Manulife Investment Management

2021 market outlook

A whole new perspective on shaping your investment portfolio

Content

Global Macro Outlook P01

Asset Class

- Asia Equities P04
- Greater China Equities P08
- Asian Fixed Income P11

Income Strategy

- Preferred Securities P16
- Multi Assets P18
- Asia Pacific REITs P21

We're squarely in phase two of our three-phase framework: the stallout

We introduced our three-phase recovery framework last July, outlining key pillars of the recovery—a road map to help navigate a complicated economic rebound. In our view, 2021 will be the year we transition out of phase two and move into phase three: the new normal. We expect global economies to make this transition at different times, with Asia and other manufacturing-based economies exiting the recessionary environments earlier in the year, before their Western peers and other services-based economies. The transition, however, will likely be bumpy, marked by challenges for global central banks and policy makers due to the structural scarring created by the COVID-19 recession.

Our 3-phase recovery framework

Phase 1 : the rapid rebound
(April to ~ September 2020)

- Upbeat economic data
- Release of pent-up consumer demand provides some support to the retail sector
- Extraordinary level of monetary easing
- Record level of fiscal transfers to households

Phase 2 : the stallout
(September 2020 to year-end 2021)

- Economic uplift from income support moderates
- Reduced operating capacity (due to social distancing requirements) hurts business income
- Unemployment in certain segments of the economy remains stubbornly high
- Geopolitical risks come to the fore

Phase 3 : the new normal
(From 2022)

- Structural changes amplified by the COVID-19 outbreak are brought forward
- The shift toward deglobalisation becomes increasingly observable
- Calls for austerity grow louder

A year of two halves

In developed markets, we expect much of the first half of 2021 to be very challenging—the winter months in particular could be uncomfortable, with fiscal spending acting as a critical stopgap until normalisation can begin. While our base-case scenario doesn't include a double-dip recession, we believe this period will be defined by soft economic data and we could even witness recession-like characteristics in some areas. However, we expect this period of weakness to be short-lived as the distribution effort for the various COVID-19 vaccines ramps up. In our view, a gradual return to a business-as-usual environment will create a very favourable outlook for the second half of the year.

Defining macroeconomic features by quarter

First quarter

- We could see periodic surges in infection cases, dampening aggregate demand while significant segments of the economy are subject to new lockdown measures.
- This period's likely to be defined by weak (and increasingly soft) economic data.
- The global economy's likely to experience it's most vulnerable stage during this recovery, igniting speculation about a possible double-dip recession.

Second quarter

- Market focus will likely turn to an expected jump in inflation levels, which will be largely driven by base effects, a weak U.S. dollar, and supply chain disruptions.
- The worst of the expected weakness in economic data should be over by this point, but economic activity such as hiring should remain muted.
- Crucially, economic data wouldn't have been strong enough to warrant anything other than extremely easy monetary policy.

Third quarter

- A combination of warmer weather and vaccine rollout should lead to stronger economic data as revenge spending, particularly in discretionary services, takes hold.
- The return of discretionary services could spur hiring in the services sector, enabling the sector to catch up with its manufacturing peer.
- Combined with the ongoing base effects from inflation, we believe this could be a point where talk of normalisation begins to materialise in the markets. Crucially, we expect monetary policy to remain extremely loose.

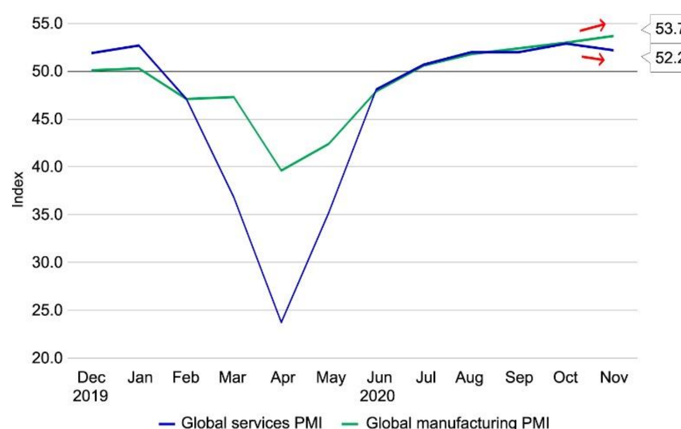
Fourth quarter

- This could be the first quarter that provides a reasonable sense of what the new normal could be like in a post-COVID-19 environment.
- Some economic distortions will likely persist, including favourable second-wave base effects, and residual pent-up demand in areas such as travel; however, the quarter should provide a baseline for what activity in 2022 could look like.

The recovery takes on a more prominent K shape

We expect the K-shaped nature of the recovery to become more accentuated in 2021 as global manufacturing sectors roar back to pre-COVID-19 levels early in the year while global services and hiring activities struggle to recoup 2020's losses even after taking into account likely growth in the next 12 months. This divergence will likely add to the disconnect between global equity markets—typically biased toward manufacturing and tech sectors—and the global economy. It also suggests that stock markets with a bigger manufacturing component (emerging markets) could see higher returns. Crucially, a K-shaped recovery could aggravate global income inequalities.

A growing divergence: global manufacturing and services Purchasing Managers' Index (PMI)[1]

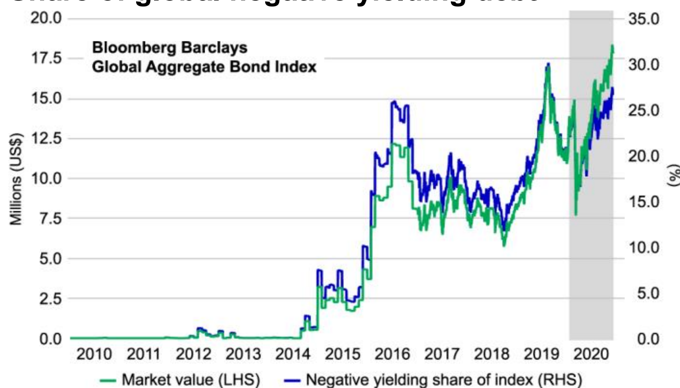


The new normal: very low interest rates and very high government spending

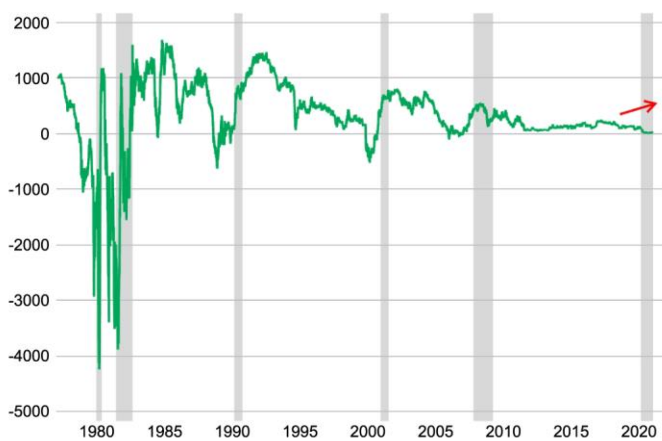
While the first half of 2021 will likely be focused on downside risks and growth challenges, we're confident that the global economy will continue to be supported in important ways: extraordinary accommodation from central banks and rising fiscal spending from national governments. These policies carry two important implications for investors in the year ahead: First, the search for yield narrative will continue to dominate, sending investors further out on the risk spectrum and deeper into alternative asset classes; second, as fiscal spending rises, so will government issuance (particularly at the long end of the curve), potentially driving up long-term rates, steepening the yield curve.

1. Source: Macrobond, Manulife Investment Management, as of 21 December 2020.

Share of global negative yielding debt[2]



U.S. Treasuries 2-year, 30-year



Hidden themes to watch in 2021

Our base-case expectations for 2021 contain no surprises—we think it's almost predictable given the context within which we're working, knowing what we know, even though we're still facing an incredible level of uncertainty. However, in light of the sizable policy responses to COVID-19, and the economic transformations and acceleration of macro trends in the months since the health crisis, we've identified some nascent themes that bare monitoring in 2021. To be clear, these themes aren't likely to be primary growth drivers in 2021, but they will, in our view, become increasingly relevant to investors.

Themes to monitor[3]:

1. Monetary policy and fiscal policy convergence, and the gradual rise in popularity of the modern monetary theory
2. An increased mainstream focus on cryptocurrencies as a reaction to massive central banking easing and the growing size of government
3. A shift in central bank focus toward broader social issues, including income and racial inequalities, climate change, and housing affordability
4. The continued rise of sustainable investing through the lens and the incorporation of green government spending

2. Macrobond, Manulife Investment Management, as of 11 December 2020. The gray areas represent recession.
3. Source: Chicago Board Options exchange, Manulife Investment Management, as of 28 September 2020.

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Despite a challenging 2020 for investors, Asian equities provided one of the few bright spots globally. After the COVID-19 outbreak, segments of the region contained the virus more effectively than others, leading to a divergence in economic and equities' performance in the second half of the year. In this 2021 outlook, Ronald Chan, Chief Investment Officer (Equities, Asia ex-Japan) believes that while Asia (ex-Japan) is tapped to strongly rebound in 2021, divergences should remain, giving investors attractive opportunities in a region that is greater than the sum of its parts.

