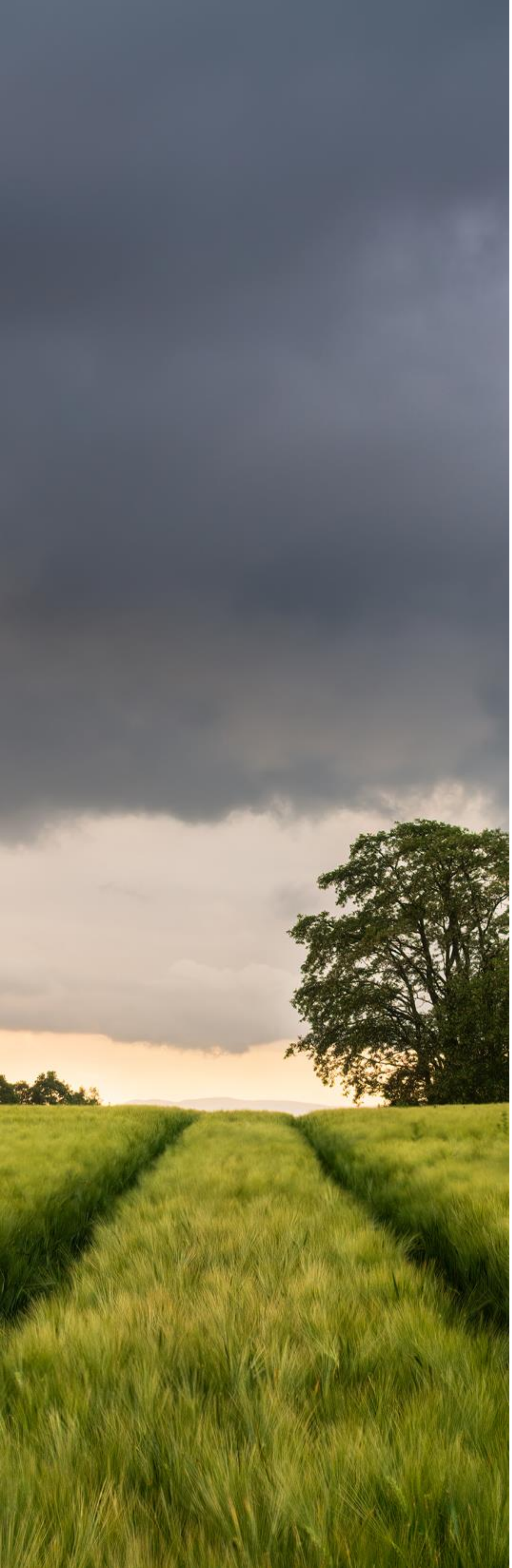

Manulife Investment Management

Q3 2022 | Global Macro Outlook

Navigating the gathering *storm*

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Global overview

Big picture

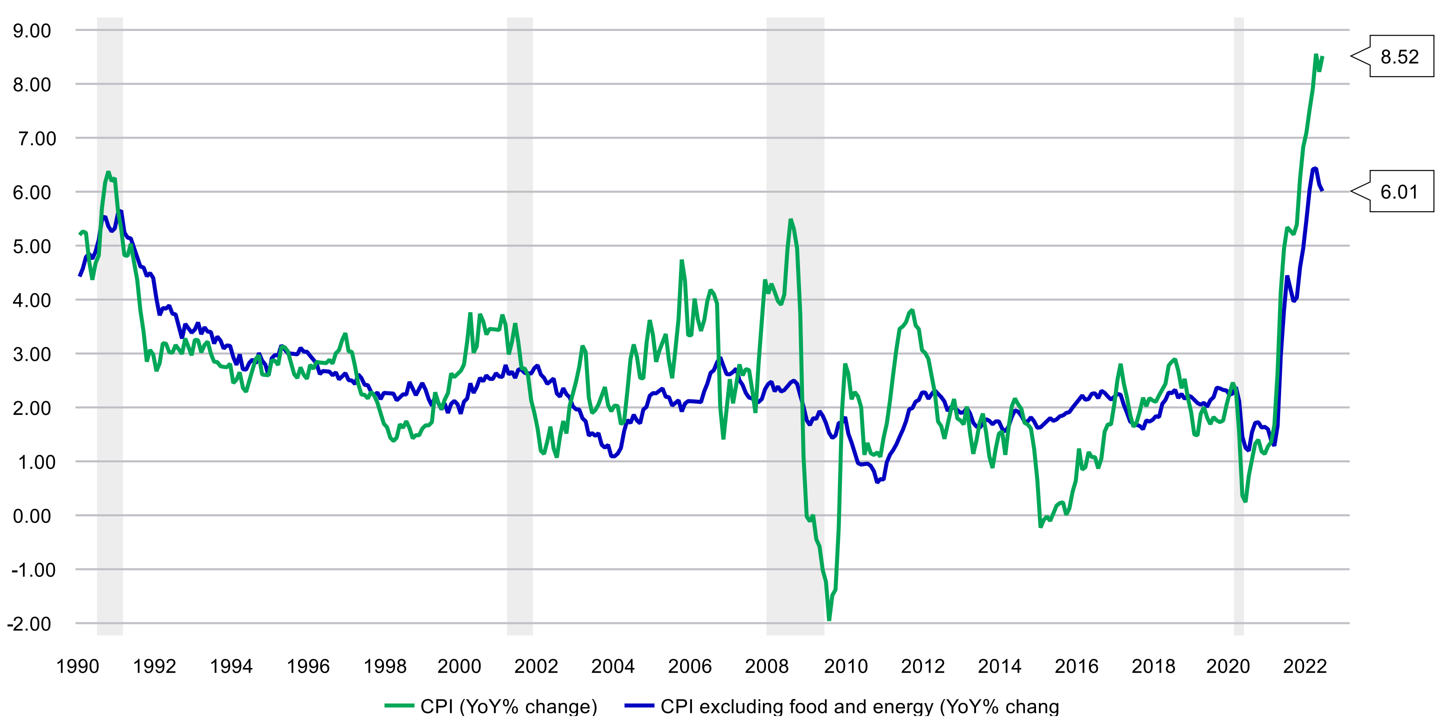
As we look back on the first half of 2022, it's hard to overstate how extraordinary global macro and markets have been. From a macroeconomic perspective, since the beginning of the year, we've experienced a devastating conflict in Europe, a COVID-19 crisis in China, and, most notably, an extremely hawkish U.S. Federal Reserve (Fed).

Barely six weeks after Fed Chair Jerome Powell noted that Fed officials weren't actively considering a 75 basis points (bps) interest-rate hike, the FOMC delivered just that on June 15. Cryptically telegraphed to the markets a few days before the June Fed meeting, the key takeaway in our view is receiving confirmation—albeit indirectly—that the U.S. central bank *will* knowingly hike into a material economic growth slowdown to tame inflation. Make no mistake: We're witnessing the Fed implement its most aggressive monetary policy tightening cycle in decades.

The Fed's hardened stance meant that many economists and forecasters (ourselves included) have had to recalibrate their views. At the very least, the global growth outlook has become more challenging, and prospects of achieving a soft landing have dwindled.

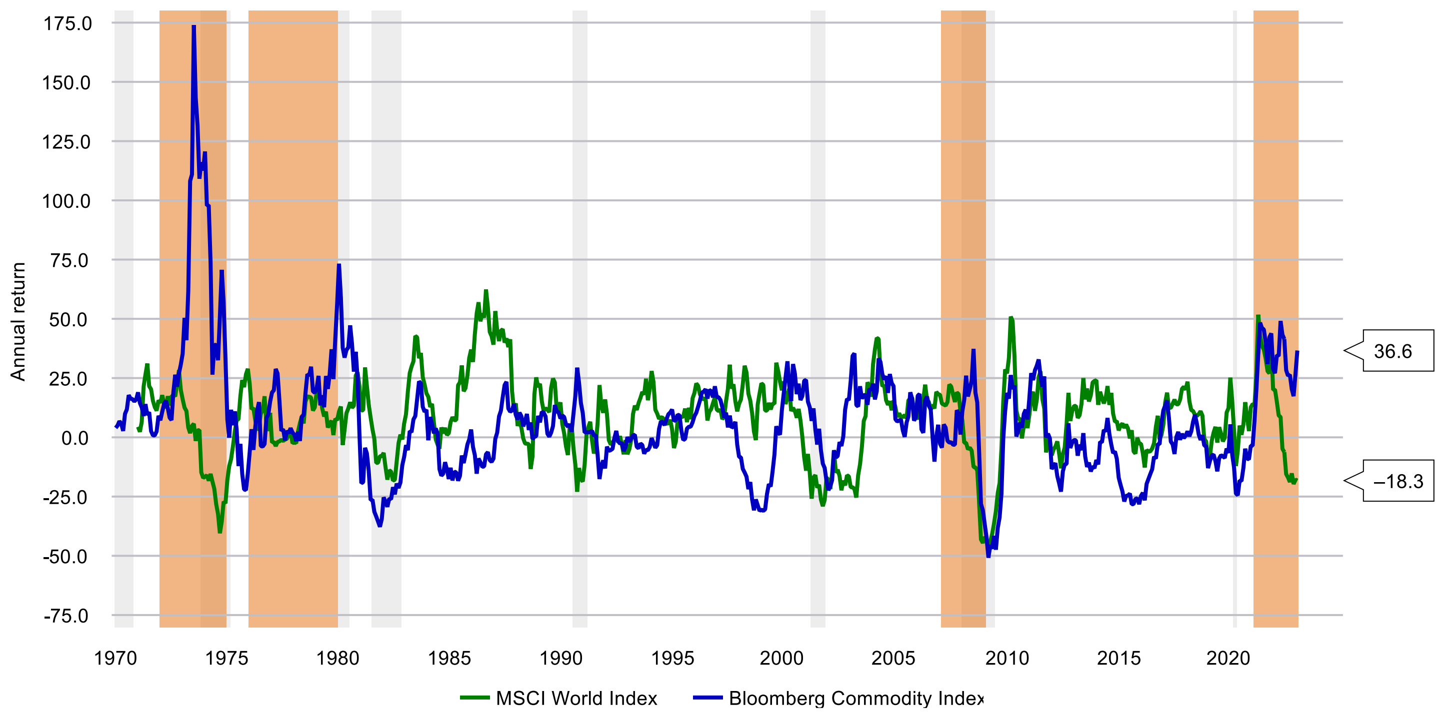
"The last time bond and equity markets moved two standard deviations in the same direction was 30 years ago, in December 1991, when both markets rallied."

U.S. inflation: stickier than expected (%)



Source: U.S. Bureau of Labor Statistics, Macrobond, Manulife Investment Management, as of June 20, 2022. CPI refers to Consumer Price Index. It is not possible to invest directly in an index. YoY refers to year over year. The gray areas represent recessions.

Commodities are on track to outperform the MSCI ACWI for the second consecutive year (%)



Source: Bloomberg, Macrobond, Manulife Investment Management, as of March 10, 2022. The orange areas represent periods in which commodity prices outperformed the MSCI All Country World Index (ACWI) for more than a year. It is not possible to invest directly in an index. YoY refers to year over year. The gray areas represent recessions.

> **"Technology stocks led global equities lower … and even cash—the most liquid form of an asset in any portfolio—has suffered due to elevated inflation."**

Unsurprisingly, year-to-date losses[1] across many financial assets have reached double digits. Technology stocks led global equities lower, traditional safe haven assets such as U.S. Treasuries have turned in their worst performance since 1980, and even cash—the most liquid form of an asset in any portfolio—has suffered due to elevated inflation. The last time bond and equity markets moved two standard deviations in the same direction was 30 years ago, in December 1991, when both markets rallied.[2]

Amid the upheaval, the U.S. dollar (USD), commodities, and commodity-linked assets have provided investors some shelter from the storm. That said, it's worth noting that the positive correlation between the USD and the commodities complex is also an extraordinary occurrence by historical norms. In fact, commodities are on track to outperform the MSCI All Country World Index for the second consecutive year—a phenomenon that has only occurred three times since 1970: 1972/1974, 1976/1979, and 2007/2008. These are uncomfortable analogs and consistent with our assertion last quarter that paradigm shifts in the global financial system are under way.

1 As of June 12, 2022. **2** Bloomberg, as of June 12, 2022.

Are we there yet?

The question many investors are asking is whether the worst start for global markets in decades is behind us. Yet, as we enter the final half of 2022, the macroeconomic outlook remains extremely challenging, characterized by high inflation, weaker economic growth, and tighter financial conditions.

While our base case is that inflation will ease into 2023, at this point in time, we find ourselves preoccupied with emerging risks to that view.

- **Inflation, especially headline inflation, may prove sticky at elevated levels for longer**

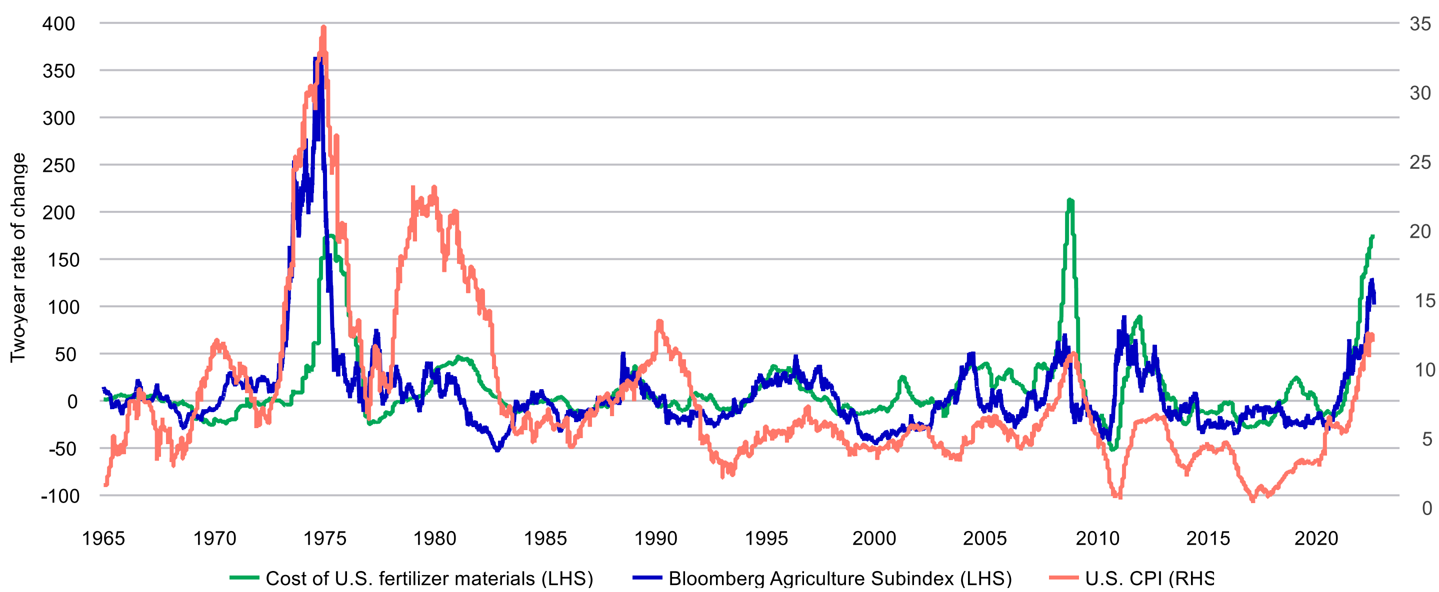
  A multitude of factors are at play here: The surge in fertilizer prices (50%–200% appreciation over the past 18 months, depending on input) points to the intensifying food scarcity and food price inflation ahead; inflation is becoming geopolitically entrenched—the global economy is fragmenting, characterized by the weaponization of strategic resource commodities and the USD; and logistical issues are taking longer to address.

