFR, Bloomberg. Highest allocation as represented by weekly notional value of money market fund assets. As of November 22, 2023.
3. Source: Bloomberg, Bureau of labour Statistics. Current cycle represented as period between June 2020 and November 2023. As of November 21, 2023.
4. Bloomberg data as of 11/30/2023
5. Source: Bloomberg, Bureau of Economic Analysis. Metric calculated as change in real disposable income from 6 months prior, annualized. As of November 21, 2023.
6. Source: Bloomberg, Federal Reserve. Metric calculated as change in total consumer credit from 6 months prior, averaged. As of November 21, 2023.
7. Source: Bloomberg, Federal Reserve Bank of New York. As of November 21, 2023.
8. Source: Bloomberg. As of November 21, 2023.
9. Source: Bank of Canada. As of February 2023
10. Source: Stat Canada, Third quarter 2023 data. As of December 15, 2023. https://www150.statcan.gc.ca/n1/daily-quotidien/231213/cg-a003-eng.htm
11. Source: Bloomberg, Bureau of Economic Analysis. As of November 21, 2023.
12. Source: Bloomberg, Federal Reserve Bank of San Francisco, <https://www.frbsf.org/our-district/about/sf-fed-blog/excess-no-more-dwindling-pandemic-savings/>. As of August 16, 2023.
13. Source: Bloomberg. As of December 31, 2023
14. Source: Bloomberg. As of December 31, 2023
15. Source: Bloomberg, IMF. As of November 20, 2023.
16. Source: BlackRock, Bloomberg. Low financial leverage exposures as represented by M2USSNQ Index, 'well-rewarded theme' as represented by total return outperformance relative to the broader market, SPX Index. As of November 28, 2023.
17. Source: BlackRock, Refinitiv Datastream. As of November 29, 2023.
18. Source: Bloomberg, Markit. Small-caps as represented by RTY Index, 'cheap valuations' as represented by P/E ratio relative to historic averages. 'Underweight allocations' as represented by ETF flows year-to-date relative to historical averages. ETF groupings determined by Markit. As of November 28, 2023.
19. Source: BlackRock, Markit. ETF groupings determined by Markit. As of November 23, 2023.
20. Source: CHIPS and Science Act of 2022, https://www.commerce.senate.gov/services/files/2699CE4B-51A5-4082-9CED-4B6CD912BBC8. As of November 20, 2023.
21. Source: BlackRock, Markit. ETF groupings determined by Markit. As of November 27, 2023.
22. Source: Bank of Japan Research of Statistics Department, as of September 20, 2023.
23. Source: BlackRock Investment Institute, with Data from Refinitiv Datastream, as of October 31, 2023. Japanese equities represented by the MSCI Japan Index. Valuations an average of percentile ranks versus available history of earnings yield, cyclically adjusted earnings yield, trend real earnings, dividend yield, price to book, price to cash flow, and forward 12-month earnings yield. Historical range begins in 1986.
24. Source: Bloomberg, as of November 21, 2023.

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