Manulife Investment Management

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Global Macro Outlook

Navigating COVID-19

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Introduction: a time of great change

The global macroeconomic outlook is facing unprecedented levels of uncertainty. Economies are responding to a substantial supply - and demand-side shock of a scale—and kind—of which we have precious little experience with. Markets are behaving in ways they have, quite literally, never before. Likewise, central banks worldwide are responding with tools and actions the size and scope that dwarf even the global financial crisis. Forecasting in this environment is a near-futile exercise: Macroeconomic data significantly lags real-time developments and the parameters by which we're able to contextualize them meaningfully change on an almost hourly basis. However, we're operating with several important assumptions with which we carry moderate-to-high levels of conviction. These assumptions are fluid, but they form the pillars of how we're thinking and reacting to the global macro outlook. In this special edition of **Global Macro Outlook**, we review these seven key pillars and outline their implications for capital markets in both the short and long run.

Seven working assumptions

Every major economy in the world is going to experience its sharpest contraction in growth since the 1950s. The economic damage will likely occur within a compressed timeframe.
Of note: We believe the coming recession will be services-led, as opposed to the typical investment- and manufacturing-led recession.

What matters most to markets isn't the depth of the economic contraction in Q2, but the length of the expected weakness. In our view, the global economy can meaningfully bounce back from two to three months of severe weakness, but if it lasts longer than that, a prompt "return to normal" will seem even less likely.

Aggressive central bank action has reduced the likelihood of a credit crisis, although the risk still remains and should be monitored closely. We don't believe the U.S. Federal Reserve will pursue negative interest rates, but we also don't expect interest rates to rise in the next few years.

Fiscal stimulus is significant, but it'll mostly support the recovery, as opposed to being able to prevent the Q2 contraction from taking place. We believe the amount of global fiscal support announced so far will produce some mild but non-negligible inflation in the medium term and is likely to steepen the yield curve.

The recent sharp decline in oil prices is creating additional disruptions in the global economy and financial system. We believe this will be a more significant drag on growth and capital markets than consensus currently suggests. We believe a floor in oil prices is necessary for a sustained risk rally.

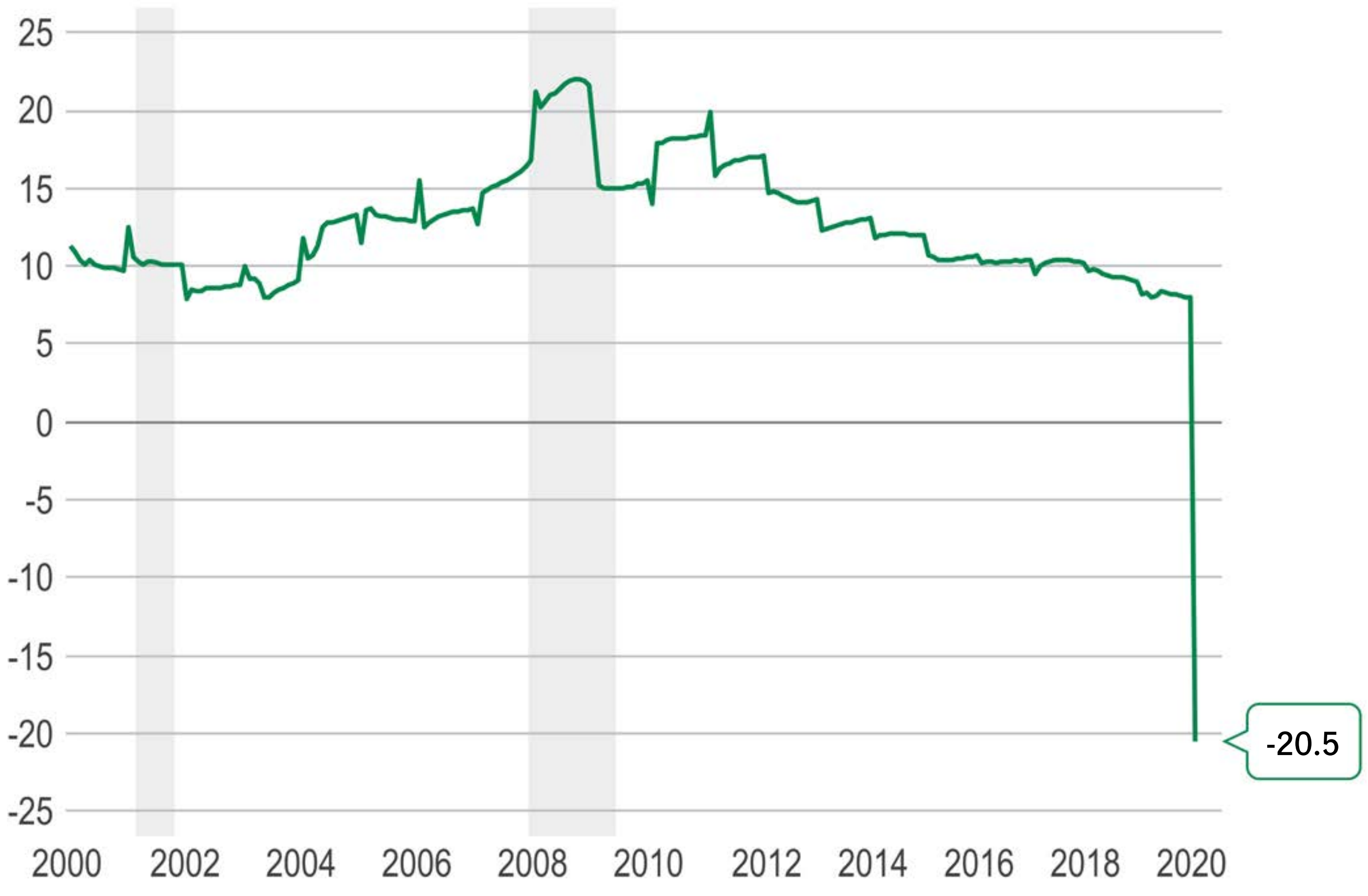
Asia is likely to see its economic data rebound more quickly on a short-term basis (although we believe the region will struggle with several long-term implications of COVID-19). Meanwhile, we believe several developed markets with high levels of household debt such as Australia and Canada are at risk of experiencing significant deleveraging.