- **Concerns about economic growth are rising**

  For many economies, the question isn't if there will be an economic slowdown, but how deep and how long it will be. Since recessions are measured in real terms, the hurdle rate to avoid a recession is especially high when inflation is elevated. Moreover, should the upside inflation risks mentioned earlier persist in 2022, it would imply that larger-scale demand destruction will be required to achieve aggregate disinflation.

Against that backdrop, we expect global policymakers to come under heightened pressure in the second half of the year to simultaneously break the back of supply-driven inflation and address the cost-of-living crisis enveloping many households. If policymakers are serious in that endeavor, it will be difficult for central banks to deliver a dovish pivot until they've witnessed a decline in commodity prices and a rise in wages expressed as a percentage share of real GDP.

Surge in the price of fertilizers points to more food price inflation



Source: International Monetary Fund, Food and Agriculture Organization of the United Nations, U.S. Bureau of Labor Statistics, Macrobond, Manulife Investment Management, as of June 13, 2022. CPI refers to Consumer Price Index. It is not possible to invest directly in an index. LHS refers to left-hand side. RHS refers to right-hand side.

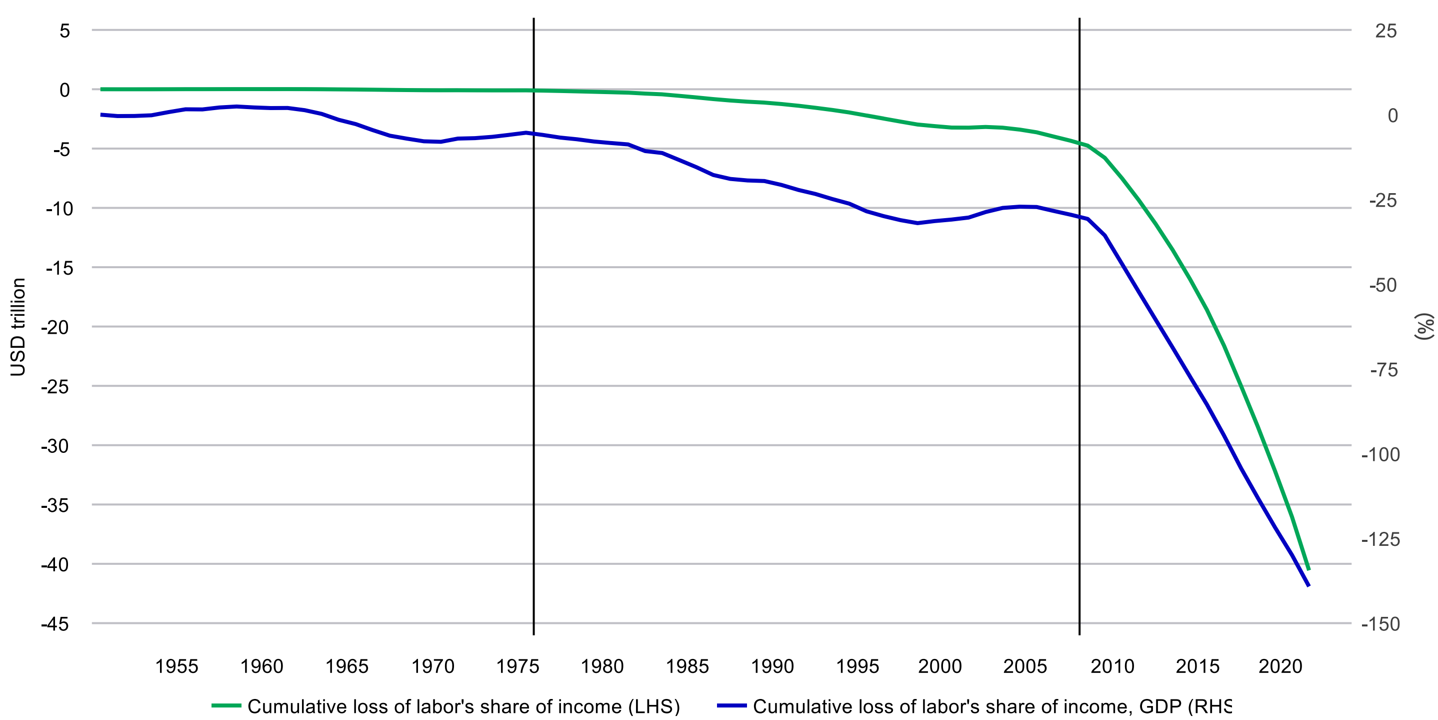
From that perspective, policymakers aren't likely to achieve their goal in H2 2022 and must forge ahead with policy that will—unsurprisingly—be unwelcome for financial asset prices. These risks were acknowledged in the latest global economic outlooks from the World Bank and the Organisation for Economic Co-operation and Development (OECD).

The World Bank cut its global GDP growth forecast for 2022 from 5.7% in 2021 to 2.9%, shaving nearly a third off its January 2022 forecast (4.1%). The downgrade is significant: It's the bank's biggest short-term global growth downgrade in 80 years. Crucially, the World Bank noted that "for many countries, recession will be hard to avoid ... even if a global recession is averted, the pain of stagflation could persist for several years," and noted that "subdued growth will likely persist throughout the decade."

Meanwhile, the OECD observed that "the global economy is set to weaken sharply," adding that despite having incorporated expectations of a moderation in demand growth and a reduction in supply chain and commodity price pressures, core inflation is likely to "remain at or above central bank objectives in many major economies" at the end of 2023. The intergovernmental organization also highlighted that "the cost-of-living crisis will cause hardship and risks famine and social unrest."

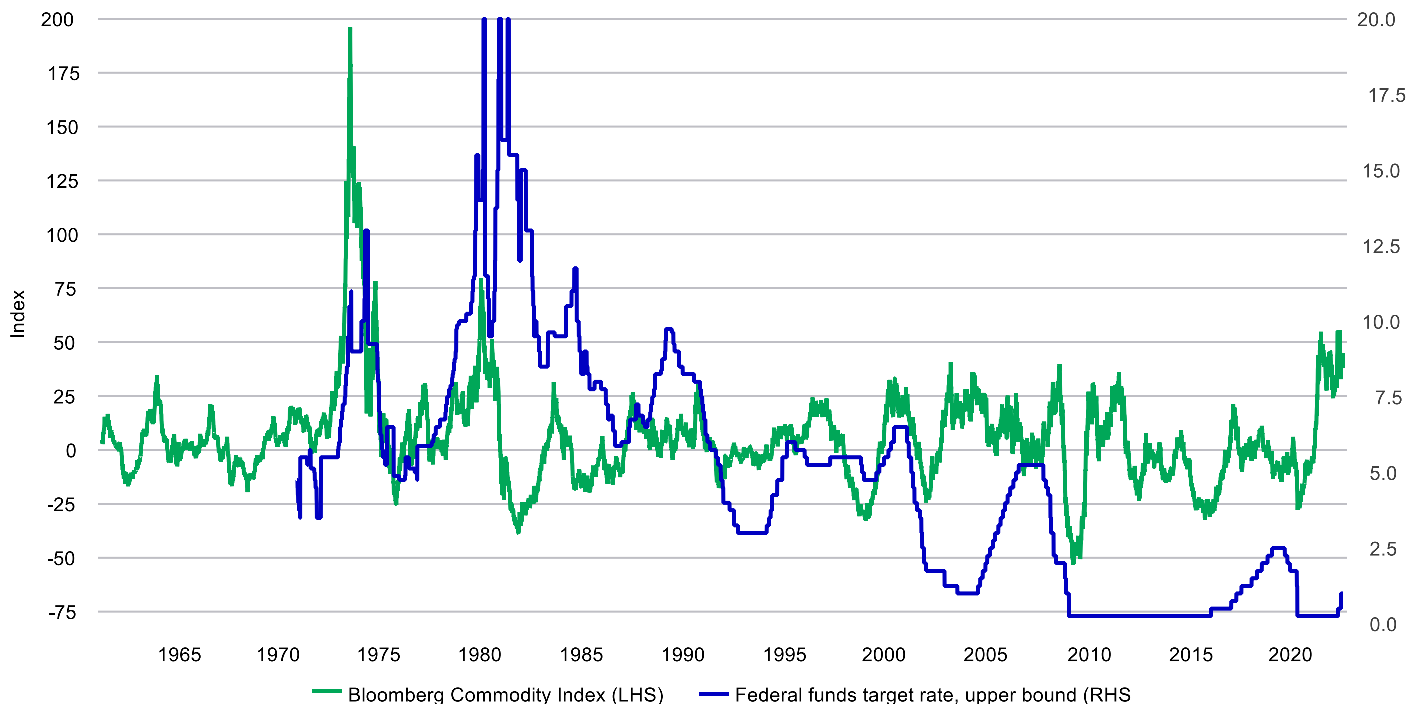
In H2 2022, we expect to see a recession in the euro area, a weaker-than-expected economic recovery in China, and a material economic slowdown in the United States (a recession in early 2023 seems likely at this point). Given that these are the top three destinations for emerging-market (EM) exports, many emerging economies are likely to face reduced global trade volumes and increased capital outflows. Below-trend economic growth will also likely mean that corporate earnings growth disappoints analysts' lofty expectations even as stronger underlying price pressures delay the end of the tightening cycle. Longer-dated U.S. Treasury yields typically don't peak until just before the end of Fed tightening cycles.

Dovish pivot constrained by the need to lift labor's share of income



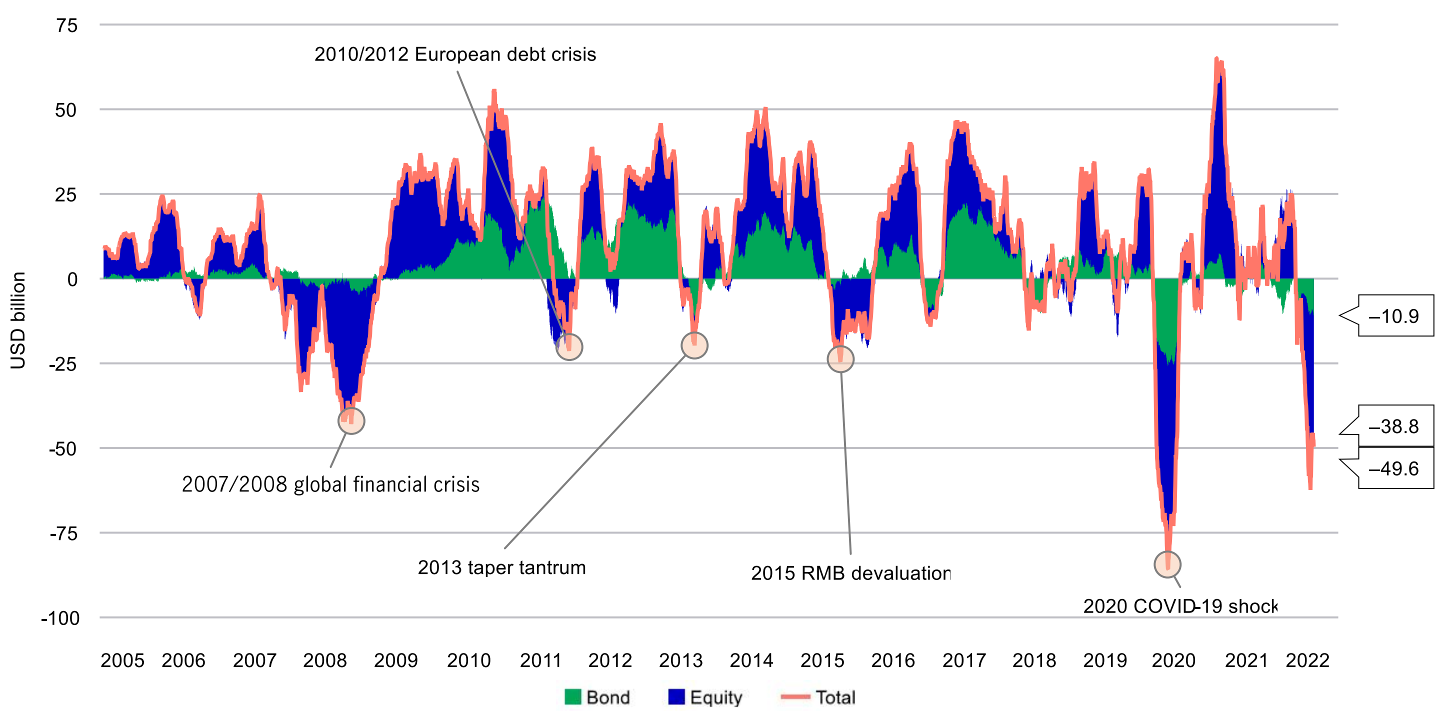
Source: Conference Board, U.S. Bureau of Economic Analysis, CPB Netherlands Bureau for Economic Policy Analysis, Macrobond, Manulife Investment Management, as of June 13, 2022. LHS refers to left-hand side. RHS refers to right-hand side.

Dovish pivot constrained by rising commodity prices



Source: Bloomberg, Macrobond, Manulife Investment Management, as of June 13, 2022. It is not possible to invest directly in an index. LHS refers to left-hand side. RHS refers to right-hand side.

Nonresident investment flows into EM



Source: Institute of International Finance, Macrobond, Manulife Investment Management, as of June 11, 2022. EM refers to emerging markets. RMB refers to the Chinese yuan.

A game of chicken

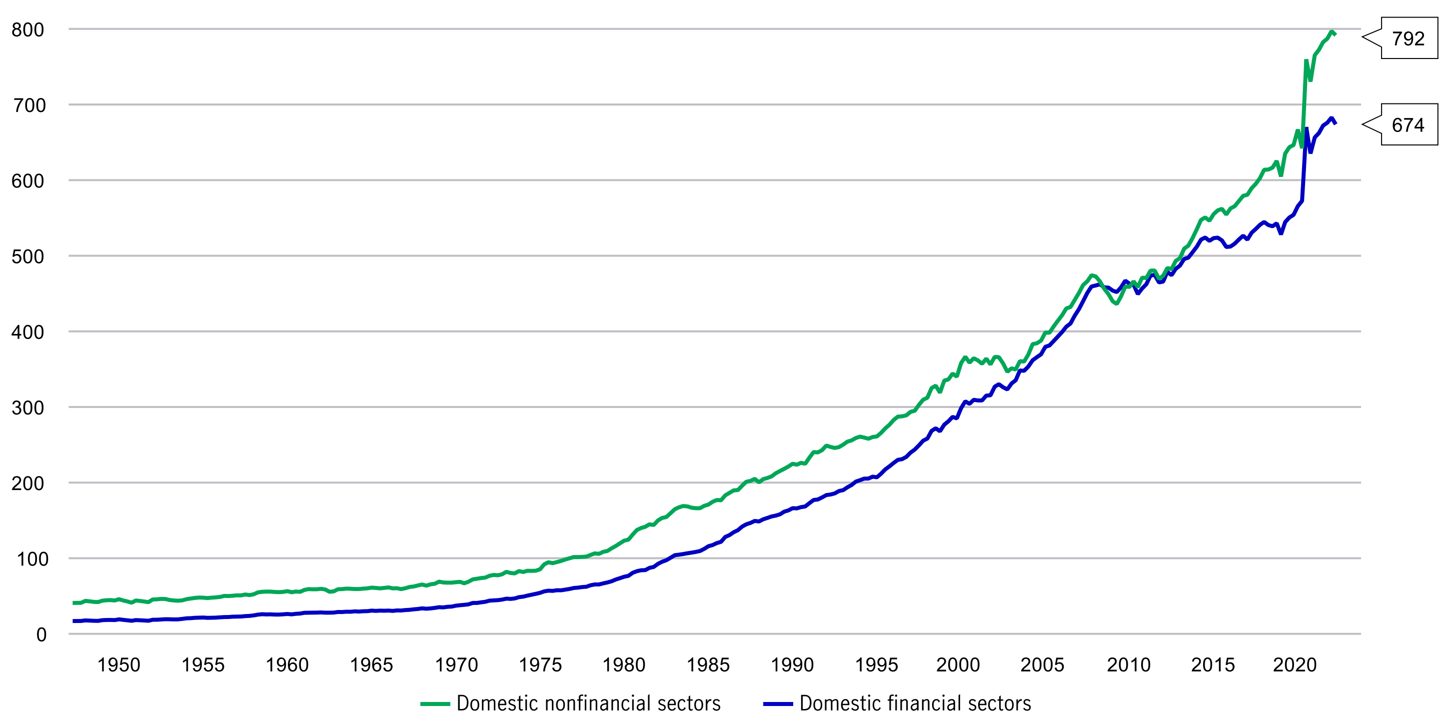
Despite the drawdown to date, we're of the opinion that many markets aren't fully priced for this challenging backdrop. This is partly due to what's become commonly accepted wisdom in the post-global financial crisis (GFC) era that the Fed has its back—the belief that the Fed will always step in to limit the decline in asset prices beyond a certain threshold. In an era in which the unthinkable is occurring with ever-increasing frequency, however, banking on the continuation of the Fed put around asset prices—at least as investors have come to understand it—is a big gamble.

