Global Emerging Markets

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Overview

Global equities (MSCI World + MSCI Emerging Markets, cap-weighted) fell 3.8% in 2018[1], representing the worst annual return since 2008. No sooner had global equity indices touched record highs in late January than shares came into competition from higher US short and long rates. Despite faring less badly in the fourth quarter, EM underperformed DM over the 12-month period falling by 9.3%.

Although global growth in 2018 is estimated to have been a respectable 3.8% year-on-year, there was an appreciable deceleration from the 4.0% run-rate seen in the first half of the year. This was due, most notably, to China's desire to curb shadow financing and rein in domestic infrastructure projects, and the US Federal Reserve's policy to normalize monetary conditions by raising interest rates and beginning to withdraw Quantitative Easing (QE).

Manulife AM Emerging Markets Equity Composite Performance vs. Global, Regional, and EM Index Performance, December 2018

GBP Returns	Month (%)	QTR (%)	1-YR (%)
MAM Emerging Markets (Gross)	-4.1	-8.4	-11.0
MAM Emerging Markets (Net)	-4.2	-8.6	-11.8
MSCI Emerging Markets	-2.5	-5.3	-9.3
MSCI Latin America	-0.6	2.8	-0.8
MSCI AC Far East ex Japan	-2.8	-7.7	-9.9
MSCI EMEA	-1.4	-1.9	-10.9
MSCI World	-7.4	-11.3	-3.0

Source: Manulife Asset Management, Bloomberg - Data is indicative as of 31/12/2018

Past performance is not indicative of future results.

Performance shown is the Manulife AM 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.

This culminated in a perfect storm in 4Q18 – high oil prices, a strong dollar and a shift upwards in the US yield curve – which acted to alter perceptions towards risk assets and encouraged investors into cash. No sooner had the US yield curve shifted upwards than investors began to worry about an inversion of the yield curve, and concerns over a US recession and a wider global slowdown forced further liquidation of equities. Small changes in volatility led to sharp outflows as investment strategies that tended to perform well during QE became strained during the Quantitative Tightening (QT) of the last ten months.

As perceptions relating to the state of the global economy have flip-flopped in recent weeks commodity prices have rolled over. Oil prices, which peaked in September at their highest levels since 2014, have moved sharply lower as Iranian sanctions have proved to have a more modest impact and evidence of slowing global growth has seen demand slacken as reserves have grown. Significantly, the ability of US based shale producers to crank up supply when prices rise above $50/bl has remained under appreciated. Other materials prices have also retreated, although without much evidence of significant new capacity being added.

Against this challenging backdrop the EME strategy has struggled over the quarter, giving up all its relative out-performance and more. The principal contributor to this disappointing outcome has been our sustained over-weighting of Chinese growth equities, which accounted for most of our relative shortfall over the quarter. Although the on-going trade dispute between China and the US has weighed on markets, a slowdown in earnings growth appears to be the main culprit behind the selling pressure.

[1] Bloomberg, as of December 31,2018.

Market Performance – December 2018

Best and Worst Performing Countries in Manulife AM EM Equity Strategy & MSCI EM (Net) Index for December 2018

Best	Portfolio Average Weight (%)	Benchmark Average Weight (%)	Benchmark Total Return (%)	Worst	Portfolio Average Weight (%)	Benchmark Average Weight (%)	Benchmark Total Return (%)
Mexico	1.8	2.7	3.5	Pakistan	0.0	0.0	-11.6
Malaysia	0.0	2.4	1.8	China	30.3	31.0	-5.9
Philippines	1.1	1.1	1.7	Greece	0.0	0.2	-5.2
Peru	2.1	0.4	1.7	Turkey	0.0	0.6	-5.0

Source: Factset, as of 31 December 2018.
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After several months of poor performance following the accession to power of socialist President Lopez Obrador (AMLO), the Mexican market was buoyed by a strengthening Peso following the announcement of a fiscally responsible budget and the Mexican Central Bank's move to raise its benchmark rate by 25bp. Similarly, the Asean markets of Malaysia and the Philippines managed to buck the downward trend. Both have been viewed as beneficiaries of the developing US-Sino trade war with manufacturers seeking to re-allocate production away from China to avoid tariff duties.

Having no exposure to the small markets of Pakistan, Greece, and Turkey (combined index weight of 0.9%) marginally contributed to performance. However, the positive attribution from this source was more than swamped by the weakness across Chinese and Hong Kong listed equities, to which we remain overweight. The relief following what appeared to be successful trade talks between China and the US at the start of the month after the G20 meeting in Buenos Aires proved short-lived. The arrest of Huawei (a leading Chinese communications equipment company) CFO Meng Wanzhou in Canada following US requests for extradition to face Iranian sanctions busting charges, was viewed as inflammatory and further dampened investor sentiment.

