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This is the Private Wealth Podcast with Manulife Private Wealth.

Speaker Participants

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VP, Managing Director, Head of Manulife Private Wealth

Frances Donald
Global Chief Economist, and Global Head of Macroeconomic Strategy, Manulife Investment Management

James (Jamie) Robertson
Head of Asset Allocation Canada and Global Head of Tactical Asset Allocation, Multi-Asset Solutions Team

Presentation

Glen Brown, VP, Managing Director, Head of Manulife Private Wealth

Hello, everyone. Welcome and thank you for taking the time to join us for Manulife Private Wealth's Summer Webinar. My name is Glen Brown and I'm the Head of Manulife Private Wealth.

With news confirming the lifting of the lockdown restrictions, there's a sense of relief and a healthy dose of optimism as we head into summertime. It's a confirmation life can finally begin returning to business as usual, consumers can resume spending, jobs can resume, and policymakers can turn their attention to other pressing issues. However, the great economic reopening also brings with it a series of uncertainties. Today we will look beyond the reopening and provide macroeconomic pillars and asset allocation analysis that can guide investment decisions in both the near and the long term.

As always, the upcoming webinar is going to be videotaped and it's solely for information purposes. For those interested in a replay, we will be launching this onto our website at manulifeprivatewealth.ca, and also on our LinkedIn site at Manulife Private Wealth. If you have any questions or requests after this call, please feel free to contact any of the members of the Manulife Private Wealth team.

Our first speaker, Frances Donald, is the Global Chief Economist and Global Head of Macroeconomic Strategy at Manulife Investment Management. She analyses the economic and capital markets for potential opportunities and risks and serves as a thought leader both within the firm and externally. As a senior member of the firm's multi-asset solutions team, she coordinates macroeconomic research, assists in the team's return forecasting process, and contributes to portfolio positioning views. She's also a key partner to Manulife Private Wealth and we're thrilled to have her with us today. Frances, over to you.

Frances Donald, Global Chief Economist and Global Head of Macroeconomic Strategy, Manulife Investment Management

Thanks, Glen. I'm happy to be here and particularly because, you know, throughout the last year we've had these regular updates, how are things progressing, but right now literally in the last two weeks and into the next two weeks I do believe we're at a very interesting inflection point in the macro story. And we have a fantastic outlook that's coming out next week that talks about what this inflection point means, but I do think we could do a little preview today of how the way we're thinking about the world is changing and I want to do that in two steps.

The first thing I want to do is talk about why we believe we are currently at what I'm going to call peak macro – mostly because I feel like that would be a great slogan on a t-shirt. Peak macro, what does that mean, why are we talking about it, why is everybody else going to be talking about it. And then, part two, I want to talk about what that means for your investment outlook. And I think I'm going to give you a little spoiler here, peak macro is not as nefarious or negative as it might seem, we just have to get a little bit more creative about how we're going to position in the next year or two as we go through that.

So let's start with the first part of my comments here, what is peak macro. Glen, you talked about how we're all feeling a little bit more excited. My husband got his second shot today, he's taking it easy on the couch. I'm excited, I want oysters and beef tartare, the two things I have not been able to replicate at home. We're all feeling very enthusiastic about that and yet the expectations for our growth – Canada, U.S., Europe – have probably reached just as high as they can go. And so when we talk about peak macro, we're essentially talking about five elements of the macroeconomic story that have provided significant tailwinds to the economy starting in about March 23 of last year, the bottom of that equity market, up until now.

So what are those five areas that have reached peak? Well, the first one I will say is peak reflation. Now generally when we talk about reflation narratives, we're talking about positively framed increases in prices and growth. And if you use a four-quadrant system to measure growth and inflation, this is one of the more optimistic areas it can go in. Growth reaccelerating, inflation reaccelerating, typically a very good environment for equities over time typically associated with a recovery.

Now what we're witnessing is that as much as we are still feeling inflationary pressures in our life all of the time, most of the inflation data probably did peak out in May. That has to do with broad inflation measures like U.S. CPI, it also has to do with market-based measures of inflation like break-evens for example, consumer-based levels of inflation have peaked out and are now going to start to decline.