Historically, the specific asset market to which the central bank put applies differs around the world. For the Fed, it was understood to be equity and/or credit markets, for the European Central Bank (ECB), it was peripheral bond spreads. Where the People's Bank of China and the Reserve Bank of Australia (RBA) are concerned, it was supposed to be the property market.

These policy puts have led to wider distortions in income distribution and, therefore, regressive outcomes in the real economy and greater economic, social, and geopolitical fragility. We're seeing significant departures from this post-GFC regime.

William Dudley, highly influential former president of the Federal Reserve Bank of New York, argued that the Fed must "inflict more losses" on stock market investors to tame inflation. U.S. Treasury Secretary Janet Yellen has pivoted from her earlier opinion that the Fed might help the U.S. economy in a future downturn if it could buy stocks and corporate bonds and said in April 2022 that she was looking through stock market weakness and that the stock market wasn't "a reflection of the underlying strength of the economy."

U.S. financial assets as a share of real GDP (%)

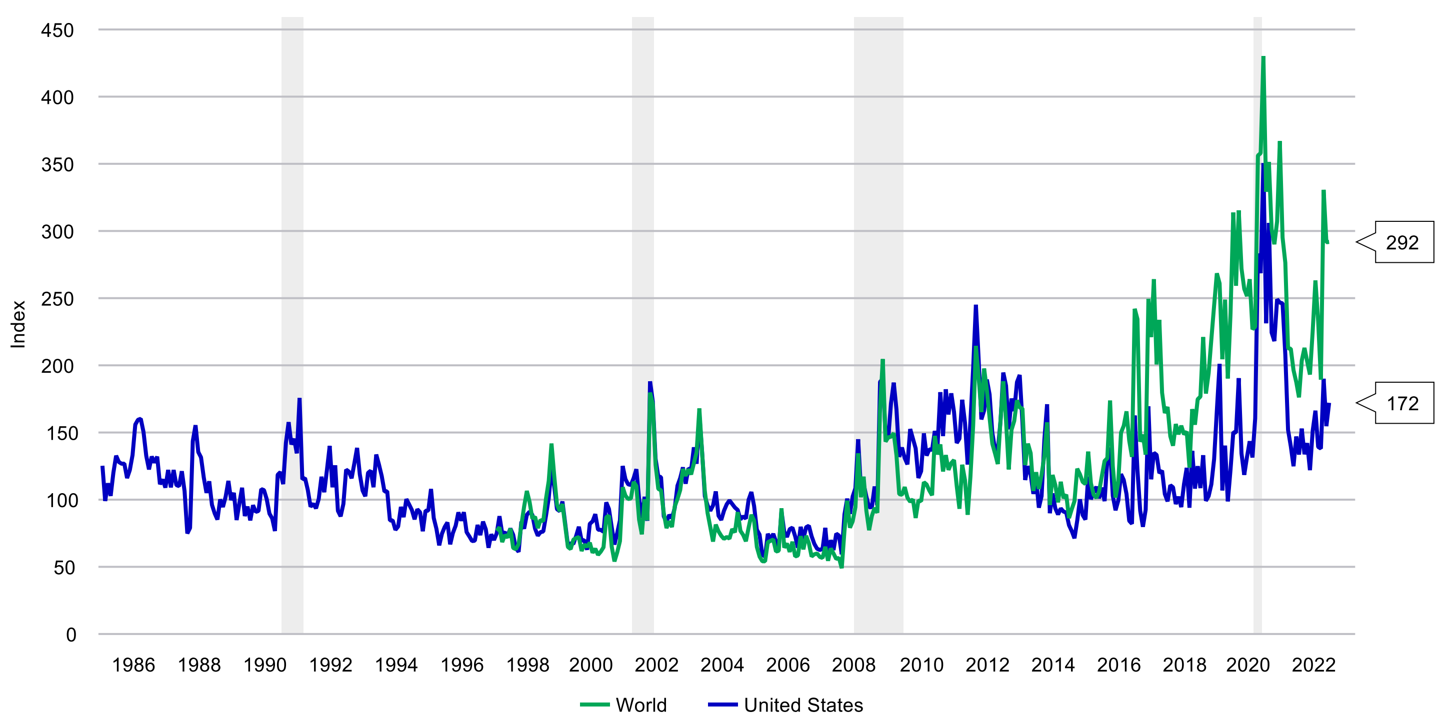


Source: U.S. Federal Reserve, U.S. Bureau of Economic Analysis, Macrobond, Manulife Investment Management, as of June 13, 2022.

On the other side of the Atlantic, the ECB signaled that monetary policy is in play and offered no detail on support mechanisms for the eurozone's periphery bond markets, even as peripheral sovereign bond spreads keep widening. In China, despite its systemic importance, officials have systematically deflated the property market, while the RBA surprised with a larger-than-expected 50bps hike—the biggest interest-rate hike since 2001—even as property prices in most Australian cities are expected to fall by double digits over the next two years.

For years, the central bank policy put enabled the growth of financial assets to vastly exceed that of the real economy and critical investment and production needs, a policy choice that contributed to exposing the global economy to the stagflationary dynamics we see today. It therefore stands to reason that in order to reverse current stagflationary conditions, this central bank policy put must act in the opposite direction. While it's an uncomfortable truth, the economic, social, and geopolitical costs of not acting now, we believe, will only be greater in the future. We can call it what we want—kicking the can down the road, or taking the path of least resistance—but, essentially, it's just another way to describe a game of chicken.

Economic Policy Uncertainty Index



Source: Economic Policy Uncertainty, Macrobond, Manulife Investment Management, as of June 13, 2022. The gray areas represent recessions.

United States

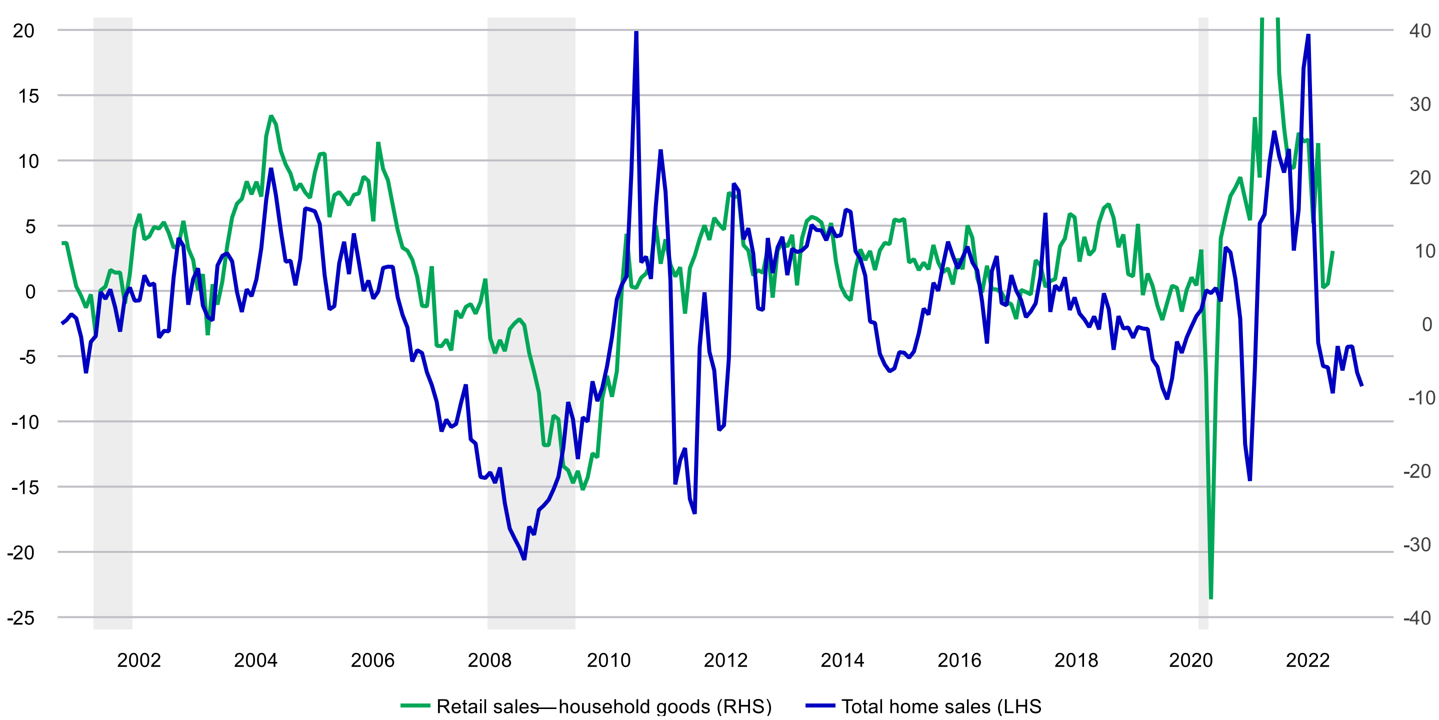
Big picture

Concerns about supply shortages in everything ranging from housing to goods and labor have been compounded by rapidly tightening financial conditions as the Fed continues to try to rein in stubbornly high inflation. It remains unclear how effective tighter monetary policy will be in dampening conflict-driven food and energy inflation, two areas that are taking up a larger portion of the consumer's wallet.

At this stage, we think most risks are weighted to the downside going into the latter half of the year and into the first few quarters of 2023. In addition to inflation, sharply higher interest rates have already translated into slower housing activity, and we would expect this to migrate into broader interest-rate-sensitive goods in which inventories look to have accumulated.

"At this stage, we think most risks are weighted to the downside going into the latter half of the year and into the first few quarters of 2023."

Weaker U.S. home sales activity could dent demand for durable goods, YoY (%)



Source: U.S. Census Bureau, National Association of Realtors, Manulife Investment Management, as of June 16, 2022. Household goods includes furniture, electronics, and building material components of the retail sales report. YoY refers to year over year. LHS refers to left-hand side. RHS refers to right-hand side.

What we're watching

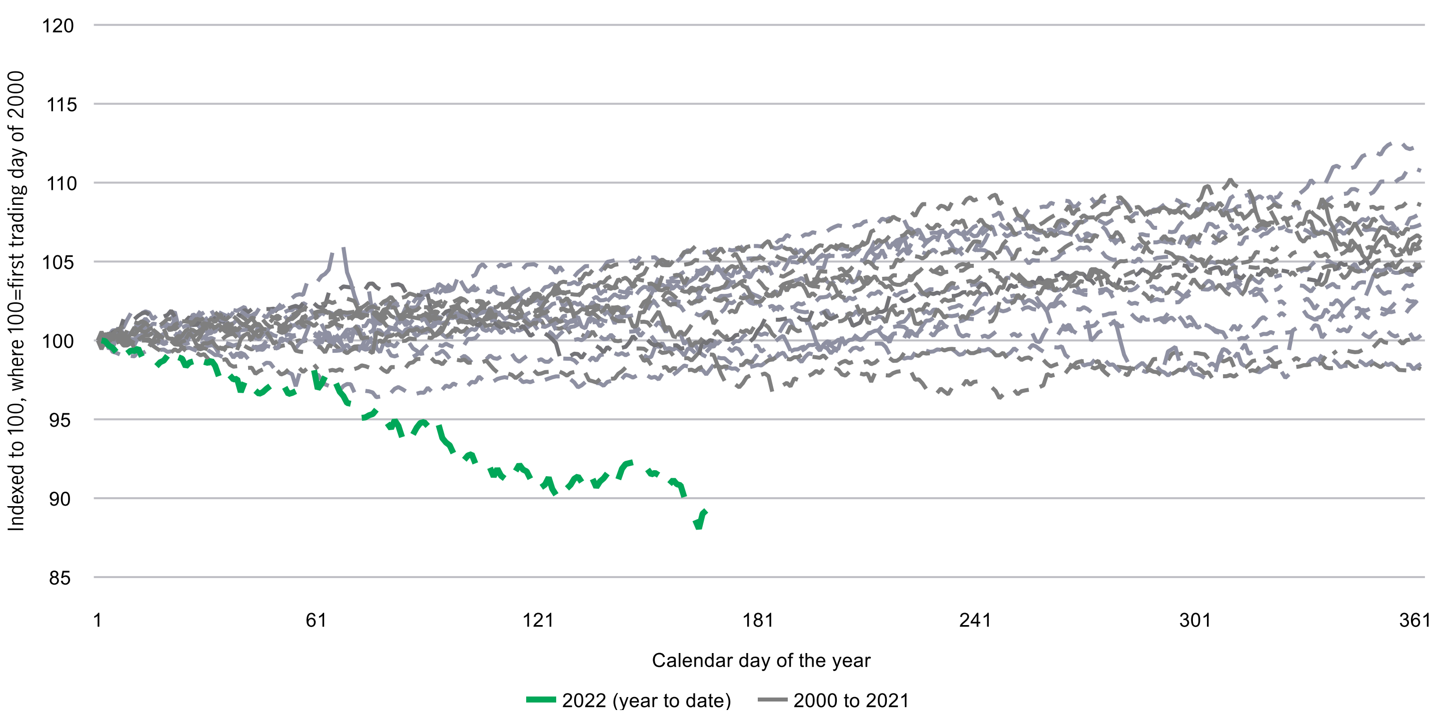
- **Fed—**Recent months have proven that monetary policy decisions are nowhere near as predictable as they were before the pandemic. Monitoring the Fed for shifts in tone—which has so far been unambiguously more hawkish—is critical to understanding the fixed-income space, market volatility, and the interest-rate-sensitive parts of the economy.
- **The U.S. consumer—**Eroding purchasing power and higher financing costs are likely to weigh on consumer spending, which accounts for ~70% of the U.S. economy. A possible mitigating factor is that household balance sheets are healthy and unlevered, which could lend support if lending standards stay easy.
- **Inventories—**While the auto sector is massively distorting broad levels, a more granular look would suggest that several sectors are in oversupply.