Sector Performance – December 2018

Best and Worst Performing Sectors in Manulife AM EM Equity Strategy & MSCI EM (Net) Index for December 2018

Best	Portfolio Average Weight (%)	Benchmark Average Weight (%)	Benchmark Total Return (%)	Worst	Portfolio Average Weight (%)	Benchmark Average Weight (%)	Benchmark Total Return (%)
Utilities	0.0	2.6	0.9	Health Care	5.4	2.8	-7.7
Consumer Staples	9.5	6.6	0.5	Consumer Discretionary	13.4	10.6	-6.7
Industrials	1.1	5.5	-0.1	Energy	8.4	8.1	-5.0

Source: Factset, as of 31 December 2018.
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Unsurprisingly given the market volatility over the month, Utilities and defensive Consumer plays were the only sectors that produced positive returns. Having no exposure to the former, albeit a small sector, only marginally detracted from returns and was counterbalanced by our overweight stance to the latter.

In the Healthcare sector, our Chinese holdings proved a significant drag as poor sentiment towards the country was exacerbated by fears that further industry reforms would damage their profitability. Specifically, we believe that one of our health care holding's innovate drug portfolio will not only protect the company from pricing reforms targeting generic manufacturers but positions it well for growth in important underserved areas relating to oncology and arthritis.

Although not amongst the worst sectors for the month, our exposure to North Asian companies within the Information Technology and Communication Services sectors hurt us particularly. Fears as to the impact of tariffs on the export of electronics goods from China, Taiwan, and Korea undermined share prices.

Stock Performance – December 2018

Best Performing Stocks in Manulife AM EM Equity Strategy & MSCI EM (Net) Index for December 2018[2]

Best	Portfolio Average Weight (%)	Benchmark Average Weight (%)	Portfolio Total Return (%)
Anglo American Plc	1.6	0.0	11.6
Colgate-Palmolive (India) Limited	0.9	0.0	10.2
Lojas Renner S.A.	2.0	0.2	8.8
Grupo Financiero Banorte SAB de CV	0.9	0.2	6.4
Kweichow Moutai Co., Ltd.	0.7	0.0	5.9

Source: Factset, as of 31 December 2018.

Worst Performing Stocks in Manulife AM EM Equity Strategy & MSCI EM (Net) Index for December 2018[2]

Worst	Portfolio Average Weight (%)	Benchmark Average Weight (%)	Portfolio Total Return (%)
Ping An Healthcare and Technology Company Limited	0.6	0.0	-20.8
Baidu, Inc.	2.5	1.0	-15.6
Kroton Educacional S.A.	0.7	0.1	-15.4
Pacific Basin Shipping Limited	1.1	0.0	-14.7
Alibaba Group Holding Ltd.	4.1	3.9	-14.6

Source: Factset, as of 31 December 2018.

The diversity available across EM is well captured by this month's outperformers, which span 5 different countries and a range of sectors. Anglo American, despite falling commodity prices, was able to demonstrate at the company's recent analyst day the extent by which its returns are likely to be driven by balance sheet deleveraging, portfolio restructuring, and a policy of returning capital to shareholders. Another company that appears to be re-establishing itself is Colgate-Palmolive (India), which has begun to reverse market share losses and is gaining share in India's rapidly developing oral hygiene market due to better quality products.

[2] 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 AM clients. Past performance does not guarantee future results. Contact your Manulife AM 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.

Banorte's positive contribution over the month reflects the sharp sell-off seen following suggestions that the new Mexican administration would seek to cap fees earned by financial institutions. Initial fears as to the impact on the local bank industry appear to have been overstated. However, we will watch developments in this regard closely. Kweichow Moutai (China), China's premium producer of high-end spirits, also recovered ground lost earlier in the year as signs emerged of slowing consumer activity. Significantly, the company appears to be exceeding analysts' expectations as reflected in their preliminary 2018 results.

With the exception of Kroton (Brazil) and Pacific Basin (HK), the worst performing stocks over the month had two distinct characteristics that were clearly out of favour – they were Chinese and operated internet-based platforms or applications. Baidu and Alibaba are two of the most established Chinese internet operators, being the foremost search and ecommerce operators respectively. While both stocks have de-rated over the last 6 months, the companies are expected to resume rapid expansion as recent investments in new operating areas begin to deliver results. Ping An Healthcare & Technology, an off-shoot of China's largest private sector life insurer, while also an internet based business is at an earlier stage of development having recently been listed. The company offers a mobile platform for online medical consultations and hospital referrals, as well as connecting consumers and patients with healthcare resources. The company, while not profitable yet, has a significant first mover advantage and is already serving over 500,000 people daily.