Asian equities: Greater than the sum of its parts

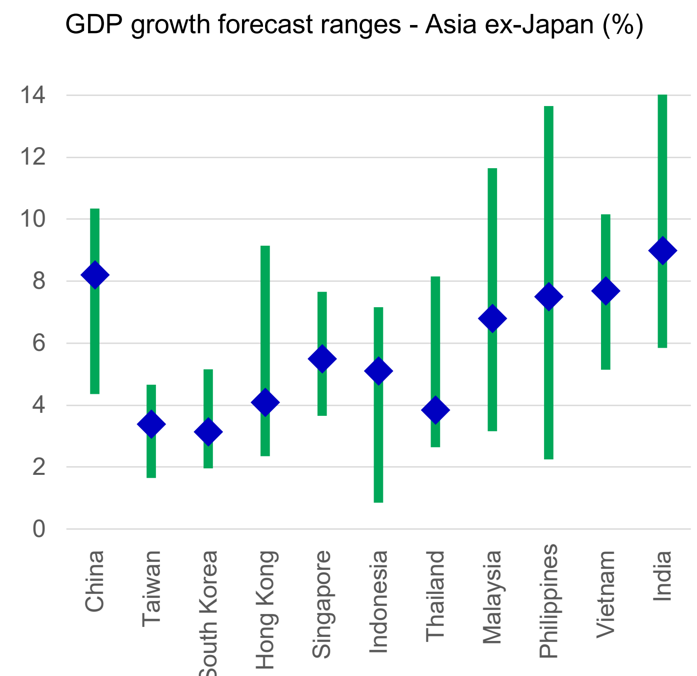
The past year posed unprecedented challenges and opportunities for investors. The global outbreak of COVID-19 in the first quarter of 2020 roiled markets and economies alike. Although North Asian economies were the first affected, they were also among the first to effectively contain the spread of the virus, with some avoiding entering a technical recession[1].

In contrast, South and South-east Asian economies were affected later, but due to higher population density and less developed health systems, bore a heavier cost of the pandemic. India and some ASEAN economies (most notably Indonesia) fell into technical recession for the first time in decades.

Robust fiscal and monetary stimulus globally and in Asia allowed equities to recover, with regional equity indices posting a nearly 19% return[2], but with significant dispersion in performance across the region[3].

Moving into 2021, the region is tapped to strongly rebound at roughly 5.5% growth overall[4]; however, this comes from a lower base and we anticipate economic recovery to be gradual and uneven due to varied policy responses as well as divergent access and rollout of vaccines in Asia (see Chart 1).

Chart 1: Asia's growth forecast varies by market in 2021[5]



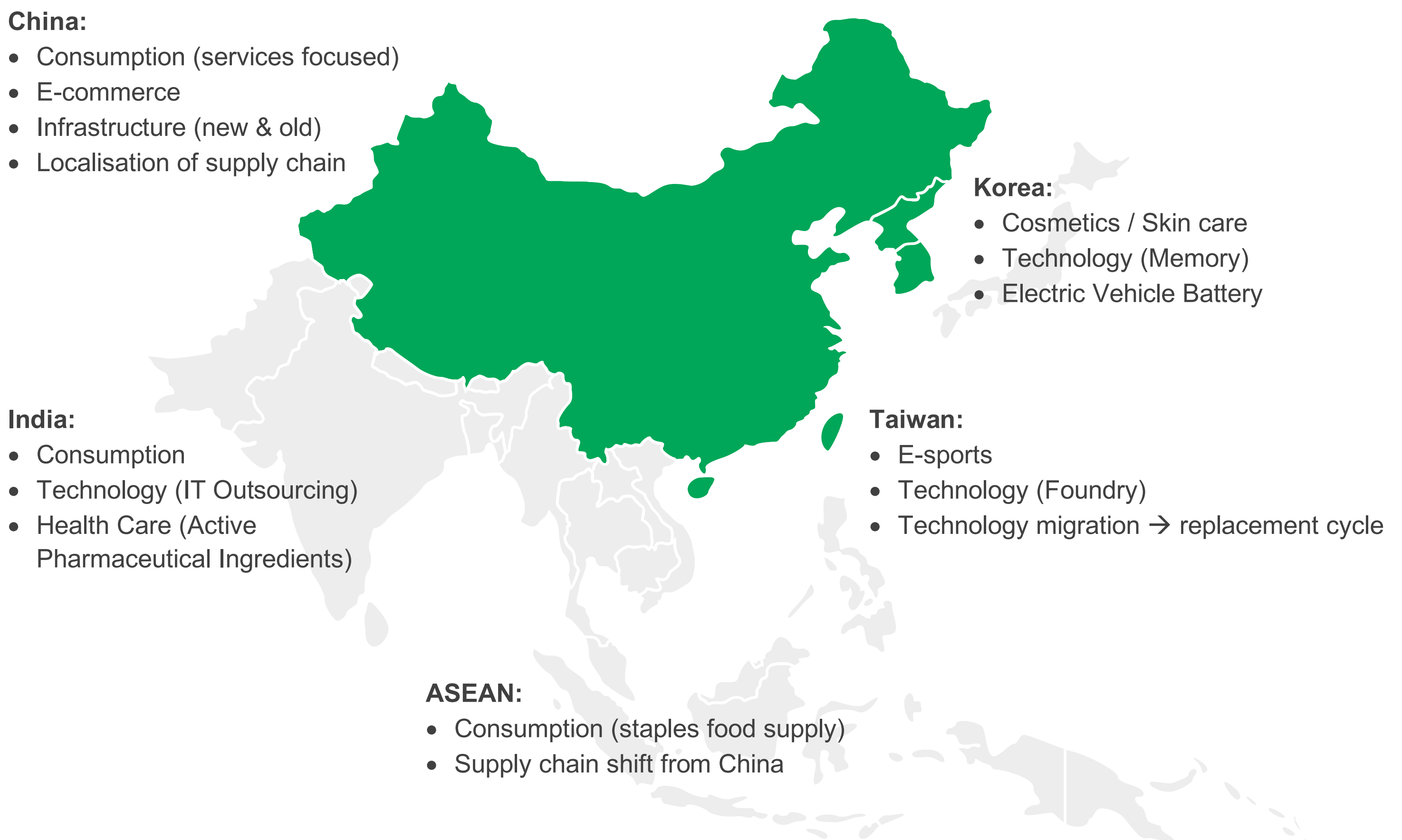
[1] China and Taiwan did not enter technical recession, while Hong Kong and Korea did.
[2] Bloomberg, as of 29 December 2020, MSCI Asia (ex-Japan) posted a return of 21.84% (total return in US dollar).
[3] Bloomberg, as of 29 December 2020., MSCI Korea was the best performing regional market up roughly 40.30% (total return in US dollar), while MSCI Thailand was the worst performing market declining by 10.79% (total return in US dollar).
[4] Bloomberg, as of 15 December 2020.
[5] Bloomberg, as of 15 December 2020.

Asia: A region of diverse economies and strengths

Before exploring the major regional themes for 2021, it is important to understand how we view long-term investment opportunities in Asia. Indeed, investors should be vigilant that with optimistic economic growth forecasts and elevated valuation in some regional equity markets, it is necessary to understand where sustainable, long-term growth can be achieved rather than a cyclical upswing as economies recover from the shock of COVID-19.

As Chart 2 shows, we envision the region as possessing a diverse array of strengths that offer opportunities for investors with different needs.

Chart 2: Asia's diverse comparative advantages[6]



China: China has adopted a robust policy response in answer to fractious economic relations with the US that will deepen existing competitive advantages.

The Chinese government's newest five-year plan (2021-2025) emphasises cultivating domestic consumption (over exports) and innovation in key strategic technological industries. This should mean continued emphasis on developing already advanced e-commerce and internet platform capabilities. At the same time, the government wishes to develop technology for electric vehicles (EV), as well as 5G to boost the country's technological base.

Korea: Companies remain leaders in the memory chip and EV and renewable energy storage sectors. We believe these companies will be at the forefront of the development and structural growth trend of

[6] Manulife Investment Management.

migration to 5G technology, EV and renewable energy.

India: We remain optimistic about the outlook of the IT outsourcing and pharmaceutical sectors. These sectors represent India's core comparative and competitive advantage globally and we believe the demand for their products and services is structural in nature.

Over the longer term, we are closely monitoring the opportunities created by India's "Make in India" initiatives. India has announced several measures aimed at self-reliance including import disincentives, production-linked incentives, tax benefits and digitisation to increase the share of manufacturing in GDP from 17% currently to 25% over the medium term[7].

ASEAN: ASEAN countries are strengthening efforts to attract foreign direct investment and deepen their competitive advantages.

Countries in the region possess different strengths. Thailand has a strong automotive supply chain and a well-established food manufacturing industry. Malaysia possess an advantage in the manufacturing of electronic and electrical products, rubber gloves and wooden furniture. In contrast, the Philippines provides great service in terms of business process outsourcing (BPO) and Indonesia is offering itself as the hub for electric vehicle supply chain. Finally, Vietnam has established a niche in the manufacturing of smartphones and electronic components.

Taiwan: The technology supply chain in Taiwan is expected to continue to play an important in supporting tech innovation in China and the US over the mid-term. The ability of local producers in key industries such as semiconductors to stay ahead of the technology curve has given them a competitive advantage over global rivals. Taiwan has also developed world-class companies in servers, 5G components, and IC design.

2021: Structural themes for investors

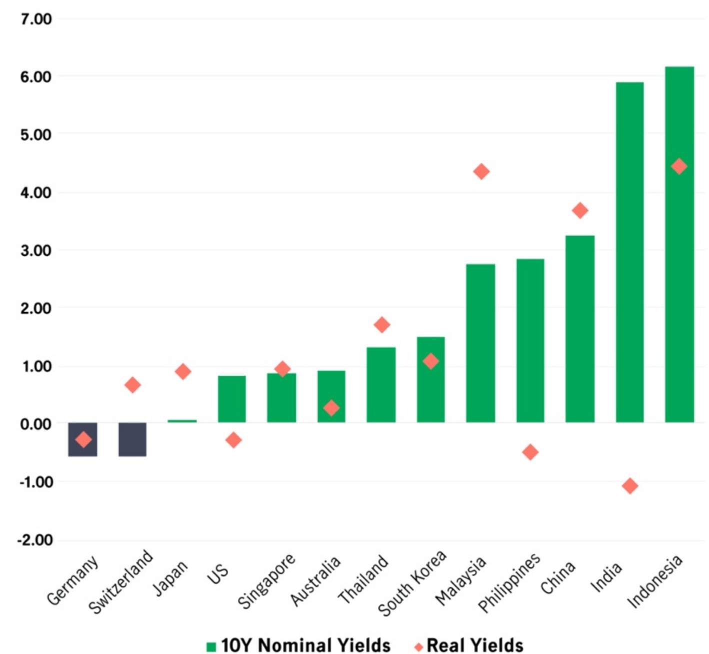
Based on this vision for Asia, we see the following four structural themes as critical for investors in 2021:

- **Search for (positive) yield leads to Asia**

  We expect that major central banks will keep interest rates near zero over the short-term. With inflation forecast to be in positive territory, this has and should continue to result in negative real rates and bond yields in many developed markets.

