Manulife Asset Management™

Global Intelligence

Interim Outlook: June 2015

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The Asset Allocator's View

Robert Boyda, Co-head of Asset Allocation at Manulife Asset Management

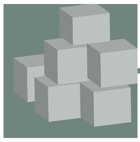
This table summarizes the views of our asset allocation experts while drawing on the in-depth knowledge of our on-the-ground investment specialists around the globe.

Asset Class	Overall Sentiment	View	Investment Expert Insight: Specific Opportunities For Investors
Global Equities	Positive	We are positive about global equities. For the foreseeable future, we think that global liquidity continues to support strengthening economic activity and corporate earnings growth and therefore equity prices. Equity valuations in certain markets like the US are elevated and pose the risk of corrections in the 6-10% range. We think equity investors should maintain a rigorous focus on stock selection in higher-growth areas.	Wendell Perkins: Around the globe, we are looking for earnings growth. At a sector level, we continue to see opportunities in telecommunications companies that are strong generators of free cash, particularly in Europe.
European Equities	Enthusiastic	We are enthusiastic about European equities. Many sectors look more attractive than their US counterparts. Some caution tempers our enthusiasm since stocks in Europe do not look cheap in terms of price/earnings multiples. Investors here will have to buy ahead of the full recovery believing that earnings are currently depressed, and that some level of normalization and margin expansion is in the forecast. On many other valuation metrics like price-to-sales and price-to-book ratios, we think European equities are very attractive.	David Hussey: We think building suppliers are well positioned for a recovery in European housing starts. We are also positive on bank stocks and telecommunication services companies.
US Equities	Positive	We are positive about US equities, which we consider on a long-term basis to be fairly valued to expensive. We would like to see more real, continued top-line revenue and earnings growth instead of further multiple expansion.	Sandy Sanders: We continue to see opportunities in the US housing and e-commerce sectors, as well as large cap banks.
Emerging Markets Equities	Enthusiastic	We are enthusiastic about Emerging Markets (EM) equities. They offer among the highest potential returns over the next three to five years in our view. But, EM is no longer a homogenous asset class. We make a major distinction between the commodity producers and dirty cyclicals (negative) and commodity consumers along with segments tied to consumption, environmental health, healthcare and the consumer (positive).	Kathryn Langridge and Philip Ehrmann: We see opportunities in a relatively concentrated number of emerging markets, including rate- and reform-sensitive China, India, Indonesia, the Philippines and Mexico. Thematically, we are finding opportunities in areas of secular growth driven by demographic trends including consumption.

Asset Class	Overall Sentiment	View	Investment Expert Insight: Specific Opportunities For Investors
Asian Equities	Positive	We are positive about Asian equities that look attractive as growth candidates, particularly those in the consumer and technology areas.	Ronald CC Chan: We see opportunities in markets including India, South Korea and Taiwan based on different drivers across the region.
Japanese Equities	Positive	We are positive about Japanese equities. We think Japan is a rare non-consensus opportunity that could last for a decade or more. The disappointments of the past are fading and companies are reforming to be more ROE and shareholder driven.	Ed Ritchie: We think Japanese financials will benefit from loan growth driven by domestic capital expenditure and construction demand, as well as the potential for rising bond yields.
Global Fixed Income	Cautious	We are cautious about global fixed income. We expect subdued fixed income returns relative to those of the past decade and favor credit over government-backed debt. Our emphasis is on finding yield and keeping durations short. As long-term investors, we believe this is the right position over the next five years.	Tom Goggins: We see opportunities in bonds denominated in non-Japan Asia currencies hedged with currencies from developed countries with weaker growth outlooks. We think emerging market government bonds, particularly in Asia, will also offer opportunities for investors as those economies outperform.
US Fixed Income	Cautious	We are cautious about US fixed income. We expect total returns to remain challenged over the next several years as rates normalize against a strengthening global economy and the massive liquidity injections begin to taper.	Terry Carr: We think investors can continue to find opportunities in investment grade and high-yield corporate debt. Keeping durations shorter can give investors a safer, more defensive posture if interest rates do rise.
Emerging Markets Debt	Positive	We are positive about EM debt, which we think 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 a projected annualized rate of return above 4%.	Roberto Sanchez-Dahl and Paolo Valle: We see opportunities for investors in Indonesia and India – countries that elected new, reform-friendly presidents in 2014. We are positive on Mexico with its improving credit story and, contrary to consensus views, also like Brazil.
Commodities	Cautious	We are cautious about commodities. Pricing power is gone as the 15-year secular bull market in commodities has brought on new supply. Billions of capex dollars building mine capacity and infrastructure means that future cyclical surges in demand will be met with large incremental supplies. We believe investors will need to be extremely selective in finding opportunities.	Diana Racanelli and Craig Bethune: We continue to see opportunities in gold companies and think the pullback in energy prices has created opportunities to buy higher quality companies at lower prices.

Global Economic Outlook

Megan Greene, Chief Economist



THE BACKDROP

We expect oversupply – creating an environment of low growth, low wages and low inflation – to continue over our five-year forecast horizon.

In our view, oversupply is the central theme defining the global macroeconomic environment. There is an oversupply of public and private debt, as total indebtedness by governments and households continues to increase; liquidity and credit, as central banks' easing efforts have injected significant liquidity in the global monetary system; regulation, as capital requirements for many asset classes are rising; people, thanks to the ageing population; and labor, with an overabundance of workers globally translating into little upward pressure on wages.

To create demand, the first port of call for governments is typically to provide stimulus, but few governments have room on their balance sheets to do so given their enormous debt overhangs. The next available option is to corner as much of the globe's aggregate demand as possible. Most countries are now trying to do this by devaluing their currencies through a series of monetary policy stimulus measures. The end result is an environment of low growth, low wages and low inflation – a backdrop that we think is unlikely to change over our five-year forecast horizon.

