Global Emerging Markets

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Overview

Developed equity markets (DM) consolidated over the month after the very strong gains seen in June, with Emerging Markets (EM) pulling back modestly as declines in two of Asia's larger markets - Korea (-6.2%) and India (-5.2%) – impacted the benchmark. Concerns relating to the pace of global economic growth continue to abound, with leading indicators pointing to a gathering slowdown despite efforts by Central Banks to stimulate activity. This process was underlined at the end of the month by the 25bp cut in interest rates undertaken by the US Federal Reserve, its first downward shift since December 2008. However, it should be noted that a number of EM countries, including Brazil, Turkey, South Africa, India, Korea, and Russia acted to bring down borrowing costs before the Fed's move.

Manulife IM Emerging Markets Equity Composite Performance vs. Global, Regional, and EM Index Performance, July 2019

GBP Returns	Month (%)	YTD (%)	1-YR (%)
MIM Emerging Markets (Gross)	4.0	20.1	7.3
MIM Emerging Markets (Net)	3.9	19.4	6.3
MSCI Emerging Markets	2.7	13.6	4.8
MSCI Latin America	4.1	17.3	16.3
MSCI AC Far East ex Japan	2.5	13.9	4.0
MSCI EMEA	3.3	17.0	8.4
MSCI World	4.5	22.3	11.0

Source: Manulife Investment Management, Bloomberg - Data is indicative as of 31/07/2019

Past performance is not indicative of future results.

Performance shown is the Manulife IM composite gross of fees, including advisory fees an investor may incur, which when deducted will reduce returns. Net performance results reflect the application of the highest incremental rate of the standard investment advisory or management fee schedule to gross performance results, unless otherwise indicated. Performance shown in GBP.

While there is no doubt that fiscal and monetary action are being deployed across the world's major economic regions, the simmering impact of trade frictions and the on-going need for important policy reforms remain an important influence as well. Significantly, July saw the Sino-US trade dispute put in the shade by rising tension between Japan and Korea. This has stemmed in part from Japan's colonial rule over the Korean peninsula in the early 20th Century and the recent decision by South Korea's high court to allow its citizens to sue Japanese companies for using forced Korean labor during the Second World War. Japan as a result has reviewed and downgraded South Korea from its "White List" of preferred trading partners which will further threaten, amongst other things, the global supply chain for smartphones and other electronic devices.

Against this backdrop the EM strategy performed relatively well, augmenting its year-to-date out-performance. Although EM consensus earnings forecasts have succumbed to downward revisions in the face of trade frictions and slowing growth, our focus on quality growth companies that have been able to withstand cyclical headwinds has meant that companies held in the portfolio have generally met our expectations and delivered good results.

Market Performance – July 2019

Best and Worst Performing Countries in Manulife IM EM Equity Strategy & MSCI EM (Net) Index for July 2019

Best	Portfolio Average Weight (%)	Benchmark Average Weight (%)	Benchmark Total Return (%)	Worst	Portfolio Average Weight (%)	Benchmark Average Weight (%)	Benchmark Total Return (%)
Turkey	0.0	0.5	15.7	Korea	9.8	11.9	-2.5
United Arab Emirates	0.0	0.7	12.8	Peru	1.9	0.4	-2.1
Taiwan	8.4	11.0	7.3	India	10.2	8.8	-1.5
Brazil	9.4	7.9	6.6	Chile	0.0	0.9	-1.2

Source: FactSet, as of 31 July 2019.
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As an indication of the importance we place on stock selection, this month's worst performing market - Korea – produced the best contribution to returns over the month! While we have remained underweight the market for some time, the strong showing by three of our five Korean positions resulted in the country contributing most significantly to this month's outperformance.

Even in India, where we are overweight, good stock performance meant we also produced positive attribution. This was despite the market's sell-off due to an uninspiring budget that followed Prime Minister Modi's recent election success. Business reforms are clearly needed in India, and are on the agenda. However, the political process is not fleet of foot, and until proposals are passed by the country's upper house capital investment and consumer confidence are likely to remain depressed. The Peruvian market performed poorly due to the prospect that a snap election might be called. Finally, we have no holdings in the Chilean market, which came under pressure as commodity prices eased in the face of slowing global growth.

Turkey, following several months of poor interaction by the government with financial markets, continued to bounce strongly on the back of a 425bp cut in local interest rates as inflationary pressures eased modestly. We continue to remain on the side-lines as the Erdogan administration has yet to demonstrate that it is capable of delivering a robust economic platform that would allow the country's stronger companies to thrive.

