



# Asset Allocation Outlook

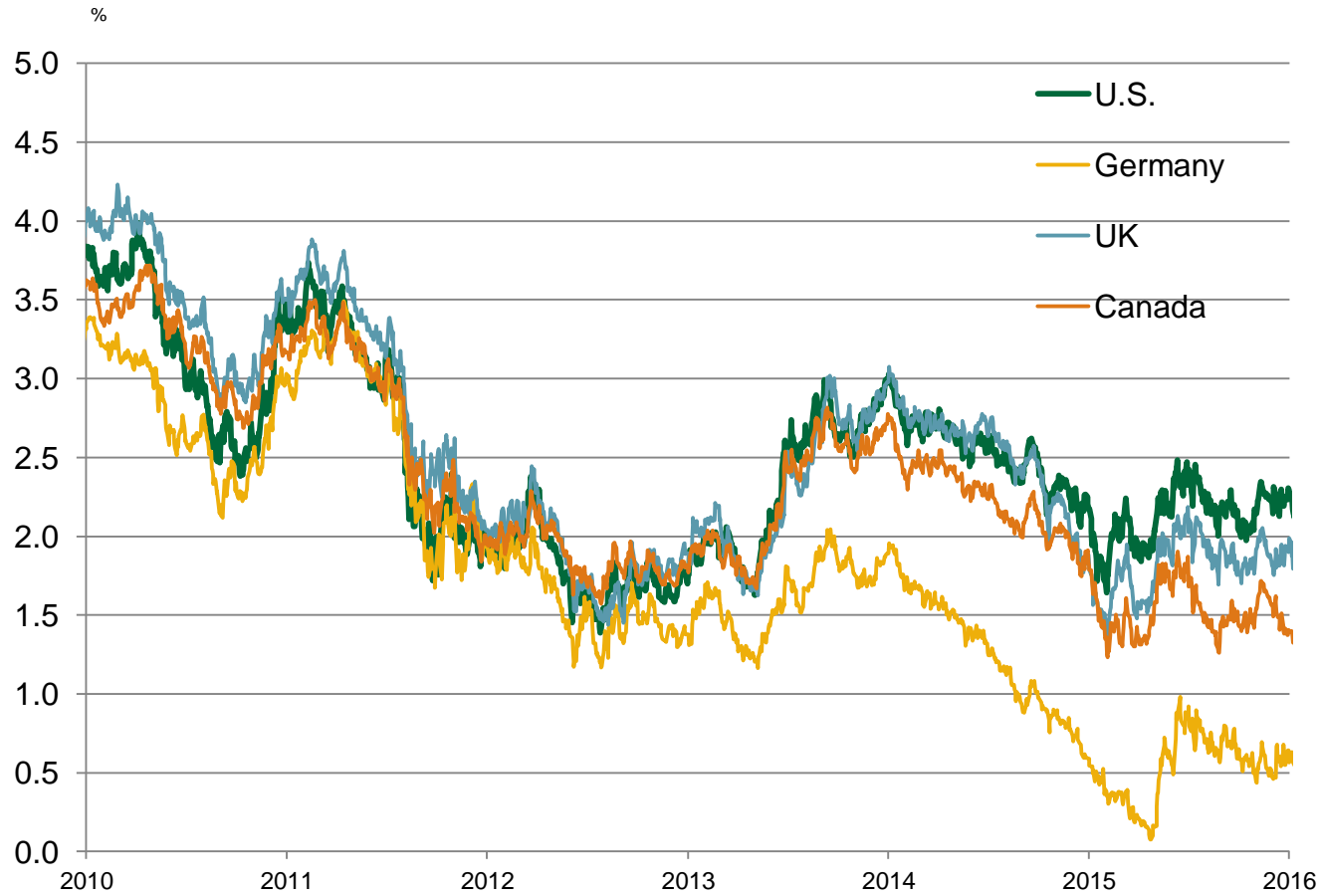
**Victoria, BC**  
**February 4, 2016**

**Bob Boyda**  
**Head of Capital Markets & Strategy**  
**Manulife Asset Management**

# The Search for Yield (you think this is bad...)



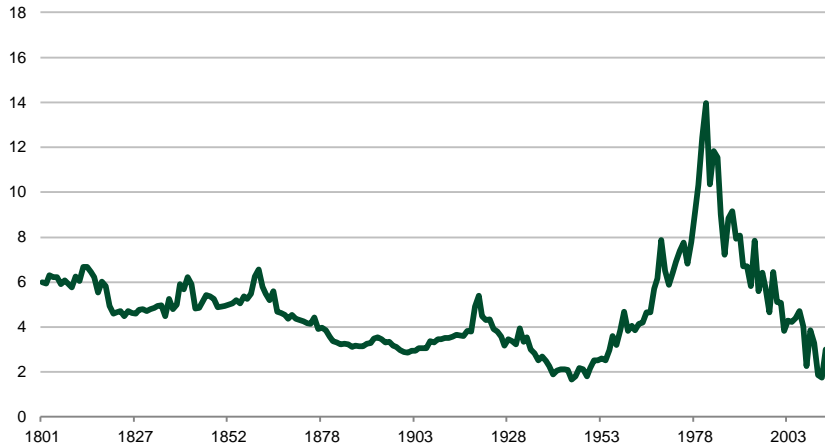
## 10yr Bond Yields: Globally low



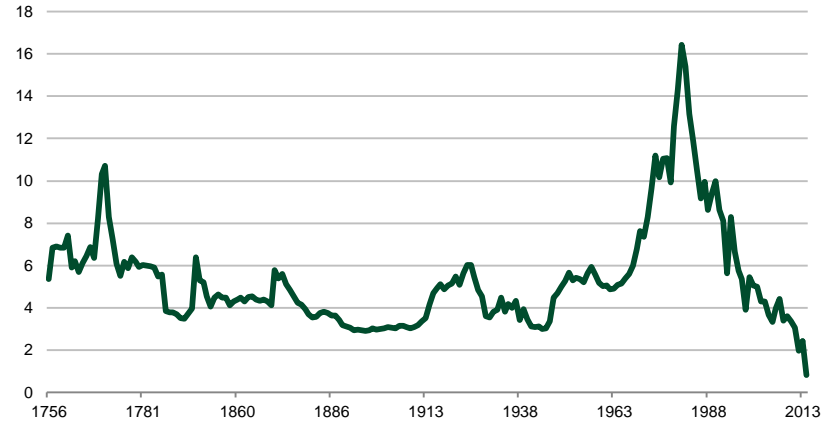
Source: Bloomberg, Manulife Asset Management. As of Oct '15.