ECONOMIC BRIGHT SPOTS

The US and UK are the brightest spots among developed countries. We expect GDP growth of 2.4% for both economies this year.

Among developed countries, we think the US and UK are the brightest spots from an economic standpoint. Q1 growth in the US was much weaker than had been expected towards the end of last year and, recent trade data revealed the US trade deficit is now the largest since 2008. While the US is unlikely to return to its historical average of 3.5% GDP growth per year, we expect growth of 2.4% this year – well above our expectations of 0.7% in Japan and 1.5% in the eurozone. We expect GDP in the UK to grow by 2.4% this year, with short-term stability provided by the Conservatives winning a surprise majority in the May 7 general election. The likelihood of a referendum on EU membership in 2017 has shot up as result, though we think a "Brexit" remains unlikely.

Among developing countries, we believe India is on the cusp of a significant cyclical upturn. New light vehicle registrations indicate that business activity is picking up, as does recent coal consumption data. A lot will hang on how successful Prime Minister Narendra Modi is in eradicating corruption and boosting transparency. We think China is another bright spot from an economic growth perspective in the short term, even if China's growth will continue slowing as the government cracks down on corruption and rebalances the economy towards consumption. We expect China to hit its 7% GDP growth target this year, aided by continued stimulus measures from the government and the People's Bank of China (PBoC).

China poses a risk to global growth over the medium to long term.

RISKS

While we believe China is an economic growth bright spot in the short term, we think it poses a risk to global growth over the medium to long term. Given the size of non-performing loan portfolios on bank, shadow bank and local government financing vehicle balance sheets, it is possible that the private sector in China will experience cascading defaults. If this occurs, we expect the government will bail out these entities since it has a relatively clean balance sheet. Still, a series of large bank bailouts could put a large damper on GDP growth as the US saw during the global financial crisis.

In addition, we think the eurozone poses a major risk to global growth. The region lacks domestic demand, and despite some better lending data in the region recently, we expect Europe is heading for a Japanese-style lost decade of little growth or inflation. Within Europe, Greece remains a significant hot spot and we expect it will continue to be one for years to come. While we expect a Greek exit from the eurozone is very unlikely, it would be extremely disruptive to markets and to eurozone growth.

We are also highly skeptical of Abenomics in Japan. The first two arrows – monetary and fiscal stimulus – have done little to support the private sector's contribution to GDP growth or to boost inflationary pressures. The real success or failure of Abenomics will rest on the government's ability to push through difficult structural reforms, particularly labor market liberalization. So far, the government has relied on corporate tax cuts to encourage companies to boost wages and therefore put some upward pressure on inflation. Nevertheless, this has yet to materialize. We expect Japan to experience very sluggish growth and inflation over our forecast period, and think that the Bank of Japan will monetize much of the country's public debt by the time QQE (quantitative and qualitative easing) is unwound.

The potential Greek default and eurozone exit could disrupt markets and call the irreversibility of the common currency union into question.

ON OUR RADAR

- **The eurozone:** While many policymakers and investors will insist that the rest of the eurozone and the world have been ring-fenced from a potential Greek default and eurozone exit, we disagree. In addition to market disruptions, a default or exit would call the irreversibility of the common currency union into question. The eurozone would go from being a currency union to a currency peg, with the latter being much weaker than the former.

- **Monetary policy developments:** We are following monetary policy developments globally. We believe there is a currency war underway, and expect the US dollar to remain strong relative to most other major currencies. This will provide a headwind to US GDP growth as exporters struggle to compete globally. When the US Federal Reserve hikes rates, which we expect will happen this December, we will likely see some capital outflows from emerging markets. In our view, the PBoC in China is concerned about this – particularly given that China is already experiencing significant capital outflows – and is easing monetary policy and joining the currency war in order to fill the vacuum left by capital leaving the country.

Manulife Asset Management Economic Research Global Forecast

	5-Year Average 2010-2014[1]	2014	2015	2016	2017	2018	2019	5-Year Average 2015-2019[1]
			Forecasted data					
Gross Domestic Product (annual % change)								
World	2.9	2.6	2.5	3.0	3.1	3.1	3.3	**3.0**
United States	2.2	2.4	2.4	2.8	2.5	2.4	2.3	**2.5**
Canada	2.5	2.5	2.2	2.0	2.3	2.4	2.2	**2.2**
Eurozone	0.7	1.1	1.5	1.8	1.8	1.8	1.6	**1.7**
Germany	2.0	1.6	1.7	2.2	1.8	1.7	1.5	**1.8**
France	1.0	0.4	0.8	1.3	1.5	1.5	1.2	**1.3**
United Kingdom	1.7	2.8	2.4	3.1	2.6	2.4	2.3	**2.5**
Asia-Pacific[2]	5.2	4.3	4.5	4.8	4.6	4.7	4.6	**4.6**
Japan	-0.1	-0.1	0.7	1.4	0.7	0.8	1.0	**0.9**
China	7.3	7.3	6.9	6.7	6.6	6.5	6.2	**6.6**
India	7.2	7.2	7.2	7.3	7.2	7.3	7.3	**7.3**
Inflation Rates (annual % change)								
United States	2.0	1.6	-0.2	2.2	2.2	2.1	2.0	**1.6**
Canada	1.8	1.9	0.9	2.1	2.0	2.0	2.0	**1.8**
Eurozone	1.8	0.3	0.2	1.8	2.1	1.9	2.0	**1.6**
Germany	1.5	0.9	0.6	1.9	1.6	1.6	1.6	**1.5**
France	1.5	0.9	0.0	0.9	1.8	1.8	2.2	**1.3**
United Kingdom	2.9	1.5	0.3	1.1	1.9	2.0	2.0	**1.5**
Asia-Pacific[2]	2.9	2.9	1.8	2.4	2.7	2.7	3.0	**2.5**
Japan	0.4	2.7	0.8	1.7	2.0	1.8	1.7	**1.6**
China	3.2	2.0	1.4	1.9	2.0	2.3	2.8	**2.1**
India	9.5	6.4	5.6	5.8	5.7	5.7	6.5	**5.8**

[1] 5-year averages; forecast period end; average 2015-2019 is EoP averages.
[2] Asia-Pacific includes China and Japan.
Note: As of May 2015.