COVID-19 is likely to introduce structural changes to the global economy over the next several years, including further de-globalization, an emphasis on the digital economy, extremely low interest rates, and a move toward substantially larger government deficits.

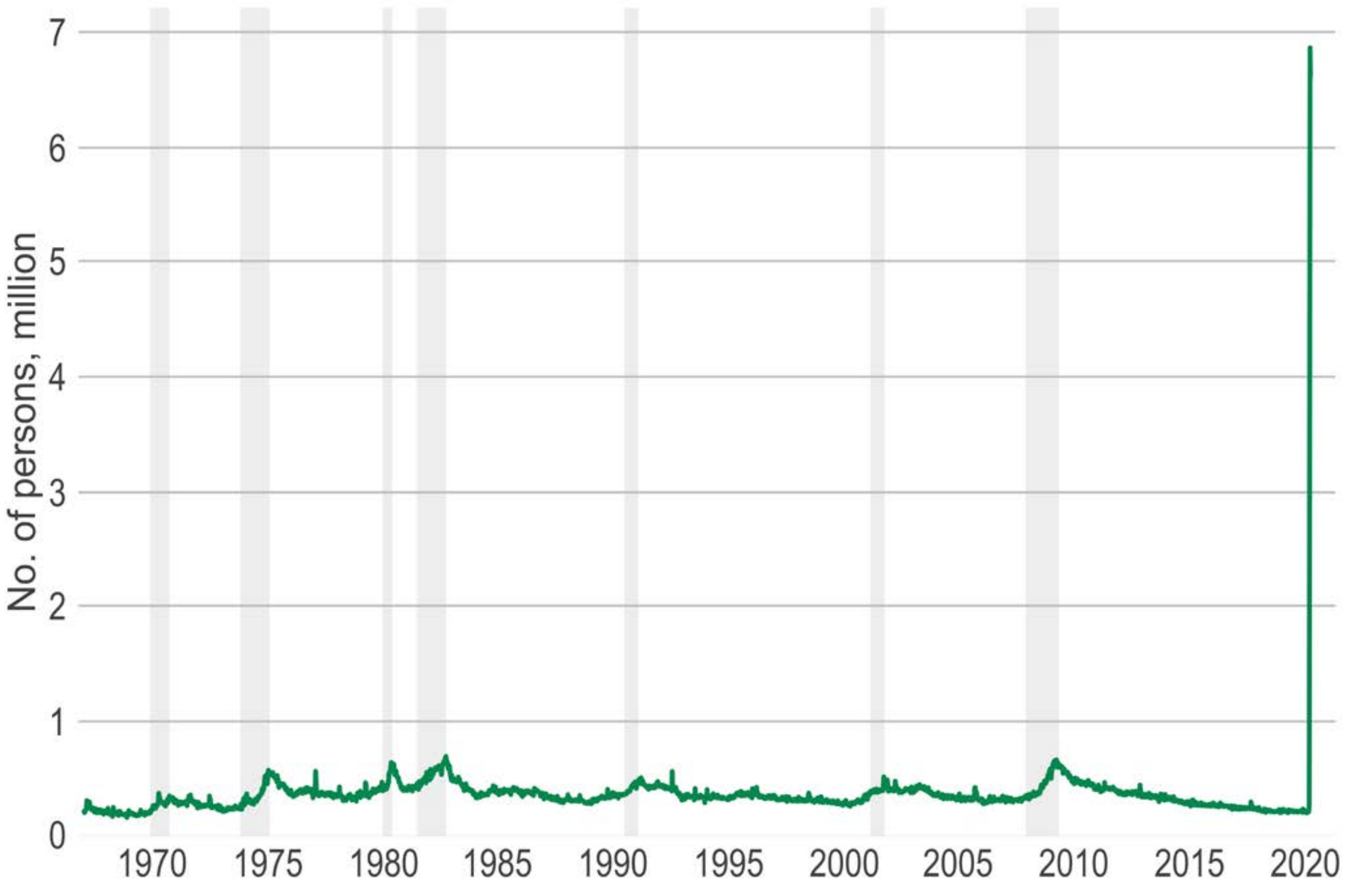
The sharpest contraction in modern economic history

As of early April, there are very few data points that include the COVID-19 shock. That said, China's experience, along with some limited weekly data in the United States, paints a difficult picture. We expect almost every major economic data point across almost every major developed market to post its worst data in recent history. Inevitably, all are likely to experience formal recessions. However, we believe the severity of the contraction is largely a function of the compressed nature of this recession: The demand destruction that would typically occur in a year will occur in a three- to six-month period, or less.

China retail sales (YoY % change)[1]



U.S. initial jobless claims[2]



[1] Bloomberg, Manulife Investment Management, December 12, 2019.

[2] U.S. Department of Labor, Manulife Investment Management, April 2, 2020. YoY refers to year on year.

The coming recession: duration vs. the depth of the contraction

In our view, the contraction in Q2 will be extremely sharp and unlike anything we've ever seen in modern economic history. However, the depth of the contraction will be less important than how long the economic weakness lasts. Our base case is that the contraction will take place within a super compressed timeframe, but so will the recovery. It's futile to time these developments—it'll largely depend on the effectiveness of containment efforts and when governments decide to "reopen" for business and unwind social distancing requirements. The longer it takes to return to normalcy, the more challenging it will be to avoid rising defaults among businesses and households, and the more severe the long-lasting implications will be.