# Multi-generational, multi-century low yields!

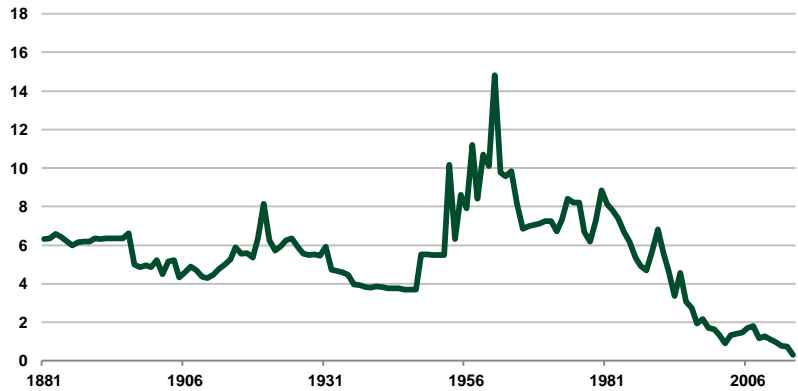
US 10 Year Yield (%)



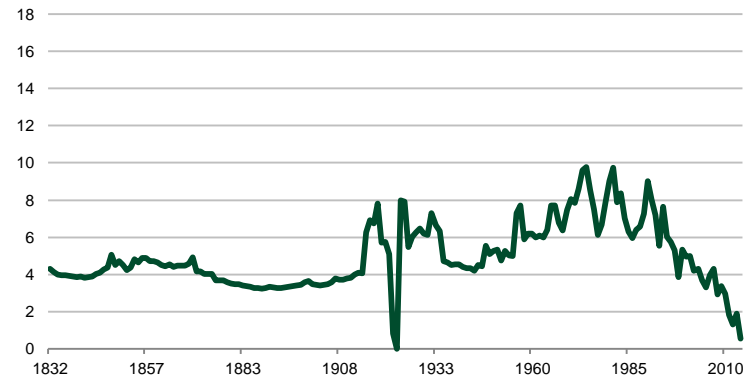
France 10 Year Yield (%)



Japan 10 Year Yield (%)



Germany 10 Year Yield (%)



Source: Global Financial Data, 05/01/2015

# Fixed Income Forecasting

What you see is what you get...



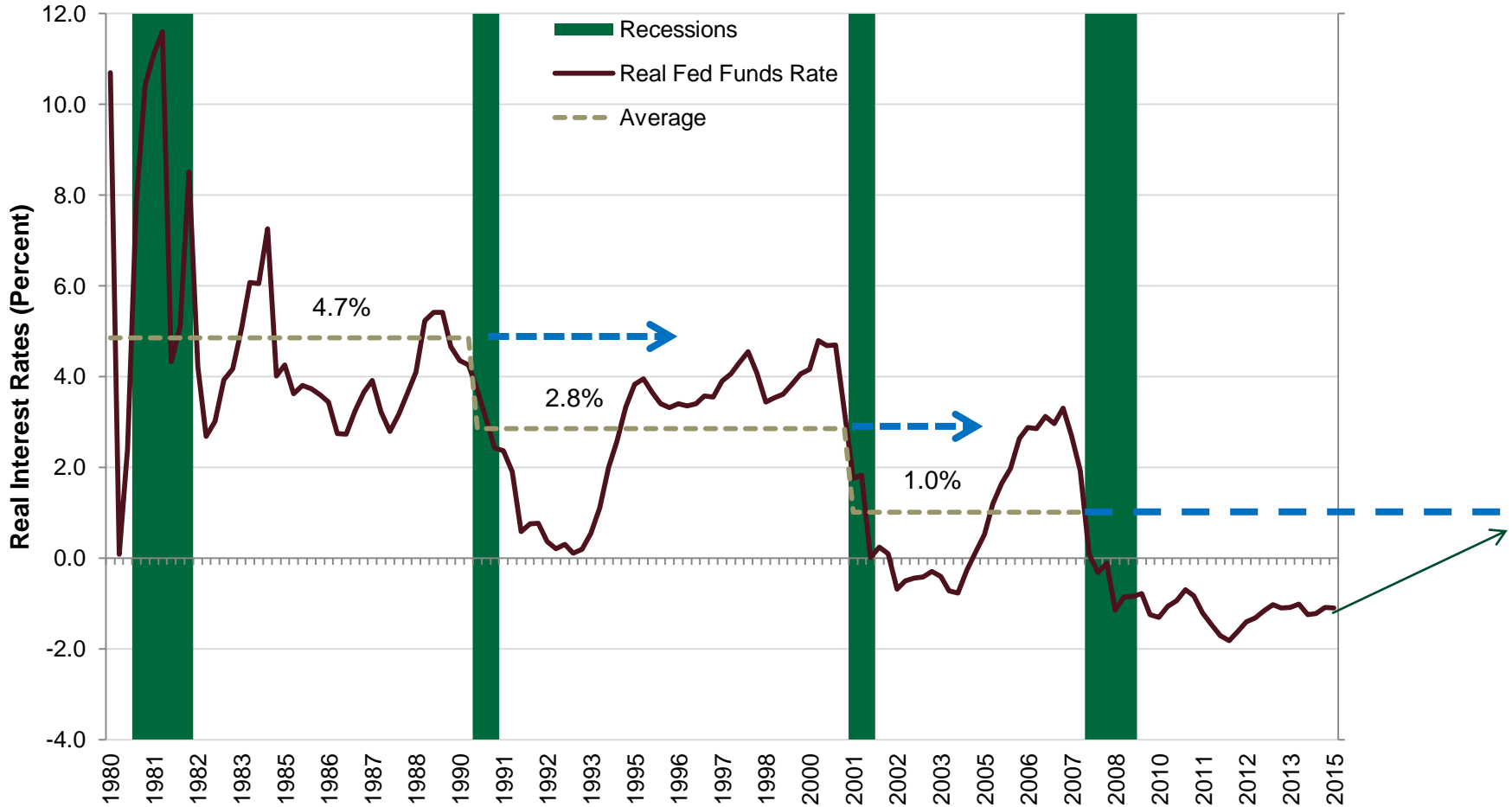
## Barclays US Aggregate Bond Index:

