Manulife Asset Management™

Global Intelligence

Interim Outlook: June 2016

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June 2016

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Global Economic Outlook

Megan Greene, Chief Economist

The second quarter of 2016 has hardly felt like it belongs to the same year as the first quarter.

After beginning the year with unprecedented amounts of volatility in the first few months of 2016, investors and policymakers may have been lulled into complacency in the second quarter by the dissipation of volatility. This can be attributed to a few different developments. Concerns about China's growth receded as earlier fiscal stimulus measures fed through to the real economy. Additionally, the US Federal Reserve projected a much more dovish tone starting in March relative to the beginning of the year; the Fed's "dot plots" suggested the number of likely rate hikes fell from four to two[1].

The market's reaction was almost tangible: the US dollar (USD) weakened, easing financial conditions across the globe and sending crude oil prices higher. Both factors, in turn, provided a much needed boost to emerging markets (EM), sparking a rally in the markets.

In our view, investors should not get used to this rally. USD strength could, to a large extent, influence the general path of global markets in the coming months. The relative strength of the US dollar will be impacted by the Federal Reserve's rate path towards normalization of monetary policy as well as by the actions of other central banks.

In the wake of a dismal May jobs report[2] and close opinion polls in the UK referendum on European Union membership, we now think a Fed rate hike this summer is unlikely. In addition to a shockingly small number of new jobs added in May, wage growth remains incredibly weak. There are indications that US consumption continues to drive the recovery, but manufacturing in the US has been weak. The next Federal Open Market Committee (FOMC) meeting with a press conference after June is in September. We think it unlikely the Fed will hike rates shortly before the election. Our base case scenario is now for a 25bps hike in December 2016.

We continue to expect the Fed to adopt a gradual approach to monetary policy normalization. The risks to our forecast are evenly balanced and will be data dependent. If the May jobs report turns out to have been a one-off aberration and other economic data justifies a rate hike (particularly core Personal Consumption Expenditure), the Fed might hike rates by 25bps in July. We think this is unlikely, in particular because there is no press conference at the FOMC meeting in July and the Fed will want to communicate its rate path very clearly. If the economic data in the second half of this year does not justify a rate hike, however, there is a chance the Fed may be forced to stay on hold until 2017. The biggest risk to the US economic recovery remains a policy mistake by the Fed in which rates are hiked by too much, too rapidly.

A summer rate hike is not priced into the market, and so we would expect to see the USD appreciate moderately if the Fed does tighten monetary policy this summer. Even if the Fed does not hike rates in the next few months, however, we expect the USD to strengthen. This has more to do with what other currencies and central banks are doing than what the Fed is doing.

The Chinese renminbi (RMB), for example, has weakened slightly against the USD year to date[3], but the currency is significantly lower against a basket of currencies (including the euro and the yen) during the same timeframe. In other words, where Japan and Eurozone economies are concerned, their respective currencies appreciated against both the US dollar and the RMB. China has also been dumping steel, further eroding Japan's and the Eurozone's competitiveness[4]. This will provide a headwind for growth that Japan and the Eurozone can hardly afford given their already lackluster growth prospects.

Furthermore, inflation expectations in Japan and the Eurozone remain well below target[5]. In my view, it is a question of when and how, not if, the Bank of Japan (BoJ) and European Central Bank (ECB) will aggressively ease further. When they do, it is likely to push the USD up relative to the yen and the euro, although not at the same rate we saw last year given that the foreign exchange channel of monetary policy seems somewhat blocked in Japan and the Eurozone; the last time the BoJ and ECB eased monetary policy, their currencies actually appreciated[5]. If, then, the USD appreciates, it will have negative implications for oil and for financial conditions in EM.

[1] Federal Reserve: Economic Projections, March 16, 2016
[2] US Bureau of Labor Statistics, June 3, 2016
[3] Manulife Asset Management, Bloomberg as of May 13, 2016
[4] Bloomberg: China's steel glut tops G-7 chatter as Leaders meet in Japan, May 26, 2016
[5] Manulife Asset Management, Bloomberg as of May 13, 2016

We continue to be more constructive about China relative to some analysts, but the slowdown in China's GDP remains a major risk to the global economy. We expect the People's Bank of China to continue to offer monetary stimulus while the government offers fiscal stimulus, and continues to pull on traditional levers to stoke the property market and fixed asset investment as a way of propping up growth. Over the medium- to long-term, authorities are faced with the gargantuan task of rebalancing the economy, opening up the capital account, supporting the renminbi and avoiding significant capital outflows. In the short-term, the government is likely to address these challenges by simply not doing any of them until growth has stabilized. The government has little incentive to push through with these reforms in the short-term, particularly now that the RMB has been included in the IMF's special drawing rights (SDR). A massive deleveraging in China's private sector—particularly among corporates and State Owned Enterprises (SOEs)—is rife with downside risk.

In Europe, the threat of a British exit from the European Union (Brexit) continues to weigh on sentiment. The referendum is set to take place on June 23 and opinion polls suggest the vote will be very close. In my view, the UK's best path forward is to remain in the EU and try to reform from within. Fortunately, this is also our base-case scenario. A "Brexit" would likely hamper trade, reduce foreign direct investment and undermine the UK's ability to stem migration. The pound sterling (GBP) is likely to weaken, inflation could creep in, growth could slow and capital would flee, leaving the Bank of England with a difficult decision about whether to prioritize price stability or growth. All of the models that the UK might use for trading with the EU from outside the bloc would leave the UK worse off than its current arrangement as a member state. Brexit could also pose an existential threat to the UK, with Scotland likely to hold a referendum in the wake of a UK decision to leave the bloc and troubles between Ireland and Northern Ireland possibly stoked as well.

Brexit could also pose an existential threat to the EU. According to Ipsos, more than half of French and Italian voters would like to hold a referendum on their country's membership of the EU, and almost half would choose to leave[6]. The Netherlands would also likely hold a referendum on EU membership in the wake of Brexit[7].

This existential threat for the EU would be layered on top of a number of other crises in the region. While Greece and its creditors have provisionally agreed to a deal on debt relief if necessary, the details are entirely unclear[8]. Greece was promised debt relief on publicly held debt back in 2012 as well and we have yet to see it happen. In the absence of significant debt relief, Greece will be unable to find sustainable growth. Furthermore, the EU-Turkey deal designed to slow the flow of refugees into Europe is already unraveling at the seams, with Turkey refusing to adopt new terrorism laws and Greek authorities refusing to recognize Turkey as a safe third country[9]. Even if this deal unraveling does not open the Aegean route for refugees, they will find other routes through Albania or Libya and Italy into Europe. We expect national borders in the Schengen Area to remain in place, undermining European solidarity.

Finally, we are still waiting for signs that the collapse in energy prices can stimulate private consumption globally – exactly the type of stimulus that governments appear unable or unwilling to provide. The two-year oil price crash effectively transfers more than $3 trillion from producers to consumers[10] . This has not fed through into more robust demand.

It is possible that consumers are smarter than markets and simply don't believe that oil prices will stay down. They have been tucking the savings away for now. In the end, the consumers may be right. The oil market may be far closer to rebalancing than the consensus believes with higher prices and less consumer benefit as the consequences.

For these reasons, investors should not be complacent. The second half of the year could be closer to the rollercoaster ride we experienced in January than the oasis-like calmness of this past spring.

[6] Ipsos Mori: Half of people in nine European countries believe UK will vote to leave EU, slide 8, May 9, 2016

[7] The Times: Envious Dutch want to hold their own referendum, February 23, 2016

[8] European Council: Eurogroup Statement on Greece, May 26, 2016

[9] Der Spiegel: 'Disaster in the Making': The Many Failures of EU-Turkey Refugees Deal, May 26, 2016

[10] Bloomberg: BoFA – The Oil Crash is Kicking off one of the largest wealth transfers in human history, February 1, 2016

Manulife Asset Management
Economic Research Global Forecast

	Forecasted data					
	2016	**2017**	**2018**	**2019**	**2020**	**Average 2016-'20[1]**
Gross domestic product (annual % change)						
World	2.3	2.8	2.9	2.9	2.9	**2.8**
United States	1.9	2.7	2.3	2.0	2.0	**2.2**
Canada	1.8	2.4	2.3	2.2	2.2	**2.1**
Eurozone	1.6	1.8	1.7	1.5	1.5	**1.7**
Germany	1.6	1.5	1.3	1.2	1.3	**1.4**
France	1.7	1.9	1.8	1.3	1.7	**1.7**
United Kingdom	2.1	2.2	2.0	2.0	2.2	**2.1**
Asia-Pacific[2]	4.2	4.2	4.5	4.6	4.4	**4.3**
Japan	0.5	0.4	1.2	1.3	1.0	**0.8**
China	6.5	6.2	6.1	6.0	5.9	**6.1**
India	7.2	7.4	7.9	7.8	7.5	**7.6**
Inflation Rates (annual % change)						
United States	0.9	1.8	1.9	1.9	2.0	**1.6**
Canada	1.5	1.8	1.9	1.9	1.9	**1.7**
Eurozone	0.7	1.4	1.5	1.6	1.7	**1.4**
Germany	0.7	1.4	1.4	1.4	1.4	**1.2**
France	0.7	1.2	1.4	1.6	1.7	**1.3**
United Kingdom	0.7	1.7	1.8	1.6	1.6	**1.5**
Asia-Pacific[2]	1.8	2.9	2.6	2.5	2.6	**2.4**
Japan	-0.1	1.9	1.8	1.3	1.2	**1.0**
China	2.0	2.2	1.8	2.1	2.5	**2.1**
India	5.6	5.6	5.2	5.1	4.5	**5.4**
Baseline - Long Interest Rates	**2016 EOP**	**2017 EOP**	**2018 EOP**	**2019 EOP**	**2020 EOP**	**2016-'20 EOP (Avg)**
US	1.9	2.5	2.7	3.1	3.4	**2.6**
Canada	1.3	1.8	2.3	2.8	3.3	**2.1**
Germany	0.4	1.0	1.5	1.9	2.5	**1.4**
France	0.6	1.1	1.6	2.0	2.7	**1.6**
UK	1.5	2.3	2.5	3.0	3.4	**2.4**
Japan	0.1	0.6	0.8	1.0	1.5	**0.7**

Source: Manulife Asset Management, as of May 11, 2016

[1] 5-year average: 2016 - 2020 is EoP averages.

[2] Asia-Pacific includes China and Japan.

The Asset Allocator's View

Robert Boyda, Co-Head of Asset Allocation

The Big Turn: The 3% Solution

The typical investor response to most things economic or capital markets related to Canada, outside of Canada of course, can be summed up, politely, as "who cares." Canadians cue up Rodney Dangerfield and his infamous tagline "I don't get no respect". Investors should pay a lot more attention to the US' northern neighbor not so much for its 3% allocation[1] in the global benchmarks as its stellar economic acceleration in the first quarter of 2016. To preview our thesis and conclusion, we disagree with the consensus that low commodity prices are the near signpost today as in the past of very dire economic misfortune to come. In fact, falling oil prices create a stimulus for delivering a meaningful economic boost and by proxy foretells higher equity markets.

"If Canada is indeed a window into the goings-on in the more opaque emerging world, then we conclude the whole of the developing world is in better shape than the consensus would have us believe."

The commodity price decline is in our view good deflation with more salutary and positive effects than negative ones. The economic world today in our humble view is more like Canada than ever, a tale of two economies. The very overabundance of things – particularly commodities and especially energy – may weigh on one part of the economy, but the tale of the other economy is quite different. That Canada, widely likened right now to one of the emerging markets, part of the woebegone oil and commodity-exporting nations, is seeing economic growth in the first quarter of 3%[2] speaks volumes about the way the other half of the economy is dealing with low energy prices. The energy dividend alone from the past two years of low prices sums to global consumer savings as large as the spending packages doled out globally in the midst of the Great Financial Crisis of 2008-9[3].

Since the Great Financial Crisis (GFC), the economic and investment order of things has been dominated by what my colleague Megan Greene calls the "Salient Seven:" too much labor, materials, commodities, savings and debt, regulation, central bank activity and too little aggregate demand. The usual government-spending antidote is not happening due to the aforementioned overabundance of debt. Here too we are pleased to note the exception is Canada, in that the new Canadian government came to power recently on a platform of additional fiscal spending. Fiscal policymakers of the world take note! In this regard (or in all things hockey related) a pity that we are not all more Canadian. For the rest of the world, if not government spending, then what delivers us all from the morass of lower and slower growth of the past eight years and toward the light of higher equity markets? Our answer is the very overabundance of things, and especially energy, creates the stimulus we had hoped would come to start the big turn.

