

# **CAPITAL MARKET ASSUMPTIONS & KEY MARKET THEMES**

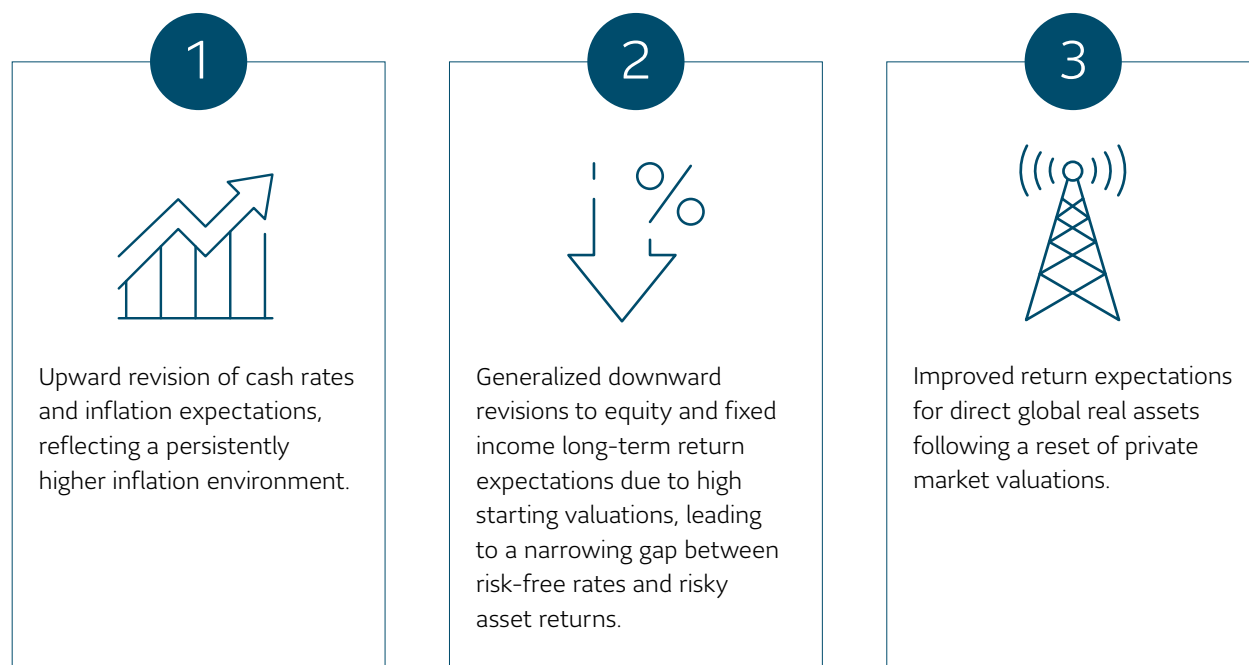


# Executive summary

At Sun Life Global Investments, our purpose remains clear - to help Canadians achieve lifetime financial security and live their most meaningful lives. Supporting this purpose, we are excited to introduce our **2025 Capital Market Assumptions (CMAs)**. This provides our latest 10-year forecasts and forward-looking insights that serve as valuable inputs for investment decision-making in Sun Life Granite Target Date Funds and Sun Life Granite Target Risk Funds.

Annually, the Multi-Assets Solutions (MAS) Team conducts a thorough analysis of market conditions and future prospects to recalibrate and derive their CMAs and reassess where opportunities lie for the next 10 years. The CMAs reflect a concise view from the MAS Team and best-in-class global asset managers, leveraging our multi-manager approach to offer a comprehensive outlook on global markets. This report presents their 2025 10-year findings, key market themes and the methodology used for these insights.

## Key themes



# Market outlook

## SETTING THE SCENE FOR THE ROAD AHEAD

Recent market developments are shaped by converging factors. This includes five key themes identified at the start of 2025:

1. **America 1st?** Question of continued U.S. equity market dominance driven by tech stocks and potential policies under the return of President Donald Trump
2. **The U.S. Federal Reserve and global central banks** – chart a path to their “terminal” destination
3. **Three potential paths for the global economy** – soft landing, hard landing or no landing
4. **Beyond the “Magnificent 7”** – broadening of earnings growth beyond these seven companies
5. **Be active for an edge in 2025** – increasing breadth of earnings growth and valuations re-rating globally is a great environment for active management.

