Manulife Investment Management

Manulife Asset Allocation Portfolios

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Market Review

U.S. stocks delivered a solid rally in the fourth quarter of 2020, with November accounting for most of the advance. On the final day of the year, the S&P 500 Index and the Dow Jones Industrial Average both closed at all-time highs, while the NASDAQ Composite Index was close.

October was a choppy affair, with share prices rising early in the month, but then declining on renewed fear about the resurgence of coronavirus cases in the U.S. and Europe. Pre-election jitters and Washington's inability to deliver another economic stimulus package for cash-strapped Americans also hurt the market.

The first six trading sessions of November ushered in a meaningful advance for stocks. Investors took comfort in Joe Biden's November 3rd victory in the U.S. presidential election, coupled with the avoidance of a "blue wave" in Congressional races that some feared might give Democrats firm control of Congress and set the country up for big changes in health care and other policies.

A divided Congress, where Democrats control one house and Republicans have a majority in the other, increases the chances of legislative gridlock and maintaining the status quo, which reduces the uncertainty associated with major policy changes. The stock market generally reacts badly to uncertainty. With that said, the fate of the Senate hung in the balance at year-end, as investors awaited the results of runoff elections for the two Georgia Senate seats scheduled for January 6th.

On Monday, November 9th, stocks gained further ground on news that a COVID-19 vaccine developed by pharmaceutical giant Pfizer and partner BioNtech was more than 90% effective in a late-stage clinical trial.[1]

Positive news on the vaccine front continued throughout the quarter. U.K. regulatory authorities granted the Pfizer-BioNtech vaccine an emergency use authorization (EUA) early in December.[2] The U.S. Food and Drug Administration (FDA) followed suit on December 11th with an EUA permitting distribution of the vaccine in the U.S.[3] A week later, the FDA issued an EUA for a vaccine developed by Moderna.[4] A number of other vaccines were also in development or already approved in the U.K., China, and Russia.[5]

[1] https://abcnews.go.com/US/pfizer-announces-initial-phase-data-showing-vaccine-effective/story?id=74103607.
[2] https://www.pfizer.com/news/press-release/press-release-detail/pfizer-and-biontech-achieve-first-authorization-world.
[3] https://www.fda.gov/emergency-preparedness-and-response/coronavirus-disease-2019-covid-19/pfizer-biontech-covid-19-vaccine.
[4] https://investors.modernatx.com/news-releases/news-release-details/moderna-announces-fda-authorization-moderna-covid-19-vaccine-us.
[5] https://www.raps.org/news-and-articles/news-articles/2020/3/covid-19-vaccine-tracker.

Meanwhile, Congress finally hammered out a compromise on a roughly $900 billion economic stimulus bill, which – after calling the legislation a "disgrace" days earlier – President Trump signed into law near the end of the quarter. The stimulus was part of a larger package that included an omnibus spending bill, and delaying any longer would have resulted in a shutdown of the federal government.[6]

The stimulus bill calls for one-time checks of $600 for individuals – half the amount in the March CARES Act – and an extra $300 per week in unemployment benefits for at least 10 weeks, among other provisions.[7] At the president's urging, Congress was considering an additional $1,400 in one-time payments, but the matter remained unresolved as of year-end.

The most recent dose of economic stimulus has garnered the support of the Federal Reserve (the Fed), as well as a broad selection of economists and legislators on both sides of the political aisle, as the U.S. economy appeared to be losing momentum in the final quarter of 2020. The weekly number of individuals filing for unemployment benefits in state programs remained elevated, at around 800,000, as of late December.[8] Meanwhile, personal income for November fell 1.1%, the second consecutive monthly decline. Personal spending for November was also lower.[9]

Despite shaky economic data, stock prices were supported by expectations for a strong rebound in corporate earnings. According to financial data keeper FactSet Research Systems, as of late December, the estimated year-over-year earnings growth rate for S&P 500 companies in 2021 was a robust 22.1%. If achieved, this would be the largest annual earnings growth rate for the index since the 39.6% mark posted in 2010. FactSet reports that both easy comparisons with weak 2020 earnings and improving earnings are expected to drive the 2021 profit expansion, with the energy, industrials, and consumer discretionary sectors leading the way.[10]