The simple math of lower oil prices is as follows. The world consumes 95 million barrels of oil per day plus or minus a million barrels depending on whether you are bullish or bearish on the liquid black gold[4]. The price has fallen by some $50 per barrel since the late summer of 2014[5]. So, global consumers have enjoyed a price break of US$4.8 billion per day for something beyond 20 months – a global gift nearing $3.0 trillion dollars in savings and rising! Take away the $400-500 billion[6] in canceled capital expenditure spending by the oil companies and the net economic benefit comes within horseshoe-throwing distance of US$2.5 trillion. For the US, which consumes well north of 20% of global oil production, the net benefit sums to $400 billion in savings – about half the total stimulus package that was delivered by the current administration to rescue us from the depths of the GFC. And, we're getting this current benefit while the US economy is puttering along, employment is climbing, and unemployment nears 5%[7].

What's the point for capital market investors?

First, we need to acknowledge that all this happiness is not universally shared. It is a tale of two economies, and the oil producers are struggling. Second, the producers, particularly in emerging markets, devalue their currencies mitigating some and, in cases like Russia, all of the net savings benefits. But, the Canadian example shows that even among the producers and after a currency devaluation of 30% the other side of the economy more than makes up for the downside: the whole is materially better.

[1] MSCI All Country World Index, Country Weights, as of May 2016

[2] Manulife Asset Management estimates, as of May 26, 2016

[3] Manulife Asset Management estimates, Federal Reserve Bank of S. Louis: A Closer Look – Assistance Programs in the Wake of the Crisis, January, 2011

[4] US Energy Information Administration: Short-Term Energy Outlook, May 10, 2016

[5] Manulife Asset Management, Bloomberg as of May 26, 2016

[6] Financial Times: Delayed oil projects total nears $400 billion, January 14, 2016

[7] Bureau of Labor Statistics: Employment Situation Summary, May 6, 2016

If Canada is indeed a window into the goings-on in the more opaque emerging world, then we conclude the whole of the developing world is in better shape than the consensus would have us believe. At two-decade lows on the valuation front, Emerging Market Equities look better all the time. Our forecast returns for this asset class at over 8% annually for the next five years easily tops the middling 5-6% forecast returns for developed market equity.

Second, we have to acknowledge that the US consumer has done something very uncharacteristic. Unlike all prior oil price drops, the US consumer has decided to save the money![8] US savings rates are climbing during this period. There are two thoughts on the savings and spending statistics that bear comment. Consumer savings are a check stop underneath the economy that pushes out the risk of recession beyond our five-year horizon which is good for investors in risk assets. There is a measurement issue in the land of falling prices that understates economic activity. Spending is tricky to measure when prices are falling in that we might be consuming 20% more, gasoline for example, but as we pay 50% less in price, the GDP accounts say the value of economic activity is shrinking. Our view is that economic activity is stronger than the topline GDP measures because of this lower price phenomena.

"I think there is room for a modest cyclical uptick in headline and core inflation but nothing that will get us or policymakers excited. Long-term inflation is not a risk in our view."

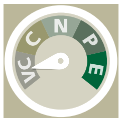
For bonds, all this deflationary pressure has been so welcome that in the past nine years it has led to complacency and the risk of a cyclical bounce in economic activity and even inflation is not properly priced into nominal bonds in developed markets. With US 10-Year Treasuries fetching less than 1.8%[9] and less than core inflation (core CPI is 2.1%[10]), bond investors had best brace for bumpier roads. Just to reiterate from last quarter, I think there is room for a modest cyclical uptick in headline and core inflation but nothing that will get us or policymakers excited. Long-term inflation is not a risk in our view.

Finally, all this happy talk about the oil stimulus can carry equity markets higher, bond markets lower and reignite interest in Emerging Market equity and debt. The cautionary tale from my perspective is that oil prices are at risk of climbing once again. The theory that the oil market is already in balance came early in April when the typical seasonal inventory build reversed into a decline. The inventory drop was relatively immaterial at 18 million barrels[11] against a 3 billion barrel OECD total storage number[12]. But, the drop signifies that the market is radically underestimating the past and current oil demand. Should the inventory draws continue contra-seasonally through June it is likely that much of the excess inventory of 300 million barrels will disappear by year-end. With OPEC (Organization of the Petroleum Exporting Countries) and particularly Saudi Arabia pumping near full capacity, there is no big player available to ramp production and balance the market. New production would have to be funded by the same investors who just dumped all the energy high yield paper at distressed prices – those wounds have not healed yet. The best case scenario puts oil in a sweet spot near US$65 per barrel, sufficient to provide both a net savings benefit and encourage capital to keep the market adequately supplied. Absent this sweet spot, be prepared for more volatility.

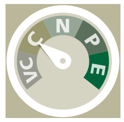
[8] Federal Reserve Bank of St. Louis: Personal Saving Rate (one year chart), as of April 29, 2016
[9] Manulife Asset Management, Bloomberg, as of May 26, 2016
[10] Bureau of Labor Statistics: Consumer Price Index Summary, May 17, 2016
[11] Cornerstone Analytics, May 12, 2016
[12] US Energy Information Administration: Short-Term Energy Outlook, May 10, 2016

The following table summarizes our views on various asset classes:

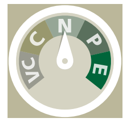
Legend:



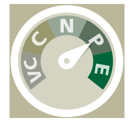
VC - Very Cautious



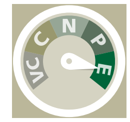
C - Cautious



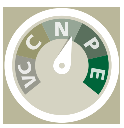
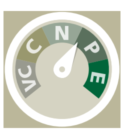
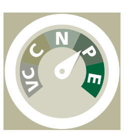
N - Neutral



P - Positive

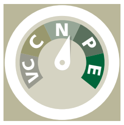
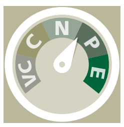
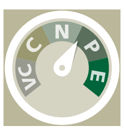
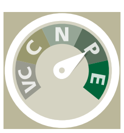
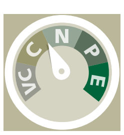


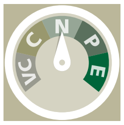
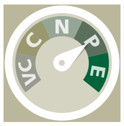
E - Enthusiastic

Asset Class	Our Sentiment (12-Month View)	Our Big Picture View	Investment Expert Insight: Specific Opportunities for Investors
Global Equities		Short-term, the precursors of stronger economic activity and the potential for an expanding global recovery are showing up in the US, Europe and Japan. China is stabilizing. Global surveys of service sector remain in strong expansionary territory. We are out of consensus on this matter but believe that persistent deflationary pressure results in under-reported economic strength. Global economies are churning through higher volumes of output than is reflected in the standard index measures. We remain positive about the relative performance of global equities over the next three to five years. Global liquidity and low energy prices will continue to support consumption and therefore corporate earnings growth and equity prices. But, investors should start to focus on some of the most downtrodden areas of the capital markets.	Our commitment to quality companies remains unchanged. These companies proved to be resilient in the face of market turbulence earlier in the year. We view positively companies that are going through value-add transitions – especially where the wider market has yet to give them credit for doing so.
US Equities		Overall, near-term, we remain cautious on US equities given high valuations, declining profitability, inventory overhang and struggling top-line revenues. The US dollar headwind is abating as we expected in spite of divergent monetary policies with the rest of the central banking world. As with global equities, we are relatively positive on US equities over a three-to-five-year horizon.	US consumers, which account for nearly 70% of the GDP, are still spending. We expect this to continue to translate into opportunities in the consumer discretionary space. We believe financials have been underappreciated. We also believe the Fed will raise rates at least once this year – a development that could enhance the sector's profitability.
European Equities		From what we see today, there are once again green shoots among the negatives across the European equity landscape. Spain, Italy, Germany, and France are reporting better economic data and short term money (M2)[1], the economic lifeblood, is expanding again. All good signs for risk assets. Risk of Britain's potential exit from the European Union (Brexit) has knocked down some of the surges in industrial and commercial activity. However, there is risk appetite in Europe seen in the unsolicited bid that Bayer made for US-based Monsanto[2].	We are seeing opportunities across all sectors but especially in areas that have fared poorly in the past 18 months, for example, in mining, oils as well as financials.

[1] Manulife Asset Management, European Central Bank data as of May 26, 2016

[2] Bayer: Press Release – Bayer Offers to Acquire Monsanto to Create a Global Leader in Agriculture, May 23, 2016

Asset Class	Our Sentiment (12-Month View)	Our Big Picture View	Investment Expert Insight: Specific Opportunities for Investors
Canadian Equities		Near to medium term, Canada is demonstrating that it is a tale of two economies and that, on-balance, the markets are in much better shape than consensus believes. With both the monetary support of the Bank of Canada and the promised fiscal support of the new government, there is plenty of hope. We have an out of consensus view that oil prices will stabilize and should revert in the direction of equilibrium at $60 per barrel; all good for a balanced economy.	While we expect oil prices to firm in the medium term, the assessment is not without risk. From that perspective, we believe upstream energy firms with quality assets, strong balance sheets and cash flow generation are likely to weather any potential storms better. We think there could be opportunities in financials in the short to medium term – especially banks with strong capital levels, scale and the ability to diversify outside of Canada.
Emerging Markets Equities		Our view of Emerging Markets (EM) equities continues to improve. These are not the EM countries of the 1996-97 debacles. Many have reformed and re-balanced (though not all). Over the next three to five years, we are enthusiastic about local growth opportunities in EM. While we may see a cyclical bounce in oil and stabilization in commodity prices that would benefit the EM asset class, we would view that turn as temporary. This is a stock-pickers asset class for now with abundant growth opportunities.	Valuation levels in China remain close to those observed at the time of the Global Financial Crisis, and we see opportunities in well-run companies poised to benefit from further developments in the new economy. We believe there are opportunities in Brazil: the beginning of a new political equilibrium brings forward the prospects for a more effective macroeconomic adjustment program like structural reforms.
Asian Equities		We are more cautiously optimistic about Asian equities than last quarter as early signs of stabilization in China bode well for the region. Our three-to-five-year outlook for the asset class is positive as we believe these economies are more self-sustaining, particularly in the consumer and technology areas.	In China, one of the key areas we are focusing on is the spending power of the millennial generation, which should be dramatically different to the prior generation before China opened up. The shift in consumption patterns appears to now focus on lifestyle experiences and availability of choices. We believe spending on travel, movies and mobile gaming could be where opportunities arise.
Japanese Equities		In spite of 14 consecutive quarters of earnings growth and beating estimates that would be the envy of any country in the world, Japanese equities, at the moment, continue to command no respect. We are out of consensus here but we believe that the opportunity in Japan could last for a decade or more, in the long-term. Companies are reforming to be more "Return on Equity" and shareholder driven and merit more attention from investors.	We believe many sectors are 'cheap' compared to other major markets, while there could be strong earnings forecasts for the likes of construction, telecoms and food companies in the coming months. Areas like tourism and security could benefit from the Tokyo 2020 summer games.
Global Fixed Income		Sovereign fixed income returns are expected to be generationally low over the secular horizon. US Treasuries offer some positive carry and are potentially useful for defensive purposes. Inflation expectations have collapsed far below core inflation rates, pressuring relative returns on Treasury Inflation Protected Bonds (TIPS). If as we expect there is a cyclical uptick in inflation, then the trend reverses and TIPS outperform Treasuries.	We continue to like investment grade credit, municipal bonds and asset-backed securities, the latter two potentially offering diversification opportunities when yields are so low.

Asset Class	Our Sentiment (12-Month View)	Our Big Picture View	Investment Expert Insight: Specific Opportunities for Investors
US Fixed Income		Right now, we think US credit is in good shape. We like the risk-adjusted returns in high yield better than most equity returns.	We think the best returns will likely come from corporate markets. High yield looks relatively interesting, though we have retained a cautious approach towards the energy sector.
Emerging Markets Debt		We continue to think emerging markets debt will offer above average returns over the next five years. In the short term, the returns may be bolstered by steady to slightly strengthening currencies. Valuations are attractive and the asset class has been thrown out with the commodity downtrend. We think that most of the EM countries are in far better financial condition than at any time in the past 20 years to weather a downtrend.	We are positive on Argentina – a country left out of the capital markets for 15 years – on business friendly reforms. We remain constructive towards Brazil and opportunities could be found across sectors: quality companies with good cash flows, strong balance sheets whose fortunes have been overshadowed by recent turmoil might do well.

