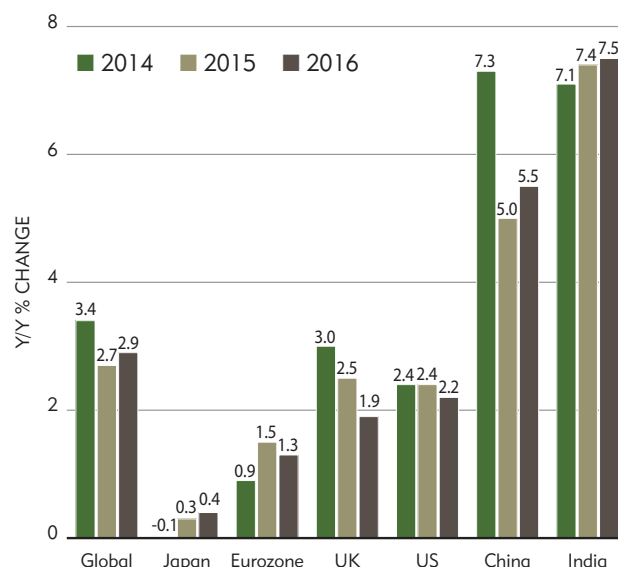


## 4Q 2015 Outlook

# Key issues have not changed much this year

As the final quarter of 2015 begins, we are reminded of several topics of focus from the start of the year: concerns that global central bankers are stuck with their current monetary policies because the global economy now depends on them; market acceptance that higher U.S. interest rates are inevitable, even if they rise only slightly; and favorable prospects for U.S. consumers, who benefit from a stronger labor market and lower energy prices. If the topics sound familiar now, it is because little has changed in these areas while global risks have increased for several reasons.

### Global growth continues slow pace



Forecasts for annual gross domestic product growth by country.

Source: 2014 International Monetary Fund data, 2015 and 2016 Ivy Funds forecasts

The International Monetary Fund in July reduced its forecast for 2015 global gross domestic product (GDP) to 3.3% and again in October to 3.1%. We think global real GDP growth will be about 2.8% for the year. The “imminent” beginning of interest rate increases in the U.S. has been delayed, and we think the Bank of Japan (BOJ), European Central Bank (ECB) and People’s Bank of China are likely to implement further monetary stimulus measures to support their economies.

We’re concerned that the global economy remains in a balance sheet recession. Historically, demand from households and the corporate sector improved when central banks lowered interest rates and stimulated their economies. That largely has not happened since the global financial crisis (GFC) and not to the extent economists expected from the various quantitative easing (QE) actions in the U.S. Instead, there has been a slow economic recovery with inflation rates far below the targets of central banks in developed markets. It is unclear to us how the economy can return to “normal” without monetary policy support while structural reform and fiscal stimulus is addressed.

There was a time when zero was thought to be the low boundary for interest rates. Europe crossed that boundary into negative territory earlier this year and U.S. Federal Reserve (Fed) Chair Janet Yellen admitted in September that negative rates had been part of the discussion. An unprecedented event occurred in early October in the U.S. Treasury market: An auction for 3-month Treasury bills was four times oversubscribed for a yield of 0%. There was little fanfare, as though the world now accepts rates at 0% or below as the new normal. We are closely watching these developments.

We believe the foundation of the global economy is fragile, but it’s the environment in which we seek investments that can weather low-conviction and uncertain markets. To us, equities continue to make the most sense. The recent market gyrations have made us somewhat more defensive at the asset class and security levels, adding liquidity by way of U.S. Treasuries, raising the cash level and reducing exposure to markets such as China, where we have reduced visibility or confidence in the near- to medium-term fundamentals. We have continued increasing exposure to the U.S. consumer through names in retail and staples.

### Market overview

The level of the S&P 500 Index had moved about 2% higher in 2015 until a roughly 12% correction in late August. This sounds remarkable given the large moves in both directions in individual stocks and sectors. The sell-off in China's A-share equities market in June kicked off a new round of global-growth fears that intensified by the end of the summer. Those fears led to narrow leadership in the equity market, where safety and growth are highly prized and everything else gets discarded. Exposure to the U.S. consumer and healthcare sectors has been rewarded while exposure to emerging markets has been punished. The lack of "winners" may have added to fears of a slowing economy.

The spreads between the yields of U.S. Treasuries and both investment-grade and high-yield bonds reached their widest points in three years. In high yield, energy was previously behind much of the move beyond the averages, but that has broadened to telecommunications and chemicals. We think investors have changed their view on leverage. Although we see opportunities in mergers and acquisitions (M&A), such as the proposed SABMiller plc takeover by Anheuser-Busch InBev NV, there are difficulties for some companies trying to get deals done while yields are relatively low. We think levered strategies used to hit target returns may begin to unwind, which would place further pressure on asset prices.

*The U.S. remains the bright spot in terms of economic growth versus the rest of the world.*

Since the GFC, periods of large selloffs in the equity markets generally have been followed by additional monetary stimulus by the Fed. QE3 ended in October 2014 and we believe another form of monetary policy accommodation is unlikely. The U.S. appears to be on adequate footing to begin rate normalization, but the Fed may view this foundation as just tenuous enough to further delay an increase in rates.