  In contrast, many Asian markets currently offer positive real yields (see Chart 3). With a relatively optimistic growth forecast in 2021 for the region, we expect the yield differential between developed markets and Asia to continue in the upcoming year. This dynamic should be constructive for capital inflows in Asian equity markets, as global investors look to capitalize on the region's robust economic rebound and attractive yields.

Chart 3: Positive real rates in Asian markets[8]



[7] Goldman Sachs, as of 15 November 2020.

[8] Bloomberg, as of 30 November 2020.

- **Wider adoption of 5G technology**

5G technology promises to transform the 2020s into a time of unprecedented connectivity and technological advancement, dramatically expanding the reach of Internet of Things (IoT). Indeed, 5G and IoT will enable greater use of connected devices that automate onerous business processes. This includes factory automation: Many manufacturers have announced their plans to automate their factories to overcome the issues of labour shortages and enhance productivity.

We expect broader availability of devices developed with 5G to be launched in the next few years. This is expected to trigger a replacement cycle globally and we believe the supply chain in Asia, particularly the tech supply chain in North Asia (Taiwan, China, Korea) will benefit from this trend.

- **Greater focus on climate change and sustainable development**

With the risks of climate change becoming more apparent, countries are adopting ambitious policies to address the problems[9]. These initiatives, coupled with greater attention to ESG in investment decisions should lead to more climate friendly and sustainable projects, e.g. renewable energy infrastructure and equipment. As a result, we envisage that the development and adoption of electric vehicles and energy efficient products should accelerate and the ecosystem of renewable energy and resources, e.g. energy storage, battery charging stations, energy efficient semiconductors/chips and recyclable materials. Investments in this area is expected significantly grow.

- **More diversified China+1 sourcing strategy**

Global supply chains, and China's role in it, have undergone significant changes due to the global spread of COVID-19 and the fallout from the prolonged Sino-US trade conflict. Some firms may shift production out of China (production relocation) on concerns over the vulnerability of single production location or rising tariffs. Others might choose to diversify customers and redirect exports to other markets (trade redirection) in light of geopolitical risks. South-east Asian countries, particularly Vietnam, have benefited from multinational and Chinese companies relocating or setting up new factories in the region. We expect this trend to continue and governments in South-east Asia have introduced incentives and amended regulations[10].

Conclusion

Although parts of Asia have fared better than others after the global shock of COVID-19, the road to recovery (both physical and economic) should remain a key theme of 2021.

For long-term investors, Asia offers the opportunity to not only participate in sustainable growth in world-class companies, but also to achieve diversification through exposure to different industries. Overall, the region's opportunities add up to more than the sum of its diverse parts.

[9] In a September speech to the United Nations, Chinese President Xi Jinping put a 2060 end date on his country's contribution to global warming. President-elect Joe Biden has also pledged to re-join the Paris Agreement after being sworn in on 20 Jan 2021.

[10] Indonesia recently passed the Omnibus Law in Indonesia, while India passed the Production Linked Incentive in India.

The Greater China equity market has finished the eventful 2020 on a high note on the back of steady economic activities and quick recovery from the pandemic-driven downturn seen in the first quarter. Kai Kong Chay, Senior Portfolio Manager, Greater China equities, believes that China continues to deliver differentiated growth, even after the pandemic, and opportunities can be found through careful, bottom-up stock selection, especially in the tech and consumption sectors.

Greater China equities: A resilient way forward

As the world continues to grapple with the coronavirus pandemic, Greater China equities have emerged relatively unscathed, outperforming emerging, developed, and regional markets in 2020[1]. In particular, Taiwan and China equities have gained 28% and 26% year-to-date respectively, while Hong Kong has posted double-digit returns. The better visibility of earnings growth and diversification benefits have attracted inflows both home and global investors driving all three market indices all-time highs[2].

Economic data also appears to support the performance of China equities. With effective measures to control the spread of the pandemic, China was the first major economy to recover, posting positive growth for the second and third quarters of 2020[3]. Caixin's manufacturing Purchasing Managers' Index posted seventh straight month of expansion since May. Corporate earnings have also been healthy, with the latest third-quarter data showing most MSCI China constituents reporting better-than-expected or in-line numbers. Taiwan also recorded positive GDP growth for the third quarter, primarily on the back of robust demand for electronic exports[4].

A Biden administration – China's pre-emptive response

Throughout 2020, US-China tensions lingered in the background. With a Biden administration, we believe that the relationship between the two countries could remain under pressure. As such, we will adopt a wait-and-see approach in order to assess how the situation develops. However, we believe that the impact on Chinese equities should be well-contained supported by an estimated earnings growth of 15–20% in 2021[5].

Furthermore, China has already mapped out a response with its 14th five-year plan (2021–2025). The emphasis is now on growth through a "dual circulation" strategy led by "internal circulation" – in other words, moving toward a self-sufficient economy supported by home-grown innovation and domestic consumption. "External circulation", as a supplementary driver, should extract China's growth potential via allowing the domestic and foreign markets to lift one another.

When combined, these factors make it probable that China's growth can continue to show a clear and positive differential compared to the rest of the world. The nature of the post-pandemic economy, although still fluid, is likely to amplify this gap.

[1] Bloomberg: MSCI Zhong Hua Index posted a 21.38% gain, while MSCI Emerging Market Index was up 10.51%, MSCI World Index up 11.72%, MSCI Asia-Pacific ex Japan Index higher by 15.06%. Total returns in US dollars, as of 30 November 2020. Past performance is not indicative of future performance.
[2] Bloomberg: MSCI Taiwan Index rose by 28.48%, MSCI China Index was higher by 26.18%, and MSCI Hong Kong Index was up by 12.18%. Total returns in US dollars, as of 30 November 2020. Past performance is not indicative of future performance.
[3] Bloomberg, 7 December 2020. China economy grew 3.2% and 4.9% year-on-year in Q2 2020 and Q3 2020 respectively.
[4] Bloomberg, 7 December 2020. Taiwan economy grew 3.92% year-on-year in Q3 2020, after shrinking 0.58% in Q2 2020.
[5] Manulife Investment Management, December 2020.

Positioning for an increasingly self-sufficient China

With China having laid out a clear path toward an internally driven economy, opportunities are now arising in the technology and consumer sectors. On the technology front, more home-grown innovation in areas like biotech is anticipated. These efforts will likely be bolstered by additional fiscal and policy support, such as tax incentives and low-cost funding to boost local R&D and reduce reliance on imports.

There are numerous opportunities along the tech supply chain, especially in areas that are crucial for fuelling the drive toward self-sufficiency. For instance, the upstream semiconductor equipment supply chain has a low level of localisation, which has spurred targeted and supportive policies. Electric vehicle (EV) development is another attractive theme, backed by both domestic demand and the local industry's increasing presence in the global EV supply chain. A few domestic mid-end models tailored to Chinese consumers have been very well received, showcasing the capability of Chinese EV brands to adapt and cater for local needs and tastes.

On the consumption front, there is still plenty of unmet demand for lifestyle-related services. Increasing e-commerce penetration is another catalyst that is seeing both product-category expansion and wider age-group adoption. Online fresh grocery is one of the examples where growth can continue to be fuelled by shifting from offline, product premiumisation and expansion to the elder generation.

In both areas, investors should remain focused on the long-term fundamentals and seek to benefit from secular themes, such as those stemming from consumption upgrades, innovation, and policy tailwinds. The opportunity set has also been expanded by the inclusion of mid-cap China A-Shares into the MSCI index. This move offers unique investment opportunities not available in the offshore universe, with a focus on under-researched ideas with stable growth outlooks. After all, we believe the global indices inclusion have raised the profile of China equities as a whole, arousing interests from global investors to tap into the structural growth opportunities in the onshore and offshore China equities space.

Niche competitive advantages should benefit the Greater Bay Area

Within mainland China, the competitive advantages in the Greater Bay Area (GBA) – including ample policy support – can sustain strong and tangible long-term growth for the region, and reward investors by way of corporate earnings. The central government pledged to deepen economic integration by enhancing inter-cities infrastructure, talent mobility, logistic and investments within GBA. Furthermore, the push for smart-city implementation and management in the GBA, led by Shenzhen, shall create opportunities for infrastructure, education, healthcare, and more. The investment case for the GBA can continue to benefit from cross-provincial initiatives in wealth management, insurance, and property-connect programmes in the GBA region. Regional champions with their own growth dynamics will probably be best placed to exploit such opportunities.

Stock market reforms in Hong Kong and Mainland presents more opportunities

In Hong Kong, we believe that capital-market liberalisation will continue to provide investment opportunities for investors and attract further capital inflows. Since the introduction of new listing regimes in 2018, we have already seen a growing number of pre-profit biotechnology companies listing on the market[6], some of which are already industry leaders. The relaxation of the rules has also brought CRO (contract research organisations) and CDMO (contract development manufacture organisations) companies to the market, which has helped to fund their development. The investment choices could be further enriched by the secondary listings of Chinese American Depository Receipts (ADRs) and companies with weighted voting rights (WVR) structures. The expanding connectivity and investor base can also be witnessed by the recent

[6] On 30 April 2018, Hong Kong Exchanges and Clearing Limited added new listing rules, under Chapter 18A, to permit listings of biotech issuers that do not meet any of the Main Board financial eligibility tests. As of 30 September 2020, there is a cumulative of 40 biotech companies listed in Hong Kong under Chapter 18A.

announcement of Stock Connect Programs expansion to include biotech companies and Shanghai STAR board stocks.