Global Equities

Paul Boyne, Lead Portfolio Manager, Global Equity Strategy

THE BACKDROP

It is fair to say that monetary policy globally remains accommodative despite the US Federal Reserve's decision to raise interest rates last December. As long as this is the case, there is always the risk that slowing global growth and deflationary pressures from overseas could overwhelm any recovery.

Looking at the cyclically adjusted price earnings ratio, we think that the US markets remain highly valued. We suspect that forward estimates may veer towards the optimistic end of the spectrum, in light of the above comments, particularly if we take into consideration the fact that profit margins might have peaked as well as the declining impact of share buybacks.

From a valuation perspective, European stocks may appear cheaper than their US counterparts and could look like they have more earnings recovery potential. However, we believe much of this is sourced in structurally challenged industries.

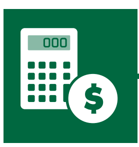
From a valuation perspective, European stocks may appear cheaper than their US counterparts and could look like they have more earnings recovery potential.

OPPORTUNITIES FOR INVESTORS

Our commitment to quality companies remains unchanged. Quality companies proved to be resilient in the face of market turbulence earlier in the year. Companies with wide moats are typically in the best position to weather a downturn in the market – especially those with strong balance sheets, and sustainable cash flows in addition to being committed to be the best at everything that they do. These are the kinds of companies that will do well when the broader markets are struggling.

We also continue to view positively companies that are going through value-add transitions – especially where the wider market has yet to give them credit for making positive and accretive changes. An example would be a proposed merger between a European food retailer with a significant footprint in United States and one of its American counterparts. In our view, the proposal makes strategic sense because both companies operate in similar territories and their strengths complement each other.

Quality companies proved to be resilient in the face of market turbulence earlier in the year.



RISKS

On the macro front, our biggest concerns at the moment are deflation risk, excess debt and slowing global growth.

Sectorally, we remain underweight commodity industries (and by implication emerging markets) and European financials and retain big exposures to 'sustainable' quality franchises with areas such as healthcare and consumer staples. We remain wary of excess leverage and continue to focus on quality companies with sustainable cash flow streams.

We remain wary of excess leverage and continue to focus on quality companies with sustainable cash flow streams.

ON OUR RADAR

- Deflation
- Excess Debt
- Slowing Global Growth

Slowing global growth.

US Equities

Sandy Sanders, Senior Portfolio Manager, US Equities

THE BACKDROP

Risks of a US recession have eased dramatically and financial markets have recovered.

It has been a challenging start to the year so far. But we continue to see the glass as being half full, as opposed to being half empty.

Risks of a US recession have eased dramatically and financial markets have recovered. The overall environment continues to be characterized by low growth and low inflation. However, we expect the pace of growth to pick up as we head into the second half of the year, supported by consumer spending, a strong housing market and industrial activities.

Corporate earnings during the first quarter were fairly subdued. Broadly speaking, Q1 results for financials came in above expectations, but the performance within the consumer staples, technology and healthcare sectors was more mixed.

OPPORTUNITIES FOR INVESTORS

According to the National Association of Home Builders, 86% of markets in the country have shown year-over-year improvement in the first quarter of the year.

It's all about the US consumer. The group, which accounts for nearly 70% of US GDP[1], is still spending. More importantly, their balance sheets remain healthy[2]. We expect this to continue to translate into opportunities for investors in the consumer discretionary space.

We are maintaining a constructive view of companies in the housing sector. The housing market remains healthy. According to the National Association of Home Builders, 86% of markets in the country have shown year-over-year improvement in the first quarter of the year[3].

Separately, we believe financials have been underappreciated by investors. The sector took some beating earlier in the year due to the following:

1. Fears that lower energy prices could materially hurt bank profitability and loan provisions;
2. Concerns that a hard landing in China could lower global growth; and
3. Worries about a potential recession in the US, which could lead to further monetary easing and thus affect profitability.

[1] Federal Reserve Bank of St Louis: Graph – Personal Consumption Expenditures/GDP, as of May 11, 2016

[2] Federal Reserve Bank of St Louis: Graph – Household Debt Service Payments as a Percentage of Disposal Income, as of May 11, 2016

[3] National Association of Home Builders: Housing Markets Continue to Edge Forward, May 5, 2016

Commodity prices have recovered from the low levels we saw earlier this year while pessimistic assumptions about China and the US did not materialize. Bank balance sheets are healthy and as mentioned earlier, first quarter earnings for the sector were better than expected. We have maintained our positive stance towards the sector.

Current valuations for the sector indicate investors are not expecting the Federal Reserve to raise interest rates for some time. We disagree. We believe the Fed will raise rates at least once this year – a development that could enhance the sector's profitability.

On the technology front, we continue to favor firms in the e-commerce space that are able to capture additional market share, where the incremental dollar is being spent. Companies with the ability to enhance end-user experience and rejuvenate their existing product offerings are more likely to do well in the longer term.

RISKS

The healthcare sector continues to receive a lot of attention from both regulators as well as the media, and valuations remain elevated by our estimates.

We continue to monitor the energy sector for opportunities. For more volatile and uncertain businesses, we demand a larger discount to our estimate of intrinsic value; in other words, a larger margin of safety. While there are signs of improving fundamentals, we do not believe most energy company valuations adequately compensate for the associated risks of investment.

We are also finding few opportunities in the healthcare space. The sector continues to receive a lot of attention from both regulators as well as the media, and valuations remain elevated by our estimates. Any change in the regulatory environment could potentially affect profitability.

ON OUR RADAR

The divergence of policy among the world's central banks bears watching, as does the timeline of the Fed's desire to return to a more "normal rate environment".

- **US Presidential Election:** All remaining likely candidates have pledged to stimulate economic growth and create more jobs. From that perspective, the election might not have as much direct impact on the markets as the media would have you believe. However, the process could be interesting.
- **US interest rate path:** The divergence of policy among the world's central banks bears watching, as does the timeline of the Fed's desire to return to a more "normal rate environment."

Canadian Equities

Patrick Blais, Senior Portfolio Manager, Canadian Equities

THE BACKDROP

The negativity towards Canadian equities in the last two years was probably overdone.

We have seen a turnaround in investor sentiment towards Canadian equities. Investors are warming up to the asset class once again after what has been a challenging 18 months. Canada's economy is very dependent on global growth, given where the country sits in the global supply chain due to the nature of our main exports (energy and resources).

There are two catalysts behind the change: China and oil prices. Recent economic data assured investors that China is not spiralling out of control. Government measures brought in to stabilize the country's economy appear to be working. Separately, the fact that oil prices appeared to have found a floor earlier this year also helped.

In our view, the negativity towards Canadian equities in the last two years was probably overdone. We believe it's a factor that has also contributed to the bounce we saw this year.

OPPORTUNITIES FOR INVESTORS

Banks with strong capital levels, scale and the ability to diversify outside of Canada could be in a better position to navigate through any potential downturn.

Given the expected trajectory of energy prices and the belief that the oil oversupply situation is slowly working its way through the system, it can be easy to view energy producers positively. However, that optimism needs to be qualified. While we expect oil prices to firm in the medium term, the assessment is not without risk. From that perspective, we believe upstream energy firms with quality assets, strong balance sheets and cash flow generation are likely to weather any potential storms better.

Similarly, we think there could be opportunities in the financials sector in the short to medium term. In our view, banks with strong capital levels, scale and the ability to diversify outside of Canada could be in a better position to navigate through any potential downturn. From a valuation perspective, we also believe select asset managers might be worth monitoring.

RISKS

If the momentum in China falters, it would have significant implications for global growth and associated with that, commodity prices.

China remains to be a central part of the wider jigsaw puzzle. If the momentum in China falters, it would have significant implications for global growth and associated with that, commodity prices.

While that is not our base case scenario, it remains a risk. China's economy remains to be opaque, and it can be difficult to ascertain if the efforts at transitioning it into a services-led economy will be smooth. In the longer term, the government would also need to demonstrate its commitment to addressing the imbalances in the economy.

In a similar sense, we are also monitoring the Canadian economy very closely. The real estate sector is a concern, as is the overall level of leverage. These need to be unwound in a progressive fashion.

ON OUR RADAR

Global trade statistics have been weak. This is a trend that bears monitoring, as it could have implications for companies involved in transporting cargos.

Gold: The precious metal has had a good run this year. While we think prices have run too far too fast, at these levels many gold companies are able to generate cash flow and earnings. With cost structures lower than they have been in the past, cash flow generation can continue if prices remain above the US$1,200 level. A major risk of course is the potential action from the US Federal Reserve. If they increase rates in June, sentiment will likely weaken and gold stocks may correct.

Global Trade: Global trade statistics have been weak. In fact, by one measure, the value of goods that were traded internationally last year fell 13.8% in dollar terms[1]. This is a trend that bears monitoring, as it could have implications for companies involved in transporting cargos.

[1] Financial Times: World trade records biggest reversal since crisis, February 26, 2016

European Equities

David Hussey, Head of European and
EAFE (Europe, Australasia and Far East) Equities

THE BACKDROP

In our view, the overall picture looks reasonable – liquidity support from the European Central Bank remains in place and valuations stayed on the sensible end of the spectrum on a margin-adjusted basis.

Economic recovery in Europe has been stilted in the last few years, but it appears to be back on track. Leading indicators such as the Purchasing Managers' Index in the Eurozone[1] stayed in expansionary territory in recent months. Although the broader inflationary picture remains on the worrying end of the scale, the backdrop is improving, helped along by recovering commodity prices and signs of wage inflation (for example recent wage rounds in Germany[2]).

The corporate earnings picture also looks reasonable. Expectations were heavily revised down following the turbulence we experienced at the start of the year. But as it turns out, things are not as bad as initially thought – first quarter results thus far have beaten (scaled back) expectations.

In our view, the overall picture looks reasonable – liquidity support from the European Central Bank remains in place and valuations stayed on the sensible end of the spectrum on a margin-adjusted basis. The overall environment is constructive for earnings to recover – a message that we are hearing consistently in our meetings with company representatives.

OPPORTUNITIES FOR INVESTORS

In the commodities space, long-term cashflows coming from "best in class" metal producers that can pay large and growing dividends continue to appeal.

We are seeing opportunities across all sectors but especially in areas that have fared poorly in the past 18 months, for example, in mining, oils as well as financials. There are some high quality global companies that might be under-appreciated, offering yield-hungry investors attractive and growing dividends.

In the commodities space, long- term cashflows coming from "best in class" metal producers that can pay large and growing dividends continue to appeal. Similarly, we can find well capitalized financials that are offering very tempting dividend yields and multi-decade low valuations.

The energy sector, in our opinion, is one that bears monitoring. Crude prices sank below US$20 a barrel in the late 1990s, leading to a massive under-investment in oil-refining infrastructure. That contributed to soaring crude prices in the following decade as demand outstripped supply (compounded by geopolitical tension). It is our belief that we could be moving close to a repeat of that cycle again after global oil companies will have cut production and exploration capital expenditure by hundreds of billions of dollars.

There is also a structural element to this: many large-cap integrated businesses in the sector have reduced fixed "cash costs[3]" near current oil prices. We believe oil prices will react positively into next year as the reduced capacity and rising consumer demand begin to be reflected in crude inventories data. This could, at some point, translate into a positive earnings growth story for the sector.

[1] Markit: Markit Eurozone Composite PMI, May 4, 2016

[2] Reuters: German wage deals moderate so far, seen boosting growth less than in 2015, May 18, 2016

[3] Cash costs refers to the minimum sum that producers would require to keep their operations running.

We believe UK voters will ultimately choose to remain in the European Union and opt for stability as pragmatism takes over.

RISKS

The China story is positive in many ways and recent economic data suggests the economy has stabilized. However, the amount of leverage that has crept back into the system as authorities worked to reflate the economy is a cause for concern. Similarly, the country's transition from an export-based economy to one that's led by consumption is fraught with challenges. The path may not be as smooth as hoped.

Brexit, unsurprisingly, is a short-term risk that has the potential to sow the seeds of quite extreme volatility at the end of June. But we believe UK voters will ultimately choose to remain in the European Union and opt for stability as pragmatism takes over.