Global Equities

Wendell Perkins, Senior Portfolio Manager, International Equities

THE BACKDROP

Central Banks' accommodative monetary policy continues to drive equity markets around the globe.

Global equity markets are singularly thematic right now: they continue to be liquidity- and Central Bank-driven, with the European Central Bank (ECB) and People's Bank of China as the latest to initiate monetary efforts to stimulate their economies. While the Federal Reserve (Fed) has stopped their Quantitative Easing (QE) program, they haven't stopped easing altogether; given ongoing US growth challenges, if economic data isn't strong enough, the Fed may not be able to raise interest rates this year as widely anticipated. While we believe economic factors and earnings growth are imperative, equity markets continue to treat them as secondary to accommodative monetary policy.

OPPORTUNITIES FOR INVESTORS

Earnings growth and the Bank of Japan's pro-reform efforts appear to have boosted the appeal of Japan for equity investors.

We are warming up to opportunities in Japan where we are seeing earnings growth and pro-reform efforts from Prime Minister Abe, who is putting pressure on Japanese corporations to use their plentiful excess cash. (The total cash sitting on Japanese corporate balance sheets is the equivalent of 50% of Japanese GDP,[1] giving companies in the market enormous firepower.) Earnings revisions are modestly rising, many corporations are raising dividends, and equity markets are now trading at a discount to Europe on an earnings, cash flow, and book basis – all creating an attractive market for equity investors. At a sector level, we continue to see opportunities in telecommunications companies that are strong generators of free cash, particularly in Europe.

RISKS

In Europe, subpar earnings growth and multiple expansion pose risks that could reign in investor enthusiasm.

In Europe, a number of risks could reign in the investor enthusiasm we have seen since the ECB's QE announcement in January[2]: a "Grexit" is still possible and the geopolitical risks of Russia persist, while European equities have lost their discount advantage as earnings growth has been subpar and we've seen a lot of multiple expansion. Around the globe, the negative impact of the drop in commodities prices continues to pose meaningful risks, particularly in markets such as Canada and Australia. The massive fall in oil prices – on top of metals and mining weakness – has removed key pillars, leaving little to support the currencies in these economies. On the currency front, we are also keeping an eye on the US dollar rally that is unprecedented on a trade-weighted basis, posing significant risks and uncertainty for emerging markets.

ON OUR RADAR

Around the globe, we are looking for earnings growth as a key driver of equity markets.

In the coming months we will be looking out for:

- **Fed action:** We'll be watching the language the Fed uses to frame its position in the coming months. Whether or not the Fed raises rates has emotional spill over effects, impacting interest rates, currencies, and global equity markets.
- **Earnings growth:** Overall, we think ongoing monetary easing will not be a sufficient driver of global equity markets. Corporate earnings and fundamentals need to be solid. If we don't see this in Europe, we worry that the massive recent bounce in equity markets is not justified.

[1] British Embassy Tokyo (December 2014): https://www.gov.uk/government/publications/japan-monthly-economic-report-december-2014.

[2] Wall Street Journal, "Aggressive ECB Stimulus Ushers In New Era for Europe" (January 22, 2015): http://www.wsj.com/articles/ecb-announces-stimulus-plan-1421931011.

European Equities

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

THE BACKDROP

European equity valuations look attractive versus debt and the equity markets of other developed countries.

Though it is still too early to assess whether the European Central Bank's (ECB) injection of €60 billion per month into the eurozone economy from March 2015 through September 2016 will achieve its 2% inflation target, the combination of Quantitative Easing (QE), a weak euro and lower oil prices has laid the foundations for GDP growth in the region. Historically, currency devaluation has been a tried and tested method Europe has used to export its way out of recession. With 10-year average Price-Earnings (PE) ratios near all-time lows and QE suppressing bond yields, European equity valuations look attractive versus debt and the equity markets of other developed countries.

OPPORTUNITIES FOR INVESTORS

We see opportunities in building suppliers that are well positioned for a recovery in European housing starts.

Following years of restructuring, we think building suppliers are well positioned for a recovery in European housing starts. We expect volumes to pick up as current supply is insufficient to meet household formation growth. We are also positive on bank stocks that look relatively cheap compared to historical valuations; in the medium term, we think they could benefit from falling loan losses, falling unemployment and rising business investment (creating demand for more loans). In addition, we think regulatory approval for consolidation could improve the profitability of telecommunication services companies in mobile, which are enjoying strong fibre broadband take up.

RISKS

We are cautious on oil majors, believing the market has not properly discounted the capital investment needed to replenish shrinking reserves.

We are cautious on oil majors, believing the market has not properly discounted the capital investment needed to replenish shrinking reserves. We are also cautious on consumer staples; though we acknowledge their business strengths, we think valuations appear stretched. Regionally, we think certain countries present greater risk – for example, Greece, due to a potential eurozone exit. Finally, political issues continue to be a risk – including the rise of populist parties in Spain and Greece – though member states appear committed to retaining the euro.

ON OUR RADAR

QE

In the coming months, we'll be watching for concrete signs of QE's positive impact, including falling unemployment and loan growth.

- **Evidence of QE success:** In the coming months, we will be watching for concrete signs of QE's positive impact, including falling unemployment and loan growth.
- **Inflation:** We will be keeping an eye on inflation numbers, in particular. In our view, deflation must be avoided lest it lead to a downward spiral of falling investment and consumption and deteriorating debt-GDP ratios.
- **Political reform:** Central bank policy alone cannot solve the issue of low growth in the eurozone. We think Southern Europe must embrace free market policies, deregulate labor markets, increase the tax base, raise the pension age and take on vested interests.