While the MAS Team expects these themes to play out and impact asset valuations over 2025, they also maintain a longer-term perspective to establish strategic asset allocations for the Granite Funds.

# Capital market assumptions key themes

## Cash rates and inflation

We have **revised our expectations for cash rates and inflation upward**. The previous decade saw very low cash yields, followed by a post-pandemic inflationary period. In response, we reassessed our projections for inflation and cash rates in the strategic investment horizon that extends beyond a traditional business cycle. Given the changing economic forces likely to lead to more persistent price pressures compared to the pre-pandemic era, we forecast a modestly elevated level of inflation of 2.25% compared to the past decade of 2% inflation. Within this backdrop, we believe central banks will need to have a slightly positive neutral level of real interest rates at 0.5%. As a result, we have increased our estimate of the cash or risk-free rate to 2.75%. This increase will have broader implications on portfolio optimization and risk allocation.

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## U.S. vs. non-U.S. equity

We expect **ex-U.S. developed markets to outperform U.S. equities over the next 10 years**. This follows a multi-year period of U.S. equity outperformance and is based on higher starting valuations. This outlook was formed before recent tariff and trade uncertainty culminating on Liberation Day and leading investors to call into question the U.S. exceptionalism narrative (America 1st?).

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## Emerging markets vs. developed markets equities

We anticipate **higher returns from emerging markets equities compared to developed markets equities**, reflecting their higher equity risk. Emerging markets present opportunities such as higher economic growth rates, better demographics (younger population, growing middle class), lower asset valuations, potential for governance/reforms and technological improvements. Risks to consider include political instability, regulatory changes, currency volatility, and less developed financial markets.

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## Core fixed income

**The long-run return expectation for core Canadian bonds is modestly lower compared to core U.S. bonds.** Higher yields and a higher neutral policy rate support this higher return forecast for U.S. bonds.

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# Capital market assumptions key themes (continued)

## Private fixed income

**Private fixed income and Canadian commercial mortgages return expectations have come down due to higher starting valuations,** but still remain higher than core universe bonds due to the illiquidity premium.

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## Non-investment grade (IG) and emerging markets debt (EM)

We continue to forecast **non-IG (speculative grade) to outperform IG due to higher starting yields.** We expect stronger returns from emerging markets debt and U.S. high-yield bonds compared to core IG bonds. However, the projected return differential has narrowed due to high valuations and tight credit spreads since the last CMAs formulation.

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## Private assets

**Global direct real estate longer-term return expectations have improved** following a reset of private markets valuations from the rise in interest rates following the record low-interest-rate environment during the pandemic.

**Global direct infrastructure returns have similarly improved,** but to a lesser degree.

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## Liquid alternatives

We continue to view systematic trend following **liquid alternatives primarily as diversification providers** rather than return generators in terms of portfolio construction. Liquid alternatives have lower expected returns but low and often negative correlations to traditional equities, helping to provide diversification and downside protection.

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## Key changes since last CMAs review:

- Upward revisions to the cash/risk-free rate and inflation expectations as we anticipate the higher inflation environment to persist.
- Generalized downward revisions to equity and fixed income long-term return expectations.
- An environment of falling return expectations across equity and fixed income asset classes and a rising cash rate leads to a narrowing of the gap between the risk-free rate and risky asset returns. It also leads to a convergence in risk-adjusted returns (e.g. Sharpe ratios). This type of environment will have widespread implications for the allocation of risk in portfolio optimization.

Directional changes	
<p>UPWARD REVISIONS</p> 	<ul style="list-style-type: none"> <li>• Cash/risk free rate</li> <li>• Inflation expectations</li> <li>• Global direct real estate and global direct infrastructure 10-year return expectations</li> </ul>
<p>DOWNWARD REVISIONS</p> 	<ul style="list-style-type: none"> <li>• Equity &amp; Fixed-income 10-year return expectations</li> </ul>

Compared to last CMAs conducted in 2023.