Greece, as always, remains to be a potential risk event despite the recent debt agreement which once again delayed any meaningful decision about potential debt relief[4].

Lastly, politics is and will remain a major risk. The rise of anti-establishment parties across Europe is a reaction to the perceived shortcomings of capitalism in recent years and the rising income disparities.

We think the growing gulf between the "haves" and the "have-nots", partly caused by sustained unconventional monetary policies, bears monitoring.

ON OUR RADAR

From a longer term perspective, we are worried about the ageing demographic in Europe. Consistently low birth rates and improving life-expectancy could have far reaching impact on the continent, with implications for economic growth and public finances (among others). The issue is unlikely to affect the financial markets in the near term, but it will become more salient in the coming decade.

We also think that the growing gulf between the "haves" and the "have-nots", partly caused by sustained unconventional monetary policies, bears monitoring. If left unchecked, it could have a negative impact on future economic growth in addition to fueling the rise of populist movements which could destabilize political establishments.

[4] New York Times: Vague Promises of Debt Relief for Greece, May 30, 2016

Emerging Markets Equities

Kathryn Langridge, Senior Portfolio Manager,
Head of Global Emerging Markets Equity

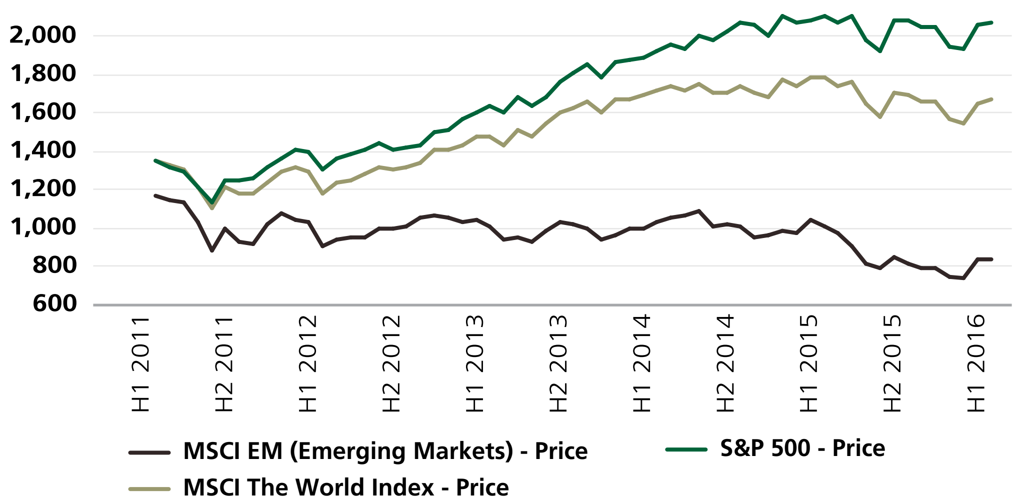
Philip Ehrmann, Senior Portfolio Manager,
Global Emerging Markets Equity

THE BACKDROP

We believe, from a very low base, that corporate earnings across the GEMs asset class are primed to surprise positively.

The 22% rally from the January 21 low in emerging market equities has been dramatic[1]. However, it is important to place it in the context of a much more modest 6% rally from the end of 2015 and the near 20% decline experienced over the last five years (see chart below). The global emerging market (GEM) equity asset class has clearly been unloved – this is reflected by the estimated $153.5bn outflow of funds over the last three years[2]. Returns have decayed and GEM equities have delivered negative earnings growth over the last few years.

Emerging Markets Equities vs. Other Major Indices



Source: Factset as of May 16, 2016

In our view, there are three factors that we believe are critical in turning around sentiment and providing a firm foundation for a sustained recovery in the GEM fortunes.

These relate to:

- The path of the US dollar and its impact on the competitiveness of emerging economies;
- A more predictable and stable path for commodity prices; and
- A recovery in relative and absolute profitability across emerging market companies.

[1] Manulife Asset Management, Bloomberg as of May 10, 2016
[2] EPFR, April 2016

Whilst the jury remains out with respect to when the US Federal Reserve will next seek to take a further step in normalizing interest rates, the US dollar appears to have plateaued. Our economics team, however, believes the dollar will likely appreciate following the recent downdraft. We are more sanguine. In the past, rate rises have not necessarily seen the US dollar strengthen further. Our observation is that, as a group, currencies across the markets we cover are competitive and past rigidities are not in place. Thus we do not believe that at this time the US dollar is an impediment to the GEM story.

Turning to commodities, we would note that the recent sharp recovery in oil and iron ore prices is as much a function of how extreme the falls have been, as it is a response to resurgent demand. To extrapolate that these moves will continue is to take an aggressive view on global growth – something we do not believe is merited. Instead we take a more sanguine view that the global economy is on the mend. Imbalances are being resolved and a more stable environment is likely once inventory liquidation and financing pressures are behind us.

Finally, and to our mind most importantly, we turn to earnings prospects. We believe, from a very low base, that corporate earnings across the GEMs asset class are primed to surprise positively. As excess supply is removed and the benefits of lower input costs begin to work their way through, companies are well positioned to begin to enjoy higher margins. The first quarter of the year has already suggested that this is starting to manifest itself: South Korea (62% positive Earnings Per Share surprises versus 33% in Q4, 2015); India (58% versus 39%); and China (53% versus 46%)[3]. Importantly, this process is likely to be an extended one reflecting the currently deeply depressed starting point.

OPPORTUNITIES FOR INVESTORS

The beginning of a new political equilibrium brings forward the prospects for a more effective macroeconomic adjustment programme including structural reforms.

We continue to believe that a portfolio of strategically and operationally well managed, financially strong companies with a track record of delivering sustainable earnings growth will continue to outperform their peers.

We remain constructive towards China. The rise in the US dollar appears to have stalled – a development that has reduced fears that a sharp one-off devaluation of the renminbi was imminent. Significantly, China actually experienced a small increase in its foreign reserves in March and April[4], suggesting that the growing chorus proclaiming a full blown currency crisis was wide of the mark. The country's economic data has been generally better, following earlier measures to boost the important property sector, although there is only scattered evidence that the sharp contraction in activity that has been experienced over the last 18 months has come to an end.

We continue to focus on the all-important transition away from a centrally managed economy to one driven by market forces. Ironically, the key to this remains actions by the centre to rein in state owned enterprises, thereby removing excess loss-making capacity and freeing up trapped capital. Progress is being made but not at the speed fickle markets would like.

Valuation levels in China remain close to those observed at the time of the Global Financial Crisis, and we see opportunities in well-run companies that are poised to benefit from further developments in the new economy.

[3] BofA Merrill Lynch, April 2016

[4] Reuters: China April FX reserves rise to $3.22 trillion, May, 6, 2016

We also believe there are opportunities in Brazil. The beginning of a new political equilibrium brings forward the prospects for a more effective macroeconomic adjustment programme including structural reforms. As of writing, the prospect for declining interest rates combined with a competitive exchange rate and early signs of corporate earnings turnaround balances out what remains a volatile political environment in the short term.

In the technology space, we continue to concentrate on software-focused companies, as internet and e-commerce remain an important theme for us. In this respect we watch with interest the up-coming index re-balancing (end-May) which should see the MSCI Emerging Markets Index complete the integration of the last significant tranche of US-listed Chinese ADRs (American Depositary Receipts), which would include many of the large cap ecommerce stocks. This should see China's info-tech sector weighting exceed that of Taiwan for the first time.

RISKS

Given our preference for quality companies, it is unsurprising that we remain wary of firms that are highly geared – both from a financial and operational perspective. The recent commodity price rally could have provided some relief for companies whose very existence was threatened as recently as a few months ago. We would also caution that whilst the worst of the commodity down-trend may be behind us, prices have rebounded too quickly and more industry rationalization is likely to be necessary to establish foundations for sustainable future recovery. From a sectoral perspective, we are cautious towards hardware-focused companies in the technology space.

The recent commodity price rally could have provided some relief for companies whose very existence was threatened as recently as a few months ago.

ON OUR RADAR

- Any abrupt change in the pattern of China's growth adjustment or the path of Fed normalization has the potential to cause further turbulence in a typically volatile asset class.
- Signs of a structural recovery in profitability in GEM companies.
- Whether global policymakers will deliver additional fiscal and monetary stimulus in an effort to boost growth.

Whether global policymakers will deliver additional fiscal and monetary stimulus in an effort to boost growth.

Japanese Equities

Edward Ritchie, Senior Investment Analyst, Japanese Equities

THE BACKDROP

We saw a further strengthening of the yen, while appetite for Japanese equities diminished on a weaker earnings view and general pessimism about the outlook for the real economy.

During April 14 – 16, the city of Kumamoto, on the Southern island of Kyushu, was hit by a series of earthquakes. Though not as devastating as 2011's earthquake/tsunami, there was nevertheless a significant loss of life and severe damage to housing, rail and road infrastructure. There was also a temporary halt to production across electronics and car–part makers[1].

In terms of near-term impact to the market, we saw a further strengthening of the yen, while appetite for Japanese equities diminished on a weaker earnings view and general pessimism about the outlook for the real economy[2].

More broadly, we believe the earthquakes could influence government economic policy in the following areas. Firstly, next year's consumption tax hike has been postponed as the government tries to lift spending and improve sentiment[3]. Next, there is the potential for a supplementary fiscal budget to support construction and rebuilding in the impacted regions.

OPPORTUNITIES FOR INVESTORS

As long-term investors in Japanese equities, we believe recent bearishness to be overdone.

The performance of the main benchmark for Japanese equities, the Topix, continues to lag certainly compared to last year[4]. Many investors, especially foreign-based funds, have taken flight, arguably perturbed by a relatively stronger yen – which has dimmed the outlook for corporate earnings – and skepticism on the durability of Abenomics. The Topix tends to underperform in a downward global cycle, so concerns over last year's Fed rate hike and the slowdown in China have also been a negative.

However, as long-term investors in Japanese equities, we believe this bearishness to be overdone. Many sectors are cheap compared to other major markets like the US, while there could be strong earnings forecasts for the likes of construction, telecoms and food companies in the coming months. There is also plenty of ammunition for potential buybacks given the levels of idle cash sitting with corporates. We continue to see opportunities for strong niche Japanese companies to grow domestically and overseas.

Finally, nothing has changed our longer-term view that rail and road spending, and linked areas like tourism and security, could benefit from the Tokyo 2020 summer games.

[1] The Japan Times: Manufacturers jolted into production line suspensions by Kyushu quakes, April 17,2016
[2] Reuters: Nikkei tumbles as earthquake, strong yen reduce risk appetites, April 17, 2016
[3] Reuters: Japan PM delays sales tax hike, puts fiscal reform on backburner, June 1, 2016
[4] Manulife Asset Management, Bloomberg as of May 5, 2016

RISKS

A foreign investor base that is, from where we stand, prone to seeing Japan equities as a trade rather than a long-term investment, can sometimes make for a volatile market.

While we have stressed the potential for strong earnings upgrades in certain sectors, consensus earnings forecasts for 2016 have ebbed lower since the beginning of the year by around 5% because of the stronger yen. Despite this, the market is still expecting 15% earnings growth for FY16[5]. Additionally, a foreign investor base that is, from where we stand, prone to seeing Japan equities as a trade rather than a long-term investment, can sometimes make for a volatile market. Separately, a long-term negative rate environment continues to press on the financial sector's ability to grow profits, although banks continue to be attractively valued.

ON OUR RADAR

Forthcoming Upper House elections, potentially in July, will be an intriguing test for Prime Minister Abe and his ruling Liberal Democratic Party.

- Has the Bank of Japan's monetary easing run its course? The central bank maintained its -0.1% deposit rate at the end of April to the surprise of some who had forecast further stimulus measures[6]. If it has, then we suggest the government might do more within fiscal policy to try and boost growth and inflation.
- Forthcoming Upper House elections, potentially in July, will be an intriguing test for Prime Minister Abe and his ruling Liberal Democratic Party.

[5] CLSA: Where did Mr. Gaijin go?, April 8, 2016
[6] Bank of Japan: Statement on Monetary Policy, April 28, 2016

Asian Equities

Ronald CC Chan, Chief Investment Officer, Equities, Asia (ex-Japan)

THE BACKDROP

In China, we are seeing the government's pro-growth rhetoric at the National People's Congress work report come through.

