

**GLOBAL
INTELLIGENCE**

DECEMBER 2014

The Outlook for 2015



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EXECUTIVE SUMMARY

Global Intelligence draws together the individual views of Manulife Asset Management investment and economic teams around the world. In this Year Ahead edition, our experts outline their expectations for the economy and markets in 2015.

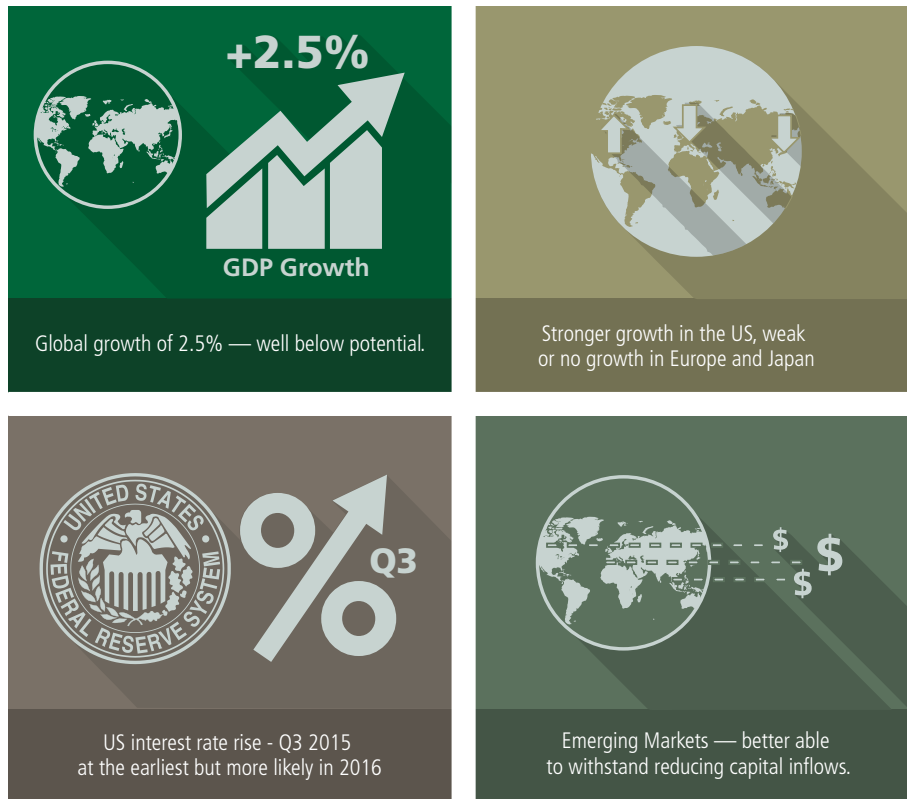
We start with a global economic outlook from our Chief Economist Megan Greene, including the major factors impacting growth in key regions around the world. Watch a video summary of Megan's outlook at manulifeam.com.

Our investment experts then discuss their market outlooks across geographies and asset classes, outlining potential opportunities and risks for investors.

Key themes on our radar for 2015 include:

1. **Monetary policy divergence.** Policy in the US and UK will likely tighten while other major economies will likely loosen or maintain a holding pattern. The timing of a US interest rate rise is uncertain but most experts believe it is unlikely to happen until the second half of 2015 at the earliest, and may even be delayed until early 2016.
2. **Signs of progress towards structural reforms,** particularly in Japan, Europe and Emerging Markets.
3. **Impact of a stronger US dollar on global economies and markets.** This is unlikely to result in outflows from Emerging Markets and Asia on the same scale as 2013's "taper tantrum."
4. **Oil price** – how will the declining price of crude oil continue to have an economic impact in 2015?
5. **Ongoing geopolitical uncertainty** in multiple regions is likely to provide both opportunities and risks to investors in the year ahead.

2015 GLOBAL ECONOMIC OUTLOOK



- Global growth in 2015 is likely to be well below potential at around 2.5%.
- The US economic recovery is gathering steam and will benefit from lower oil prices but faces headwinds from an appreciating currency.
- At the same time, other major markets — including Japan and above all the Eurozone — will serve as worrisome drags on the global recovery.
- Inflation is expected to be subdued — central banks in the US, Eurozone, and Japan in particular are not likely to hit their inflation targets in the next two years.

A global growth “tug-of-war” in 2015

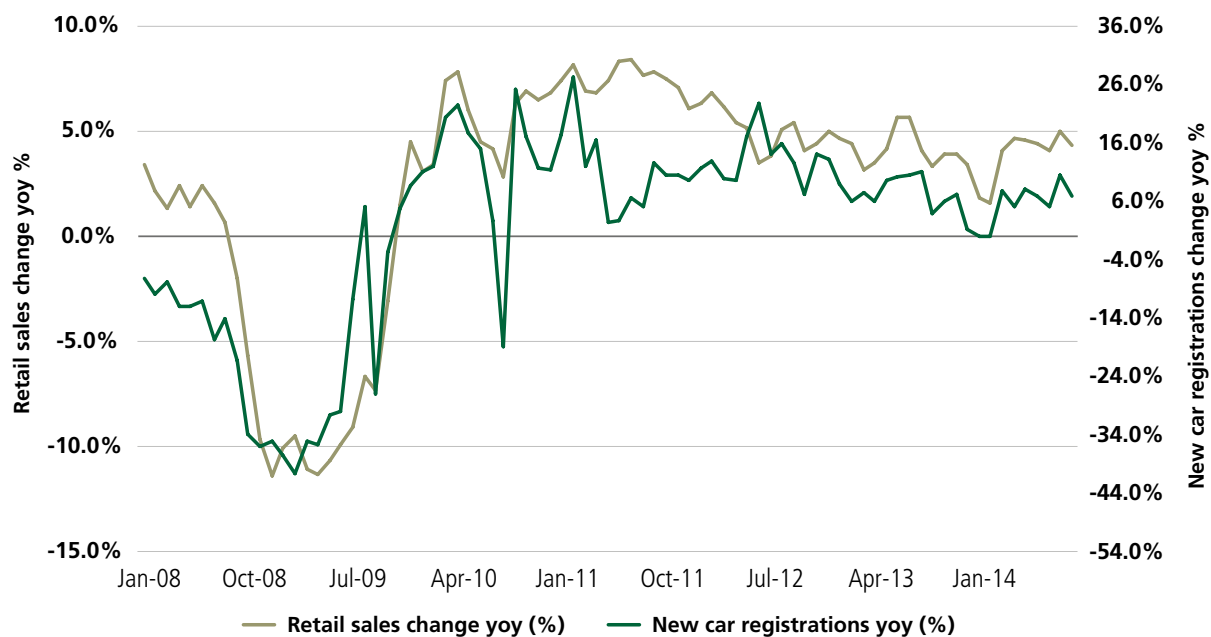
Megan E. Greene, Chief Economist, Manulife Asset Management

The year ahead is likely to see the global economy caught in a tug-of-war between a modest recovery in the US on one hand and a slowdown in China and low to no growth in Japan and Europe on the other. We expect these competing influences to keep global growth bumping along a baseline of around 2.5%.

US: Leading the way with a broad-based recovery

The US has seen a number of false dawns in its recovery since the onset of the global financial crisis, but we think this time is actually different and that the recovery is more likely to be sustained. We expect growth of 2.3% in 2014, 2.9% in 2015 and an average of 2.7% in 2016–18.

Retail sales and new car registrations robust over the past few quarters



Source: Bloomberg, September 30, 2014.

The US recovery has been primarily consumer-driven, with retail sales, new car registrations, and consumer confidence figures remaining robust over the past few quarters. Households have repaired their balance sheets, with household debt falling from around 95% of GDP in 2008 to around 80% of GDP in 2014¹. Industrial production has been buoyant, while manufacturing sentiment surveys have reached new highs since 2011.

The number of jobs added monthly to non-farm payrolls (NFP) has averaged over 200,000 — a very positive headline figure — and the unemployment rate is back to 2008 levels. However, digging into the details of NFP, there are a number of signs that falling unemployment may not translate into more robust private consumption and that there is significant labor market slack.

¹ Source: Federal Reserve Bank of St Louis

US non-farm payrolls averaging over 200,000 new jobs per month

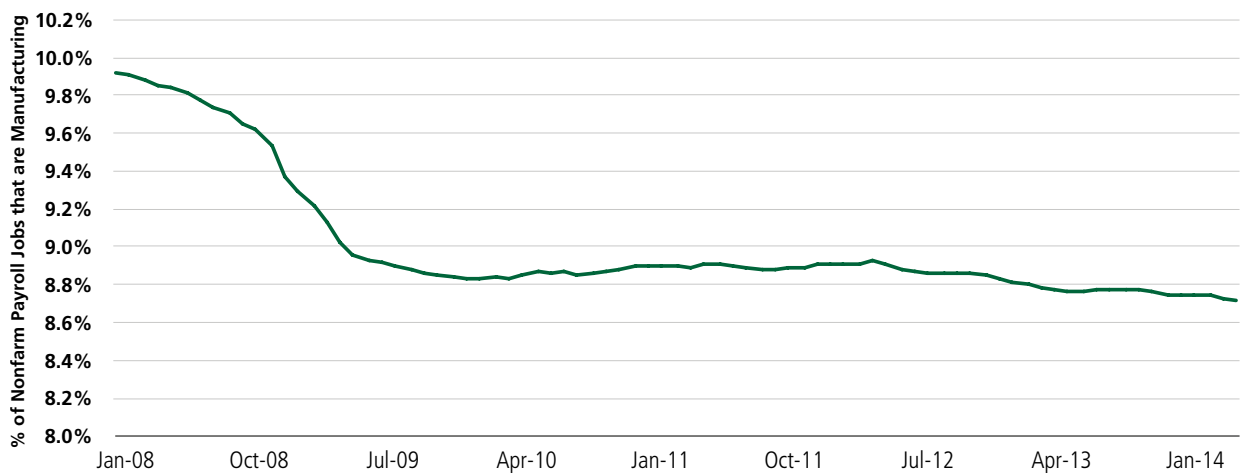


Source: Bloomberg, September 30, 2014

Since 2013, the number of high wage jobs (above US\$20 per hour) has flattened while the number of low wage jobs has increased. This is reflected in the share of manufacturing jobs (typically well paid) in the NFP figures; in the third quarter of 2014, they hit a record low. One reason is that long-term unemployment benefits were terminated in 2013, so high wage workers who were holding out for higher paid jobs were forced back into the work force at lower wages.

With most jobs being added in low wage industries, a fall in unemployment is unlikely to translate into significantly higher private consumption. As those receiving means-tested benefits (such as the Earned Income Tax Benefit or the Supplemental Nutritional Assistance Program) find low wage jobs, their benefits are reduced. Low-wage workers are using their newfound wages to make ends meet, not increase their consumption.

% of US non-farm payroll jobs in higher paying manufacturing sectors reached a record low in 2014



Source: Bloomberg, September 30, 2014

The concentration of new jobs in low-wage sectors also suggests that wages will remain low for a number of years. While unemployment in the US has fallen significantly to 5.8% in 2014 as at December 2014, wage growth has remained sluggish. Without upward pressure on wages, we expect inflation to remain weak as well. The Federal Reserve (Fed) will, therefore, see its two mandates — employment and price stability — moving in opposite directions. In our view, the Fed will maintain a low policy rate despite growing employment through 2015, hiking rates only in early 2016.

The greatest risks to economic growth in the US are external. With the Bank of Japan (BoJ), the European Central Bank (ECB), the Bank of England (BoE) and the People's Bank of China (PBOC) all expanding their balance sheets over the next few years, the US dollar is likely to appreciate relative to the yen, euro, sterling and renminbi. The world's other major economies will all be engaging in the same beggar-thy-neighbor strategy, and the US will likely face headwinds as a result. Net exports are expected to remain subdued with a strong US dollar.

Eurozone: Without action, the region could face a lost decade

The Eurozone is the biggest drag on our 2015 global outlook. We expect the region to register very low growth and inflation over our five-year forecast period — with average GDP growth of 1.4% in 2014–18 and average inflation of 1.3%, well below the ECB's target of just below 2%.

The approach to growth in the Eurozone has been for the weaker, peripheral countries — namely Greece, Ireland, Portugal, Italy and Spain — to boost their competitiveness by cutting wages and pensions to achieve an internal devaluation. Unit labor costs in most of the periphery have fallen relative to those in Germany since the onset of the crisis in 2008, with Italy being the sole exception. The result has been stronger net export growth in most of the periphery, alongside plummeting domestic demand. Consequently, most of the periphery has experienced either outright recession or very low growth over the past five years. As wages and pensions have been slashed, the weaker countries have also experienced outright deflation or extremely low inflation.

More recently, the Eurozone's woes have spread from the periphery to the core of the region. Germany — Europe's growth engine since the 1990s — is now seeing growth and inflation flag. German industrial production, new factory orders and exports saw contractions or weak growth in the third quarter of 2014. This is partly due to a slowdown in one of Germany's main trading partners, China, as well as the imposition of sanctions on Russia. It is also the result of low demand in countries like France and Italy, which have not implemented the necessary structural reforms to find a sustainable growth model and are consequently importing fewer German goods and services.