How COVID-19 could hurt U.S. growth: an illustration based on historical data

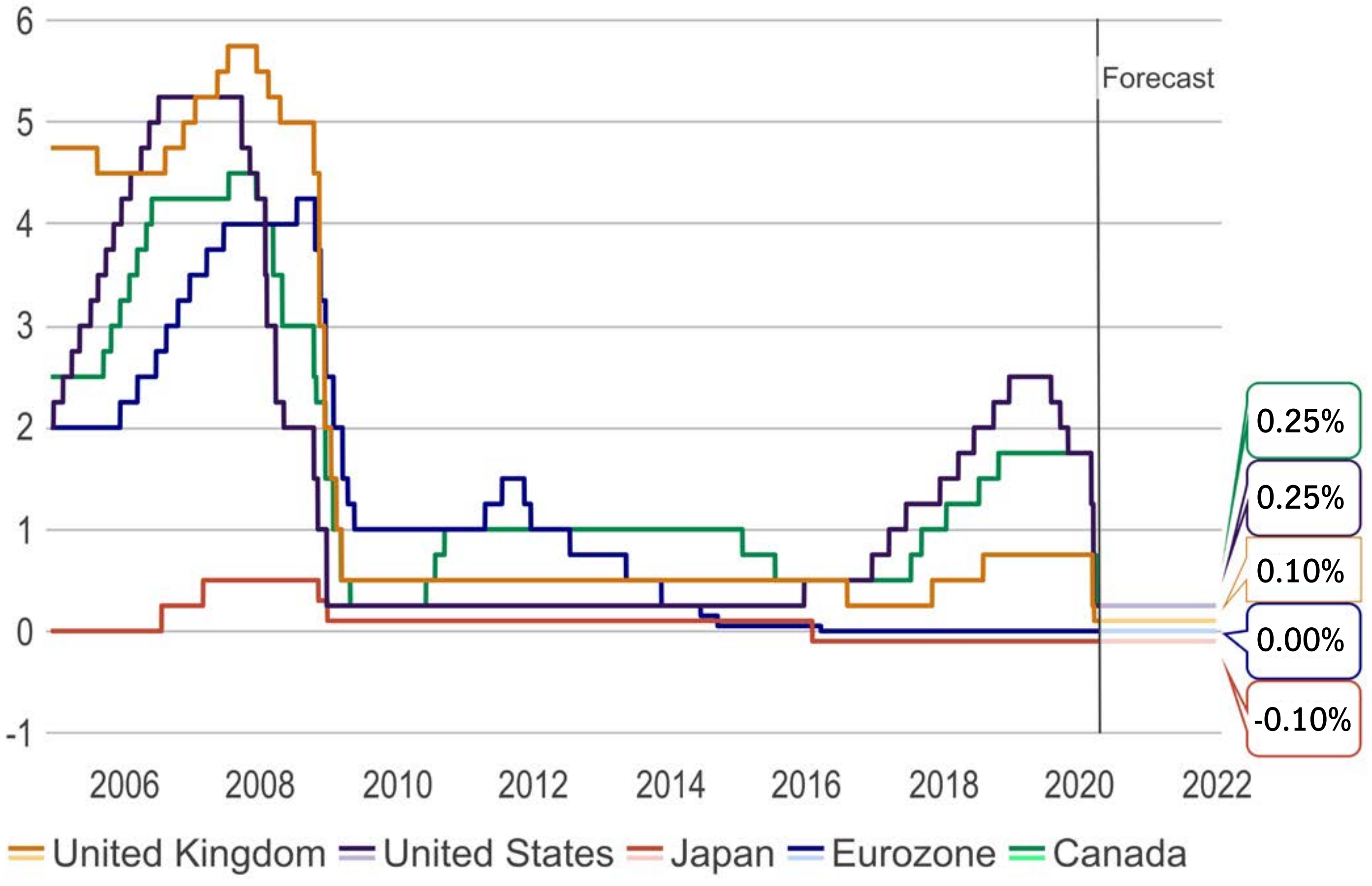
Economic contraction		Peak to trough decline in real GDP (%)	Duration in months			
Began	Ended		Peak to trough	Trough to peak	Peak to peak	Trough to trough
November 1948	October 1949	-1.7	11.0	37.0	45.0	48.0
July 1953	May 1954	-2.5	10.0	45.0	56.0	55.0
August 1957	April 1958	-2.9	8.0	39.0	49.0	37.0
April 1960	February 1961	-0.7	10.0	24.0	32.0	34.0
December 1969	November 1970	-0.7	11.0	106.0	116.0	117.0
November 1973	March 1975	-3.1	16.0	36.0	47.0	52.0
January 1980	July 1980	-0.4	6.0	58.0	74.0	64.0
July 1981	November 1982	-2.2	16.0	12.0	18.0	28.0
July 1990	March 1991	-1.4	8.0	92.0	108.0	100.0
March 2001	November 2001	-0.1	8.0	120.0	128.0	128.0
December 2007	June 2009	-4.0	18.0	73.0	82.0	91.0
	Average	**-1.8**	**11.1**	**58.4**	**68.5**	**69.5**
COVID-19 estimate						
January 2020	September 2020	**-4.0%**	**3–6**			

Source: For illustrative purposes only. National Bureau of Economic Research, Manulife Investment Management, April 2, 2020.