US Equities

Sandy Sanders, Senior Portfolio Manager, US Equities
Walter McCormick, Senior Portfolio Manager, US Equities

THE BACKDROP

After a slow start, we expect the US economy to turn around in the back half of 2015.

The US equity market has reached an inflection point: after steady gains over the last few years, it is waiting for stronger signs of an acceleration in the US economy. Valuations are now in line with long-term averages; we need to see consumer spending and housing follow through and reaccelerate corporate earnings growth. US GDP contracted in Q1 due to headwinds caused by the strong US dollar (USD), lackluster growth and low commodities prices. Though the US economy is off to a slow start in 2015, we expect it to turn around in the back half of the year. We are seeing meaningful upside in the key metrics we follow, including inflation, housing starts, industrial production and mortgage-related activity.

OPPORTUNITIES FOR INVESTORS

We continue to see opportunities in the US housing and e-commerce sectors, as well as large cap banks.

The two biggest opportunities we see in US equities are the housing and e-commerce sectors. US housing starts in April were around 1.1 million[1] – the highest level of month-over-month growth since 1991. We think housing starts will likely move higher as pent-up demand in the economy overtakes supply, benefiting homebuilders and related companies while creating jobs and generating inflation in the economy. At the same time, we continue to see e-commerce companies gaining market share from offline retailers. In our view, this sector is a fairly straightforward growth driver as more consumers migrate to online shopping, particularly driven by mobile consumption. Finally, we continue to be positive about large cap banks, which are looking cheap versus the overall market with bottom-quintile valuations over the last decade. We think the sector is well positioned for a strengthening US economy and would benefit from higher interest rates flowing directly to the bottom line.

RISKS

A rapid slowdown in the Chinese economy would negatively impact US manufacturing businesses selling into China.

We believe one of the biggest risks today is a rapid slowdown in the Chinese economy – falling into the 5-6% growth range – that would create a shock effect for US manufacturing businesses selling into China. The strong USD poses a continued risk for US companies (hurting their ability to export) but appears manageable, as many US companies have done a good job diversifying. Geopolitical concerns surrounding the Middle East also continue, with the potential to negatively impact the global and US economies.

ON OUR RADAR

We are watching WTI oil prices. Prices in the US$65-70 range could be very supportive of US energy companies.

In the coming months, we'll be monitoring:

- **Energy prices:** We are watching the benchmark West Texas Intermediate (WTI) oil price that recently recovered off the bottom. If WTI gets into US$65-70 range, we think it could be a very positive development for energy companies.
- **US housing starts:** We are closely monitoring starts that are well below long-term averages. We are looking for the number to increase to 1.5 million this year.
- **Interest rates:** We are watching for signals that the Federal Reserve will begin raising interest rates, which we think is likely later this year once the US economy reaccelerates.

[1] Source: Bloomberg, as of May 19, 2015.

Emerging Markets Equities

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

THE BACKDROP

The strength of the US dollar means dollar indebtedness is an important determinant of emerging market health.

In an environment defined by a strong US dollar (USD), persisting economic and earnings growth deceleration, subdued inflation, weak commodity prices, and accommodative Central Banks, emerging markets are succeeding or struggling based on their commodity exposure, USD indebtedness, commitment to reform, and degree of current account and fiscal stress.

OPPORTUNITIES FOR INVESTORS

We are finding opportunities in areas of secular growth driven by demographic trends including consumption.

On a geographic basis, we are seeing opportunities in a relatively concentrated number of markets, including rate- and reform-sensitive China, India, Indonesia, the Philippines and Mexico. In Russia, we are positive about companies that are relatively free of state interference, with strong earnings, governance and a consistent dividend policy. In China, we think reform, liberalization and monetary stimulus are creating opportunities in the financial sector. Thematically, we favor areas of secular growth driven by demographic trends such as consumption, including the capex-light, rapidly growing new economy and e-commerce.

RISKS

We remain cautious about energy and materials sectors due to commodities price weakness.

We are cautious about Brazilian equities as the toxic combination of a recession, falling industrial and consumer confidence, and political unrest have undermined the local currency (real) and Brazilian companies. In Europe, Greece-related risks continue, as ratings agency Fitch downgraded the country's sovereign rating in March and debt negotiations stretch on. Overall, commodity price weakness has led to significant underperformance by related energy and materials sectors and we remain cautious about both.

ON OUR RADAR

We are looking for companies that are reducing costs via automation and innovation.

Key themes we continue to watch across emerging market equities include:

- Companies reducing costs via automation and innovation.
- Consumption growth driven by demographic trends surrounding Asia's growing incomes.
- The deregulation and development of financial markets across emerging market equities.

Asian Equities

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

Upwards earnings revisions and strong earnings per share growth may provide positive momentum for Asian equities.

THE BACKDROP

Markets in the Asia ex-Japan region continue to be underpinned by low inflation and a benign interest rate environment. Unlike previous periods of potential US Federal Reserve tightening, most central banks in the region are easing monetary policy and reducing interest rates to counteract disinflation. Liquidity remains ample, while upwards earnings revisions and strong earnings per share growth are also likely to provide positive momentum. A mixture of policy reforms and monetary easing in Asia is likely to pave the way for sustainable long-term growth.

We see opportunities in markets including India, South Korea and Taiwan based on different drivers across the region.

OPPORTUNITIES FOR INVESTORS

We believe there are different drivers across markets in the region. In India, we are positive on the revival in domestic growth and see upside in domestic cyclical sectors like consumer discretionary, financials and industrials. In South Korea, we expect to see homebuilders' earnings recover due to improving pre-sale prices and expectations of further monetary easing. In Taiwan, we continue to like companies that are exposed to the industrial automation and the Internet-of-Things.