The crux of the problem is indigenous to Germany though; Germany has long been reliant on exports for growth, with a high national savings rate and low levels of domestic investment. This has been evident in Germany's persistent current account surplus over the past decade. As long as the peripheral countries in the Eurozone must undergo massive adjustments without Germany adjusting alongside them — namely by boosting domestic investment — we expect German economic growth to remain sluggish. Unfortunately, the German government is unlikely to change its approach to growth in Germany or in the greater Eurozone over the forecast period. As a result, we expect continued economic weakness, low inflation and fiscal consolidation across the region.

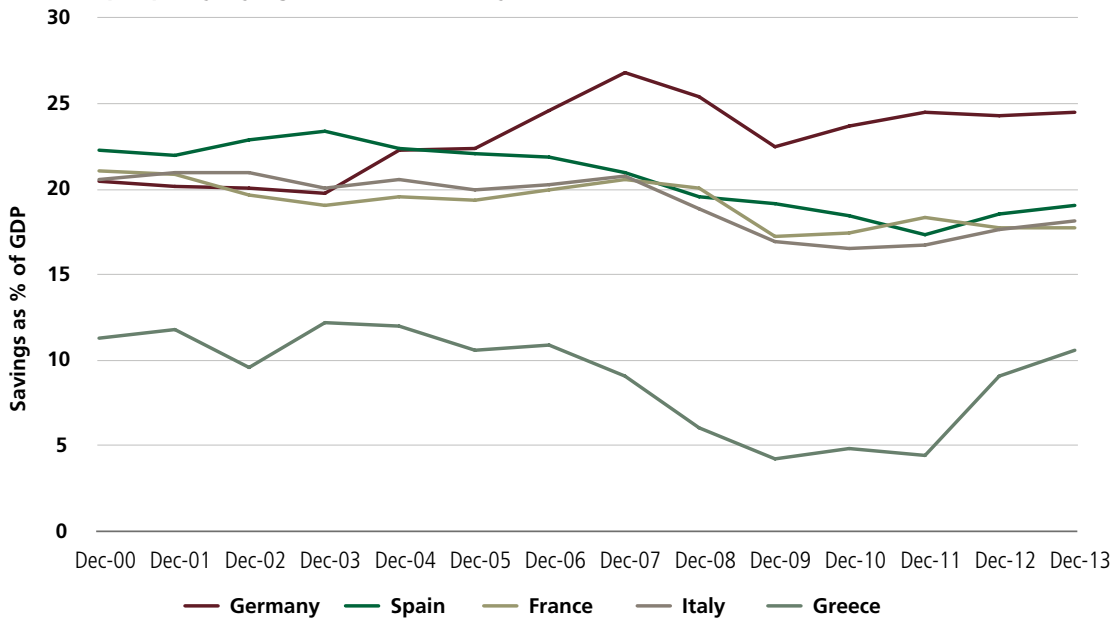
The ECB has committed to expanding its balance sheet by around 1 billion euros over the next two years. It aims to do this by purchasing covered bonds and asset-backed securities. In our opinion, not enough of these instruments exist for the ECB to hit its balance sheet target, and consequently the central bank will

In our view, Eurozone policymakers only push through difficult reforms when their feet are held to the fire, so the window of opportunity may close before any meaningful reforms take place.

also purchase corporate loans. We do not expect the ECB to purchase sovereign debt, as Germany is staunchly opposed to it and sovereign bond yields across the Eurozone are low relative to fundamentals.

Credit easing by the ECB will buy policymakers time to implement difficult structural reforms. In our view, Eurozone policymakers only push through difficult reforms when their feet are held to the fire, so the window of opportunity may close before any meaningful reforms take place. Still, the ECB's measures will likely cause the euro to depreciate relative to the US dollar, which will improve the region's external competitiveness

The Eurozone periphery trying to follow Germany's lead



Source: Bloomberg, September 30, 2014

Throughout the crisis, the Eurozone has seen public debt to GDP increase despite fiscal retrenchment across the region. This is particularly a problem in the periphery of the region. Low growth and low inflation will make it even more difficult for Eurozone countries to stabilize their massive public debt burdens. Beyond our five-year forecast period, we expect there will be a debt conference in the Eurozone in which the net present value of public debt for Greece, Ireland, Portugal, Italy, Spain and France will be written down, most likely through a rescheduling of debt. This is not currently priced into the markets, but could be a hugely disruptive event.

UK: Economic rebalancing tabled as robust growth continues

The UK has outperformed the Eurozone in recent years, aided by its separate central bank, the Bank of England, which has conducted a significant amount of quantitative easing to reflate asset prices since the onset of the crisis. We expect the UK economy to grow by 3.1% in 2014, 2.8% in 2015 and an average of 2.5% in 2016–18.

The recovery in the UK has been largely consumer-led, with robust retail sales figures and a frothy property market. In the immediate aftermath of the global financial crisis, Westminster talked of rebalancing the economy away from a growth model reliant on domestic demand and financial services towards one based on manufacturing and exports. Very little progress on this major rebalancing has occurred, and the chances of it happening dwindle the closer we get to the May 2015 general election.

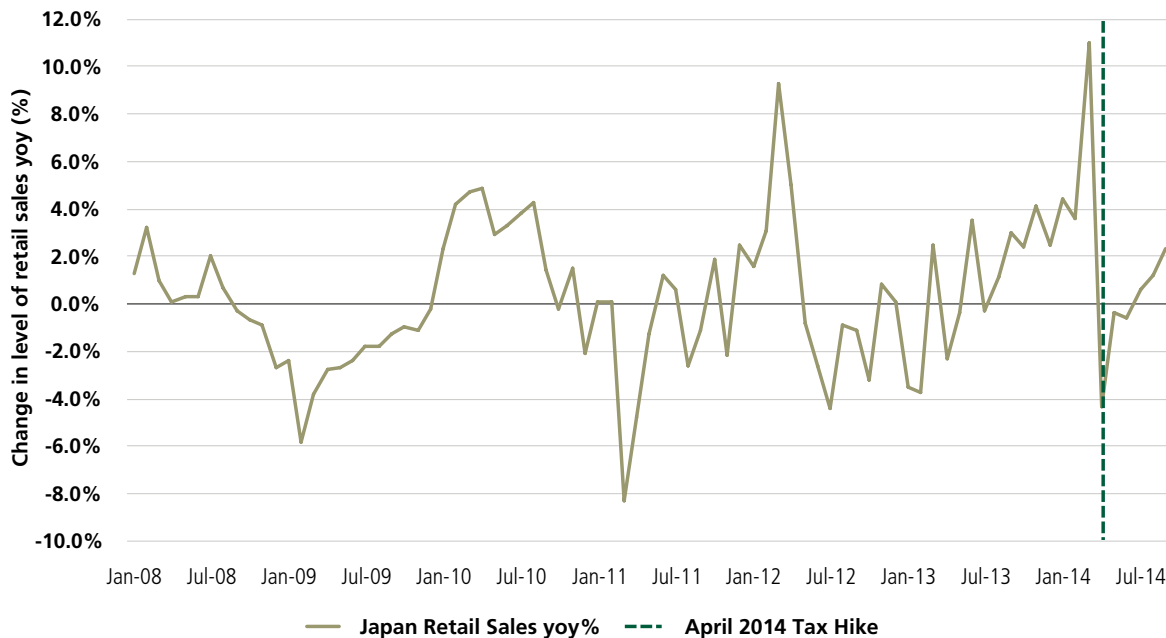
An easy monetary policy by the Bank of England will cause the pound sterling to depreciate relative to the US dollar, which should support export growth. Having missed its inflation target of 2% in the third quarter of 2014, we expect the Bank of England to keep its policy rate at 0.5% until after the general election. When interest rates do rise in late 2015, it will likely restrain private consumption — particularly as a number of mortgage holders have difficulty servicing their reset mortgages.

Japan: Abenomics severely tested

In Japan, Abenomics — Prime Minister Abe's three-pronged policy approach to increasing the country's potential growth rate — continues to be severely tested. The platform's first two arrows, fiscal and monetary stimulus, have already been implemented and have been fairly successful in generating some inflation and growth. But in our opinion, the third arrow of structural reform is the most critical. We expect growth in Japan to be muted over the forecast period, reaching 0.3% this year, 0.8% in 2015 and an average of 1% in 2016–18.

Prime Minister Abe hiked the consumption tax rate from 5% to 8% in April 2014². Consumption subsequently declined more than expected, leading the economy to fall into a recession (GDP contracted by 1.9% quarter-on-quarter in the second quarter and by 0.4% in the third quarter). Mr. Abe was under significant pressure to raise the tax rate in order to collect more tax revenues and try to stabilize Japan's staggering public debt burden. The tax rise has had a much longer-lasting impact on Japanese real incomes than the government expected. Retail sales growth has been sluggish and consumer confidence has been low since the third quarter of 2013. Mr. Abe called a snap election for December 14th to gain a mandate to delay the next consumption tax hike (to 10%) from October 2015 to April 2017 at the earliest.

Japanese retail sales dropped after April 2014 consumption tax hike



Source: Bloomberg, September 30, 2014

In the third quarter of 2014, the BoJ announced further monetary easing, which we expect will cause the yen to continue to depreciate. Unfortunately a weaker yen has not translated into greater net export growth. This is partly because many Japanese companies have moved their production offshore and so are not benefitting from a weaker yen. It is also likely a result of a loss of competitiveness of Japanese firms globally.

While a weaker yen could foster net export growth at the margins over the forecast period, it is also likely to cause a drag on the Japanese economy as offshore companies delay the repatriation of profits.

With the first two arrows of Abenomics stalling, the jury is still out on the third arrow: structural reform. Last June, the government announced a detailed list of structural reforms, without much in the way of implementation plans or deadlines. We anticipate the government will mainly rely on cutting the corporate tax rate from around 35% to just below 30% to entice businesses back to Japan. However, we do not expect this tax cut to be a game-changer in boosting Japan's potential growth.

² <http://www.bloomberg.com/news/2013-10-01/abe-proceeds-with-japan-s-first-sales-tax-increase-since-1997.html>

Without substantive structural reform, it's tough to see Japan finding sustainable growth over the next few years.

One key reform Mr Abe should focus on is increasing female participation in the labor force. The current rate is very low and given Japan's shrinking population, improving female employment rates would create some much needed demand in the Japanese economy.

In the absence of significant structural reform, we expect Japan to pursue a beggar-thy-neighbor strategy, with the government providing fiscal stimulus and the central bank continuing to ease as the yen depreciates. This is not a sustainable growth model, and we expect Japan's economy to remain sluggish and its debt burden to continue to rise in 2014–18.

China: Good short-term growth but more focus needed on consumption and productivity

We expect better news in Asia Pacific will come from China in 2015. Overall, we are fairly sanguine about Chinese growth in the short term, expecting GDP growth of 7.1% for 2014, 6.9% for 2015, and an average of 6.4% in 2016–2018.

The Chinese growth model over the past decade has been reliant on credit and investment. Private debt to GDP has risen significantly since the beginning of the global financial crisis, from 117% in 2008 to 192% in 2014³. The stock of private debt is worrisome, but the flow of private debt is an even greater concern; it has accumulated rapidly despite robust GDP growth over the past few years. The current Chinese leadership is committed to shifting the growth model towards consumption and higher productivity.

Two areas to watch closely in the Chinese economy are: the property market and the banking sector, as local government financing vehicles have many non-performing loans (NPLs) on their books. The government is trying to deflate the property market and coax the banks to write down some of their NPLs. The Chinese government has more tools to achieve this than most governments; macroprudential regulations can be used to cool off the property market, the government owns all the banks, and the ministry of finance has not levered up significantly over the past few years and consequently has a relatively clean balance sheet.

Given that China is the largest economy in the world, a growth slowdown will draw significantly from global demand and will create a headwind for the global outlook.

The Chinese government aims to drive employment rather than profits. As a result, it is likely the government will use these various tools to maintain growth of around 7% in 2015.

As long as the Chinese leadership is intent on maintaining such robust growth, it will have to prop up investment growth, and consequently will not be guiding the economic growth model towards consumption and productivity improvements. We saw the limits of Beijing's tolerance for an economic slowdown in November 2014 when the PBOC announced monetary easing, which will, among other things, help prop up the property market. This is an unsustainable growth model, and we expect Chinese growth to slow towards 6% at the end of our forecast period.

³ Source: Bloomberg. As at December 2014.

Given that China is the largest economy in the world, a slowdown to 6% over the next five years will draw significantly from global demand and will create a headwind for the global outlook, particularly for countries reliant on commodity exports to China for growth.

We expect that the PBOC will engage in targeted monetary easing, particularly in the event of city or regional government or property owner defaults. While the renminbi is not a free-floating currency, this could translate into a depreciation of the currency. China, like many other economies, may therefore also engage in a beggar-thy-neighbor growth strategy over the forecast period.

Emerging Markets: A mixed bag

When the Fed announced it would start to taper its asset purchases in 2013, it caused a “taper tantrum” as investors pulled capital out of the Emerging Markets. Once the US raises rates in 2016, followed eventually by the UK and later still the Eurozone, we expect capital will flow out of Emerging Markets, but we do not expect a repeat of the crisis we witnessed in the 1990s.

Countries with large external financing needs will feel the most pressure. Most Emerging Markets have stronger current account positions, larger currency reserves and less public debt than they did in the 1990s, so are better placed to weather any kind of monetary tightening by the Fed and other central banks.