But problematically, areas of inflation are still going to remain persistently problematic, particularly supply chain distributions. Lumber prices have collapsed 50 percent, I know this because I am actively trying to build a fence and my costs haven't come down yet, but there are other areas like semi-conductor space, electronics, a lot of what is happening in the used car area that still are going to be problematically high. And this is one reason why we're going to move from reflation, the positively framed type of story, into a little bit more of concern about price pressures in select areas.

Now, just to give you one overview, we have written a lot about inflation. We do view inflation as going through three main steps. The first step is going to be this overheat strong inflationary pressures through to about September/October. If you want to say August or December go for it, I don't have that much conviction, but we're talking about a little bit of the fourth quarter.

We're then going to see a transition towards 2 percent inflation throughout 2022. A lot of those base effects come up; supply chain disruption is lower. And then in my view, we're going towards something I'll call the new inflation. I guess I'll make another t-shirt with that one, I can have a whole collection. The new inflation for 2023 where we're likely to see something around 2 to 2.5 percent inflation. Higher than pre-COVID, but nothing to become overly alarmed about.

So when we talk about peak macro, the number one area of that is peak reflation, inflation measures now coming down, we're talking a little bit more about concern about pockets of supply chain disruption.

The second area of peak macro is that we have likely seen the peak in monetary policy support. Now again, we're still going to be in extraordinary amounts of easiness from central banks. Central bank activity right now is still suppressing bond yields across the curve in every major economy, but every major central bank has now either directly or indirectly told us that they are beginning their normalization process. Of course, the Bank of Canada is front of the pack, they began tapering in April and they've in some ways been one of the most hawkish along with the Chinese Central Government, they are indicating whether they mean to or not a 2022 rate hike.

The Federal Reserve this past month, another reason why people are talking a little bit more about peak, told us that that was the meeting where they talked about talking about tapering. And then you might remember Chair Powell asked us to stop using that expression, but I still like it. So we know that a taper is coming from the Federal Reserve in the months ahead. I believe that we will either have the taper fully priced or at least – or implemented by the end of this year and that's an area we need to watch.

Now interestingly you might think OK, well if there is a tapering and we've seen peak monetary policy that must mean we're going to see interest rates shoot up, but I'm not entirely convinced of that. We do believe that interest rates will slowly start to rise but I don't think it's going to be Fed-driven. For one, the Fed has already told us that they are going to be implementing a taper, it's known information. If everybody knows it, chances are it's probably in the price to a certain extent.

The second is that the market has already priced a pretty hawkish Federal Reserve. There's three rate hikes priced in this market by the end of 2023, one of those is in 2022. It's really challenging to get more rate hikes priced in and, in some ways, we actually expect that the central bank will try to push back against some of those expectations for a 2022 rate hike. We may even see the curve flatten a little bit along that process.

The third area of peak macros is peak fiscal support. This is largely a U.S. story but to a certain extent Canada as well. We of course experienced the greatest fiscal policy response we've seen in modernity or in recent history or actually in the past 100 years, all the data that I have, and that was actually necessary. We do believe if we hadn't experienced that we would be in a great depression.

Problematically a lot of that short-term support is now being withdrawn. Twenty-five states in the United States have pulled back on their additional employment assistance and now we're left with a giant hole. Yes, you might be thinking, "Aren't they going to be passing an infrastructure package in the U.S.", they probably will but problematically infrastructure – and we actually know this as Canadians because we've experienced this in the past – are not really shovel ready projects. Most infrastructure projects take three to eight years before they hit our real economy. So the U.S. is actually heading into a growth pothole in 2022 and 2023 and, unfortunately, it doesn't look like they'll be getting any more stimi-cheques as we increasingly call them. Similarly in Canada, while we are still going to see very high levels of support, it is going to start declining on a year-over-year basis.

Another area we need to watch is of course China. If you read anything we've written, we've been talking about this since January. China was first in first out of the COVID crisis and therefore they've experienced their ramp-up in growth, they experienced the beginning of their tightening cycle and unfortunately what happens in Chinese monetary policy hits all of us with a lag of about 10 to 12 months. Their growth impulse has been slowing very dramatically, that's also going to reduce one of the tailwinds that supported us in the recovery and be incrementally less supportive for us.