We started the year with a series of concerns related to China, particularly on the back of a potential economic hard landing. As economic data improved and the currency stabilized, fears have subsided. We are also seeing an improvement in investor confidence as fiscal and monetary stimulus measures from the region's central banks start to flow through into the real economy.

In China, we are seeing the government's pro-growth rhetoric at the National People's Congress work report come through. We have seen an increase in liquidity from the monetary side[1] and an increase in infrastructure-related investments from the order books of companies as evidence[2]. All these factors lead us to believe that the worst might be over. It's a development that can be seen across Asia as well — central banks are cutting rates and the governments are taking fiscal measures to support growth. What needs to be seen is whether the current momentum from these measures can be translated into earnings in the coming quarters.

OPPORTUNITIES FOR INVESTORS

One of the key areas we are focusing on is the spending power of the millennial generation, which should be dramatically different to the prior generation before China opened up.

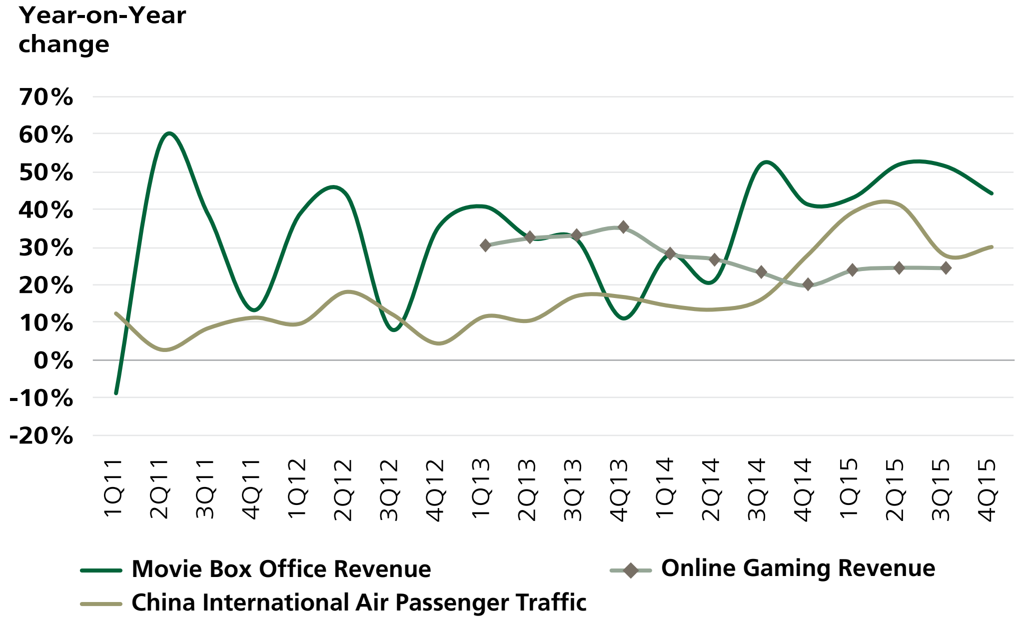
Within a backdrop of improving economic stability and supportive policies in Asia, opportunities are emerging, especially in North Asia.

Supported by macro factors such as China stabilizing, a stronger Japanese yen and a recovering US economy, South Korea is best positioned to capture these favorable opportunities as the country's domestic demand improves. Corporate earnings for the first quarter are either in line or better than expected and the capital management initiatives introduced by the government have added value to shareholder returns[3].

In China, one of the key areas we are focusing on is the spending power of the millennial generation, which should be dramatically different to the prior generation before China opened up. The shift in consumption patterns, as shown in the chart as shown in the chart next page, appears to now focus on lifestyle experiences and availability of choices. We believe spending on travel, movies and mobile gaming could be where opportunities arise. The increased interest in sports should be a multi-year trend, given rising consumer demand among the middle class and supportive government policies. We expect the private sector to play a key role in the sport services industry and new technology.

[1] Financial Times: China injects cash to boost growth and counter capital outflows, February 29, 2016
[2] Reuters: China official factory activity unexpectedly expands but job losses mount, April 1, 2016
[3] Barron's: South Korea Fires Its Own 'Three Arrows', May 17, 2016

Movies, international air travel, online gaming have undergone particularly strong growth in China



Source: CEIC, SARFT, CNNIC, Goldman Sachs Global Investment Research, December 2015

India has more specific investment opportunities as the country's government sharpens its focus on the development of rural areas. We believe that the growth in demand for white goods could create opportunities for investors. There could also be opportunities emanating from increased infrastructure spending as public infrastructures are created.

In the ASEAN region, respective local governments have put in place fiscal policies that should boost infrastructure spending. Indonesia and Thailand are prime examples. Additionally, the "One Belt, One Road" initiative from China should lead to increasing infrastructure investment as China looks to deepen relations to promote sustainable and coordinated socio-economic development in major Southeast Asian cities.

For Asia as a whole, we have seen fewer negative earnings revisions since the beginning of the year. As a result, corporates have reported earnings that have been in-line to better-than- expected. From a historical context, we believe that valuations are attractive and Asian equities as an asset class is under owned by foreign investors. We believe that the earnings outlook for the second half of the year could improve as the corporate world reaps the benefits of government policies.

RISKS

The upcoming US Presidential election and the UK referendum on its EU membership are events to pay attention to as the respective outcomes will determine the magnitude of any potential impact in Asia.

The upcoming US Presidential election and the UK referendum on its EU membership are events to pay attention to as the respective outcomes will determine the magnitude of any potential impact in Asia. With regards the possibility of a 'Brexit', it is important to note that certain large corporations in Asia have a significant presence in Europe.

The main risk in Asia will be the ability of the region's governments to execute planned monetary and fiscal measures. The longer-term concern will be the commitment to reform and whether governments have the willingness to implement policies that are required for continued growth.

Within China, there remains the risk of a sharp devaluation of the renminbi. Although this is not our base case, we believe that any unanticipated move will be taken negatively by the market.

Lower oil prices have benefitted emerging Asian economies as they are net importers of oil. If prices do move higher in a significant way, we could see current account surpluses move into negative territory.

Given all the moving parts that could have an impact on Asian equity markets, the key is less volatility and more stability. On balance, the risks are external. Impact on Asian equity markets from risks related to this region are likely to be less volatile and have been priced in by markets.

ON OUR RADAR

We will also be keeping a close eye on the US dollar given the impact that movements in the currency can have on the Asian markets.

We will continue to monitor China's Producer Price Index (PPI) and Consumer Price Index (CPI). Recent data shows that the PPI figure is becoming less negative than before and the CPI figure is trending upward over the past few months. If this trend continues, it could translate into more pricing power for corporates and that could imply an improved earnings outlook.

We will be watching for any sign of revival of private investment in China.

A decision on inclusion of China A-shares in the MSCI indices will be announced in June[4]. The implication of this decision is far reaching as it could have an impact on how quickly the China market opens up and the speed at which the securities regulator will approve the Shenzhen-Hong Kong connect scheme.

We will also be keeping a close eye on the US dollar given the impact that movements in the currency have on Asian markets and the price of oil.

[4] SCMP: China investors eye possible mainland share inclusion in MSCI annual review, May 12, 2016

Greater China Equities

Kai Kong Chay, Senior Portfolio Manager, Greater China Equities

THE BACKDROP

Taiwan's exports growth has been trending downward for the past twelve months and continues to bear monitoring.

The Chinese government has been using stimulus measures to show its commitment to stabilize their economy. In March, the National People's Congress annual work report wrapped up with "pro-growth" as the key message, which gives investors comfort that the government is employing monetary and fiscal measures to prevent any type of hard landing scenario.

There are over-weighing concerns over continued sluggish retail sales growth in Hong Kong dragged by the slowdown in inbound tourism. Year to date, housing market activities in Hong Kong have remained subdued. Although primary-market transactions have held up, recent data has suggested that secondary housing prices continued to soften[1]. Taiwan's exports growth has been trending downward for the past twelve months and continues to bear monitoring[2]. As the National Stabilization Fund has been involved since last August, their announcement to withdraw from the equity market could be taken positively as they believe that investor sentiment has stabilized[3].

OPPORTUNITIES FOR INVESTORS

We think it might be worth monitoring Taiwan's auto parts industry.

In China, the opportunity lies in consumer spending and taking advantage of the paradigm shift of moving from the old economy to the new. The emergence of the millennial theme presents opportunities as expenditure on new avenues like internet, online gaming and travel increases. These new growth sectors will potentially create the differentiating value as long as investors can capture this tide.

Meanwhile, the government is still juggling between the old economy and the new economy—when the Chinese leaders stated that they support growth at the National People's Congress' annual meeting, they are referring to sectors such as infrastructure and housing. Hence, a paradigm shift is taking place, representing a host of opportunities to tap into China's present and future.

We think opportunities in Hong Kong are tilted to the defensive sectors, such as utilities and companies with attractive dividend yield. As Macau's struggling gaming market appear to have bottomed out after posting almost two years of continuous declines in monthly gross gaming revenues, there could be select opportunities on a relative value basis.

Benefitting from an evolution in how cars are being manufactured, electronic components are becoming more important and small Taiwanese companies are willing to take up new opportunities that larger peers would not look at. Hence, it might be worth monitoring Taiwan's auto parts industry. Its biotechnology industry is also strengthening on the back of strong government support.

[1] Hong Kong Monetary Authority: Half-Yearly Monetary & Financial Stability Report, p.60, March 2016
[2] Bloomberg: Taiwan economy shrank in first quarter as weak exports drag, April 29, 2016
[3] The China Post: Record-long stabilization fund exits markets, April 13, 2016

RISKS

In China, the biggest risk is execution of economic reforms.

In China, the biggest risk is execution of economic reforms. This needs to come through for them to move on a multiple year growth trajectory. Also, there is a risk of currency devaluation (again) by the government as against a gradual depreciation—even though there is nothing on the cards in this regard. However, it is worth remembering how Beijing surprised the markets when it decided to devalue the currency last August.

For both Hong Kong and Taiwan, the risks are mostly external and significantly dependent on the US. In Taiwan, if exports continue to decline, as they have been for the past twelve months, then it will cause a negative impact on the island's companies and the overall economic outlook. The good news is that both Hong Kong and Taiwan have a good current account surplus which is a major support to the health of the respective economies. Yet, further negative external factors for Hong Kong and further dent on exports for Taiwan could weigh on sentiment.

ON OUR RADAR

We will be monitoring bank earnings, and keeping an eye on the level of non-performing loans.

In China, the first half yearly corporate earnings reports will begin in August. We will be monitoring bank earnings, and keeping an eye on the level of non-performing loans. There is a general lack of clarity on how big these numbers are and the ambiguity is a cause of worry.

As China's foreign exchange reserves have been drawn down over the past two years, we will continue to monitor these figures although we have seen an increase, albeit slight, in the reserve figure over the past two months.

For Hong Kong, we need to monitor the Fed's stance on interest rates outlook because of its currency peg, as a rise in US interest rates will eventually lead to a rise in Hong dollar interest rates[4] — which may affect sentiment in both the stock market and the property market.

For Taiwan, we need to keep an eye on the export data and the impact of the National Stabilization Fund's announcement on the equities market. We will also be monitoring tech earnings for the first half of 2016 given the weaker than expected results and lower guidance from Apple.

[4] Hong Kong Monetary Authority: Statement by Norman Chan, Chief Executive of HKMA to the media, December 17, 2015

Global Fixed Income

Daniel Janis, Head of Global Multi-Sector Fixed Income

Thomas Goggins, Senior Portfolio Manager,
Global Multi-Sector Fixed Income

THE BACKDROP

We are cognizant that a calmer environment has induced a rally in riskier bond assets… yet what we think is more significant is the reaction to the dovish outlook of the US Federal Reserve.

The global economic backdrop has generally steadied in the past few months: US jobs and housing numbers, and a more stable outlook for China, have been supportive of a less choppy climate for the market. We are cognizant that a calmer environment has induced a rally in riskier bond assets, like high yield and emerging markets debt, yet we think what is more significant is the reaction to the dovish outlook of the US Federal Reserve. Here, risk assets have trended up because the market expects the Federal Reserve to keep its powder dry for the foreseeable future, while we see this interpretation as being too bullish: these assets will come under pressure should the Fed ratchet-up its rate hike schedule.