Russia is currently an area of particular focus for investors. We expect the Russian economy to contract by 0.5% in 2014 and 0.6% in 2015 and grow by an average of 2.4% in 2016–18. Russian businesses are facing a credit crunch as a result of sanctions imposed by the US and Europe. Businesses are having difficulty rolling over external debt, and there is a chance that President Putin will allow them to default on this debt to leave the West with the bill. More likely, we expect the Russian government will step in and buy corporate debt. While the sanctions have had some impact on the Russian economy, the falling price of oil has had a much larger impact. We expect oil prices to remain low in the first half of the forecast period. Tensions between Russia and the West will remain over the next five years, but we think an all-out conflict will be avoided given the West and Russia’s shared reliance on oil and gas.

Brazil faces significant macroeconomic challenges going forward. Dilma Rousseff won re-election in Brazil in October 2014, but by a very small margin, making it more challenging for her government to implement badly needed structural reforms. We expect Brazil to roughly stagnate in 2014 and grow by 1% in 2015 and by an average of 3.3% in 2016–18.

A notable bright light among Emerging Markets is India. India has run counter to the global business cycle, with interest rates now higher than in 2008 and a currency that is appreciating relative to the US dollar. India is on the brink of a significant cyclical upswing. Commercial light vehicle sales, a good indicator of Indian production, have been soaring over the past six months. The coal production index has improved in 2014 as well. India’s current account balance has also improved significantly as gold imports have diminished and the price of oil has fallen. We expect inflation to remain under control through the first half of the forecast period and believe the rupee is undervalued on a real effective exchange rate basis. India also stands to benefit from new Prime Minister Narendra Modi’s focus on eradicating corruption and improving transparency. We expect India to grow by 5.5% in 2014, 6% in 2015 and an average of 6.3% in 2016–18.

GLOBAL FIXED INCOME



GDP Growth

We think global growth will be positive with the US and China in the lead.



Q2/Q3

The Fed will begin raising rates when it believes the recovery is "self-sustaining," likely sometime in the second or third quarter.



US

Other countries may not be ready to raise rates, so the interest rate differential would cause the US dollar to strengthen against all currencies.



REFORM

It will be important for Japan, Europe and emerging countries in Latin America to make progress with much-needed structural reforms in 2015.

Opportunities to be found in fixed income in 2015

Tom Goggins, Senior Portfolio Manager, Global Multi-sector Fixed Income

In 2015, the US will likely continue to be the developed market outlier from a global growth standpoint, growing in a range of 2.5–3%. To reach that level, the US will need to continue to add jobs in the range of 200,000+ per month. We'll be looking to hear words from the Federal Reserve (Fed) like "self-sustaining" to describe the economic recovery. That will indicate the economy is back on a solid track and can sustain the level of growth with no headwinds on the horizon.

At that point we also expect to see the Fed embark on a policy of normalizing rates. Other countries, especially Europe, Japan and some other developed markets will not be ready to raise rates, so the interest rate differential between the US and those countries will likely cause the US dollar to move higher. If US economic data continues to improve, we expect rates will move higher on the 10-year to the range of 2.6–3%.

Economic growth in Asian countries has slowed down to a range of 3–7%, which still looks decent. China will continue to be the regional leader with GDP growth closer to 7%. As China transitions from an export- to a consumer-based economy, it will grow at a slower rate than in years past. But we expect this rate to be more sustainable because it will be based on domestic, rather than foreign demand.

Structural reform progress needed to regain market confidence

To regain the confidence of investors, it will be important for Japan, Europe and emerging countries in Latin America to make progress with needed structural reforms in 2015. Within Japan, we'll be looking to see if progress is made with the third arrow of Abenomics — a reform program aimed at making structural improvements to the Japanese economy.

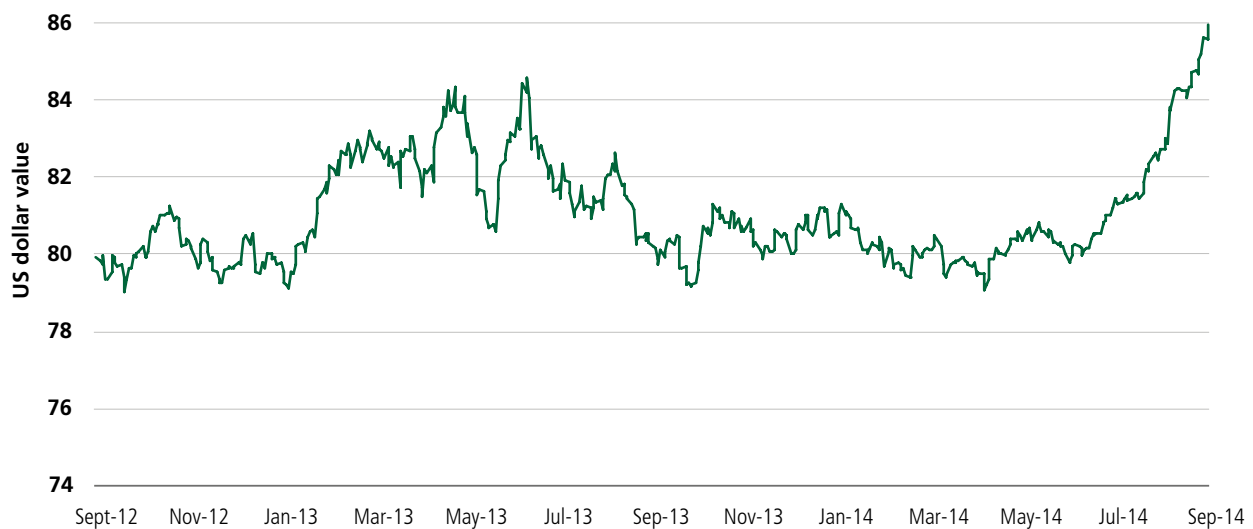
Europe is still a work in progress, and we think its economic downturn is in the midst of bottoming out. The region is heading towards a solution; however, it will likely take a few more years to get the governments of member countries on the same page to implement structural reform and the European Central Bank may need to implement quantitative easing efforts similar to the Fed's in the US to help the region spur necessary growth and improve inflation expectations.

We think we are in the midst of a multi-year uptrend for the US dollar; it will be important for investors in foreign markets to understand the impact that a rising US dollar will have on their investments.

Currencies: Multi-year uptrend for the US dollar vs. all global currencies

We think we are in the midst of a multi-year uptrend for the US dollar. It will be important for investors in foreign markets to understand the impact that a rising US dollar will have on their investments.

US dollar in the midst of a multi-year upward trend



Source: Bloomberg, September 30, 2014.

We expect the US dollar to strengthen against most commodity currencies, including the dollars of Australia, New Zealand and Canada. Developed market currencies, including the euro, Swiss franc and yen will also weaken versus the US dollar. Emerging Markets with current account deficits, such as India, South Africa, Indonesia and Turkey, could see their respective currencies weaken as they are more reliant on foreign investment to fund their liabilities.

Fundamentally stronger Asian currencies might also weaken versus the US dollar but will likely still outperform relative to the other currencies. In Latin America, the Brazilian real will likely weaken slightly more than Mexico's peso, but Brazil's interest rate differential will insulate its currency to some degree against the impact of rising rates in the US.

We expect the Canadian dollar to weaken against the US dollar, as well as Asian and Latin American currencies, but think it could do better than some other commodity currencies (including the Australian and New Zealand dollar) and possibly better than the euro, yen and Swiss franc. We expect the Canadian dollar will trade in the range of C\$0.80–0.85 in 2015.

High-yield debt looking attractive from a relative value standpoint

We expect the yield curve will steepen when rates start to rise in mid- to late 2015. However, our strategy is to position our portfolios in order to maximize the potential to make money whether rates go up or down.

We're not expecting to see much price appreciation in high-yield securities in 2015; we expect the coming year will be about clipping the coupon. US high-yield companies have strengthened their balance sheets, default rates should remain low, and we expect the total return for high-yield securities will likely be around 5%, which will look attractive from a relative value standpoint globally.

Playing defense

Investing in high-yield corporate bonds in 2015 will be about playing defense — avoiding out of favor industries, companies or industries with too much leverage and poorly managed companies. We have reduced our exposure to cyclical sectors in favor of defensive sectors such as healthcare and utilities, and have moved out of CCC-rated securities, using some of those proceeds to increase our allocation into bank loans.

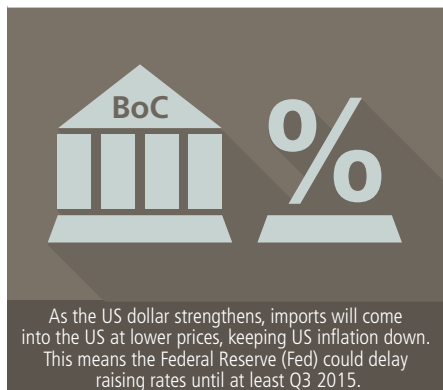
We will continue to focus on corporate credits, primarily in the US, but we will also look to Emerging Markets. Within credit, we see opportunities in investment grade, below investment grade, bank loans, convertibles, and preferred debt in the US.

Emerging Market debt – focusing on fundamentally stronger countries

In terms of Emerging Market debt, we are looking to invest in fundamentally stronger countries. It will be important to avoid overreaching for yield and we'll continue to avoid investing in bonds from countries with weak fundamentals, bad liquidity, geopolitical risks or a history of treating bond holders poorly (e.g., Argentina, Venezuela, Russia and Ukraine). We will also continue to avoid countries that need to fund their current account deficits in US dollars (e.g., South Africa and Turkey) because these countries will be the most vulnerable to rising rates in the US.

The Philippines is an example of an Emerging Market that has the fundamentals we're looking for — an improving credit story, a consistently improving debt to GDP ratio, good fiscal positioning, a current account surplus, a strong level of currency reserves and a high level of economic growth. The Philippines has already seen upgrades in its credit ratings, and we think that will continue to be the case going forward.

NORTH AMERICAN FIXED INCOME



Yield curve to steepen with US and Canadian rate rise in late 2015

Hosen Marjaee, Senior Portfolio Manager, Canadian Fixed Income

We expect continued growth in North America in 2015, with the US economy expanding around 3% and Canada's following suit at around 2.3–2.5%. We are expecting inflation will stay tame at just below 2% for both countries.

US dollar strengthens as investors flock to currency safe haven

The US dollar strengthened in the second half of 2014 against all major currencies, mainly due to ongoing issues in countries around the world. The economy in Europe is weak, China is growing but at a slower pace than previously, and Japan is having difficulty trying to reignite its economy through Abenomics. These challenges — along with geopolitical events such as the continued standoff between Ukraine and Russia, issues in the Middle East and recent protests in Hong Kong — are weighing on investors' minds. This is prompting many to avoid these hot spots and move their investments to the US, resulting in a strengthening US dollar.

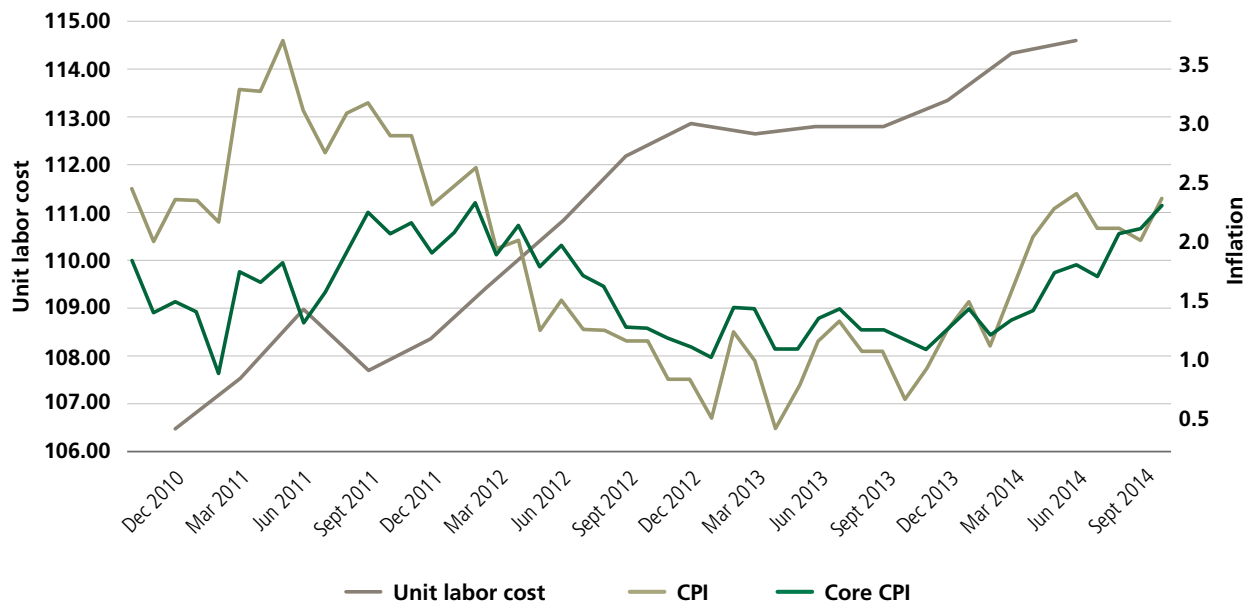
Strengthening US dollar to keep inflation down, possibly delaying Fed rate hike until late 2015

As investors continue to flock to the US because of its relatively promising economic outlook and “safe haven” status, the US dollar is likely to continue to strengthen in 2015. That means imports will come into the country at lower prices, keeping inflation down and supporting our expectation that the Fed will start raising rates by a 25bps hike in the third quarter of 2015. Following that, we think it will likely raise rates by another 25 bps before the end of the year.