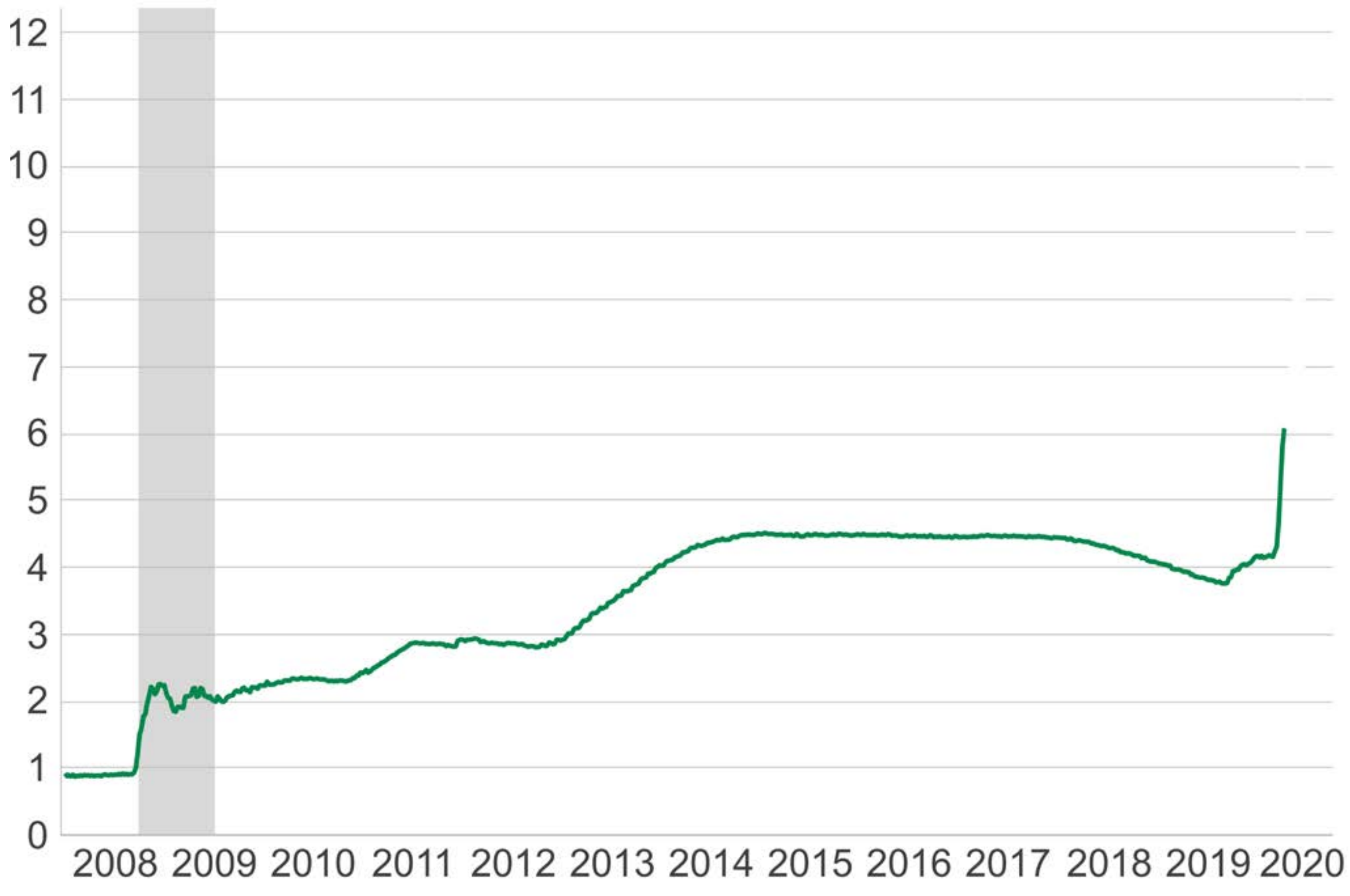
Aggressive central bank action has mitigated the rise of credit stress

Every major central bank has returned to what it deemed to be the "lower bound" of interest-rate policy. We don't expect any major central bank to cut its base policy rates further. In other words, we don't expect the U.S. Federal Reserve, the Bank of Canada, or the Bank of England to implement negative interest rates. Instead, we believe central banks will deploy a growing list of facilities aimed at providing liquidity and ensuring healthy market function in both the U.S. Treasury and the credit markets. Policy actions taken in March suggest that global central banks have probably prevented a credit crisis from developing for now, although the issue continues to merit careful monitoring.

Global central bank policy rates (%) [1]



U.S. Federal Reserve balance sheet (USD trillion) [2]

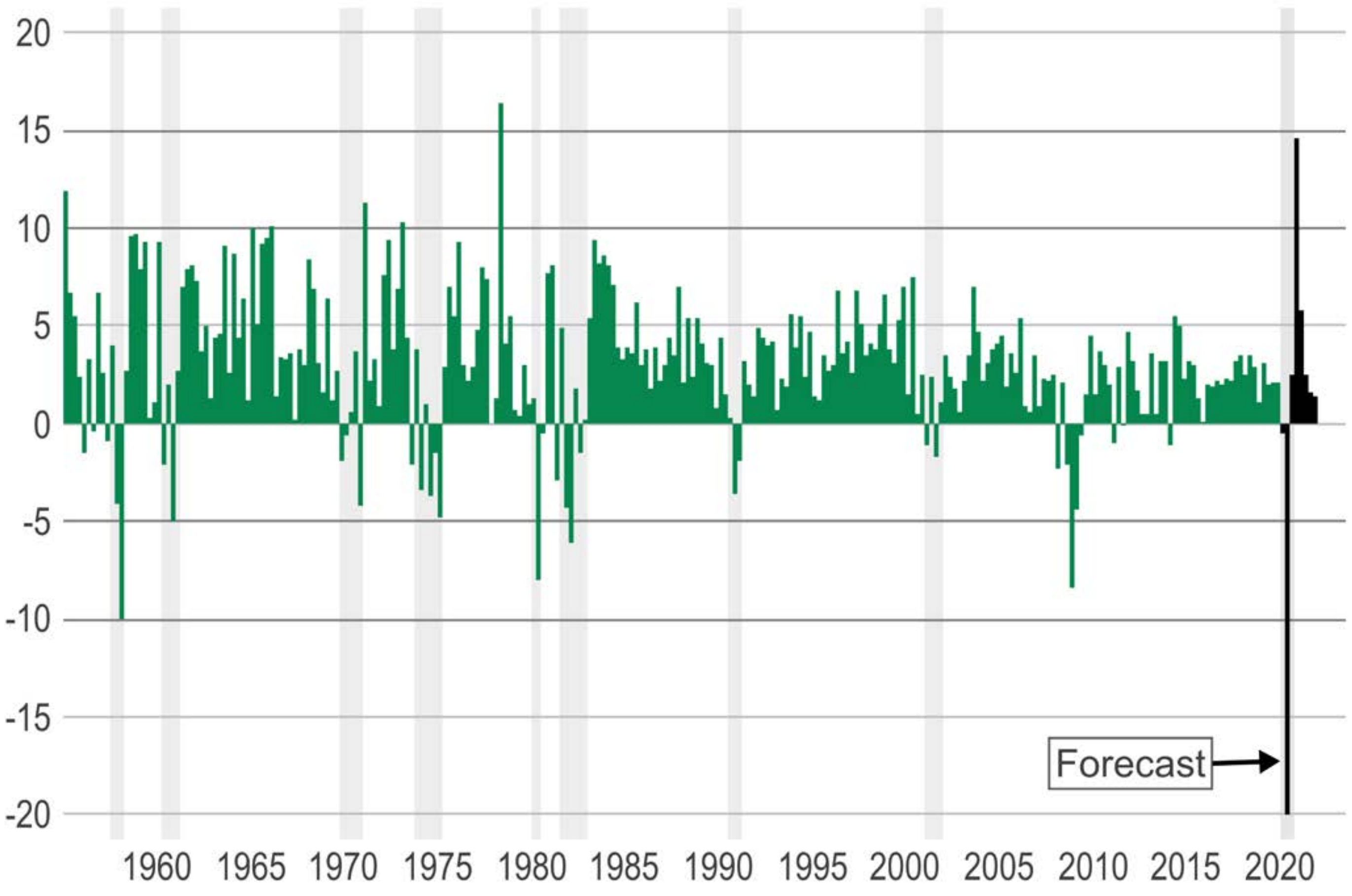


[1] Bloomberg, Manulife Investment Management, as of April 2, 2020.
[2] Bloomberg, Manulife Investment Management, as of April 2, 2020.