## In our 2025 CMAs and Strategic Asset Allocation refresh, we broadened our opportunity set by including three new asset classes:

- **Global direct real estate:** In previous exercises, we modelled direct Canadian and direct U.S. real estate. We decided to move to global for a broader allocation.
- **Global direct infrastructure:** This asset class is expected to provide diversification benefits alongside potentials for yield enhancement, downside protection and inflation protection.
- **Commodities:** We included broad commodities into our modelling as another diversifying asset class. With its lower correlation to traditional equities, the asset class can be beneficial in the heightened inflationary environment of the post-pandemic period.

10-Year Asset Class Expected Returns, Volatility and Correlations

Asset Class	Expected Returns (%)	Expected Volatility (%)																				
Canadian equity	6.02	13.63	1.00																			
U.S. equity	5.12	12.17	0.69	1.00																		
International equity	6.74	13.60	0.73	0.81	1.00																	
Emerging markets equity	7.08	14.46	0.74	0.59	0.81	1.00																
Global developed REITs	7.19	15.72	0.69	0.69	0.76	0.62	1.00															
Global listed infrastructure	6.12	12.00	0.75	0.66	0.78	0.64	0.83	1.00														
Global natural resource equity	4.28	16.37	0.82	0.59	0.66	0.65	0.47	0.65	1.00													
Canadian bonds	3.75	5.07	0.18	0.24	0.21	0.24	0.37	0.25	-0.12	1.00												
Canadian commercial mortgages	4.47	3.28	0.17	0.24	0.20	0.23	0.36	0.23	-0.14	0.88	1.00											
Private fixed income	4.90	4.97	0.38	0.32	0.37	0.45	0.53	0.40	0.03	0.92	0.83	1.00										
U.S. bonds	4.00	4.55	0.16	0.10	0.16	0.20	0.36	0.22	-0.20	0.87	0.79	0.80	1.00									
U.S. high yield bonds	5.43	8.38	0.83	0.55	0.66	0.79	0.63	0.59	0.58	0.40	0.38	0.62	0.38	1.00								
Emerging markets debt	5.39	9.60	0.68	0.47	0.60	0.72	0.61	0.57	0.42	0.60	0.58	0.75	0.62	0.88	1.00							
U.S. bank loans	5.05	7.84	0.76	0.43	0.53	0.71	0.50	0.46	0.54	0.13	0.16	0.43	0.08	0.90	0.69	1.00						
Commodities	5.15	21.06	0.52	0.26	0.28	0.27	0.15	0.37	0.70	-0.45	-0.37	-0.27	-0.47	0.25	0.05	0.38	1.00					
Global direct real estate	4.92	10.49	-0.62	-0.19	-0.36	-0.60	-0.25	-0.27	-0.42	-0.13	-0.11	-0.32	-0.23	-0.76	-0.66	-0.76	-0.17	1.00				
Global direct infrastructure	7.21	15.63	-0.13	0.05	0.12	-0.11	0.26	0.22	-0.17	0.39	0.40	0.32	0.43	-0.11	0.11	-0.26	-0.28	0.31	1.00			
Liquid alternatives (systematic trend following)	3.33	13.99	-0.40	-0.12	-0.31	-0.44	-0.22	-0.23	-0.27	-0.21	-0.22	-0.33	-0.31	-0.59	-0.56	-0.46	-0.07	0.64	0.19	1.00		
Cash	2.75	0.69	-0.05	0.06	0.08	-0.01	-0.06	-0.01	-0.09	0.14	0.12	0.12	0.12	-0.05	0.01	-0.07	-0.11	-0.17	0.11	-0.03	1.00	
Inflation	2.25	1.57	0.05	-0.18	-0.11	-0.07	-0.15	0.07	0.13	-0.34	-0.34	-0.28	-0.32	-0.15	-0.24	0.02	0.53	0.02	-0.38	0.14	-0.01	1.00

Directional changes compared to prior CMAs\*

- Increased return expectations
- Reduced return expectations
- No change

Largest changes in strategic return assumptions:



Largest increases in cash rate and inflation expectations



Largest decreases in U.S. equity, U.S. high-yield bonds and emerging markets bonds due to starting valuations

Source: SLGI Asset Management Inc. Data as of September 30, 2024. Data in CAD. Asset return expectations are gross of fees, forward-looking, are not guarantees, and they involve risks, uncertainties, and assumptions. They are not necessarily indicative of future performance, which could differ substantially. Correlation is a statistical method of measuring the strength of a linear relationship between two variables. The correlation between two variables can assume any value from -1.00 to +1.00, inclusive. Past performance does not guarantee future results. For representative indices used, please see page 10, Disclosures. \*The last CMAs were in 2023.