Taiwan equities – a key beneficiary of the tech race

For the Taiwan market, COVID-19 does not appear to have impacted economic growth and corporate earnings in 2020. As we expect the US-China tech conflict to continue, with US policy focusing on the protection of intellectual property and high-end technology, Taiwan equities should remain the key beneficiary under this macro backdrop. This explains the market expectation of earnings per share to grow by 18% in 2021, from an already high base of 10% year-on-year growth in 2020[7].

In 2021, we have a positive view toward the technology sector, especially semiconductors. Taiwan is well-positioned in the semiconductors industry, as it has the largest share of the global foundry market[8]. The localisation of the region's technology supply chain, coupled with Chinese companies reducing their reliance on US suppliers, should benefit the semiconductor supply chain, foundry industry, and integrated-circuit-design companies in Taiwan. Meanwhile, the demand and development of high-speed transmission continues. We anticipate investment opportunities to emerge given a robust new-product cycle in the tech sector, with developments such as new-generation wireless transmission for high-quality video and livestreaming.

In a similar vein to China equities, EV is an investment theme that we consider when looking at Taiwan equities. There are numerous upstream players with interesting opportunities in the EV market, especially power-related components.

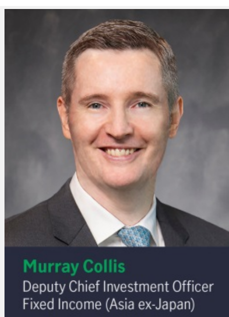
Conclusion – well-positioned in a digitalized and de-globalised world

Even before the pandemic, we saw a pullback in globalisation trends. This has only been accelerated by recent events, which have combined with existing geopolitical tensions to push companies in the direction of shorter and more regional supply chains. The Greater China region is prepared for this shift.

China's differentiated growth expectations and capital market liberalisation initiatives are likely to attract more foreign capital to renminbi-denominated assets or high-growth and well-managed Chinese enterprises. We believe investors are becoming more confident about the growth trajectory of China's economy. With uncertainty remaining elevated where search for sustainable growth may prevail, it is vital to identify stock drivers with a bottom-up approach that seeks to uncover long-term fundamentals supported by secular themes like consumption upgrades, innovation, and policy tailwinds.

[7] Manulife Investment Management, December 2020.

[8] Source: McKinsey, July 2019.



In this 2021 outlook, Asian Fixed Income team led by Endre Pedersen (Chief Investment Officer, Asia ex-Japan) and Murray Collis (Deputy Chief Investment Officer, Asia ex-Japan) talks about why they envisage that Asian fixed income can continue to perform on the back of a supportive global backdrop and continued policy support.

Asian fixed income: Optimism amid new focus on sustainable investing

Amidst a challenging 2020, Asian fixed income turned in a resilient performance[1, 2]. With the global spread of COVID-19 accelerating in the first quarter of 2020 leading to lockdowns globally, the virus roiled economies and financial markets. Asia was not spared: the region's GDP was expected to take a hit that surpassed even that of the 1997 Asian Financial Crisis; however, North Asian economies contained the virus better with many expected to post positive growth in 2020 (such as China, Taiwan, South Korea). With significant monetary and fiscal stimulus, however, the region's economies and financial markets gradually recovered over the year.

Entering 2021 we envisage that Asian fixed income can continue to perform on the back of a supportive global backdrop and continued policy support. With better fundamentals than its peers, we feel the asset class is poised to be in a better shape for potential upside, anchored to Asia's resilient credit profile and burgeoning multi-year sustainable investing opportunities in Asia.

2020: Resilient performance amidst a sharp downturn

Despite the notable challenges of the past year, the fundamentals of Asian fixed income remain intact. The asset class remained resilient throughout the year delivering positive performance. During the first quarter of 2020, the *JP Morgan Asia Credit Index (JACI)* corrected around by 8-9% (to the trough), as the pandemic dented global financial markets. It also exhibited a lower drawdown relative to US credit markets [1]. As more global monetary and fiscal

Chart 1: Policy rate changes in Asian and developed markets

Economies	Policy Rate 31 Dec 2019 (%)	Rate Changes (%) Jan 2020	Feb 2020	Mar 2020	Apr 2020	May 2020	Jun 2020	Jul 2020	Aug 2020	Sep 2020	Oct 2020	Nov 2020	Policy Rate 20 Nov 2020 (%)	Year-to-Date Change in Policy Rates (basis points)
United States	1.75			↓ 1.50									0.25	↓ 150
Euro Area	(0.50)												(0.50)	
Japan	(0.10)												(0.10)	
China	3.25		↓ 0.10		↓ 0.20								2.95	↓ 30
India	5.15			↓ 0.75		↓ 0.4							4.00	↓ 115
Indonesia	5.00		↓ 0.25	↓ 0.25			↓ 0.25	↓ 0.25				↓ 0.25	3.75	↓ 125
Korea	1.25			↓ 0.50		↓ 0.25							0.50	↓ 75
Malaysia	3.00	↓ 0.25		↓ 0.25		↓ 0.50		↓ 0.25					1.75	↓ 125
Philippines	4.00		↓ 0.25	↓ 0.50	↓ 0.50		↓ 0.50					↓ 0.25	2.00	↓ 200
Thailand	1.25		↓ 0.25	↓ 0.25		↓ 0.25							0.50	↓ 75
Vietnam	6.00			↓ 1.00		↓ 0.50					↓ 0.50		4.00	↓ 200

[1] Bloomberg, as of 23 March 2020. The JP Morgan Asia Credit Index (JACI) corrected by 8.79%, while the ICE BofA US Corporate Index corrected 15.14% over the same time period. As of 23 December 2020, the JACI had gained 12.32% from its low point.

stimulus came into place, the Asian credit market then experienced a sharp-but-steady rebound of about 12% (from low to high) towards the end of 2020. Indeed, the aggressive rate cuts and market stimulus provided by the US Federal Reserve provided cushion for Asian central banks to follow suit (see Chart 1[2]). Most Asian currencies also stabilised and strengthened on the back of a weaker US dollar as global rush-to-safety capital flows receded[3].

As the pandemic's impact on credit markets also varied across different markets and industries, we saw an increasing divergence in credit quality. That said, the region is in a relatively better position due to the unique structure of JACI, where a majority of issuers are investment grade with many state-owned enterprises and quasi-sovereign entities benefitting from a diversified range of funding channels including the local banks and bond markets.

In the high-yield space, while defaults have indeed ticked higher, the impact has been less pronounced than initially feared[4]. For instance: full-year default forecasts for Asian high-yield have been revised lower from 4% in July to 3% in October[5]. Furthermore, the region has thus far only seen about 1.4% of investment-grade credits turn into "fallen angels"– only marginally higher than the 10-year average at 1.2%[4].

2021 Outlook – limited fallen angel risks for sovereign and quasi-sovereign

The more favourable macro landscape in 2021 should be constructive for Asian fixed income. We are positive on the broader Asian fixed income landscape given its resilient credit fundamentals, continued accommodative monetary and fiscal policy, and downward pressure on the US dollar. As mentioned, aggressive rate cut and unprecedented balance sheet expansion by global central banks, more and more developed market government bonds become negatively-yielding (Chart 2[6]). In the event of "tail-risk-event", i.e. US Treasury yields to

Chart 2: Asian Bonds in global context (government bond yields, %)

	1Y	2Y	3Y	5Y	7Y	10Y	15Y	20Y	30Y
Germany	-0.70	-0.75	-0.78	-0.75	-0.69	-0.57	-0.38	-0.36	-0.17
Switzerland	-0.86	-0.81	-0.81	-0.76	-0.68	-0.55	-0.40	-0.32	-0.33
Netherlands	-0.70	-0.73	-0.74	-0.70	-0.63	-0.49	-0.41	-0.24	-0.10
Denmark	-0.58	-0.64	-0.66	-0.61	-0.54	-0.46	-0.35	-0.24	-0.05
France	-0.64	-0.69	-0.70	-0.66	-0.55	-0.33	-0.16	0.09	0.36
Ireland	-0.67	-0.68	-0.66	-0.60	-0.48	-0.27	-0.05	0.02	0.33
Sweden	-0.15	-0.39	-0.37	-0.34	-0.20	-0.01	0.15	0.31	
Japan	-0.13	-0.13	-0.14	-0.10	-0.09	0.03	0.22	0.40	0.65
Portugal	-0.58	-0.69	-0.59	-0.45	-0.25	0.03	0.40	0.42	0.75
Spain	-0.59	-0.59	-0.57	-0.38	-0.23	0.08	0.39	0.65	0.89
United Kingdom	-0.03	-0.03	-0.03	0.01	0.11	0.30	0.53	0.81	0.85
Italy	-0.47	-0.40	-0.25	0.04	0.26	0.63	0.99	1.22	1.48
United States	0.11	0.15	0.19	0.36	0.61	0.84	1.10	1.36	1.57
Singapore	0.22	0.26	0.33	0.49	0.64	0.87	1.11	1.17	1.13
Australia	0.01	0.09	0.11	0.30	0.53	0.90	1.24	1.66	1.89
Thailand	0.49	0.52	0.59	0.76	1.24	1.31	1.62	1.80	2.05
South Korea	0.62	0.96	0.99	1.38	1.42	1.50	1.62	1.74	1.73
Malaysia	1.65	1.79	1.93	2.16	2.59	2.76	3.48	3.73	4.14
Philippines	1.68	1.93	2.07	2.72	2.79	2.84	3.37	3.90	
China	2.85	2.94	3.04	3.07	3.27	3.26	3.56	3.85	3.89
India	3.32	3.91	4.36	5.08	5.63	5.91	6.21	6.34	6.61
Indonesia	2.63	4.06	4.56	5.04	6.03	6.16	6.65	6.90	7.16

[2] Central bank websites, as of 20 November 2020. 1-year medium term lending facility rate is used for China (market players use the 1-year medium term lending facility rate as a guide for the monetary direction of People's Bank of China,
[3] JP Morgan Asia Dollar Index gained 3.7%, as of 17 December 2020.
[4] Although defaults in the high-yield space have hit a record US$8.8 billion, robust issuance means the default rate has been kept in check at a mere 2.4%. The percentage of high-yield paper trading at distressed levels (below 70 cents on the dollar) has moderated from 14% in March to 2% in October 2020. JP Morgan, October 2020.
[5] JP Morgan, as of October 2020.
[6] Bloomberg, Manulife Investment Management, as of 30 November 2020.

turn negative in 2021 (e.g. a delay with the distribution of vaccine, or deflationary environment), we could see a major asset-rotation among bond and income investors, driven by the ongoing search for "positive" yields, making Asian bonds stand out given their sound fundamentals.