Key market views

- **Overall markets—**We expect volatility to persist across asset classes until the Fed sends a clear signal that the tightening cycle is coming to an end. At that point, we'd expect to see some reprieve in the fixed-income space in what has been a historically negative year.
- **Currencies—**We expect the USD to continue to serve its role as a safe-haven asset for as long as monetary policy uncertainty is prevalent across developed markets. Consequently, we'd expect ongoing support until there's a clear mollification in the Fed's rhetoric.
- **Fixed income and equities—**We have a preference for higher-quality, investment-grade credit and lower beta equities in view of ongoing market volatility.

Bloomberg U.S. Aggregate Bond Index

Performance by year (total return, unhedged USD)



Source: Bloomberg, Manulife Investment Management, as of June 15, 2022. It is not possible to invest directly in an index. Each line on the chart represents year-to-date total returns in each calendar year from 2000 to June 15, 2022. USD refers to the U.S. dollar.

Canada

Big picture

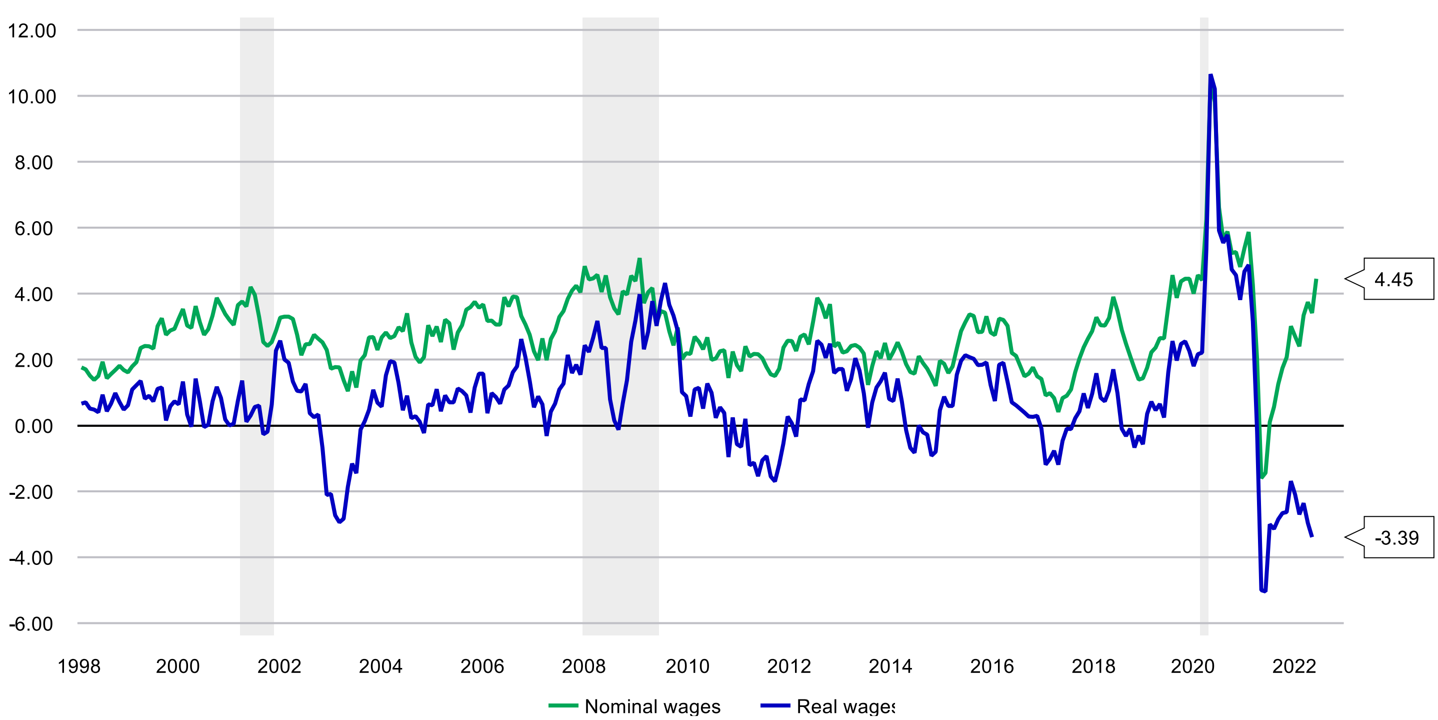
Canada's economy proved resilient in the first half of the year, benefiting from several factors its U.S. counterpart didn't: booming energy prices that supported exports, a smaller fiscal cliff, and a healthier labor market, which has recovered well beyond pre-COVID-19 levels. These developments have emboldened the Bank of Canada (BoC), which remains resolute in its intention to fight inflation.

Consistent with the hawkish guidance provided by Governor Tiff Macklem, the bond market has priced in three more consecutive 50bps hikes for 2022, which we think will significantly weaken the Canadian economy in H2 2022 and into 2023 without directly putting the inflation problem to bed. Crucially, the majority of the inflation plaguing Canada is, like most countries, global in nature and isn't particularly interest-rate sensitive, especially *Canadian* interest rates.

Conversely, Canada's record and sizable exposure to the housing sector, along with its higher share of variable rate mortgages, makes the economy much more rate sensitive than its U.S. neighbor.

The bond market has priced in three more consecutive 50bps hikes for 2022, which we think will significantly weaken the Canadian economy in H2 2022 and 2023.

Wage growth in Canada, YoY (%)



Source: Statistics Canada, Macrobond, Manulife Investment Management, as of June 15, 2022. YoY refers to year over year. The gray areas represent periods of recession.

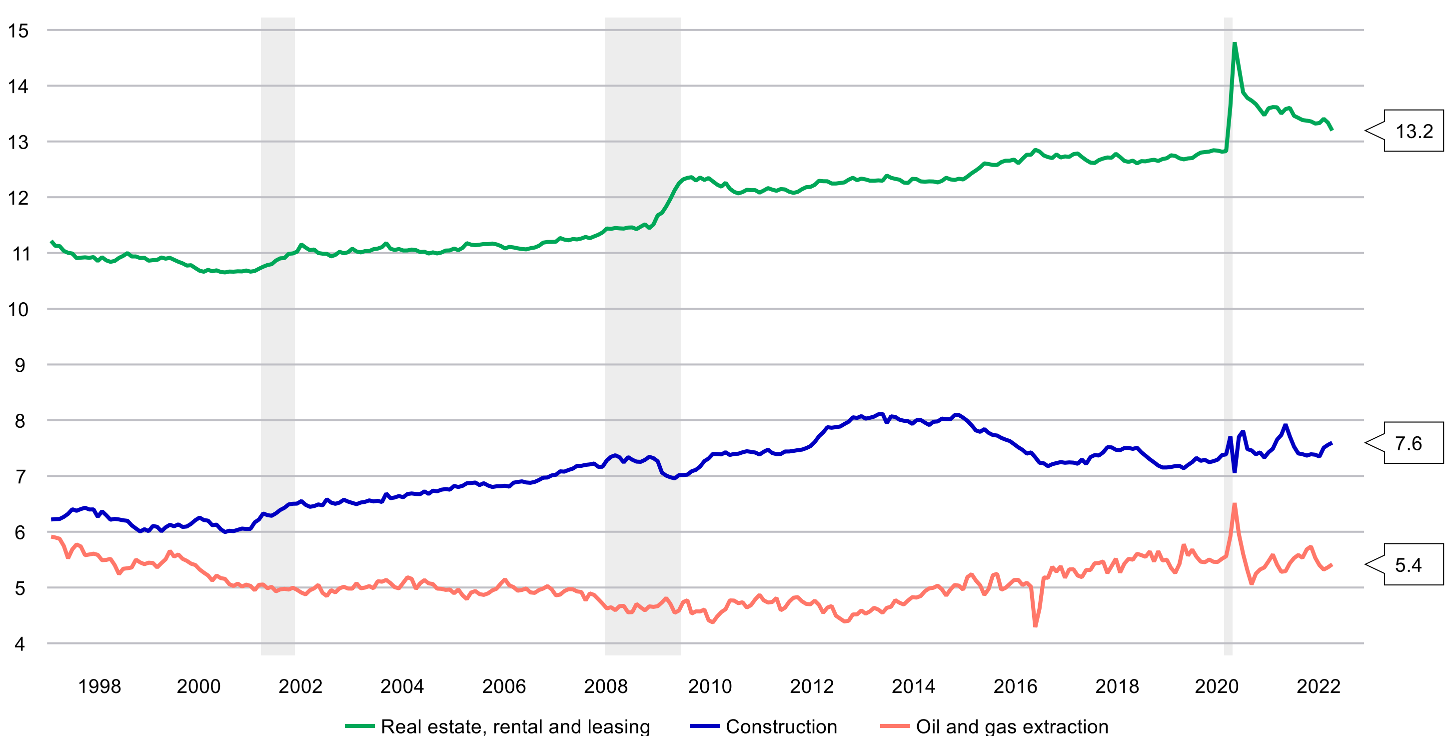
What we're watching

- **Housing activity—**This may be the most important Canadian indicator as sharp falls in certain pockets within this space are likely to be precursors to more large-scale and broad declines in economic activity. We expect home prices to decline, on average, by ~20% nationwide by year end.
- **Energy and food costs—**Rising prices will continue to erode real wage growth in Canada, dampening consumer activity. Higher energy costs aren't translating into investment at the level they had done in prior cycles as the structural move away from oil continues to evolve. As a result, any offsetting benefits arising from higher energy aren't as supportive of growth relative to the past.
- **Central bank—**We expect the BoC to make a dovish pivot in Q3 as housing weighs on economic growth; we're monitoring factors that might spark that transition.

Key market views

- **Equities—**Despite the weak macro outlook, we believe the Canadian stock market's exposure to commodities provides attractive upside on a short-term basis. Even though Canada's long-term economic growth profile is somewhat modest relative to the United States, Canadian equities benefit from a supportive dividend profile and reasonable valuations.
- **Fixed income—**In our view, risks to the Canadian dollar (CAD) are tilted toward further weakening, with a chance that the USD/CAD pair might break above its recent 1.25 to 1.30 trading range. The CAD has primarily been trading off of global risk sentiment more than fundamentals, which we expect to continue; however, we believe the CAD's fundamental drivers—commodities and the interest-rate differential—are likely to become less supportive in the coming quarter.

Canada's energy industry as a share of total Canadian GDP (%)



Source: Statistics Canada, Macrobond, Manulife Investment Management, as of June 15, 2022. The gray areas represent periods of recession.

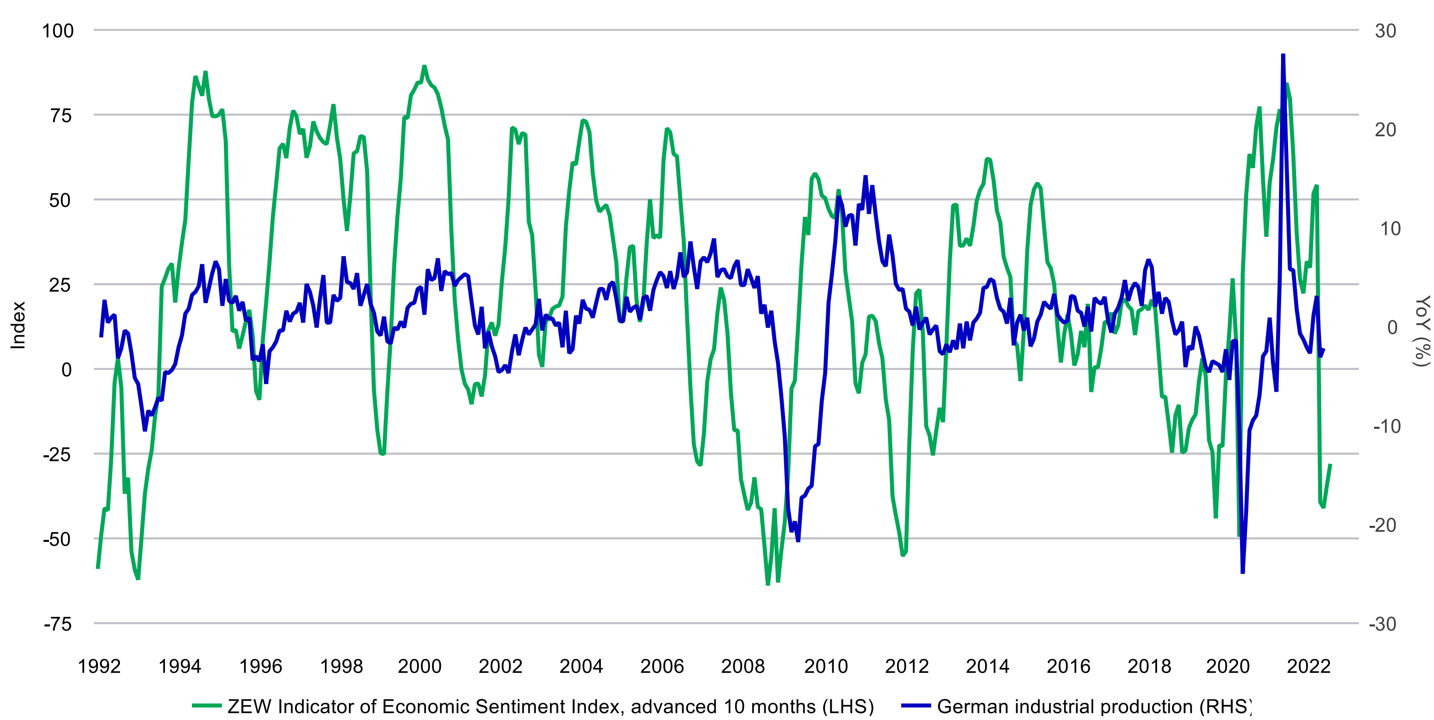
Euro area

Big picture

Our base case is that the euro area will slip into a recession in 2022 on the back of the large spillovers from, most notably, Russia's invasion of Ukraine; the negative terms of trade shock in food and energy, and the supply shortage of these key resources. The squeeze on household disposable income will likely weigh on consumption, and rising input costs will be a drag on private investment. Rising inflation has forced the ECB to normalize monetary policy amid economic weakness (like most central banks), albeit in a manner that's becoming severely disruptive for the currency bloc. Collateral damage can be observed in the sovereign bond market, with peripheral yield spreads widening in a manner that complicates the ECB's policy transmission. Medium-term risks remain elevated as uncertainties around energy security have yet to be resolved, leaving Europe vulnerable to a continued rise in energy prices. Political risks remain prominent, highlighted by the surprise outcome of the French legislative election in June and opinion polls in Italy, which revealed a shift toward far-right parties ahead of the next general election scheduled for mid-2023.

"Medium-term risks remain elevated as uncertainties around energy security have yet to be resolved, leaving Europe vulnerable to a continued rise in energy prices."

Germany's ZEW Indicator of Economic Sentiment Index: already at levels generally associated with recession



Source: Bloomberg, Macrobond, Manulife Investment Management, as of June 16, 2022. YoY refers to year over year. It is not possible to invest directly in an index. LHS refers to left-handside. RHS refers to right-hand side.

What we're watching

- **Evolution of the ECB's policy normalization—** High inflation has forced the ECB's hand in accelerating the rate at which it tapered its asset purchases and brought forward expectations for interest-rate hikes. Given the incredibly disruptive adjustment in the outlook for monetary policy, we're looking for clues as to where the ECB needs to be in terms of its policy rate and how soon it plans to get there. We don't think the ECB will be able to deliver a 1.50% policy rate by year end, as the market is currently pricing.[3]
- **How Europe's energy shock plays out—** The initial energy price shock has morphed into a supply shock as a result of Europe's response to the Russia-Ukraine conflict. It's difficult to imagine a scenario in which energy security won't feature prominently through the second half of 2022 as European countries seek to find alternatives to Russian energy supplies.