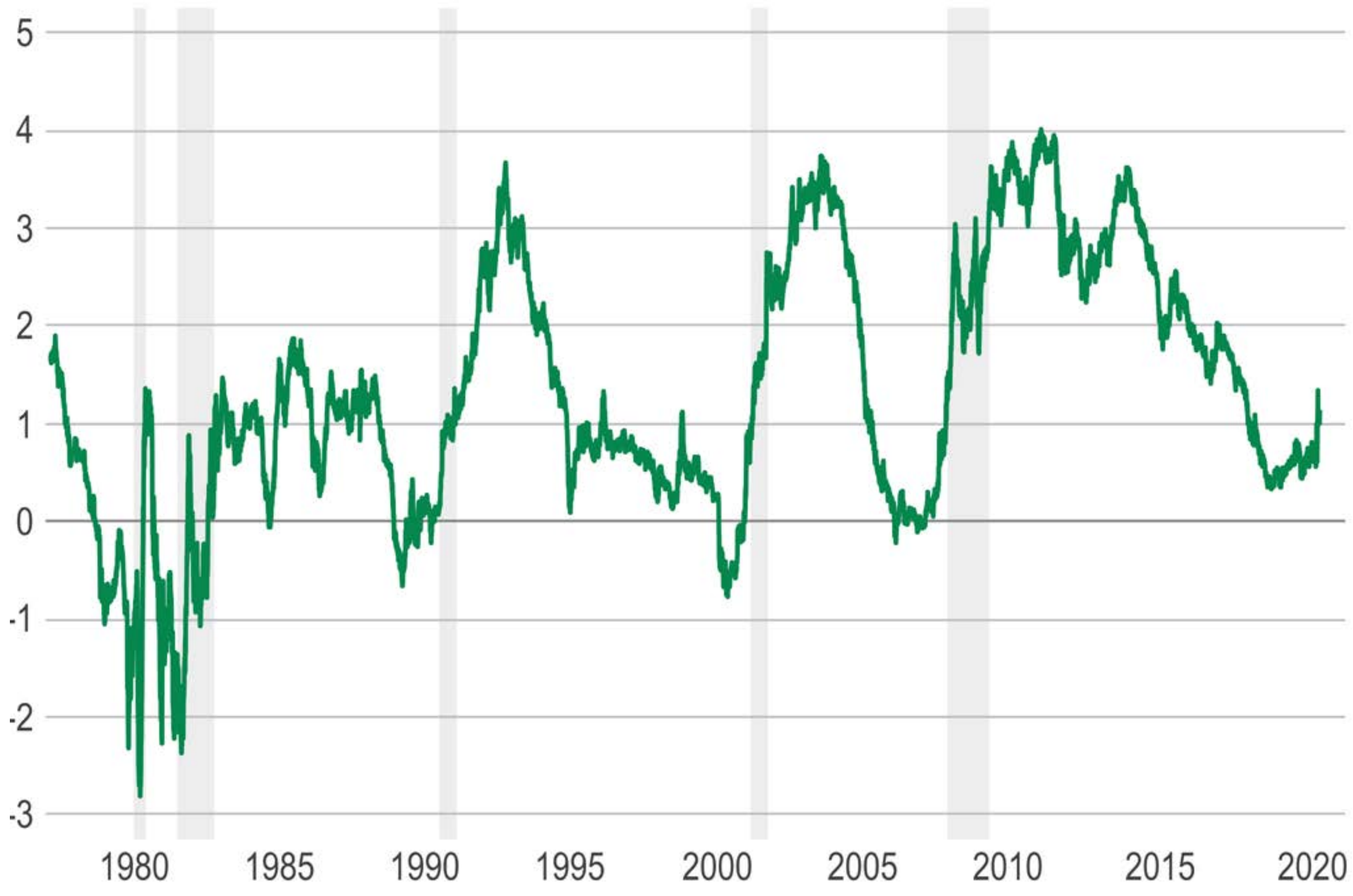
Fiscal policy set to help the recovery and steepen the yield curve

Although they vary in size and scope, political leaders in almost every major economy have enacted an emergency fiscal package to tackle the economic challenges associated with the COVID-19 outbreak. In our view, these packages are unlikely to prevent a recession, although the provision of wage subsidies could help save jobs. Crucially, these policies are incredibly relevant to the eventual recovery and will likely shape economic activity during the second half of the year. We also believe the combination of extremely easy monetary policy and aggressive fiscal stimulus will continue to steepen yield curves globally.

U.S. real GDP (QoQ % change) [1]



Spread between 30-year and 2-year U.S. Treasury yield [2]