The last element of the peak framework is that we need to watch a lot of data is now going to start decelerating sharply. And as I said, you know, I'm going to be out there. As soon as we're all double-vacced and I can go and the restaurants are open, I will be there. I will go to the gym when it's safe to do it, I want to spend all my money out of my house. It might seem like there's a lot of spending to be had but as we go into the second half of the year we're going to see a transition from the things that we spent money on during COVID – housing, cars, appliances, I bought a $250 toaster because I thought I'm making a lot of toast lately, I really like it but let's be honest it wasn't necessary to do that – we're now going to be transitioning to new forms of spending. And, when that happens, the items that ramped up in the past year are going to so-called mean revert downwards, but that mean reversion back to where we were pre-COVID is going to be sharp and a little bit painful.

And one of the best examples of that is U.S. housing activity is already sharply decelerating, new home sales are down about 20 percent from their peak mortgage applications falling, retail sales on balance are also going to pull back, those stimulus cheques have now been spent. If you want to know how we know that, we were looking at debit versus credit card activity and most of the stimulus cheques, if you have any American friend send you a picture, came on a debit card. So we saw a ramp-up in debit card purchases. Those have now fallen back and people are now starting to use credit cards again. Debit cards loosely, stimulus cheque money, credit cards, their own money, so we're feeling that coming back.

Now critically when we talk about PQS data, peak monetary policy, peak fiscal policy, peak macro, we're still talking about extraordinarily high levels of activity, we're still going to be near some of the highest growth we've ever seen. And that's what makes this environment so complicated from an investor perspective is how can you, you know, rely on those second derivative changes and how can you say we've reached peak but we're still at historically high levels of stimulus, historically high levels of growth. Well it makes it a little bit tricky and the way we think about it is we have to figure out which regime we're heading into next and to me, there's two candidates.

The most likely candidate – and I think Jamie and I are on the same page about this – is that we're heading into a period that we call Goldilocks. Goldilocks is a period economists refer to where interest rates stay relatively low because macro has probably peaked, but growth is still quite high. That's probably where we're heading into next, but we do need to take into consideration that it's possible that we see both inflation and growth start to decelerate from here and that can be more problematic. I think we'll have a good idea of which regime we're heading into probably in the next two months or so, so it is a really key period where we feel a little bit in limbo.

So what do we do? I have five things that I think we can do as we wait, as we think about the world. And again, I am sort of working with Jamie on an ongoing basis and we have to have sort of some of these what do we do in the next three months views. Generally what I advocate is keep your big picture hat on so no matter what the volatility produces in the next two months, really consider which regime are we going into in the next two years or so. Keep that long-term perspective because there is going to be some bumpiness here.

So number one for us as we navigate this, we do need to understand that our return profiles going forward over the next year are probably not as juicy as they were starting in March 23 of last year. We're moving from early-cycle to mid-cycle, that's pretty natural. Now our negative returns just slightly reduced over that period.

Number two, I am a big believer right now in best-in-class stock picking, best-in-class sector picking, best-in-class credit picking. And I will admit to you it pains me to say this because I am a macro strategist. Earlier on Monday I was on a call with Jamie and the whole team globally and I said, "My best advice right now in the next couple of months is stop listening to me" and trust me, I hate saying that, "Start thinking about your best active managers, the best stock pickers, the best credit pickers because they're the ones that are going to help you navigate some of these price pressures on a go-forward basis".

The third thing we need to do I talked about a little bit. We are moving from early-cycle to mid-cycle, it's a very compressed economic recovery now. We're only a year off of the worst of the recession and are already talking about mid-cycle. We do need to monitor for late-cycle dynamics but I don't think we're quite there yet and when we transition from mid-cycle to late-cycle, it's likely going to be a function of how much CapEx we see and business confidence we see. So those data points are going to very important to me. Hopefully, when we talk in three months, we can have an update on that.

Four here is again, you know, there's a lot of perspective out there that we're going to see yields ratchet up very, very quickly. And I still have a 2 percent target for the 10-year by the end of this year. I'll tell you something, that's everybody's target for the end of this year. Some people and the outliers are saying different things, but I have a little less conviction on that than maybe I did a few months ago.

The biggest translation from peak macro to the broad process environment is probably that it keeps yields from taking off too quickly, too aggressively because yields are going to be just a little bit more worried about growth and the future that we're going on to next.