### U.S. economy

The U.S. remains the bright spot in terms of economic growth versus the rest of the world. The labor market continues to improve, as indicated by increases in payrolls, low unemployment claims and wage growth of just over 2%. Business and consumer sentiment indicators have returned to pre-GFC levels. Consumers have been repairing their balance sheets (a hallmark of a balance sheet recession). They are better positioned and more willing to take on debt for mortgage and car loans, use credit cards and generally

spend more on areas such as home furnishings, technology and consumer goods. Even when interest rates rise, we think it will be at a slow pace and the long end of the bond yield curve will stay relatively anchored, allowing interest rate-sensitive sectors to continue to expand.

The Millennial Generation (those born in 1980-1995) is increasingly critical to the recovery. They now outnumber other generations in the labor market and are benefitting from an improving U.S. economy. We believe their willingness to buy or rent homes indicates increased confidence and will translate to higher spending on goods and services. The latest reading on household formations continues the modest uptick that began in the fourth quarter of 2014. The demand for housing has increased and units priced appropriately are selling quickly. Rental rates also are rising faster than wage growth, which could add to demand for mortgages.

While the allocation to U.S. equities in the Fund has not changed much over the last quarter, we have added exposure within the healthcare, industrials and staples sectors while reducing holdings in media and semiconductors.

### China slowing

There are indications China's economy is slowing faster than expected. This is in part because of a transition from China's dependence on fixed-asset investment to a focus on "new economy" areas such as services, technology and consumer goods. We believe these changes will be positive for China in the long term, but there are near-term pains across the region in making this switch.

China's decreased demand for commodities has led to sell-offs in industrials, energy and materials and is an indication of an economy that will invest and spend much less. That has unsettled companies that sell into China and other developing markets and has been worsened by the strength of the U.S. dollar.

China devalued its currency, the yuan, in August. We think this was an effort to reinvigorate the export sector. It is unclear if the government intends to weaken the yuan further. But the move put pressure on other emerging market currencies.

The administration of President Xi Jinping has eight more years to leave its mark on China and implement reforms to escape the middle-income trap of so many developing economies. We believe China must reform its policies on land ownership, social security, health care, the structure of state-owned enterprises and more. China also has excess capacity in materials and infrastructure from its post-GFC stimulus. A good portion of that capacity has been idled. China's One Road, One Belt campaign

to shift some of these resources south and west is an attempt to influence regions in the Middle East, Africa, Southeast Asia and Eastern Europe.

Our exposure to the region has roughly halved since the beginning of the third quarter.

### Europe easing

Europe is experiencing the ECB's own version of monetary easing. The euro has weakened throughout the year, although the lowest points were reached immediately after QE began. The eurozone has shown improvement in GDP, unemployment and consumer spending. Sentiment indicators also have turned higher. The debt crisis in Greece appears to be manageable, although it does not look like the country will be required to make needed structural changes.

The path for Europe became less clear recently for three reasons: weakness in China, the Volkswagen (VW) diesel engine scandal and the numbers of migrants from Syria, Iraq and North Africa.

Lower spending by China means less consumption of Europe's goods. Automakers and their suppliers already had begun to feel the effects of reduced demand from China and this worsened after VW admitted it manipulated emissions test results on its diesels.

*The path for Europe became less clear recently for three reasons: weakness in China, the Volkswagen diesel engine scandal and the numbers of migrants from Syria, Iraq and North Africa.*

We recently visited Germany and Austria and saw the impact from the arrival of refugees. While the large numbers will strain some resources and logistics in the short term, we believe the migrants will be beneficial in the long term to a region challenged by demographics. For example, Germany has an aging population, low unemployment and rising wages and needs additional workers to fill some low-wage jobs to continue to be productive.

We have reduced some of the Fund's exposure to Europe in names vulnerable to emerging markets, such as semiconductors, household products and materials.

### Japan struggles

The BOJ has increased its balance sheet by a larger degree than the Fed and over a longer time period, but has not

achieved much in the way of inflation or economic growth. We believe third-quarter GDP will be negative for the second quarter in a row and additional monetary or fiscal policy measures are likely. China's slowdown will add to the difficulties since it will import less from countries like Japan.

We have decreased Fund holdings related to Japan, exiting a position related to transportation.

### Opportunities and outlook

We are focused on companies with solid balance sheets, high free cash flow, pricing power and goods or services that consumers and companies desire. These characteristics can be found throughout the portfolio and we continue to add to them at what we consider attractive valuations. However, identifying such companies with an appealing risk/reward profile in a low-conviction and uncertain environment means we think returns broadly are likely to be lower from here.

We are beginning to consider the changing lifestyles of the Baby Boom Generation (those born in 1946-1964). Many are working longer and reevaluating spending and saving habits to align with longer lives, which have implications for many areas of the economy.

