Manulife Investment Management

Q4 2022 | Global Macro Outlook

A *difficult* climb ahead

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Global overview

Big picture

Set against a backdrop of deteriorating global economic growth, elevated inflation, and negative investor sentiment, global markets have spent the past quarter pricing in an increasingly hawkish profile for central bank rate hikes, leading to a sharp spike in volatility across asset classes.

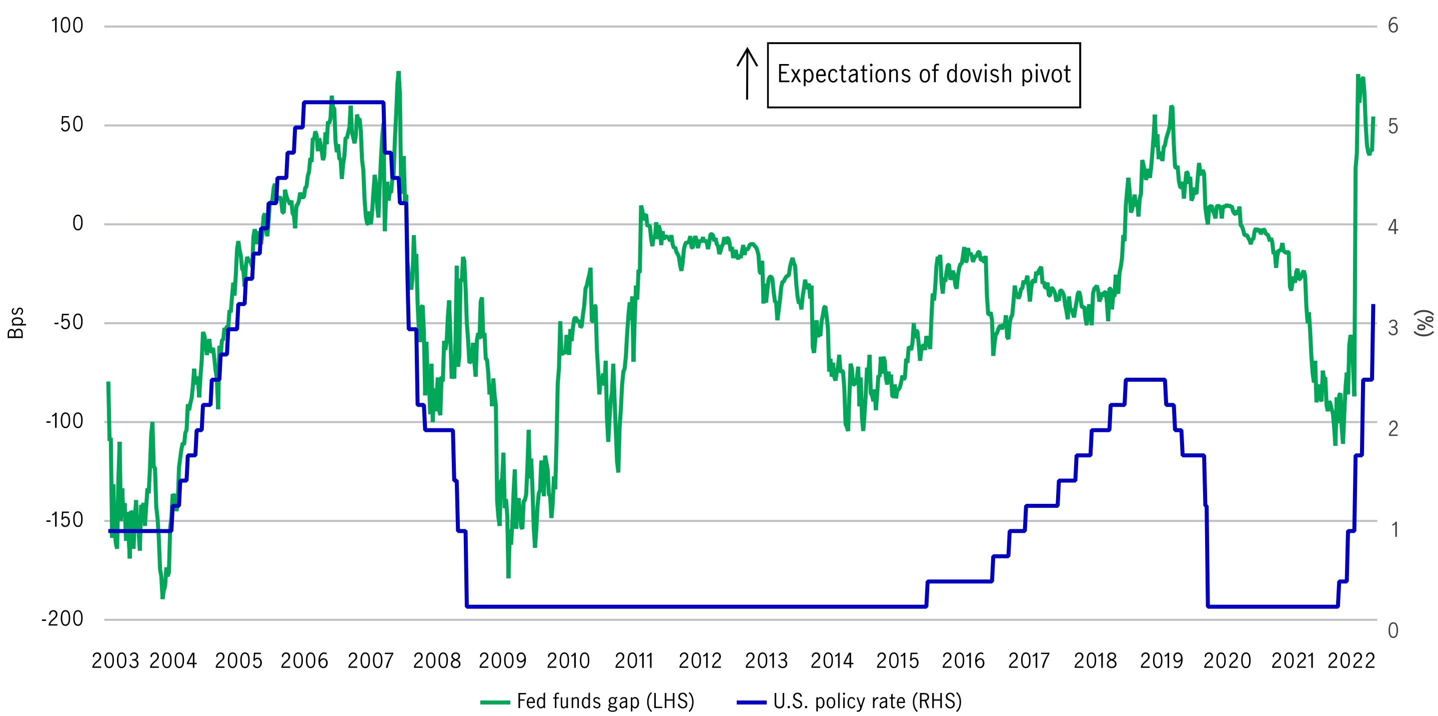
Global fixed-income markets sold off sharply during the quarter, with yields for the two-year U.S. Treasuries soaring to a post-2007 high of 3.92%.[1] Global equities experienced their worst trading day since June 2020, while the U.S. dollar (USD) strengthened to a new multidecade high[1] as investors embraced the greenback's role as a safe haven asset amid the uncertainty.

Emerging markets (EM) underperformed developed markets (DM), reflecting the fact that the combined headwinds of elevated inflation, liquidity tightening, and the lingering food and energy crisis have a much more negative impact on EM economies than their developed peers.

While investors still largely expect the U.S. Federal Reserve (Fed) to make a dovish pivot next year, they're less convinced of a rapid U-turn in U.S. monetary policy.

The combined headwinds of elevated inflation, liquidity tightening, and the food and energy crisis have a much more negative impact on EM than their developed peers.

Wavering expectations of a dovish Fed pivot



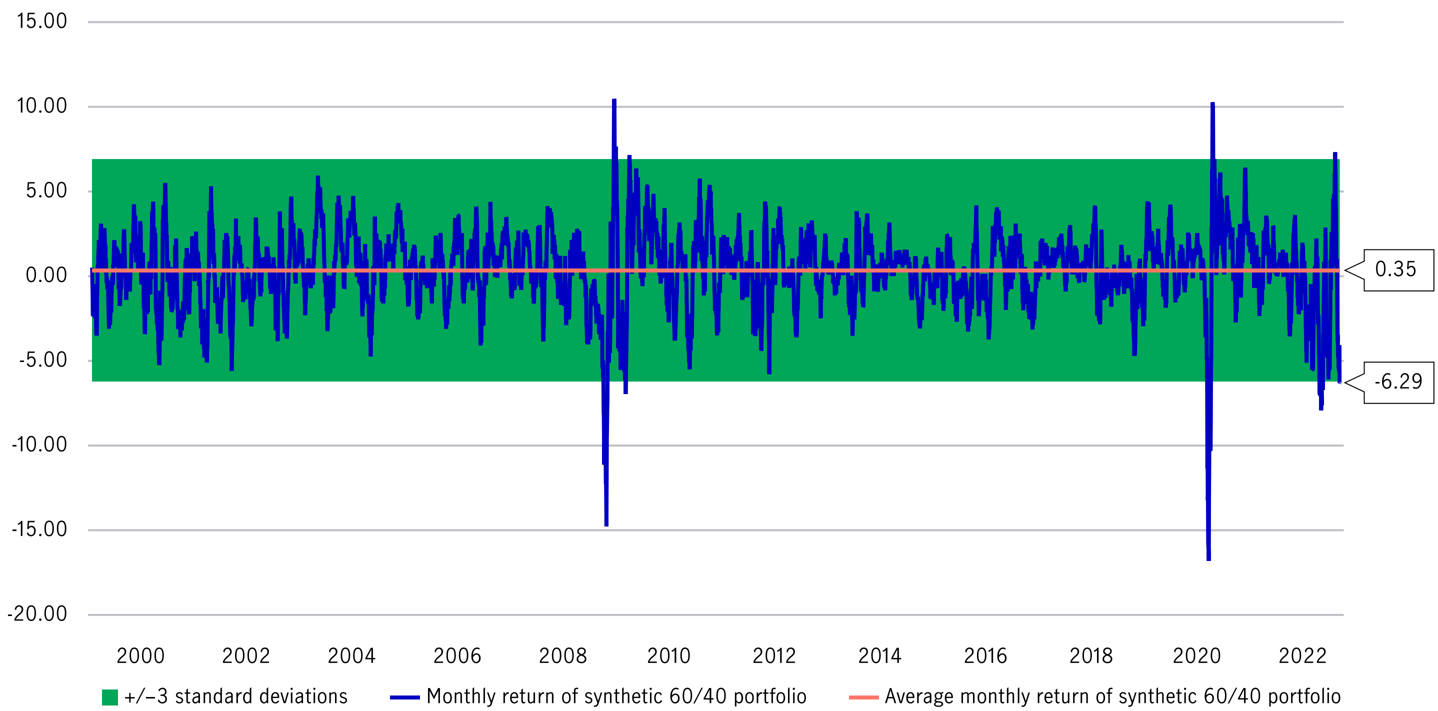
Source: U.S. Federal Reserve, Macrobond, Manulife Investment Management, as of September 26, 2022. Fed funds gap refers to the difference between the implied yield on the second federal fund futures contract (6-months forward) and the implied yield on the sixth federal funds futures contract (18-months forward). Bps refers to basis points. LHS refers to left-hand side. RHS refers to right-hand side.

1 Bloomberg, as of September 26, 2022.

Hawkish rhetoric from Fed officials and stronger-than-expected U.S. August Consumer Price Index (CPI) inflation data have prompted the market to price an extended period in which interest rates will stay higher.

These developments have taken a toll on market returns. Data shows that annual returns from a synthetic 60/40 global equity/bond portfolio—which can be gleaned from the construction of a risk parity index using the MSCI All Country World Index and the Bloomberg Global Aggregate Bond Index—have fallen to levels last seen in the global financial crisis of 2008. Monthly returns from such a portfolio would also have been subjected to unprecedented volatility (up to +/–3 standard deviations on multiple occasions). In a nutshell, it hasn't been pretty.

Monthly returns on a synthetic 60/40 global portfolio have been subject to unprecedented volatility (%)



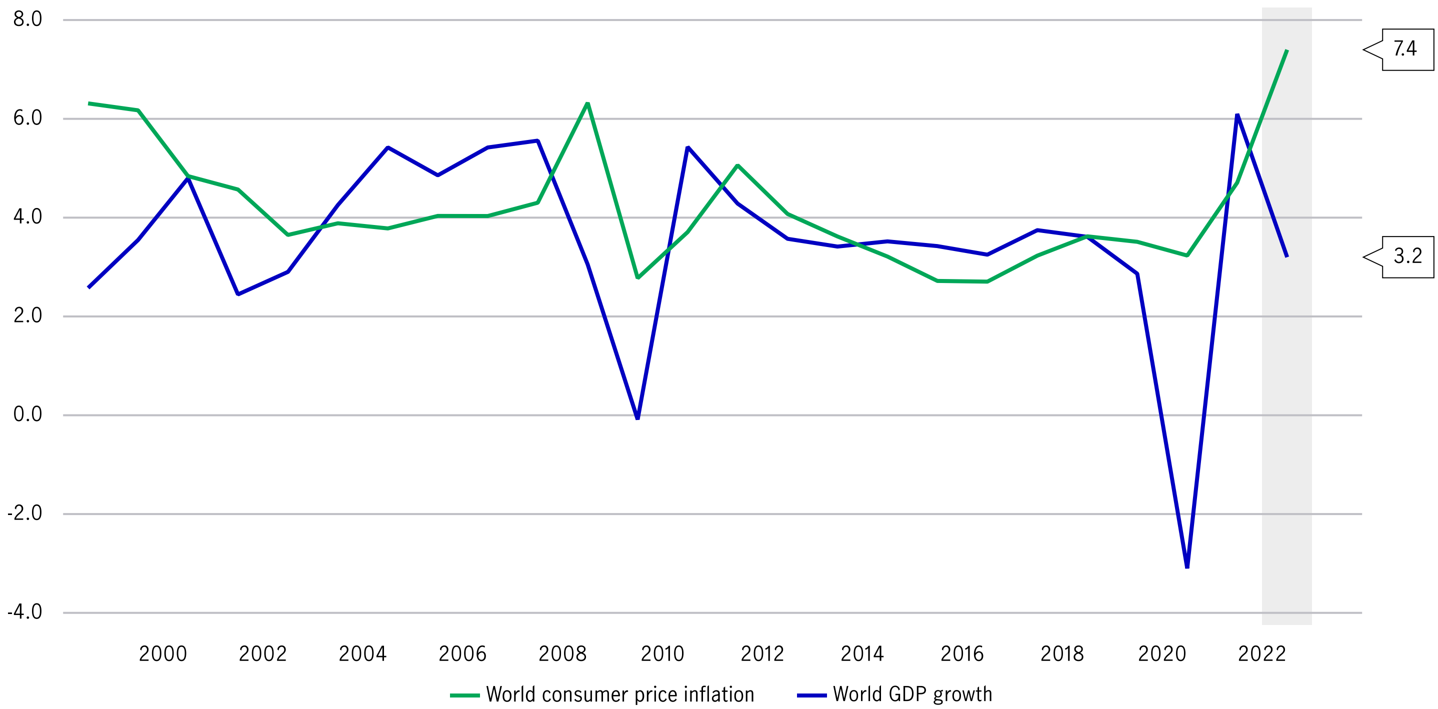
Source: Bloomberg, Macrobond, Manulife Investment Management, as of September 15, 2022.

A period of slowing growth

Investors hoping for a return of Goldilocks-like trading conditions are likely to find themselves disappointed in the coming months. In our view, the global growth picture—which will be reflected in the trading environment—appears set to deteriorate through the rest of 2022 and to remain weak in the first half of 2023.

Much of current market commentary seems overly focused on whether the global economy or a specific region will slip into recession. We've always felt that such a binary "will it, won't it" framing isn't helpful. What's more important is how quickly we're likely to enter a period of *very* slow growth and how long it will last. In our view, we could be looking at between four and six quarters. For context, we *do* expect the United States, Canada, and Europe to slip into recession next year: Stagflationary dynamics—which have been amplified by Russia's invasion of Ukraine—remain at play and make for a challenging backdrop for risk assets.

Stagflationary dynamics could persist until the end of 2022, YoY (%)



Source: Bloomberg, Macrobond, Manulife Investment Management, as of September 15, 2022. YoY refers to year over year. The gray area represents a recession.