Last but not least, whenever we talk about where things are maybe not going as well, we have to talk about where there are opportunities and even in this peak macro-environment there are a lot of opportunities. So a lot of people will say to me, "Everything is at peak", my response to them is, "Find the things that are not yet at peak" because that's where there's going to be opportunities. I like incrementally adding to Europe, for example. We've become very focused on emerging markets and being selective within it. There are certain emerging markets that look real darn good right now, places like South Korea, Indonesia, we talk a lot about Brazil and within that environment, we do still believe that there are some upsides. Even sectors, energy is still an area that I think has not quite yet peaked for supply-related reasons.

So as we're facing this little bit more challenging type of outlook ahead, there's still lots of possibility for return, we just got to get a little bit more creative about it. We are at a regime shift, that I think is when your underlying managers, that's when Manulife Private Wealth is going to shine for you in exactly these types of environments.

So I'm going to just pass here because my colleague is here with us today, Jamie Robertson. We work together every day all day – he's probably rolling his eyes thinking, "I know. How much of a saint am I to do that". So I'll pause here. Again, we have a great report coming out next week, it's over 35 pages of everything I've talked about peak macro. And if you need something from me, reach out to your Manulife Private Wealth individual and they'll get in touch with me, and we'll help you out. Thanks again.

Glen Brown, VP, Managing Director, Head of Manulife Private Wealth

Frances, thanks so much. I'm really looking forward to the Goldilocks period. I haven't actually heard that one before. Manulife Private Wealth aims to provide institutional expertise based on your personal goals and through a disciplined and detailed process, Manulife asset solutions team has developed priority asset models for Manulife Private Wealth. These models leverage the framework and methodology Manulife developed for its own balance sheet of investment. Historically this has been available only to institutional clients and this sophisticated process is available now to high-net-worth Canadians through Manulife Private Wealth.

Our next speaker, Jamie Robertson, is responsible for overseeing all aspects of the firm's Canadian asset allocation franchise, including portfolio management, research and development, product development, business development, and trading. He leads the Canadian portfolio management efforts across a wide range of multi-asset and multi-manager solutions. In addition, as global head of tactical asset allocation, Jamie takes a leading role in driving the positioning and portfolio construction process of tactically oriented solutions globally. All of the asset mixes that Jamie and his team provide are a key element to Manulife Private Wealth and we're really pleased he can join us on the call today. Jamie, over to you.

James (Jamie) Robertson, Head of Asset Allocation Canada and Global Head of Tactical Asset Allocation, Multi-Asset Solutions Team

Thank you so much, Glen, and thank you, everyone, for joining us today. I do want to clear one thing up at the outset. I have to tell you that we don't always do what Frances tells us to do, so when Frances tells us to ignore her we don't. We continue to listen to her, and we continue to value her advice on an ongoing basis. So I just want to make sure that just because she tells us to ignore her, we do not.

Normally what I would want to do is I want to go through three things today. I want to talk about the team a little bit to give you a sense of the firepower, the manpower that goes behind the asset allocation, the allocations that we provide for Manulife Private Wealth and you. I want to talk a little bit about the importance of asset allocation and the importance of having a proper time horizon. And then I'm going to talk to you about our process and how we actually build these portfolios and what the nuts and bolts of that are.

So normally I would start off with a slide and really what it would show, it would show that we are the largest portfolio management team at Manulife, we got about $140 billion of AUM. We've got over 35 investment professionals, we've got offices in Boston, in Toronto, Montreal, London and Hong Kong. But really that would be superfluous a little bit just because you've had the opportunity today to listen to the chief economist of Manulife, the head strategist for Manulife Investment Management and most importantly she's part of our team. So if you have any question about the resources that we have, the commitment that we have, the real firepower that we have behind this team, you can rest assured that this is a very committed team.

All we do is asset allocation; we don't do anything else. We have 35 people who get every single morning with one singular focus in mind of how do we allocate the next dollar of clients' capital to where it's going to be treated the best. That's all we do, a huge team behind it, a lot of resources, Frances is a key component of that. I get a chance to listen to Frances every day, I talk to her every day. This is a very complex world, she makes it very, very simple and it's of enormous value to us.

