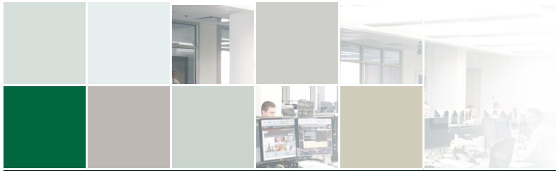
Manulife Asset Management™



Global Intelligence: Summer 2014

MARKET OUTLOOKS

GLOBAL FIXED INCOME

Tom Goggins, Senior Portfolio Manager, Fixed Income

Sticking with a lower duration bias

Against a backdrop of rising Treasury yields and a steepening yield curve, we plan to maintain a lower duration bias over the year.

In the first half of 2014, global bond market performance aligned with a number of expectations we had going into the year. Both high-yield and investment grade corporate bonds performed well. Broadly speaking, emerging markets debt also did well in the first half, with currencies appreciating generally and economies including the Philippines and South Korea continuing to plug along with growth rates stronger than global averages.

The first half also brought two surprises. First, US Treasuries rallied, largely driven by US economic data stumbling out of the gate in Q1 and a flight to quality due to escalating geopolitical situations including Ukraine and Iraq. Second, European bonds rallied sharply, particularly in peripheral Europe. In our opinion this performance was not driven by fundamentals but rather by the hope of additional European Central Bank (ECB) stimulus in Q1 and the realization of those hopes in Q2 with the ECB's announcement of unprecedented measures including a negative rate on ECB bank deposits and a record low benchmark interest rate. We continue to believe that economic data, though it is broadly improving, does not warrant the valuations we have seen in these peripheral markets.

Taking a closer look at the second quarter, the major theme was low volatility as markets slowed in large part due to the lack of central bank divergence globally. Economic data in China began to show signs of improvement, as disinflationary pressures eased. Global bond markets performed well late in Q2, led by rallies in higher-quality, longer-maturity bonds. High-yield corporate bonds and investment-grade corporate bonds both performed well in the quarter as spreads tightened. Emerging market debt, including Mexico, Brazil and Korea, also had a good quarter. Conversely, detractors included shorter duration exposure as Treasuries rallied.

Looking ahead, we expect Treasury yields to rise and the yield curve to steepen over the coming periods. Against that backdrop we plan to maintain a lower duration bias over the year. We also believe that corporate bonds, particularly **US high-yield corporate bonds**, will offer attractive returns in the coming months, generally driven by interest income earned rather than price appreciation. With the US economy showing signs that the recovery is on track and first-quarter weakness was only a temporary disruption, we will continue to look for companies in the high-yield space with the potential to outperform due to credit upgrades as they benefit from the improving economy.

In addition, we expect **emerging markets with better fundamentals and stronger economies, particularly those in Asia**, to offer attractive returns as those economies outperform global averages. Within these markets, we believe that Asia (ex Japan) currencies offer the most attractive relative opportunities, particularly versus currencies in economies with lower growth expectations such as Canada. In wider emerging markets, we see particular opportunities in **Mexican bonds** as a result of structural reforms taking place in the country.

In terms of potential risks, while we believe that Europe is beginning to emerge from a sustained economic downturn, we think the risk/reward metrics for **European government bonds** remain somewhat unfavorable.

Overall, we think that messaging from the Fed will be a key variable in the coming months. We think the language Yellen uses to shape market expectations on how the Fed plans to raise short-term interest rates after its tapering concludes will be the main driver for all asset classes for the remainder of the year.

This material, intended for the exclusive use by the recipients who are allowable to receive this document under the applicable laws and regulations of the relevant jurisdictions, was produced by and the opinions expressed are those of Manulife Asset Management as of August 2014, and are subject to change based on market and other conditions. The information and/or analysis contained in this material have been compiled or arrived at from sources believed to be reliable but Manulife Asset Management does not make any representation as to their accuracy, correctness, usefulness or completeness and does not accept liability for any loss arising from the use hereof or the information and/or analysis contained herein. The information in this document including statements concerning financial market trends, are based on current market conditions, which will fluctuate and may be superseded by subsequent market events or for other reasons. Manulife Asset Management disclaims any responsibility to update such information. Neither Manulife Asset Management or its affiliates, nor any of their directors, officers or employees shall assume any liability or responsibility for any direct or indirect loss or damage or any other consequence of any person acting or not acting in reliance on the information contained herein. All overviews and commentary are intended to be general in nature and for current interest. While helpful, these overviews are no substitute for professional tax, investment or legal advice. Clients should seek professional advice for their particular situation. Neither Manulife Financial, Manulife Asset Management™, nor any of their affiliates or representatives is providing tax, investment or legal advice. Past performance does not guarantee future results. This material was prepared solely for informational purposes, does not constitute an offer or an invitation by or on behalf of Manulife Asset Management to any person to buy or sell any security and is no indication of trading intent in any fund or account managed by Manulife Asset Management. No investment strategy or risk management technique can guarantee returns or eliminate risk in any market environment. Unless otherwise specified, all data is sourced from Manulife Asset Management. Issued in the United Kingdom by Manulife Asset Management (Europe) Limited. Manulife Asset Management (Europe) Limited is authorized and regulated by the Financial Conduct Authority to carry on regulated activities in the United Kingdom.

Manulife Asset Management

Manulife Asset Management™ is the institutional asset management arm of Manulife Financial. Manulife Asset Management™ and its affiliates provide comprehensive asset management solutions for institutional investors and investment funds in key markets around the world. This investment expertise extends across a full range of asset classes including equity, fixed income and alternative investments such as real estate, timber, farmland, as well as asset allocation strategies.

Manulife Asset Management has offices with full investment capabilities in the United States, Canada, the United Kingdom, Japan, Hong Kong, Singapore, Taiwan, Indonesia, Thailand, Vietnam, Malaysia, and the Philippines. In addition, it has a joint venture asset management business in China, Manulife TEDA. It also has operations in Australia, New Zealand, Brazil and Uruguay. Additional information can be found at ManulifeAM.com. Manulife Asset Management™, Manulife and the block design are trademarks of The Manufacturers Life Insurance Company and are used by it and its affiliates including Manulife Financial Corporation.

Additional information about Manulife Asset Management may be found at ManulifeAM.com

195021

Manulife Asset Management™