Key risks include a potential rise in US interest rates, deflation due to lower oil prices and a Chinese economic slowdown.

RISKS

A potential rise in US interest rates, deflationary risk for some markets due to lower oil prices and the resurgence of the US dollar are some of the key macro risks facing the Asia Pacific region. While we do not expect a rapid rise in US interest rates, speculation of interest rate movement could increase the volatility of capital flows. A slowdown in Chinese growth could also spill over into equity markets in the region.

Tourism and friendly travel policies would support earnings growth of companies in the hospitality and services, transport and consumer sectors.

ON OUR RADAR

Key themes we believe investors should continue to watch include:

- **Tourism:** Strong outbound tourism and friendly travel policies introduced by a number of Asian governments is expected to underpin earnings growth of companies in the hospitality and services, transport and consumer sectors.
- **Oil prices:** In the longer term, lower oil prices should help India and Indonesia boost investment in infrastructure. The economic multiplier effect from these activities is set to drive earnings growth for companies in both markets.
- **Oil supply:** The oversupply of oil is likely to continue until shale producers in the US cut production. As a result, we remain cautious on energy and material stocks.

Greater China Equities

Kai Kong Chay, Senior Portfolio Manager, Greater China Equities

As a net importer, low oil prices are benefitting China as a form of indirect economic stimulus.

THE BACKDROP

Following several quarters of headlines about China's slowing economy, the government has stepped up with aggressive stimulus efforts, cutting the benchmark interest rate in May – the third cut in six months – and loosening bank lending requirements.[1] At the same time, it presses on with social, political and economic reforms designed to lay a foundation for more stable long-term economic growth. This strategy has been successful to date, maintaining generally robust economic growth that is expected to continue. The government targets 7.0% economic growth for 2015, which seems achievable alongside continued moderately loose monetary and fiscal policy. As a net importer, low oil prices are benefitting China as a form of indirect economic stimulus.

We see opportunities in sectors that stand to benefit from continued government stimulus, including e-commerce.

OPPORTUNITIES FOR INVESTORS

We see attractive investment opportunities with companies in sectors that stand to benefit from continued government stimulus. These include the e-commerce and environmental protection technology sectors and selective property development companies. We also see potential winners in construction companies, logistics providers and transportation companies that could benefit from the rollout of the much vaunted "one road, one belt" plan to invest in infrastructure along new maritime- and land-based trading routes between China and Europe.

Key risk factors include geopolitical tension in Asia, Eastern Europe and the Middle East.

RISKS

Key risk factors facing the Chinese economy externally include continued geopolitical tension in regions such as the South China Sea, Eastern Europe and the Middle East. In addition, any sudden shock to the global financial system – such as renewed economic woes in Europe or a sudden deceleration of the US economy – would hit China. Internally, policy risk is ever-present as continued reforms cannot always be anticipated. Local government debt loads also remain a concern, though the government has acknowledged and taken steps to address this.

We will be watching for further stimulus measures and additional moves to reform the financial system.

ON OUR RADAR

Key themes we think investors should continue to watch include:

- The potential for **further stimulus measures** in 2015, including the possibility of further rate cuts.
- Progress on rolling out the **"one road, one belt" program[2]** and announcements of related contracts.
- Further moves to **reform the financial system** through increased regulation and opening of China's capital account.

[1] Bloomberg, "China Adds Stimulus With Third Interest-Rate Cut in 6 Months" (May 10, 2015): http://www.bloomberg.com/news/articles/2015-05-10/china-cuts-interest-rates-in-stepped-up-effort-to-stem-slowdown.

[2] Bloomberg, "China Follows Silk Road in Search for Land of Fast Growth" (April 14, 2015): http://www.bloomberg.com/news/articles/2015-04-14/china-follows-the-silk-road-in-search-for-land-of-fast-growth.

Japanese Equities

Edward Ritchie, Senior Investment Analyst, Japanese Equities

THE BACKDROP

Japanese companies' attitudes towards shareholders are shifting, resulting in higher returns on equity.

Three main factors are driving the Japanese equities market right now:

- First, a set of macro-economic factors, including: a consumption recovery after the annualizing of the consumption tax hike that happened in April 2014; continued overseas demand for Japanese goods helped by the weak yen; and a build up in private and public sector demand for construction and investment that we expect to see going forward.
- We also expect Japanese government pension funds to continue their strong purchasing of Japanese equities to meet their asset allocation targets.
- Lastly, we continue to see Japanese corporates increase their focus on improving returns to shareholders, driving higher returns on equity (ROE). The proxy firm Institutional Shareholder Services Inc. (ISS) has recommended Japanese investors vote against company management that has achieved ROE of less than 5% over the last five years, creating significant incentives for management to be more shareholder-centric.[1]

OPPORTUNITIES FOR INVESTORS

Loan growth and rising bond yields would be positive for financials.

We believe loan growth driven by domestic capital expenditure and construction demand, as well as the potential for rising bond yields, will be positive for Japanese financials that have been fairly weak over the last 18 months on the back of bond yield declines. As inflation moves back up and the short-term impact of lower oil prices lessens, we expect to see a positive impact on bond yields that will have a positive impact on financials.

RISKS

Continued weak economic demand in China would have a negative impact on demand for Japanese goods.

While overseas demand has been boosted by a weak yen and the Chinese equities market is doing well, overall economic demand in China is weak. That has affected Japanese companies in two ways: construction machinery demand in China continues to decline, and was down significantly in March; and exports from China declined 15% in March.[2] If demand and exports are declining in China, this has a knock-on negative impact on demand for Japanese goods. This is a particular risk for any Japanese export sector that has large exposure to China, such as industrials (construction, machinery and factory automation).

ON OUR RADAR

Rising inflation will signal wage growth and stronger consumption demand, boosting overall economic growth.