So what I ask then is why is asset allocation so important. My apologies, it's a little bit of a noisy slide here but I do want to point out a couple of things. That purple bar across the bottom, this is the difference in any given year between the top-performing asset class and the worst-performing asset class. So let's just look at the column of 2016.

In 2016 the difference between those asset classes was over 40 percent. So the red box shows you that Canadian small cap equities returned 38 percent that year. In the same year, that same 12-month period, that international equities were negative two. So what this really tells you is that in any given year, over any time horizon getting the asset allocation correct, you know, is an enormous benefit. If you're thinking about, which we do, you know, we're trying to create solutions. We're trying to get – you know, it might be to increase your wealth, it might be to build up a retirement nest egg, whatever the solution that you're looking for, that's what we are trying to create and you got to get the asset allocation right.

The other thing that to me is so interesting is the 2020 experience. I would never have guessed on March 23 when the S&P was down 35 percent, when credit spreads had blown out to such an extent that you had fixed income securities that were having negative returns year to date, you also had a market that was, you know, largely broken when you think about it because a lot of our portfolios, particularly in the tactical space where I spend some of my time, you know, these were instruments that were trading at huge discounts of their underline. So you had massive, massive dislocations occur over basically a 20-day period last year in March.

But after all was said and done, it was a year where basically everything sort of made you 12 to 14 percent. We had the smallest dispersion of returns in the course of the year at only 12.3, that's the lowest we've seen in five years. It's a very rare event that virtually all asset classes did very, very well in the teeth of the worst recession since 1946, one of the largest drawdowns in earnings. It was really quite surprising. But the bottom line is you've got to get this asset allocation correct because it has a major, major impact on the type of solution and the type of results that you're going to get.

So what do you need to get that asset allocation correct? Well, you have to some idea of what the expected returns from those asset classes might be. You have to have a sense of how those asset classes are actually going to interact with one another, you know, their correlations. And you're going to also have some sense of how volatile those asset classes are. But you also have to have the right time horizon and I want to show you, you know, what I think is an interesting conundrum shall we say.

So here's a slide that potentially, you know, an advisor could go to you and say, "I know we want to create value over time. I know you've got these particular goals. How about we allocate to this asset class". And as you can see, you can go wow, in 1985/1986 you're looking at returns of 35 percent, you know, it breaks your heart in 1988, it goes down minus 20. You get these fantastic periods of time and you get these horrible periods of time and, you know, 2008 you're looking at ranges between down 45 and up 55, right.

So if you wanted to build, you know, a path to wealth, a path to capital appreciation, this might not be the most comfortable ride that you would be looking for. This might not be the perfect choice for you, but maybe on the next slide this might seem to be a little bit more appealing.

So here is a different return profile and, as you can see, this is an asset class or a return profile that is much smoother. The declines are much more muted. You're not looking at 50 percent declines in some periods, you're looking at negative five, negative six, negative seven and you go through very prolonged periods of time where you're looking at basically around 15 percent – 12 to 15 percent. Yes, you have some disappointing periods but you don't have these gut-wrenching experiences. So this is probably something that you would be probably more interested in. This is what I'm more interested in, frankly.

And on the next slide you can see that this is a bit of a canard because it's exactly the same asset class. This is the S&P. The first one I showed you in purple is if you look at it on a one-year time horizon and the orange one is if you look at it over a five-year time horizon. We always say, advisors will tell you take the long run, look to the long view and you really, really should. You should ignore what's going on in CNBC and Cramer and what's been shown, you know, what you're reading in the financial press as they talk about doom and gloom. Really what you're looking for is a smoother run and you get that with that longer-term horizon.

You know, someone like Warren Buffett will tell you that, you know, one of his competitive advantages is, is that he can take the longer view. And anyone sitting on this call who's owned a house for more than 10 or 15 years or who's owned their company stock for more than 10 or 15 years or has held assets for a very long period of time understands that this is a key component of building wealth is to take that longer view, don't make huge changes, don't try to market time, and actually think of drawdowns as an opportunity to add to positions. So I just think that really try to divorce yourself from the noise that you hear on an ongoing basis and really, really focus on where you want to be in five or 10 years.

So how do we build portfolios, like what are the foundations of our portfolios? Well, what we do is we build portfolios, not surprisingly, with a five-year time horizon because we're looking for trying to achieve those type of returns and those type of outcomes over a five-year horizon. Five years makes a lot of sense for a number of reasons.

