Manulife Asset Management

Wealth STYLES

2018 Spring Edition

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Editor's Note

As we move into the Year of the Dog, we would like to wish all our readers good health and a smooth sailing investment journey!

Looking back at 2017, the notable rise of major stock and bond indices around the world had benefitted portfolios of many investors[1]. However, increased volatility earlier this year has sparked concerns on whether this favourable economic environment for financial markets can be sustained. Apart from economic indicators, Asian investors should watch out for four factors which are expected to shape market performance in 2018. This issue's **Cover Story** has more details.

Mutual funds are one of the many investment vehicles that can diversify risk. However, some investors view them as similar to investment-linked assurance schemes when in fact, the two differ greatly in terms of product structure, flexibility in holding period and fees. Be sure to check out our **Wealth Q&A** to find out why.

Wealth management knowledge goes a long way in our lifetime. Parents can continue to play an integral role in inculcating good financial habits in their children, sharing advanced wealth management knowledge, and making sure they have the right attitudes. Find out more in **Financial Parenting**.

Finally, if you have any wealth management-related questions, we would like to hear from you. Email us at **WealthStyles_Asia@manulifeam.com**.

[1]Source:Manulife Asset Management, Factset, January 2018

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Understanding the differences between ILAS and funds

Q **I would like to invest in funds, but have heard that investment- linked assurance schemes (ILAS) also have similar characteristics. What exactly are the differences between the two?**

A **Many people think that funds and ILAS refer to the same thing, but the two products differ greatly in terms of product structure, flexibility in holding period, fees and potential returns. Investors should therefore consider factors such as their investment objectives and financial circumstances before choosing between the two.**

Mutual funds are basically pooled investment vehicles, where the capital is managed on behalf of investors by investment managers. The investment manager invests the pool of money into different markets or regions (such as Asia and global markets) or asset classes (such as stocks, bonds, currencies), in accordance to the fund's intended investment objective.

This makes mutual funds suitable for investors who seek to invest over the mid to long-term, and are looking to grow and diversify their investments more effectively.

On the other hand, ILAS are life insurance products which also contain investment elements. This makes them more ideal for mid to long-term investors looking to meet both investment and estate planning goals simultaneously.

There are two common misconceptions regarding the difference between these products, the most common of which is the understanding about ownership.

When purchasing an ILAS, the investor is actually purchasing an insurance policy. Unlike life insurance, the ILAS policyholder can enjoy potential returns via "underlying fund" investments. Only by directly purchasing mutual funds offered by asset management companies do investors become true "owners" of their investments.

The second misconception is that the two products, if given the same investment objectives, offer the same rates of return.

This is incorrect; on top of fund-related fees, ILAS products also incur fees at the insurance policy level, to cover for insurance elements such as the death and disability benefits.

What this means is that the overall return from an ILAS may be lower than that of the chosen underlying fund.

For more wealth management related enquiries, please email
WealthStyles_Asia@manulifeam.com

Source: Manulife Asset Management, website of the Securities and Futures Commission. The information above only covers the Hong Kong market. The name of schemes, investment periods, returns and investment structures, etc. may be different for other countries/regions.

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Where is 2018 headed? "TIME" will tell

Despite synchronized expansion in the global economy so far this year, financial markets have experienced considerable volatility. This has in turn sparked investor concerns on whether the favorable economic climate for financial markets can be sustained. In addition to the economic data, "TIME" will dictate where markets will head in 2018.

T: Tax reform

The recent US tax reform bill is aimed at alleviating the tax burden of American companies and taxpayers. However, its effectiveness in boosting the economy and corporate earnings remains to be seen.

Markets expect this to lead to year-on-year GDP growth rising by 0.3 to 0.4 percentage points in 2018[1]. US financial and industrial sectors are set to benefit the most, as their earnings are expected to grow by 51% and 36%, respectively this year[2].