The current yield is the best predictor of expected long-term returns for bonds



Source : Bloomberg, June 30, 2015. It is not possible invest directly in an index. Past performance is not indicative of future results. See appendix for index definitions.

# Where is the Fed going and... Why it won't matter

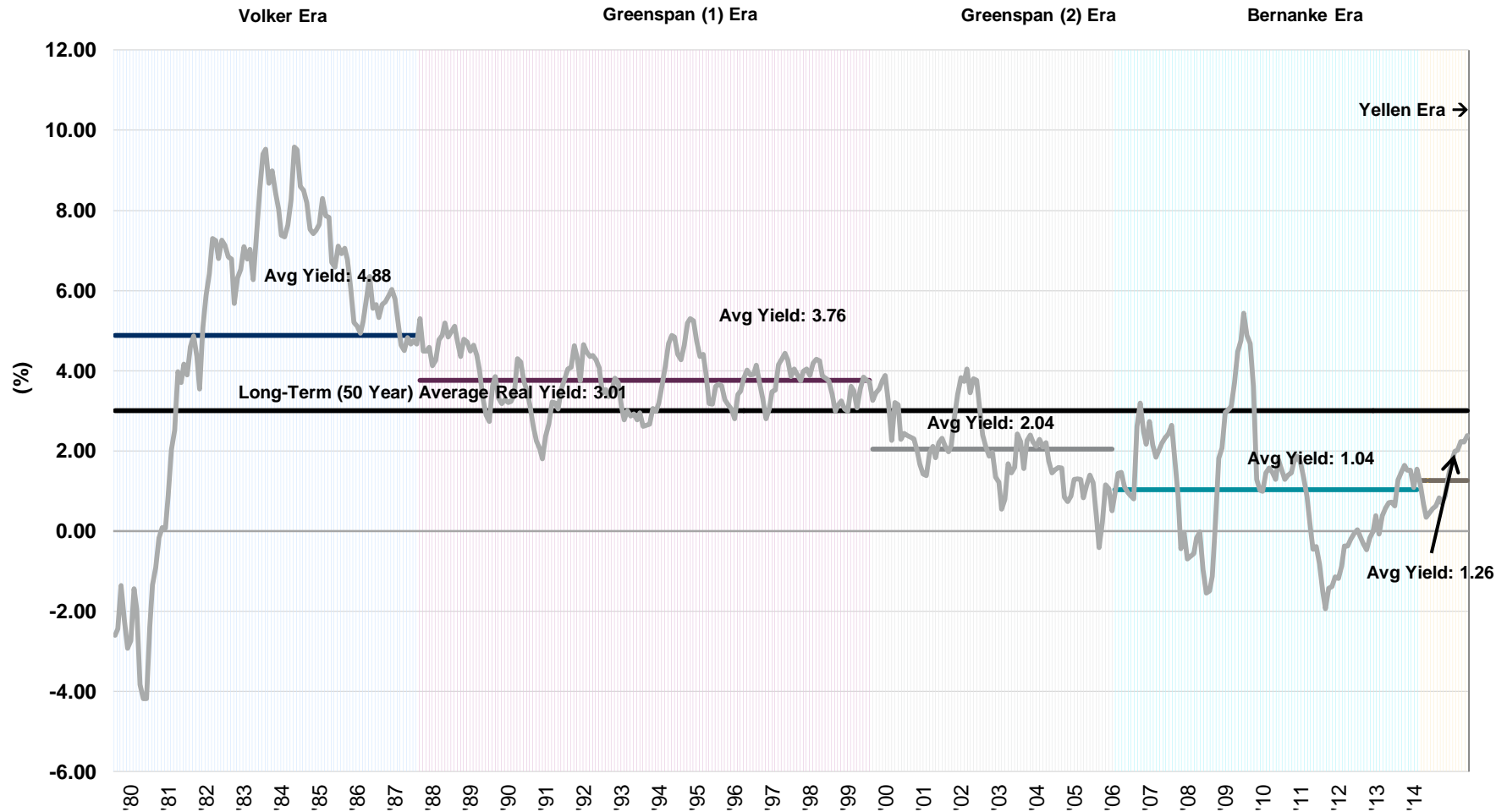


Source: John Hancock Asset Management as of January 1, 2015

# Bond Market Framework

## Where the 10 year Treasury is going and what it means

### 10 Year Real Treasury Yield vs. Long-Term Average and Average of Each Fed Chair Era

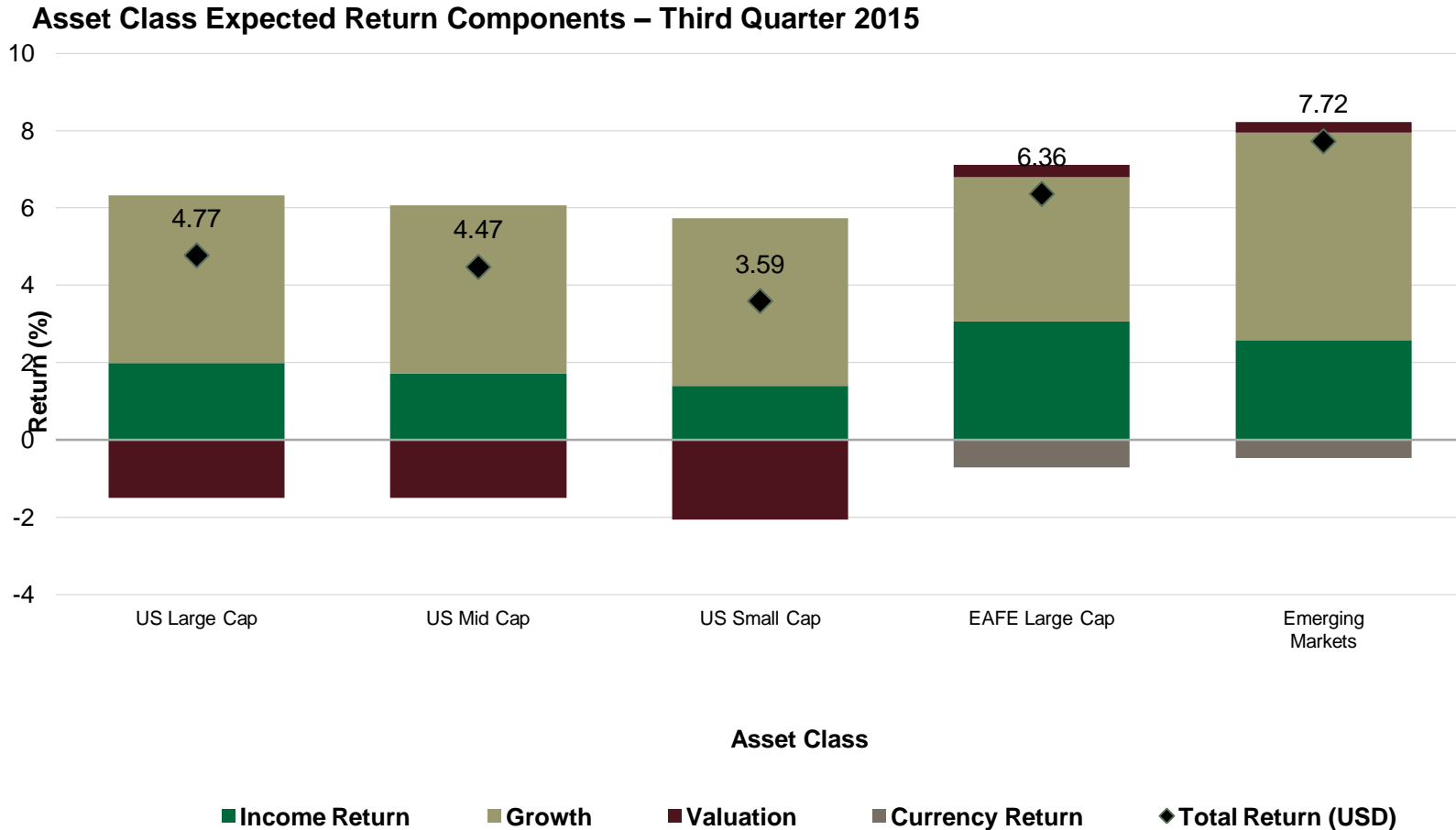


Source: FactSet, Bloomberg, June 5, 2015. Some of the most heavily traded securities in the world, 10-year U.S. Treasuries are the de facto proxy for intermediate-term interest rates. Past performance is no guarantee of future results.

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# 5-Year Expected Return Forecasts