First of all, we're building strategic asset allocation for four years. We're not trying to trade in and out of the market, all the friction that comes with that, the tax consequences that come with that. We're trying to build for the longer run so five years makes sense from a strategic asset allocation perspective. But it also makes the most amount of sense because really what our research has shown is that five years is the shortest period of time over which you can actually capture market inefficiencies. And really what I'm referring to there is how do you capture a situation where an asset class has become extraordinarily overvalued.

You don't want to be buying extraordinarily overvalued asset classes, at the same time what you really want to do is you want to gravitate towards cheaper asset classes. You know, you want to buy things when they're cheap. So what our research has shown is that five years is the shortest period of time over which you can expect to see some sort of mean reversion, some sort of return to the more normal valuations.

And when I think of, you know, my experience in investing and in trading, you know, in 1999 equities got very, very expensive. If you had sold them, you would've looked pretty foolish for a year or so but five years later you would have looked very intelligent. Same in 2008/2009, you know, equities became very, very cheap, and sure enough by 2013/2014 all that valuation expansion had occurred and you had gone back to more average valuations and actually it got a little bit more expensive.

So we build portfolios, we have a five-year lens, it's appropriate from the terms of our process and it's a very rigorous process that we go through. So we meet quarterly and it's a series of three meetings that we go through and Frances is involved in each one of them. The first one is the macro where she's giving us expectations in terms of growth, you know, in terms of inflation, monetary policy and interest rates. So that's the first of this and this goes on. The next one is a very deep dive into equities and the third one is a very deep dive into fixed income and I'll speak a little bit about how we do that. And in each one of these things, you know, there's a number of components that go into it.

So let me go to the next slide to show you how we think about building, you know, an expected return forecast for an equity market and we sort of decompose it into basically four factors or four components that go into coming up with an equity expectation.

So the first is, you know, why do you buy equities? Well, part of it is you'd like to have some dividend yield. Dividend yields are very observable, they're pretty stable over time. So that's the first component that we look at. We look at what the actual dividend yield for each of the components are. So each country that we look at, each region, each sector we're looking at what the dividend yields are.

The second thing that we're doing is we have to come up with some idea of what the price appreciation might be from buying an asset class such as equities and again our research has shown is that within the developed market, you know, nominal GDP is a pretty good proxy for price appreciation. So generally speaking when you hear about GDP, you're going to read in the paper that – you know, they talk about real GDP. They talk about what GDP is actually doing, but if you add on the amount of inflation that's in the economy that gives you nominal GDP and it's a very, very good proxy for price appreciation. Now not necessarily for every market, certainly for developed markets but in emerging markets that's not necessarily the case. We factor that in, we make adjustments and we move forward.

The third thing is, is we think about that valuation component. So if we're thinking about an asset class that's extraordinarily expensive, you know, we are going to factor in that there is going to be some valuation compression that's going to drag on returns going forward. Conversely, if it's a valuation that's very cheap we're going to expect to see a little bit of a boost as those evaluations return. So we break it down in terms of what we can expect to see from an absolute valuation perspective.

And then finally in Canada – this is less of an issue for certainly our colleagues in the U.S. – is we have to have a sense of what the currency is because obviously in Canada we've got a lot more assets that are denominated in other currencies, primarily the U.S. Dollar. So we have to take into consideration whether we think that over that five-year time horizon the Canadian Dollar will be appreciating which would be a drag on foreign returns, or it's depreciation which would boost foreign returns. So that's the fourth adjustment we make.

The graph at the bottom shows you really, you know, why that whole issue of nominal GDP versus the S&P price level is a good one. This goes all the way back to 1950 – it's always nice to have 70 years of data – and you can see that there are periods of time over which, you know, nominal GDP will lag the S&P and sometimes it'll be ahead of it. But generally speaking, it's a pretty good proxy and you can see that over time that's actually worked very, very well.

So that's how we think about, you know, from an equity standpoint. We're taking into consideration what the dividend yield is, we're taking into consideration valuation is going to change, we're going to take into consideration nominal GDPs, and we're looking at the currency component.