Kroton, Brazil's largest education services company, has had a challenging year as the company has embarked on developing a school division to complement its university and higher education activities. We believe that although growth of the new business may be slower than originally stated, management will be successful in re-invigorating the company.

Pacific Basin, being a marine shipper of dry bulk commodities, has sold off in the market as it is viewed as a likely "loser" in the event of any slowdown in global growth, particularly if it is due to trade frictions. While the company clearly depends on trade activity, it is a specialist operator of modern small shallow-draft ships that work in regional markets, most of which are to be found in the faster growing areas of the world. Furthermore, new environmental regulations are likely to enhance the company's prospects as competitors are forced to scrap old polluting vessels.

Market Performance – Q4 2018

Best and Worst Performing Countries in Manulife AM EM Equity Strategy & MSCI EM (Net) Index for Q4 2018

Best	Portfolio Average Weight (%)	Benchmark Average Weight (%)	Benchmark Total Return (%)	Worst	Portfolio Average Weight (%)	Benchmark Average Weight (%)	Benchmark Total Return (%)
Brazil	9.7	7.5	16.1	Pakistan	0.0	0.1	-20.5
Indonesia	2.1	2.1	12.3	Colombia	0.0	0.4	-17.0
Qatar	0.0	1.1	11.0	Mexico	2.4	2.9	-16.8
Hungary	0.0	0.3	8.4	Greece	0.0	0.3	-14.0

Source: Factset, as of 31 December 2018.
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As commented previously, the most interesting market moves over the quarter revolved around the contrasting fortunes in Latin America between Brazil and Mexico. The former rose sharply on prospects of market and social reform following the election of President Bolsonaro, as the latter laboured in the face of the first policy measures advocated by the incoming AMLO administration. While we were overweight Brazil and underweight Mexico, our positions in both markets did not contribute sufficiently to match the local markets. As the economy in Brazil begins to respond to improving consumer sentiment we would hope to garner better returns as private sector growth stocks catch up with the reflex moves seen in the large State controlled monoliths that have been leading the market.

Although not one of the worst performing markets, China's 10.7% fall over the quarter was worse than the EM index's 7.5% decline. As a result, our overweight stance to Chinese growth companies was the primary contributor to our poor showing over the final quarter of the year.

Sector Performance – Q4 2018

Best and Worst Performing Sectors in Manulife AM EM Equity Strategy & MSCI EM (Net) Index for Q4 2018

Best	Portfolio Average Weight (%)	Benchmark Average Weight (%)	Benchmark Total Return (%)	Worst	Portfolio Average Weight (%)	Benchmark Average Weight (%)	Benchmark Total Return (%)
Utilities	0.0	2.6	6.1	Health Care	5.1	2.9	-14.2
Real Estate	0.0	2.9	3.8	Information Technology	15.6	14.8	-13.3
Financials	26.0	24.4	1.5	Consumer Discretionary	12.0	10.3	-9.8

Source: Factset, as of 31 December 2018.
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Once again, Utilities proved a safe-haven for investors over a difficult quarter. It should be noted, however, that we have no exposure to the space as we find it difficult to find attractive well managed growth stocks in this relatively small (2.6% weight) sector. The companies tend to be State Owned Enterprises that are heavily swayed by government policies that often do not generate what we believe to be adequate rates of return.

Counterintuitively, the Real Estate and Financial sectors performed well despite fears as to the likely impact of rising US rates. This serves to remind investors that EM are made up of a wide range of economies that respond to local as well as global influences. For example: Real Estate held up as Chinese mortgage lending was eased to stimulate economic activity; while Financials held up well as Brazilian and Indian banks surged on the prospect of political change and industry reforms respectively.

One bright spot in an otherwise dark quarter proved to be our holdings in the Consumer Discretionary sector. While overweight an underperforming area of the market, our holdings performed relatively strongly yielding a significant positive contribution to returns. Most notable was our position in Brazilian retailer, Lojas Renner, that is discussed below.

Stock Performance – Q4 2018

Best Performing Stocks in Manulife AM EM Equity Strategy & MSCI EM (Net) Index for Q4 2018[2]

Best	Portfolio Average Weight (%)	Benchmark Average Weight (%)	Portfolio Total Return (%)
Lojas Renner S.A.	1.7	0.1	44.6
Colgate-Palmolive (India) Limited	0.9	0.0	33.0
Wise Talent Information Technology Co., Ltd.	0.4	0.0	28.2
Itau Unibanco Holding S.A.	2.6	0.9	27.5
ICICI Bank Limited	1.3	0.2	25.5

Source: Factset, as of 31 December 2018.