*Developed Markets Similar; EM Expected to outpace but not without risk*

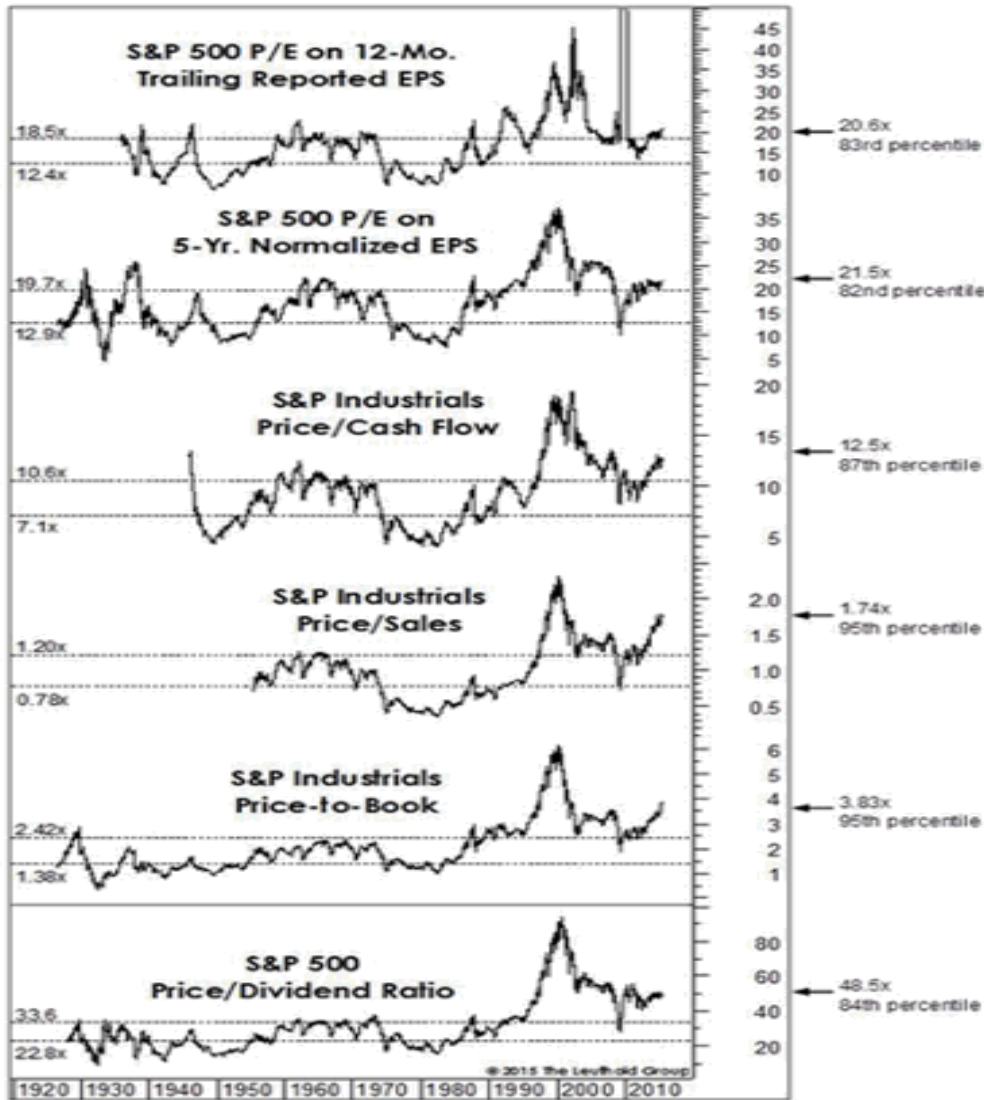


Source: Portfolio Solutions Group, September 2015.

Note: The above represents 5-year, forward looking predictions for specific asset classes using a proprietary model and are not meant as a recommendation to buy or sell any particular asset class, mutual fund or investment vehicle. Components not represented in the chart are zero or negligible values. Past performance is no guarantee of future results.

# US Equities: Valuations at Risk

## No room for misses



Dashed lines represent 36th and 70th historical percentile readings. Valuation levels associated with these percentiles are shown at far left.

### US Equities at 90th p'tile expensive

- no room for mistakes
- rising \$ is an issue, as it strains margins.
- so far so good but another \$ rise of 15% tips the scale.

Prepare for a profits recession at some point over the next 3-5 years.

Favors large over small at these prices

### Risks:

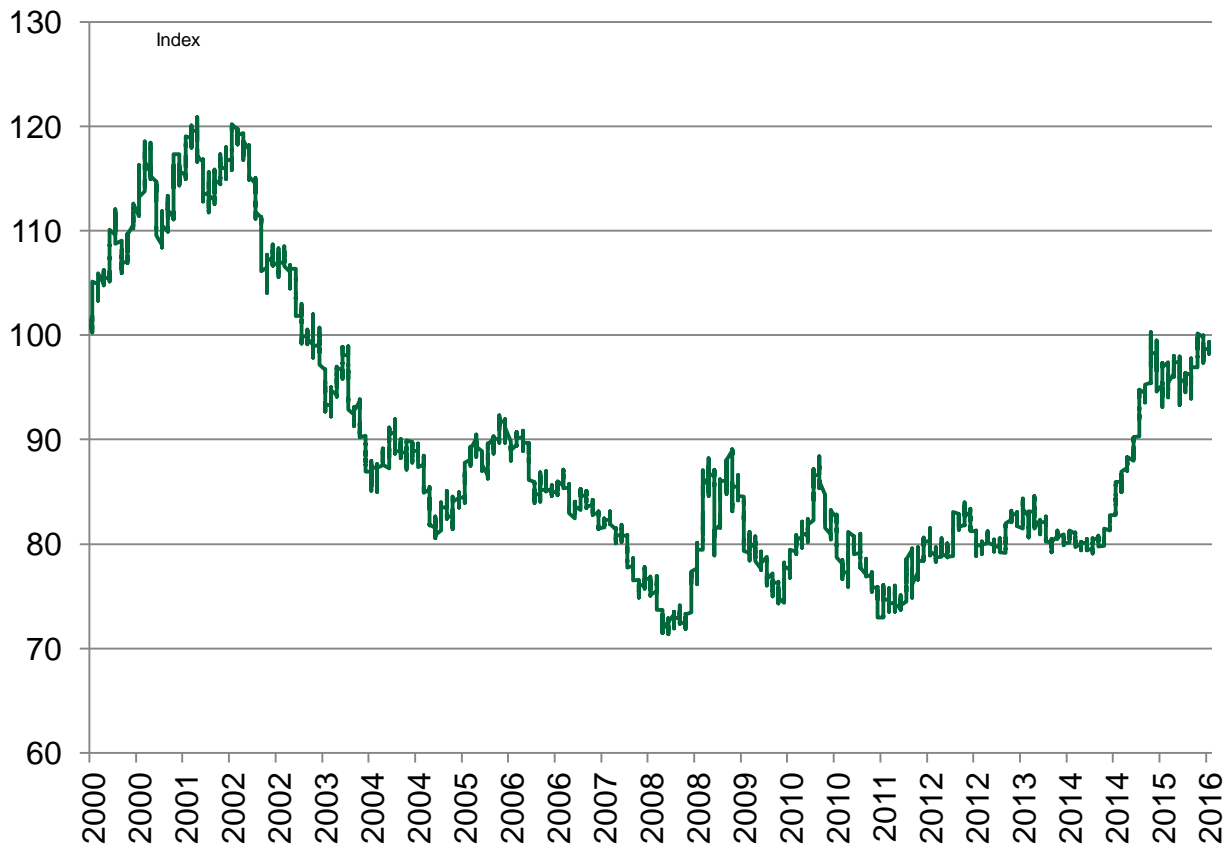
- US\$ rally.
- A savings-oriented consumer
- Technology