Looking for signs of wage growth to increase consumer spending

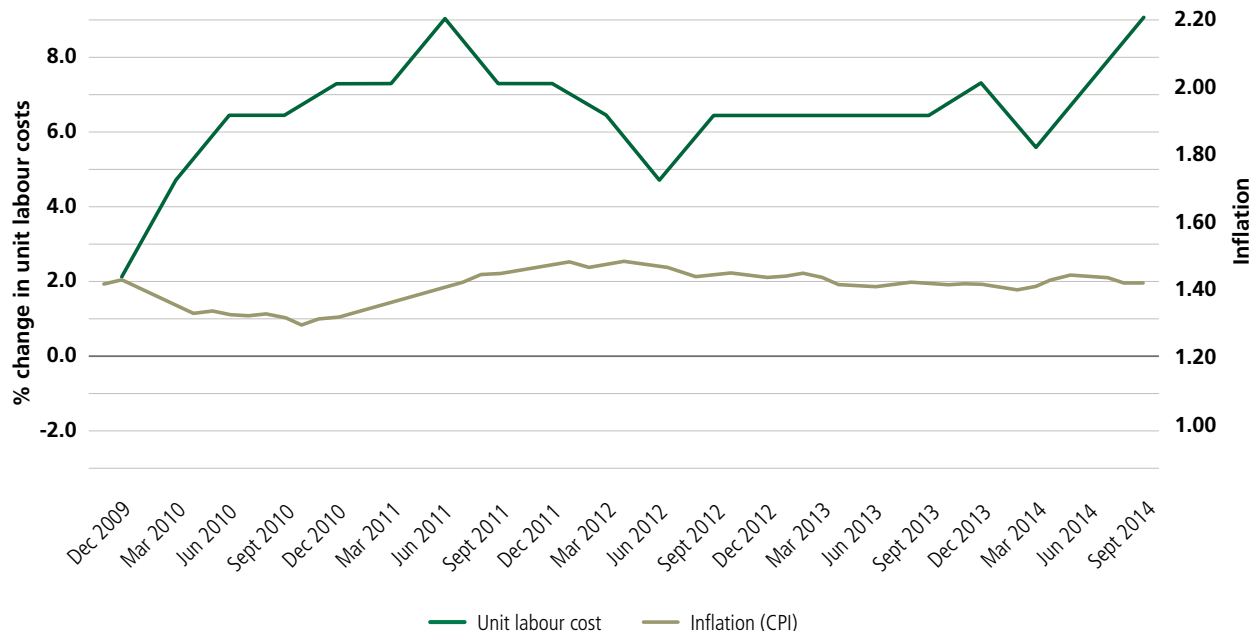
One risk to North America’s economic rebound is the quality of jobs being created. While the US will likely continue to add 200,000 jobs per month — keeping the unemployment rate just below 6% — the jobs likely won’t be as well-paying as in the past. So far, we’ve seen very little wage growth in the US or Canada. If wages start going up, it will be a good sign that the consumer will be in better shape financially and will be able to spend a bit more money.

Canada: Wage growth not keeping pace with inflation



Source: Bloomberg, October 31, 2014.

US: Wage growth and inflation flat since start of recovery



Source: Bloomberg, November 17, 2014.

US: Opportunities as yield curve steepens; corporate bonds still look favorable

We see a number of fixed income opportunities once the Fed starts to raise rates. At that time, the front end of the yield curve will tend to move up a lot faster than the long end. That could provide an opportunity to redeploy assets from the front end to the long end, while maintaining a short duration. We expect the rates on the 10-year US bond to increase by 50 bps next year.

We still like corporate bond yields. The spread for US corporates is around 450 bps against US government bonds. As long as spreads stay in the mid- to high-400s, we think they offer good value and are a good place to deploy new money. If spreads fall below 400, we'll become more cautious.

Canada to lag US in raising rates, maintaining a lower Canadian dollar

Canada is expected to lag the US in raising rates because its economy is weaker. If the Bank of Canada raises rates before or on pace with the Fed, it will increase the interest rate differential between the two countries. This is likely to cause the Canadian dollar to strengthen, which will weaken exports and manufacturing. We expect Canada will only raise rates once or twice next year, after the US does.

We don't see the Canadian dollar strengthening much in 2015 from its current levels. We expect it will trade in the range of 1.17 to 1.10 versus its US counterpart in 2015, likely trading in the lower end of the range. As the Canadian dollar weakens against the US dollar and some other currencies, importing goods will become more expensive, which could create some inflation.

Canada is expected to lag the US in raising rates because its economy is weaker. If the Bank of Canada raises rates before or on pace with the US, it will increase the interest rate differential between the two countries.

The impact of a decelerating Chinese economy and lower oil prices

Any continued slowdown in the pace of economic growth in China is likely to impact Canada in terms of lower demand for commodities. We are slightly concerned about the impact of lower oil and energy prices on the energy producing provinces. Alberta, Saskatchewan and BC are in great shape financially, with a low debt to GDP ratio, but as oil prices go down, these provinces will collect less royalties.

Canada: Opportunities in investment grade corporate and provincial bonds from Ontario and Quebec

In a rising rate environment, we expect the rates on the 10-year Canadian bond to go to 2.50% in 2015, which will be an opportunity to make money on a longer duration strategy.

In Canada, our investments in corporate debt are mostly in the investment grade category. The high-yield market in Canada is small and not very liquid, so we prefer to invest in the US high-yield market. The spread on Canadian investment grade bonds over Government of Canada bonds is fairly wide at 115 to 120 bps. As long as the Canadian economy is growing and companies continue to make money, the risk of default on investment grade corporates is present but not amplified.

Within Canadian investment grade debt, we think there is still opportunity to take advantage of wider spreads on some provincial bonds, specifically Ontario and Quebec, which yield more than 85 bps over Government of Canada bonds. As the Canadian economy continues to grow at a rate of 2.3–2.5%, revenues for provincial governments will grow and their budget deficits will fall. Provincial governments are also working on balancing their budgets, which will have a positive impact on provincial bonds.

Possible short-term market reaction to Canadian federal election in 2015

There will be a Canadian federal election in 2015. The current Conservative government is committed to balancing the budget and is on track to create a budget surplus, some of which is being used to help Canadians reduce taxes. As the election approaches, this will likely continue. If taxes fall, Canadians will have more money to spend and there could be an increase in consumer spending. If a non-Conservative government wins the election, the market might react as it tries to determine the policies the new government will put in place.

JAPANESE FIXED INCOME



2015: A year of countervailing forces?

Takeshi Kanamaru, Portfolio Manager, Japanese Fixed Income Investment

Expanded Quantitative Easing boosts markets

As the fourth quarter of 2014 dawned, Japan's fixed income market saw two significant surprises. First, the Bank of Japan (BoJ) decided to significantly expand its Quantitative Easing (QE) program, pledging to:

- Expand the monetary base by 80 trillion yen per annum (an additional 10-20 trillion yen per annum).
- Increase Japanese Government Bond (JGB) purchases to 80 trillion yen per annum (an additional 30 trillion yen per annum).
- Extend the maximum maturity of JGB purchases to 10 years.
- Increase exchange traded fund (ETF) and Japanese real estate investment trust (J-REIT) purchases to 3 trillion yen and 90 billion yen per annum, respectively (each to triple).

Immediate market reaction was similar to that which followed the initial QE launch under BoJ Governor Haruhiko Kuroda in the spring of 2013, with the yen depreciating, stock prices climbing and JGB yields falling alongside the yield curve flattening.

Election as a referendum on Abenomics and tax hike delay

The second surprise came close on the heels of the first, with Prime Minister Shinzo Abe announcing his intention to suspend a second consumption tax hike planned for 2015, dissolve parliament and hold a snap election — an unexpected move as the market widely believed that Abe and the BoJ had essentially reached a policy accord under which the BoJ expanded QE in return for Abe's pledge to go ahead with the second tax hike in October 2015. The election was essentially a referendum on Abenomics and the postponement of the second tax hike.

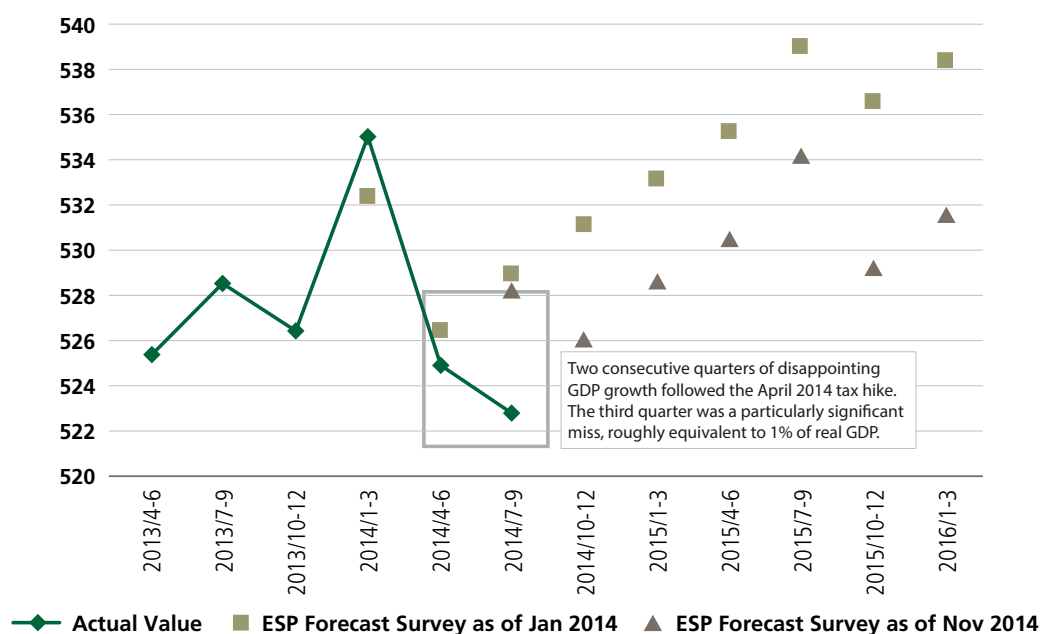
QE and tax hike are countervailing forces

As illustrated by Japan's disappointing second- and third-quarter GDP growth of -7.1% and -1.6% respectively, the 3% consumption tax hike implemented in April 2014 had a severe impact and forced policymakers in Tokyo to lower their economic projections. While the BoJ decision to expand QE is likely positive for the wider economy, the problem is that the two policies clash in essentially the same way as putting one foot on the gas pedal (expanding QE) and the other on the brake (hiking the tax). Indeed, even if the second tax hike is postponed to April 2017 from October 2015, it is still likely to come as a blow to the economy and at minimum would likely require another round of QE support from the BoJ.

Downward pressure on JGB yields to continue

Against this backdrop, JGB yields are likely to continue to see downward pressure on the back of massive JGB purchasing. The BoJ decided at its end of October board meeting to not only increase the quantity of buying (i.e., larger amounts) but also the quality (i.e., longer maturities). As for the timing of a potential QE exit, we can only speculate that this has been delayed due to the sharper-than-expected economic downturn following the April 2014 tax hike, suggesting that current accommodative policy will continue over the longer term.


Real GDP misses forecast estimate after April 2014 consumption tax hike



Note: *ESP Forecast Survey of professional forecasters in Japan.


Source: Japan Center for Economic Research, Manulife Asset Management

ASIAN FIXED INCOME



+7%
GDP Growth

Chinese GDP expected to continue to grow at around 7% in 2015.



Further economic stimulus in China is possible in 2015 if economic growth is below expectations.



ASIAN CORPORATE BOND

We will continue to focus on corporate bonds in Asia, favoring US dollar-denominated bond.



US

We are keenly aware that higher interest rates in the US in 2015 remain a clear possibility

Continued focus on credit

Endre Pedersen, Senior Managing Director, Asian Fixed Income

Asian economies laying foundations for growth in 2015

Asian fixed income markets have held up relatively well during 2014 in comparison to developed markets, with benchmark yields in both the US and Europe remaining low as the US Federal Reserve (the Fed) and European Central Bank (ECB) continue to pursue accommodative monetary policy. Year-to-date, local-currency Asian bonds have returned 5.7%, while hard-currency (ie, US-dollar-denominated) Asian bonds have returned 8.1%⁴.

⁴ HSBC Asia Local Bond Index, JP Morgan Asia Credit Index; Bloomberg, 31 October 2014.

The US economy continues to stand out in comparison to Europe, with GDP forecast rising to 2.5–3.0% in 2015. Despite more robust growth and unemployment falling below 6.0%, the US Federal Reserve (Fed) is unlikely to raise interest rates quickly. We expect a hike in rates during the second half of 2015, in conjunction with rising US Treasury yields. The Eurozone outlook is more challenging; GDP is expected to rise to 1.7% in 2015, up from 1.0% growth in 2014, according to European Commission forecasts, but recovery in the region remains somewhat fragile.⁵

At the same time, the Chinese economy is expected to continue its transition to a more sustainable growth path and avoid a significant slowdown, with the GDP forecast remaining around 7.0% for 2015. Additional targeted economic stimulus is possible in 2015 if economic growth falls short of expectations. Meanwhile, the Indonesian economy should remain buoyant as a result of domestic consumption growth and a growing middle class. President Joko Widodo's plans to streamline his government and the efficiency of state-owned enterprises are also positive. In addition, India is expected to release a new monetary policy framework at the end of 2014 or early 2015. Any changes to monetary policy and inflation targets are likely to influence the direction of domestic interest rates going into the new year.