Geoff Lewis, Senior Asia Strategist, Manulife Asset Management believes that the passage of the US tax reform has more positive than negative implications for Asia in the short term. This is because increasing demand for Asian exports in the US will bode well for export-oriented economies in Asia. As a result, the expansionary trend of Asian exports is expected to continue in 2018[1].

While the tax reform can stimulate the US economy, it may also create inflationary pressures, forcing the US Federal Reserve to accelerate the tightening of monetary policies. It is therefore important to monitor the inflation trajectory in the US.

I: Inflation

Inflation is closely linked to interest rate trends. If inflation rises too quickly, central banks may be forced to hike rates at a faster pace, resulting in higher funding costs and bond yields. This can in turn bring about detrimental effects to the financial markets.

One crucial factor that affects inflation in Asia is oil price. In fact, the price of oil and inflation often share a cause-and-effect relationship. In 2017, international oil prices rose by over 10% and this upward trend continued in January this year. As many Asian regions are net importers of crude oil, rising oil prices may result in imported inflation and this merits attention.

M: Monetary Policies

A number of major central banks will be undergoing leadership changes in 2018. For example, all eyes are on Jerome Powell who was sworn in as Chairman of the US Federal Reserve in February this year, replacing Janet Yellen. Markets are concerned whether Powell would adopt a more hawkish stance, or follow Yellen's policy of gradual rate hikes. We will have a better understanding at Powell's press conference in March, after he hosts the Fed Board Meeting for the first time.

Meanwhile, Bank of Japan (BoJ) Governor Haruhiko Kuroda was reappointed for second term until 2023. Even though there is no leadership change, the BoJ has already cut back long-term bond purchases since January this year. If accommodative policies were further trimmed during his second term, capital flows in bond markets, bond yields, forex and even equity markets may potentially be affected.

E: Elections

With several elections set to be taking place all over the world, 2018 will be a hectic year both politically and economically.

In particular, the spotlight will be on the Russian and Brazilian presidential elections, as well as Japan's Liberal Democratic Party leadership elections. Thailand is also sitting tight as it awaits its first election since the 2014 military coup. This is expected to take place in November, the same month in which midterm elections in the US will be held.

Investors should therefore not neglect the potential effects of election campaigns and results on financial markets.

[1] Source: Manulife Asset Management, January 2018.
[2] Source: John Hancock Investments, 19 January, 2018; Factset, 2018.

2018 KEY POLITICAL AND ECONOMIC EVENTS

02

3 Feb
Powell sworn in as Chairman of the US Federal Reserve

03

3 Mar
Convening of the Chinese People's Political Consultative Conference

4 Mar
Italian general elections

5 Mar
Convening of China's National People's Congress meeting

18 Mar
Russian presidential election

20-21 Mar
Powell to hold first press conference as Fed Chairman

04

9 Apr
BoJ Governor Haruhiko Kuroda's second term starts

05

3 May
UK local elections

06

Jun
China A shares to be added to MSCI Emerging Markets Index

8-9 Jun
G7 summit

27 Jun
Indonesian local elections

08

24 Aug or before
Malaysian general elections

09

30 Sep
European Central Bank's bond-buying program ends

10

7 Oct
Brazilian presidential election

11

6 Nov
US midterm elections

Nov
Thai general elections

12

31 Dec
OPEC's supply cut agreement ends

Source: Manulife Asset Management, Citi, Credit Suisse, as of 26 February, 2018
Estimated dates of events in local time, the information above is for reference only.

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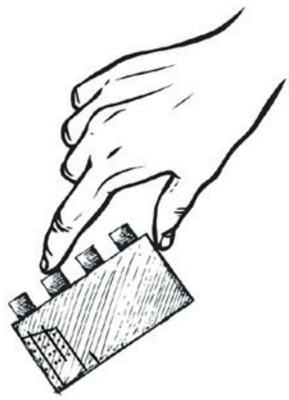
Never let setbacks prevent you from attaining financial freedom

Parents can influence their children in more ways than one. Apart from being a role model in their formative years, parents also play an integral role when it comes to inculcating good financial habits in their children. After all, financial discipline and a good head start in money management go a long way in ensuring that one remains self-sufficient and ultimately attains financial freedom during old age.