Two key areas are on our radar screen for the coming months:

- **Aggregate earnings:** The Japanese fiscal year began on April 1. We believe the Japanese economy will be stronger in 2015 and corporate earnings forecasts will be stronger than what we saw in 2014. We are expecting double-digit aggregate earnings forecasts for the next fiscal year could be possible.
- **Inflation trend:** While there may be some delay in core inflation improvement thanks to the short-term impact of oil prices, if inflation doesn't start moving up, it will be a sign that no real wage growth is happening. If it does, we will know wage growth and stronger consumption demand is feeding through to the Japanese economy again which will support overall economic growth. Bond yields may start rising, which could then be positive for financials.

[1] Bloomberg, "No Mercy for Profit-Shy as ISS Urges Japanese Executive Cull" (May 27, 2015): http://www.bloomberg.com/news/articles/2015-05-27/no-mercy-for-profit-laggards-as-iss-urges-japan-executive-cull.

[2] Wall Street Journal, "China Exports Point to Weak First-Quarter Growth" (April 13, 2015): http://www.wsj.com/articles/china-trade-slumps-on-weak-demand-1428893964.

Global Fixed Income

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

THE BACKDROP

We expect the US economy to outperform most of its developed market peers in 2015. External factors may keep long-term rates in the US lower for an extended time.

As central bank policy divergence around the world continues – particularly between Europe and the US – we are seeing heightened volatility in the global fixed income market and expect this trend to continue in the coming years. We anticipate that the US economy will continue to grow at a moderate pace in 2015, outperforming most of its developed market peers; however, we expect Federal Reserve (Fed) rate hikes may be implemented at a slower pace than market consensus, and external factors including foreign economic growth and relative yield levels across developed markets may keep long-term rates in the US lower for an extended time. Meanwhile, interest rates are negative in Europe and Japan. We are seeing all currencies depreciate relative to the US dollar (USD) as central banks around the globe continue to ease.

OPPORTUNITIES FOR INVESTORS

Emerging market government bonds, particularly in Asia, can offer opportunities for investors as those economies outperform.

As we've been more cautious on high-yield debt, we continue to be positive on investment grade credit risk. We think investors can find opportunities in bonds denominated in non-Japan Asia currencies hedged with currencies from developed countries with weaker growth outlooks, including the Canadian dollar, euro, Singapore dollar and Japanese yen. We believe that emerging market (EM) government bonds, particularly those in Asia, will also offer opportunities for attractive returns as those economies outperform global averages, and see particular opportunities in developed EMs (e.g., Singapore, South Korea, Philippines, Thailand, and Mexico) and those countries with current account surpluses. Given the absolute level of yields, we think investors can consider maintaining a slightly lower duration bias.

RISKS

We are cautious about non-investment-grade exposure. Within Europe, we find risk/reward metrics for government bonds unfavorable.

We expect increased volatility in currencies, rates, and yield curves to persist as central bank policy divergence continues. Instead of seeking broad-based exposure to the entire global fixed income marketplace, we think country and currency selection in fixed income and currency markets will be much more important for investors. Within Europe, we find the risk/reward metrics for government bonds unfavorable right now. In terms of currencies, investors can consider hedging their foreign currency exposures as we expect continued economic growth in the US and the potential for wider interest rate differentials will be positive for the USD. We are cautious about non-investment-grade corporate exposure, recognizing that sector, quality and issuer selection are more important factors now than they were earlier in the credit cycle.

ON OUR RADAR

We expect to see a lot of volatility when the Fed transitions from monetary easing to tightening.

In the coming months we'll be watching for:

- Indications of when the Fed will hike rates – which we expect to happen at the end of 2015 – as there tends to be a lot of volatility when a transition from easing to tightening takes place.

US Fixed Income

Terry Carr, Head of Fixed Income, Canada

The most likely time frame for a US interest rate increase is late Q3 or Q4, with no more than one increase this year.

THE BACKDROP

Soft US economic conditions in the first quarter – probably the result of extreme weather – have unsettled the Federal Reserve (Fed), shifting its stance from slightly hawkish to more neutral, with an emphasis on the data dependency of any monetary tightening. As a result, we have shifted our interest rate outlook slightly and think the most likely time frame for a rate increase is late Q3 or Q4, with no more than one increase this year. Across the pond, the beginning of the European Central Bank's (ECB) Quantitative Easing (QE) has driven a strong European bond rally (with lower yields and higher bond prices) in the region, particularly in Germany. Push and pull factors are at play: unprecedented negative yields in Europe's strongest countries have been largely supportive for the US bond market, which looks very cheap to global investors right now. Inflows to the US are strong, further strengthening the US dollar (USD). At the same time, the US economy strengthening in the coming months would have the opposing effect, creating a headwind for the US bond market.

A strengthening US economy should continue to favor corporate debt.

OPPORTUNITIES FOR INVESTORS

We think investors can continue to find opportunities among investment grade and high-yield corporate debt. Credit health is very good, and many corporations have strong balance sheets and income. We expect the US economy will start to firm up in Q2 and Q3, creating a more supportive environment for corporate debt. Though yields are very low, we think the relative value of US fixed income, combined with the strong USD, will keep funds flowing into US bond markets. Keeping durations shorter can give investors a safer, more defensive posture if interest rates do rise.

Oil price uncertainty poses risks for high-yield debt.

RISKS

Energy – specifically, uncertainty over oil prices – continues to pose risks, particularly within the high-yield space where energy is the biggest industry sector, comprising about 15% of the market.[1] Though oil prices have firmed up recently, rising 20% from mid-March to the beginning of June[2] and helping the high-yield market recover its losses due to the oil price decline, forecasting what oil will do next is a difficult task, involving moving pieces like OPEC behavior, the Iran nuclear deal, and US shale production if prices go up. The strong USD is also posing risks. It has been steadily appreciating since June 2014, creating a headwind for the US economy. This is intertwined with the bond market: if foreigners like higher US yields, they will buy the USD as well as US Treasuries, strengthening the USD further.