Macro anchors that could shape risk markets in the coming months

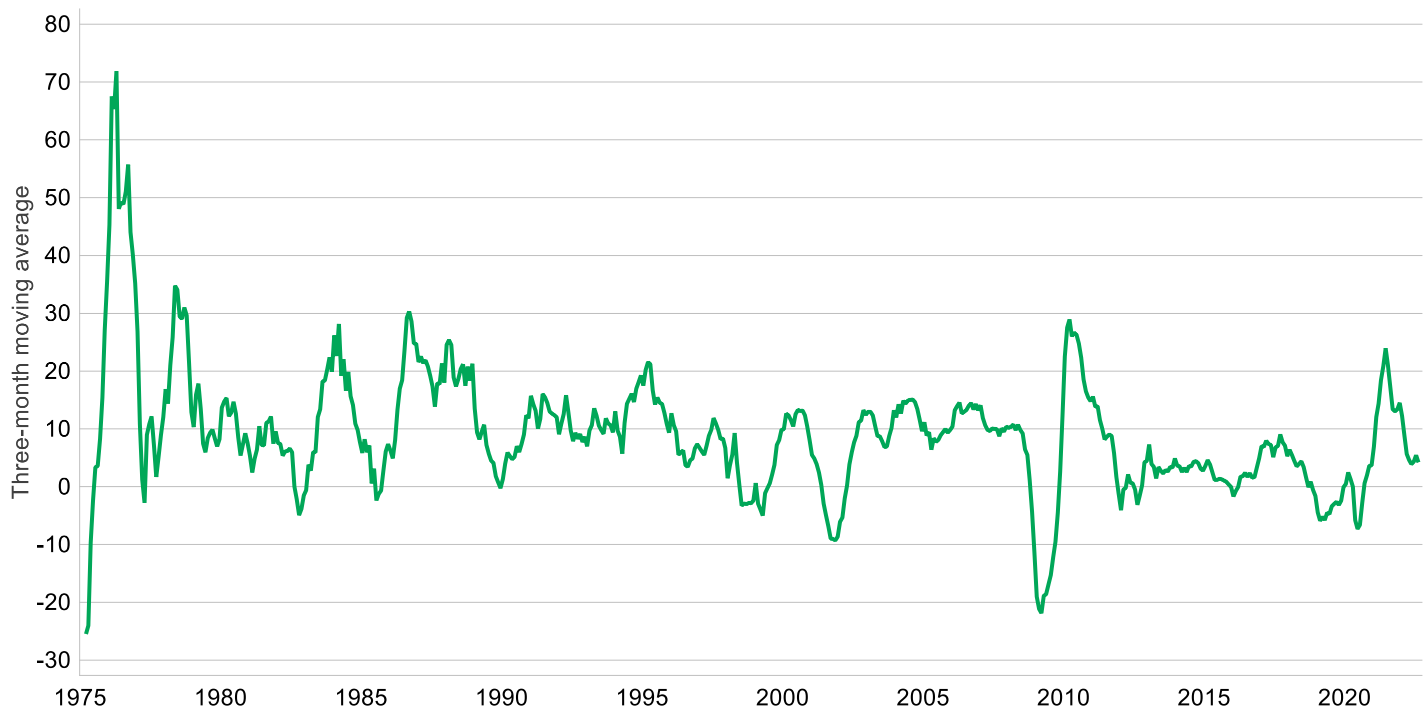
1 Slowing growth in China

We continue to have concerns about China's economy. The economic costs of the country's dynamic zero-COVID policy mount as the fear of additional large-scale lockdowns persists. This could signify further disruptions to supply even as China's property sector continues to deteriorate. Slowing global growth would also likely mean a reduction in global appetite for Chinese exports. These are all nonnegligible headwinds to growth. Crucially, policy support remains underwhelming relative to the scale of the economic challenges that the economy faces.

Slowing Chinese growth is also likely to weigh on the outlook of regional economies in Asia, which are already dealing with an inventory overhang and the effects of a synchronized global growth shock. That said, the gradual resumption of economic activities in recent months after the Omicron outbreak may help provide an offset for economies in South and Southeast Asia. CPI inflation in these parts of Asia is showing nascent signs of easing, which may give central banks in the region an opportunity to moderate their respective tightening cycles in the coming months.

> "Slowing Chinese growth is also likely to weigh on the outlook of regional economies in Asia, which are already dealing with an inventory overhang and the effects of a synchronized global growth shock."

Growth in Asia's annual export volume is slowing sharply, YoY (%)



Source: Bloomberg, Macrobond, Manulife Investment Management, as of September 15, 2022. YoY refers to year over year.

2 Inflationary pressures should ease, but inflation is likely to remain elevated

Inflationary pressures should unwind gradually over the coming months, but they're likely to remain at elevated levels through the rest of 2022 and into next year. We expect headline CPI readings to begin to diverge from Core CPI readings: Food and energy prices are likely to remain high, but more interest-rate-sensitive items should begin to display signs of disinflation. We expect inflation to have materially decelerated by the middle of 2023 on the back of base effects kicking in, an expected buildup in excess inventories in non-auto retail goods, and the alleviation of supply chain disruptions.

"That said, we believe the Fed, the BoC, and other major central banks will begin cutting rates in Q3 2023, a view that's consistent with current market pricing."

3 Central bank tightening as a headwind to growth

Global central bank tightening in both DM and EM will contribute to deteriorating global liquidity conditions and act as a headwind to growth. While we initially expected central banks to shift their focus from tamping down inflation to addressing growth-related concerns later this year as economic data worsened, obstinately high inflation readings gave most central banks little choice but to continue raising rates despite slowing growth, thereby amplifying recessionary dynamics.

That said, we believe the Fed, the Bank of Canada (BoC), and other major central banks will begin cutting rates in Q3 2023, a view that's consistent with current market pricing. The brewing energy crisis in Europe has cast a dark shadow over the region's outlook—talks of preemptive gas rationing in the winter months are a reflection of how severe things can get on the Continent.

Tightening financial conditions

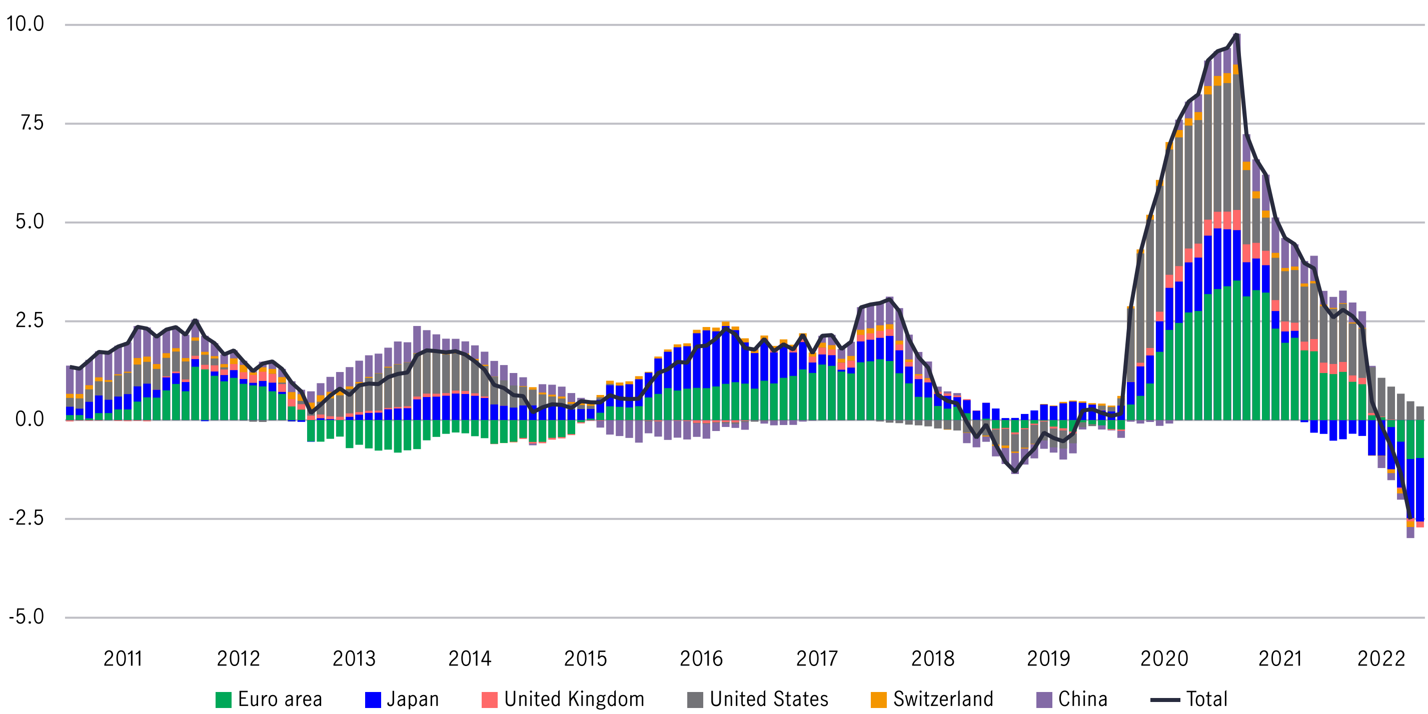
The full impact of central bank policies can typically only be fully felt in the real economy after a lag of between 12 and 18 months. Beyond central bank tightening that's already in the pipeline, there are several developments that also have an impact on the global liquidity picture:

- **Quantitative tightening—**The Fed has accelerated the pace at which it's shrinking its balance sheet beginning September 2022, from US$47.5 billion a month to US$95.0 billion a month.
- **Europe's energy crisis—**The energy crisis has heightened concerns of hidden financial stress on the Continent as surging energy prices have prompted requests for stricter collateral requirements in the energy market.
- **Negative feedback loop—**Tighter USD liquidity is creating a self-reinforcing feedback loop of USD strength. In September, global financial conditions hit their tightest level since April 2020.[1]

A challenging few months ahead

In our view, the prognosis is clear: We're entering a challenging period for risk markets, in the short term at least. The broader geopolitical environment doesn't help, as two important events—the Chinese Communist Party Congress in October and the U.S. mid-term elections in late 2022—will no doubt dominate market chatter. In times like these, it's important to consider enhancing portfolio resilience. While it's true that opportunities can emerge in times of uncertainty and volatility, it's just as important for investors to cut through the white noise in the near term and train their goals on the longer term.

Central bank balance sheets are shrinking, YoY (%)



Source: National central banks, Macrobond, Manulife Investment Management, as of September 15, 2022. YoY refers to year over year.

United States

Big picture

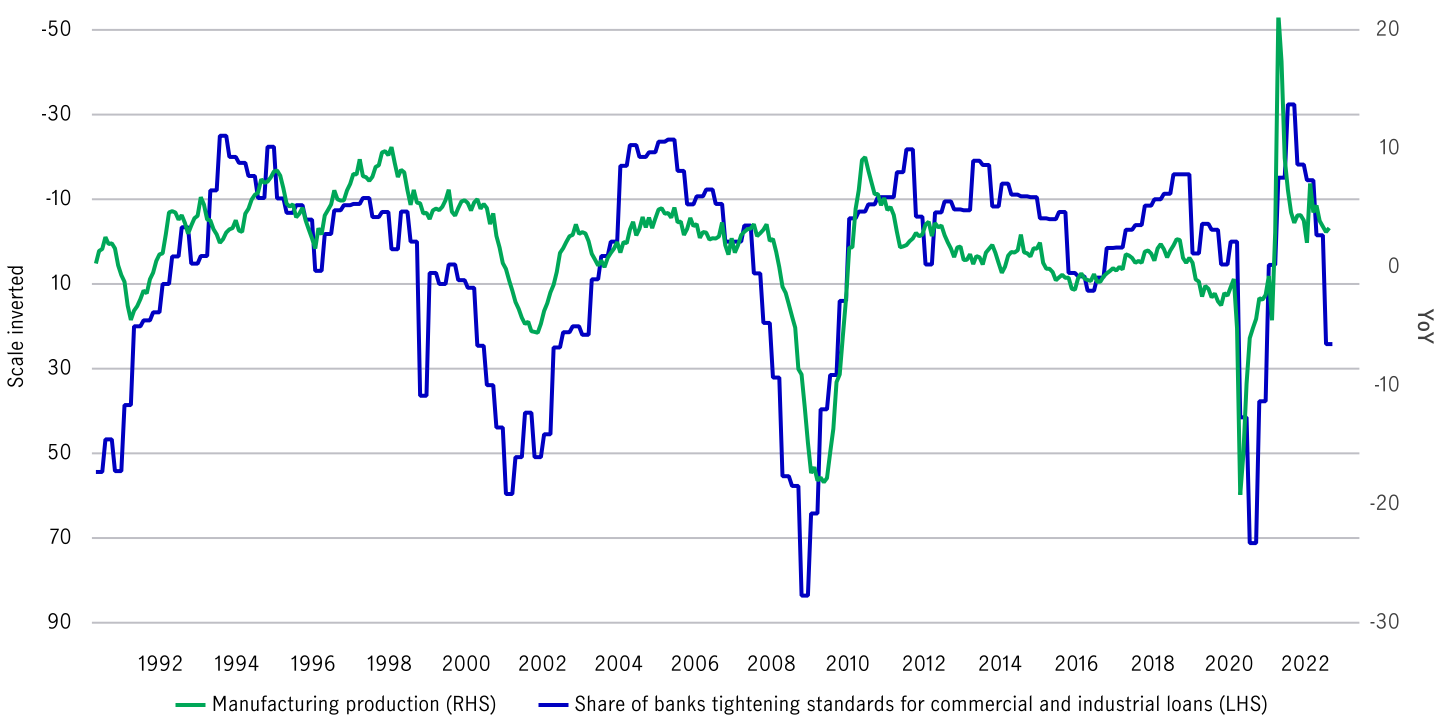
Inflation remains the largest area of concern in the United States by far. In the absence of a meaningful easing in price pressures, the Fed, which has already been cornered into tightening into a downturn, will likely have little choice but to continue increasing the federal funds rate beyond what's been currently priced in.[2]

The impact of the Fed's policy is beginning to show—U.S. housing activity has deteriorated sharply as affordability plunged, and business surveys are also more downbeat. Assuming the usual delays in the transmission of monetary policy to the real economy, reduced access to inexpensive financing is likely to bleed through to other areas of consumption and business investment in the coming months.

When might things get better? By mid-2023, we believe. There will come a point at which policymakers will once again prioritize supporting the slowing economy. This evolution should allow the Fed to pause its tightening cycle early next year, with the potential for policy easing in the second half of the year.

"When might things get better? By mid-2023, we believe. There will come a point at which policymakers will once again prioritize supporting the slowing economy."