Key market views

Currencies—We foresee medium-term weakness for the euro (EUR). We expect the EUR to trade defensively in the absence of a resolution to the simmering sovereign bond crisis. Efforts at containing the widening in peripheral bond yield spreads have so far proved insufficient and have weighed on the currency. We also see greater scope for a continued deterioration in the outlook for relative central bank policy as we suspect that the ECB will struggle to meet the market's expectations in regard to how far it can tighten. We expect the EUR to continue its march toward parity against the USD in the second half of 2022.

EUR/USD likely to reach parity in the second half of 2022

Source: Bloomberg, Macrobond, Manulife Investment Management, as of June 15, 2022. EUR refers to the euro. USD refers to the U.S. dollar.

3 Bloomberg, as of June 16, 2022.

United Kingdom

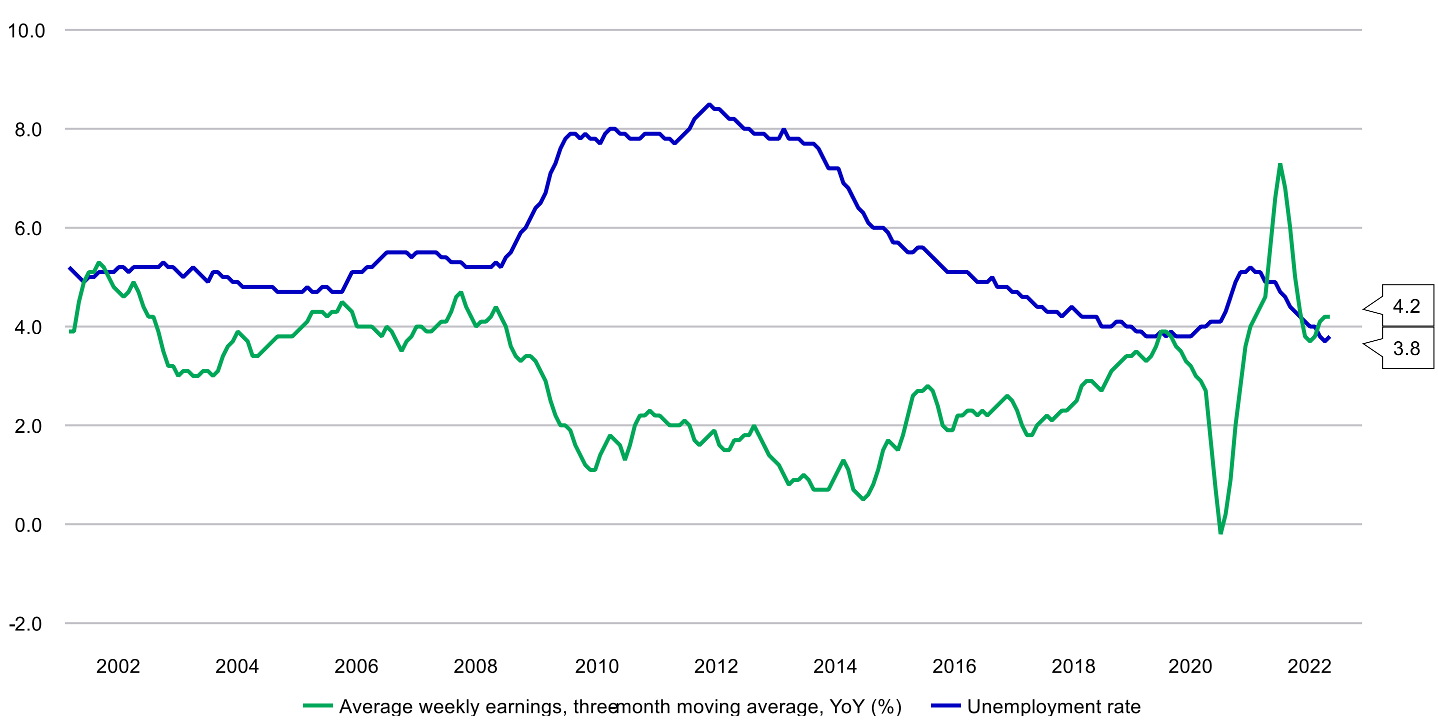
Big picture

The United Kingdom's economic outlook remains worrisome. Growth data has been moderating and offers a challenging handoff into the second half of 2022. The British labor market is tight, but we expect conditions to ease into H2 and will be watching how wage growth evolves. The Bank of England (BoE) has an unenviable task as it seeks to put a lid on inflation while keeping an eye on the medium-term growth outlook where risks are increasingly shifting to the downside. As such, even though the BoE offered a more hawkish forward guidance in June, the tightening path is likely to remain restrained.

The unveiling of the bank's quantitative tightening (QT) plans will feature prominently going into, and through, its August meeting. Fiscal efforts to address consumers' cost-of-living woes have been relatively limited in aggregate, and it appears that officials wish to retain a greater range of options going into Q4. Domestic political risks continue to be an issue; however, Brexit woes remain an ongoing source of uncertainty as the country seeks to unilaterally modify key portions of its exit agreement with the European Union.

"The BoE has an unenviable task as it seeks to put a lid on inflation while keeping an eye on the medium-term growth outlook where risks are increasingly shifting to the downside."

Tightness in the British labor market is expected to ease (%)



Source: Macrobond, Manulife Investment Management, as of June 13, 2022. YoY refers to year over year.

What we're watching

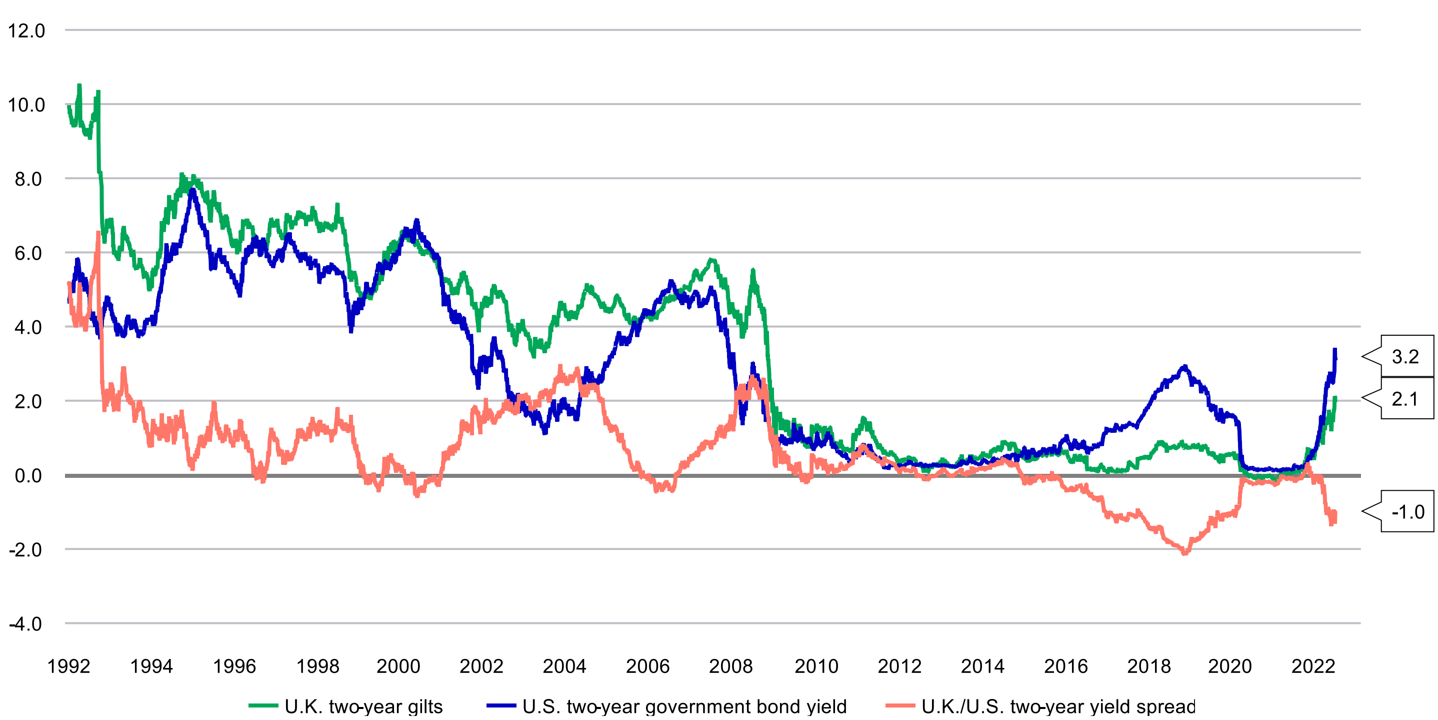
Evolution of the labor market—We're expecting tightness in the labor market to ease going into the second half of 2022 and anticipate a rise in the unemployment rate alongside a moderation in wage growth. How the labor market evolves from here will be critical for the BoE, as it will inform the extent and pace at which rate normalization can take place as well as the trajectory of the bank's QT program.

Political risks—Uncertainty around political leadership within the ruling party remains high, but risks related to Brexit continue to stay at elevated levels as the country seeks to unilaterally modify fundamental components of its exit agreement, which could heighten economic uncertainty.

Key market views

Currencies—The risk of continued underperformance in the British pound (GBP) remains. The GBP has been one of the worst-performing currencies among developed economies year to date, having logged an ~11% decline versus the USD as of this writing. Only the Norwegian krone (–12%) and the Japanese yen (–15%) have fared worse.[4] The main driver behind GBP weakness is the narrowing in interest-rate differentials versus other currencies, which has been significant. There have been, however, a few signs suggesting this may turn around soon given the BoE's stated preference for more active QT rather than interest-rate hikes above the 1.00% bank rate threshold.

U.K./U.S. interest-rate differentials are proving to be a headwind for GBP/USD (%)



Source: Bloomberg, Macrobond, Manulife Investment Management, as of June 15, 2022. GBP refers to the British pound. USD refers to the U.S. dollar.

4 Bloomberg, as of June 13, 2022.

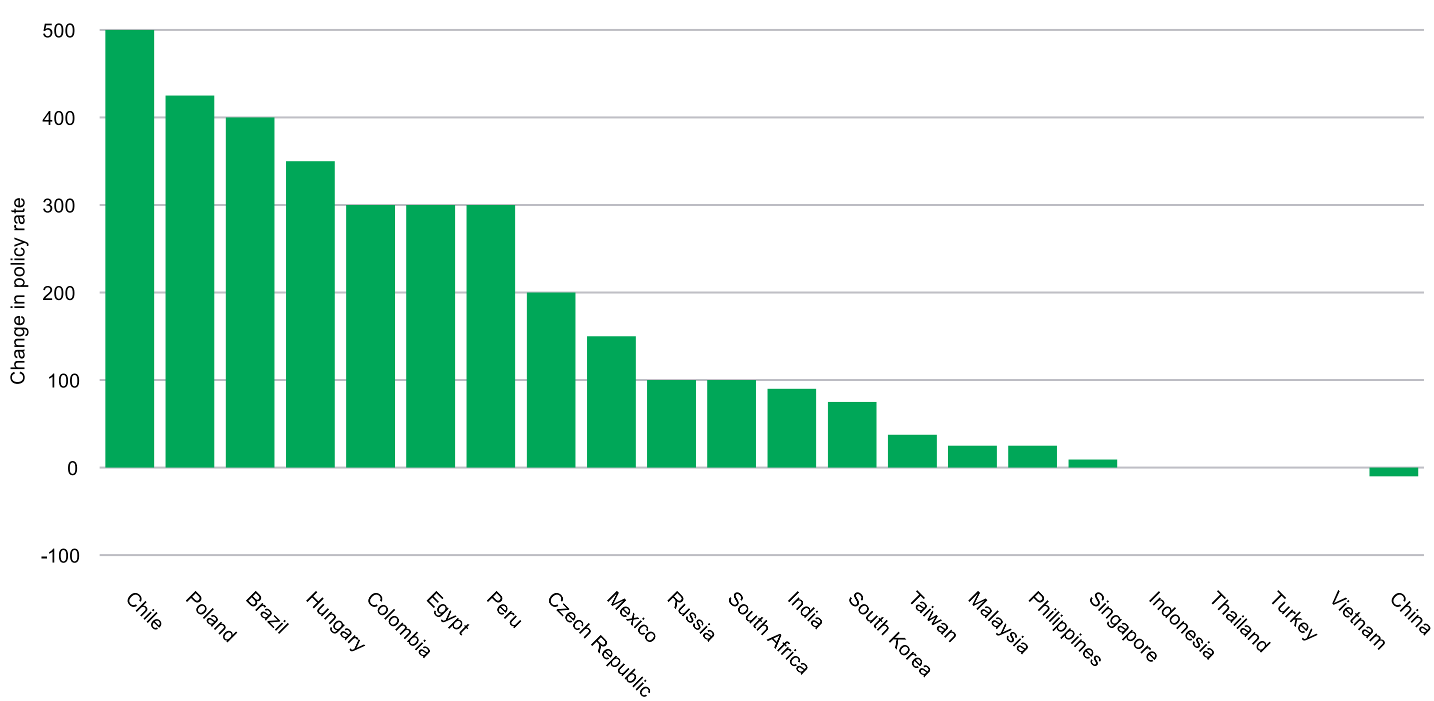
Asia-Pacific

Big picture

Most economies reported an expansion in Q1 GDP thanks to a relaxation in domestic restrictions and the reopening of international borders. Over the past quarter, central banks in the region have all surprised the market with their hawkishness; however, the policy trade-off between slowing growth and higher inflation will likely grow starker. In our view, Asia's recovery from the pandemic is still incomplete. That said, external demand has peaked, and higher commodity prices will hurt consumers' purchasing power as tighter global financial conditions conspire to hold back the recovery even further. Meanwhile, the path toward fiscal support/consolidation looks challenging. Government finances were hit materially during the pandemic and are again under pressure amid policies introduced to cushion households from the surging cost of living (in the form of subsidies, price caps, tax cuts, cash transfers, etc.) and the evolving geopolitical climate (higher defense spending). We expect central banks to prioritize tackling inflation, but with broad price pressures in the region more benign versus the rest of the world, the ultimate magnitude of tightening cycles will likely be relatively muted.

"We expect central banks to prioritize tackling inflation, but with broad price pressures in the region more benign versus the rest of the world, the ultimate magnitude of tightening cycles will likely be relatively muted."

Monetary tightening: Asia lags EM year to date (bps)



Source: National central banks, Macrobond, Manulife Investment Management, as of June 13, 2022. EM refers to emerging markets. Bps refers to basis points.