# US\$ ... winding up for another run



## DXY Dollar Index: Broad USD strength



Source: Bloomberg, Manulife Asset Management. as of Jan '16

# US\$ (up) vs GCSI Commodity Prices (down) same trade right now

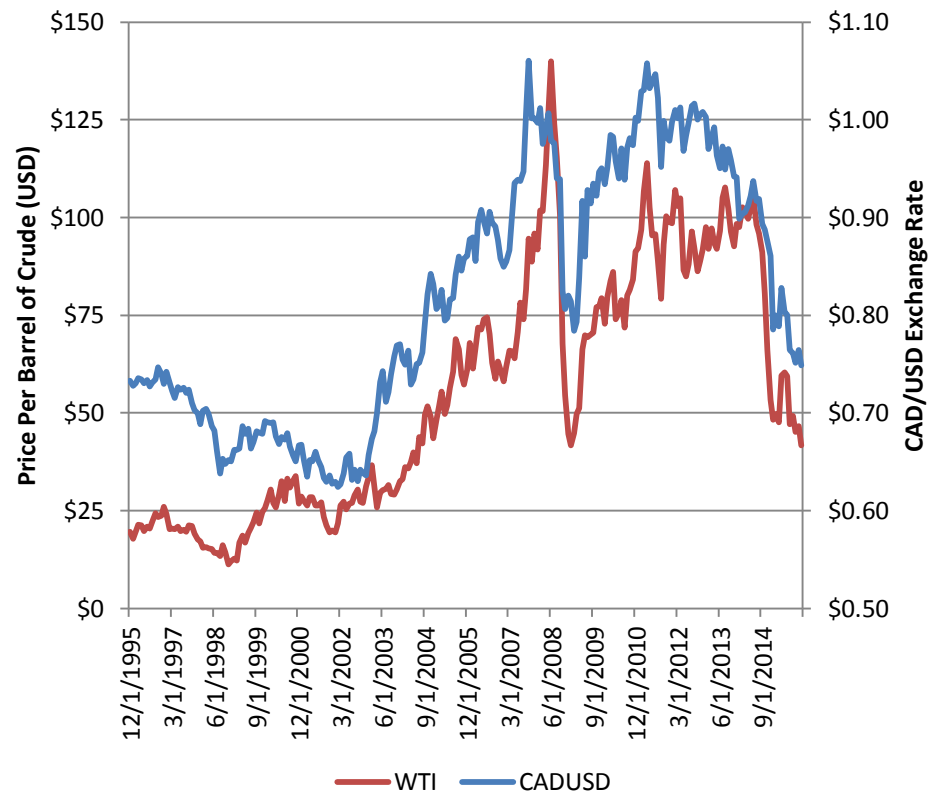
## U.S. commodity prices versus U.S. Dollar Index

Left scale—S&P GCSI Spot Commodity Price Index, natural log scale (Solid)

Right scale—U.S. Real Broad Trade-Weighted Dollar Index, inverted scale (Dotted)