# Methodology

Sun Life Global Investments' MAS team derives its long-term CMAs once a year during the annual strategic allocation modelling review. The MAS team collaborates with Sun Life International Investment Centre (IIC) in these efforts. The IIC is an independent investment research engine for the Sun Life group of companies, including Sun Life Global Investments. With a vast network of over 100 global asset manager relationships, the IIC provides valuable research to support external manager selection and oversight as well as strategic asset allocation modelling.

These annualized expected returns are for a broad set of core and specialty asset classes that make up our diversified investment universe. Our long-term strategic forecasts span the next 10 years.

When deriving our CMAs, we first start with historical return, risk and correlation data for the asset classes that make up our diversified investment universe. From these baseline parameters, an initial set of long-term, forward looking return assumptions are estimated for a global portfolio using the Black-Litterman model. Second, we survey multiple leading global asset managers for their long-term return expectations. This method of polling multiple sources offers several benefits: it represents a consensus or "market" view and allows us to identify and account for the degree of consensus or dispersion around that market view. The surveyed managers use different methodologies and models to arrive at their long-term CMAs. Key inputs include historical data and forward-looking expectations, and these may be overlaid by professional judgement.

The average of these historical returns and global asset managers surveyed forecasts are then subjected to our degree of confidence for each asset class. For specific asset classes, we utilize proprietary higher conviction forecasts.

Once our views and confidence levels are imposed, Black-Litterman modelling is run to determine our long-term CMAs – which balances markets' views with our own. Empirically, we have found that the Black-Litterman model tends to generate markets assumptions that are conducive to practical portfolio construction.

Long term CMAs do not change dramatically year over year, but they do shift from time to time. We examine the changes in CMAs and adjust our optimization accordingly.

## Multi-Asset Solutions Team

The MAS Team is devoted to fund manager selection, oversight, and building solutions that deliver the best possible retirement outcomes for Canadian investors. Through optimizing allocations to asset classes, glidepath design, broad diversification, and their proven multi-manager approach, they are the investment engine for Sun Life Granite Target Date Funds, Sun Life Granite Target Risk Funds and other Sun Life Global Investments solutions.

A dedicated group of analysts and investment professionals support the MAS Team and provide ongoing research on new managers, investment strategies and market exposures.



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# Disclosures

## Indices representing each asset class:

Canadian equity	S&P/TSX Composite
U.S. equity	S&P 500 CAD
International equity	MSCI EAFE CAD
Emerging markets equity	MSCI EM CAD
Global developed REITs	FTSE EPRA NAREIT Developed CAD
Global listed infrastructure	S&P Global Infrastructure CAD
Global natural resource equity	S&P Global Natural Resources CAD
Canadian bonds	FTSE Canada Universe Bond
Canadian commercial mortgages	SLF Mortgages*
Private fixed income	SLF PFI*
U.S. bonds	Bloomberg US Agg Bond Hdg CAD
U.S. high-yield bonds	Bloomberg US HY Ba,B 2% Cap Hdg CAD
Emerging markets debt	JPM EMBI Global Diversified Hdg CAD
U.S. bank loans	Morningstar LSTA US Leveraged Loan Hdg CAD
Commodities	S&P GSCI CAD
Global direct real estate	MSCI Global Quarterly Property Index (Unfrozen) CAD
Global direct infrastructure	EDHEC Infra 300 index CAD
Liquid alternative (systematic trend-following)	SG Trend Index CAD
Cash	FTSE Canada 91 Day T-bill
Inflation	CAN Total CPI CAD

\*SLF proprietary benchmark



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