U.S. Treasury yields crept higher during the quarter amid the expected boost to economic growth from additional stimulus and the rollout of COVID-19 vaccines. The 10-year Treasury note yield approached the 1% level but couldn't penetrate it, ending the quarter at 0.93%, versus 0.69% at the end of September. Rising yields were a headwind for Treasuries; corporate and municipal bonds did considerably better, as did TIPS (Treasury Inflation-Protected Securities).[11]

International stocks in developed markets were also strong in the fourth quarter. Like the U.S., France, Germany, the U.K., Japan, and other nations saw a resurgence of COVID-19 cases. However, the prospect of having multiple vaccines to do battle with the coronavirus kept investors upbeat. Moreover, a weaker U.S. dollar provided a tailwind for foreign equities. With that said, Canada's primary stock benchmark lagged those in the U.S., despite the currency backdrop.

Emerging market (EM) stocks more than kept pace with their developed-market counterparts. Capital flows into emerging markets picked up during the quarter, as investors were attracted by EM valuations – both historically and relative to developed-market equities – and the anticipated boost to economic activity from the sooner-than-expected arrival of coronavirus vaccines, as well as supportive fiscal and monetary policies worldwide and a weaker dollar.[12]

Portfolio Review

During the fourth quarter of 2020, all four of the Manulife Asset Allocation portfolios posted positive absolute returns and also led their benchmark. From an asset allocation perspective, an overweight to high yield bonds was the top contributor during the quarter as risk-on sentiment pushed markets higher through year-end. Within equity, an overweight to emerging market equities boosted returns as the push towards an economic recovery and a weakening U.S. dollar boosted returns for the region. U.S. Financials, a substantial position in the opportunistic sleeve helped portfolio performance as the continued economic recovery saw a rotation in favor of traditional value sectors and away from the leaders year-to-date, including technology. Against the trend of previous quarter's performance, gold, another position in the opportunistic sleeve, lagged other assets as investors were not seeking safety during the risk-on market. Additionally, though it is traditionally a hedge against dollar weakness, many investors sought out cryptocurrencies like bitcoin instead of gold.

Across the portfolio, we are positioned for dollar weakness and a continued economic recovery. Looking ahead into 2021, we retain our opportunistic positioning in U.S. Financials and evaluate opportunities in non-U.S. developed equities and Brazilian equities, while remaining strategically overweight Canadian equities. Within fixed income, we have a tilt towards Canadian core bonds. We also maintain our position in gold as it is the team's view that low interest rates offer an opportunity for strong returns in gold longer term.

From a manager selection perspective, the top detractors came from the Manulife World Investment Fund and the Manulife Global Listed Infrastructure Fund. The top relative contributors were the Manulife Strategic Income Fund and the Manulife U.S. All Cap Equity Fund.

Outlook

As of December 31st, the global economic recovery remains uneven and is likely to resemble the letter "K," in which some sectors recover rapidly, while others stall or slip back into recession-like conditions. Broadly speaking, we expect to see this difference play out in the first half of 2021 between manufacturing, which continues to recover

[6] https://www.nytimes.com/2020/12/22/us/politics/second-stimulus-whats-included.html.
[7] https://www.theguardian.com/us-news/2020/dec/28/us-stimulus-coronavirus-relief-package-bill.
[8] https://www.briefing.com/calendars/economic/display-article?ArticleId=ER20201231083000InitialClaims&FileName=claims.htm.
[9] https://thehill.com/policy/finance/531426-personal-income-falls-11-percent-spending-down-in-november.
[10] https://www.factset.com/hubfs/Website/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_121820.pdf.
[11] https://www.treasury.gov/resource-center/data-chart-center/interest-rates/pages/TextView.aspx?data=yieldYear&year=2020.
[12] https://www.ft.com/content/e12a1eee-2571-4ae5-bc91-cc17ee7f40d0.

extremely quickly, and services, which remains mired in COVID-19-related headwinds. This atypical recovery implies that sectors, industries, and economies with more leverage to manufacturing (for example, industrials and Asia) should outperform those that are more leveraged to services (e.g., retail and U.S.). In the second half of 2021, we expect more convergence between manufacturing and services, as the global economy gains momentum.