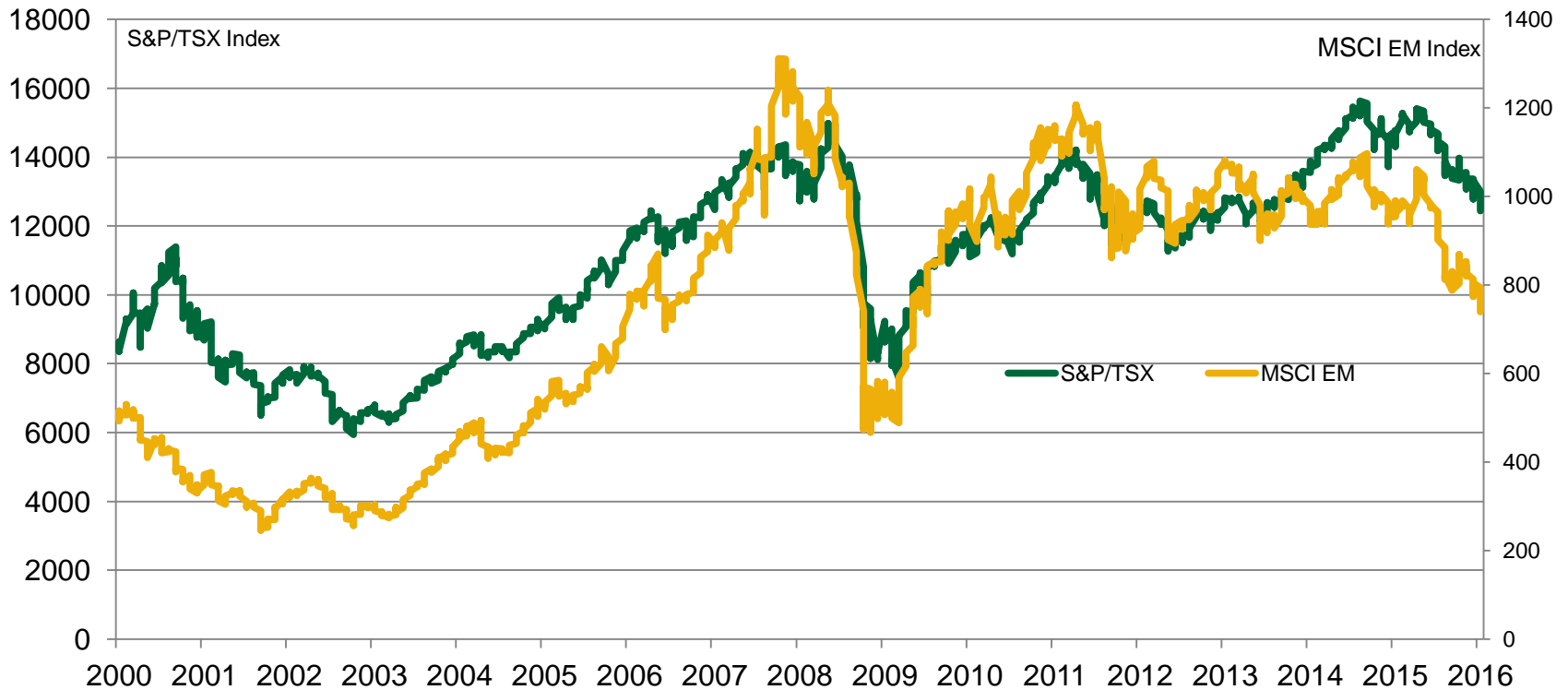


## Oil vs the Loonie



# Canadian equities more global than domestic

## Canadian equities trading more like EM equities

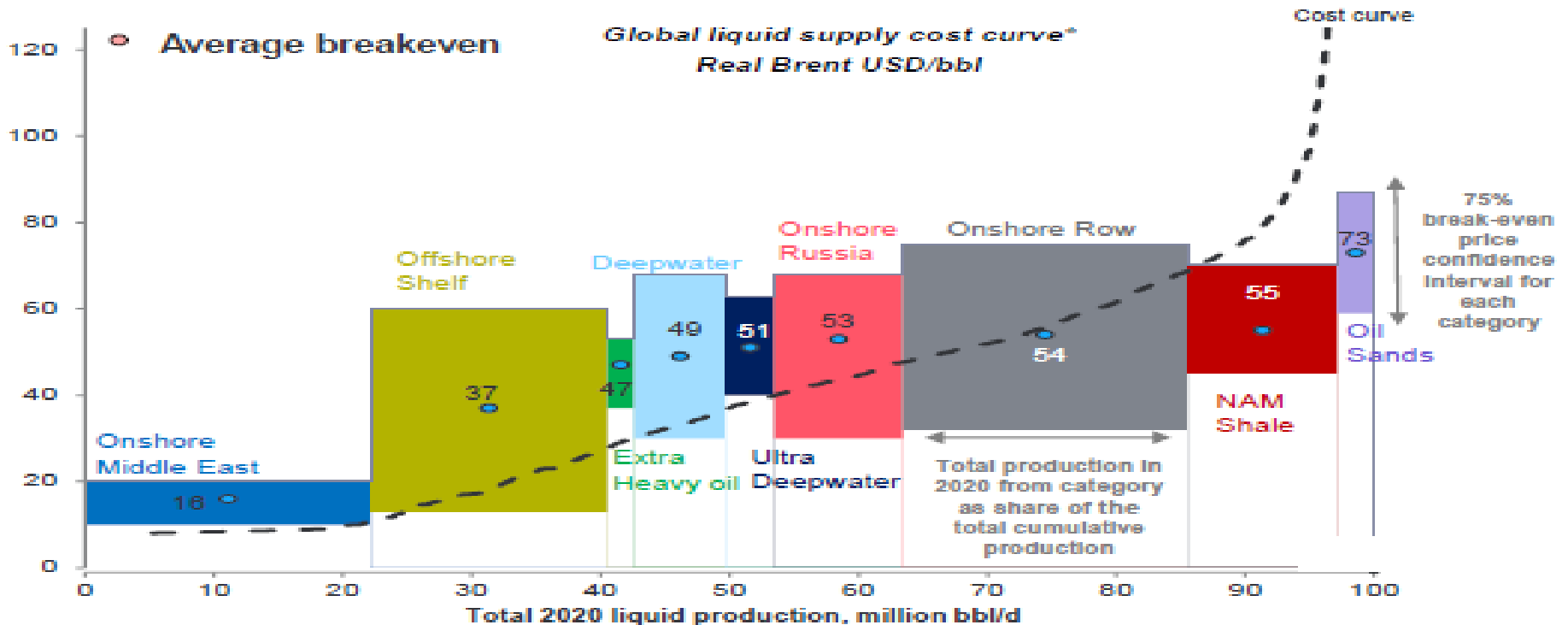


Source: Bloomberg, Manulife Asset Management. As of Jan'16.

# The Supply-Cost Curve

Demand growth at 2% annually requires 2mm bbl./day of new production