OPPORTUNITIES FOR INVESTORS

The Mexican peso continues to warrant attention in our view on compelling fundamentals, however, the currency continues to be volatile.

Based on the above, we maintain a generally cautious and defensive view of high yield and emerging markets debt, though we still like Mexico and the Philippines on a fundamental basis. We believe Brazil will continue to have its share of problems until its political situation steadies.

We continue to like investment grade credit, municipal bonds and asset-backed securities, the latter two potentially offering diversification opportunities when yields are so low.

On currencies, we tend to favor the US dollar and, to a lesser extent, the Canadian dollar, while identifying relative value opportunities in select others. The Mexican peso continues to warrant attention in our view on compelling fundamentals, however, the currency continues to be volatile.

Until the outcome of the UK's referendum on its EU membership is known, markets will continue to be nervous.

RISKS

While the energy sector has seen something of a comeback more recently, should oil prices remain low for an extended period of time, defaults in risk assets (e.g. high yield issuers) could tick up, potentially increasing volatility in the emerging markets debt space.

Until the outcome of Brexit – the UK referendum on whether it should remain in the European Union – is known, markets will continue to be nervous. The Spanish general election set for the end of June is also on our radar of potential flashpoints. We are also watching how Australia's 'double dissolution' election concludes: the first since 1987, it means both the Senate and House of Representatives are shut down in order for a federal election to take place.

We believe Brazil will continue to have its share of problems until the political situation steadies.

ON OUR RADAR

- The UK referendum on its EU membership and a slew of election campaigns over the summer like the US Presidential battle as well as the Spanish election could make for an unpredictable few months.
- Continued volatility linked to a market that is arguably mispricing what it thinks the US Fed will do next in rate hikes.
- We believe Brazil will continue to have its share of problems until the political situation steadies.

US Fixed Income

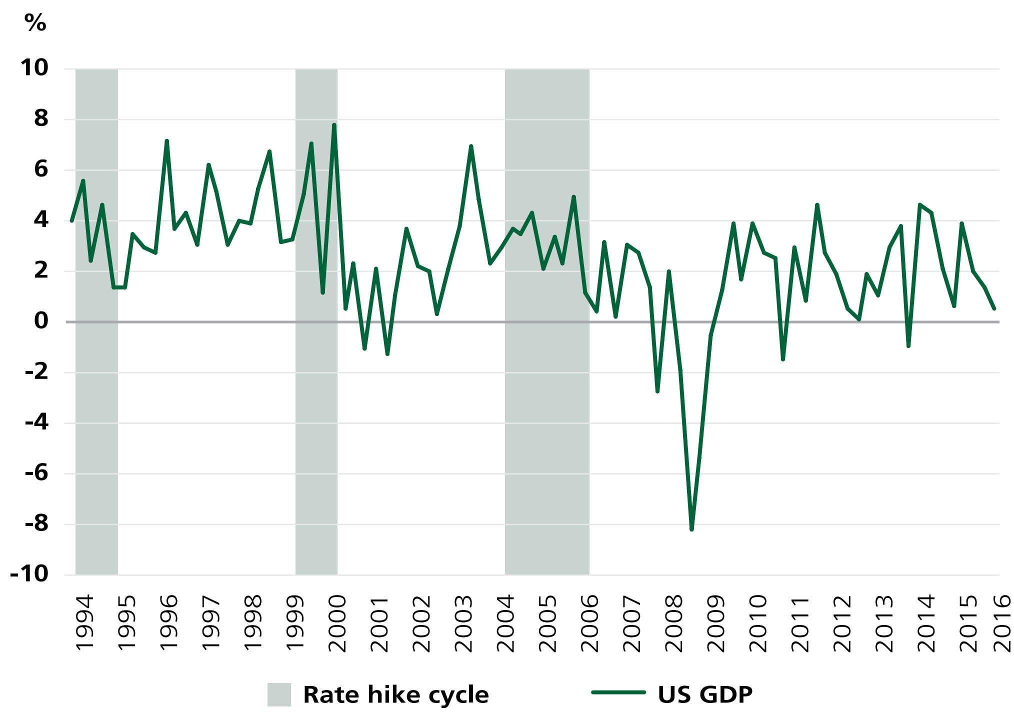
Howard Greene, Head of US Fixed Income

The Federal Reserve may not want to add more uncertainty and volatility to the market right around the time of the Brexit vote.

THE BACKDROP

As we enter into the current rate hike cycle, the key issue that US fixed income investors are trying to understand is how far and how fast can interest rates rise. We went away and took a closer look at the previous few interest rate hiking cycles by the Federal Reserve. We found that the current cycle is rather different from the previous three. When we look at the last three monetary policy tightening cycles (1994, 1999 and 2004), GDP at the start of those three cycles was approximately 5.6%, 5.1% and 3.7% respectively[1]. Most recently, US GDP was 1.4% in 4Q'15 and 0.5% in Q1'16. In addition, interest rates remain near historic lows and inflation (CPI) is also well below the Fed's stated 2% target.

US Real GDP (Percentage Change from Preceding Period)



Source: Federal Reserve Bank of New York, US Department of Commerce, May 2016

At this point, we believe the Fed will not raise interest rates before December (thus differing slightly from the views of our economic team). The Federal Reserve may not want to add more uncertainty and volatility to the market right around the time of the Brexit vote. However, data dependency rules, and the current quarter is looking stronger, so it bears careful watch. History tells us that the Federal Funds rate tends to rise to the level of the 10-year Treasury yield in place at the start of the hiking cycle, in this case in the neighborhood of 2.25%, plus or minus approximately 50 basis points.

Crucially, we expect the current cycle to be much more extended – taking two years or more to play out.

[1] US Department of Commerce, Bureau of Economic Analysis, April 28, 2016

OPPORTUNITIES FOR INVESTORS

Within the investment grade credit space, we think opportunities can potentially be found in financials.

Overall, we believe 2016 is likely to be another "coupon-clipping" year, where investors can only expect income from yield without material capital appreciation or loss. However, in a slow growth environment, it can be considered a relatively favorable outcome.

At this juncture, we think the best return will likely come from corporate markets – investment grade and high yield. Within the investment grade credit space, we think opportunities can potentially be found in financials. The group has underperformed their peers in recent months and therefore has some catching up to do. Separately, we believe there could be interesting propositions in the cable and media space. The high yield market also looks relatively interesting, though we have retained a cautious approach towards the energy sector.

RISKS

Duration risk, or the sensitivity of bonds to interest rate changes, continues to be a concern.

Duration risk, or the sensitivity of bonds to interest rate changes, continues to be a concern. Liquidity also remains an issue that investors should be mindful of, especially for smaller corporate issues. In the current low yield climate, we consider US Treasuries and Agency mortgages as being relatively less attractive options.

ON OUR RADAR

The expectation is the Fed will want to avoid any unexpected moves around the election.

Brexit: Markets hate uncertainty and it is the role of central banks to try and maintain stability in the market. We believe the Fed will stay on the sidelines if polls closer to the day suggest the vote will be close.

US Presidential Election: We think the upcoming election will have minimal impact on the bond market. However, the expectation is the Fed will want to avoid any unexpected moves around the election in order to retain the autonomy that is essential for Fed effectiveness going forward.

Foreign Ownership: It is interesting to note that the US bond market is experiencing increased technical support from demand by foreign investors, as a result of ultra-loose monetary policies and negative interest rates in Japan and Europe. Foreign ownership of US debt securities, particularly in the investment grade corporate bond market, has been strong and has increased over the past year[2]. We think this trend is likely to continue.

[2] Bloomberg: Negative yields from Paris to Tokyo draw investors to US Debt, February 2, 2016

Canadian Fixed Income

Terry Carr, Head of Canadian Fixed Income

THE BACKDROP

Canada continues to benefit from its trade relationship with the United States, with its modestly growing economy, and a relatively weak Canadian dollar.

The devastating fire in Fort McMurray made headlines globally, turning the spotlight on the city which is home to the largest single oil deposit in the world[1]. Thankfully, as of writing, the worst appears to be over. Nearly 90% of the city survived[2] – a relatively positive outcome compared to initial estimates.

The fire is likely to affect Canada's economy in the near term, especially the province of Alberta, although the longer term impact is expected to be moderate as the negative impact of the fires is offset by the government stimulus that will be needed to repair the damage. The broader Canadian economy has continued to do well. Commodity prices have firmed since February and oil prices appear to have stabilized in the mid-40s level. The country continues to benefit from its trade relationship with the United States, with its modestly growing economy, and a relatively weak Canadian dollar.

Overall, the economic backdrop is stronger than expected and, should this continue, we expect the Bank of Canada to still stand pat on changing the overnight lending rate for the balance of the year.

OPPORTUNITIES FOR INVESTORS

Canadian government bonds continue to reside on the "quality" end of the "safe haven" spectrum.

In our view, Canadian government bonds continue to reside on the "quality" end of the "safe haven" spectrum. Relative to European debt such as in Germany, where 10-year bunds are yielding around 0.13%[3], Canada's sovereign 10-year bonds – yielding 1.3% – suggests there might be a disconnect in the markets, which could represent opportunities.

This is particularly salient considering that similar offerings from less stable, "periphery" European countries like Spain and Italy are yielding around 1.6% and 1.5% respectively.

We also think there could be opportunities in provincial debt as liquidity in the space remains relatively robust. We are likely to see increased bond issuance from the provinces to upgrade local infrastructure and we are drawn to more stable provinces such as British Columbia, Ontario and Quebec who are less exposed to oil prices and should benefit from a lower Canadian dollar.

Venturing out of Canada but staying within North America, we believe there could be opportunities in the US high yield space. That market has recovered significantly year to date and could turn out to be attractive from a risk-return context, especially as a complement to a portfolio of Canadian investment grade bonds.

[1] Washington Post: A Canadian oil sands town is on fire, 80,000 must evacuate, May 4, 2016
[2] BBC News: Canada Fort McMurray – Leader says 90% of city survived, May 10, 2016
[3] All market data sourced from Bloomberg as of May 13, 2016, unless otherwise noted

RISKS

Liquidity risk remains a concern and could potentially hinder investor appetite despite offering decent returns.

The changing trading dynamic continues to be a challenge in the Canadian fixed income market – particularly for corporate bonds. Liquidity risk remains a concern and could potentially hinder investor appetite despite offering decent returns.

ON OUR RADAR

We believe the Fed may raise interest rates twice at the most this year.

US interest rates: We believe the Federal Reserve may raise interest rates twice at the most this year, a view that broadly corresponds with that of our Chief Economist. Should the Fed surprise the markets by raising rates three times this year, it would suggest that the global economic environment has picked up, thereby slightly increasing the odds of a corresponding rate hike in Canada.

US Presidential Election: We will be monitoring the currency market because, to our minds, it is the most efficient way for global investors to indicate their assessment of the outcome.

Japanese Fixed Income

Keisuke Tsumoto, Managing Director,
Head of Japanese Fixed Income Investment and
Head of Credit Research and Management

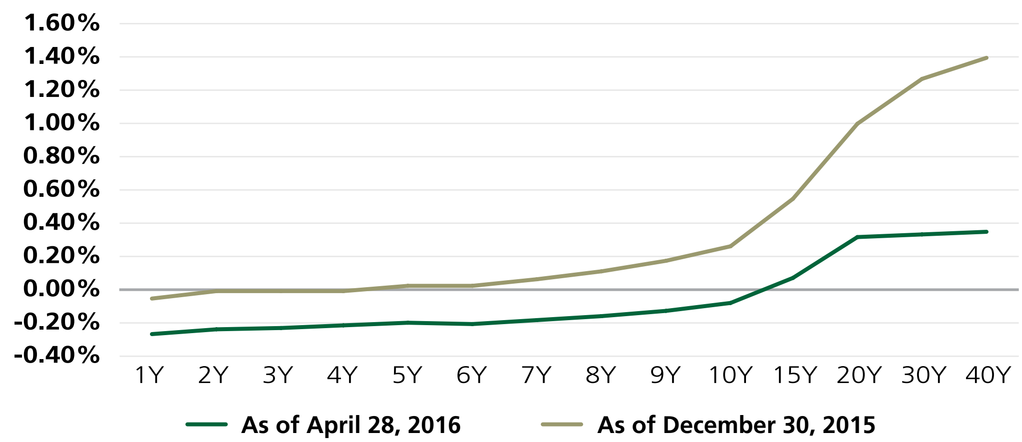
THE BACKDROP

The Bank of Japan brandished a new weapon on January 29, surprising markets by introducing negative interest rates.