The right attitude towards wealth management is key to growing your assets. One golden rule to bear in mind: never let investment setbacks get the better of you. We have all heard stories of people giving up on investments, after a few bad experiences. With a defeatist attitude, this group of people believes they are destined not to have any luck with investing. As such, they choose to enjoy the present and spend what they earn, rather than saving and investing for their future.

Start saving, avoid speculation

It is important to examine their motivation for investment. For example, did they lose money because they had invested in anticipation that their stocks of choice will gain 50% in two days? While some stocks can gain 50% in the short run, they can also fall by the same amount or more over the same period. Speculative investing, without any background research, is tantamount to gambling. In contrast, investing with clear financial goals in mind paves the way towards financial independence.



Mindset change is imperative

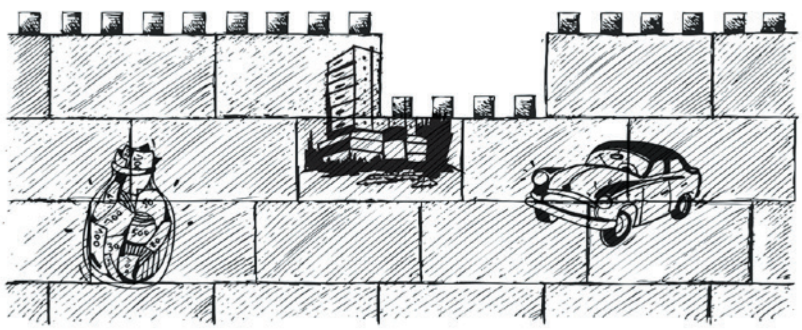
The lack of savings and investment may have severe consequences. In particular, those who have not drawn up a sound financial plan by the age of 35 risk losing their financial freedom in the latter years.

There is a Chinese proverb: "It is better to rely on oneself than on the help of others." The current mindset held by many that "savings are meaningless, the government will support me when I'm old" has to change.

So start figuring out how to be more constructive with your finances. Remember, an early start gives you the best chance to build wealth through savings and sound investment strategies.

Edmond Lee

Previously an investment banker, Edmond is the co-founder and mentor of the 'Child and Adolescent Financial Education Fund'. He has hosted more than 70 financial parent related workshops and published numerous financial parenting books.



A road less travelled:

From writing to financial planning

Rajen Devadason,
Licensed Financial Planner and Unit Trust Advisor,
Manulife Asset Management Services Berhad

Rajen Devadason, Diamond member of the elite Manulife Gems Club, may have gotten his investing acumen from his years of writing.

The co-author of Malaysia's first comprehensive financial planning book, *Financial Freedom – Your Guide to Lifetime Financial Planning*, published in December 1998, started the financial planning leg of his career in 1996 as one of the pioneer writers with Smart Investor magazine in Singapore.

In 1999, a year after that book was published, Rajen was invited to write for the Financial Planning Association of Malaysia. His various writing projects for the association were significant, as they formed part of the early initiatives to develop the financial planning profession in Malaysia.

This was how Rajen's interest in financial planning grew.

He notes, "Most people enter the financial planning profession through deeply-grooved insurance, investment or estate planning tracks. My road was less travelled – via writing."

The Certified Financial Planner is also licensed by the Malaysian Securities Commission. He specialises in providing English-speaking business owners and professionals with long-term retirement funding solutions.

His journalism background, coupled with an earlier degree in Physics and Computing from King's College, University of London, gave him a competitive edge. He has a knack for breaking down complex investment concepts into simple, layman's language.

