Manulife Investment Management

Investment Note

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On the back of escalating tariffs between the United States and other parts of the world, markets have dropped significantly as economic growth concerns have risen and investor sentiment and consumer confidence have destabilized, with some markets tiptoeing precariously on the precipice of bear market territory as of this writing.[1] Here's how **Nathan W. Thooft, CFA,** CIO, Multi-Asset Solutions Team, Global Equities, is thinking about asset allocation in the current environment.

Riding the wave: building resilience amid volatility

Navigating choppy markets amid rising tariffs

We entered 2025 with an expectation for greater policy uncertainty and market volatility—a scenario that's certainly played out in the first quarter. However, the recent tariff announcements—both larger in scale and higher than expected—have brought about even higher levels of disruption.

In our view, this period of volatility and uncertainty is likely to continue until we see more conciliatory tariff conversations take place between the United States and its trading partners, which have historically taken time to negotiate. We do expect even after negotiations that tariff rates will be materially higher than recent history, therefore requiring other offsetting growth policies to minimize the economic pain such as tax reductions, deregulation, and fiscal spending.

The Office of the United States Trade Representative used trade deficits relative to imports to calculate reciprocal tariffs, which we believe could complicate future negotiations as it's unclear what each country can concede to the United States to gain carve-outs.

Consequently, it appears that the rough framework the United States would apply to more challenging trade partners might look like this: Retaliatory tariffs get announced, Washington ratchets up its multiplier, negotiations begin, and eventually a détente/pause ensues. In our view, the ability for Washington and its trade partners to reach an agreement is constrained by the administration's desire to eliminate the country's trade deficit.

The longer the negotiations take, the longer the period of uncertainty, and the more of a paralytic effect it'll likely have on consumers, companies, and investors. In the absence of a clear policy framework, planning can become challenging. As a result, it's likely that fewer decisions will be made, reducing purchasing decisions accordingly. This decision paralysis compounds existing concerns that the United States and other economies are already experiencing weakening economic growth, leading to growing concerns of a recession.

Uncertainty may abound, but we'd remind investors that markets often defy odds and manage to scale walls of worry as they look past near-term concerns to opportunities further in the future. However, this doesn't mean investors should be overly complacent.

One of our key themes for 2025 is to adopt a more defensive posture in our approach to investing. At a time when we're seeing U.S. equity valuations at near-peak levels, tight credit spreads, geopolitical uncertainty, and uneven economic growth around the world—not to mention the potential for varying degrees of trade wars—enhancing portfolio resilience while still taking advantage of upside opportunities seems prudent. For investors with a

[1] Bloomberg, as of 8 April 2025.

longer investment horizon, we believe recent events can lead to compelling investment opportunities.

Not doomsday, but defense matters

We've seen markets slip into panic mode before (was March 2020 just five years ago?). As it was then and in periods before that, it's important for investors to maintain a broader perspective and consider diversification to help mitigate the worst of the impact of the market drawdown. Here's how we're thinking about asset allocation in the current environment.

Equities

- We've reined in our long-standing overweight in equities, moving to a modest underweight view; *however*, we believe there may be an opportunity to add more equity risk on further market weakness.
- Within U.S. equities, high-quality companies continue to be a focus. This doesn't mean we're abandoning the large-cap growth story, particularly technology companies, which still have secular advantages.
- Within developed markets, we're of the view that Japan represents a quality growth opportunity with good fundamentals and reasonable valuations and could likely benefit from ongoing, positive corporate governance reforms.
- Additionally, we continue to see short-term improvement in European equity performance driven by new government spending initiatives and investors redeploying assets back into the region after years of avoiding it.
- While we remain neutral on Asian equities overall due to ongoing tariff uncertainties, we see opportunities within the region. In our view, supply chain restructuring continues to create opportunities for select domestically focused markets, including Mainland China. India remains among the faster growers,[1] and recent underperformance could create potential entry points.

Fixed income

- Within fixed income, the credit spread environment gives us some pause—we think non-investment-grade bonds don't have much margin for error should they be faced with unexpected negative news. We remain underweight lower-grade credit in favor of higher-quality investment-grade debt. Within riskier areas of fixed income, we have a more favorable view of U.S. dollar-denominated emerging-market bonds.
- Longer term, the risk/reward profile of traditional fixed income looks compelling; however, we're concerned about the underpricing of term premium further out the yield curve. At current interest-rate levels, we see opportunity in the shorter end through the belly of the yield curve given the macro uncertainty. Overall, we remain neutral on duration.

Gold and real assets

- Gold remains appealing despite its recent rally. We expect the precious metal to continue to benefit from favorable supply-demand dynamics, supported by structural demand in emerging markets such as China and India and an uptick in demand from global central banks.
- Real assets continue to serve an important diversifying role in portfolios.

Listen to what history tells us

Although it's likely that market volatility may abate as Washington engages in more constructive conversations with its trading partners, we expect the process to be protracted. That said, it's worth bearing in mind that not everything needs to be resolved before markets start to head in a positive direction.

Predicting market performance is seldom straightforward even in the best of times; however, we do have access to historical data that can serve as a guide for us. Historical data indicates that equity markets often recover following steep sell-offs, and these rebounds are typically sharp, sustained, and *swift*, underscoring the importance of staying invested.

S&P 500 Index: 10 worst trading days and what happens after (%)

In descending order

Dates	1-day drawdown	Return after 1 year	Return after 3 years	Return after 5 years	Return after 10 years
Mar 16, 2020	-12.0	68.9	74.2	157.0	N/A
Mar 12, 2020	-9.5	61.8	63.1	144.0	N/A
Oct 15, 2008	-9.0	24.0	41.4	109.0	275.4
Dec 1, 2008	-8.9	39.3	62.9	146.3	315.0
Sep 29, 2008	-8.8	-1.5	12.2	69.9	226.4
Oct 9, 2008	-7.6	20.9	40.5	103.5	292.2
Mar 9, 2020	-7.6	43.6	49.8	121.0	N/A
Oct 27, 1997	-6.9	23.4	62.0	8.7	102.5
Aug 31, 1998	-6.8	39.8	22.5	13.0	60.1
Nov 20, 2008	-6.7	48.8	68.7	164.3	334.5

Source: Manulife Investment Management, as of April 7, 2025. The S&P 500 Index tracks the performance of 500 of the largest publicly traded companies in the United States. It is not possible to invest directly in an index. Past performance does not guarantee future results.

In our view, adopting an active approach to investing, rather than a reactive one, makes the most sense at this point. It’s far more constructive to remain thoughtful and considered, ensuring that allocation decisions remain aligned with long-term goals. While opportunities can emerge amid volatility, having the clarity of mind to recognize them is just as critical.

The coming weeks—possibly, months—are likely to be rocky, and market conditions could well test even seasoned investors with nerves of steels. However, in times like this, we think it's even more important to stay diversified, nimble, and above all, invested.

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