Key surveys point to a slowdown in U.S. industrial production (%)



Source: U.S. Federal Reserve, Macrobond, Manulife Investment Management, as of September 14, 2022. YoY refers to year over year. LHS refers to left-hand side. RHS refers to right-hand side.

2 Bloomberg, as of September 14, 2022.

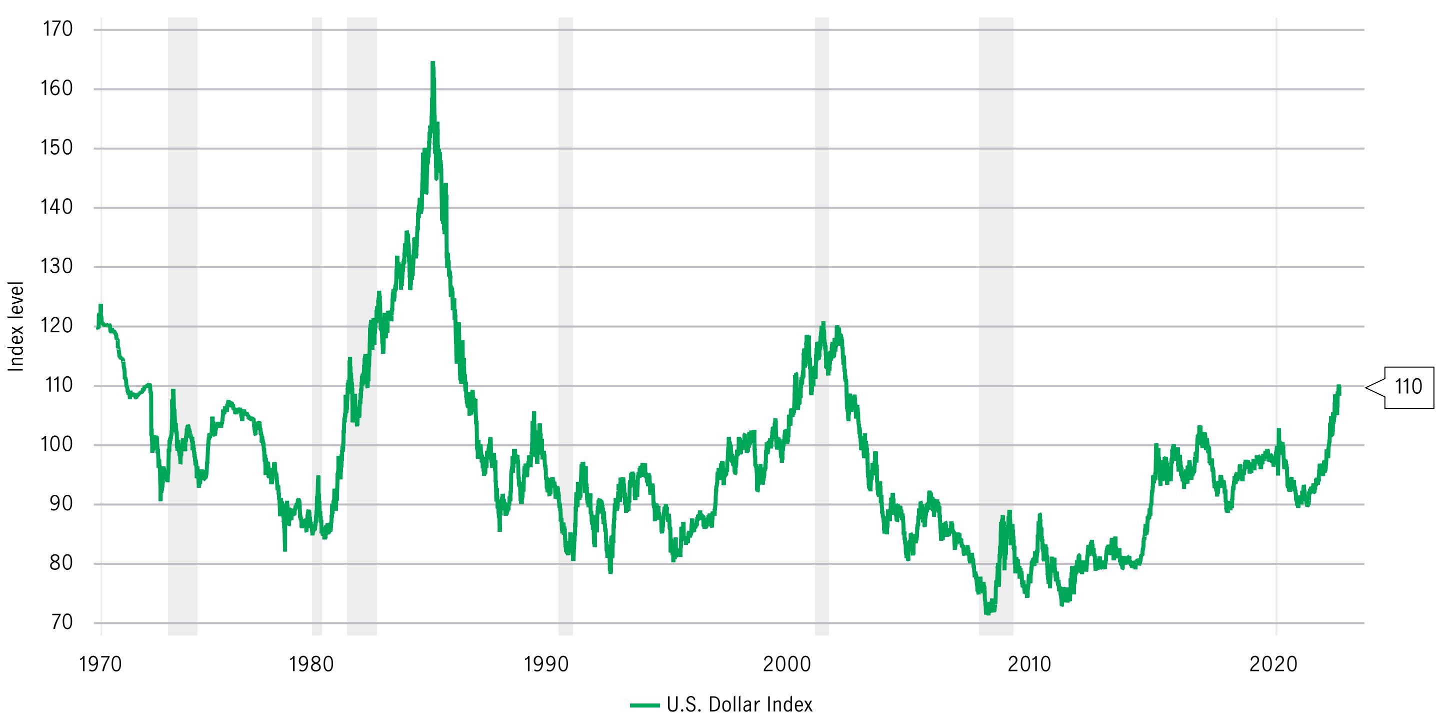
What we're watching

- **Inflation—**Until we get several consecutive months of modest sequential growth in core inflation (i.e., 0.3% on a month-over-month basis or less), we believe there's little chance that the Fed would feel comfortable enough to stop tightening.
- **The Fed—**Investors will be closely monitoring Fed communications for signs that the current hiking cycle is coming to an end (or at a minimum, a pause). Once that's been communicated, we expect greater policy certainty to support the economy and markets.
- **Employment—**A tenuous path to more benign growth could present itself through employment: If employers hoard labor based on their experience during the pandemic, it could provide some support for consumption and, by extension, the U.S. economy by more than is currently expected.

Key market views

- **Overall markets—**We expect volatility and a lack of clear direction to persist across asset classes until the Fed signals an end to the tightening cycle. Until that time, a more defensive stance is appropriate. Specifically, we'd be looking for higher-quality credit and lower beta equities.
- **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 DM, implying that the greenback is likely to continue to trade at tactically higher levels. That said, we believe that there's scope for some USD weakness to emerge against other currencies when there's a clear mollification in the Fed's rhetoric.

The USD has hit multidecade highs against other major currencies



Source: Bloomberg, Macrobond, Manulife Investment Management, as of September 14, 2022. It is not possible to invest directly in an index. The gray areas represent recessions.

Canada

Big picture

Year to date, economic momentum in Canada has surpassed its Group of Seven counterparts: booming commodity prices, resilient services consumption underpinned by a slightly later economic reopening, and a smaller drag from lower government spending. These developments, coupled with strong wage growth and sticky prices, continue to embolden the BoC. After raising its policy rate by a total of 175 basis points (bps) at its last two meetings to 3.25%, the BoC has shown no intention of pausing; however, recent data has surprised to the downside, and job creation has stalled. Rising inflation continues to erode real wages and will eventually dent consumer activity. Capital investment has held up reasonably well, but rising energy prices haven't translated into investments to the same extent they had in prior cycles. We think the Canadian economy will continue to weaken in the remaining months of 2022 and into 2023 even as inflation levels stay elevated. Indeed, the majority of the inflation plaguing Canada remains global in nature and isn't particularly interest-rate sensitive, especially *Canadian* interest rates.

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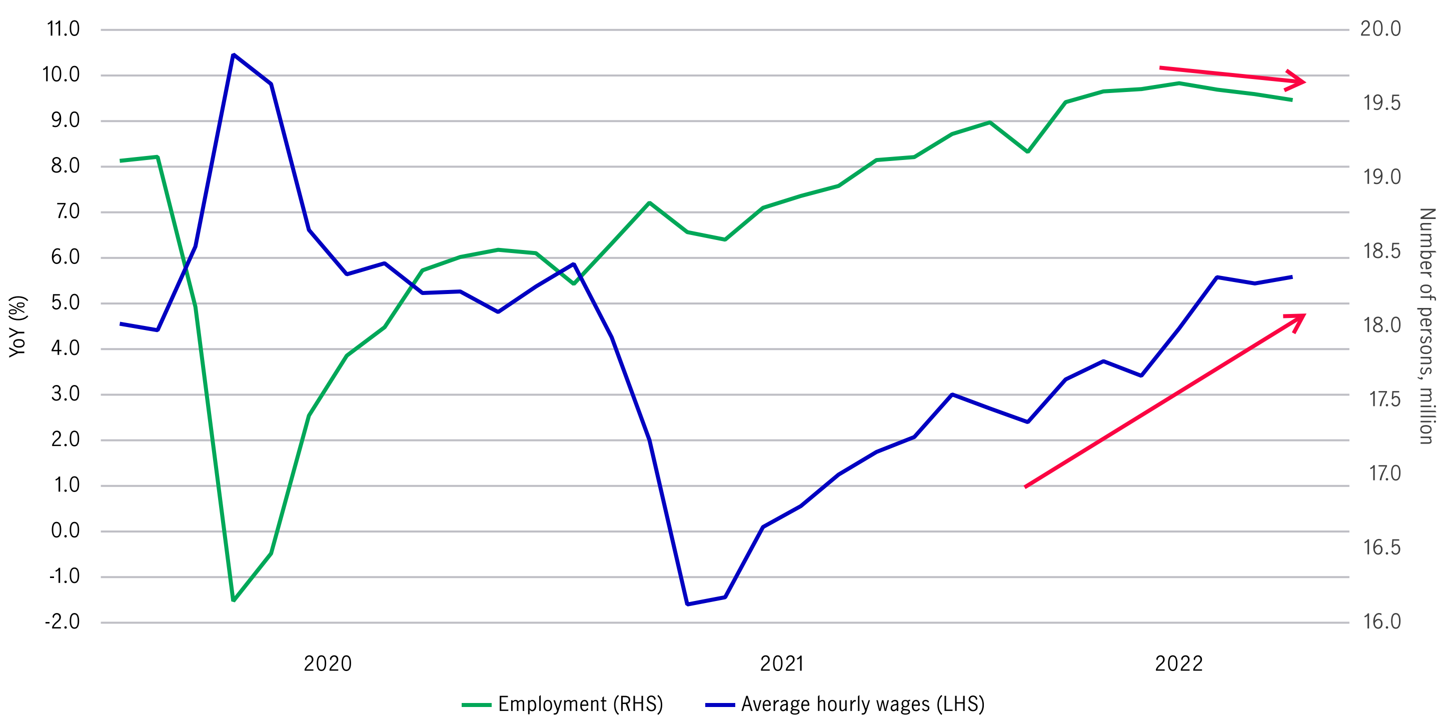
Job creation has slowed, but wage growth continues to trend upward



Source: Statistics Canada, Macrobond, Manulife Investment Management, as of September 13, 2022. YoY refers to year over year. LHS refers to left-hand side. RHS refers to right-hand side.

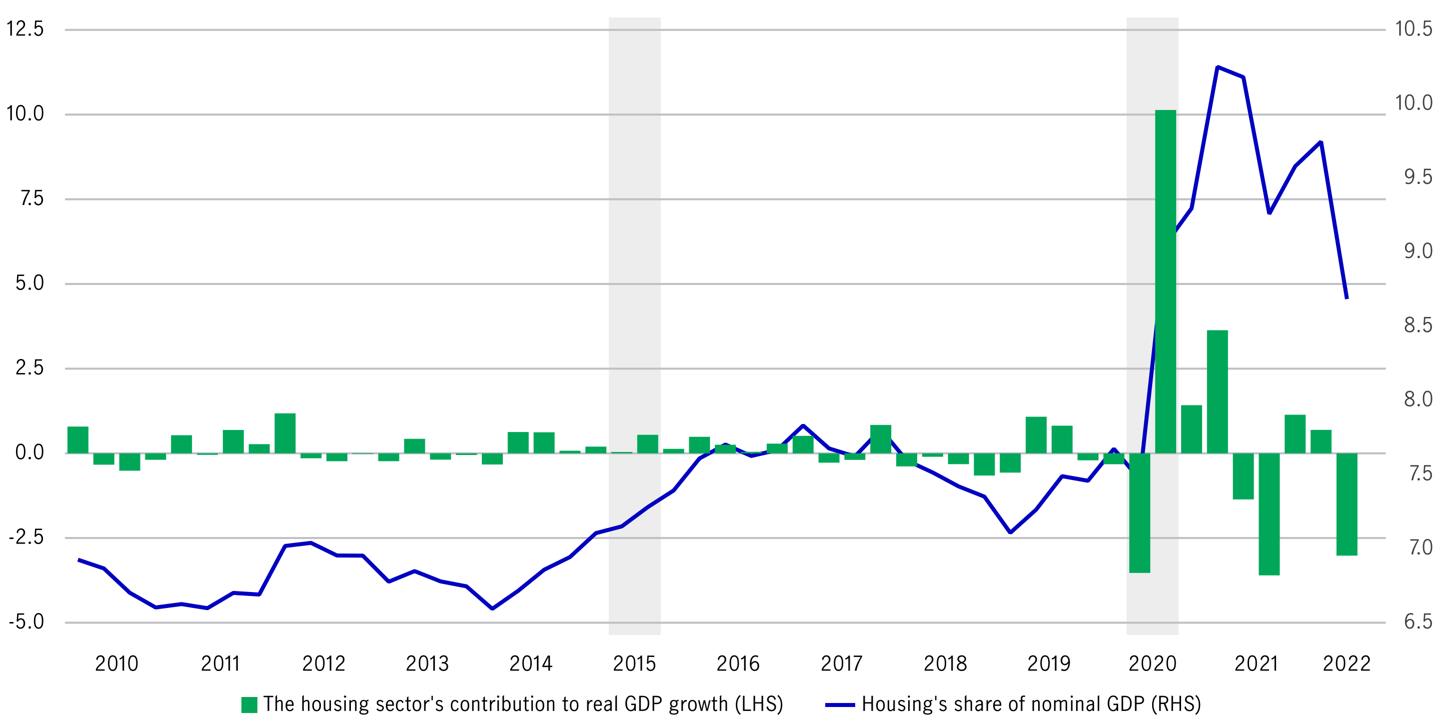
What we're watching

- **Housing activity—**Deteriorating affordability could hurt resale activity across most regions in the country. Prices have begun to pull back, and we expect that negative trend to accelerate. That said, construction activity has held up so far in 2022 but could roll over as new demand fades. Canada is particularly vulnerable to a housing downturn given its dependence on real estate for economic growth.
- **BoC—**We expect the central bank to hit pause on rate hikes after raising rates to 4.25%, possibly by next January. Signs that price pressures could be easing, along with lower prospective demand, should provide the BoC with enough assurance that inflation could be on its way back to the bank's official target (although it could take a while to get there). The risk to this view is sticky Core CPI inflation. If it remains at an elevated level, it could force the BoC to veer even further into the restrictive territory.

Key market views

- **Equities—**Despite a weak macro outlook, the Canadian stock market remains tilted toward the value end of the equation (as opposed to growth), which should help the market sustain its outperformance this year. Economic momentum may have slowed, but the asset class continues to benefit from a supportive dividend profile and reasonable valuations. From a strategic perspective, the financial sector's exposure to the housing market could be an area of weakness, particularly if the BoC indeed knowingly raises interest rates into a recession.
- **Currencies—**In our view, risks to the Canadian dollar (CAD) are tilted toward further weakening, given the significant erosion in the currency's fundamentals as a result of weaker oil prices and challenging interest-rate differentials. While the USD/CAD's range break is notable, we don't expect material upside from here and see limited risk of a retest of the 2020 pandemic high.

