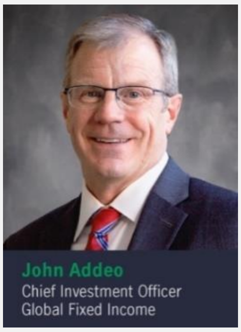
Manulife Investment Management

2022 outlook series: Manulife Global Multi-Asset Diversified Income Fund

Jan 2022

1. Manulife Global Fund – Global Multi-Asset Diversified Income Fund ("Manulife Global Multi-Asset Diversified Income Fund" or the "Fund") invests in a diversified portfolio of equity, equity-related, fixed income and fixed income-related securities of companies and/or governments globally (including emerging markets), which exposes investors to fixed income and equity (including REITs) market risk, and geographic concentration and currency risk.
2. The relevant distributing class of the Fund does not guarantee distribution of dividends, the frequency of distribution and the amount/rate of dividends. Dividends may be paid out of income, realized capital gains and/or out of capital of the Fund in respect of Inc share class(es). Dividends may be paid out of realized capital gains, capital and/or gross income while charging all or part of their fees and expenses to capital (i.e. payment of fees and expenses out of capital) in respect of MDIST (G) and R MDIST (G) share class(es). Dividends paid out of capital of the Fund amounts to a return or withdrawal of part of the amount of an investor's original investment or from any capital gains attributable to that original investment and may result in an immediate decrease in the net asset value per share in respect of such class(es) of the Fund.
3. The Fund invests in emerging markets, which may involve increased risks and special considerations not typically associated with investment in more developed markets, such as likelihood of a higher degree of volatility, lower liquidity of investments, political and economic uncertainties, legal and taxation risks, settlement risk, custody risks and currency risks/control.
4. The Fund's investment in fixed income and fixed income-related securities, as well as cash and cash equivalents, is subject to high yield bond risk, credit/counterparty risk, interest rate risk, sovereign debt risk, valuation risk and credit rating and downgrading risk.
5. The Fund intends to use financial derivative instruments ("FDIs") for investment, efficient portfolio management and/or hedging purposes. The use of FDIs exposes the Fund to additional risks, including volatility risk, management risk, market risk, credit risk and liquidity risk.
6. Investment involves risk. The Fund may expose its investors to capital loss. Investors should not make decisions based on this material alone and should read the offering document for details, including the risk factors, charges and features of the Fund and its share classes.
7. Given RMB is currently not a freely convertible currency, payment of redemptions and/or dividend payment in RMB may be delayed due to the exchange controls and restrictions applicable to RMB. As offshore RMB (CNH) will be used for the valuation of RMB denominated Class(es), CNH rate may be at a premium or discount to the exchange rate for onshore RMB (CNY) and there may be significant bid and offer spreads and thus the value of the RMB denominated Class(es) will be subject to fluctuation. Any devaluation of RMB could adversely affect the value of investors' investments in the RMB denominated Class(es) of the Fund.



As we move into 2022, the pace of recovery is difficult to predict, given the sheer number of variables to consider. Data has seen pockets of improvement, but areas of weakness remain. However, all indications point to an extended period of low interest rates and continued government support to put the global economy back on a positive trajectory. We think the environment should prove favourable for income-oriented solution like the Manulife Global Multi-Asset Diversified Income Fund, as investors continue to seek income, but tactical positioning in three different sleeves (fixed income, equity and options) would be key to generating performance returns.

An income-oriented solution in a higher-yielding environment

This is a challenging environment for global markets – growth and earnings could disappoint due to logistical challenges, and there is pressure on policymakers to reduce stimulus in the face of rising and less transitory inflation.

Indeed, the inflationary backdrop is worth considering. We've seen reasonably strong job creation; however, the labour market is still tight, which is leading to wage inflation. Looking ahead, we think above trend inflationary pressures will remain in place for longer than people have originally hoped, but these are not expected to be permanent.

Accommodative policy remains supportive even as tapering begins

Across the largest developed markets, fiscal tailwinds are likely to start to fade as the US Federal Reserve (the Fed) began tapering in November 2021. Meanwhile, the Bank of England raised interest rates in December 2021.

In the US, Jerome Powell will be entering his second term as Fed Chair, which we believe will be positive for the market, as he takes a pragmatic and thoughtful approach to inflation. For example, Powell is data dependent when considering rate-hike decisions, taking a less hawkish stance. The quality of economic data over the coming months is more likely to determine how the Fed's tapering is conducted and help guide the market's reaction.

We think the Fed's monetary policy will remain highly accommodative with a slow and gradual approach to rate hikes, which we expect sometime in 2022. Against this backdrop, we believe the Fund is well positioned to benefit from the re-opening theme and capture higher yields given its diversified income-oriented objective. This environment should prove favourable as investors continue to seek income.