Uncertainty remains the watchword, as a second COVID-19 wave sweeps over the world, and we expect market volatility to remain elevated for the foreseeable future. And yet, there is also reason for longer-term optimism, with two vaccines already being distributed in the U.S. Another nagging uncertainty for the U.S. was addressed in December, with the passage of the new economic stimulus legislation. Granted, questions remain about whether this legislation goes far enough. But assuming continued improvement in the economic outlook, we believe risk assets could have more room to run in the coming year, albeit at a more moderate pace.

Overall, we currently favor assets that tend to perform well in an economic recovery, including emerging markets, small- and mid-cap stocks, and cyclical sectors. We believe there are better values in equities than in bonds, and better values in non-U.S. equities than in U.S. equities. We particularly like emerging markets (EM) stocks because of the U.S. dollar weakness we anticipate, as well as an improving macro story there.

In fixed income, we like EM debt – particularly U.S. dollar-denominated EM debt – better than U.S. high-yield bonds for its higher credit quality with comparable yields. We also favor global credit over government bonds. Private assets that are supply-constrained, such as timber and infrastructure, also look attractive to us. Defensive holdings we favor include U.S. corporate bonds – which the Fed is buying – and gold, which tends to do well when real yields are low or falling.

Recent events have underscored the need for special care to maintain a portfolio that can reasonably withstand unexpected shocks that might occur in the economic or geopolitical landscape, consistent with the level of risk investors are comfortable taking on. Increasingly, we believe a global portfolio should include not only traditional equity and fixed-income securities, but also meaningful exposure to alternatives and non-traditional strategies.

Performance for Manulife Asset Allocation Porfolios vs. Benchmark

As of 12/31/2020

Manulife Asset Allocation Portfolios*	3 Months	1 Yr	3 Yr	Since Inception	Inception Date
Manulife Conservative Portfolio	**2.59%**	**7.22%**	**5.56%**	**4.88%**	May 5, 2017
Conservative Portfolio Benchmark	1.54%	8.75%	6.36%	4.92%	
Manulife Moderate Portfolio	**4.01%**	**9.07%**	**6.27%**	**5.71%**	
Moderate Portfolio Benchmark	2.86%	9.50%	7.11%	5.74%	
Manulife Balanced Portfolio	**5.60%**	**10.31%**	**7.27%**	**6.61%**	
Balanced Portfolio Benchmark	4.67%	10.33%	8.00%	6.79%	
Manulife Growth Portfolio	**7.15%**	**11.74%**	**7.85%**	**7.32%**	
Growth Portfolio Benchmark	6.08%	10.82%	8.58%	7.55%	

Source: Manulife Investment Management as of December 31, 2020. Performance histories are not indicative of future performance.

*Since inception, May 5, 2017, Series F is generally designed for investors who have a fee-based or wrap account with their dealer. Series F performance is net of fees and expenses. Advisor Series is also available and includes a 1.00% trailing commission. Conservative Portfolio Benchmark consists of 40% FTSE Canada Universe Bond Index, 40% Bloomberg Barclays Multiverse Bond Index, 10% S&P/TSX Composite TR Index, 10% MSCI World NR Index. Moderate Portfolio Benchmark consists of 30% FTSE Canada Universe Bond Index, 35% Bloomberg Barclays Multiverse Bond Index, 13% S&P/TSX Composite TR Index, 22% MSCI World NR Index. Balanced Portfolio Benchmark consists of 20% FTSE Canada Universe Bond Index, 25% Bloomberg Barclays Multiverse Bond Index, 18% S&P/TSX Composite TR Index, 37% MSCI World NR Index. Growth Portfolio Benchmark consists of 15% FTSE Canada Universe Bond Index, 15% Bloomberg Barclays Multiverse Bond Index, 22% S&P/TSX Composite TR Index, 48% MSCI World NR Index.

The indices cited are widely accepted benchmarks for investment performance within their relevant regions, sectors or asset classes, and represent non-managed investment portfolios. Although these indices are similar to the fund's objectives, there may be material differences including permitted holdings or investment strategies, which may impact returns. Please refer to the Fund Facts of the fund for more information.

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