Canada's economy is particularly vulnerable to the housing cycle (%)



Source: Statistics Canada, Macrobond, Manulife Investment Management, as of June 15, 2022. LHS refers to left-hand side. RHS refers to right-hand side. The gray areas represent recessions.

Euro area

Big picture

Europe's economic outlook continues to darken. The energy crisis confronting the Continent is quickly evolving from an inflationary price shock to one in which the possible curtailment of energy supplies could lead to economic shutdowns—bearing resemblance to those observed in March and April of 2020. In our view, risks to growth in the region remain firmly to the downside. Fiscal efforts to mitigate the economic burden of the energy crisis represent an upside risk to core inflation, given that any support provided will be focused on the most vulnerable. The European Central Bank's (ECB's) front loading of policy tightening presents an additional headwind and carries considerable spillover risk in terms of wider sovereign bond spreads. Meanwhile, recent political developments reveal a broad, rightward shift in a number of countries. Currently, these developments pose a minimal risk to the integrity of the euro (EUR), but we think it could challenge existing fiscal frameworks as well as broader social policies, most notably around the subject of immigration.

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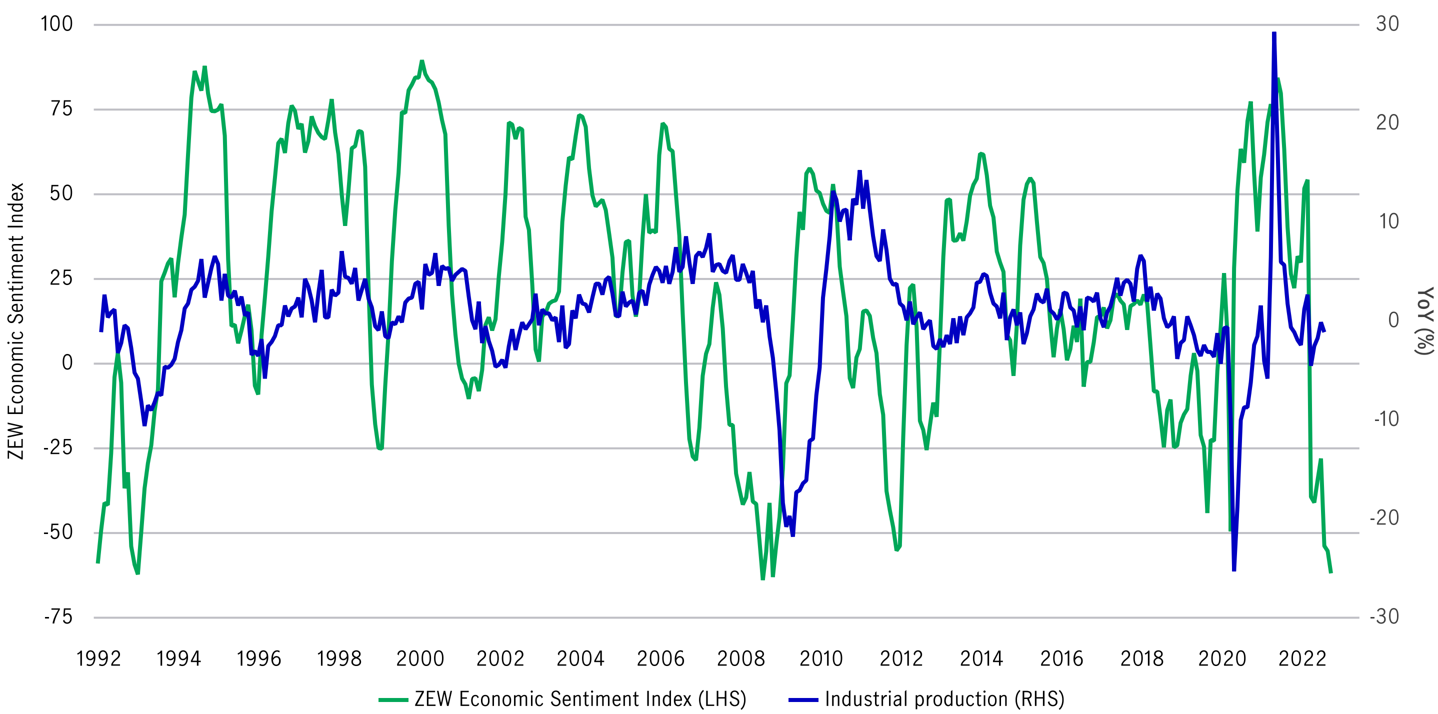
Germany's ZEW Economic Sentiment Index implies a severe contraction in industrial production



Source: Bloomberg, Macrobond, Manulife Investment Management, as of September 15, 2022. YoY refers to year over year. It is not possible to invest directly in an index. LHS refers to left-hand side. RHS refers to right-hand side.

What we're watching

- **EU energy policy—**Efforts to manage the energy crisis have broadened as supply curtailments have forced preparations for energy rationing (voluntary and imposed). The most severe phase of the European Union's (EU's) emergency plan will require economic shutdowns similar to those observed during the worst of the pandemic in 2020.
- **Italy's upcoming election and the country's approach to fiscal policy—**Political developments in Italy have necessitated a renegotiation of the terms on which Italy receives funding from the EU. It's likely that the proposed adjustments to pension eligibility could jeopardize the disbursement of European recovery funds. The spread between the German bund and the Italian government bond remains a critical barometer of the EU-Italy relationship.

Key market views

- **Equities—**We remain bearish European equities on both an absolute and relative basis. On the whole, we expect European equities to continue to underperform global benchmarks as a result of the energy crisis.
- **Currencies and fixed income—**The EUR trading at parity against the USD remains a psychologically important level for investors. It's a level at which we're likely to see heavy two-way trading, meaning that the EUR/USD exchange rate is likely to trade sideways in the near term. That said, we believe that brewing political risk in Italy could lead to a widening in sovereign bond spreads to levels last observed in 2018. As such, we believe the medium-term risk to the path for EUR/USD is neutral to negative.

Spread between German bonds and Italian government bonds is widening (%)

Source: Bloomberg, Macrobond, Manulife Investment Management, as of September 15, 2022.

United Kingdom

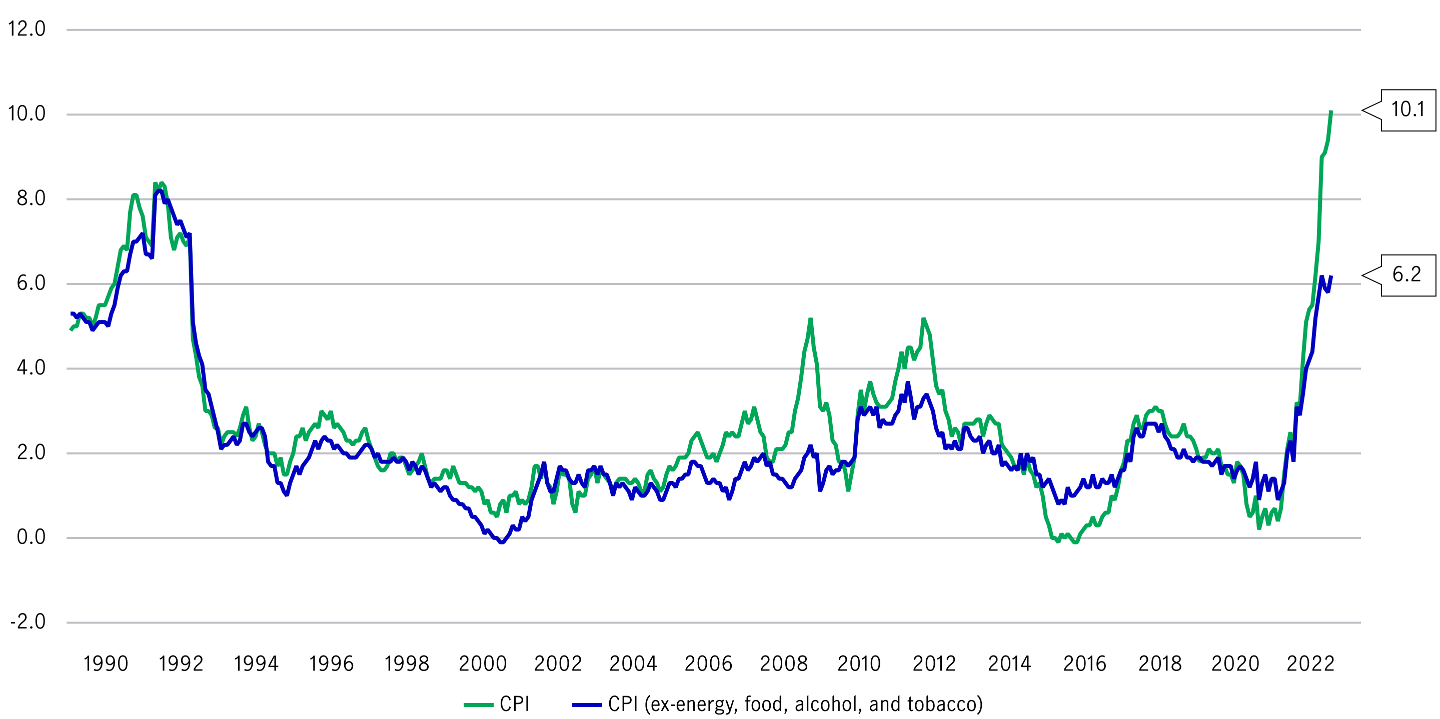
Big picture

The evolving global energy crisis has significantly darkened the United Kingdom's economic outlook, aggravating already elevated inflation levels while also dealing a blow to consumers in the form of skyrocketing utility bills. The situation has forced a significant amount of burden sharing on the part of the government in a manner that's sent U.K. yields soaring, reflecting expectations of a significant deterioration in public finances over coming years.

Real GDP growth in the United Kingdom is expected to be close to zero in 2023, while inflation is expected to remain persistently elevated above 5% year over year through 2023 and only drift toward 2% by 2024.[1] The Bank of England (BoE) is playing catch-up in chasing inflation and will continue to hike within the context of a tight labor market. Political uncertainty is set to remain elevated as markets eye ongoing Brexit negotiations over Northern Ireland as well as the nascent risk of another referendum on Scottish independence.

"The evolving global energy crisis has significantly darkened the U.K.'s economic outlook, aggravating already elevated inflation levels while also dealing a blow to consumers in the form of skyrocketing utility bills."

U.K. inflation has skyrocketed, YoY (%)



Source: Bloomberg, Macrobond, Manulife Investment Management, as of September 15, 2022. YoY refers to year over year. CPI refers to Consumer Price Index. It is not possible to invest directly in an index.

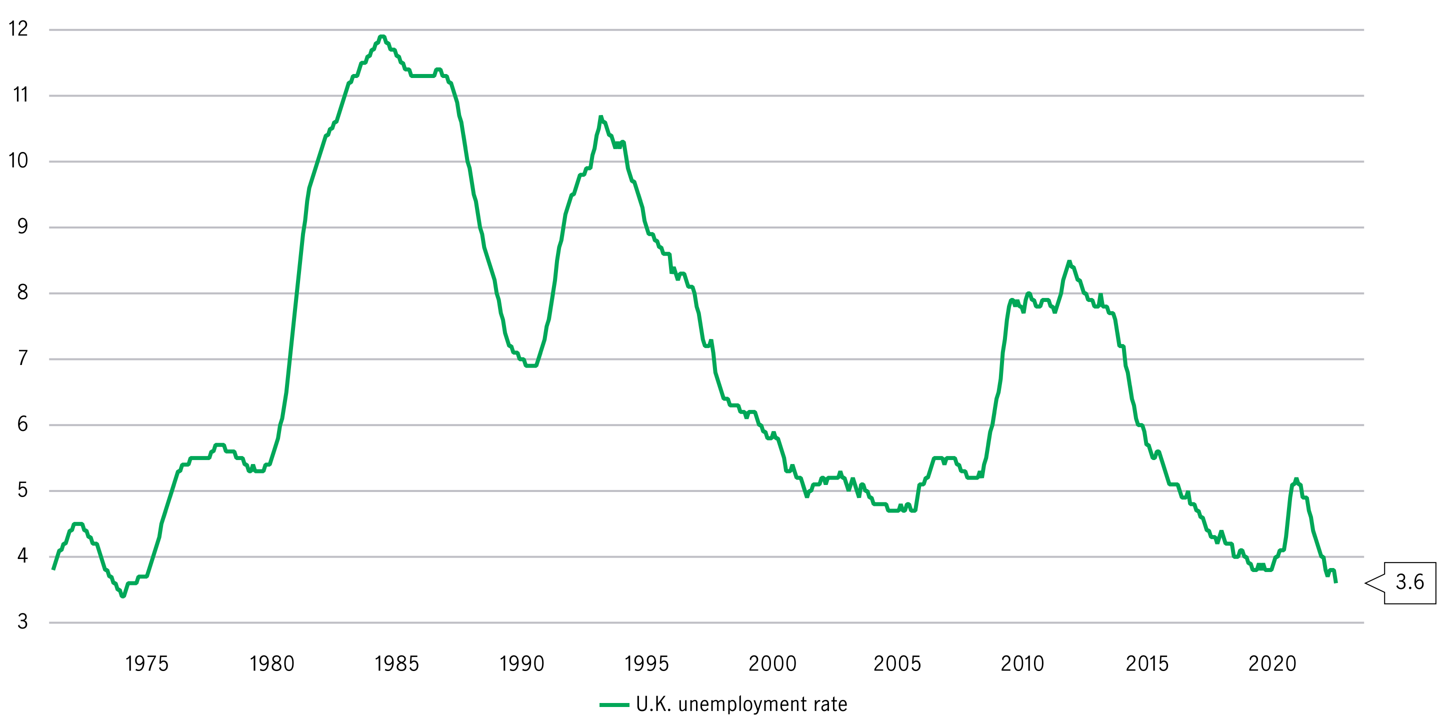
What we're watching

- **Wage negotiations and risk of supply chain disruptions—**The British labor market remains tight: The unemployment rate has reached a fresh multidecade low of 3.6%, levels last seen in the mid-1970s. Wage negotiations appear fraught, and labor unions in the country are threatening strike actions across a range of critical industries.
- **BoE mandate review—**Newly installed Prime Minister Elizabeth Truss had promised a review of the BoE's mandate during her bid for Conservative Party leadership. While the issue has taken a back seat in favor of formulating an appropriate response to the developing energy crisis and fiscal response, a renewed focus on the subject could generate unwanted interest-rate and currency volatility.