Oil prices and the US dollar: movements in both could impact US economic growth.

ON OUR RADAR

After a weak Q1 likely due to weather, we will be looking to see whether the US economy steadily firms, supported by fundamentals including GDP and employment growth. That would be a signal that the Fed will start nudging rates up. We'll also be watching oil prices and the USD – and specifically whether movements in both will help or inhibit US economic growth.

[1] Source: Bloomberg, as of June 4, 2015.
[2] Source: Bloomberg, as of June 4, 2015.

Emerging Markets Debt

Roberto Sanchez-Dahl, Senior Portfolio Manager, Emerging Market Debt
Paolo Valle, Senior Portfolio Manager, Emerging Market Debt

THE BACKDROP

Structural reforms to strengthen domestic sources of economic growth are more important for EMs given global economic weakness.

We continue to see weaker fundamentals creating challenges for Emerging Markets (EMs), including: worsening terms of trade, weaker economic growth, lower commodities prices, and a persistently strong US dollar (USD). Weaker growth in the global economy has increased the importance of structural reforms and the need to strengthen domestic sources of economic growth in EMs. Despite these challenges and the volatility EM debt has experienced in recent months, investor inflows to the asset class continue to be substantial, with investors showing a preference for EM debt over equity positions. Unless the Federal Reserve (Fed) tightens monetary policy more aggressively than anticipated and both the European Central Bank and Bank of Japan end Quantitative Easing – all unlikely in our view – we think this trend should continue.

OPPORTUNITIES FOR INVESTORS

Contrary to consensus views, we see opportunities in Brazil given attractive valuations and policymakers' reform response to the political and economic crisis.

In Asia, we see opportunities for investors in Indonesia and India – both countries that elected new, reform-friendly presidents in 2014. In Latin America, we are positive on Mexico with its improving credit story and increased number of companies going to the capital markets. We also like Brazil (contrary to consensus views), where we think valuations are attractive and are constructive on policymakers' reform response to the political and economic crisis at hand. In addition, we see opportunities in the Andean region (Peru, Colombia and Chile) in anticipation of the Pacific Trade Agreement. Though we are cautious on Russia, in spite of geopolitical concerns we see selective opportunities in Russian corporate credit – specifically companies with low amortization profiles, healthy balance sheets and dollar revenues with ruble costs (exporters).

RISKS

We expect credit quality deterioration across EMs to continue for the rest of 2015.

We have seen a deterioration in credit quality in recent months across EMs and expect this trend to continue for the remainder of 2015. We have identified a number of risks external to the asset class: a disorderly normalization of policy rates by the Fed – for example, rates being hiked faster than expected – would result in higher than usual Treasury yields disruptive to all fixed income markets; lower than expected economic growth in China would surprise markets and impact sentiment towards EMs; and a stronger USD could also negatively impact inflows into EMs.

ON OUR RADAR

We have positive expectations for 2016 GDP growth in key markets such as Brazil, Russia, Eastern Europe and Asia.

In the coming months, we will be watching for a combination of structural and cyclical improvements across EMs as a key to strengthening EM economies. We have already noticed green shoots on the cyclical side, with growth forecasts in key markets brighter for 2016 – for example, we expect GDP growth in Brazil to be 1-2% next year after an expected decline of 1-1.5% this year, and have similarly positive expectations for Russia, Eastern Europe and Asia. After a packed political calendar in 2014 that stalled structural reforms, we will be looking for governments to focus on short- and medium-term measures to increase productivity and competitiveness.

Asian Fixed Income

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

We expect short-term volatility in Asian interest rate and currency markets due to monetary policy divergence.

THE BACKDROP

In an environment of monetary policy polarization between the US Federal Reserve and other major central banks, we expect some short-term volatility within Asian interest rate and currency markets. At the same time, we expect China's economy to continue its transition to a more sustainable growth path and avoid a significant slowdown. Several Asian economies, including China, India, Indonesia, South Korea and Thailand have already eased monetary policy this year.

We see opportunities to generate positive returns in Asian bond markets by focusing on Asian US dollar-denominated credit.

OPPORTUNITIES FOR INVESTORS

Following the relative strengthening in the US dollar (USD) in recent quarters, we believe there are opportunities to generate positive returns in Asian bond markets by focusing on Asian US dollar-denominated credit while adding exposure to selective Asian currencies with strong economic fundamentals. We think most Asian currencies are still undervalued versus the USD and could continue to contribute positively to performance in the medium to long run. Overall, we are relatively constructive on South Asian economies due to encouraging growth outlooks and ongoing policy reforms. In Indonesia, we expect further policy reforms to improve economic fundamentals and reduce the country's current account deficit. We believe Malaysian economic fundamentals remain sound despite the recent market volatility caused by lower oil prices.

A rapid rise in US interest rates, while unlikely, could lead to an outflow from emerging bond markets, including Asia.

RISKS

An expected hike in US interest rates in the second half of 2015 is likely to result in higher US Treasury yields. If there is a rapid rise in interest rates and correspondingly higher US Treasury yields, we could witness outflow from Asian bond markets. This would have a direct impact on Asian hard currency bond yields, driving local currency yields higher by varying degrees, and could result in outflow from emerging market to developed market fixed income. Against this backdrop, we believe that the relative spread offered by Asian credit will become increasingly important as a buffer against potential interest rate hikes.

We are closely monitoring targeted stimulus efforts by Chinese authorities to support the economy.