Overall, we expect defaults to remain reasonably contained and idiosyncratic in the first half of 2021 before an improvement in the second half as vaccines roll out globally, and Asia's US dollar bond market is ready for re-financing issues, which are conducive to improve risk sentiment. Having said that, credit selection will remain key in Asian markets, as the recovery is expected to uneven across countries and sectors.

China's impressive economic recovery should continue: real GDP growth for China is forecast to accelerate from 2% in 2020 to 8.2% (year-on-year) in 2021, before falling back to trend growth (5-6%) range in the following year[7]. Riding on optimism that the rollout of vaccines will help to support a return to global growth and broader economic recovery in China, we could see China withdraw some of the highly expansionary credit and fiscal policies implemented during 2020 to counter the pandemic. Policy rates are expected to remain relatively stable as the People's Bank of China (PBOC) has consistently signalled that it is against excessive stimulus. It will likely continue with targeted monetary policy actions that could include more targeted reserve ratio requirement (RRR) cuts, as well as open market operations, to manage market liquidity.

China bonds stand out in the current market cycle, relative to other global bond markets, due to its high nominal and positive real yields and diversification opportunities. In the current macroenvironment and credit down cycle, we believe capturing the most attractive income opportunities with credit selection is key.

As 10-year CGB yields have now moved back to around the 3.3% level, we believe this is an attractive entry point for investors and now offers a very decent pick-up of around 2.4% against US treasuries[8]. From a curve perspective, the 5–7-year segment looks particularly attractive compared to longer-dated paper in terms of relative value. We believe the renminbi will stay broadly around current levels with the potential to appreciate further against the US dollar targeting the 6.40 level in the first half of 2021, after appreciating against the US dollar by 6% in 2020. This is driven primarily by the softness in the US dollar that may weaken further on possible delays to the US economic recovery. We remain focused on systemically important state-owned enterprises that are also less reliant on the US from both an operational and funding perspective. Domestically concentrated sectors, such as utilities, property, telecommunications and media, are also areas of focus. The tail risks stemming from continuing US-China tensions will likely persist – especially given recently passed legislation authorising the potential delisting of US-listed Chinese firms. Also, we see increased tolerance on the part of Chinese regulators to orderly allow some bondholders to take losses, particularly for less strategically important state-owned enterprises.

Turning to **Indonesia,** the country arguably suffered the most economically among regional markets, posting its first negative year-on-year growth and technical recession since the Asian Financial Crisis. In response, the Indonesian government and Bank Indonesia released unprecedented levels of stimulus, including the use of debt monetisation. These unique policy tools helped to boost economic growth and maintain confidence in the country's credit markets. At the sovereign level, its current credit ratings (BBB, stable outlook by Moody's and Fitch) provide it with an ample buffer against being pushed below investment grade. Major quasi-sovereign corporates and leading banks also feature resilient credit metrics with adequate liquidity, making them well-positioned to retain their investment-grade ratings. Although the Indonesian rupiah experienced a volatile 2020, it is potentially poised for more stable performance in 2021 on the back of the country's stronger economic prospects – this is despite the nation's reliance on external debt. Within the high-yield space, quality high-yield issuers with adequate liquidity and decent corporate governance appear well positioned.

[7] Bloomberg consensus as of December 2020.

[8] Bloomberg, as of 16 December 2020.

For **India**, fallen-angel risks are on our radar as bank non-performing loans (NPLs) are expected to rise to double-digits over the next 12 to 18 months[9]. However, the risks are mitigated by the improvement in COVID-19 containment (e.g., a 69% decline in active cases since mid-September[10] compared to an increase in the rest of the world in general) and its resilient financial-sector metrics. This would be supportive of macro-economic recovery in 2021. From a fiscal policy perspective, India has increased debt to support the economy; however, despite having a debt-to-GDP ratio approaching 90%, we are less worried as external debt only comprises about 20% of GDP[11], which is considered to be at the lower end of the spectrum among emerging-market economies. In India, "national champion" state-owned enterprises are likely well positioned, as well as renewables with strong parent supports.

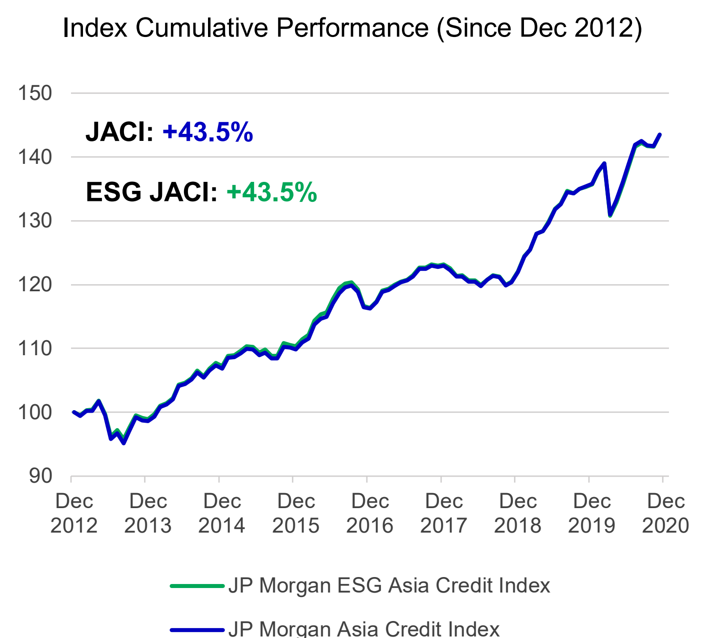
This theme of careful credit selection also extends to a major emerging opportunity – ESG investing.

Emerging Opportunities in Asian sustainable bonds

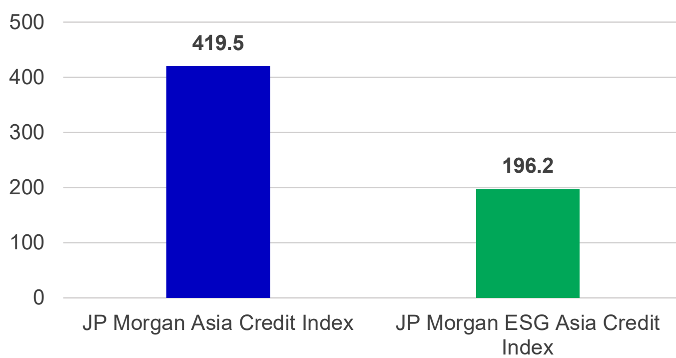
Although Asia arguably emphasised ESG later than other regions such as Europe, recent trends show momentum and optimism for investors in the space. With China, Japan, South Korea, Hong Kong, and New Zealand committing to becoming carbon neutral[12], and other governments are likely to follow, we expect to witness a greater number of green-bond issuance. Global green bond issuance grew 12% in 2020 compared to the first nine months of 2019 and the global trend is supportive of further growth in the green and sustainable-labelled bond segment[13].

Beyond this trend, another reason investor should favour opportunities in this space is the ability to generate genuinely holistic returns beyond just traditional financial metrics. Outperforming a benchmark now is more multi-faceted than simply looking at the differences in returns, but also includes ESG factors, such as carbon intensity (E), ability to provide aging population support (S) or stronger governance structures (G). If a certain sustainable portfolio matches the benchmark but does so with significantly less carbon emissions, this could support climate objectives. Even from a strict financial return perspective, research and evidence suggest sustainable investing *does not* compromise returns (see Chart 3[14]). For instance, the cumulative risk-adjusted return for the J.P. Morgan ESG Asia Credit Index from December 2012 to November 2020 is on par with the JACI (upper chart), from a carbon intensity perspective, JACI's constituents emit nearly 420 tonnes of carbon dioxide (CO2) for every US$1 million of sales generated. In contrast, constituents of the J.P. Morgan ESG Asia Credit Index emit only 196 tonnes of CO2 per US$1 million of sales.

Chart 3: Asian bond indices and portfolio with contrasting ESG footprints



[9] For Indian banks, projected NPL ratios and credit costs have been revised downward, and collection rates have spiked to 90% in October from just 50–60% a few months prior.
[10] The Center for Systems Science and Engineering (CSSE) at Johns Hopkins University.
[11] CEIC, yearly figure as of March 2020.
[12] "Asian giant's carbon pledges boost global climate action, says UN climate chief", Straits Times, 4 November 2020.
[13] Another bumper year sees green bonds push through the $1tn mark, PV Magazine, 6 October 2020.
[14] Bloomberg, 30 November 2020. Figures shown are in gross USD terms. Past performance is not indicative of future results. Investment involves risk. The J.P. Morgan ESG Asia Credit Index (JESG JACI) tracks the total return performance of the Asia ex-Japan USD-denominated debt instruments across the Asian Fixed Income asset class, including floating, perpetual, and subordinated bonds issued by Sovereign, Quasi-Sovereign and Corporate entities. The index applies an Environmental, Social and Governance (ESG) scoring and screening methodology to tilt toward green bond issues or issuers ranked higher on ESG criteria, and to underweight or remove issuers that rank lower. *Carbon intensity data sourced via Trucost ESG Analysis. Carbon intensity refers to Scope 1 & 2 Tons CO2 equivalent emissions per million USD revenues.