Potential headwinds

We are keenly aware that the likelihood of higher US interest rates in 2015 remains a clear possibility. In particular, if we were to experience a rapid rise in interest rates and concurrent higher US Treasury yields, we could witness outflow from Asian bond markets, though this would not likely be on the same scale as that witnessed in the “taper tantrum” of 2013. Meanwhile, continued slowing of the Chinese economy would likely have a spillover effect on other Asian economies and could negatively impact Asian corporates — a situation that would further highlight the importance of careful credit analysis when investing in Asian markets. Finally, geopolitical events in Ukraine and the Middle East and border disputes within Asia remain isolated risks but nevertheless cannot be ignored.

Continued slowing of the Chinese economy would likely have a spillover effect on other Asian economies and could negatively impact Asian corporates.

Opportunities in corporate bonds for investors seeking to limit interest rate risk

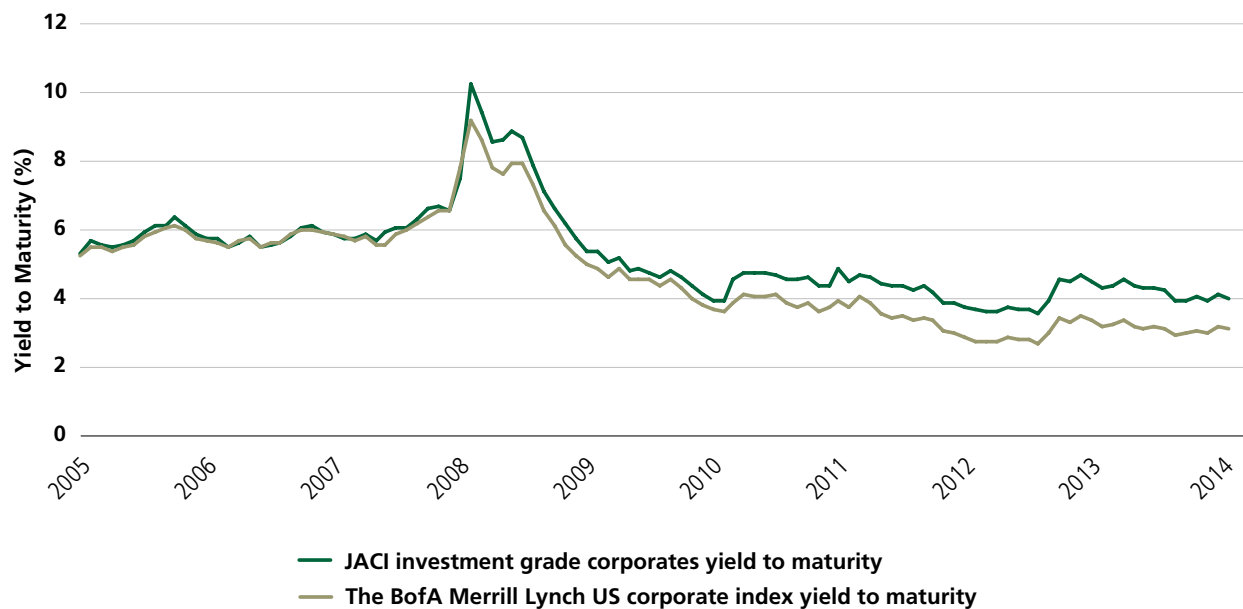
We continue to believe that the key to generating positive investment returns in Asian bond markets in 2015 is to continue to focus on credit to position appropriately for a potential rise in interest rates. In the year ahead, we believe investors should consider maintaining a relatively short interest rate duration, overweighting carefully selected credit issuances which offer higher spreads — including sub-investment grade or high-yield credit — and favoring hard currency bonds.

Maintaining a short interest rate duration is one reason corporate credit may offer particular opportunities in the year ahead, as sovereign bonds tend to be of longer duration and are thus more sensitive to interest rate movement. Selective exposure is key and we are positive on selective Chinese property and Indonesian corporates. Offshore — CNH-denominated or “dim sum” — corporate bonds also offer relatively high yield and low volatility, in addition to portfolio diversification.

⁵ European Central Bank, June 2014.

Asian corporate credit also delivers higher-than-average yields when compared to sovereigns and developed world credit with equivalent ratings — investment grade corporate bonds in Asia currently deliver 4.0% yield versus 3.1% for investment grade corporate bonds in the US.⁶ This is because Asian bonds generally carry an “Asia premium” to offset investor perception of higher risk in Asian markets.

Asian corporate bonds carry an “Asia premium” over US corporate bonds



Source: JPMorgan Asia Credit Index, Bank of America Merrill Lynch US Corporate Index, Bloomberg, October 31, 2014.

Within interest rate markets, Australian 10-year government bonds currently offer the highest AAA-rated yield⁷. We also favor Indonesian government bonds as diversification plays that also offer attractive yield.

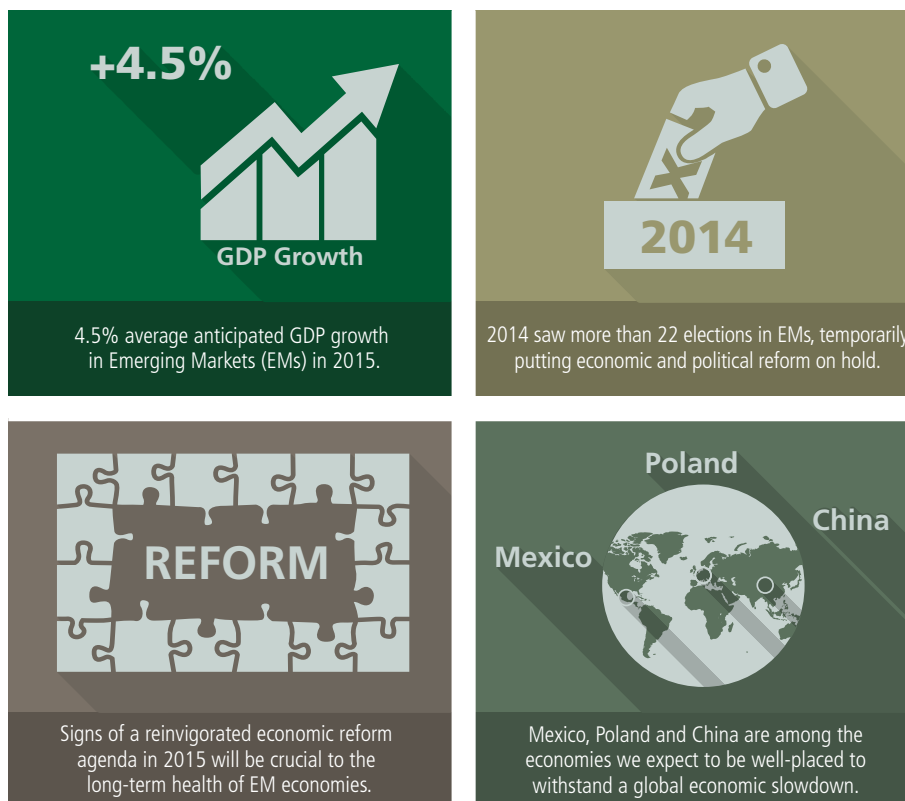
Asian currencies to perform strongly relative to other developed and emerging market currencies

In currencies, while we expect the US dollar to remain strong, we also see Asian currencies performing strongly relative to other developed and Emerging Market currencies. We continue to believe in a moderate appreciation of the renminbi in the mid to long term and as such remain constructive on renminbi-denominated bond markets. With US Treasuries expected to rise, we are more cautious about safe haven markets such as Hong Kong, Singapore and Taiwan and are positive on Indonesia, where we see potential for good returns.

⁶ JP Morgan Asia Credit Index and Bank of America Merrill Lynch US Corporate Index; Bloomberg, October 31, 2014.

⁷ Bloomberg, October 31, 2014

EMERGING MARKET DEBT



Reigniting the embers of economic reform

Paolo Valle, Senior Portfolio Manager, Manulife Asset Management

Roberto Sanchez – Dahl, Senior Portfolio Manager, Manulife Asset Management

Unprecedented number of elections sets stage for progress in 2015

It's rare in the investment world to be able to describe an event or series of events as truly "unprecedented" but in many ways that is the only way to describe the electoral change we have seen in Emerging Markets in the past year. 2014 saw in excess of 22 presidential and parliamentary elections in Emerging Markets including India, Indonesia, Turkey, South Africa and Brazil.

This heavy electoral calendar left many of these economies in a state of political paralysis with incumbent governments unable to pursue economic structural reforms until the elections had passed. Now that the dust is settling and governments have the necessary mandates to pursue reforms, we believe that these countries will be reigniting the embers of economic and structural reforms.

However, having navigated the heavy political calendar, it is not all plain sailing for Emerging Markets. With global growth looking less assured, concerns are rising about the impact of weakness in the global economy on Emerging Markets.

Key to gauging the outlook for Emerging Markets will be the speed and vigor with which they are able to reignite the reform touchpaper.

Structural reform more important than ever

Two key issues — the political drive to continue reforms and the global economic outlook — are more intertwined than many realize. The pace of economic structural reform is an important bellwether for how well individual Emerging Markets will withstand global economic weakness, both now and in the future.

Economies that have done their homework over the years implementing structural reforms are likely to have a greater range of policy tools at their disposal to respond to a global economic slowdown. Markets that have their finances in order — such as Mexico, Colombia and Peru — will be better able to increase their spending and cut taxes if necessary. In the case of Eastern Europe, Poland should be able to show the progress they have made in economic reforms over the years. In Asia, we expect countries like the Philippines, Singapore and China are likely to have greater flexibility to implement policy response. Overall, we anticipate growth for next year in Emerging Market economies to average around 4.5%.

Particular opportunities in Mexico and Poland

One of the countries in which we see particular opportunity is Mexico. It has already approved and in some instances implemented relevant structural reforms to its pension system among others, and more recently to its telecommunications and energy sectors. They have a healthy financial system and the economy is particularly open to private sector and foreign investment. We also believe that its geographical proximity to and economic links with the USA are likely to cushion Mexico to some degree in the event of a global economic slowdown. We think Poland is another country to watch. It became a member of the European Union in 2004 and has implemented key structural reforms and opened its economy to foreign direct investment. Meanwhile, its strong economic and commercial links with Germany should also support continued economic growth.

Much has been made over the last year about the potential for economic weakness in China. In spite of many market watchers' concerns about a potential hard landing, we think that the country's economic and financial situation is manageable in the medium term. We believe China has enough financial resources and fiscal flexibility to implement an effective policy response to support the economy. China is in the process of rebalancing its traditional economic model towards growth in domestic demand from households and away from export-driven growth, which should provide some degree of protection from the worst effects of any global slowdown.

In short, the global economy seems to have some challenges ahead and an upward growth trajectory is by no means assured. 2015 is not a year to access the market indiscriminately and simply get beta. It will be about discerning the Emerging Markets that are likely to be the most resilient in the current economic environment and avoiding weaker markets that may struggle to push through the longer-term reforms needed to put their economies on a surer footing.

GLOBAL EQUITIES



2015 to provide clarity on Quantitative Easing's ability to boost the global economy

Wendell Perkins, Senior Portfolio Manager, International Equities

The outlook for global growth in 2015 is uneven and subject to further downgrade as many of the world's largest economies continue to struggle. We are likely to see disappointing economic growth in Japan, Brazil, China and the Eurozone.

When one looks at expectations for 2015, it seems like we will have another subpar year of growth in the Eurozone, probably around 1%, which is below the consensus expectation of 1.3%. At the end of 2014, the outlook for economic activity and earnings in the region was weak — Italy fell back into a recession, France clung to positive growth, and Germany's economy had completely stalled.

While we will likely finish 2014 with positive earnings per share (EPS) growth, market expectations of double-digit earnings growth in 2015 seem unrealistic given recent subpar economic activity. From our perspective, earnings growth next year in Europe will, most likely, be a repeat of 2014 in terms of higher single-digit EPS growth, which will probably disappoint the markets.

In Japan, economic momentum appears to have peaked, weighed down by the negative impact of the consumption tax hike. Real GDP growth estimates for 2015 have been downgraded sharply in recent weeks from 1.3% to only 1.0%. The devaluation of the yen hasn't been as stimulative as hoped and the pace of reform, a key component of Abenomics, has been disappointing. Earnings revisions for 2015 have also turned negative as expectations fell 12% during the back half of 2014, and we are likely to see further downgrades as the economy weakens.

One of the overarching themes for 2015 will be central banks' ability to keep investors buying equities despite multiple weakness points that could hinder economic growth globally: the Eurozone, Japan, China and Latin America are weakening, and the periphery of Europe is moving back toward recession. The US and UK remain the only major economies that are pulling ahead...a bit.

We think one of the biggest ongoing risks, particularly for the global equity markets, is investor willingness to accept Quantitative Easing (QE) as a solution to the low-growth challenges facing the global economy.

Central banks need to make progress with reforms to retain investor confidence

Looking at the year ahead, one of the key risks will be central banks' ability to retain investor confidence. It's certainly worth watching what happens with ECB policy and, in particular, the ability of Germany and the ECB to find a path together. There is certainly growing tension between both camps: fearing inflation, Germany is wary of ECB activity.