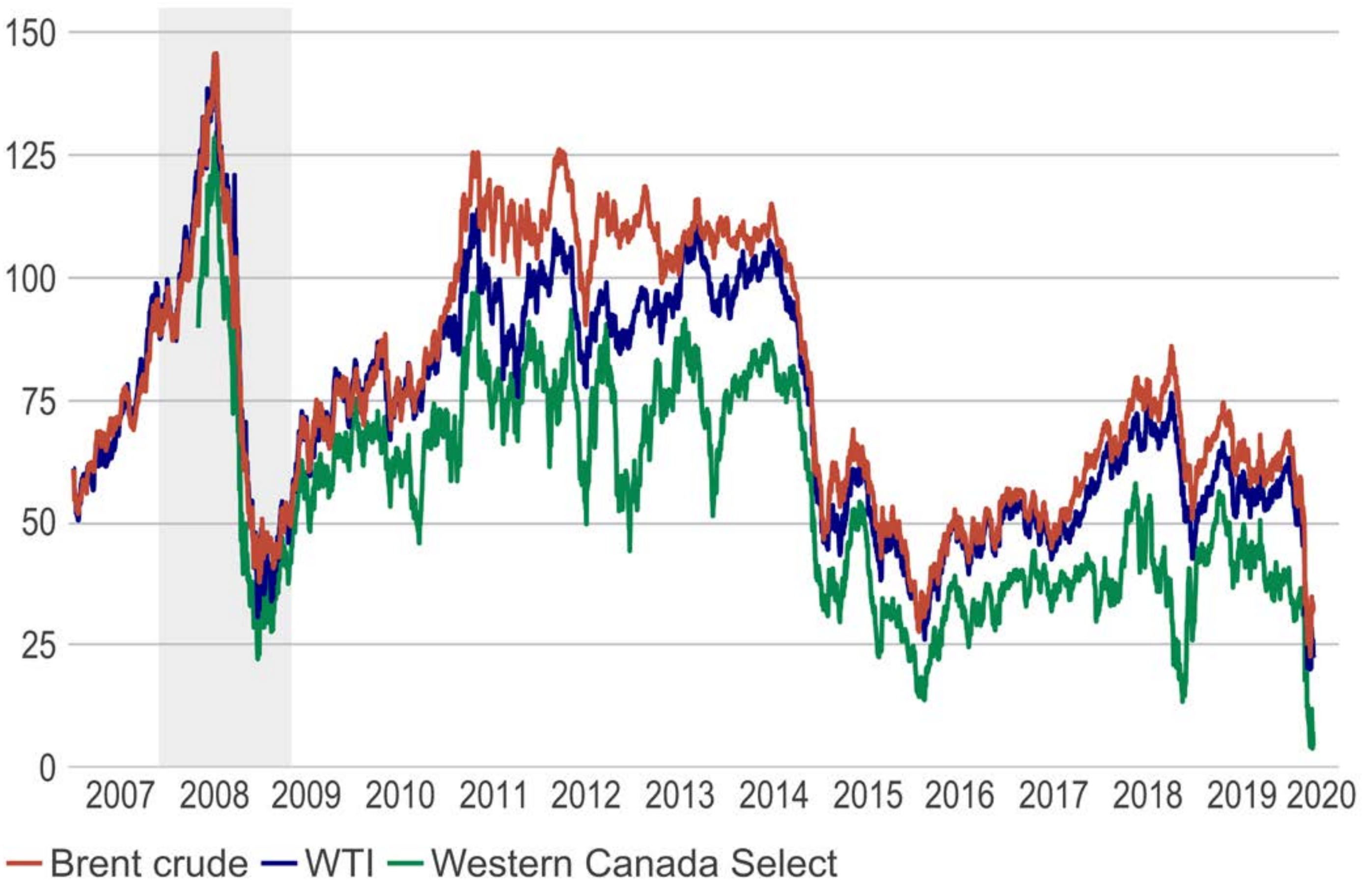


[1] Bureau of Economic Analysis, Manulife Investment Management forecasts, April 2, 2020.
[2] Bloomberg, Manulife Investment Management, April 2, 2020. QoQ refers to quarter on quarter.

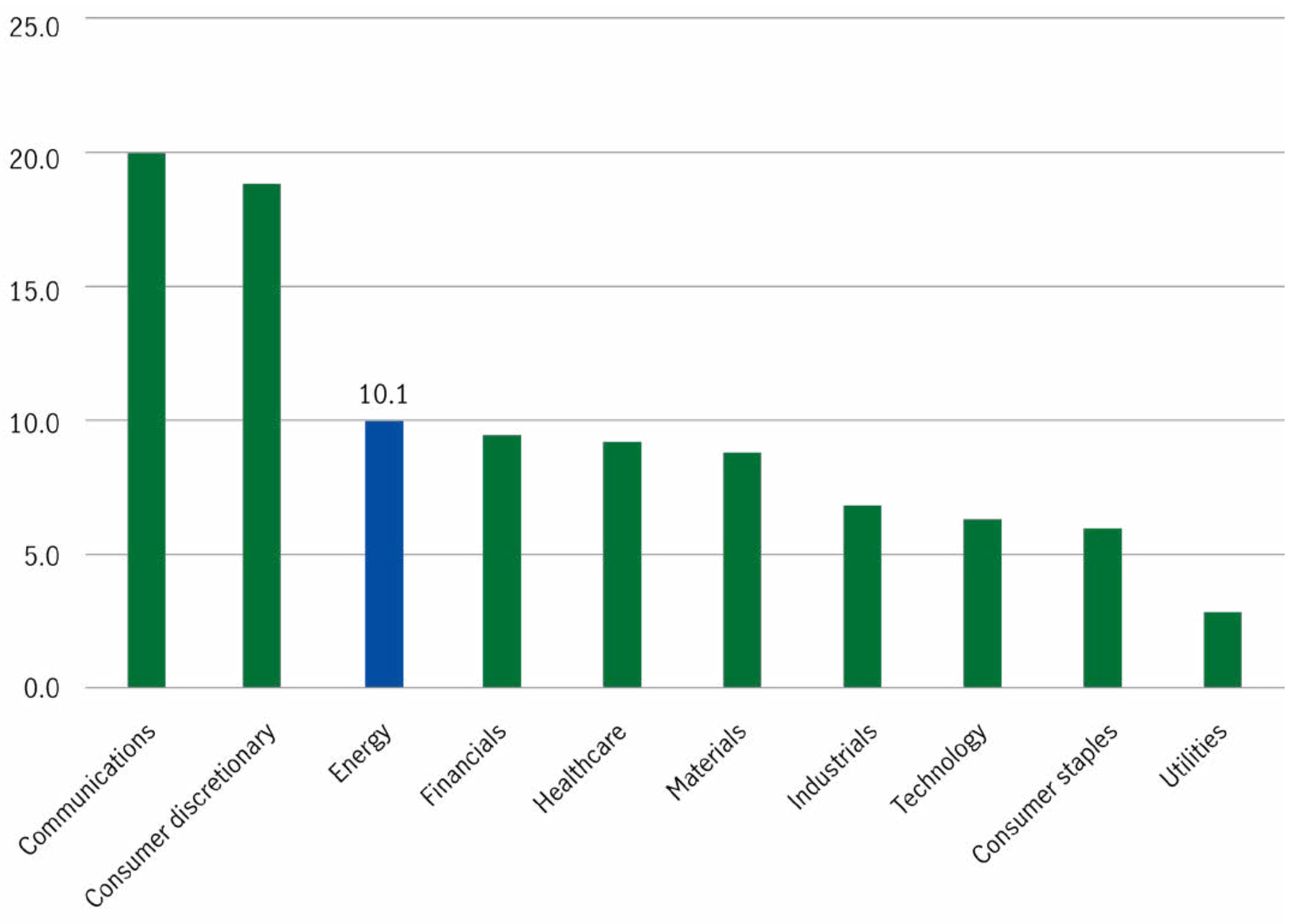
The drop in oil prices exacerbates the challenges posed by COVID-19