each year (US shale added 4.5 mm bb/s over 7 years)

Conclusion: no new projects at these prices

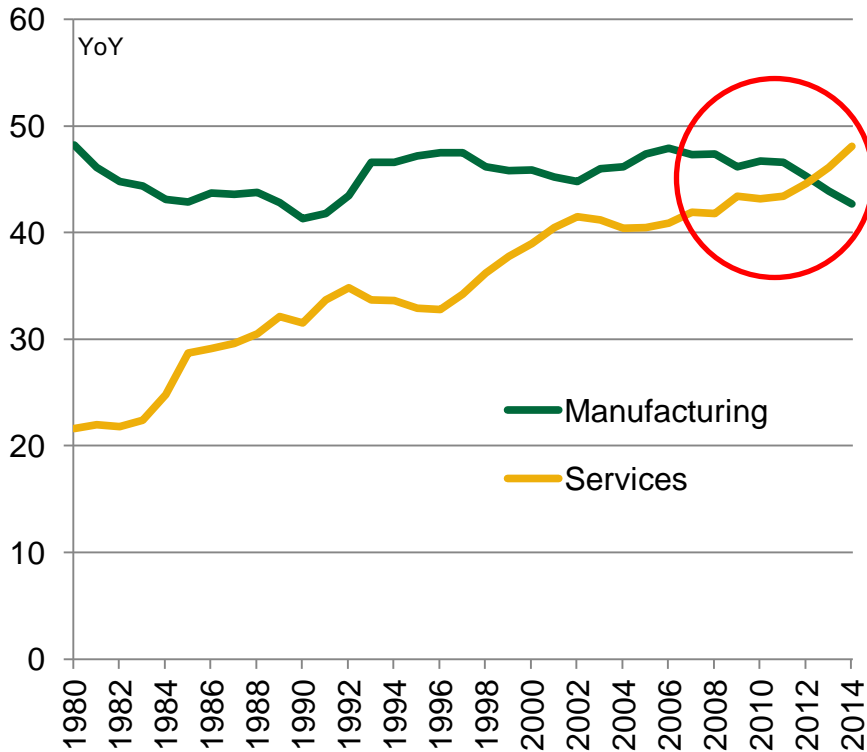


\*The breakeven price is the Brent oil price that gives an NPV of zero given a real discount rate of 7.5%. The boxes is an average of all fields within each category (producing, under development and discoveries).