In Japan, it will be interesting to see if Prime Minister Shinzo Abe's third arrow — aimed at structural reforms, especially in the labor market — will bring meaningful change. We look to see concrete reforms that show Japan's willingness to change.

Geopolitical risk will likely remain a concern in 2015

Finally, the geopolitical backdrop in 2015 may be a cause for concern for markets across the globe. Geopolitics have shifted in a way that many didn't expect, with Ukraine as a particular stress point.

The situations in Syria and Iraq pose serious threats to the flow of oil, producing a significant risk to the global economy. While the US might be able to manage an oil crisis, thanks to its shale revolution, the rest of world is not as fortunate. The recent plunge in oil prices may have a destabilizing effect on regimes in the Middle East as well as in Russia and Venezuela as oil revenues decline.

Opportunities: European financials and energy

Certain financials outside the US could present opportunities in 2015. The fact that the ECB completed its October stress tests⁸ of banks in the region without any significant hiccups may be an interesting rallying point for European financials. At some point in 2015, the energy sector could become very interesting. Although oil prices are likely to overshoot to the downside in the near term, prices should stabilize and gradually recover into the back half of 2015. Most energy stocks are trading at significant discounts to their Net Asset Values (NAV) and we believe they may offer superior long-term returns. Outside of financials and energy, we will be looking for company-specific opportunities.

Looking at the year ahead, one of the key risks will be central banks' ability to retain investor confidence.

⁸ Source: <http://www.bbc.com/news/business-29777589>

US EQUITIES



+3%
GDP Growth

The US economy is coming off a very long, slow growth period, and we're optimistic it will start to accelerate at some point in 2015.




US

Clarity on the timing of the Federal Reserve's interest rate hikes should alleviate investors' concerns and boost stocks versus bonds.



The trajectory of the US recovery in 2015 will likely depend in part on the ability of its trading partners to recover and stabilize.



Lower energy and commodity cost will likely put more money in the pocket of US consumers and improve consumer spending in 2015.

US economy is on the right path, but can't go it alone

Walter McCormick, Senior Portfolio Manager, US Equities

Sandy Sanders, Senior Portfolio Managers, US Equities

Upside for US growth will depend on Europe and emerging economies stabilizing

The US economy is in a relatively strong position compared to the rest of the world. The US economy is coming off a very long, slow growth period, and we're optimistic it will continue to lead the rest of the world and start to accelerate at some point in 2015.

We anticipate US GDP will be in the range of +/- 3% in 2015, depending on whether Europe and emerging economies start to stabilize. If those economies continue to be weak, it will reduce their demand for US exports, especially after a year when the US dollar appreciated considerably against key trading partners. The Federal Reserve (Fed) has made a strong contribution to liquidity and supported the market, and the US economy is on the right path, but it can't go it alone.

Possible recovery in employment, consumer spending and the US housing sector

US equity returns could be in the high single digits in 2015 if the economies of its trading partners stabilize. We expect there will be a recovery in employment, consumer spending and the US housing sector, which

We think there will be a re-ignition in the housing market in 2015, driven by good employment conditions, better credit conditions for first-time homebuyers and rising consumer confidence and spending levels.

should mean a decent year for earnings growth, because it will be much more dependent on earnings, instead of continued multiple expansion. Returns could possibly go higher depending on the trajectory of earnings growth at the end of 2015.

Employment conditions are improving in the US, and we expect the unemployment rate will continue to fall in 2015. At some point, US workers will bump up into the structurally unemployable level and investments in skill upgrades and training will be needed. Improving employment conditions will also have a significant impact on consumer spending and the sustainability of the recovery of the US housing market in 2015.

The housing market has lagged, and recently stalled, during the economic recovery. This is unusual because historically it's been one of the first markets to recover. This time, however, the damage to the market was severe and it took a long time to unwind. First-time homebuyers are facing tighter credit conditions than in the past and compared to other types of buyers. We think there will be a re-ignition in the housing market in 2015, driven by good employment conditions, better credit conditions for first-time homebuyers and rising consumer confidence and spending levels.

The impact of lower energy prices

The strong US dollar and the slowdown in global demand is affecting energy markets, creating a sharp pullback in what had been a leading sector as of mid-2014. Energy stocks and fuel prices have fallen dramatically, as the supply/demand imbalance emerged in favor of oversupply. This will put more dollars into the pockets of US consumers, as they will have to pay less at the gas pump. This won't be a permanent condition, but it will be a benefit to consumers.

If oil prices fall too far, drilling activity will begin to slow, and production will fall to meet lower levels of demand. In the longer term, the world will continue to grow and need carbon resources, and there will be a resumption of higher pricing in energy markets. For now, most investors want to stay on sidelines, and this could create buying opportunities in 2015.

Clarity on first interest rate increase will support equity markets

The imminence of the Fed's interest rate increase is on the minds of equity investors — and it ought to be. This first interest rate hike since the 2008/2009 financial crisis is the most forecasted rise in memory, and it's been held back by the continuation of relatively sluggish conditions in the US economy and elsewhere.

The Fed is committed to providing liquidity for as long as necessary to lead to a sustainable recovery, and it hasn't yet concluded we're at that point. But once we get there, there will be a hesitation on the part of all market participants — fixed income and equity — until they can gauge the trajectory in the backup of rates. Once that initial concern wears off, the growth of the economy will carry the day for equity investors, and we can expect better, relative returns on stocks versus bonds.


Market performance based on fundamentals in 2015

The impact of a rising rate environment will likely curb the “animal spirits” and keep the market from getting ahead of itself. Most of the recovery off the bottom has come from profit margin expansion, and that can't continue indefinitely. Revenue growth and decent operating leverage will be the key to driving earnings next year. Market performance is likely to be tied more closely to fundamentals in 2015, and we expect it to be a good market for stock pickers.

We believe that we are heading towards the end of the global dislike of US financials. We think current prices mask the recovery potential and earning power of the banking sector that could accrue in a rising rate environment once the yield curve begins to steepen. As mentioned before, we also think there will be opportunities in the housing and energy sector in 2015.

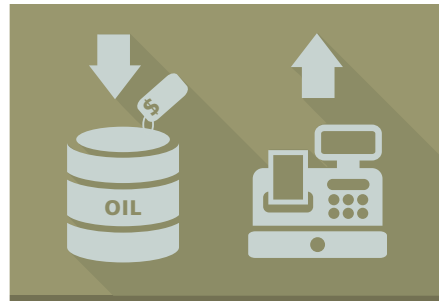
Market performance is likely to be tied more closely to fundamentals in 2015, and we expect it to be a good market for stock pickers.

EUROPEAN EQUITIES



+1-1.5%
GDP Growth

We're reasonably confident that 2015 is the year we will finally see the European recovery on a surer footing.



The recent decline in commodity prices should help to increase consumer spending power.



Europe Inc

We're optimistic that ultra-cheap money from the TLTRO program will make its way to European corporations.



Europe Inc

M&A

European companies likely to continue to be the targets of M&A activity for the next 12 months.

Despite economic challenges, opportunities still abound in European equities

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

2015 is looking more favorable as economic constraints continue to ease

We believe that the confluence of factors that have hit the demand side of the European economy are now receding, namely: weak US growth in Q1 2014, strong commodity prices, a strengthening euro as real interest rates rose, low target rates not being passed on by the banks into the wider economy, the hangover from ongoing fiscal austerity and a declining European Central Bank (ECB) balance sheet.

Indeed, we are seeing evidence that this long list of economic strictures is now easing, one by one. The recent decline in commodity prices should help to increase consumer spending power, a weaker euro/US dollar rate since the summer¹¹ could potentially add 0.5% to GDP growth and 10% to European corporate

¹¹ Source: Bloomberg . EURUSD = 1.36 as at June 30, 2014, EURUSD = 1.25 as at November 20, 2014.

earnings, as roughly 50% of European earnings come from outside Europe. The well-publicized withdrawal from the peak of austerity is expected to also remove a GDP drag by up to 1% in 2015.

Also, it's worth considering that some indicators remain in positive territory; for example, Eurozone-wide car and truck sales are rising again, house prices are rising across Europe, plus the early internal "devaluers" — i.e., those economies with wages that have become more competitive namely Spain, Portugal and Ireland — are being rewarded with decent GDP recovery.

The consensus GDP outlook for Europe as a whole in 2015 is in the 1%–1.5% range. While outright recession and deflation have been predicted by the bears, we believe it's reasonable to assume that next year is looking more favorable as long as the US economy remains strong, China avoids a hard landing and Japan shows signs of continued recovery.

Hope that liquidity will start to reach corporates

ECB President Mario Draghi has stated that corporate bond buying combined with the latest targeted long-term refinancing operations (TLTROs) could expand the ECB balance sheet by another trillion euros. Investors will be watching the level of take-up from European banks, signaling whether they can find a home for this cheap money in the underlying economy.

Sceptics point to limited demand for these funds, but we think there's a decent chance of getting the cheap money to European corporates. That hasn't previously been the case as banks haven't been willing to pass on their cheaper funding costs to SMEs. If this doesn't work, then the ECB will push the button on Quantitative Easing (QE) and force banks into higher risk assets.

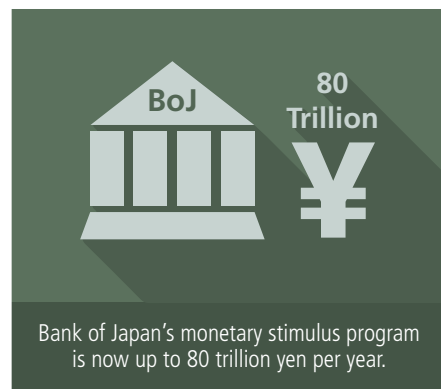
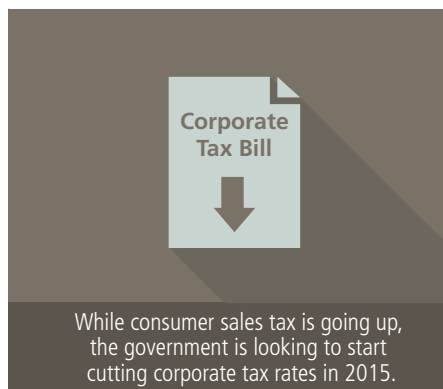
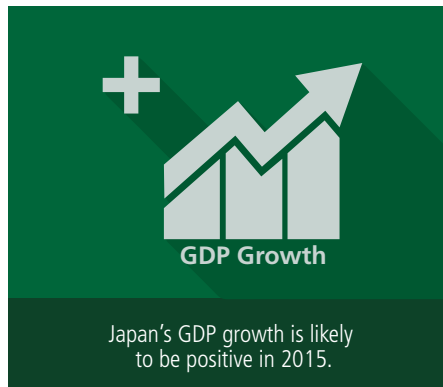
Attractive valuations, potential for more M&A activity

Currently, we believe that European equities still look attractively valued. The region's stock markets are home to global businesses that are trading at big discount multiples to their US peers. We expect to see more US M&A activity focused at European corporates for the next 12 months — especially with borrowing costs as low as they are.

Currently, we see particular value in the financials and telecommunications ("telcos") sectors. European banks emerged from the October stress test relatively unscathed. We believe we're going to see the stocks pay some healthy dividends, partly because capital generation is likely to be strong. Meanwhile, European telcos look enticingly valued on a free cash flow basis. Recent consolidation in the sector is streamlining the competitive landscape and allowing for better pricing, recovering cash flow and dividends. This in turn is helping telcos to pay down debt. The confluence of those three things is expected to release considerable value in the European telco space.

We believe that 2015 could see the fragile European and global recoveries take hold again and Europe is likely to avoid deflation. We think that QE may not happen but if required, the ECB will follow through and deliver further economic stimulus. Behind the negative headlines, the Eurozone is still home to many globally-focused stocks with attractive valuations and plenty of interesting opportunities remain for investors with a long-term view.

JAPANESE EQUITIES



2015 could be a year of change for Japan

Edward Ritchie, Senior Investment Analyst, Japanese Equities

Snap election in December 2014 viewed as Abenomics referendum

As 2014 draws to a close, there has been no let-up in the pace of news coming from Japan. Initial third quarter 2014 data, released in November, showed the country had fallen back into recession as the reality of April's consumption tax hike began to bite. This was despite a surprise announcement in October that the Bank of Japan (BoJ) would be embarking on another round of Quantitative Easing. Then, just as markets were digesting news of a downturn in the world's third largest economy, on November 21, President Shinzo Abe called a snap election.

The election in mid-December was widely viewed as a referendum on President Abe's decision to postpone the second consumption tax rise for another 18 months.

The effect of the consumption tax hike has been stronger than initially thought. Although consumption began to recover between June and September, companies held back their capital spending plans, which could have a more long-term impact on the economy. The future of Abenomics depends on corporates and consumers believing in a sustainable economic recovery and positive inflation environment. The delay in the second consumption tax hike is an attempt to achieve this in 2015.

Government looking to reduce corporate taxes

While the government is trying to move toward a more balanced fiscal policy by raising the consumption tax, there's also a plan to reduce the corporation tax, which currently stands at 35% (among the highest in world, along with the US). The goal is to eventually reduce the tax to 25%, however there are no specific plans in place to achieve this aim. By the end of 2014 or the beginning of 2015, implementation plans should be clearer. Our expectation is that it will be phased in gradually over the next five years, with a roughly 2% reduction each year.