This reinforces our belief that sustainable investing can enhance returns going forward, and the performance on ESG issues will likely resonate with investors who are concerned about sustainability. More importantly, impending changes to regulation, coupled with growing investor demand for sustainable solutions, are likely to change relative performance drivers going forward. We also expect green and sustainable-labelled bonds to be held by established, longer-term institutional investors. This could establish a more stable investor base, which could help to reduce drawdown and provide better risk-adjusted returns for the asset class.

In terms of specific ESG opportunities in Asia, investors should look for companies that will benefit from environmental or social trends such as providing cleantech that will help to mitigate climate change or demographic shifts. Besides environmental and social factors, investors shall emphasise the importance of governance factors. From a governance perspective, investors should focus on companies with more independent and diverse boards while rejecting those with a history of mismanagement or opaque business models.

All in all, we believe Asian fixed income portfolios should not only consider ESG risks but actively take advantage of the ample ESG opportunities. While 2020 was an important year for ESG in Asia, we expect even more in 2021, as investors and companies explore innovation in this space.

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Amid a persistent low-yield environment with the post-COVID economic development, preferred securities can offer a compelling opportunity that will continue into 2021: with careful issuer selection, investors may achieve potentially higher yields without the need to sacrifice quality. This makes them a valuable fit for today's income portfolios.

Maximising yield potential in an investment-grade asset class

While preferred securities were affected by the global pandemic fallout, their trajectory throughout 2020 has shown this to be a resilient asset class.

Preferred securities' 2020 trajectory – A resilient recovery

After the volatility witnessed in the first quarter of 2020, preferred securities also benefited from the Federal Reserve's (Fed's) supportive actions, recovering 16.27% in the second and third quarter of 2020, surpassing that of US high-yield bonds, which rebounded by 15.49% over the same period. Year-to-date, preferred securities posted 5.98% return while US high-yield bonds gained 4.18%[1].

With potential yield-spread tightening and a lower-for-longer interest-rate environment, we are positive that preferred securities, as an investment-grade asset class, can potentially help investors navigate the low-yield landscape that will persist into the new year.

Positive macro trends

The economic environment should continue to improve in 2021. As multiple global vaccines come into play, we anticipate broad-based spread tightening – a positive catalyst for preferred securities. The average yield spread of preferred securities versus the 10-year Treasury is still above the historical average yield spread – meaning there is potential for further spread tightening. Furthermore, this is expected to occur across sectors: consumer cyclicals and telecommunications, in particular, have the potential for greater spread tightening as the economy improves.

We also believe that the previously mentioned lower-for-longer interest-rate environment will persist in 2021. There are three reasons to support our view. First, growth and inflation expectations are expected to be muted. GDP expansion, particularly in the US, may also be hampered by demographic pressures, as the over-65 age group is set to increase by more than 50% in the next three decades[2].

Secondly, the looming prospect of a smaller fiscal stimulus stemming from a divided US government may temper inflation expectations. Thirdly, there is now a record USD 17.17 trillion in negative-yielding debt globally[3], forcing investors to look beyond the government-bond market for income.

When combined, these factors generate tremendous demand for higher-yielding securities like preferred securities, particularly as they feature stronger credit quality and lower default rates than high-yield bonds.

Better credit quality and lower default rates

Preferred yields are similar to those from high-yield issues[4]. However, the average credit quality of

[1] Source: Manulife Investment Management and Bloomberg, as of 30 November 2020. Returns in US dollar. Preferred securities = ICE BofAML US All Capital Securities Index. US High Yield = ICE BofAML US High Yield Index. Past performance is not indicative of future performance.
[2] OCED Historical population data and projections, 2019.
[3] Bloomberg Barclays Global Negative Yielding Debt Index, as of 30 November 2020.
[4] Source: Bloomberg, ICE/BofAML indices and Manulife Investment Management, Yield to Maturity, as of 30 November 2020. US high yield

preferred securities is BBB- or investment grade. High-yield bonds may indeed offer slightly higher yields, but at the cost of a lower credit rating (their average credit rating is B+, which is below investment grade)[5]. Furthermore, default rates are low for preferred securities, historically standing at only 0.33% – which makes sense given the average investment-grade rating. In contrast, global high-yield bonds have had a 30-year default rate of 4.06%[6]. We believe the credit quality and default rate of preferred securities should not be adversely affected under the current environment.

What also distinguishes preferred securities from other areas of the fixed income market, particularly high yield, is that they are less sensitive to changes in interest rates. Many of them come with a fixed-to-floating-rate coupon structure whereby for the first 5 or 10 years of the life of the security the coupon is fixed, after which it floats. Even in a rising rate environment, investors are offered some coupon protection. This further adds to their core appeal – attractive yields with reduced credit risk – and explains why we believe they may be one of the valuable portfolio tools.

In terms of sector preference, investors should be looking for companies with strong fundamentals, stable balance sheets, and attractive yields, particularly those in the US utilities, energy, and financial sectors.

Sectoral focus – Financials, utilities, and energy

In the **utilities** space, we believe that convertible preferred securities show attractive opportunities right now. Issuer fundamentals are solid, with virtually all US utilities reiterating the earnings growth guidance given before the lockdowns. The positive catalysts stemming from their investments in renewables also look set to become even more optimistic under a Biden presidency. Although the sector has acted as a defensive hedge in 2020's volatile markets, utility stocks are also at 20-year lows as compared to S&P 500 valuations – boosting future return potential[7].

As for **energy**, we see investment opportunities in midstream companies with diversified business models (e.g., natural gas pipelines and gasoline storage). Given that natural gas is principally used for heating and electricity generation, we expect robust cash flows to continue.

US **financial companies** have boosted their capital reserves since the 2008 Global Financial Crisis. Balance sheets are in the best shape in decades[8], a key factor supporting their resilience amid a challenging economic environment. Also, except for one large US bank, all the major institutions have maintained their common dividends. We believe the market is discounting these fundamentals.

While there is geographic concentration risk to the US, we think their risk-return profile remains attractive. This stands in contrast to European financial institutions, which may also be forced by the regulators to halt dividend payouts.

Conclusion – A strong play in a low-yield world

As yields on traditional fixed-income securities, such as developed-market government bonds, continue to trend lower, preferred securities are providing investors' portfolios with compelling yields. What's more, they have lower volatility, defaults, correlations, and interest-rate sensitivity. With the "search for yield" theme likely to continue in 2021, we believe preferred securities may provide the balance between yields and quality that investors clearly seek.

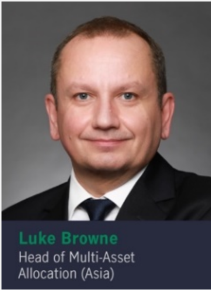
bonds, with yield-to-maturity 5.31%, are represented by Bank of America Merill Lynch High Yield Index; Preferred securities, with yield-to-maturity 4.37%, are represented by ICE BofAML US All Capital Securities Index. Yield to maturity is the rate of return anticipated on a bond if it is held until the maturity date. It is not an accurate reflection the actual return that an investor will receive in all cases.

[5] Average credit ratings refer to Standard & Poor's ratings, as of 30 November 2020.

[6] Global high yield bonds default rate is sourced from Moody's Investor Services, as of 31 December 2019. Preferred Securities default rate from 1990-2017 was calculated by Wells Fargo. Beginning in 2018 Manulife Investment Management used the ICE BofAML US All Capital Securities Index to calculate the annual default since Wells Fargo stopped providing related information after 2017. As of 31 December 2019. Past performance is not indicative of future performance.

[7] BofA Research, 1 June 2020.

[8] Federal Deposit Insurance Corporation (FDIC), November 2020.



In this 2021 outlook, Luke Browne, Head of Asset Allocation (Asia) highlights how investors' interests can be well-served by focusing on macro themes and combining these with capital market asset-allocation views within a risk-management framework. By capturing opportunities while navigating and managing downside and upside risks, Luke Browne and the Multi-Asset Solutions Team believe that this should provide investors with sustainable and resilient solutions that can withstand market cycles.

Building resilient portfolios through market cycles

2020 review - Asset classes show a stronger rebound than the underlying macro economy

2020 was a year nobody expected but most quickly adapted to. In March, the pandemic drove an indiscriminate market sell-off. In our view, this was less about systemic risk, and more a coping mechanism when faced with a crisis of uncertain depth and duration.

Governments and central banks reacted quickly. The Federal Reserve (Fed) cut rates by 150 basis points (bps), bringing the target range down to 0–0.25% and enacted extensive liquidity-provisioning measures[1]. Trillions of dollars in stimulus, including wage subsidies and furloughs were also approved by governments across the globe. These measures supported global economies at the onset of the COVID-19 pandemic; capital markets, however, reacted a lot more positively: strong momentum in risk assets drove equity performance, as well as gold, which breached the US$2,000/ounce mark[2] for the first time. Meanwhile, GDP figures unveiled the full depth of the recession, with the G20 area seeing a 6.9% fall in growth for the second quarter[3]. The US experienced a 31.4% decline[4], while the UK[5], Japan[6], and India saw drops of 19.8%, 27.8%, and 23.9%[7], respectively. China was the exception, returning to modest growth in the same period[8].