Both Taiwan and Brazil contributed positively in attribution terms. The former, only modestly, but notable due to a significant underweight stance to the market held by the portfolio. We continue to focus on a select number of technology companies that have proved to be resilient to trade friction and threatened sanctions on suppliers to a Chinese communication company. In Brazil, where we have been progressively building exposure this year, our focus on privately owned companies operating in the financial sector and service industries has continued to be fruitful.

Sector Performance – July 2019

Best and Worst Performing Sectors in Manulife IM EM Equity Strategy & MSCI EM (Net) Index for July 2019

Best	Portfolio Average Weight (%)	Benchmark Average Weight (%)	Benchmark Total Return (%)	Worst	Portfolio Average Weight (%)	Benchmark Average Weight (%)	Benchmark Total Return (%)
Information Technology	15.2	14.0	6.2	Materials	5.0	7.4	-1.6
Consumer Staples	10.1	6.7	4.7	Industrials	2.8	5.4	0.6
Utilities	0.0	2.8	4.7	Financials	31.5	25.0	1.2

Source: FactSet, as of 31 July 2019.
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Although our overweight stance to I.T. produced positive returns on an absolute basis, we lagged the strong showing of the sector. Apart from the sell-off in Kingdee International (China), which is discussed below, there was little that stood out in relation to the modest negative attribution. Similarly, the underperformance of our holdings in Consumer Staples related primarily to weakness in a Korean cosmetic and consumer products company which sold off sharply against the backdrop of rising trade friction with Japan.

We continue to hold underweight positions in the economically sensitive cyclical areas of Materials and Industrials, which contributed positively to returns. Financials, where we are overweight, also generated positive attribution despite the sector's weakness. Our holdings in strongly performing Brazilian and Asean financial stocks proved to be the key differentiating factor.

Stock Performance – July 2019

Best Performing Stocks in Manulife IM EM Equity Strategy & MSCI EM (Net) Index for July 2019[1]

Best	Portfolio Average Weight (%)	Benchmark Average Weight (%)	Portfolio Total Return (%)
Banco BTG Pactual S.A.	1.1	0.1	24.4
NAVER Corp.	1.1	0.3	22.8
Kroton Educacional S.A.	0.7	0.1	21.2
Bank of the Philippine Islands	1.1	0.0	20.0
B3 SA-Brasil, Bolsa, Balcao	1.1	0.4	19.4

Source: FactSet, as of 31 July 2019.

Worst Performing Stocks in Manulife IM EM Equity Strategy & MSCI EM (Net) Index for July 2019[1]

Worst	Portfolio Average Weight (%)	Benchmark Average Weight (%)	Portfolio Total Return (%)
Anglo American plc	2.1	0.0	-9.2
Kingdee International Software Group Co., Ltd.	0.9	0.0	-7.1
FirstRand Limited	1.2	0.3	-6.3
HDFC Bank Limited	1.6	0.0	-3.9
Reliance Industries Limited	1.2	0.9	-2.9

Source: FactSet, as of 31 July 2019.

Two Brazilian financial services companies performed particularly strongly over the month – BTG Pactual and B3. This reflected their focus on the local capital markets, which are benefitting from the faster than expected reform process that is being driven by the newly installed Bolsonaro administration. Pension and fiscal reform, combined with falling interest rates are spawning renewed interest in financial assets and the public sale of blocks of shares previously held by government controlled entities. BTG Pactual, as a leading investment bank, has seen a surge in activity that is expected to continue; while B3, as the operator of the local stock exchange, has benefited from rising trading volumes. Staying in Brazil, Kroton, an education services company, has seen its share price recover recently as recent results suggest that its move into the provision of secondary education is beginning to yield positive results.

[1] For illustrative purposes only. The holdings shown are those of a representative account and do not represent all of the securities purchased, sold or recommended for all Manulife IM clients. Past performance does not guarantee future results. Contact your Manulife IM representative to obtain a list of every holding's contribution to the representative account's performance during the period and/or the methodology used to calculate such contributions. Total return shown in GBP.

Naver, Korea's primary search engine, announced the spin-off of its e-commerce payments operation which served to highlight the undervaluation of the group's asset base. The market's reaction to this was very welcome as it showcased the under-appreciated diverse income streams that the company enjoys. Finally, the Bank of the Philippine Islands recovered well as it reported improving results following a period of relative underperformance.