As part of its ongoing battle against deflation, the Bank of Japan (BoJ) brandished a new weapon on January 29, surprising markets by introducing negative interest rates[1]. Since then, Japanese yields have declined sharply[2], while the yield curve has bull-flattened[3].

The chart below shows that as of the end April, Japanese Government Bonds (JGB) yields are negative in the front part of the yield curve, while the overall curve has also flattened sharply so far this year. This sharp flattening reflects strong investor demand for positive yield instruments.

Figure 1: Comparison of 10-year JGB yield curves



Source: Manulife Asset Management, Bloomberg, as of April 28, 2016

OPPORTUNITIES FOR INVESTORS

We see selective opportunities in Japanese corporate bonds.

Prior to the BoJ's move in January, several central banks in Europe had already introduced negative interest rate policies, with all of them lowering their policy rates even further after their first introductions. Therefore, it is widely expected that BoJ will follow suit, and also lower the policy rate further from the current -0.1%.

Although the BoJ held the policy rate unchanged at its recent Monetary Policy Meeting in April, market expectations of further rate cuts will remain in the near term.

[1] Bank of Japan: Introduction of "Quantitative and Qualitative Monetary Easing with a Negative Interest Rate", January 29, 2016
[2] Manulife Asset Management, Bloomberg, as of April 28, 2016
[3] This describes a situation when long-term interest rates on bonds fall more rapidly than short-term rates, resulting in a relatively flatter yield curve

Nevertheless, we do not see the new policy as a compelling reason to sell negative-yielding bonds indiscriminately. This is because as we expect interest rates to fall or move deeper into negative territory, capital gains (or mark-to-market gains) could exceed the negative carry income, generating a positive total return overall despite negative-yields.

Elsewhere, we also see selective opportunities in Japanese corporate bonds. These bonds are trading at around or above zero yields, and offer positive relative carry against JGBs of the same tenor.

RISKS

Investors may not be compensated for interest rate risk going forward because of negative carry and the subsequent uncertain roll-down effect.

Investors are now living in a new world of negative yields, an environment remarkably different from the positive yielding universe which they have lived in for the past many years. With this shift, we believe the traditional framework for bond investing, which aims to compensate for interest rate and credit risks, may not work well.

For one, investors may not be compensated for interest rate risk going forward because of negative carry and the subsequent uncertain roll-down effect. They may not be compensated for credit risk either, since the credit spread is being driven by the negative degree of the base JGB rate, and no longer properly reflects credit or liquidity risk.

ON OUR RADAR

Even though the BoJ has held the policy unchanged in April, bond markets still expect the BoJ to lower its policy rate further in the coming months. When this will happen, and by how much, is anybody's guess.

As we look ahead and closely monitor the BoJ's next moves, some key considerations remain. For one, even though the BoJ has held the policy unchanged in April, bond markets still expect the BoJ to lower its policy rate further in the coming months. When this will happen, and by how much, is anybody's guess.

Furthermore, in the current yield environment, we have seen a shift by domestic investors into assets such as longer-duration JGBs, credits, equities, real estate investment trusts (REITs) and foreign bonds over the past few months. Whether the shift to these assets will accelerate and ultimately have an impact on the Japanese bond market in the long term is our key consideration on the horizon.

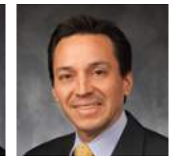
Prime Minister Shinzo Abe decided to put off a planned tax increase to October 2019[4], and he also prepares an extra fiscal package in autumn. The measures could have negative pressure on Japan's sovereign ratings and change foreign investors' appetite for JGBs. As foreign investors have been major buyers of short-tenor JGBs so far this year[5], potential change in their investment stance could have impact on bond market.

[4] Reuters: Japan PM delays sales tax hike, puts fiscal reform on back burner, June 1, 2016
[5] Bloomberg: Japan Negative Rates Alchemy Beats Australia's Highest AAA Yield, April 5, 2016

Emerging Markets Debt

Paolo Valle, Senior Portfolio Manager,
Emerging Markets Debt

Roberto Sanchez-Dahl, Senior Portfolio Manager,
Emerging Markets Debt



THE BACKDROP

The trajectory of the US dollar will remain key for emerging markets.

Investor sentiment towards the asset class has improved as early signs of relatively more balanced growth emerged, after a sustained period of negativity last year. However, it is fair to say that we need more evidence of positive developments to make sure the growth in emerging economies is sustainable.

The trajectory of the US dollar will remain key for emerging markets. Short term, we believe the level of the US dollar is likely to stay within its current range. This could be positive for emerging markets (EM) – particularly for those that mostly rely on external debt (in US dollar) for their overall financing. Our view is informed by our belief that the Federal Reserve will choose to remain on the sidelines until December this year.

Naturally, a relatively weaker US dollar could have positive implications for commodities prices, as it is their main pricing currency. Commodity exporting countries would benefit from higher revenues with a resulting lift to commodity currencies. Furthermore, under a more stable global rate environment the pressure for China to devalue the renminbi would lessen, a development that could ease concerns about the broader stability of the financial markets.

OPPORTUNITIES FOR INVESTORS

Profound changes are also taking place in Brazil that we believe would ultimately be positive in the long run.

We remain positive on Argentina. It is a country that has been left out of the capital markets for 15 years due to an earlier default and ensuing conflict with creditors[1]. As a result, the country is suffering from vast under-investment across many sectors, from infrastructure and housing, to utilities and banking systems.

The new administration led by Mauricio Macri was able to settle with holdout creditors and recently came to market with US$16.5 bn in new issuance, the largest ever sovereign deal in emerging markets. Despite only having been in office for less than six months as of writing, the new administration has implemented key business-friendly reforms: lifting capital control, taking important steps towards liberalizing the energy sector and the labor market[2]. We believe the country could offer opportunities to the astute investor.

[1] Financial Times: Argentina returns to international markets with $16.5 billion debt sale, April 20, 2016

[2] Financial Times: Argentina: Macri's change of rhythm, March 4, 2016

Profound changes are also taking place in Brazil that we believe would ultimately be positive in the long run. Michel Temer was sworn in as the country's new leader in mid-May after his predecessor Dilma Rousseff was suspended from office for up to six months[3]. Mr. Temer is widely perceived to be pro-business and we expect him to begin work on implementing reforms that will stabilize the country's economy[4]. Having surrounded himself with high caliber and well respected cabinet members, these efforts should lead to increased transparency and boost market sentiment – factors that will drive consumption as well as investment.

From a valuation perspective, we think the market has been overly negative towards the country and the recent rally can be seen as a correction. Overall, we remain constructive towards Brazil and think opportunities could be found across sectors. Quality companies with good cash flows and strong balance sheets whose fortunes have been overshadowed by recent turmoil might just find their moment in the sun again. It is important to note that Brazil is not yet out of the woods, the path to recovery in the near term could still be rocky, but long term prospects remain bright.

RISKS

Though we maintain a constructive view on Beijing's ability to steer the country through its long-term transition into a consumer/services oriented economy, challenges remain.

We are monitoring China's economy closely. Though we maintain a constructive view on Beijing's ability to steer the country through its long-term transition into a consumer/services oriented economy, challenges remain. Important supporting factors that should contain any potential credit cycle shock include high domestic savings, under-developed capital markets, government ownership of banks and many large borrowers (state-owned-enterprises), and a relatively closed capital account. However, rising leverage and level of non-performing loans in the country is a potential cause for concern and regulators need to demonstrate their commitment to address the issue. The authorities' chosen course of action could have significant implications for their perceived credibility in the longer run.

Broadly speaking, inflation is still low in the United States. However, it is worth noting that the core Personal Consumption Expenditures price index has been consistently inching higher. Although we are still quite a distance from the Fed's two percent inflation target, it is definitely worth monitoring.

ON OUR RADAR

We believe the macro environment for emerging economies has become more positive but we need more evidence that the improvement is sustainable.

Signs of growth: The growth differential between emerging markets and developed markets has widened again. We believe the macro environment for emerging economies has become more positive but we need more evidence that the improvement is sustainable.

Brexit: Should the United Kingdom vote to leave its European partners at the upcoming referendum, it could potentially destabilize the global markets in ways that we might have yet to fully appreciate.

US Presidential Election: The current discourse on the elections has a strong focus on job creation and addressing unemployment. It could translate into a tougher approach towards globalization and protectionism, which could have an impact on global trade given America's dominant position in the world economy.

[3] Bloomberg: Brazil President Dilma Rousseff Suspended After Losing Impeachment Vote, May 12, 2016
[4] Reuters: Brazil's Temer eyes pro-business plan but has scant room for major reforms, March 31, 2016

Asian Fixed Income

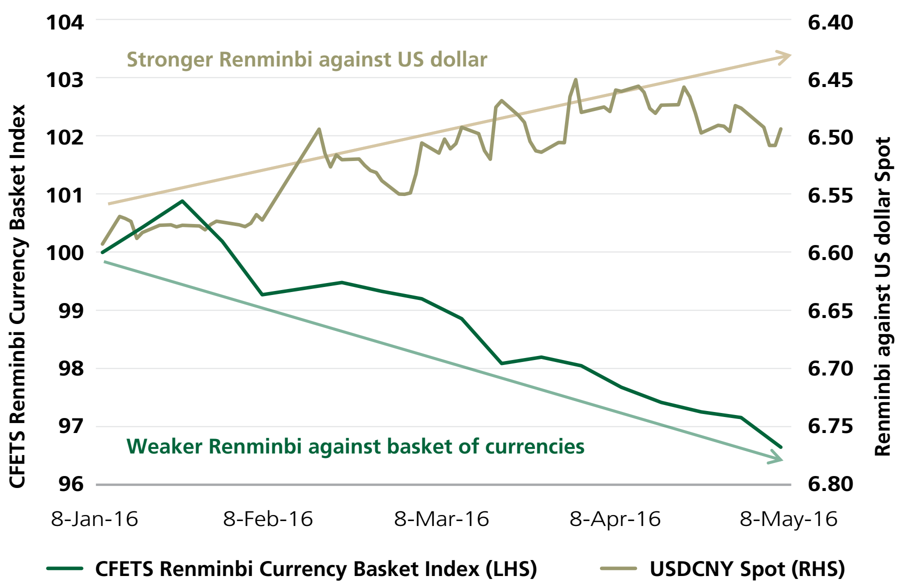
Endre Pedersen, Chief Investment Officer,
Fixed Income, Asia ex-Japan

THE BACKDROP

In China, the onshore bond market also saw a strong run-up, supported by positive economic data.

2016 kicked off on a positive note for the Asian bond market. Year-to-date, the asset class saw a rally, driven largely by softening interest rates in the region, strengthening Asian currencies, as well as a dovish stance by the US Federal Reserve. Indonesian bonds recorded outstanding performance as Bank Indonesia cut interest rates three times to 6.75% since the start of the year[1].

In China, the onshore bond market also saw a strong run-up, supported by positive economic data. However, the rally lost steam towards the end of the period, in part due to speculation over the implementation of value-added tax and its potential impact on transaction costs for quasi-government and corporate bonds. Meanwhile, since the introduction of the China Foreign Exchange Trading System (CFETS) index in December 2015, the renminbi (RMB) has been trading in range against the basket of 13 currencies[2], suggesting the Chinese government is achieving both a relatively stable currency, which is good for investors' sentiment, and a weaker renminbi helping its export sector.



Source: Manulife Asset Management, Bloomberg, as of May 6, 2016

[1] Bank Indonesia: Bank Indonesia Rate Decisions
[2] Manulife Asset Management, Bloomberg, as of May 6, 2016

Indonesia stands out from a fundamental and a valuation standpoint; monetary policy remains accommodative and the country's local currency bonds are among the highest yielding in the region.

OPPORTUNITIES FOR INVESTORS

Looking ahead, Asian fixed income investors should not be complacent despite the respectable performance year-to-date, as some Asian economies are showing signs of slowing down. We believe it is not an environment for investors to take aggressive positions, but rather an opportunity to consolidate gains while actively managing risks. Notwithstanding a cautious outlook ahead, we see pockets of opportunities in the region for astute investors.