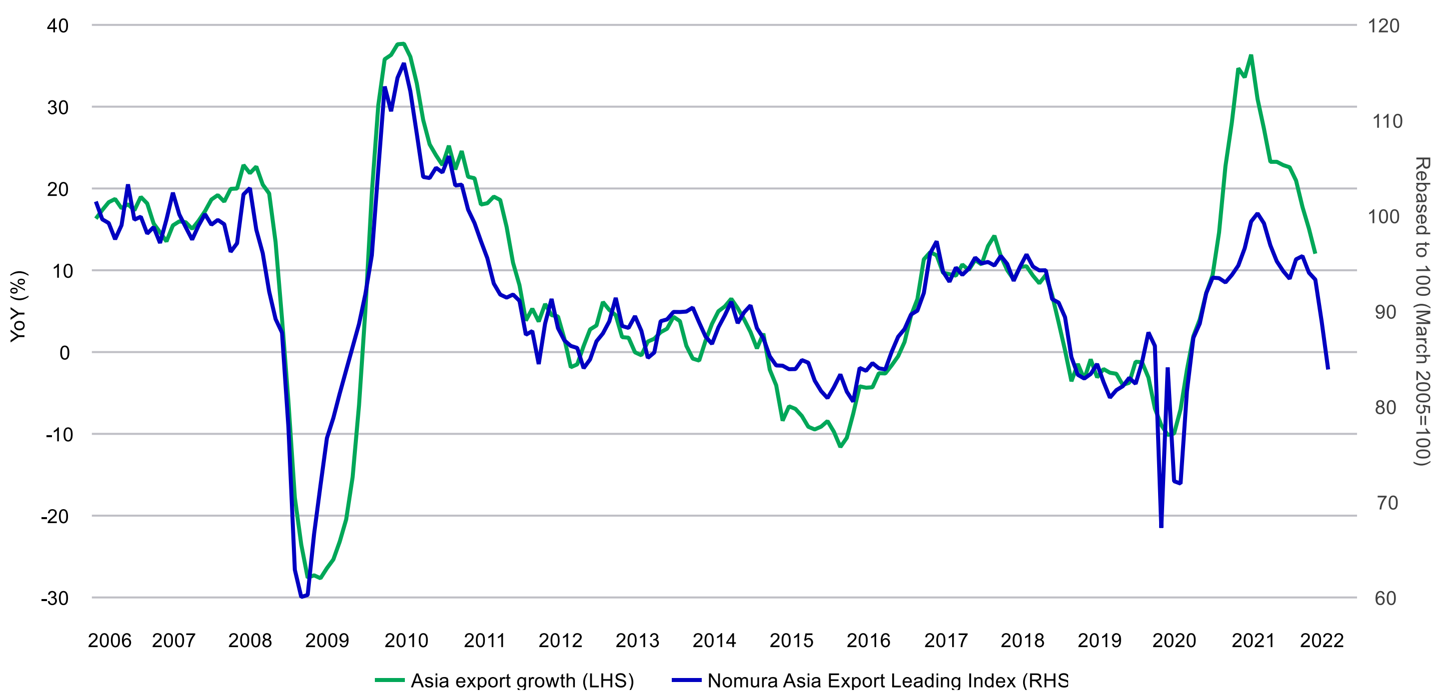
What we're watching

- **Asian export growth slowdown—**Leading indexes have fallen sharply to levels consistent with around zero export growth. If realized, this would represent the withdrawal of a key source of USD funding and economic growth for the region.
- **Contagion from significant JPY underperformance—**A weaker Japanese yen (JPY) will mainly affect the region through two channels: weaker external final demand and increased trade competitiveness. As a source of external final demand for Asia's exports and relative to GDP, exports to Japan are largest for Vietnam, Thailand, Malaysia, Taiwan, and Australia.[5] Our analysis shows that South Korea and China have the highest net export similarity with Japan and, therefore, are under the greatest pressure to maintain competitiveness with it.

Key market views

- **Equities—**We've previously recommended selective exposure to commodity exporters versus commodity importers, but the rising risk of a global recession unfolding implies higher volatility, weakness in global trade, and tighter USD funding conditions, which suggests the need for an additional screen for relative strength in external liquidity metrics. Our analysis shows that Indonesia and the Philippines rank well with the additional liquidity-risk screen, and their relative equity underperformance in the past quarter may unwind on this basis.
- **Fixed income and currencies—**We believe policymakers in the region aren't likely to match the timing nor the scale of the Fed's tightening cycle. This suggests likely outperformance in regional bonds and underperformance in local currencies.

Leading indicators signal a significant slowing in Asia export growth



Source: Bloomberg, Nomura, Macrobond, Manulife Investment Management, as of June 13, 2022. It is not possible to invest directly in an index. Asia export growth is calculated using the simple average export growth of China, Hong Kong, India, Indonesia, Japan, Malaysia, the Philippines, Singapore, South Korea, Taiwan, Thailand, and Vietnam. YoY refers to year over year. LHS refers to left-hand side. RHS refers to right-hand side.

5 Macrobond, Manulife Investment Management, as of June 13, 2022.

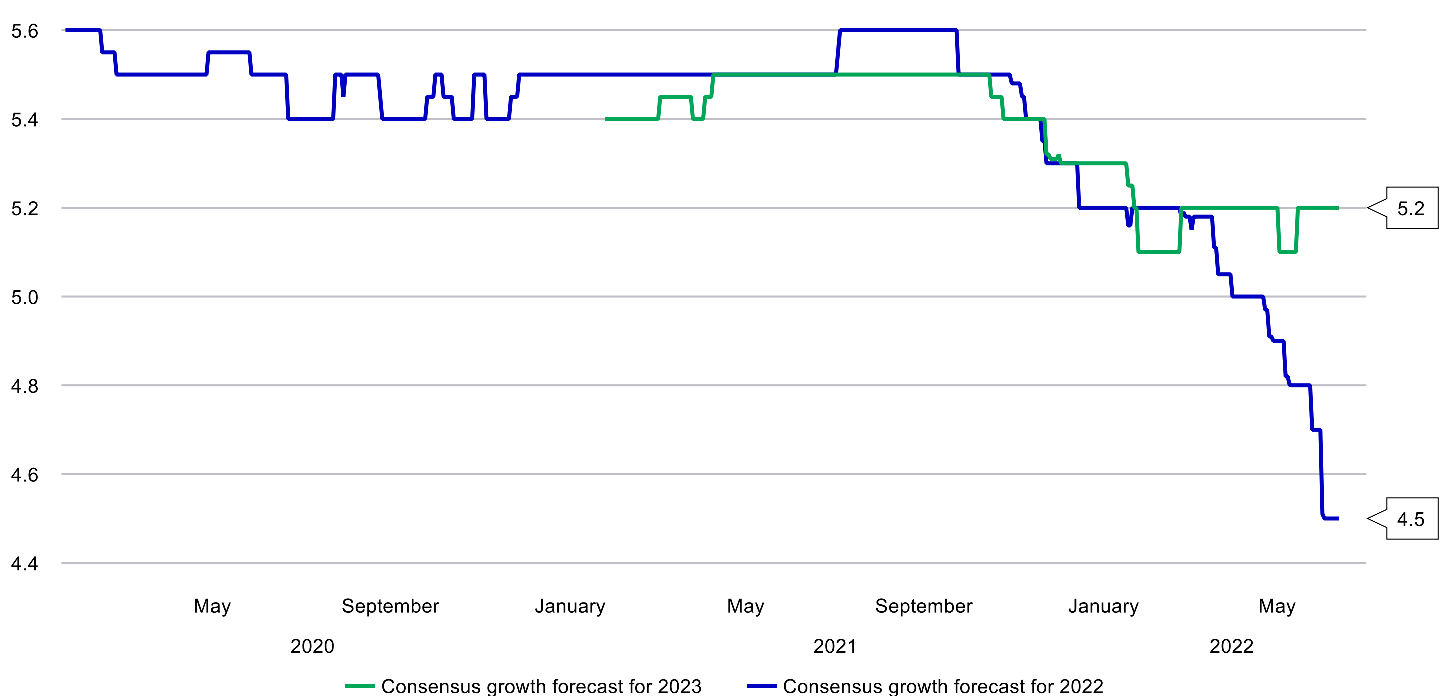
China

Big picture

The main challenges to Chinese economic growth remain in play: ongoing disruptions in supply chains, particularly in strategic resource commodities; the rising economic costs of COVID-zero policies, which will continue to hold back efforts to rebalance the economy and transition toward consumption-led growth; worsening developments in the property sector; and an upcoming slowdown in export growth as global consumption patterns are reoriented. Consensus for near-term GDP growth forecasts was finally downgraded to a level that aligns with our view, but we still think markets are too optimistic about China's medium- and long-term growth prospects. We expect further downgrades to those forecasts amid elevated debt levels, intense demographic challenges, and an increasingly zero-sum global economic environment. In our view, the offsetting stimulus response to scale of the problems that China's economy faces remains underwhelming. Worryingly, the deterioration in China's labor market is accelerating.

"Consensus for near-term GDP growth forecasts was finally downgraded to a level that aligns with our view, but we still think markets are too optimistic about China's medium- and long-term growth prospects."

Consensus Chinese GDP growth forecasts, YoY (%)



Source: Bloomberg, Macrobond, Manulife Investment Management, as of June 14, 2022. YoY refers to year over year.

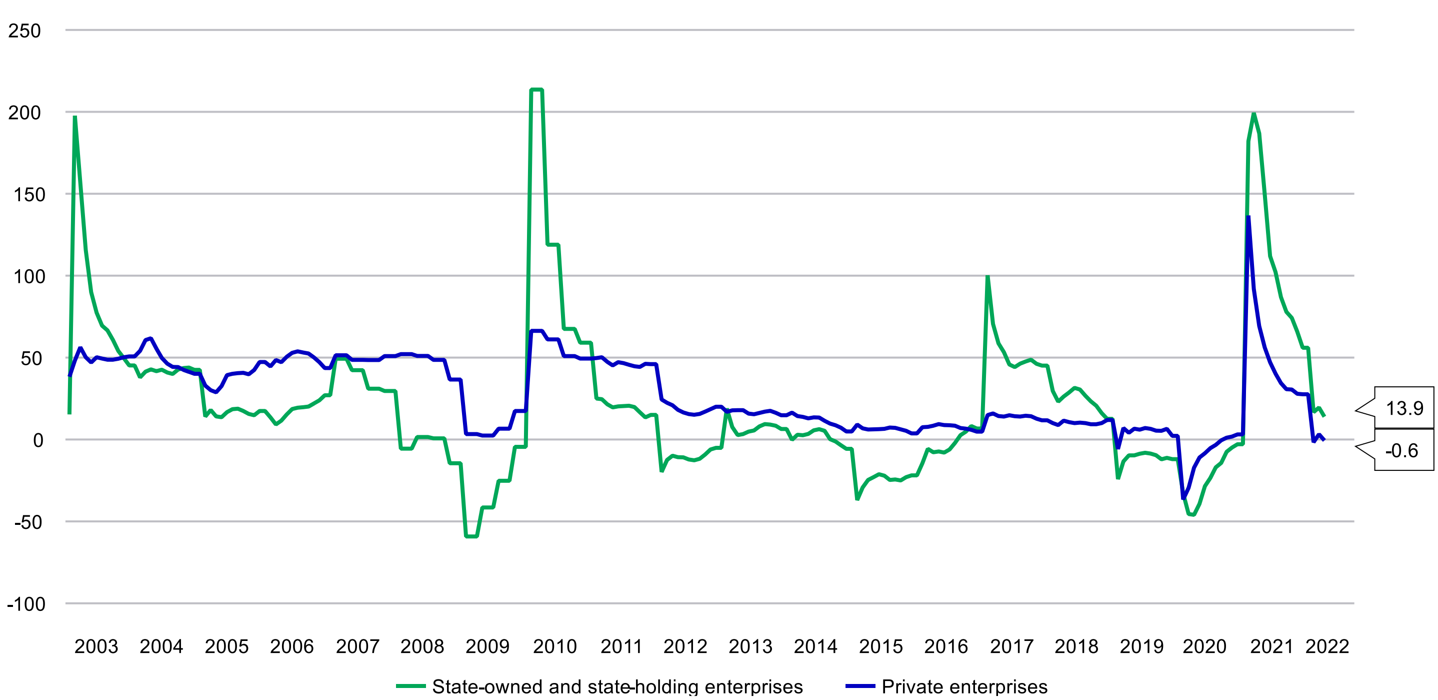
What we're watching

- **Trade surplus—**May's trade data showed a staggering increase in China's trade surplus from to US$78.8 billion, up from US$51.1 billion in April. In our view, this represents an increasingly net negative global demand impulse that will worsen societal gaps in the rest of the world, amplify global pressure to raise tariffs, introduce capital controls and/or accelerate onshoring/near-shoring, and, crucially, compound geopolitical tensions.
- **Regulatory tightening—**We believe regulatory tightening of the private sector will intensify ahead of the 20th Party Congress later this year. Our view is supported by the recent introduction of policies to regulate private sector incomes and a recommendation from the central government advising local governments to dispose of assets to ease fiscal strains.

Key market views

- **Equities—**Chinese equities have enjoyed a technical rebound recently thanks to the intersection of underweight investor positioning and perceived improvements in COVID-19 lockdowns and the regulatory environment. In our view, however, required shifts in the fundamental outlook have yet to materialize and the stagflationary global backdrop remains challenging. We're also mindful of the risk that the expected delisting of Chinese companies from U.S. exchanges could be accelerated.
- **Fixed income—**We expect Chinese bond yields to fall further as growth continues to disappoint. Risks to this view include the depreciating renminbi and a continued rise in U.S. bond yields, which has the effect of making Chinese government bonds less attractive to foreign investors.

The profit picture in China: state-owned and state-holding enterprises vs. private enterprises, YoY (%)



Source: National Bureau Statistics of China, China Banking and Insurance Regulatory Commission, Macrobond, Manulife Investment Management, as of June 14, 2022. YoY refers to year over year. A state-owned enterprise is wholly owned by the state, while a state-holding enterprise refers to an entity in which the state holds a majority stake.

India

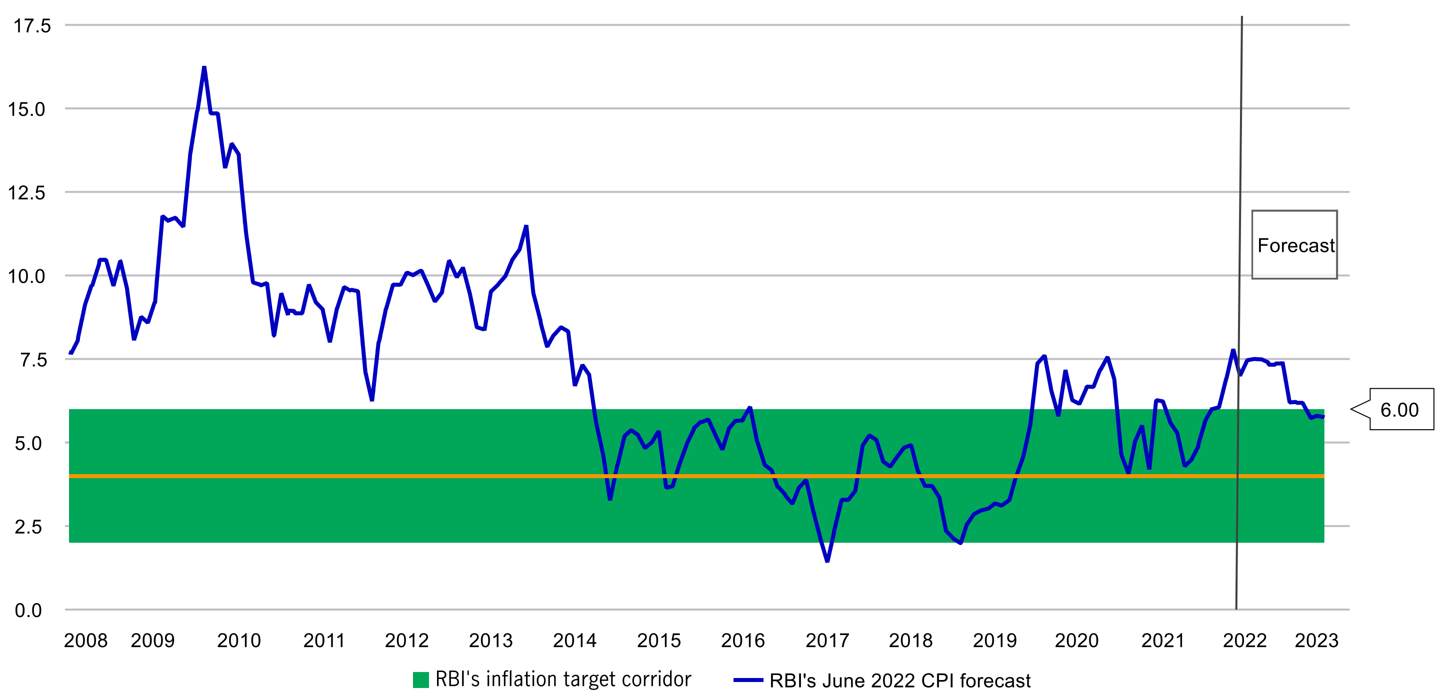
Big picture

Price pressures have been a growing source of concern for policymakers in India. At its June meeting, the Reserve Bank of India (RBI) revised up its CPI inflation projections from 5.7% to 6.7% for fiscal year (FY) 2022/23, indicating a prolonged period of above-target inflation. The bank also increased the pace of tightening and adopted a more hawkish tone. The good news is that the GDP reading for the January through March quarter showed the economy was resilient in the face of the Omicron wave and entered the current more-challenging macro environment on reasonably good footing.