BoJ increases annual stimulus to 80 trillion yen

In a largely unexpected move, the BoJ announced on October 31 that its monetary stimulus program would be increased to 80 trillion yen per year. It's important to note that the BoJ's proportion of the entire Japanese government bond market has risen over the course of the last few years from 10% to 20%¹², and we expect that this percentage may rise further.

Earnings outlook improving for new fiscal year

We expect to continue to see a gradually improving earnings outlook in 2015. A weaker yen will likely support further earnings growth in the second half of the 2014 fiscal year, so we think we could see at least 10%, probably 15% earnings growth in the Japanese market in 2015. Additionally, Japanese companies are making a bigger effort to return cash to shareholders, so investors will potentially see some more share buybacks toward the end of 2014 and into 2015, which we think will be a contributing factor to 2015 earnings growth.

We see attractive valuations in the consumer discretionary and financial sectors. Auto stocks are expected to perform well on improving demand in the US, helped by a weaker currency. Financials, particularly banks and real estate, should benefit from the positive impact of Quantitative Easing.

New technology and overseas agreements creating competitive advantages

In the year ahead, we continue to focus on companies that are at the forefront of using technology to create a competitive advantage. We are particularly seeing this in the manufacturing sector where carmakers, for example, are harnessing the investments they have made in new technology to improve market share and profitability. Hybrid vehicles are now generating higher profitability for some companies than their conventional counterparts. We also recently saw Toyota announce the launch of its first marketable fuel cell car, called Mirai¹³ (which means "the future" in Japanese) and we expect to see more innovations from Japanese carmakers in the future.

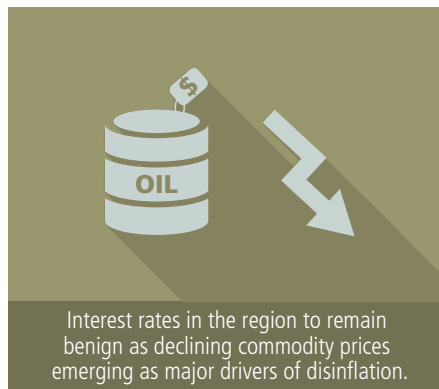
We are also seeing interesting examples of Japanese companies combining their technological know-how with overseas companies' marketing and distribution expertise. This is particularly true in the pharmaceutical sector where cross border tie-ups, such as those of Chugai with Roche and Shionogi and GlaxoSmithKline, are becoming increasingly common.

While many investors may be focusing on Japan's political and economic challenges, we believe that those who delve deeper into some of these corporate-level dynamics are likely to find particularly interesting investment opportunities in the year ahead.

¹² Source: Bank of Japan

¹³ <http://www.businessweek.com/news/2014-11-16/toyota-plans-mirai-fuel-cell-car-traveling-300-miles-per-tank>

ASIAN EQUITIES



Asian reform progress needed in 2015

Ronald CC Chan, Head of Equities, Asia

Asian equities likely to perform generally well in 2015 as progress is made on reform

We expect Asian equities to perform generally well in the year ahead, underpinned by commitments to reform in several key markets that should pave the way for sustainable long-term growth. 2015 GDP growth is expected to remain between 4–6% for ASEAN members and India, while Australia, Korea and Taiwan are forecast to show 3–4% growth — the Chinese economy is forecast to grow at the still-robust pace of 7.1% for the year.¹⁴

Declining commodity prices should help support growth in 2015

We expect interest rates in the region to remain benign as declining commodity prices, notably oil, are emerging as major drivers of disinflation. Combined with the US economy's ongoing recovery, this environment sets the region up for another year of decent growth.

¹⁴ IMF World Economic Outlook, October 2014.

North Asia remains attractive

Against this backdrop, some regional markets are trading at highly attractive valuations, and we expect selective markets to do well in the year ahead. North Asia looks particularly attractive, trading at forward price to earnings (P/E) lower than the ASEAN average.

We remain constructive on Taiwanese equities. The market currently trades at a reasonable valuation and is forecast to post healthy earnings growth in 2015 due to continued demand for products such as next-generation smartphones and wearable devices. Furthermore, the proliferation of the Internet of things (IoT), industrial automation and the development of 4G telecommunication infrastructure in Asia present new growth opportunities for the Taiwan technology supply chain. We find that many Taiwanese companies have robust balance sheets and are well-positioned to pursue growth while maintaining decent dividend payouts to shareholders.

Meanwhile, the South Korean economy should also benefit from a US\$40 billion stimulus package announced in July 2014 aimed at boosting domestic demand. A new tax plan aimed at encouraging cash-rich companies to spend more on capital good investment, wages and dividends should also be positive for the economy. Higher dividend payout ratios should support selective Korean stocks, and the government's pro-growth policy stance should help support a pick-up in investment and company earnings. Current valuations are attractive, but increased foreign exchange volatility could impact the competitiveness of Korean exporters.

Selective opportunities in Southeast Asia and India

Following the election of new governments in India and Indonesia in 2014, we expect to see significant reforms in the year ahead. Fuel subsidy cuts in India, Malaysia and Indonesia should alleviate fiscal and current account risks in these economies. Although this shifts the burden of buying fuel to households, government savings could be used to lower the budget deficit or could be reallocated towards capital and infrastructure spending. Similarly, the implementation of Goods and Services (GST) taxes in Malaysia and India in 2015 should improve direct tax collection and the fiscal balances of these countries.

Achieving the economic goals set out by governments in the Asia Pacific ex Japan region largely depends on political stability and each government's ability to execute. Failure to implement targeted reforms may impede economic growth.

We also expect governments in South East Asian economies to continue to invest in infrastructure development going forward. In particular, Indonesia plans to accelerate the development of farm irrigation systems, and ports and power plant construction over the next few years.

Finally, we should see continued growth in foreign direct investment (FDI) inflow to Southeast Asia and India as governments in the region offer incentives and improve the ease of doing business to attract foreign investors. In this vein, it is worth noting that the opening of new casinos is expected to provide a boost to the Philippines' economy next year. Related

employment opportunities in the services sector (i.e., tourism and entertainment) should help drive per capita income growth and domestic consumption. This is in addition to continued robust inflow of offshore remittances and growth in the business process outsourcing (BPO) segment of the economy.

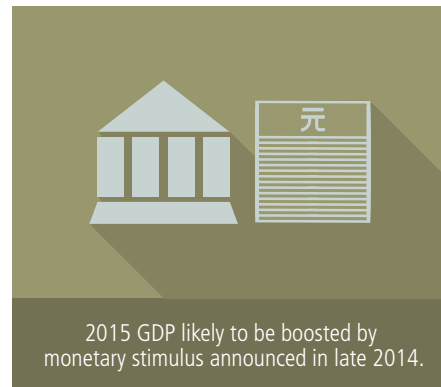
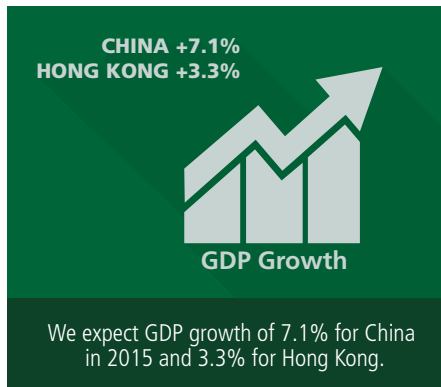
Potential interest rate risk in the near term

While we maintain a positive view on the long-term outlook of the Asia Pacific ex-Japan region, we continue to watch the US interest rate trend. We do not expect the US to raise rates rapidly, but speculation of interest rate movement alone could increase the volatility of capital flows to Asia.

Achieving the economic goals set out by governments in the Asia Pacific ex-Japan region largely depends on political stability and the ability of each government to execute. Failure to implement targeted reforms may impede economic growth. For example, if the ongoing protests in Hong Kong are prolonged, we expect they will weaken the special administrative region's (SAR) economy.

That said, an effective Modi-led government has already yielded positive changes in the Indian economy. Looking ahead, we remain optimistic that the new President of Indonesia, Joko Widodo, and his cabinet will be able to execute on planned political and economic reforms.

GREATER CHINA EQUITIES



China remains firmly on a path to growth in 2015

Kai Kong Chay, Senior Portfolio Manager, Greater China Equities, Manulife Asset Management

A foundation for potential Greater China returns in 2015

As 2015 dawns, China remains firmly on a path to growth. Painful decisions continue to be made as the government lays a foundation for long-term growth despite the potential for further short-term pain. This is no easy task, as it requires officials to strike a delicate balance between implementing the social, political and economic reforms necessary to develop an economy focused on consumer demand and innovation while also providing stimulus and support to ensure continued economic vitality.

In our view, the government has achieved this delicate balance thus far. Aggregate GDP growth averaged 7.4% over the first three quarters of 2014 based on stimulus spending, targeted monetary easing and support for smaller companies and key growth industries.

Looking forward, fourth quarter 2014 and 2015 GDP are likely to receive a boost from about US\$126 billion in liquidity support implemented over the past few months and a policy rate cut of 40 bps implemented in late November 2014.

The rate cut acknowledges that the short-term pain had reached a point where more broad-based economic stimulus was required, and we believe it will have the desired effect — 2014 GDP growth is now likely to be at the upper end of the government's 7.0–7.5% target for the year.

This is generally positive for Chinese equities as it signals that policymakers are taking a much more aggressive stance on stimulus than previously expected. Follow on rate cuts are possible in 2015 alongside potentially lower bank reserve requirement ratios (RRR) and the possibility of further moderate liquidity injections.

At the same time, developed markets continue to provide a generally supportive backdrop for the Chinese economy, and we expect policy reforms to bear fruit in 2015 and beyond. We are particularly looking forward to the Communist Party of China's upcoming 2015 National People's Congress for an update on reform progress to date and potential announcements on next steps.

Focus on corporate fundamentals

We will continue to watch economic indicators closely as industrial activity, exports/imports and the Purchasing Managers' Index (PMI) remain important gauges of the health of significant sectors of the Chinese economy. Nevertheless, we recommend that investors focus on individual stock fundamentals rather than macro indicators in order to identify companies that are poised to prosper as the country's economic reorientation progresses.

This entails selecting companies with strong management teams, compelling business models and solid and transparent financial foundations that are geared to structural growth drivers in China. Many of these companies are currently reaping the rewards of government stimulus spending and, in the medium term, should benefit from continued policy support. In this environment, we remain constructive on sectors including:

- Healthcare, which is benefiting from increased demand for high-quality medical services as salaries and living standards rise alongside higher government spending on related programs.
- Environmental protection technology, which includes clean energy and water purification companies that are benefiting from government pledges to reduce pollution.
- E-commerce, which was a key theme in 2014 that we expect to remain strong in 2015 as consumption patterns continue to shift due to increasing mobile Internet use.

Shanghai-Hong Kong Stock Connect launched

The initial November 2014 launch of Shanghai-Hong Kong Stock Connect provided a boost to many Shanghai Stock Exchange-listed shares on the back of strong trading volume, with international investors exhausting their quota on the first day. The Hong Kong Stock Exchange (HKSE) saw less inflow from Mainland China, in part because the platform restricts trading of Hong Kong shares to institutional investors and retail investors with significant account balances. While trading volume in both directions quickly tailed off in the first week, we still expect the platform to ultimately emerge as a conduit for increased demand for stocks in both markets. Connect represents the most unfettered corridor for investment between the Mainland China and global markets to date, and we believe it is just the first step toward further integration of the SSE and HKSE.

Hong Kong buying opportunity amid protests

Hong Kong shares were volatile in the first half of 2014 before posting strong gains in the third quarter. However, things changed abruptly in mid-September, with the index quickly dropping close to 10% as “Occupy Central” street protests dampened investor sentiment.

Despite this, the Hong Kong economy remains robust. Unemployment is low, property market cooling measures are expected to be scaled back and tourist arrivals to Hong Kong should rebound as the number of protesters has shrunk significantly. These developments, along with the continued operation of the Connect platform, should be positive for the market as 2015 dawns.

Taiwan expected to rebound from oversold levels

We consider Taiwan an attractive market going into 2015. Many strong companies with solid balance sheets are oversold and we expect earnings growth to drive share price re-ratings. We remain constructive on Taiwanese technology companies, which continue to benefit from demand growth in developed markets, and auto parts manufacturers.

Potential near-term risks


We maintain a positive view on the long-term outlook of the Greater China region, but we continue to watch the US interest rate trend. While we do not expect the US to raise rates rapidly, any sharp increase would likely have negative implications for corporate balance sheets and for household balance sheets due to property exposure.

GLOBAL NATURAL RESOURCES




GDP Growth

The global economy is generally improving, but the pace is decelerating.



OIL

With commodity prices having come off so severely, there is the possibility that oil production in the US might be softer in 2015.



Global GDP

Much lower energy prices should be a big boost to world economy, serving as another form of quantitative easing.



OIL **GOLD**

Oil and gold prices are reacting more to the direction of the US economy and US dollar than to geopolitical events.

Lackluster environment expected to continue in near term

Diana Racanelli, Senior Portfolio Manager, Global Natural Resources

Craig Bethune, Senior Portfolio Manager, Global Natural Resources

Global growth will remain positive but soft by historical standards

Although the pace of global growth has been decelerating, we believe that demand for commodities in general will grow as Emerging Market economies, particularly China, continue to develop. Despite shorter-term fluctuations in fundamentals, longer-term supply constraint — whether caused by changing mine economics or geopolitical risks — should support improved pricing over time.