ON OUR RADAR

- **Stimulus efforts:** Chinese authorities continue to undertake targeted stimulus to support the economy. However, the renminbi is exhibiting greater volatility and credit risks are rising in the property sector. We will continue to monitor developments closely.
- **India:** Bonds in India continue to be among the highest yielding in the region. However, post-election optimism has been fully priced into the US dollar credit market. The current account deficit is improving due to lower oil prices and the Reserve Bank of India is expected to undertake further easing this year.
- **Further monetary easing:** Elsewhere in the region, further easing is expected in China, South Korea and Thailand. However, Indonesia's scope to further ease monetary policy may be limited by persistent weakness in the Indonesian rupiah.

Japanese Fixed Income

Keisuke Tsumoto, Managing Director, Head of Japanese Fixed Income Investment

THE BACKDROP

We expect the Bank of Japan to maintain its accommodative monetary policy, with inflation well below its target rate of 2%.

Two years have passed since the introduction of quantitative and qualitative monetary easing by the Bank of Japan (BoJ). Under the first arrow of Abenomics, large-scale purchases of Japanese government bonds (JGBs), with more emphasis on long-dated bonds, has lowered Japanese yields and flattened the yield curve. However, the year-on-year rate of increase in the consumer price index (CPI minus fresh food), excluding the direct effect of the consumption tax hike in April 2014, has diminished over the past year and is currently close to 0%. This is well below the BoJ's price inflation target of 2%. We expect the BoJ to continue its accommodative monetary policy until this target is achieved. Domestic demand is expected to grow at a moderate pace, although demand for Japanese exports seems less resilient despite a weaker yen.

OPPORTUNITIES FOR INVESTORS

We think increased yield volatility could result in attractive investment opportunities in the Japanese bond market.

JGB yields are expected to remain low given the BoJ's extensive asset purchase program. That said, yield volatility has remained high in recent months, and we may see several bouts of higher volatility going forward due to diminished liquidity in the bond market. We think volatile yield movements will likely cause temporary market dislocations that could result in attractive investment opportunities.

RISKS

Surprises in inflation data may call for a change in monetary policy – either further expansion or tapering.

Some of Japan's leading companies have increased workers' wages in the first quarter of 2015 – the largest increase in the past decade.[1] If this positive move extends to the rest of the economy, the increase in CPI could surpass market expectations. On the other hand, deflationary forces could persist, depending on the movement of international commodity prices. Surprises in inflation data may call for a change in the BoJ's monetary policy – either further expansion or tapering – which in turn could change the shape of the yield curve. As the BoJ is a major player in the JGB market, a potential change in its monetary policy could impact the wider market.

ON OUR RADAR

We are watching the broader Japanese economy, including domestic demand and demand for Japanese exports.

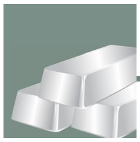
In the coming months, we think investors should continue to watch:

- **The broader economy:** Benign domestic demand versus less resilient demand for Japanese exports.
- **Inflation:** Potential acceleration in wage growth versus stagnant commodities prices.
- **Monetary policy divergence:** Accommodative monetary policy from the BoJ and European Central Bank versus the US Federal Reserve's likely increase in interest rates later this year.

[1] Financial Times, "Japan Inc gives biggest boost to base pay for more than a decade " (March 18, 2015): http://www.ft.com/intl/cms/s/0/76abfb48-cd3b-11e4-9144-00144feab7de.html#axzz3a8pUEdMM.

Global Natural Resources

Diana Racanelli & Craig Bethune, Senior Portfolio Manager, Global Natural Resources



THE BACKDROP

Pricing is at a low point for many commodities, with global economic weakness creating weak demand.

There has been a lower pricing environment for most base metals thanks to an oversupply and slowing demand, particularly in China. However, we expect the market to tighten as inventories are drawn down and excess supply is absorbed, resulting in higher pricing in 2016. Meanwhile, the gold price has trended downwards this year on a stronger US dollar (USD) and expectations of a hike in US interest rates. In energy, after a dramatic fall in oil prices over the past six months, producers have made significant cuts to capital spending. While inventories remain high in North America, we are watching for inflection points when production will begin declining and inventories will be drawn down. We think we are getting close and expect oil prices to gradually move up in the coming quarters. Natural gas supplies remain abundant and we'll be looking for incremental demand over time leading to a higher price.

OPPORTUNITIES FOR INVESTORS

We expect an increase in M&A activity throughout 2015 in gold and other commodities.

Pricing is at a low point for many commodities, which we think represents a good time to be investing. We continue to see opportunities in gold companies with strong operating assets that are controlling costs and protecting or improving their balance sheets. Gold and precious metal mine lives are at one of the lowest levels in 30 years and senior producers are finding it cheaper to buy versus build in order to address a declining production profile.[1] As a result, we expect M&A activity to continue throughout 2015 in gold and other commodities. We continue to look for companies with good resource potential to an acquirer. In our view, the pullback in energy prices has created opportunities to buy higher quality companies at lower prices.

RISKS

Rising US interest rates and a stronger USD could be a headwind for most commodities.

Economic weakness around the globe is creating weak demand across all commodities. We think a rapid rise in interest rates would be a headwind for commodities as a stronger USD tends to be negative for most commodities. Though geopolitical risks persist, we don't see many of them reflected in energy prices. For metals, the Chinese economy could pose challenges; if GDP slows further or stays sluggish for a longer period of time, demand will be negatively impacted. For gold, upside is limited by an improving US economy, strong USD and the impact of a possible increase in US interest rates.

ON OUR RADAR

Given low pricing, we are looking for resource companies that are reducing costs to generate cash flow.

In the coming months, we will be looking for resource companies that continue to reduce costs to generate cash flow in a low pricing environment. We will also be watching:

- Whether the Federal Reserve increases US interest rates and by how much as a key factor for precious metals.
- Growth rates and any changes in government policy in China – critical factors for metals.
- Global liquidity and global debt as two big factors impacting all commodities.
- The results of the nuclear negotiation with Iran.

[1] Source: Scotia Capital Inc. (Canada), April 8, 2015.

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