Despite heightened inflation concerns, the RBI has signaled increased confidence in its growth outlook and maintained its April projection for FY 2023 GDP growth at 7.2%. Beyond the cyclical headwinds, we remain constructive on India's medium- to longer-term macroeconomic outlook. India continues to be one of the fastest-growing economies in the world, supported by significant reforms in the manufacturing sector, relatively lower exposure to external demand, and much higher domestic demand-driven growth.

The GDP reading for the January through March quarter showed the economy was resilient in the face of the Omicron outbreak and entered the current more-challenging environment on reasonably strong footing.

RBI's CPI inflation forecasts prolonged above-target inflation, but may still underestimate inflation risks, YoY (%)



Source: Reserve Bank of India (RBI), Ministry of Statistics and Programme Implementation of India, Macrobond, Manulife Investment Management, as of June 14, 2022. CPI refers to Consumer Price Index. It is not possible to invest directly in an index. YoY refers to year over year.

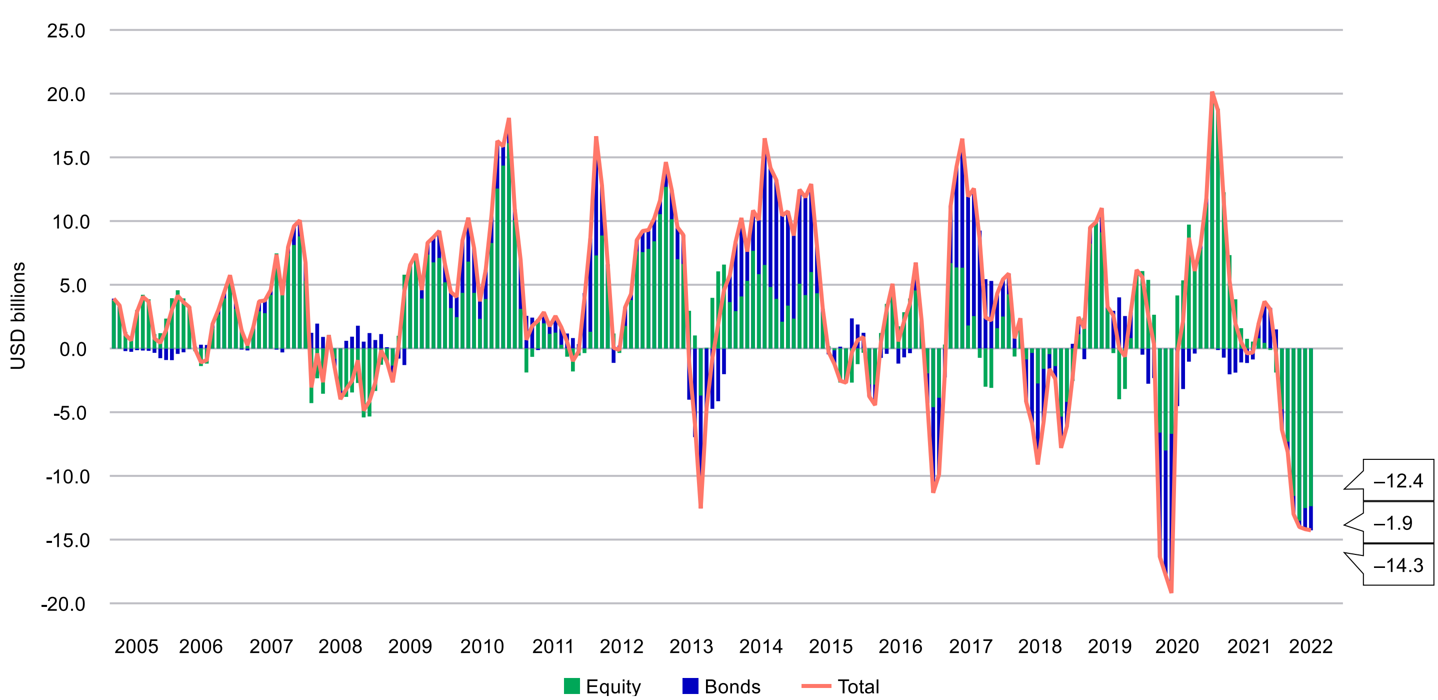
What we're watching

- **Food and energy price inflation—**The RBI has tended to underestimate inflation risks over the past 18 months, and we think the self-reinforcing feedback loop between energy, fertilizer, and food inflation poses upside risks to the bank's newly revised inflation forecasts, meaning tighter monetary policy measures may be needed.
- **Wider twin deficits (current and fiscal account)—**In our view, continued food and energy inflation could lead to a deeper economic growth slowdown, lower real yields, and potentially persistent portfolio outflows. That said, more stable sources of capital inflows such as foreign direct investments may help mitigate these risks.

Key market views

- **Equities—**Indian equities have held up relatively well in the face of challenging global crosscurrents. We think that's a testament to the fundamentally positive backdrop, and we expect relative outperformance within the region to continue. Foreign investors' current underweight stance could also turn incrementally positive.
- **Fixed income—**In our view, market pricing of RBI hikes is already very well priced in, with an implied terminal rate of around 7.15% to 7.20%.[6] As such, from a relative risk/reward perspective, an overweight in Indian government bonds could make sense. The RBI has also stated that it will intervene to smooth the trajectory of the Indian rupee, suggesting that the currency's depreciation this year will be more moderate than during the taper tantrums in 2011/2013 and 2018.

India: foreign investment flows



Source: International Institute of Finance, Macrobond, Manulife Investment Management, as of June 14, 2022.

6 Bloomberg, as of June 14, 2022.

Japan

Big picture

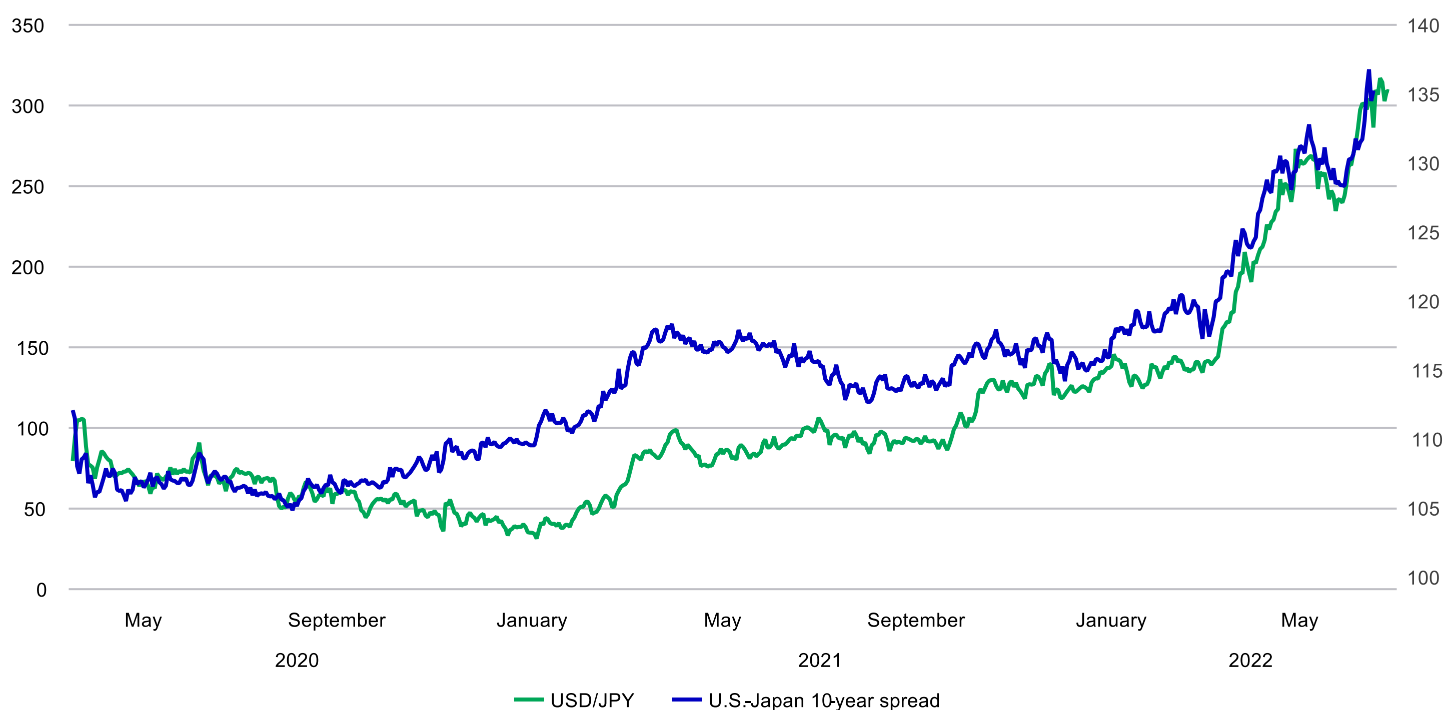
Domestic demand remains an important pillar of growth for Japan. Private consumption rose 2.5% in Q4 2021 and was unchanged in Q1 2022[7] despite social restrictions imposed across most of the country amid the Omicron outbreak.

External headwinds from the slowing global economy are picking up, however. While inflation will likely remain much lower than in other developed economies, it represents a hit to household incomes and consumer sentiment nonetheless. As such, even as the BoJ comes under increasing pressure to defend its 10-year yield target, it will want to keep its interest-rate targets low.

The Kishida Cabinet released the 2022 version of the Basic Policy on Economic and Fiscal Management and Reform on June 7, which suggests further fiscal expansion ahead. In our view, a dovish BoJ is necessary for the government to pursue such a policy direction at a lower cost. Another economic stimulus package and second supplementary budget for FY 2022 may follow the Upper House election in July.

Even as the BoJ comes under increasing pressure to defend its 10-year yield target, it will want to keep its interest-rate targets low.

BoJ's dovish bias deviates from the global trend among central banks (bps)



Source: Macrobond, Manulife Investment Management, as of June 16, 2022. USD refers to the U.S. dollar. JPY refers to the Japanese yen. BoJ refers to Bank of Japan. Bps refers to basis points.

7 Japan Cabinet Office, June 8, 2022.

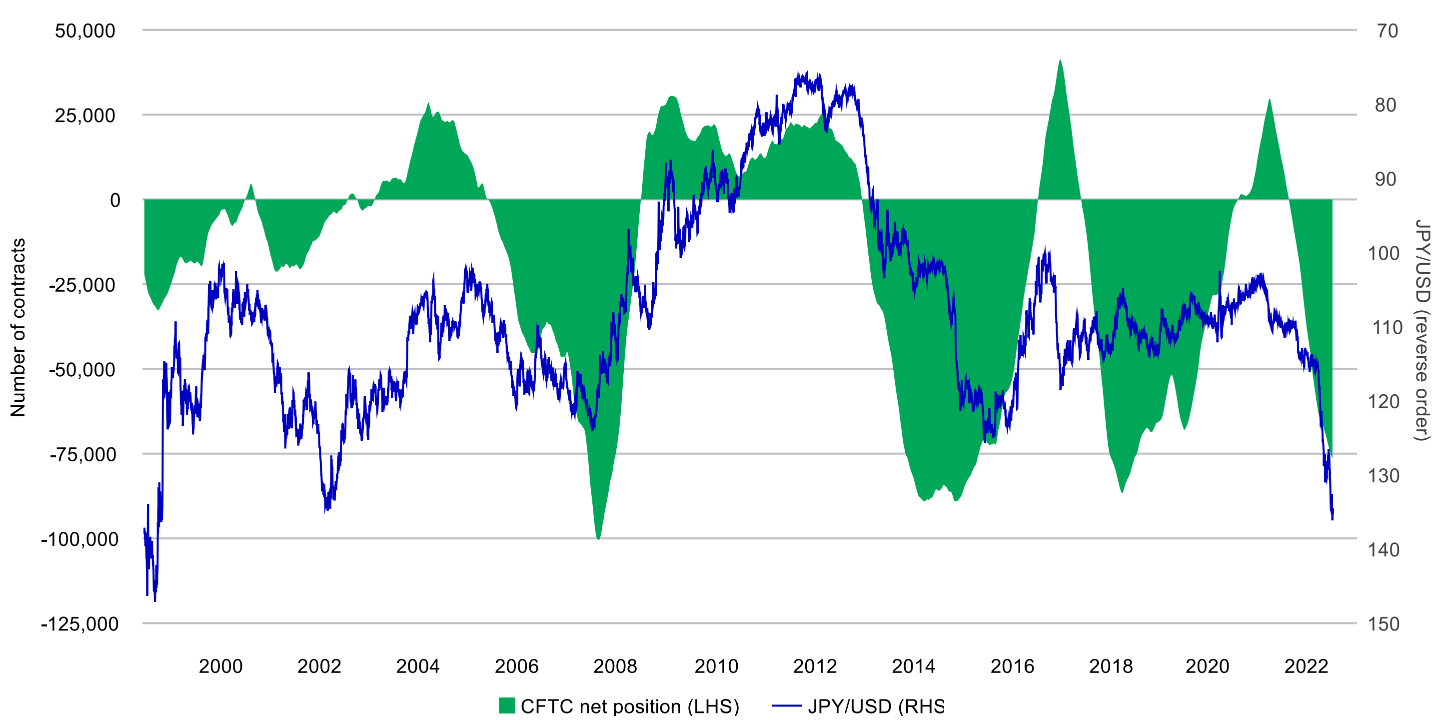
What we're watching

- **BoJ's 10-year Japan government bond yield tolerance band—**With the JPY trading near a 24-year low against major currencies, and rising input costs acting to lift underlying inflation close to the BoJ's 2% target,[8] markets continue to challenge the 10-year yield target of +/–25bps in the face of rising global yields. There's growing speculation that the BoJ may be widening its tolerance band to ±50bps.
- **JPY weakness—**It's fair to say that the JPY's extreme underperformance has been a function of Japan being a source of ultracheap global financing in a world of rising rates. That said, if the BoJ were to tighten monetary policy and introduce a higher yield target, it could catalyze a disorderly JPY appreciation as speculators rush to cover short positions.