Although the materials sector was generally under pressure over the month, Anglo American was unfairly singled out due to the sale of a long-standing stake held in the company which related to the merger with Kumba Metals some years ago. The position was held via an exchangeable bond, and the transaction allows the company's capital structure to be tidied up. Significantly, the company reported strong results with excess capital being returned to shareholders in the form of higher dividends and further share buybacks.

Kingdee International (China) has proved to have a volatile share price over the last 12 months. In part this is due to the opportunity it has to position itself as a leading provider of cloud based enterprise software services. The downside, however, has been the challenge of migrating its existing client base from one-time sales of accounting packages to interacting with them via cloud applications, which are likely to have additional features and recurring revenues. Although the company has been very successful in doing this, the upfront costs have been higher than expected and has resulted in its recent earnings report being lower than expected.

HDFC Bank and Reliance Industries - leading private sector Indian companies – underperformed over the month due to the sell-off in the broader Indian market. Both companies have recently reported strong earnings, but were standing on extended valuations and were consequently vulnerable to weaker local investor sentiment.

Summary

Strategy Positioning Relative to the MSCI Emerging Markets Index and Outlooks

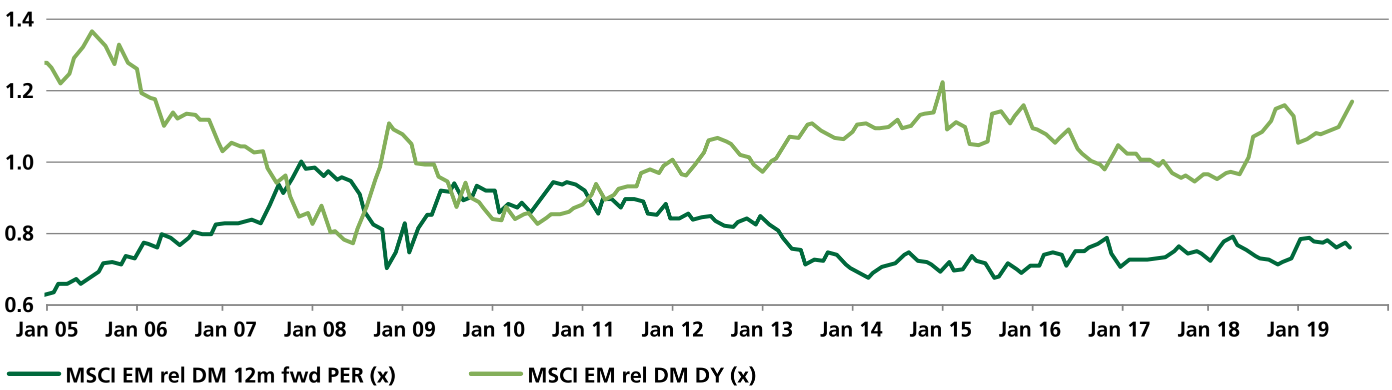
Positive	
China	Under-owned market; beneficiaries of new economy, middle class consumption, industrial restructuring and capital market reform
India	Reform of financial sector continues to yield opportunities for better managed private sector banks and consumer finance companies
Financials	Selective exposure taken in leading banks operating against backdrop of positive credit cycles and attractive valuations
Consumer Staples	Rising income levels across EM remain a key driver of demand for consumer goods; local and well positioned global brands are a focus
I.T.	Stock specific exposure – improving demand conditions yielding attractive entry points to a small number of well managed and oversold stocks

Negative	
Taiwan	Focus on tech hardware avoiding most commoditised products; domestic opportunities limited
Korea	With exception of tech leaders and selected consumer stocks, capital allocation and returns remain sub-par
Comm Servs.	Hardware/telecom operators remain challenged – Underweight; ecommerce service providers have upside to fair value – Overweight
Materials	Moderating global growth and ESG issues weighing on mineral mining stocks
Real Estate	Remains subject to policy gyrations and punctuated by poor capital allocation resulting in erratic growth

Outlook

Risk assets, including EM equities, are likely to struggle over the next few weeks as investors digest Trump administration's decision in the last few days to further raise tariffs on Chinese imports and the realization that the US Federal Reserve may not be committed to much further action given the relative strength of the US economy. The question remains as to whether the global economy is, in fact, experiencing a mid-cycle slowdown or is on the brink of a recession. Despite the protracted length of the economic cycle, we believe it is likely to be the former as there is little evidence that the global manufacturing downturn has infected the service sector to any significant degree.