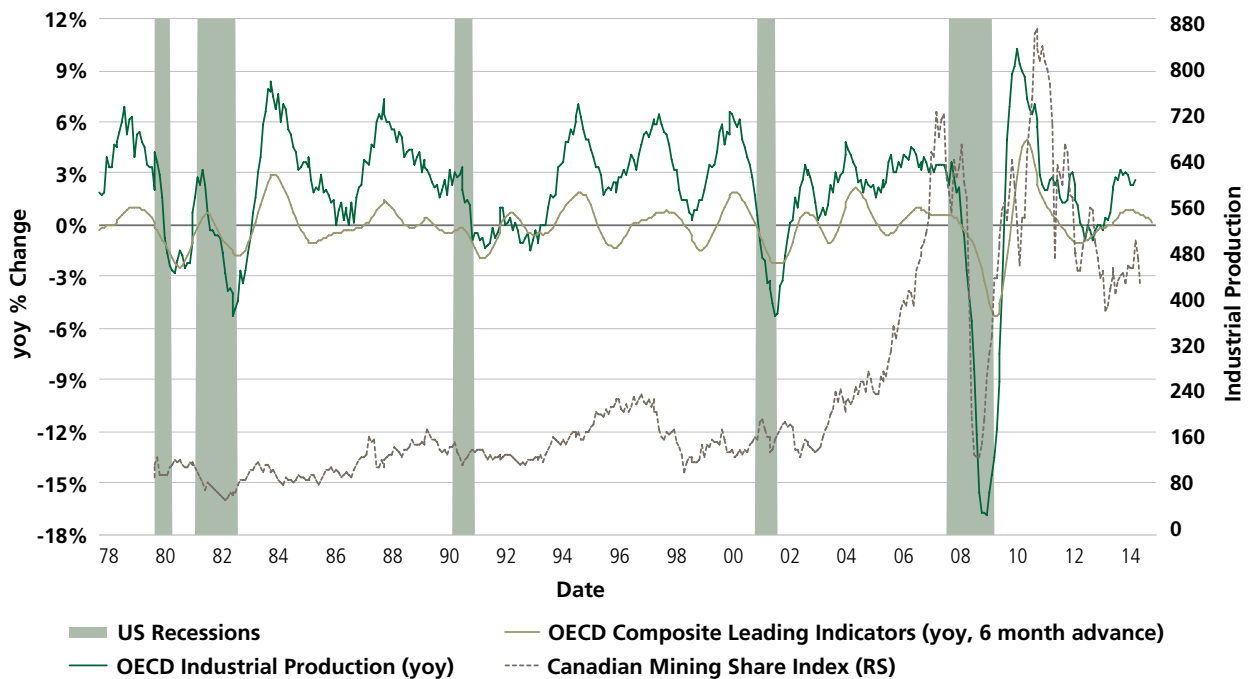
Commodity prices are a reflection of the health of the global economy, the impact of a strong or weak US dollar, and of the supply/demand environment for each of the individual commodities. For 2015, we believe that global growth will remain positive but soft by historical standards. Despite strength in the US market, unless we see stabilization in Europe and Emerging Markets, commodity prices could remain weak.

Energy

Despite geopolitical risks in Organization of the Petroleum Exporting Countries (OPEC) markets such as Libya, Iran and Iraq, the market seems complacent about oil supply risk. Today, there is no geopolitical risk in the oil price. Production growth in North America has been strong and has more than offset near-term supply issues. Moreover, with softer economic growth in many regions of the world, demand has been somewhat below expectations. As a result, we've seen considerable weakness in all grades of crude oil, with many falling 25–30% during the August to November time frame.

If prices remain weak over a longer period we expect investment in future growth to be curtailed as the average price needed to cover capital expenditures, dividends and a return on capital for the industry is closer to \$90 to \$100 per barrel, rather than the current Brent crude price of under US\$70 a barrel. Over the long run, we expect oil prices to range between US\$80–90 to sustain investment to meet future oil demand needs, a point of concern highlighted in the recent International Energy Agency's energy outlook¹⁵

Economic leading indicators and underlying global growth need to improve to drive sustained outperformance of commodity and mining share prices.



OECD: The Organisation for Economic Co-operation and Development
Source: RBC Capital Markets, October 2014.

We'll be monitoring OPEC meetings in 2015 to see how it responds to current low oil prices. Historically, it has intervened to support the price of oil closer to \$90; however, the Saudi government has been quoted indicating they are comfortable with lower oil prices as it will likely slow the higher cost US oil production. At OPEC's November meeting, it refrained from cutting production leading oil to drop to a five year low in December. The decision also caused a decline in energy stocks worldwide.

¹⁵ Source: International Energy Agency's World Energy Outlook, November 2014.

Natural gas

Today natural gas is much more of a regional market with North America enjoying some of the lowest natural gas prices globally. This is leading to growing investment in the petrochemical plants and industries in the US Gulf Coast, which should lead to higher natural gas demand in the future. In addition, coal-fired power plants are in the process of being retired and LNG exports from the US are set to start in late 2015 or early 2016.

In the near term, weather will be the key driver of prices and a cooler summer in 2014 led to a rapid build-up of storage. Ample supply remains available at very low cost, but few producers are actively investing in natural gas drilling as the economics of oil are still far superior.

Gold and other metals

As confidence in improved economic conditions increased throughout 2014 and the US dollar strengthened, the price of gold fell 18% from a peak of US\$1383 per ounce in March 2014 to a low of US\$1140 in November¹⁶. Barring a major negative political or financial event, we expect the price of gold to continue this trend of rangebound movement with its upside limited by generally improving economic conditions and a strong US dollar and its downside protected by price-sensitive Asian consumer demand. We see opportunity in companies with strong operating assets that continue to control costs and protect or improve their balance sheets.

The slowdown in the Chinese economy combined with new supply coming onto the market in 2014 has had a meaningful impact on base and bulk metals. The price of copper is down approximately 10%, iron ore is down over 40% and metallurgical coal is down 16%. As new supply continues to be added to the market, we will need to see higher-cost supply shut down along with a pick-up in Asian demand before prices can significantly improve. This should translate into a flat to slowly improving price environment throughout 2015 before a more meaningful move in 2016. Selective stock picking will be key to performance in 2015.

Lower energy prices should provide a tailwind to the broader global economy in 2015. As a result of lower energy costs, global consumers should benefit from higher disposable income. At the same time, energy companies could start reducing their capital investment in response to sustained lower prices, which would affect future growth in production and supply.

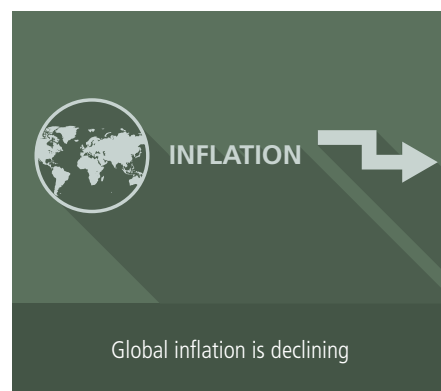
The commodities sector bore the brunt of the perception and expectation of future weaker global growth and is currently reflecting a lot of negatives. There is a wide spread in valuations across all sub-sectors. In 2015, we are expecting opportunities to buy quality companies at a discount as stocks reflect lower implied commodity prices. As the global economy improves, investors should benefit along with improving commodity prices.

¹⁶ Source: Bloomberg. As at December 3, 2014

ASSET ALLOCATION

Bob Boyda, Co-Head of Global Asset Allocation

Steve Medina, Co-Head of Global Asset Allocation



US

- We remain steadfastly bullish on the US economy bolstered by a series of positive data points showing higher growth, more corporate spending for mergers and acquisitions, and stronger consumer spending. In short, the animal spirits of the economy are not only stirring, they are also beginning to walk ahead with some vigor.
- The US has led the developed markets in the global economic recovery since 2008. Total jobs are now above pre-crisis levels, while job openings continue to improve. There is positive economic sentiment in the manufacturing and non-manufacturing sectors, and aggregate US financial conditions remain supportive of the expansion.
- We are optimists, expecting US real GDP to be close to 3.25% through 2015. We expect inflation to remain quiet between 1.5 and 2%. Our positive view of employment was reinforced in late 2014, as unemployment crept below 6%, and we look for this trend to continue well into 2015.
- In our opinion, there is still plenty of room for growth, and we expect the current version of the US economic recovery to be among the longest on record, as the former drags on growth are either mitigated or reverse course. For example, we believe: the housing recovery, which has been slow to date, will re-accelerate; fiscal policy drag, specifically budget sequestration, will be mitigated as local, state and federal

budgets have been largely repaired; and consumer spending, which has been tamed by the impulse to save and restore household budgets, is likely to re-ignite.

- We consider US equities on a long-term basis to be close to fair value, if slightly expensive. We would like to see more real, continued top-line revenue and earnings growth — instead of further multiple expansion.
- So far investors have pushed off the risks associated with geopolitics, the Ebola virus and regional conflicts, like Russia and Ukraine — any one of which might rise up and take a bite out of stock valuations. Many investors remain deeply skeptical about the US Federal Reserve's (Fed) actions over the past five years and concerned about the potential risk of a policy mistake as the Fed exits its current ultra-low interest environment. In our view, the persistence of low inflation mitigates much of this latter risk.

Europe

- European economic growth, at less than 1%, is faltering, and some countries have fallen into technical recessions. We have been expecting Europe as a whole to get back to a growth rate of closer to 2% over the next five years, and that is now the optimistic forecast.
- Our general view is that Europe is around three years behind the US, and it will eventually follow the same growth trajectory as the US. The European Central Bank's (ECB) rate cut and asset-backed securities (ABS) and covered bonds purchase program will likely be positive for the markets, as higher liquidity tends to equal higher prices for risk assets, including equities.
- Europe does not look cheap in terms of price/earnings multiples; however, earnings are currently depressed and, assuming some level of normalization, the margins and earnings potential make some of the companies domiciled in Europe look more attractive than their US counterparts.
- Our optimism is not without significant risks. Europe is still facing plenty of headwinds: geopolitical risk due to the conflict between Russia and Ukraine, which could affect investor sentiment; the risk of deflation; low growth rates; the ailing state of the economy; and the risk that the fiscal authorities will not, as we believe they should, complement what the ECB is doing to improve matters.

Emerging Markets

- We continue to see signs of progress and reform across Emerging Markets (EM) and continued stability in various economic data points like manufacturing, overall growth and inflation. Our five-year forecast for GDP across all EM is growth in the 4.25–4.5% range.
- We maintain that EM equities offer among the highest return expectations from an asset class perspective over the next 3 to 5 years. However, we are making a major distinction between the commodity producers (about which we are negative) and commodity consumers (about which we are positive). We are also distinguishing between the economic segments tied to consumption, environmental health, health care and the consumer (positive) against the extractive cyclicals (negative).
- EM currencies have wavered in recent weeks, except for the significant challenge in Russia. They did not react as much to recent Fed tapering. That said, a material sprint higher in the US dollar will produce some short-term pain for US investors in EM equity and debt. In time, the higher US dollar will support continued export growth from select EM countries to the US.
- There has been a sentiment shift towards the EM, with asset flows to match. Initial flows tend to be very beneficial to stock prices.

- Despite the fact the EM economies are growing faster than the US and the world as a whole, the growth rates have slowed from previous levels. That deceleration has had a negative impact on the returns of stock prices for the EM economies. We think the deceleration has stabilized and is generally fully reflected in current valuations; therefore, any improvement in growth rates will likely provide a floor for forward-looking returns for EM economies.

Fixed Income

- We expect subdued fixed income returns relative to what investors have experienced in the past decade and favor credit over government-backed debt.
- Our emphasis is on finding yield and keeping duration short. While this stance faces some short-term headwinds, as long as inflation stays low and European and Japanese economies remain challenged, we are long-term investors with a view that this is the right position over the next five years.
- We believe that the secular or generational low interest rates were established last year, and we are adjusting our approach accordingly.
- We think EM debt will likely offer better yields over the next five years. Valuations are currently attractive and we forecast that EM debt could do quite well, with an annualized rate of return above 4%.
- The potential risks for this asset class are first and foremost related to the strengthening US dollar. There are always political risks in many of these countries, primarily related to elections. More recently, the shift in Chinese policy towards greater consumption and away from investment will end a decade of booming exports to the Middle Kingdom. Many of the EM countries that have lived off this trend may not adapt well to the change.

Inflation

- Global inflation is declining, particularly in the developed world. We believe we are heading into a stable, low inflation world that will span the next decade. There is no shortage of global labor, capital or materials. In fact, we argue the abundance of cheap capital reinforces a disinflationary cycle. The implications for investors facing this scenario — one that we have not seen in over 40 years — argues for a continuation of below average long-term rates and persistent high equity multiples.

Short-term interest rates

- Our view is that the Fed will start raising rates in mid-2015 with a modest increase, which is in line with market consensus expectations and guidance from the Fed. There is a chance that the first rate increase could be pushed forward slightly depending on economic data — particularly around job growth.
- Despite the likelihood of the Fed raising rates, central banks around the world will likely continue to be very accommodative.

Commodities

- As an asset class commodities enjoyed 15 years of surging demand and prices, a secular bull market which we believe may now have come to an end. Billions of capex dollars building mine capacity and infrastructure means that future cyclical surges in demand will likely be met with large incremental supplies. Pricing power is gone. For the most part, and with a few rare exceptions, this is an asset class that is likely to remain significantly challenged.

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