Key market views

Equities—The TOPIX has been an outperformer in the past three months amid increased uncertainty stemming from the withdrawal of global monetary policy accommodation and rising risk aversion as a result of the Russia-Ukraine crisis. Valuations in Japanese equities have improved since mid-2021, but the asset class continues to look much cheaper than U.S. equities.

Speculators are very short JPY—a rush to cover their positions could be disorderly



Source: Commodity Futures Trading Commission (CFTC), Macrobond, Manulife Investment Management, as of June 16, 2022. JPY refers to the Japanese yen. USD refers to the U.S. dollar. LHS refers to left-hand side. RHS refers to right-hand side.

8 Bloomberg, as of June 16, 2022.

Brazil

Big picture

We expect Brazil's macro story to remain relatively strong: The Russia-Ukraine conflict will support the commodity export-driven economy and bolster terms of trade, and its fiscal landscape should continue to improve with a growing surplus.

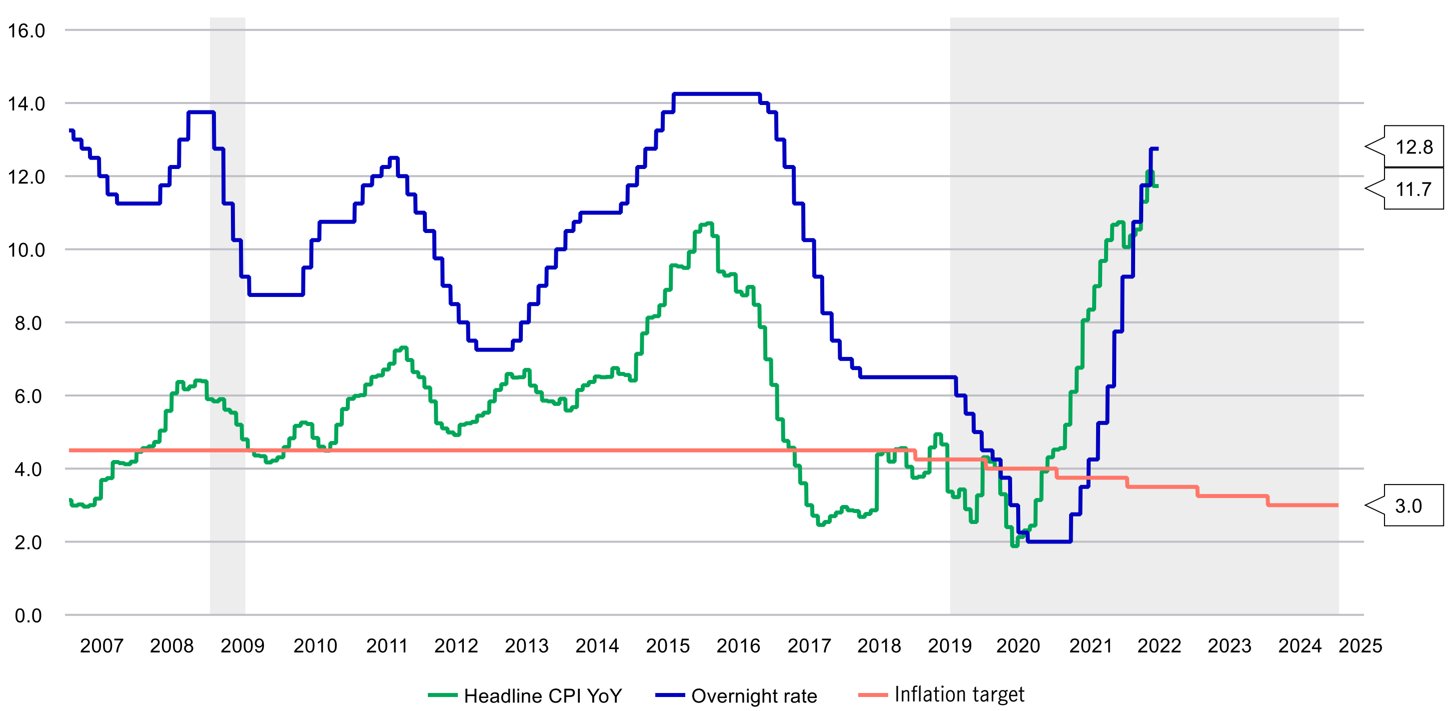
That said, there are emerging headwinds worth keeping an eye on. Improvements in fiscal surplus may not be sustainable given where we are in the country's fiscal tightening cycle. Indeed, the Brazilian government proposed tax cuts to electricity and fuel in June to ease the higher cost of living for households.

Persistent inflationary pressures also continue to be a concern. Market consensus for inflation in 2023 is close to the top end of Banco Central do Brasil's (BCB's) target inflation band of 3.25% (+/–1.5%), and underlying inflation is consistently above target.

Overall, the BCB has noted that it's in the advanced stage of its monetary tightening cycle, and the market is pricing a terminal Selic rate of 13.5% to 14.0%, a little higher than the current rate of 13.25%. Given the balance of risks, we think this is fair. In the global context, this may—ironically—provide investors with greater monetary policy certainty.

The BCB has noted that it's in the advanced stage of its monetary tightening cycle.

Hawkish BCB with above-target CPI inflation (%)



Source: Bloomberg, Macrobond, Manulife Investment Management, as of June 15, 2022. BCB refers to Banco Central do Brasil. CPI refers to Consumer Price Index. It is not possible to invest directly in an index. YoY refers to year over year. The gray areas represent recessions.

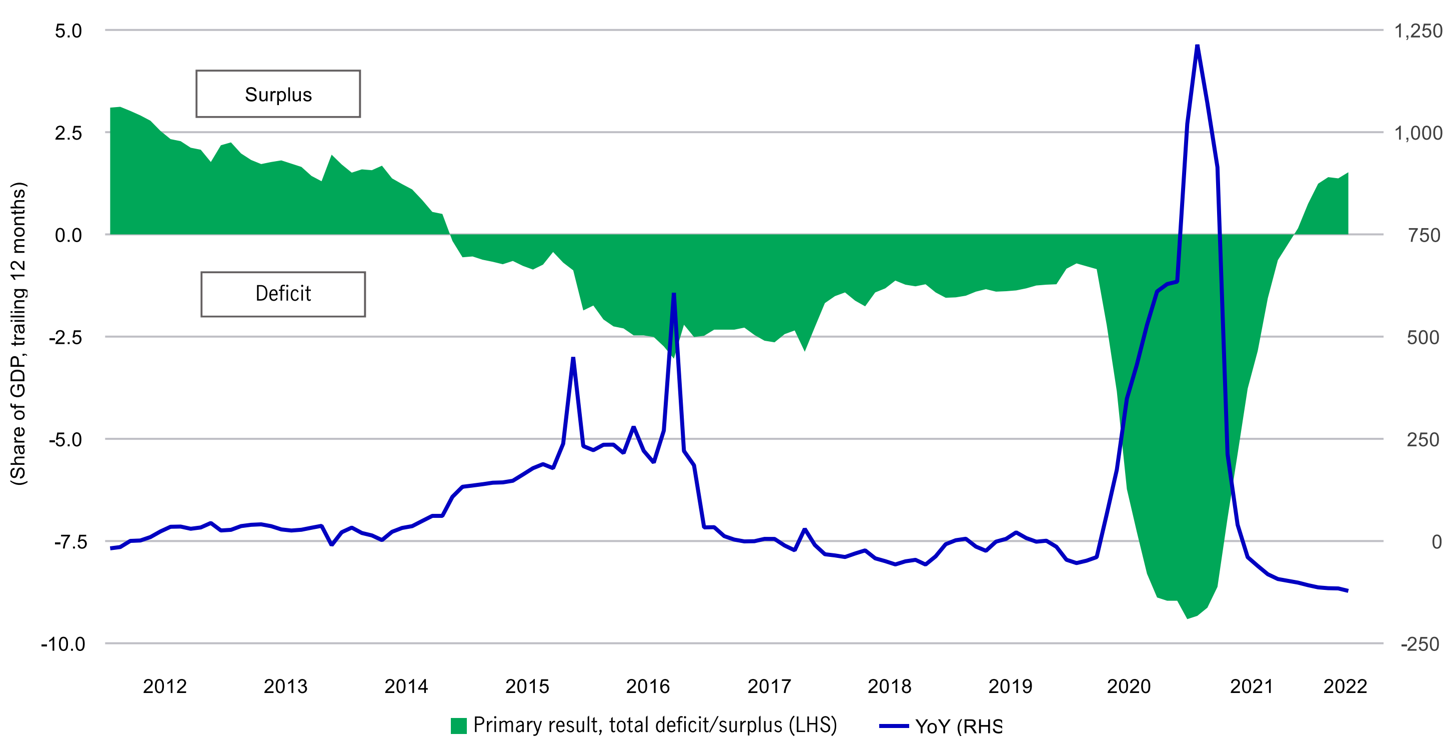
What we're watching

- **2022 election—**The political discount applied to Brazilian assets continues to wane as markets seem to find comfort in former President Luiz Inácio Lula da Silva's advancement in the polls with a more centrist platform. While the polls continue to be steady, a change in leadership will likely be accompanied by structural reform, increasing fiscal policy uncertainty postelection.
- **Flows and sentiment—**International demand for Brazilian assets remains a major driver of the Brazilian real (BRL). Its high carry has attracted global inflows to a broadly underowned asset class. But given the market is primarily sentiment driven, the risk of forceful swings in either direction is possible, and negative global risk sentiment would be a headwind given the high beta nature of Brazilian assets.

Key market views

- **Equities—**Valuations are at attractive levels, and our analysis shows that the asset class's fundamentals are, broadly speaking, stronger than they were before the pandemic. We believe the MSCI Brazil Index will continue to benefit from the supply shortages of commodities, given the cyclical exposure of the index composition.
- **Currencies—**The BRL's performance has shown much greater variability in Q2, and the intensification of global risks is setting the stage for a challenging H2 2022. Tighter global financial conditions will no doubt pose a challenge for a growth-sensitive commodity currency such as the BRL. We anticipate the BRL to remain in the 5.00 to 6.00 range against the USD.

Brazil's surplus continues to grow, but is likely to decelerate (%)



Source: Bloomberg, Manulife Investment Management, as of June 16, 2022. YoY refers to year over year. LHS refers to left-hand side. RHS refers to right-hand side.

Mexico

Big picture

Mexico's economic outlook is mixed as domestic improvement is balanced against a deterioration in the external environment. After some delay, Mexico is now in the throes of a post-COVID-19 reopening recovery that points to rising upside risk for the services sector. In manufacturing, short-term activity indexes are in expansionary territory for the first time since 2019; however, Mexico's greatest medium-term risk centers on the United States' economic outlook as we head into the second half of 2022.

Inflation appears to be peaking in Mexico, and the Banco de México, which started the tightening cycle early and has been tightening at a measured pace, should be well positioned in the event of a slowdown.

In terms of political risk, we anticipate a moderation in domestic uncertainty as President Andrés Manuel López Obrador moves into the latter half of his six-year term. Regarding the Mexican peso (MXN), we note that the currency has been remarkably stable, trading near the psychologically important 20.00 level against the USD.

Short-term manufacturing activity indexes are in expansionary territory for the first time since 2019.

Mexico's manufacturing PMI climbs into expansionary territory

Source: Bloomberg, Macrobond, Manulife Investment Management, as of June 16, 2022. PMI refers to Purchasing Managers' Index. It is not possible to invest directly in an index. A reading above 50 represents expansion.

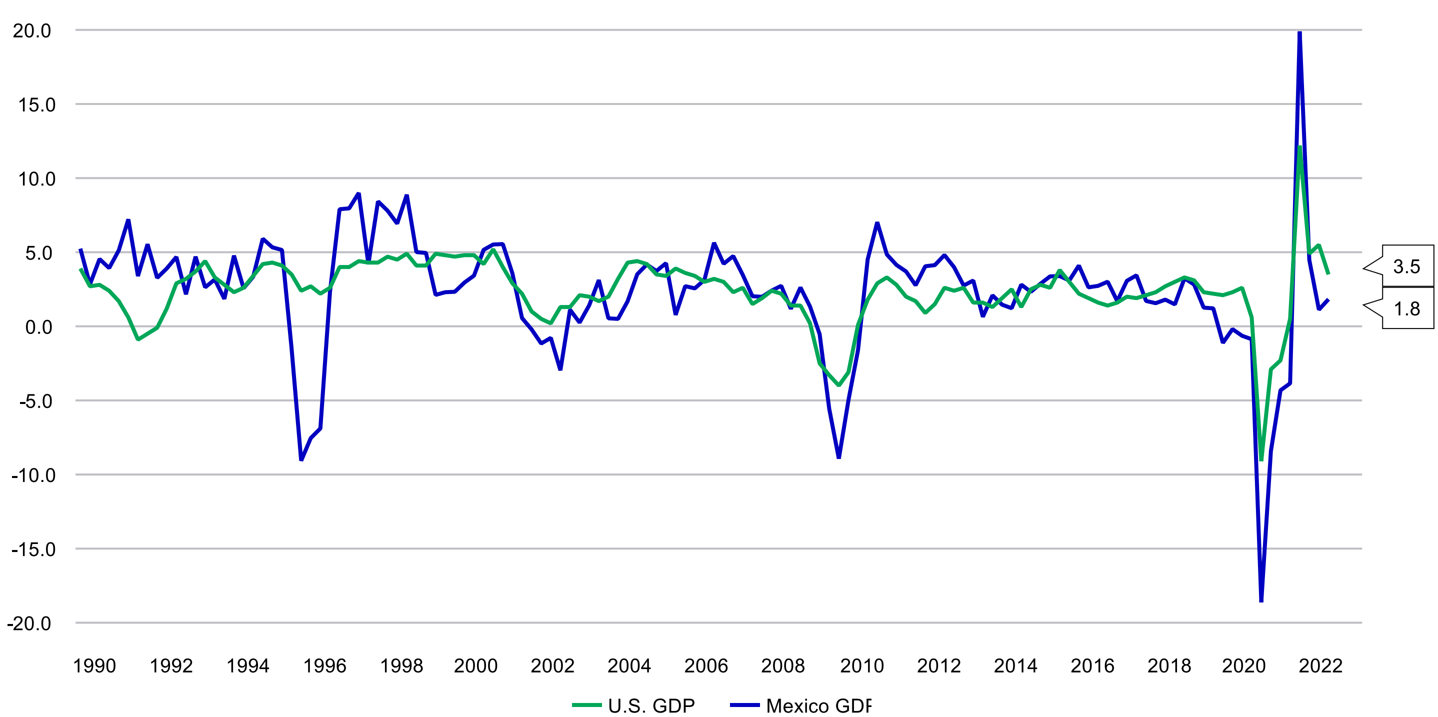
What we're watching

U.S. economy—Mexico's economic prospects have historically been closely tied to those of its U.S. peer. The post-COVID-19 recovery saw Mexico lag the U.S. economy in an atypical manner as the postpandemic reopening occurred at different points in time. That said, the U.S. outlook remains crucial for Mexico's manufacturing sector, and we'll be keeping an eye on how the U.S. growth picture evolves as we move through the second half of 2022.

Key market views

Currencies—The MXN has been remarkably stable over the past 18 months or so and has consolidated around the psychologically important 20.00 level against the greenback. In addition, it's worth noting that the currency has been strengthening against the USD since late 2021.

Historically, there's a strong correlation between the Mexican and U.S. economies, YoY (%)



Source: Bloomberg, Manulife Investment Management, as of June 16, 2022. YoY refers to year over year.

Manulife Investment Management

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