When you look at sovereign bonds it's a little bit more straightforward because really what we generally characterize is, you know, what you see is what you're going to get when it comes to sovereign bonds. So, for instance, right now with 10-year notes in the United States yielding 1.5, you know, you're kind of going to expect that. So really what you see on this graph in that orange or brown line – I always struggle, I'm a little bit colour blind so I always have a tough time with this – but you can see that that's the return that's lagged on a 10-

year basis and what you see on the purple line is really where current yields are.

And really, for the most part, they are going to – if you invest in a 10-year bond, you know, over time that's pretty much what you're going to get and if you don't, if you get a period of time over which – we got thunder in the background and lightning, I don't know if you can hear that or not – but if you're in a situation where you've got higher returns it just means that interest rates have fallen and similarly, you know, if you've got lower returns it implies that interest rates have risen.

But really in the case of sovereign bonds, what you see is what you're going to get. That's not to say it's not a very involved process because as we go through it we're looking at what high yield looks like, what bank loans look like so we're coming to some agreement as to what we think spreads are going to do over that time horizon. In the case of say high yield you're going to have some losses that are going to occur so you have to think about what the recovery rates are going to be. But generally speaking, you know, the cornerstone on the fixed income side is those sovereign bonds and it's a little bit more straightforward.

So as we go through that, we end up with our expected return forecasts. We share these with Glen and his team, I'm sure that Glen and his team make them available to you. If they don't, I'm sure that they would be prepared to do so – at least I would hope so. But really what you're looking at here is these are expected returns over that five-year time horizon and I want to bring a few things to the fore.

So on the left-hand side what you see all the way to infrastructure, those are the equity returns. But on the right-hand side, you can see that this is where you're looking at more of the fixed income components. So, for instance, the Canadian investment-grade bonds right now we're looking at about 0.9 percent, for U.S. investment-grade bonds we're looking at 0.2 percent. So that means is we are expecting a steady increase in interest rates, nothing draconian, nothing that is going to result in very negative returns, but certainly not a particularly attractive asset class.

High yield and emerging market debt, these are high-quality asset classes that again have historically generated equity. Not necessarily equity-like, but equity light returns. So these are asset classes that have a little bit of a growth component to it. You know, you're taking on a little bit more credit risk for earning a significant amount more of spread, but right now those are levels actually that are pretty low in our book as well.

U.S. high yield bonds, you know, those are spreads that will blow out to, you know, 10 percent above sovereign bonds from time to time and we're currently way down at 314 basis points above it. So when you think about it, it's got a current yield of about 5 percent so, you know, not one of the sweet spots from the perspective of high yield bonds. So we would expect high yield bonds to have somewhat more muted responses here. Sorry, I haven't been in a thunderstorm for so long that I'm sort of taken aback here. And then similarly with emerging markets, you know, you're looking at rates that another high-quality asset. A great story in emerging markets were all those – the creditworthiness of all those markets has improved over time.

But the crux of this is, is pretty muted returns on the fixed income side of the asset allocation. Not to say that they don't have a place in asset allocation because there is certainly a diversification benefit. Certainly, if we got into a situation where markets, you know, really ran into some significant level of difficulty, you know, we would anticipate that those asset classes would provide more attractive returns as well as providing that diversification benefit.

Let me now switch over to the left-hand side. So we're looking at the equities here. Sorry, if you could go back one more, just go back to my equities. Thank you very much. So what you're looking at here are returns that, you know as Frances was saying in a Goldilocks world you're going to see positive returns but somewhat more muted returns and over a five-year time horizon this is what we would be expecting.

I would draw your attention, for instance, to the third one from your left which is U.S. large cap. So U.S. large cap at our estimation because of that green bar which is the valuation drag that is going to come to bear on U.S. large cap, we're looking at about 3 percent. That's barely half of what its long-term averages are. So you can imagine that we're probably a little bit less interested in U.S. large cap at this particular point on the margin.

The second thing I would point it that emerging market equity is still an area where we feel that although valuations can be a bit of a drag over the next five years, the growth component is so much more compelling, the dividend yield is more interesting than it is in the U.S. and certainly if we ran into a situation where a more normal world unfolded, you know, the funds will flow, capital will flow to those higher growth areas and certainly emerging markets would be an attractive asset class. Infrastructure again, you know, at a little over 6 percent is pretty attractive as well.