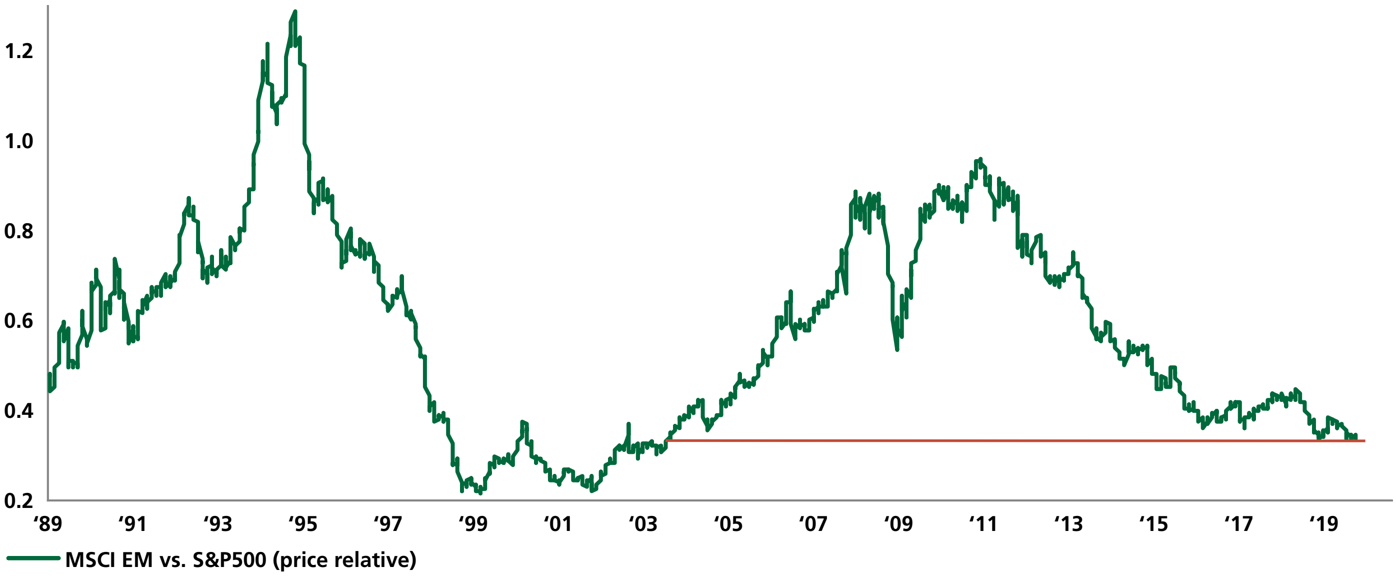
EM relative to DM 12 month forward P/E and Dividend Yield



Source: I/B/E/S, MSCI, Credit Suisse research.

In the meantime, however, there is likely to be pressure on the earnings of EM companies. To some extent these have already been reflected, with the valuation of EM equities in P/E terms looking to be towards their lower levels in historical terms, at a time when relative yield is rising.

EM equities at 16-year lows vs. US Equities



Source: BofA Merrill Lynch Global Investment Strategy, Bloomberg.

More encouraging may be the low level of institutional ownership of the asset class. This is particularly relevant when seen in the light of its relative performance against that of the US equity market as reflected in the chart above. Clearly, a catalyst or two will be required. These are likely to revolve around resolution of the Sino-US trade dispute and the prospect of a weaker US dollar.

The former may be closer than is widely thought as there is clearer evidence of the damage being done to the profitability of US companies' overseas operations, alongside the growing likelihood of imported inflation due to the impact of tariffs. Unsurprisingly, President Trump may not want to go into an election year with these elements weighing against him. On the currency front, the Greenback remains overvalued on a real effective exchange rate basis despite the administration's efforts to talk it lower. As has been the case for some time, there remain unresolved and large (growing?) twin deficits on the fiscal and current accounts.

Finally, there remains room for a number of the larger EMs to continue to stimulate domestic activity. There is also the prospect that economic and market reforms are also likely to play out over the coming quarters providing impetus for important markets such as Brazil and India.

Top Contributors and Detractors in Manulife IM EM Equity Strategy for July 2019

Contributors	Total Effect (bps)	Detractors	Total Effect (bps)
Banco BTG Pactual S.A.	21	Anglo American plc	-25
Bank of the Philippine Islands	17	AIA Group Limited	-13
Pacific Basin Shipping Limited	16	HDFC Bank Limited	-11
NAVER Corp.	15	Kingdee International Software Group Co., Ltd.	-10
Notre Dame Intermedica Participacoes SA	12	LG Household & Health Care Ltd	-9

Source: FactSet, as of 31 July 2019.

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