"While selling does not come natural to me, my conviction in financial planning has enabled me to plod on. In the process, I learn useful money lessons, apply what I have picked up and help others along the way," he adds.

To Rajen, there are three principles that will always form the bedrock of his financial planning practice; namely **intense client education, delayed gratification, and 'buy low-sell high'**. He believes strongly in dollar-cost averaging, dynamic asset allocation as well as asset class rebalancing. He is convinced that these strategies work most effectively with unit trust investments.

Rajen only takes on clients eager to learn about financial planning and investing. He then guides them to an understanding of the importance of sacrificing some consumption today for the opportunity to save and invest for a better tomorrow.

"The cerebral aspects of financial planning and investment management appeal most to me," he says. "I hope to continue serving my clients by harnessing the profound process of financial planning to help them meet their life goals."

There is no free lunch.

But Diversification comes close in investing.

In fact, the idea of diversification as the closest thing to a "free lunch" for investors has been popularised since the 1950s[1] when a diversified portfolio was shown to have the ability to optimise returns with lower volatility in the long run[2]. Many studies done over the years have also shown that divergence in the performance of portfolios can be attributed to asset allocation[2].

INVESTOR EDUCATION SERIES

DIVERSIFICATION: WHY YOU SHOULD NEVER PUT ALL YOUR EGGS IN ONE BASKET

PUT THE RIGHT NUMBER OF EGGS IN DIFFERENT BASKETS

While risk is inherent in investments, it does not mean that we should be taking additional risks blindly just to enhance our investment returns. Every asset class has its own risk and reward characteristics; they perform differently depending on the point of the economic cycle.

By putting different asset classes together in one portfolio, the variability of each asset class will matter less, while the overall portfolio volatility will be reduced.

Such, is the beauty of diversification.

So, does this mean we should put as many asset classes as possible into one portfolio?

Definitely not so; **asset allocation is the process of constructing the optimal investment portfolio, with different asset classes and weightage, according to an individual's investment objectives and risk tolerance.** The portfolio should then maximise returns for the individual's level of risk tolerance. This whole process is akin to allocating an optimal amount of eggs within different combinations of baskets.

Simply put, investing in a single asset is typically insufficient to meet investment objectives. But by expanding the investment universe from a single asset to different asset classes and from local to international markets, the risk of over concentration in a single asset is reduced.

Calendar year returns of different asset classes[3]

RETURN

2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
39.4%	5.2%	78.5%	18.9%	8.5%	22.7%	31.5%	13.0%	9.6%	14.3%
38.0%	-4.3%	73.2%	18.1%	7.8%	22.3%	27.2%	8.1%	1.2%	11.2%
36.5%	-10.9%	67.1%	15.4%	4.6%	19.6%	25.2%	6.4%	0.7%	11.2%
13.9%	-26.9%	59.4%	14.8%	3.1%	19.1%	7.3%	6.0%	0.5%	10.2%
7.0%	-29.2%	35.8%	14.4%	1.5%	18.5%	7.2%	5.5%	-0.1%	6.8%
6.8%	-37.4%	28.2%	13.6%	-11.1%	18.2%	3.4%	2.8%	-2.7%	5.8%
6.3%	-46.4%	25.6%	12.0%	-14.3%	15.2%	-2.0%	0.0%	-2.8%	3.8%
4.9%	-49.4%	16.9%	11.4%	-15.6%	11.6%	-2.6%	-2.2%	-7.1%	2.6%
3.2%	-51.9%	6.3%	6.5%	-18.4%	8.2%	-4.0%	-4.0%	-9.4%	2.4%
-4.2%	-53.3%	5.9%	3.9%	-18.4%	4.2%	-6.6%	-6.2%	-14.9%	-0.4%

US Bonds | Asian Bonds | EM Bonds | Global High Yield | Japan Equities
US Equities | European Equities | Greater China Equities | Asia Pacific ex-Japan Equities | EM Equities

[1] Nobel Memorial Prize in Economic Sciences recipient Harry Markowitz popularised the concept of "diversification" and "asset allocation" in 1952. (http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/1990/press.html)

[2] Financial Analysts Journal: "Determinants of Portfolio Performance" (May/June 1991); "Determinants of Portfolio Performance II: An Update" (Jan/Feb 1995); "The Equal Importance of Asset Allocation and Active Management". March/April 2010.

