

Global Markets Strategies View

Don Rich and his team provide Manulife Asset Management investment professionals around the world with insights and information on a wide range of issues and subjects that may affect the global markets, focusing largely on the near term. These insights, however, do not dictate investment policy nor do they represent a "house" view.

Asset	View
Cash	Neutral; watching for opportunities to redeploy
Fixed Income	Neutral short-term, negative longer term. Credit most vulnerable short term, but impending cyclical turn generally favors riskier assets
Equities	Negative (developed markets) as overbought short term, but expected to rally later in 2011
Emerging Market Equities	Favored 2011 equity class on positive economic, currency trends
Commodities	Neutral
REITs	Negative
Currencies	Positive on euro; negative on U.S. dollar and yen

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A wide range of tactical indicators is suggesting that the threat of a downturn in risk asset markets is becoming more imminent. However, the Global Markets Strategies Team ("GMS Team") expects any downturn to be moderate due to fundamental improvements, and followed by a cyclical upturn. Furthermore, not all markets are equally at risk.

The GMS Team's main composite of tactical indicators is indicating extreme levels of investor complacency and seems overdue for a correction, which would coincide with a deteriorating investment environment. In both developed and emerging markets, short-term volatility has stayed low relative to long-term volatility since last August, reflecting an overly long period of investor complacency. Credit default swap markets are also signaling that perceived risk-return trade-offs are getting stretched.

The extended risk-on environment partly reflects the huge liquidity sitting in lower-risk assets and cash that flows into risk markets any time there's a modest

pullback. However, there are many factors that could snuff out that marginal interest, including oil prices rising on geopolitical concerns, a worse than expected outcome to budget crises in several U.S. states, and the growing risk of a negative surprise on inflation.

The GMS Team does, however, see select opportunity to add value. In the second half of last year, it suggested that the first quarter of 2011 would present the best buying opportunity for emerging markets seen in years. The time is believed to be now as many emerging markets look oversold. The team is using the emerging market pullback opportunistically to add to positions in India, Brazil, Korea, etc. In addition, after selling off excessively due to the end of the "Build America" federal guarantee program last year, some U.S. municipal bonds still offer modest value despite having bounced off lows. In currencies, the euro now looks fundamentally well supported, with the European Central Bank expected to prioritize price stability over sovereign risk in upcoming policy decisions. The U.S. dollar seems to remain in a secular downtrend, with any rally likely to be driven purely by short-term risk appetite shifts. The only big risk to the negative USD view is the possible introduction of a

second version of the 2005 U.S. Homeland Investment Act, which allowed U.S. companies to repatriate foreign earnings without tax. In reintroducing the program, the government would be expecting to stimulate domestic investment, but any resultant inflows could also be expected to strengthen the dollar.

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