Despite weakening growth prospects in Latin America and Asia, we think some areas in consumer staples are attractive. Low interest rates mean credit markets are conducive to M&A activity. Developing market consumers still like global brands and we like names focused on cost-cutting and potential M&A candidates. We think some large soft drink companies such as PEPSICO and Coca-Cola Co. are interesting because they have broadly underperformed, but have become more focused on profits in developed markets. We also are awaiting further details on the proposed SABMiller plc takeover by Anheuser-Busch InBev NV, which would be the largest-ever acquisition of a U.K. company.

We think technology should be able to thrive in a slower growth environment. Companies worldwide will look to do more with less, and this drive for efficiency should benefit both legacy and newer technology companies. "Disruptive" technology – including software companies moving from licenses to subscriptions, ride sharing, automobile safety, e-commerce, social networking – also is changing the ways consumers and businesses interact with technology.

We think energy will present more options in companies with low cost structures. We now invest in exploration & production and services companies with strong balance sheets that we believe are well-positioned even with oil at current price levels. Although industrials and materials sectors have been hit hard in recent months, we believe they could present the next

opportunity. While China's slowdown again has been a factor, we think non-residential and residential construction can benefit from some of that capacity as they continue to recover.

We still think India can grow over the longer-term. With newer leadership and a large, educated population, India in our view has the best secular growth prospects in the world. Lower energy prices also help India, given the enormous infrastructure buildout needed and its "Make it in India" campaign.

While we are not forecasting a slowdown in the U.S., such a scenario would unsettle an already delicate global economic framework. The real question is: Can the U.S. economy generate growth without further policy accommodation? We do not see a clear catalyst to get the U.S. economy to accelerate much from here, but we also are not forecasting a downturn. While the recovery seems solid, the risk is that 2.4% real GDP growth is as good as it gets as the rest of the world plods along.

We think headwinds from the strong dollar continued to hurt corporate earnings in the third quarter. Currency effects technically are not part of the Fed's dual mandate of price and labor market stability, but we believe the impact of a strong dollar must be part of the discussions.

Overall, we believe disciplined application of our process should contribute to solid absolute and relative performance over a reasonable time horizon.

**Past performance is not a guarantee of future results.** The opinions expressed are those of the Fund's portfolio managers and are not meant as investment advice or to predict or project the future performance of any investment product. The opinions are current through Oct. 20, 2015, and are subject to change due to market conditions or other factors.

**Risk factors:** As with any mutual fund, the value of the Fund's shares will change, and you could lose money on your investment. The Fund may allocate from 0 to 100% of its assets between stocks, bonds and short-term instruments of issuers around the globe, as well as investments in precious metals and investments with exposure to various foreign securities. International investing involves additional risks, including currency fluctuations, political or economic conditions affecting the foreign country, and differences in accounting standards and foreign regulations. These risks are magnified in emerging markets. Fixed-income securities are subject to interest-rate risk and, as such, the net asset value of the Fund may fall as interest rates rise. Investing in high-income securities may carry a greater risk of nonpayment of interest or principal than higher-rated bonds. The Fund may focus its investments in certain regions or industries, thereby increasing its potential vulnerability to market volatility. The Fund may seek to hedge market risk on various securities, increase exposure to various markets, manage exposure to various foreign currencies, precious metals and various markets, and seek to hedge certain event risks on positions held by the Fund via the use of derivative instruments. Such investments involve additional risks, as the fluctuations in the values of the derivatives may not correlate perfectly with the overall securities markets or with the underlying asset from which the derivative's value is derived. Investing in commodities is generally considered speculative because of the significant potential for investment loss due to cyclical economic conditions, sudden political events, and adverse international monetary policies. Markets for commodities are likely to be volatile and the Fund may pay more to store and accurately value its commodity holdings than it does with the Fund's other holdings. These and other risks are more fully described in the Fund's prospectus. Not all funds or fund classes may be offered at all broker/dealers.

S&P 500 Index is composed of 500 selected common stocks chosen for market size, liquidity and industry grouping, among other factors. It is not possible to invest directly in an index.

Investors should consider the investment objectives, risks, charges and expenses of a fund carefully before investing. For a prospectus, or if available a summary prospectus, containing this and other information for the mutual funds offered by Ivy Funds, call your financial advisor or visit us online at [www.ivyfund.com](http://www.ivyfund.com). Please read the prospectus or summary prospectus carefully before investing.

#### PORTFOLIO MANAGEMENT



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Executive Vice President,  
Portfolio Manager



**Cynthia Prince-Fox**  
Senior Vice President,  
Portfolio Manager



**Chace Brundige, CFA**  
Senior Vice President,  
Portfolio Manager

Top 10 Equity Holdings as a percent of net assets as of 09/30/2015: SABMiller plc, 2.39%; AIA Group Ltd., 2.31%; Citigroup, Inc., 2.26%; Phillips 66, 2.25%; Coca-Cola Co., 2.13%; Home Depot, 2.10%; Cognizant Technology Solutions Corp., Class A, 2.10%; Kraft Foods Group, Inc., 1.99%; Microsoft Corp., 1.97%; Adobe Systems, Inc., 1.97%.



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