Key market views

- **Equities—**On a relative basis, we think that the fundamentals for U.K. equities appear mixed: Valuation and profitability metrics are solid, but earnings remain weak. That said, the medium-term technical picture is constructive, and we anticipate continued outperformance of U.K. equities relative to their global peers.
- **Rates—**Benchmark U.K. government bond yields have soared on the back of the government's fiscal response to the developing energy crisis, with estimates of government support reaching nearly 15% of GDP.[1] Meanwhile, the BoE continues to raise rates to fight inflation even as it engages in quantitative tightening. We see near-term upside to U.K. 10-year yields but anticipate a stabilization above 4.0%.

U.K. unemployment: the British labor market remains extremely tight (%)



Source: Bloomberg, Macrobond, Manulife Investment Management, as of September 14, 2022.

Asia-Pacific

Big picture

Considering that it's facing three major shocks—an aggressive Fed, growing concerns about a global recession, and a developing food and energy crisis—the Asia-Pacific region is still holding up relatively well. Growth expectations for the region in 2023 have barely budged, remaining at around 4.5%, even as global growth forecasts have been slashed from 3.6% to 2.7% since Russia's invasion of Ukraine.[1] The region as a whole is a beneficiary of reopening and global supply chain diversification. ASEAN economies in particular—barring exceptions—have the added advantage of favorable demographics and consumption trends. Within the region, India and Vietnam remain on track to deliver the fastest rate of economic growth this year and next. In terms of inflation, while expectations have been progressively revised higher this year, the expected peak remains lower than in previous cycles. Crucially, inflation in the region is much lower than the high rates seen elsewhere in the world. Encouragingly, we saw an easing in annual inflation in 6 of the region's 11 economies in August, up from 1 in June.[1] Should this trend continue, it could offer some comfort to policymakers and support the notion of a shallower and shorter tightening cycle.

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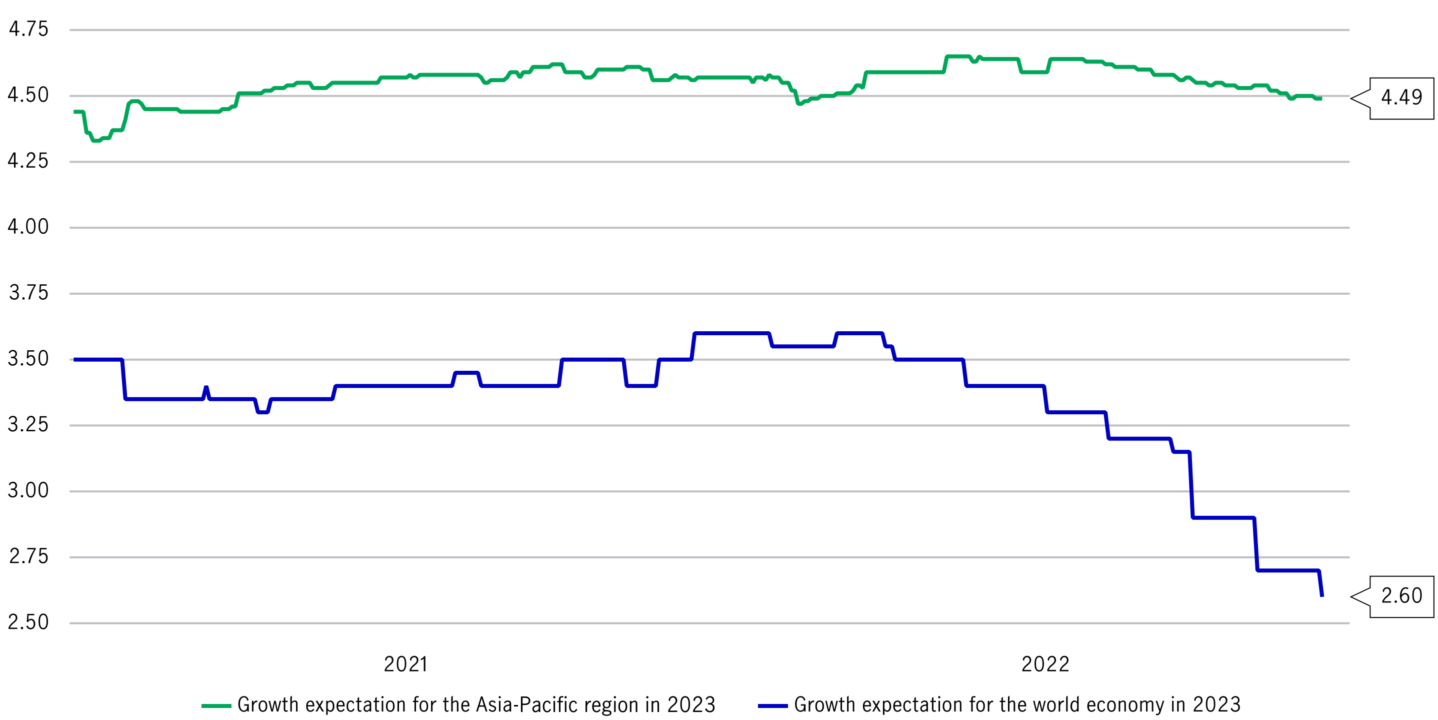
Asia-Pacific GDP growth expectations are holding up well, YoY (%)



Source: Bloomberg, Macrobond, Manulife Investment Management, as of September 6, 2022. YoY refers to year over year.

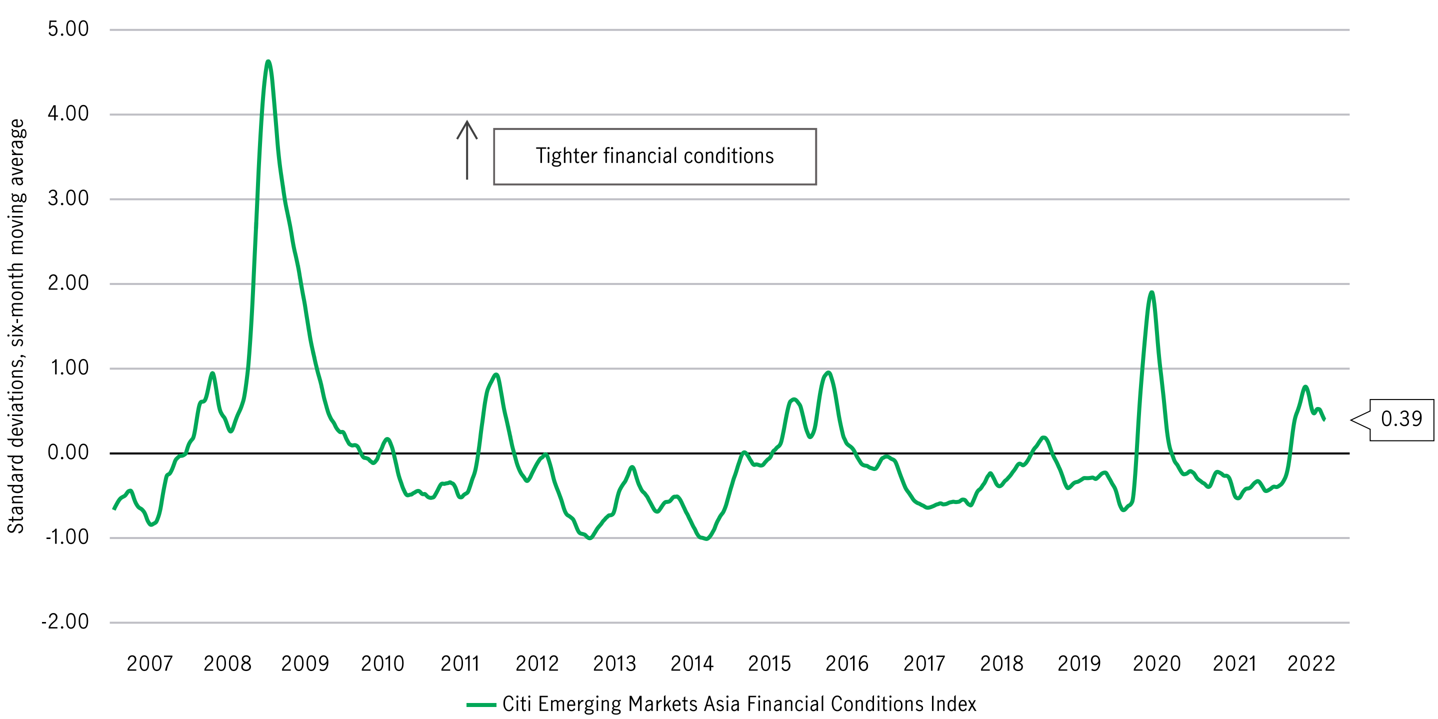
What we're watching

- **Asian export growth slowdown—**The combination of an inventory overhang in Northeast Asia and weakening global demand for Asia's exports will likely represent the withdrawal of a key source of USD funding to the region and, by extension, economic growth.
- **Financial conditions—**A more hawkish Fed has created pressure on Asia's central banks, particularly for those that are unwilling to adopt a similar stance. The Bank of Japan (BoJ), for instance, has continued with its ultra-easy monetary policy, and the People's Bank of China has moved to cut policy rates. As a result of this widening policy divergence, the Japanese yen (JPY) has slipped to a 25-year low against the greenback and the Chinese renminbi has hit a 2-year low against the USD.[2]

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, which suggests 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—**In our view, policymakers in the region aren't likely to match the timing and scale of the Fed's cycle. From a markets perspective, this suggests likely outperformance in regional bonds and underperformance in local currencies.

Financial conditions in emerging Asia



Source: Citigroup, Macrobond, Manulife Investment Management, as of September 6, 2022. It is not possible to invest directly in an index.

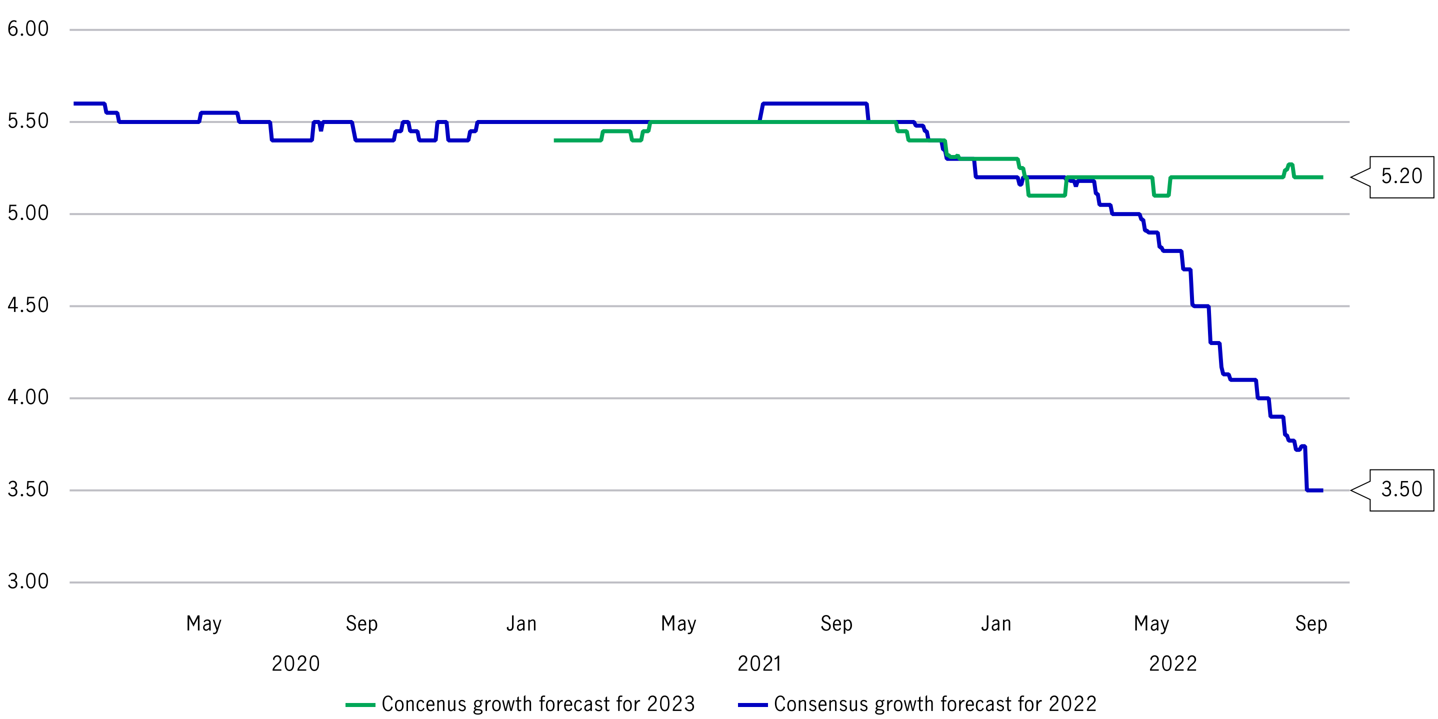
China

Big picture

The main challenges to Chinese economic growth haven't changed: 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 to consumption-led growth; worsening developments in the property sector; and a slowdown in export growth as global demand weakens. While consensus GDP growth forecasts for 2022 have been revised down meaningfully, we continue to think that expectations for China's medium- and long-term economic growth prospects remain too optimistic. 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 stimulus response has been underwhelming, particularly in view of the scale of the challenges that the economy faces. Worryingly, the deterioration in Chinese labor markets is accelerating.