The sharp decline in oil prices recently is also hampering the global economy and disrupting financial markets. While lower oil prices are typically considered to be good for consumers, the ensuing decline in investment activity in the U.S. shale patch will further hamper growth in Q2. Moreover, the drop in oil prices (i) exacerbates the stress in the credit market since the energy sector accounts for an important share of the high-yield market, (ii) acts as a major deflationary shock for the global economy, and (iii) can lead to a stronger U.S. dollar. In our view, being able to establish a floor under oil prices is an important component of a broader and more sustainable rally in risk assets.

WTI, Brent Crude, and Western Canada Select US$/barrel[1]



Bloomberg Barclays U.S. Corporate High Yield Index by sector weight (%)[2]

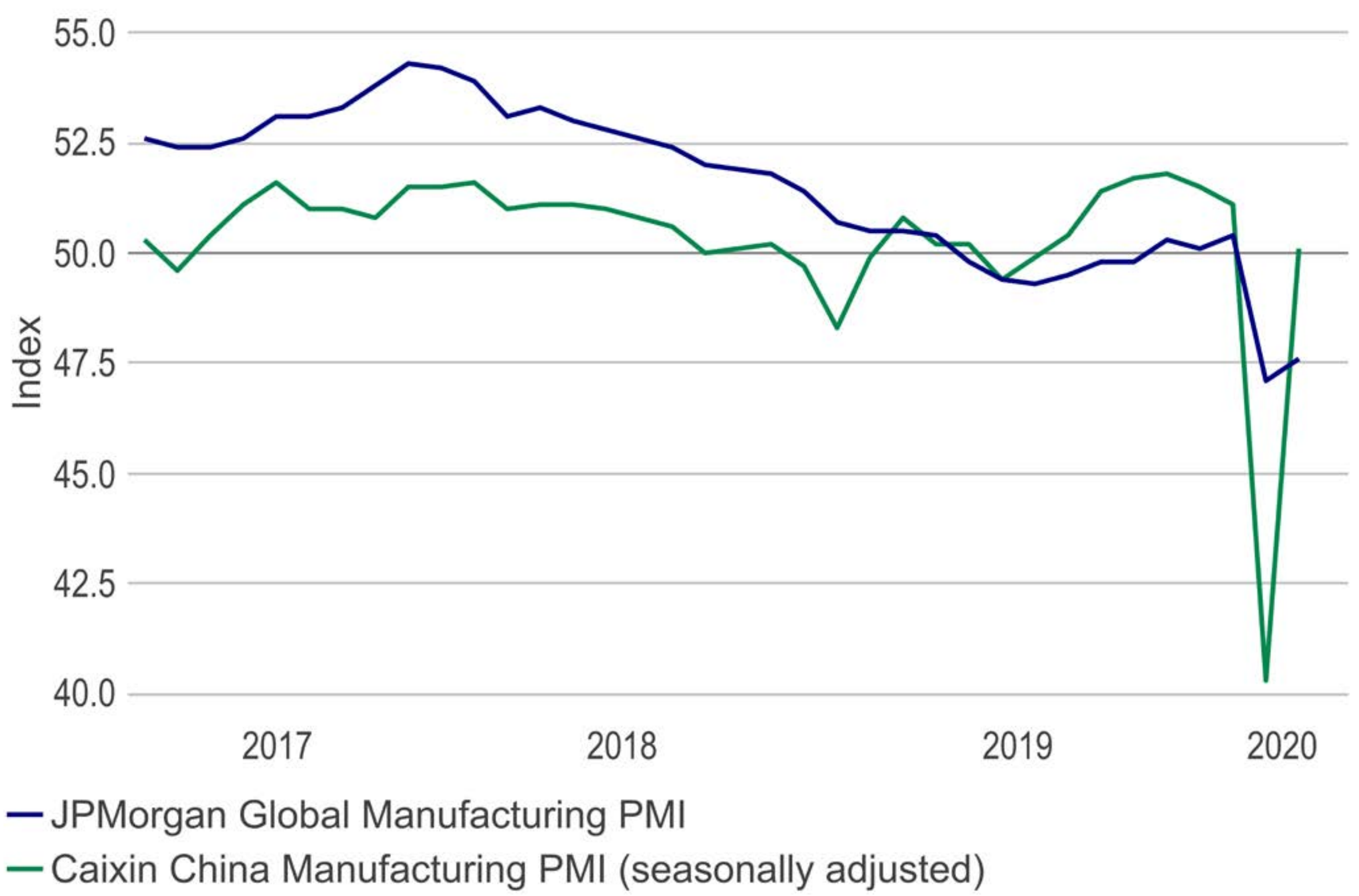


[1] Bloomberg, Manulife Investment Management, as of April 2, 2020. WTI refers to West Texas Intermediate.
[2] Bloomberg, Manulife Investment Management, as of April 2, 2020.