[3] Data source: Bloomberg, Manulife Asset Management, as of 31 December 2016, total returns in US dollar. US Bonds are represented by Bloomberg Barclays US Aggregate Index. Asian Bonds are represented by 50% JPMorgan Asia Credit Index + 50% HSBC Asian Local Bond Index (2007 to 2012)/Markit iBoxx Asian Local Bond Index (2013 to 2016); Global high yield bonds are represented by Bloomberg Global High Yield Corporate Bond Index. EM Bonds are represented by JPMorgan EMBI Global Core Index. Japan Equities are represented by MSCI Japan Index. US Equities are represented by S&P 500 Index. European Equities are represented by MSCI Europe Index. Greater China Equities are represented by MSCI Golden Dragon Index. Asia Pacific ex-Japan Equities are represented by MSCI Asia Pacific ex-Japan Index. EM Equities are represented by MSCI Emerging Markets Index. Past performance is not indicative of future performance.

So, how should one go about diversifying and allocating assets?

For a start, investors can consider the 5Rs: Risk, Return, Right Mix, Rebalancing and Review, which are the essence of asset allocation.

5Rs: THE FIVE STEPS OF ASSET ALLOCATION

Risk: Know your risk tolerance

Our needs change as we go through different life stages, and it is important to understand and evaluate our unique risk tolerance. In general, young investors usually have more time on their side and can tolerate higher risk, while middle-aged investors face greater financial pressures and can tolerate only moderate risk. Senior investors, on the other hand, lack stable sources of income and should therefore focus on capital preservation.

Return: Setting expected income objectives

Before constructing the portfolio, investors should also consider their expected returns as this would largely influence the asset allocation.

Right mix: Portfolio construction

When it comes to constructing a portfolio, investors are essentially making decisions on how to allocate their capital among different asset classes, in a way that maximizes the potential of investment returns, while ensuring that it fits the unique risk profile.

Key areas to consider would include: the associated investment risks, what the investment can do for you, what to invest within each asset class, and the right manager for your portfolio.

Rebalancing: Disciplined portfolio management

After a portfolio is established, should investors hold on to it without giving it much thought?

This is one common mistake to avoid; after all, markets are subject to fluctuations, and different asset classes perform differently depending on the market cycle. If left unmonitored, the initial weighting of the asset classes can change over time, resulting in a portfolio that may not be in line with the intended risk profile.

Therefore, portfolios should be rebalanced in a disciplined manner. When asset allocation weightings deviate from the initial asset mix (i.e. too high or too low), adjustments should be made. Better-performing assets may be sold to fund the purchase of underperforming assets at low price points, maintaining the original allocation weightings of the portfolio.

This risk management mechanism of "buying low, selling high" also instills discipline within investors by getting them to stay within their risk tolerance, instead of drifting away from their intended asset allocation. The asset allocation should be examined regularly, be it monthly, quarterly or annually. Deviations from the target allocation should be rebalanced to restore the target weighting.

Review: Choose investment products and managers wisely

It is also important to evaluate your needs or changes in financial goals depending on the current stage in life and adjust asset allocation accordingly. One good practice is to review the past performance of various asset classes in your portfolio to determine whether they have met their investment targets.

What's more, work with the right investment manager. Choose your manager wisely by evaluating the performance, philosophy and risk control principles.

PATHWAY TO DIVERSIFICATION

ASSET ALLOCATION

DIVERSIFIED PORTFOLIO

BENEFITS
Optimising return potential, mitigating risks

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