"While consensus GDP growth forecasts for 2022 have been revised down meaningfully, we continue to think that expectations for China's medium- and long-term growth prospects remain too optimistic."

Consensus Chinese GDP growth forecasts, YoY (%)



Source: Bloomberg, Macrobond, Manulife Investment Management, as of September 6, 2022. YoY refers to year over year.

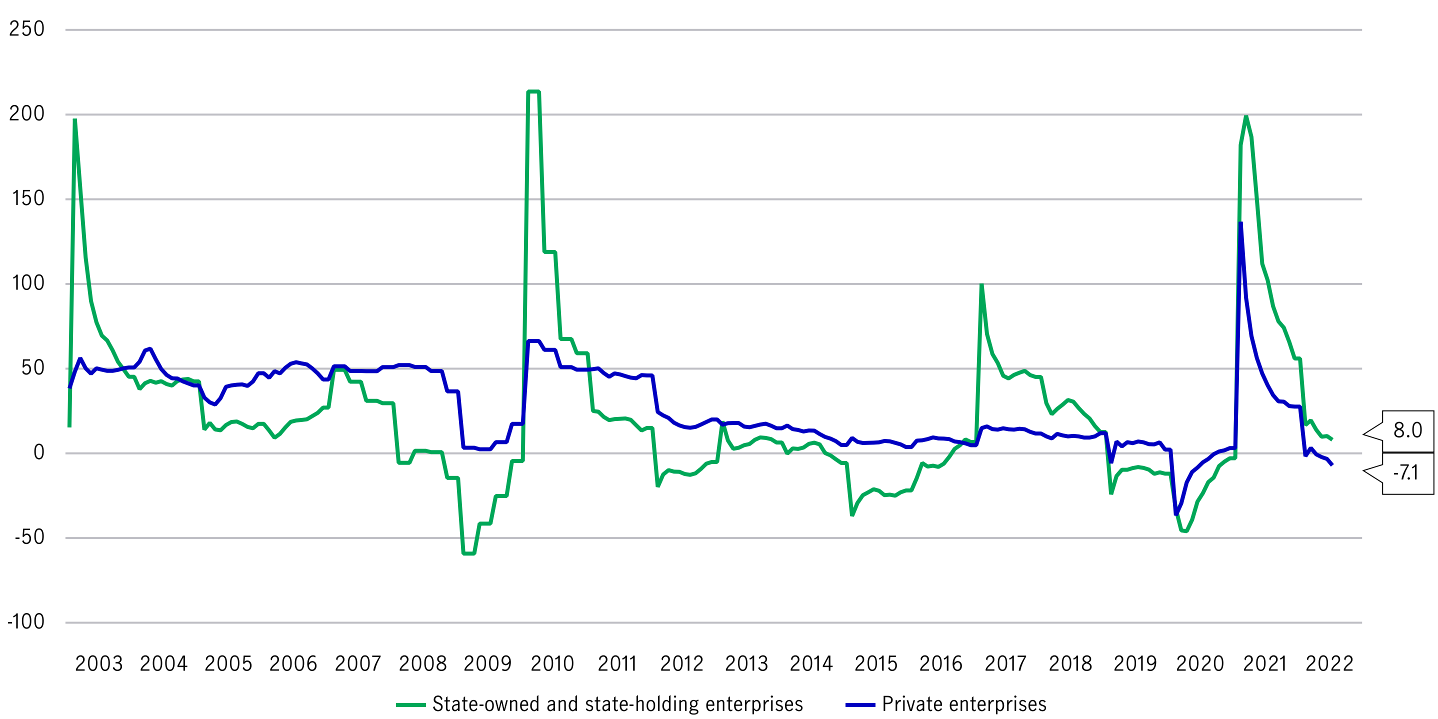
What we're watching

- **Trade surplus—**August's trade data showed a still-elevated trade surplus of US$79.39 billion.[3] As we see it, this represents an increasingly net negative global demand impulse that will worsen societal gaps in the rest of the world and could amplify global pressure to raise tariffs, introduce capital controls, and/or accelerate onshoring/ nearshoring. It isn't lost on us that these issues could also heighten geopolitical tensions.
- **Regulatory tightening—**We've expected the authorities to tighten regulations pertaining to the private sector in the run-up to the 20th Party Congress. That view is supported by recent initiatives to regulate private sector incomes. The central government is also advising local governments to dispose of assets amid increasingly negative profit growth in private enterprises.

Key market views

- **Equities—**The short-term technical outperformance in Chinese stocks proved short-lived. In our view, required shifts in the fundamental outlook have yet to materialize, and a stagflationary global backdrop remains particularly challenging for Chinese equities. We're also mindful of the risk that the timeline for the expected delisting of Chinese companies from U.S. exchanges could be brought forward.
- **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 typically make Chinese government bonds unattractive to foreign investors.

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



Source: National Bureau of 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.

3 General Administration of Customs, People's Republic of China, September 7, 2022.

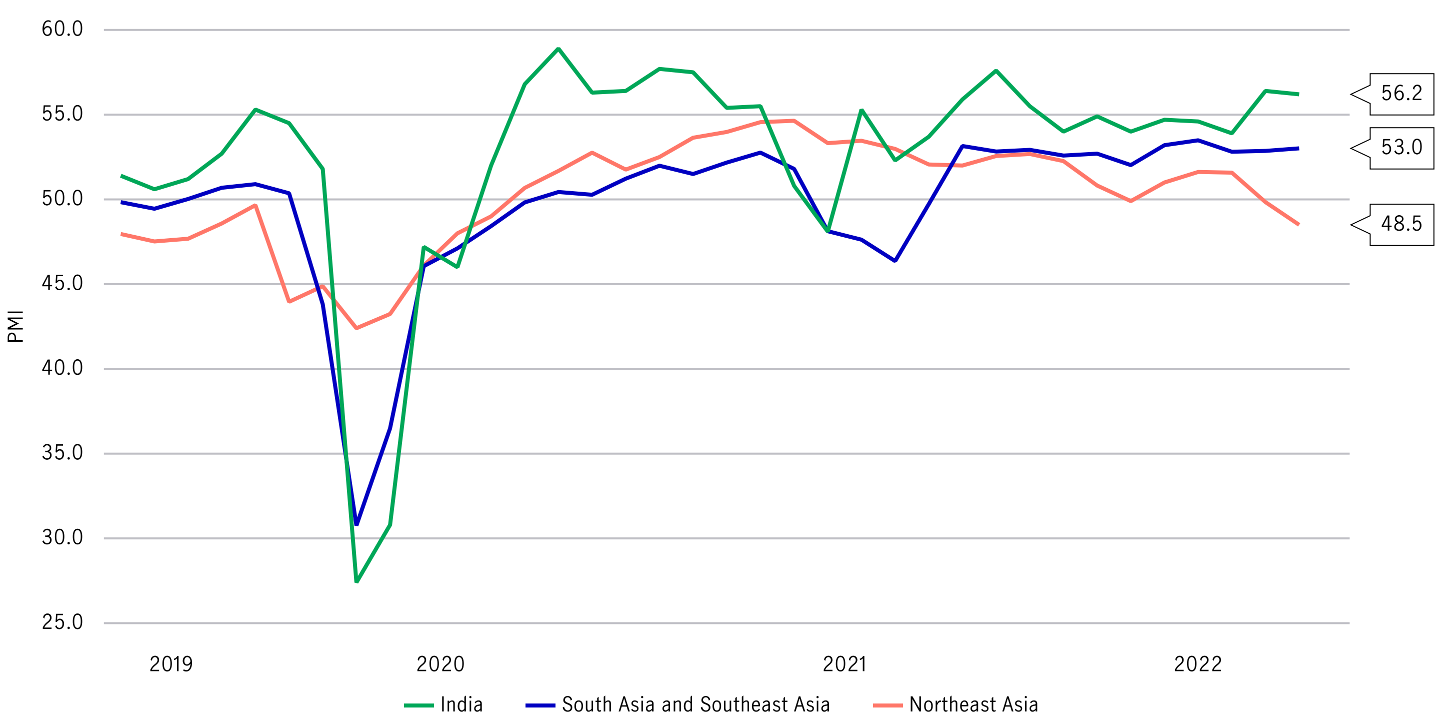
India

Big picture

Although we expect an economic slowdown to materialize over the coming quarters, the Indian economy is entering this more challenging macroeconomic environment with robust growth. For instance, Purchasing Managers' Indexes (PMIs) for both the country's manufacturing and services sectors remain in expansionary territory, thanks to the lagged effects of easy financial conditions and the postpandemic recovery, which contributed to resilient domestic demand. Inflation has been sticky at elevated levels, however, with fuel and Core CPI inflation inching higher. Electricity tariffs are being revised up, and the economy's reopening is placing upward pressure on services sector inflation. The Reserve Bank of India (RBI) delivered a hawkish 50bps hike in August and indicated it doesn't yet think that policy rates are at neutral given its continued focus on the withdrawal of accommodation. That said, we think the pace of interest-rate hikes should slow with the prospect of a global growth slowdown and the RBI's objective of achieving a soft landing.

"Although we expect an economic slowdown to materialize over the coming quarters, the Indian economy is entering this more challenging macroeconomic with robust growth."

Manufacturing PMI: India is outperforming its regional peers by a wide margin



Source: IHS Markit, Macrobond, Manulife Investment Management, as of August 31, 2022. PMI refers to Purchasing Managers' Index. It is not possible to invest directly in an index. A reading above 50 represents expansion.

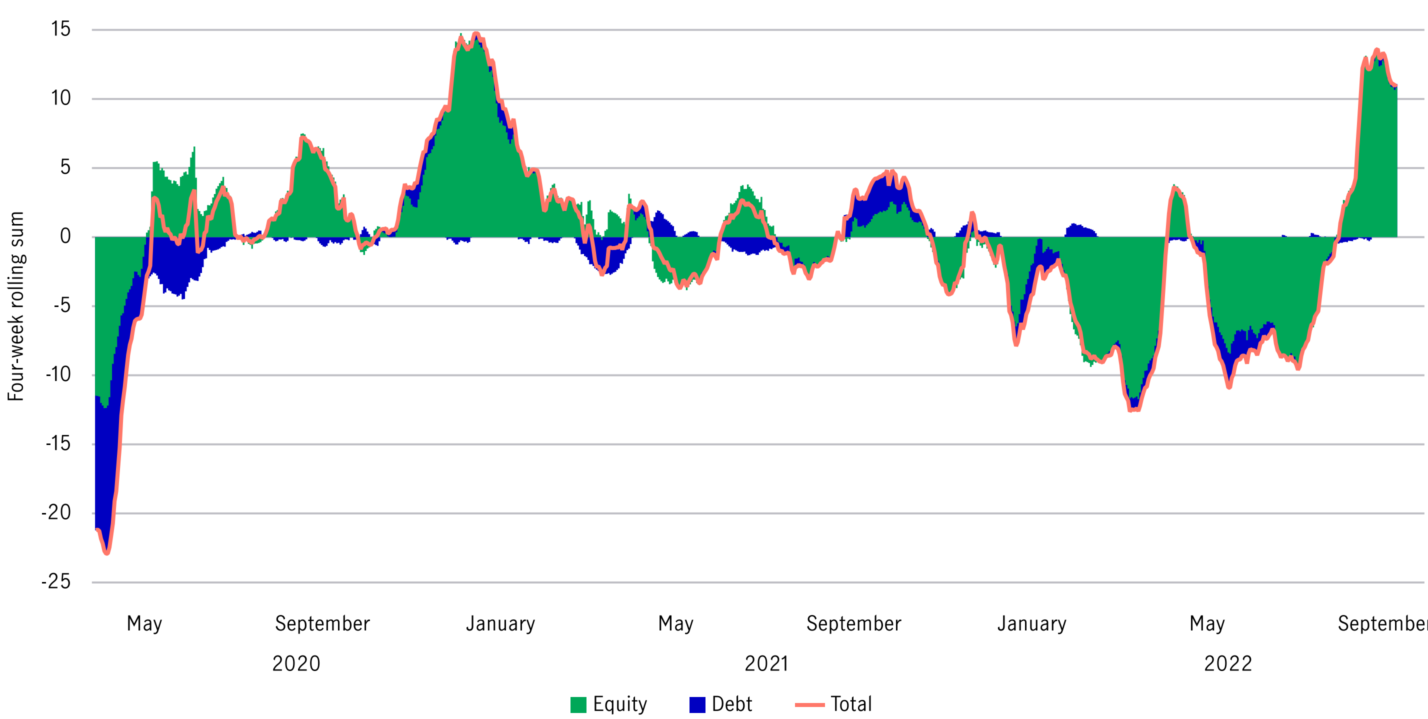
What we're watching

- **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 central bank's newly revised inflation forecasts, which means that tighter monetary policy measures might be needed.
- **Wider twin deficits (current account and fiscal account)—**In our view, continued food and energy inflation will risk a deeper economic growth slowdown, push real yields lower, and potentially lead to persistent portfolio outflows. That said, other more stable sources of capital inflows (e.g., 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 market's fundamentally positive backdrop, and we expect relative outperformance within the region to continue. Foreign investors have piled back into this market over the past quarter.
- **Fixed income—**In our view, RBI interest-rate hikes are already very well priced in, with an implied terminal rate of around 7.15% to 7.20%.[4] As such, from a relative risk/reward perspective, we believe an overweight in Indian government bonds makese sense. The RBI has also stated that it will intervene to smooth rupee depreciation, suggesting that the currency's depreciation this year will be relatively moderate compared with the 2011/2013 and 2018 taper tantrums.

India: foreign investment flows (USD billion)



Source: Bloomberg, Macrobond, Manulife Investment Management, as of September 12, 2022. USD refers to the U.S. dollar.