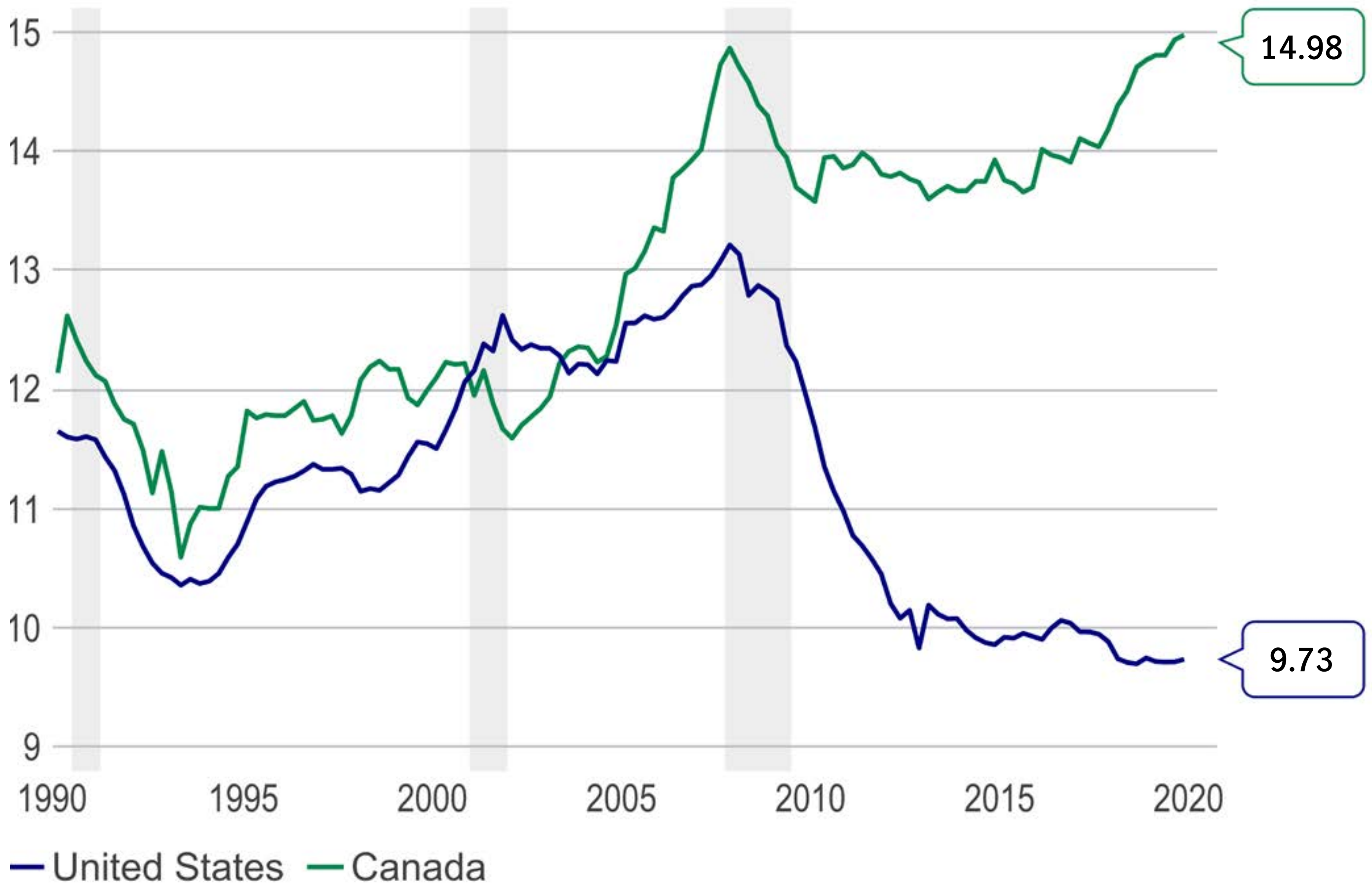
China's likely to rebound first; economic pain in Canada may last longer

Absent of a second wave of infections we expect China and several Asian economies to be among the first to recover from the economic damage brought about by COVID-19, although they're likely to continue to face significant structural challenges. Meanwhile, we're concerned that economies with extended households that went on a deleveraging exercise in 2008 (e.g., Canada) could experience a more prolonged recession than others, such as the United States, where consumers were in fundamentally better shape heading into the recession. Put differently, the impact of the economic shock will not be felt uniformly across different economies. Similarly, each country's recovery will likely be different as well.

Manufacturing Purchasing Manager Index: China vs. global [1]



Household debt service ratio: Canada vs. U.S. (%)[2]



[1] Bloomberg, Manulife Investment Management, as of April 2, 2020.
[2] Statistics Canada, Manulife Investment Management, as of April 2, 2020.

Structural shifts ahead in the post-COVID-19 world?

As much as we envision the next two quarters as a “compressed” recession, we’re already seeing signs of what can be best described as significant structural changes to the global economy as a result of the COVID-19 outbreak. Crucially, we doubt the global economy will return to its prior trend growth line because we expect potential growth to be dampened by further de-globalization. As we start to think about life after this crisis, the following macro trends appear to be increasingly relevant:

- Further de-globalization
- Acceleration in the digitization of the economy
- A fourth industrial revolution in the telecom space
- The rise of universal basic income and modern monetary theory
- Central banks as buyers of global corporate credit
- Reduced share buybacks among corporates
- Surge in infrastructure investment

Source: Manulife Investment Management, as of April 2, 2020.

Important information

A widespread health crisis such as a global pandemic could cause substantial market volatility, exchange trading suspensions and closures, and affect portfolio performance. For example, the novel coronavirus disease (COVID-19) has resulted in significant disruptions to global business activity. The impact of a health crisis and other epidemics and pandemics that may arise in the future, could affect the global economy in ways that cannot necessarily be foreseen at the present time. A health crisis may exacerbate other pre-existing political, social and economic risks. Any such impact could adversely affect the portfolio's performance, resulting in losses to your investment.

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Definitions

Purchasing Managers' Indexes (PMI)	Purchasing Managers' Indexes (PMI) are used as a leading indicator of the economic health of a country's manufacturing sector (Manufacturing PMI) and services sector (Services PMI). Manufacturing PMI measures the health of the manufacturing sector based on five major indicators: new orders, inventory levels, production, supplier deliveries, and the employment environment. The Services PMI is the equivalent for the services sector, covering transport and communication, financial intermediaries, business and personal services, computing and IT, and hotel and restaurants. It is not possible to invest directly in an index.
Bloomberg Barclays U.S. Corporate High Yield Index	The Bloomberg Barclays U.S. Corporate High Yield Bond Index tracks the performance of the U.S. dollar-denominated, high-yield, fixed-rate corporate bond market. It is not possible to invest directly in an index.

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