Fixed Income: Emerging-market credits look compelling

The Fund's strategically neutral asset allocation is broadly 50% fixed income, 25% global equities and 25% option-writing strategy. From this, the underlying yield generated from fixed income (developed and emerging market credits and sovereigns) is just over 6%, preferred securities approximately 6.7%, whilst the dividend yield of the global equities portion is around 1.7%. The option premium is approximately 100-150bps per month. The Fund's latest distribution yield is 7.19%[1].

In 2022, fixed income credit remains a key income source for the Fund, in particular, we think that Developed Market high-yield and Emerging-market credits (accounting for approximately 22% and 17% of the overall Fund) will provide the most significant investment opportunities.

US high-yield outperformed emerging-market credits in 2021, driven, in part, by demand for developed-market issues, where fundamentals are improving. As such, spreads remain relatively tight.

However, we have seen a lot of capital flow seeking opportunities, so the outlook for US high-yield remains balanced. We expect uncertainty to remain in the coming months but believe investors are generally being compensated for the risks. We believe that defaults have peaked and the trailing 12-month default rate will remain stable to lower.

More broadly, income-seeking investors are chasing credits in the broader emerging market space, as well as Asia. The situation here is more complex, as spreads are compelling, especially in Asia, where a shorter duration, higher-quality market versus broad emerging market, mean that credit spreads could be 60 to 100 basis points cheaper relative to high-yields. This is mainly driven by the property sector in China, where the market is pricing in default rates we won't see in the wider credit market.

We think that widening credit spreads, recently experienced, in emerging markets present attractive opportunities in the fixed income sleeve, and this should be a significant performance contributor in 2022. The idea of trade-off plays between emerging-market and developed-market credits depends on whether we can uncover opportunities at an individual security level.

Equities: Tilted towards the US

Equities have been a key performance driver over the year, with developed-market stock exposure dominating the equity sleeve.

Equity exposure is tilted towards the US (74% of the equity sleeve). One of the drivers here is our confidence in the country's vaccine rollout programme. Specifically, our US positioning is a balanced blend between growth and non-growth stocks, albeit with a slight value tilt. These market and sector allocations reflect our bottom-up approach to security selection, whereby we focus on individual company fundamentals. Ultimately, this stance has helped the Fund, given the outperformance of US equities over emerging markets and Asia during 2021.

While many equities have corrected significantly from their recent highs, we are still comfortable with our current allocation versus fixed income and options. The Fund's primary objective is to deliver a high level of income, and we do not think that equity markets will deliver overly excessive returns in 2022.

[1] Source: Morningstar, Manulife Investment Management. Distribution yield applies only to AA (USD) MDIST (G) class, as of 1 December 2021. Dividend rate is not guaranteed. Dividends may be paid out of capital. Refer to important note 2. Please note that a positive distribution yield does not imply a positive return. Annualised yield = [(1+distribution per unit/ex dividend NAV)^distribution frequency]–1, the annualised dividend yield is calculated based on the latest relevant dividend distribution with dividend reinvested, and may be higher or lower than the actual annual dividend yield. Please refer to www.manulifefunds.com.hk for the historical distribution yield records. Information about the asset allocation and portfolio holdings is historical and is not indication of the future composition. Due to rounding, the total may not be equal to 100%. Diversification or asset allocation does not guarantee a profit nor protect against loss in any market.

Option Writing: Expected higher premiums due to rising interest rates

Through option writing, we remain committed to managing downside risk when appropriate and harvesting consistent premiums to enhance the Fund's yield. Option writing (covered calls and collateralised puts) allows the Fund to forego some future equity upside in order to generate income today.

Option premiums are related to volatility. In the near term, we have two COVID-related concerns that may trigger a spike in volatility – namely, new variants and further developments with the Omicron strain, which could impact our ability to collect premiums.

We view the market through a long-term security-selection lens, which means we're better placed to predict short-term bouts of volatility. The Fund is able to tactically adjust the option strike rate as well as lean towards more or less equities with a call writing structure. If we're really bullish, we can stop writing covered calls altogether in order to participate fully in equity upside.

The lasting impact of COVID-19 on the global economy is not the only factor to monitor. We believe that rising geopolitical tensions, decelerating post-stimulus growth rates, supply-chain disruptions, and the general deglobalisation trend raise questions about the future trajectory of global debt and equity markets.

Conclusion: Tactical positioning is key

Overall, the Fund is positioned to generate a high sustainable income yield as well as being tilted towards capturing higher rates. Tactical positioning will become more prevalent as we move into 2022, allowing us to nimbly increase and decrease the risk profile of the Fund, as well as add yield opportunities when they arise. The trade-off between generating yield, which is the primary objective of the Fund, and capital appreciation through tactical equity allocations or options writing will be a vital determinant of the Fund's performance in 2022.