4 Bloomberg, as of September 12, 2022.

Japan

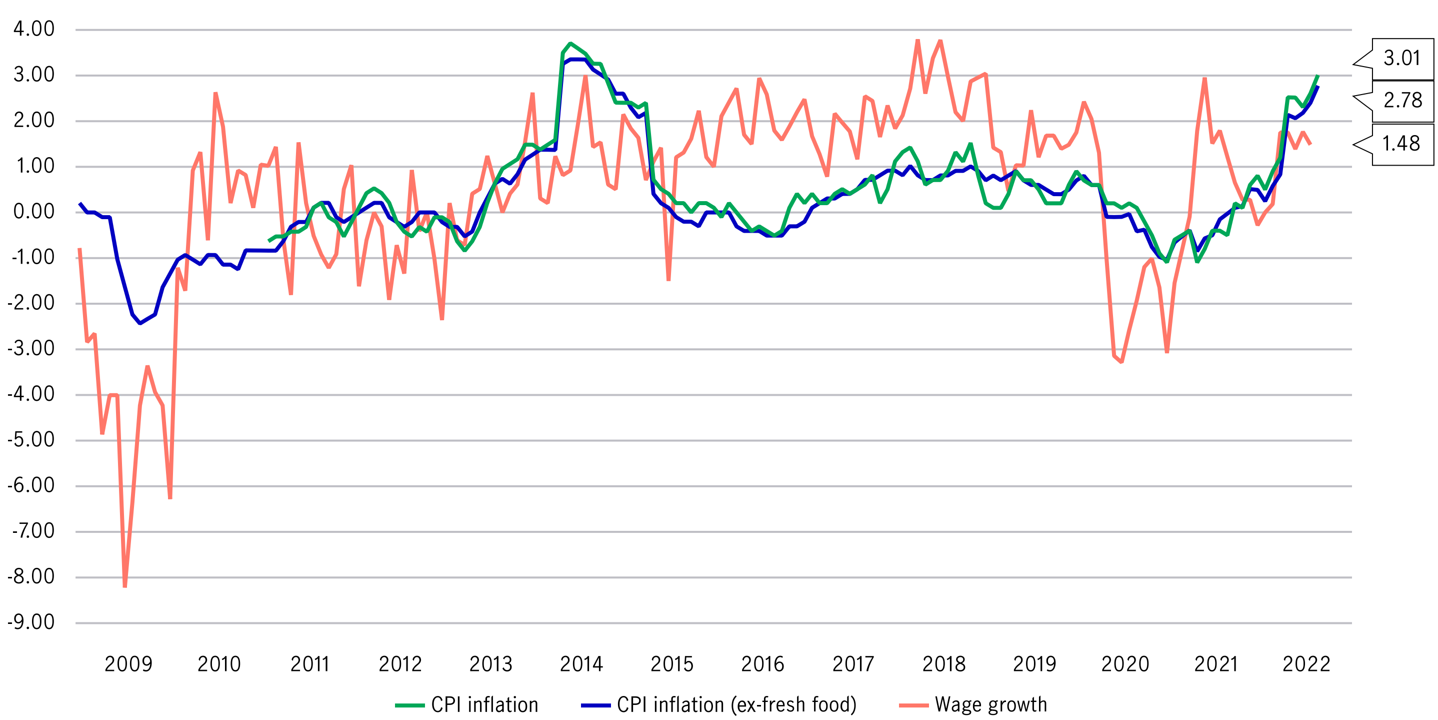
Big picture

CPI inflation in Japan pushed higher in July, with headline inflation hitting 2.6% during the month—the highest level since 1991—while Core CPI inflation (excluding fresh food and energy) rose to 1.2% (a 6.5-year high).[5] Despite speculation that the BoJ might recalibrate its yield curve control policy, the central bank has so far stood its ground: There's been no mistaking its resolve to defend its 10-year yield target in recent months.

BoJ Governor Haruhiko Kuroda has reiterated that Japan's economy wouldn't withstand rate hikes and that any tightening of policy looks a long way off. In our view, Japan is experiencing a cost-push inflation as opposed to a demand-pull inflation. Wage growth in the country has been relatively limited; moreover, recent flash PMIs and trade data also suggest that the global demand slowdown is catching up with Japan. The continuation of accommodative monetary policy and consumer-friendly fiscal measures introduced to counter inflation and support the reopening of the economy, including initiatives to support tourism (domestic and international), should help cushion any downside in the Japanese economy.

"Despite speculation that the BoJ might recalibrate its yield curve control policy, the central bank has so far stood its ground: There's no mistaking its resolve to defend its 10-year yield target in recent months."

Japanese wage growth has lagged overall inflation, YoY (%)



Source: Japanese Statistics Bureau, Japanese Cabinet Office, Macrobond, Manulife Investment Management, as of September 6, 2022. CPI refers to the Consumer Price Index. It is not possible to invest directly in an index. YoY refers to year over year.

5 Japanese Statistics Bureau, August 8, 2022.

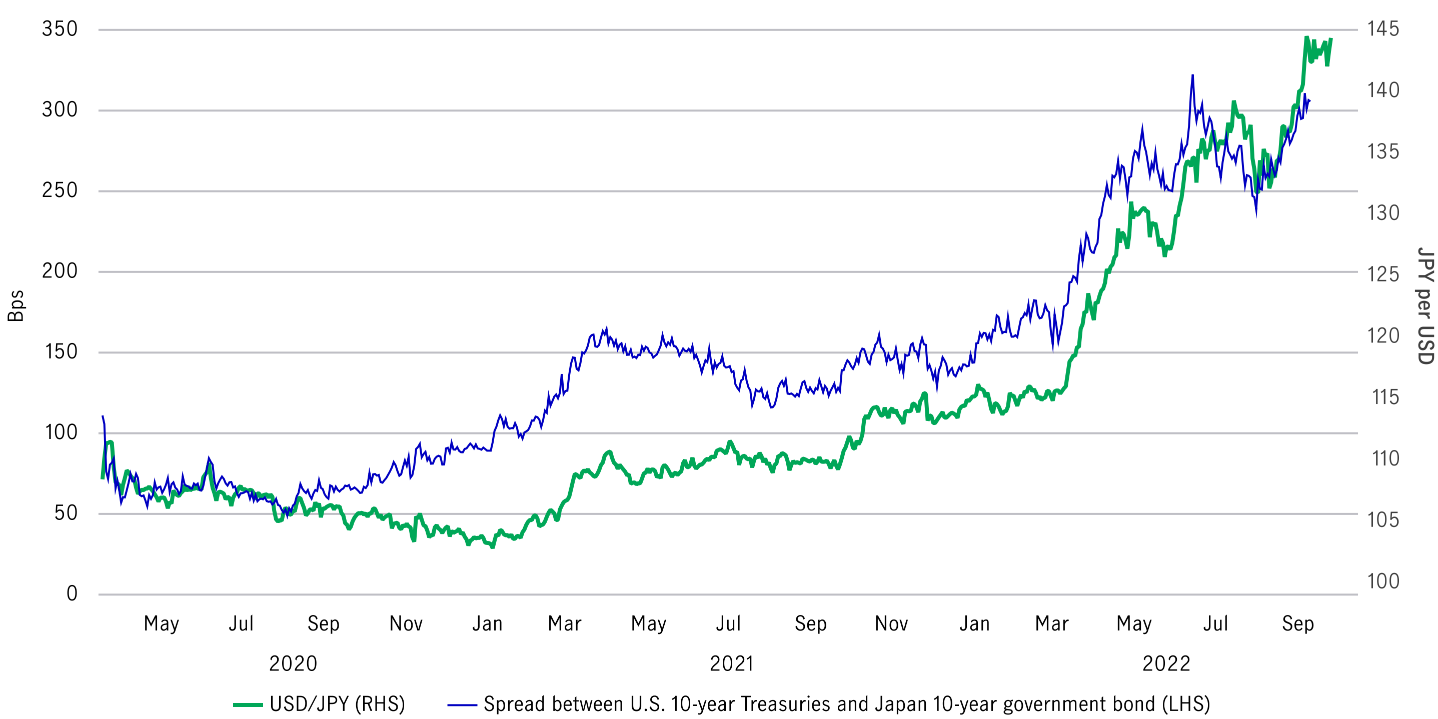
What we're watching

- **BoJ's 10-year Japan government bond yield tolerance band—**Market pressure on the central bank's 10-year yield target of +/–25bps has eased recently; however, continued weakness in the JPY and rising input costs will likely lift underlying inflation, a development that could lead to renewed market speculation of a widening in the BoJ's tolerance band to +/–50bps.
- **Fresh economic package—**Japan Prime Minister Fumio Kishida said the government will consider introducing an extra budget in October to fund the extra stimulus, which will also include efforts to promote a new form of capitalism. Few details have been released as yet, but it's certainly a development that investors should be monitoring closely.

Key market views

Equities—The MSCI Japan Index has been an outperformer relative to its global peers year to date.[4] Looser monetary and fiscal conditions have supported positive earnings revisions, in stark contrast to much of the rest of the world; however, as we head into a more challenging macroenvironment going into the end of the year, stocks with more defensive qualities and those that are leveraged to the economy's reopening might be better placed to navigate the heightened uncertainty.

BoJ's dovish bias stands in contrast to global trends



Source: Bloomberg, Macrobond, Manulife Investment Management, as of September 6, 2022. BoJ refers to the Bank of Japan. Bps refers to basis points. 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.

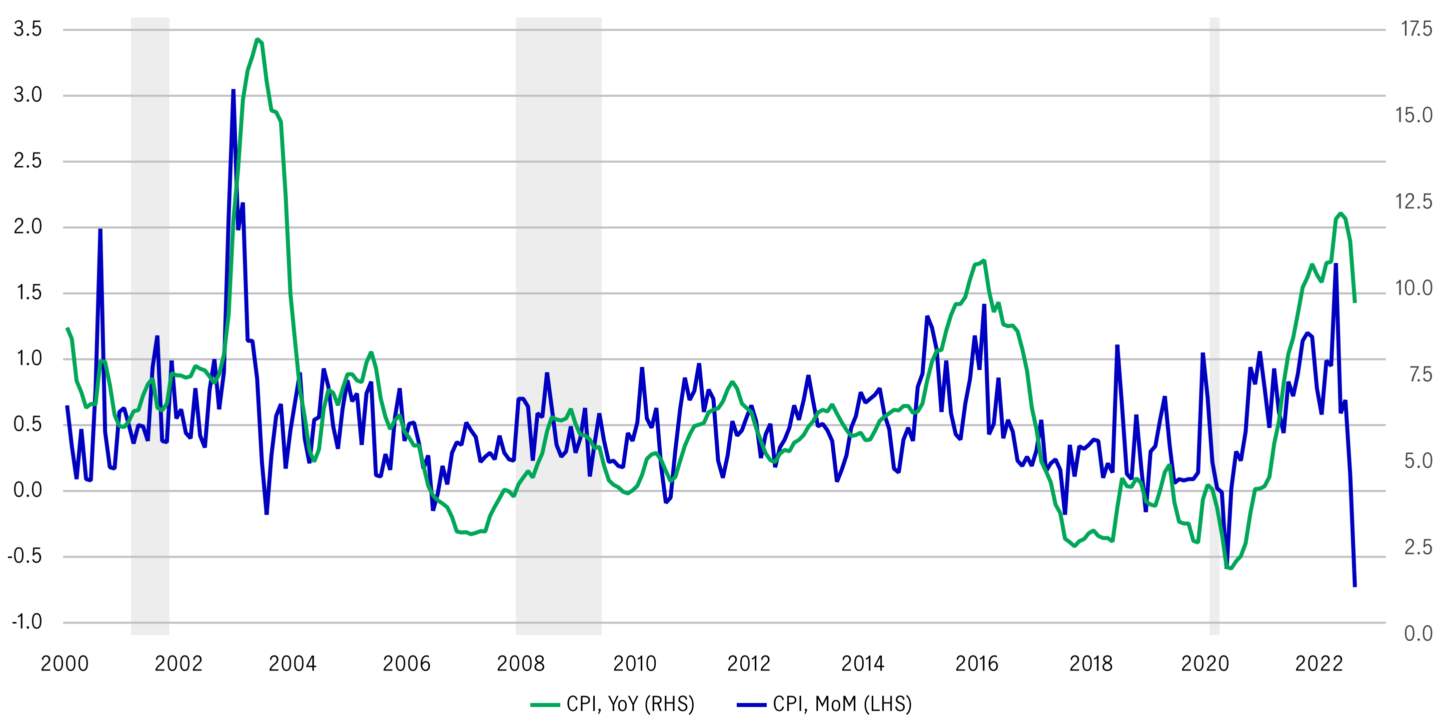
Brazil

Big picture

We expect Brazil's macro story to remain relatively strong, but some caution is warranted with the risk of increased volatility in the days leading up to—and immediately after—October's presidential elections. Critically, inflation in Brazil appears to have peaked in July, which may allow the Banco Central do Brasil (BCB) to pause on its aggressive tightening cycle. We believe the current benchmark Selic policy rate of 13.75% is the terminal rate, which may provide investors with greater monetary policy certainty, particularly within the global context. Employment and real activity growth have strengthened throughout the last nine months on the back of fiscal policy support. PMIs for both manufacturing and services may have edged lower but both remain well in expansionary territory. While hard commodities remain more susceptible to declining global demand, we remain constructive on soft commodities and see them as a tailwind for Brazil's terms of trade and assets denominated in the Brazilian real (BRL), since more than 25% of GDP comes from the agriculture sector.

"Critically, inflation in Brazil appears to have peaked in July, which may allow the BCB to pause on its aggressive tightening cycle."

Inflation appears to have peaked in Brazil (%)



Source: Bloomberg, Macrobond, Manulife Investment Management, as of September 12, 2022. CPI refers to the Consumer Price Index. It is not possible to invest directly in an index. YoY refers to year over year. MoM refers to month over month. LHS refers to left-hand side. RHS refers to right-hand side. The gray areas represent recessions.