For the broader Pan-Asia bond market, in line with our strategy to consolidate gains and manage risks, we prefer US dollar denominated Asian corporate bonds of higher quality names with lower beta combinations. We believe this subset is best positioned from a risk-reward perspective, against the backdrop of the economic slowdown globally and in the Asia region. Within local interest rate markets, we see opportunities in Indonesia and Malaysia.

Indonesia stands out from a fundamental and a valuation standpoint; monetary policy remains accommodative and the country's local currency bonds are among the highest yielding in the region. Add to that the potential for a credit rating upgrade from Standard & Poor's this year[3]. With regards to currencies, we are skeptical the strong Asian currency trend is sustainable. While our view on currencies remains defensive, we have a preference for South Asia over North Asia, supported by positive economic developments and pro-growth economic reform policies.

Within the onshore China bond market, we believe value could be found in the sovereign space, due to the easing bias of the monetary policy cycle. Although the market does not anticipate any rate cuts, there is ample short-dated liquidity, creating pockets of opportunities. Nevertheless, oversupply could be an issue.

We are also seeing opportunities in onshore credit bonds in China, as credit spreads have widened from historically tight levels. Although there have been cases of corporate defaults, these are contained to lower-rated companies. There could be opportunities within the universe of high quality credit bonds issued by state-owned enterprises operating in sectors with systematic importance to the economy.

[3] Bloomberg: Indonesia's outlook changed to Positive from Stable at S&P, May 21, 2016

RISKS

Risks include the increasing trend of corporate downgrades in the region and potentially higher inflation sparked by rising commodity prices.

Amidst opportunities, we are on the lookout for headwinds. Indeed, some of these include the increasing trend of downgrades in the region, potentially higher inflation sparked by rising commodity prices, as well as the possibility of a more hawkish-than-expected interest rate environment in the US, which Asian bond markets are not pricing in.

Investors should also look out for rising corporate defaults in China's onshore market, although we do not expect this to have a major impact on the broader Asian bond market. In fact, we believe this may have a positive long-term impact on the onshore China bond market, as it helps develop credit differentiation.

Another wildcard to watch out for, however, is the Bank of Japan's ability to steer equity, currency and credit markets in its desired direction. With uncertainty over its next steps and the subsequent potential impact on the market, we believe it is important for us to stay watchful.

ON OUR RADAR

Unconventional and experimental monetary policies from developed market central banks elsewhere could have unpredictable repercussions on the broader fixed income market.

One of the key developments we are keeping on our radar is the expansion of access to the interbank bond market in China. The People's Bank of China announced earlier this year that it would allow more qualified institutional investors to enter the market on a registration basis[4].

A more open bond market could enable the renminbi to become more "internationalized" and eventually lay the foundation for the RMB to become a reserve currency. Such a development could act as a positive catalyst for the inclusion of China government bonds in global indices and will increase China's prominence in the global bond market.

Meanwhile, we continue to keep a watchful eye on China's forthcoming economic data, mindful that unconventional and experimental monetary policies from developed market central banks such as Japan and Eurozone could have unpredictable repercussions on the broader fixed income market as well as in Asia.

[4] People's Bank of China: Public Notice No. 3, March 23, 2016.

Commodities

Diana Racanelli, Senior Portfolio Manager,
Global Natural Resources

Craig Bethune, Senior Portfolio Manager,
Global Natural Resources

We are beginning to see signs of a possible end to the two-year negative momentum that has occurred in global industrial production.

THE BACKDROP

Most commodity price indexes have rebounded from their January/February lows on improved market sentiment and a weakening US dollar. While many non-energy commodity prices fell 1-2% in Q1 2016 on persistently large inventories and supplies[1], cost reductions (largely stemming from lower energy & labor prices and other input costs) have helped stem losses in the mining industry. Moreover, while we do not expect a major trend reversal to take shape in the supply/demand dynamics of base metals and bulk commodities in the short term, we are beginning to see signs of a possible end to the two-year negative momentum that has occurred in global industrial production, which may have even bottomed in the final quarter of 2015.

Energy

In Energy, markets have remained volatile so far this year, with investors actively searching for a bottom on share price valuations for energy companies in anticipation of higher prices for oil. After reaching a multi-year low of just over US$26/bbl (West Texas Intermediate)[2] in mid-February, a price point not seen since mid-2003, oil prices recovered to finish the period higher, closing at just under US$46/bbl by April[3]. While the anticipation of an agreement among OPEC producers to freeze output helped prices recover from the mid-20 lows of February, such an outcome remains as yet uncertain following the inability to reach an agreement at the mid-April meeting in Doha. Despite the increased volatility, North American (WTI) and International (Brent) oil prices recovered to finish on higher ground by the end of April, up 24% for the year[4]. While it remains to be seen whether OPEC members will indeed come together to curtail production in order to stabilize prices, the relief rally in share prices that took place in January – before the oil price recovery from February – shows that investors believe a balancing act in oil markets might not be too far off in the future. Whilst global (and regional) supply and demand factors continue their painful but necessary transition towards greater balance, timing has become a bit of a moving target as, while sharp price recoveries for oil help from an operations and valuation standpoint, they also delay the prospects for markets to come into balance as producers keep incremental projects running.

From a fundamentals point of view, the global oil outlook is becoming increasingly constructive as the rate of non-OPEC production declines is beginning to accelerate. In addition, value creation in the upstream component of the industry is becoming increasingly challenged, resulting in diminished flexibility and extending lead times following a massive reduction in the number of active rigs: rig counts in North America are down 76% from their October 2014 peaks and are at their lowest point since 1949, with international rig activity down 26% from the 2014 peak – larger than the 15% decline experienced in 2009[5].

[1] World Bank: Commodity Markets Outlook, April 2016
[2] West Texas Intermediate, or WTI, is a grade of crude oil that is used as a benchmark for pricing oil.
[3] CNBC: WTI Crude Prices, as of May 2016
[4] Manulife Asset Management, Bloomberg as of April 30, 2016
[5] Manulife Asset Management, Baker Hughes as of April 2, 2016

In the US, onshore production reached its peak in March 2015 and has been in decline every month since. Given the imploding rig count, outsized declines in production are now seen as the norm rather than the exception. And with the evisceration of the domestic labor pool and increasing neglect of the industry fleet, many energy companies are acknowledging that it will take longer to ramp up production as prices recover, meaning non-OPEC supply previously shut in will be slow in coming back online. But this reality is not confined only to the US as industry dislocations are unfolding globally. At the individual country level, the story is becoming more dramatic. Looking at previous peak vs. current rig activity for a dozen countries, we've noticed a number of very large gaps, and few if any are inconsequential players. All of these countries are down ~30-85% from their recent activity peak[6], with Colombia one of the ugliest examples: recent peak rig count was 48, with current count at 7 – a decline of 85% from a country producing 1 million barrels per day currently[7].

Meanwhile, storage levels for oil remain the focus. The market should begin to rebalance in earnest by late 2016/early 2017 provided demand remains intact. We expect US shale producers will begin to grow production should prices move much above US$50, which we feel could happen by the end of 2016. In the long run, we expect oil prices to move higher in order to sustain investment and meet future oil demand needs, a point of concern highlighted in the International Energy Agency's energy outlook. The industry's severe capital expenditure cuts puts at risk having adequate supply to meet future demand needs.

Natural gas

Natural gas is much more of a regional commodity and North America enjoys some of the lowest natural gas prices globally. This is leading to growing investment in the petrochemical plants industries in the US Gulf Coast, which may lead to higher natural gas demand in the future. In addition, coal-fired power plants are in the process of being retired and new LNG exports from the US are set to start in 2016. In the near term, the weather will be the key driver of prices and a warm winter in 2016 has led to a growing build-up of storage. Ample supply remains available at a very low cost, but few producers are actively investing in natural gas drilling as the economics of gas production are no longer supported by associated liquids production. We expect natural gas prices to be range bound in the $2.00 to $3.50 per million cubic feet (Mmfc) level in 2016. There remains potential for higher prices in the fall as cold weather returns.

Gold and other metals

Supported by the US Federal Reserve's recent dovish comments and slower-than-anticipated uptake in raising its overnight interest rate, gold prices (in US dollars) benefitted from signs of emerging weakness in the US dollar, with announced monetary stimulus in Europe and China providing further support. Investor sentiment has turned decidedly more positive in the gold and precious metals sector, with flows into exchange traded funds (ETFs) turning markedly positive during the first four months of 2016 after experiencing three years of net outflows[8]. Against this more favorable backdrop, gold equities have staged a very strong recovery from recent cyclical lows, with share prices climbing sharply and from distressed levels in certain instances. News of improved cost containment and focus on optimization of cost structures over production growth with many senior and intermediate gold producers has also provided greater support, with an increasing number of companies already experiencing positive cash flows at prices of US$1,000/oz[9].

[6] Simmons & Company International, April 2016

[7] Baker Hughes, March 2016

[8] Financial Times: Gold demand breaks first-quarter record, May 12, 2016

[9] Manulife Asset Management, Bloomberg, May 2016

While not as strong as gold and precious metals, returns realized in the diversified metals and mining sector have also been robust as a number of base and industrial metals recovered from cyclical bottoms experienced in the first quarter. Though underlying supply/demand balances are still challenged by supply growth, restarts, high inventories, and economic growth that remains slow to uneven, many producers have weathered the storm of lower metals prices as a result of significant cost and capital expenditure reductions, becoming somewhat more disciplined with the use of capital in the process. We continue to focus on companies with strong balance sheets and low-cost assets. We continue to look for catalysts in the second half of this year as production cuts – either voluntary or forced – help to balance these markets.

OPPORTUNITIES FOR INVESTORS

Recent weakness in the US dollar coupled with a negative interest rate environment have been supportive for gold prices.

It is our view that with uncertainty often comes opportunity. In the energy sector, we are seeing signs of market participants discounting a floor in oil prices, with supply levels outside OPEC beginning to adjust through reduced production and demand levels remaining healthy on a global basis. In the gold space, recent weakness in the US dollar coupled with a negative interest rate environment in parts of the world and ongoing concerns related to the European Union (including "Brexit") have been supportive for gold prices.

RISKS

Markets have a tendency to overshoot valuations, both on the upside as well as the downside.

- The slowdown in the Chinese economy combined with new supply coming onto the market (specifically in the energy and select base metals sectors).
- Markets have a tendency to overshoot valuations, both on the upside as well as the downside. While fundamentals in energy and base metals have become more constructive, valuations are discounting prices that are higher than current levels, warranting a measure of prudence when selecting investments and patience during occasional pullbacks.

ON OUR RADAR

In metals and mining, lower economic and demand growth assumptions have been partially offset by lower supply growth due to production cuts.

In gold and precious metals, we will continue to monitor the strength of the US dollar as recent softness could be an indicator that the greenback is returning on its long-term downward trend. A potentially weaker US dollar could also provide a measure of support to other commodity prices as well.

In energy, we feel that valuations are becoming somewhat extended as investors discount a more balanced oil market that may be two or more quarters away depending on whether OPEC production levels remain in check or increase, and to what extent non-OPEC production continues its decline.

In metals and mining, lower economic and demand growth assumptions have been partially offset by lower supply growth due to production cuts, and with a few exceptions, price forecast changes have been modest. While share prices continue to trade at a discount, recent recoveries and flatter price curve warrant a patient approach, where volatility can be expected as markets continue to balance.

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Global Offices

Boston

John Hancock Asset Management (US) LLC
197 Clarendon Street
Boston, MA 02116
United States
Phone: 1 617 375-1500

London

Manulife Asset Management (Europe) Limited
18 St Swithin's Lane
London, U.K.
EC4N 8AD
Phone: 44 20 7256-3500

Toronto

Manulife Asset Management Limited
200 Bloor Street East
North Tower, 5th Floor
Toronto, Ontario
M4W 1E5
Canada
Phone: 1 877 852-2204

Hong Kong

Manulife Asset Management (Asia)
16/F, Lee Garden One
33 Hysan Avenue
Causeway Bay
Hong Kong
Phone: 852 2910-2600

Montreal

Manulife Asset Management Limited
1001 de Maisonneuve West
Suite 1000
Montreal, Quebec
H3A 3C8
Canada
Phone: 1 877 852-2204

Tokyo

Manulife Asset Management (Japan) Limited
Marunouchi Trust Tower
North Building 15F
1-8-1, Marunouchi, Chiyoda-ku
Tokyo 100-0005
Japan
Phone: 81 3-6267-1940