However, in September and October, we saw sentiment dim as uncertainty surrounding the US presidential election came to the fore. In the period following the vote, risk assets rallied strongly, particularly with the addition of positive vaccine news to the mix. Risk assets extended gains in the post-election rally: for equities, the MSCI US and Asia ex-Japan indices outperformed[9]. Sector-wise, information technology and consumer discretionary led throughout the year, as COVID-related lockdown drove increased demand for higher growth equities and those corporates with online eco-systems that could sustain their business models better during the pandemic. Towards the year-end, market breadth expanded to cyclicals and value stocks. Within bonds, global corporate bonds took the lead gaining 9%, while the broader Global Aggregate index gained 7.8%. Global high-yield and emerging-market bonds delivered 5% returns[10]. The latter part of the year also saw dollar weakness which, on top of some rotation out of US growth assets towards global cyclicals and value, also added to the investment thesis of an increased exposure to non-US dollar assets.

[1] "Federal Reserve announces extensive new measures to support the economy", Federal Reserve, 23 March 2020.
[2] Bloomberg, as of 28 July 2020.
[3] "Unprecedented falls in GDP in most G20 economies in second quarter of 2020", OECD, 14 September 2020.
[4] Bureau of Economic Analysis, 29 October 2020.
[5] Office for National Statistics, 30 September 2020.
[6] Japan's Cabinet Office, 17 August 2020.
[7] National Statistical Office India, 2 September 2020.
[8] National Bureau Statistics of China, 17 July 2020.
[9] Factset, as of 30 November 2020. MSCI US and MSCI Asia Pacific ex-Japan equities gained 16.6% and 15% versus MSCI World gained 11.72%) year-to-date respectively.
[10] FactSet, as of 30 November 2020.

As the world breathed a sigh of relief that 2020 was finally over, the reality of 2021 still looms. The worst may be behind us, but uncertainty persists. In our view, one of the most critical features of the COVID-19 recession is that it has more disproportionately impacted the services side of the economy, while being much less painful for the manufacturing sector, which has recovered more quickly, promoting a ”K-shaped” recovery. Successfully navigating this unprecedented environment will require specific near-term asset class, regional, and sectoral tactical shifts, underpinned by a longer-term strategic view. Looking at the opportunity set in 2021, taking a balanced approach could prove sensible with a tilt towards sectors that are poised to benefit from a continued economic recovery, while incorporating some more cyclical areas that look undervalued.

Tactical equities – A cyclical rotation with preference for the US and Asia

On the equity front and geographically speaking, we believe that market liquidity will continue to support US share prices in 2021, especially as short-term risk factors, such as US political uncertainty, dissipate. Global politics, however, will continue to grab the headlines, particularly between the US and China, even under a new Biden administration. Emerging-market stocks, bolstered by supportive monetary policy and heavily levered towards global trade and manufacturing, should also continue to outperform in the recovery. Two regions – US and Asia (largely China) – are preferred when considering tactical positioning.

On a sectoral basis, we could see the IT sector continue its leadership trend; however, the sector may come under further tax and regulatory scrutiny under a new Biden administration. Consumer discretionary is another sector in focus, despite elevated valuations. From a style perspective, we are aware that further stimulus and the re-opening of economies could spur a second wave of rotation away from growth into value and cyclicals. Value sectors may be relatively cheap, but our concern is that they remain just that. As such, having some exposure at this stage is, we believe, the right approach. Supported by low interest rates, a growth bias still holds favour – although in the near term, some of the cyclical and value-oriented markets, such as Europe and Japan, are worth considering.

Tactical fixed income – The hunt for yield

We expect the Fed to keep rates at the zero-lower bound, without dipping into negative territory. However, such a low-yield environment is a recipe for anaemic fixed income returns in developed-markets.

Therefore, emerging-market debt and global high-yield issues are in scope. The former boasts improved valuations, plus the potential of even greater yield for local-currency issues (albeit at the expense of higher volatility). Similarly, continued near-term uncertainty should offer investors attractive entry points for global high yield. Corporates are seeing better access to capital, which should improve their credit-risk metrics and ameliorate default-rate expectations.

As we shift beyond this near-term tactical view and explore longer-term strategic ideas, specific themes become more prominent.

Structural themes – Weakening dollar, retreating globalisation

Structurally, the Fed’s liquidity-boosting measures and persistently low rates will see the US dollar gradually weaken over time. This should present a moderate tailwind for emerging-market assets, further supporting our strategic overweight towards such assets.

That said, we bear in mind that the US-China dispute will remain a key talking point, even under the Biden administration. Assuming a smooth transition to a new US administration on 20 January, we do not expect any material change in US foreign policy towards China, nor do we anticipate an imminent unwinding of the tough measures imposed by the Trump administration, e.g., trade tariffs, revoking of visas, sanctions, and travel restrictions. Indeed, the Biden administration prioritising climate change and human rights may present new challenges for the US-China relationship. Meanwhile, the potential for “financial decoupling” has risen, if the US follows through with additional financial sanctions on

Chinese corporates as well as threats of further action.

Beyond just the US, the larger Western trading blocs' perception of China will also have geopolitical implications. Deglobalisation is likely to continue rearing its head as we move forward, and may push economies towards smaller, more regional trading groups.

These structural themes reflect long-term strategic views – some of which differ from more tactical considerations.

Strategic views – Looking towards emerging markets

For our five-year strategic outlook, investors can favour emerging markets, both within equities and fixed income. Continued supportive monetary policies, a more synchronised global cyclical rebound, and a weaker US dollar should allow emerging-market equities to maintain a robust growth profile with attractive long-term valuations. A vaccine will be a game-changer for the economies of Latin America, Indonesia, and India. However, a medical solution is unlikely to drive a robust and rapid economic solution. Fiscal stimulus is unlikely to be enough for a rapid economic recovery, as a return to pre-COVID growth rates is likely to be pushed into 2022. Nevertheless, on a relative strategic basis, we see higher equity and fixed income returns in emerging markets (EM) versus developed markets (DM).

Among emerging markets, Asia is more attractive given its healthier economies versus Latin America and emerging Europe. A relatively stronger starting point in Asia versus the rest of the broad EM space, lends to a higher probability of targeted stimulus measures and the relaxation of credit standards. In the US, higher valuations and a weakening US dollar mean that investors can be strategically more neutral on its equity sector over a longer time horizon.

From a multi-asset perspective, in a world where investors are feeling increasingly compelled to reach for yield, we believe that the most attractive opportunities lie outside of the sovereign debt space, making investment-grade global credit and high-yield issues a preference. While investors must keep an eye on particular sectors that have a much more binary outcome determined by the path of COVID 19, such as energy and healthcare, we believe there's adequate room to run within this segment over the next five years.

Conclusion: Where uncertainty and opportunity collide

2020 saw investors embrace risk, despite one of the most distressed macro environments in a century. 2021 should be about balancing what feels like market complacency with rising risks. The key market drivers for 2021 are likely to be the Fed and the US dollar, government stimulus efforts, China and the pathway of COVID-19, and vaccine success. We expect the Fed to be more reactionary than it was back in Spring 2020, in anticipation that COVID-lockdowns will release pent-up economic demand, spurring a consumer and economic led recovery. The expansion of the Fed's balance sheet has stalled and growth in balance -sheet expansion has been sideways since June 2020.

Geopolitics will remain a headline risk – we don't expect the Biden administration to remove Phase 1 tariffs on China, with expectations of a similar policy in the near term. The US and Europe, however, could see improved relations under Biden.

From ambiguity always arises opportunity. We believe that investors' interests can be well-served by focusing on macro themes and combining these with capital market asset-allocation views within a risk-management framework. This should point the way to capturing opportunities while managing potential downside and upside risks and providing investors with sustainable and resilient solutions that can withstand market cycles.

2020 was a challenging year for many asset classes. Asia-Pacific REITs (AP REITs) was no different, as the COVID-19 pandemic roiled real estate markets across the globe, including Asia. Despite these challenges, regional real estate markets have gradually recovered from lows, stabilising historically predictable dividend payouts, while the "lower for longer" global interest rate environment has provided a beneficial tailwind. In this 2021 outlook, Hui Min Ng, Portfolio Manager, explains why investors traditionally have chosen REITs, and outlines why it should be an attractive investment for next year[1] and beyond.

Asia-Pacific REITs: Past, present, and future

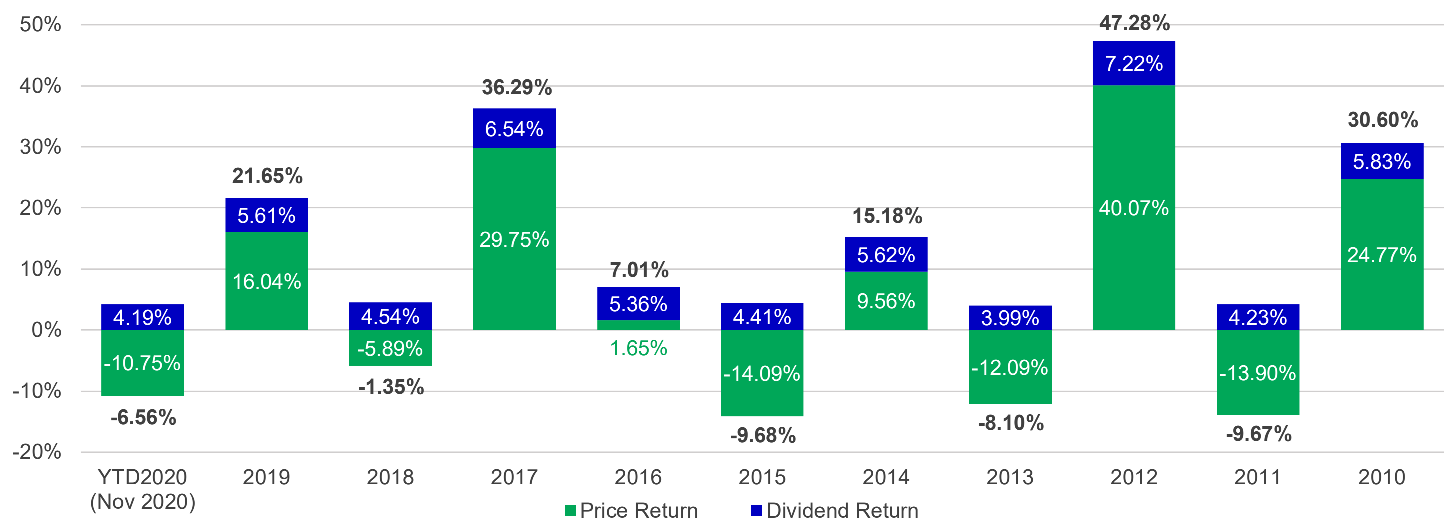
Despite a volatile and unpredictable 2020, it is always important to remember why investors choose to invest in REITs. While they certainly can offer the possibility for price appreciation (or depreciation), a stable and predictable income payouts through dividends has been the main historical source of return.