Source: Rystad Energy UCube May 2015

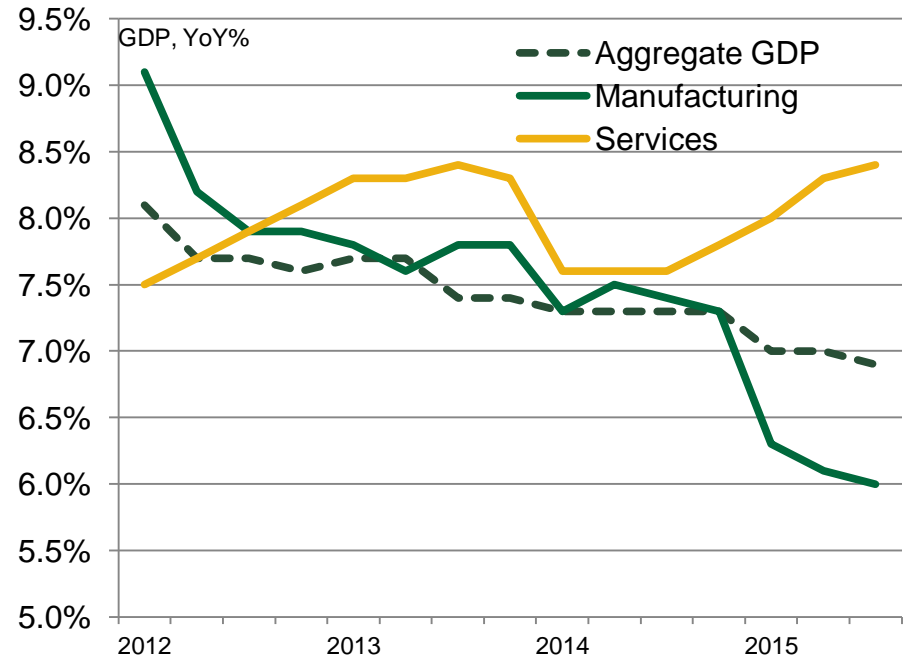
# China is a manufacturing vs. services story now... (...with a lot resting on services)

## Contribution to Chinese GDP, by sector



Source: Bloomberg, Manulife Asset Management. As of 2014.

## Chinese GDP: supported by services, dragged down by manufacturing

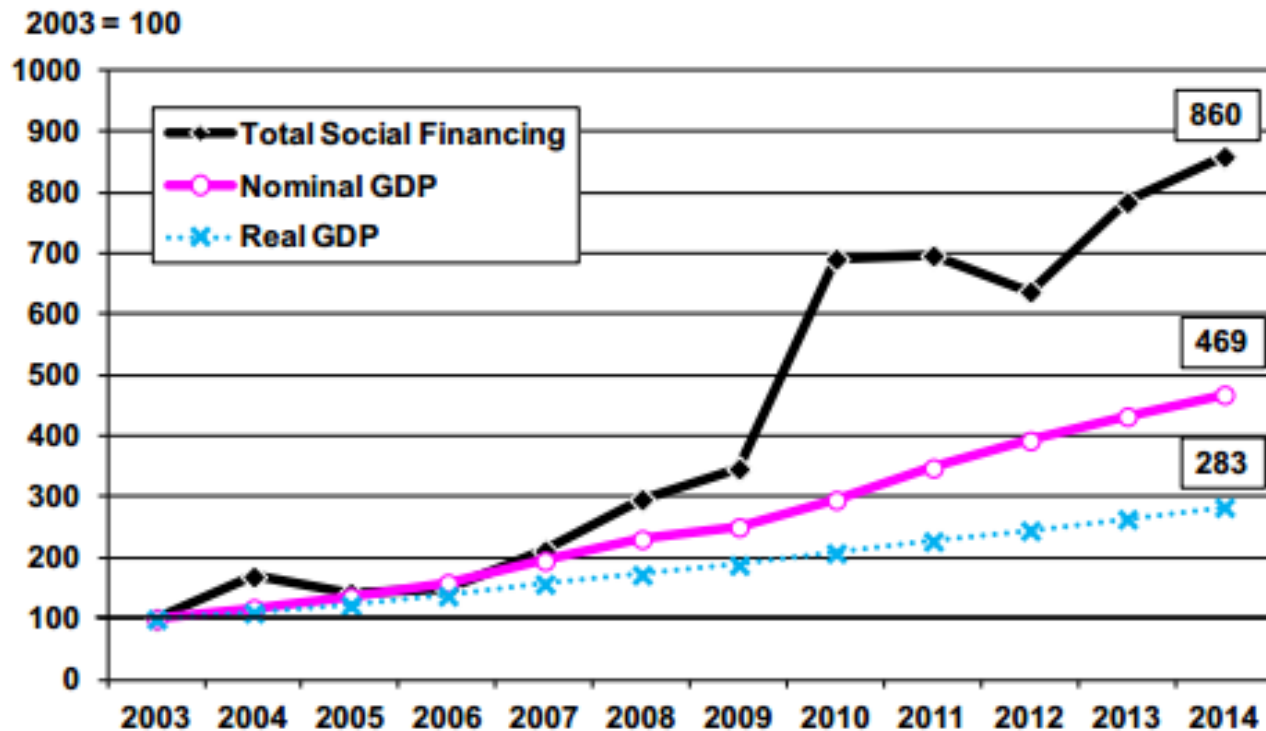


Source: Bloomberg, Manulife Asset Management. As of Q3 '15.

# China: Debt vs Restructuring

## China Credit Creation & Growth

Total Social Financing, Real GDP, Nominal GDP



CEIC, ISI Calculations  
donald.straszheim@evercoreisi.com

ISI Group

# Conclusions and Risks

## Overall investment and macro thesis.

- There are few if any cheap assets out there.
- Emphasis on beta tracking is in final innings
- Need to rebalance to more alpha, less emphasis on beta strategies.
- Allocators ceding more control of aa decisions to expert PMs to find alpha.
- Across all mandates, next 3-5 years will focus on alpha generation -- hedged equity, long short, TAA, DAA, absolute return-- not beta ( things are too expensive)

## Major Risks over the secular horizon

- US\$ produces a repeat of 1997-8 upturn. EM craters. EM debt craters. U S consumer does not come to the rescue as in 2000-02. [probability <20%.]
- Cyclical uptick in inflation turns virulent, fed is perceived to be behind the curve and makes a mistake. [Probability <10%]
- Market interest Rates react too strongly to Fed and rates climb too fast putting us into recession <5%
- Euro zone disintegrates. [probability <5% within 3-5 years]
- China's rebalancing fails. Another major RMB Devaluation. Debt spirals out of control. Govt is perceived to be ineffective [probability <20%]
- Cyber-terror attack dislocates the financial clearing system [probability <5%]