On the other side you Canadian large cap equities and Canadian small cap equities. This is a very interesting asset class to us. This is one of the equity asset classes that relative to the long-term valuations that we look at are less expensive. There's a very minimal drag from a valuation perspective. We've got, you know, a much more attractive dividend yield in Canada, as well we've got a growth component that although not quite as substantial as the U.S., is still very, very attractive. So, you know, there's a lot of research going around now in terms of how cheap Canadian equities are to the U.S. You can slice and dice it in a number of ways, but I certainly concur that Canadian equities are a very attractive place to be.

Frances mentioned earlier, you know, that energy is one of the areas that she's a fan of. You know, we are a fan of energy equities at this particular point. You know, I think that the big surprise is, is that as you head into this world that's really preoccupied with carbon neutral and with the elimination of fossil fuels, you know, you're into this perverse sort of world where you got crude oil almost at $75 and it seems to be in a situation where it's suffering from a lack of chronic underinvestment. Not only at a capital market's perspective, from an investment perspective, but also at the company level as there's been a lot of pressure on energy companies to be more capital discipline. So we definitely like Canada and Canadian small caps would be an interesting area as well.

So one thing I want to point out or one thing I want to highlight. For those of you who have not heard me speak before, I would think that I might not have all that huge amount of credibility, you know, if I came to you said that I could predict equity returns within 10 basis points over a five-year time horizon and I would agree with that. I don't know whether U.S. large cap are going to be negative three, plus three or plus six over the next five years but I do know that from a perspective of valuation, relative growth rates, dividends, you know, the U.S. is a less attractive asset class than a lot of other areas.

So really, it's not so much, you know, the absolute returns that are the key component from us, it's the ordinal rankings of these returns that are important because we're building portfolios that on the margin are trying to generate the highest expected risk-adjusted returns. So we're making tweaks along the way and we want to allocate to asset classes that are a little bit cheaper.

So really, you know, that's how we start to build a portfolio. That's like the key building block of the portfolio is these expected return forecasts. We will then take all these expected returns; we will feed them into an optimizer that will take into consideration correlations and we're constantly looking as to whether correlations are remaining constant or whether there's a structural shift on that side. One of the things that's tricky about correlations is when you get these difficult periods of time, you know, you do get correlations will go to one and that diversification benefit in a very, very short period of time, you know, will look a little bit more obtuse and this is one of the other reasons why I would just encourage people to continue to take that longer-term view and think about where you need to be in five years or 10 years down the road.

So that's the crux of the way we approach it. You know, what you have behind the scenes helping out Glen and his team is the asset allocation team that has been doing asset allocation, you know, on a fully dedicated basis since 1994. We have an enormous team behind us, we have a process that has been time tested, we've gone through all market cycles. You know, we've got the resources on the team, a perfect example is Frances, we've got a lot of resources on the team. Frances has got her own team of strategists so we've got a lot of depth, a lot of resources and a lot of commitment. And after all is said and done what are we trying to do, we're trying to provide for you, you know, the best risk-adjusted returns so that you can have confidence that as you work through your financial plan you have the utmost confidence that you'll be able to achieve your objectives.

So with that, I'm going to pass it back to Glen. I thank you for spending the time with me today and I thank you for your support.

Glen Brown, VP, Managing Director, Head of Manulife Private Wealth

Thanks very much, that was great. I hope today's comments were insightful understanding the approach that we're able to deliver on asset allocation and analysis and the way that Manulife Private Wealth is able to leverage the expertise of the multi-asset allocation team, it's a really key building block for Manulife Private Wealth. And when you look at how we deliver on these forward-looking asset allocation recommendations, this is where Manulife Private Wealth really relies on the global manager research team who works with the investment committee at Manulife Private Wealth to deliver a platform of quality investment managers, both internal and external, to help you reach your financial goals.

If you missed our spring webinar, more insights are available on our website for replay if you want to see it today. We hope you found this update valuable. To learn more about Manulife Private Wealth's investment platform, or if you have any questions on our investment process or anything you've heard today, please reach out to a member of the Manulife Private Wealth team. On behalf of the whole team, thanks very much for joining us and we look forward to hosting you at our next session.

Have a great summer.

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