Indeed, over the past 10 years, AP REITs have provided, on average, a 6.8% annualised return; roughly 5% of the total return came from dividend payouts[2,3]. To put this dividend yield in perspective, Asia (ex-Japan) equity markets offered, on average, a 5.4% total return, with only 2.4% coming from dividends over the same time period[4].

Despite the notable challenges of the past year, from another perspective, AP REITs historical yield is also attractive in the current "lower for longer" interest rate environment. As Chart 2 shows, developed markets' sovereign bond yields have steadily declined since December 2015. In some developed markets, bond yields have even turned negative, with the current level of negative-yielding debt instruments near US$ 18 trillion and expected to climb even further in the near-term.

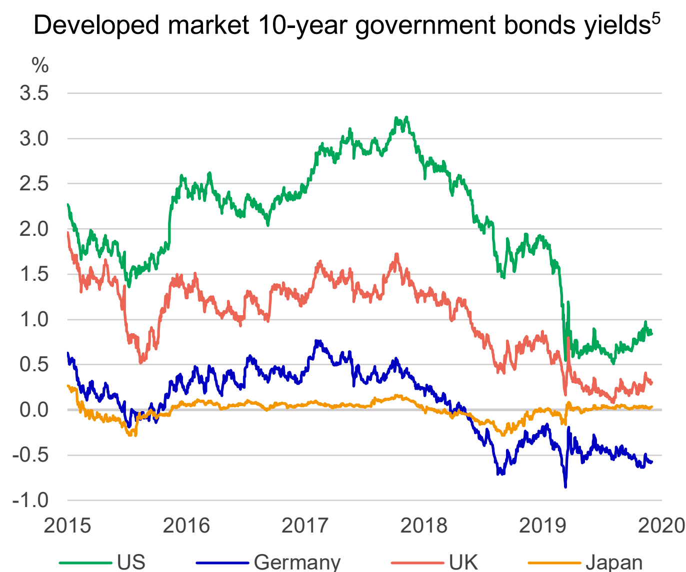
Chart 1: AP REITs historical payout[2]

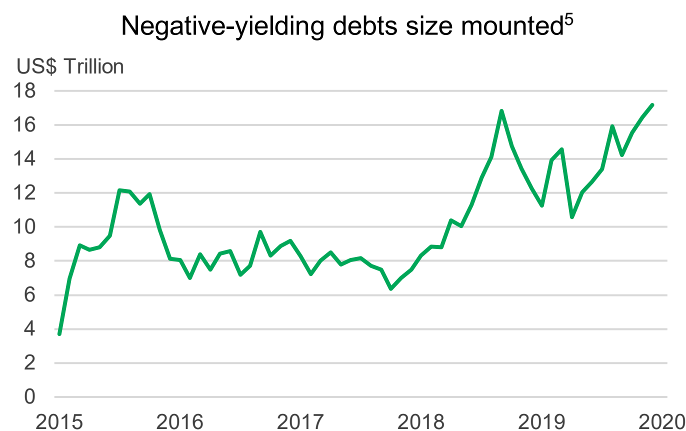
Annual total returns of Asia ex-Japan REITs (2010 –2020 YTD)



[1] As of this writing, December 2020.
[2] Bloomberg, as of 30 November 2020.
[3] Bloomberg, as of 30 November 2020, Asia ex-Japan REITs are represented by FTSE EPRA/NAREIT Asia ex-Japan REITs Index. Performance in US dollar.
[4] Bloomberg, as of 30 November 2020.

Chart 2: Negative yielding bonds[5]





While the lower for longer interest rate environment is a headwind for many fixed income segments, it is supportive for REITs due to lower borrowing costs.

Despite these traditional strengths, 2020 was indeed a challenging year for REITs globally as well as Asia, as the economic impact of the COVID-19 pandemic called into the question the asset class's predictable history of dividend payout.

The past: Early 2020

The global outbreak of COVID-19 had a varying impact across the sub-sectors of real estate, but initially led many to question the viability of dividend pay-outs in a worsening environment. The worst hit sector globally was retail as a result of national lockdowns and social distancing requirements.

In contrast, industrial/specialised real estate assets continued to generate stable cashflows and high-income visibility, as the acceleration in ecommerce trends led to stronger demand in warehousing and logistics facilities.

Many segments of AP REITs have gradually recovered from the economic shock due to unprecedented monetary and fiscal policy measures. Policy responses from governments such as Singapore and Australia have helped save jobs and companies, with some packages totalling up to 20% of GDP. At the same time, central banks across the region have slashed rates, with the Reserve Bank of Australia starting quantitative easing for the first time in 2020.

The present: End of 2020[1]

The top priority across all landlords and REITs managers has been to ensure high cleaning/maintenance standards, temperature checks to ensure safety for all their tenants and instil confidence for people to visit their facilities. The pandemic has brought about unprecedented economic impact and all stakeholders in one form or another must bear some pain from it.

Landlords for commercial assets in Singapore and Australia are mandated to provide rental holidays for tenants who were badly affected by the loss of sales/income. landlords have also offered help in terms of rental commissions, waiver of management fees, lease restructuring to tide tenants through the difficult period.

We saw suburban retail landlords have also accelerated their digital marketing plans to help their tenants to sell their products online or food delivery services for their food and beverage tenants, with more people working from home, these suburban malls have ramped out digital offering to capture the sales in their neighbourhood.

[5] Bloomberg, as of 30 November 2020.

The future: 2021

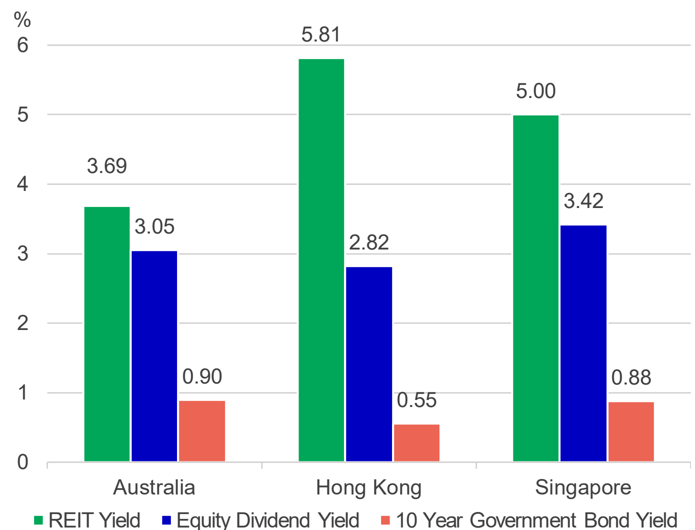
Moving into 2021, we envisage the macroeconomic backdrop should gradually improve across the region, with significant dispersion in economic growth across the region[6]. Despite the economic rebound, we expect that the low interest rate environment should remain a strong tailwind for the asset class. The low cost of borrowing continues to underpin healthy demand in trophy assets across Asia.

Our base case scenario is that key markets like Singapore, Hong Kong, and Australia should not enter into national lockdowns given policy learnings and experiences. The positive newsbytes on vaccines successes could restore confidence in consumer and corporate spending in 2021.

Retail landlords should enjoy recovery in cashflows given the low base in 2020 (high rental reliefs) and industrial REITs remain stable with growth boosted from accretive acquisitions.

Based on this base case and favourable macro backdrop, the outlook for yields of AP REITs should remain attractive next year (see Chart 3). Forecasted yield for AP REITs is approximately 5.1% compared to a 2.1% yield for Asian equities[7]. In our view, this payout is expected to remain stable over the long-term, largely due to the strength of the asset class and improved economic conditions.

Chart 3: AP REITs offer attractive forward yield[8]



Conclusion

In our view, the main attraction of AP REITs as an asset class is the stable, sustainable payout of dividends to investors. While this assumption was challenged in early 2020, the response by governments and central banks helped to stabilise the real estate sector. Moving into 2021, we believe an improving economic outlook and continued low interest rates should be beneficial for the asset class.

[6] Bloomberg, as of 15 December. The consensus growth estimate for Asia-Pacific in 2021 is 5.5%. India and China are expected to lead the region at 8%, with Southeast Asian countries experiencing a slower expected rebound.

[7] Bloomberg, as of 4 January 2021.

[8] Bloomberg as of 30 November 2020. REIT Yield and Equity Dividend Yield are the projected 12-month yield from Bloomberg consensus. REIT Yield: Australia REIT – S&P/ASX 200 A-REIT Index, Hong Kong REIT – Hang Seng REIT Index, Singapore REIT – FTSE ST Real Estate Investment Trusts index. Equity Dividend Yield: Straits Times Total Return Index, Hang Seng Index, S&P/ASX 200 index. 10- Year Government Bond Yield = Local Generic 10-year Government Bond Yield. Projections or other forward-looking statements regarding future events, targets, management discipline or other explanations are only current as of the data indicated. There is no assurance that such events will occur, and if they were to occur, the result may be significantly different than that shown here.

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