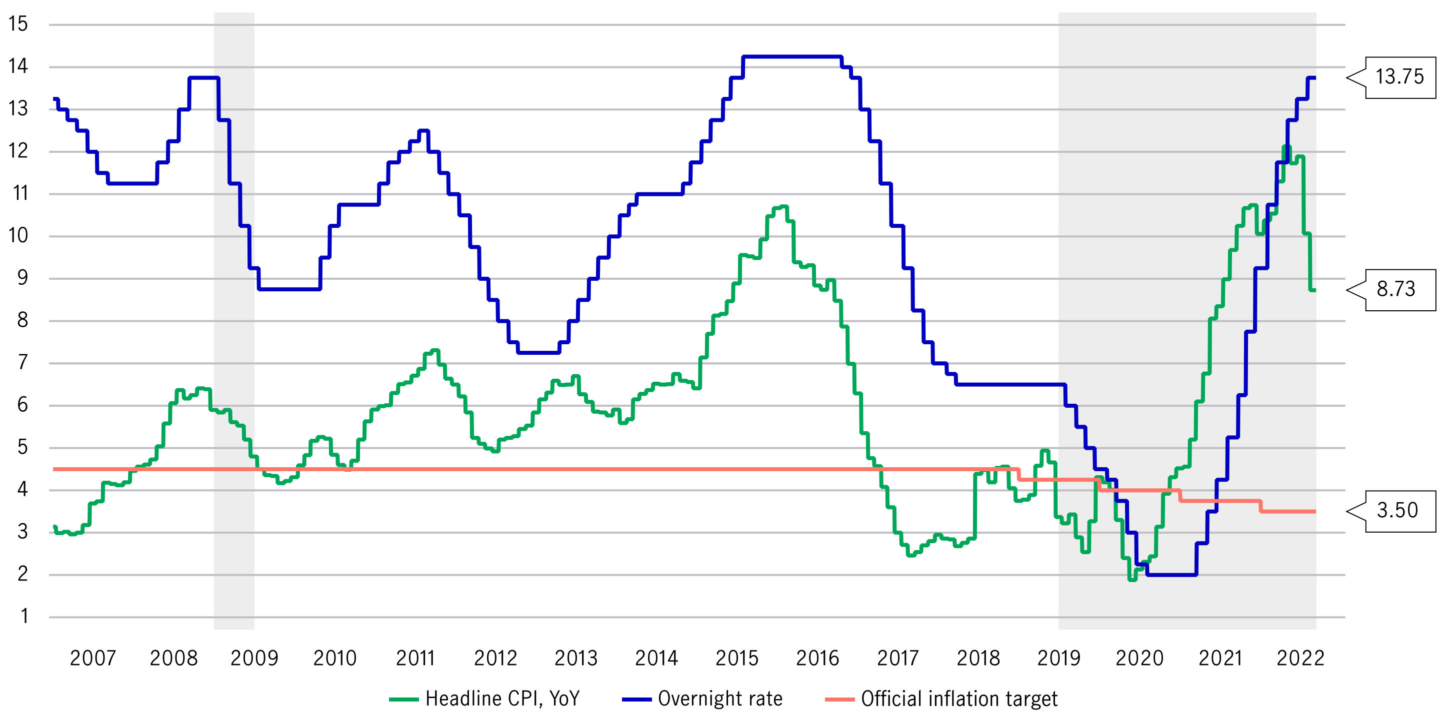
What we're watching

- **2022 election—**While former President Luiz Inácio Lula da Silva had consistently led opinion polls, support for incumbent President Jair Bolsonaro has been growing in recent weeks. Regardless of the outcome, we expect structural reforms to take place in the coming months, with little visibility in regard to the direction in which fiscal policy might head.
- **Flows and sentiment—**International demand for Brazilian assets remains a major driver of the BRL. The relatively high level of yields on offer has attracted global inflows to a broadly underowned asset class. That said, the market continues to be primarily driven by sentiment; as such, sudden and forceful swings in either direction are possible. In addition, negative global risk sentiment translates into a headwind to the market given the high beta nature of Brazilian assets.

Key market views

- **Equities—**In our view, the fundamentals of the MSCI Brazil Index remain remarkably strong, with index metrics such as forward profit margins and dividend yields remaining elevated on a relative, global basis. From a valuation perspective, Brazilian stocks also rank favorably against their EM and DM counterparts. The cyclical nature of the index also means it could benefit from the current shortage in commodities supply globally; however, it should be noted that the asset class can be prone to sharp swings in view of its sensitivity to the evolving geopolitical backdrop.
- **Currencies—**The BRL's trend has been volatile, and risks tilt to the downside into 2023. Global risks remain elevated in an environment of weaker economic growth and tighter financial conditions. We expect the BRL to push toward the 5.60 to 5.80 range against the USD.

The BCB may be able to end its hiking cycle as inflation moves closer to target (%)



Source: Bloomberg, Manulife Investment Management, as of September 12, 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.

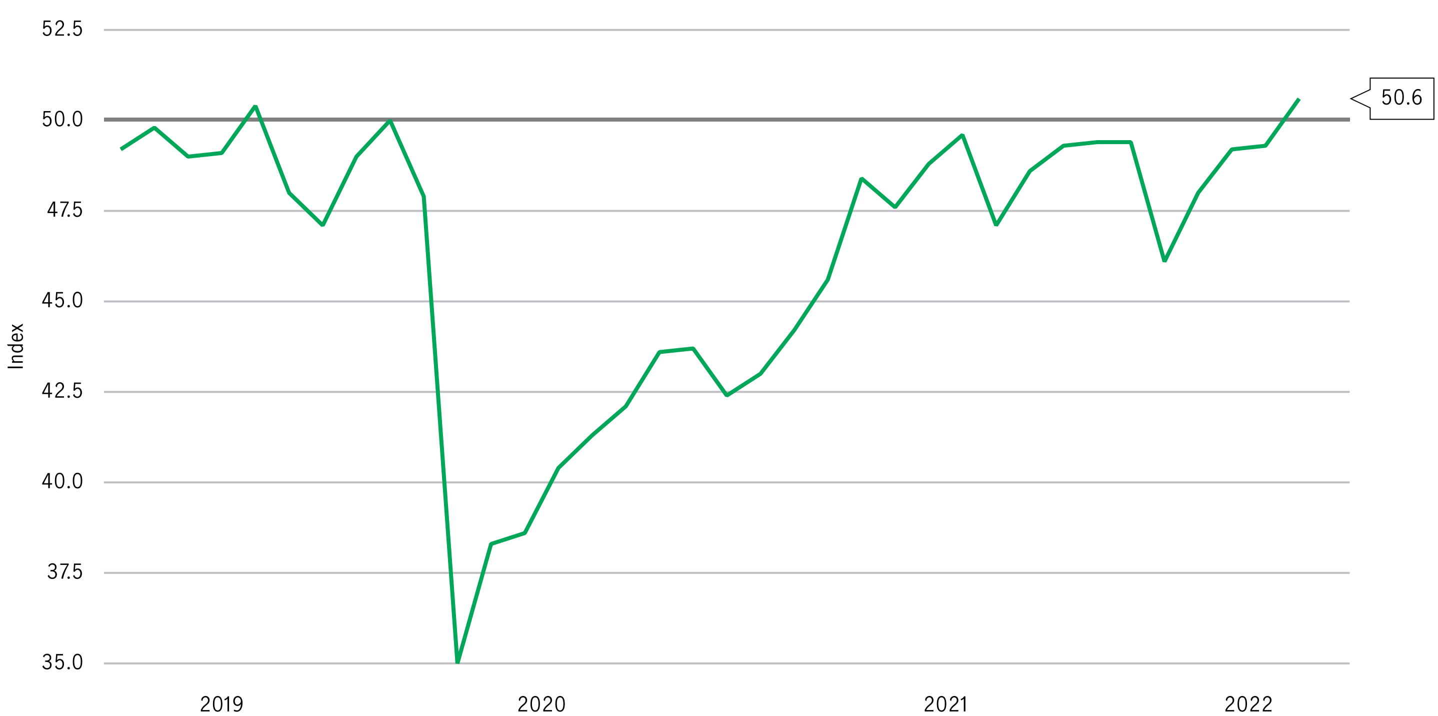
Mexico

Big picture

As Mexico's growth prospects remain closely tied to the performance of the U.S. economy, it's unsurprising that headwinds are intensifying amid the deterioration in the U.S. outlook. High-frequency indicators of domestic manufacturing activity, for instance, are already pointing to a softening in external demand. At the moment, the economy's still receiving a nice boost from the rise in domestic spending, having eased lockdown requirements later than many of its neighbors. That said, it's unlikely to be sufficient to fully mitigate softer growth in 2023. Inflationary pressures remain strong, limiting the scope for relief from Banxico as the central bank seeks to tamp down CPI inflation, which is at a multidecade high. U.S. allegations that Mexico has breached the U.S.-Mexico-Canada trade agreement by favoring domestic firms have cast a shadow over trade relations. While both sides have expressed willingness to work toward a solution, it remains an issue that investors will want to keep an eye on.

Mexico's lagged reopening remains an important domestic economic tailwind for now; however, it's unlikely to be sufficient to fully mitigate softer growth in 2023.

Mexico's manufacturing PMI edges back into the expansionary territory



Source: Bloomberg, Macrobond, Manulife Investment Management, as of September 15, 2022. PMI refers to Purchasing Managers' Index. It is not possible to invest directly in an index. A reading above 50 represents expansion.

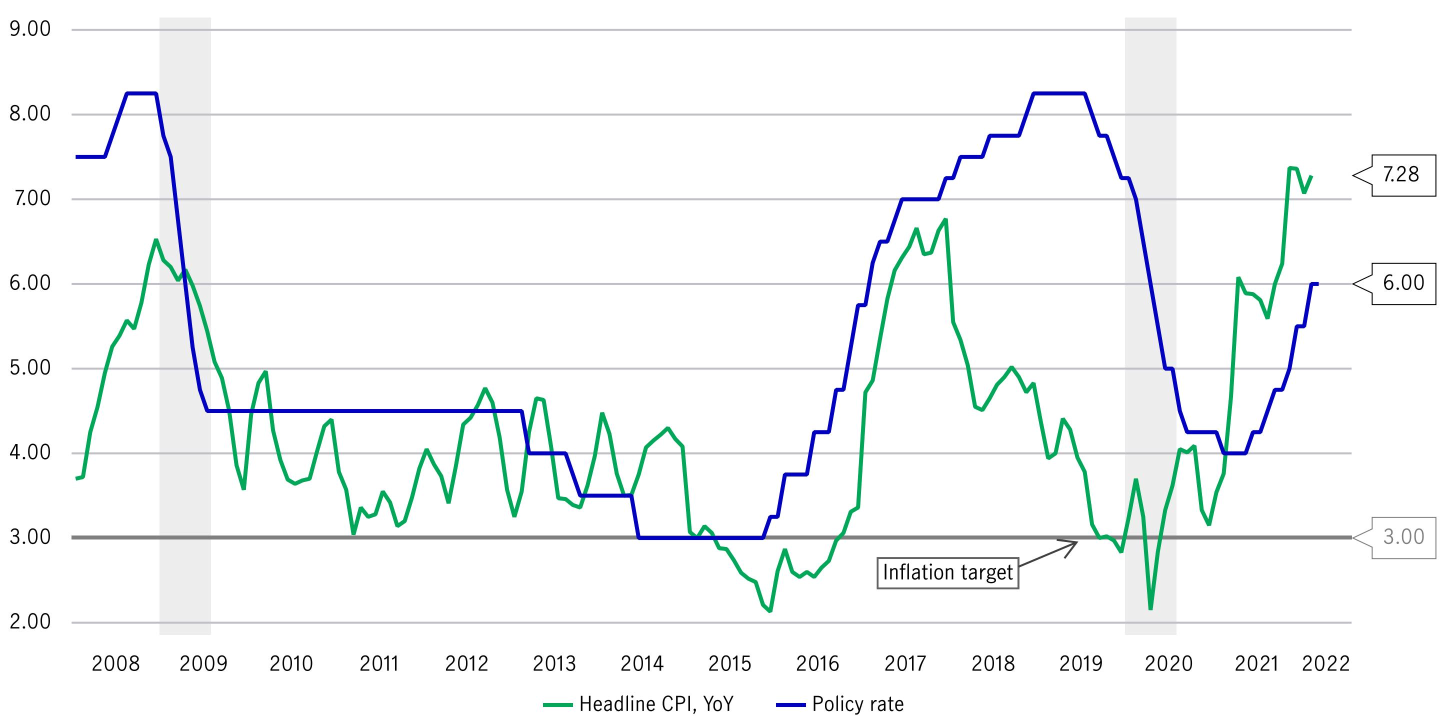
What we're watching

- **U.S.-Mexico energy dispute—**Initial discussion between both parties has been encouraging. The tone of these meetings is important as both sides are seeking to collaborate on semiconductor and electric vehicle production.
- **Banxico—**The central bank continues to prioritize tamping down inflation and has maintained a steady pace of aggressive interest-rates hikes to get prices under control. We're looking for signs of a deceleration in price pressure that could provide cover for Banxico to make a dovish pivot.

Key market views

- **Equities—**We have a favorable view of Mexican equities relative to their global peers. The MSCI Mexico Index has outperformed the MSCI All Country World Index in the past two years, and we expect this trend to continue within the broader context of continuing deglobalization trends and the industrial reshoring of North America.
- **Currencies—**We expect the Mexican peso (MXN) to remain in a stable trading range against the greenback. The USD/MXN cross has consolidated around the 20 level for much of the past two years, and we expect this trend to continue.

Banxico tries to tamp down inflation with aggressive rate hikes (%)



Source: Bloomberg, Macrobond, Manulife Investment Management, as of September 14, 2022. CPI refers to the Consumer Price Index. It is not possible to invest directly in an index. YoY refers to year over year. The gray areas represent recessions.

Manulife Investment Management

Important information

Manulife Investment Management

Manulife Investment Management is the global wealth and asset management segment of Manulife Financial Corporation. We draw on more than a century of financial stewardship to partner with clients across our institutional, retail, and retirement businesses globally. Our specialist approach to money management includes the highly differentiated strategies of our fixed-income, specialized equity, multi-asset solutions, and private markets teams—along with access to specialized, unaffiliated asset managers from around the world through our multimanager model.

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