Worst Performing Stocks in Manulife AM EM Equity Strategy & MSCI EM (Net) Index for Q4 2018[2]

Worst	Portfolio Average Weight (%)	Benchmark Average Weight (%)	Portfolio Total Return (%)
Ping An Healthcare and Technology Company Limited	0.7	0.0	-46.0
Focus Media Information Technology Co., Ltd.	0.8	0.0	-36.9
Grupo Financiero Banorte SAB de CV	1.0	0.3	-31.2
Baidu, Inc.	2.6	1.1	-29.0
Ctrip.com International Ltd.	0.9	0.3	-25.5

Source: Factset, as of 31 December 2018.

Lojas Renner and Itau Unibanco have benefited over the quarter from the resurgence of the Brazilian stock market following the election of President Bolsonaro. Both companies are expected to benefit from a pick-up in economic activity as consumer confidence continues to recover.

In India, following management changes and signs of a decline in stressed loans, ICICI Bank (India) has performed well and appears poised to regain lost ground driven by low cost deposits and retail lending growth.

Unsurprisingly, given earlier comments, except for Banorte, four of the five laggards over the quarter were Chinese companies whose activities are linked to the internet and ecommerce. Ping An Healthcare & Technology's decline is particularly frustrating as the company has met the various milestones set out at the time of the company's IPO at the beginning of May.

Summary

Strategy Positioning Relative to the MSCI Emerging Markets Index and Outlooks

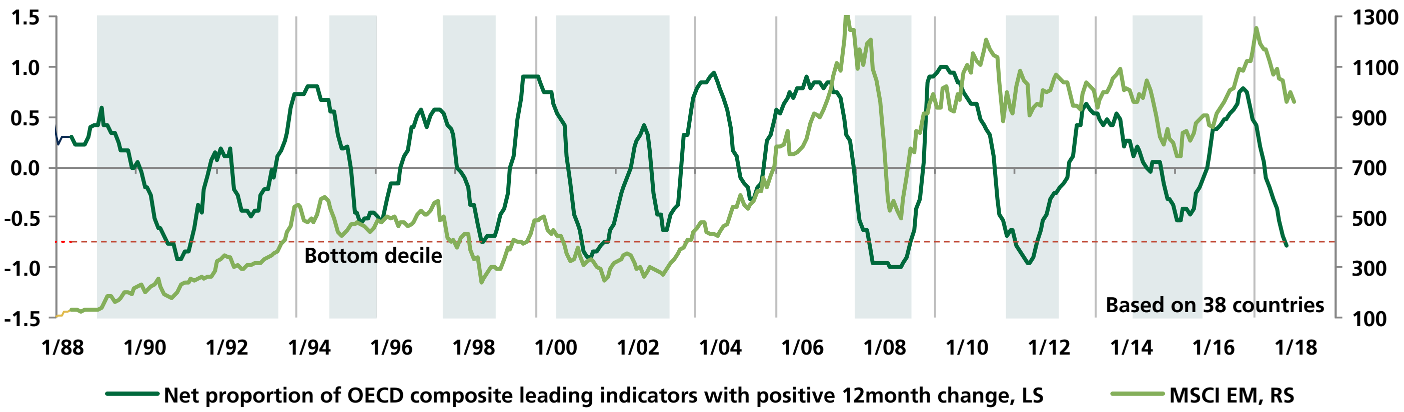
Positive	
China	Under-owned market; beneficiaries of new economy, middle class consumption, industrial restructuring and capital market reform
Brazil	Market oversold into recent election; deferred consumption and economic recovery expected to play out under incoming reformist administration
Consumer Staples	Rising income levels across EM remain a key driver of demand for consumer goods; local and well positioned global brands are a focus
Consumer Disc.	Aspirational demand for goods and services; new distribution models are driving ecommerce and logistics opportunities
Healthcare	Healthcare reform coupled with rising end-user demand is creating opportunity for both providers and distributors

Negative	
Taiwan	Selective opportunities in 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
Comms. Services	Hardware/telecom operators remain challenged; ecommerce service providers, however, look attractively priced
Utilities	Local regulatory environments challenging; valuations generally extended in relation to growth prospects
Real Estate	Remains subject to policy gyrations and punctuated by poor capital allocation resulting in erratic growth

Outlook

Notwithstanding the influence of political noise relating to trade and sanctions - which has been deafening over the last 12 months - the resetting of interest rate expectations as it relates to the US Federal Reserve and action by the Chinese administration to unleash infrastructure expenditure will determine whether EMs will recover their poise after a disappointing year.

Breadth of OECD Leading Indicators and MSCI EM performance



Source: BofA Merrill Lynch Global Research, OECD, Datastream. Note: Shaded regions denote OECD-defined global slowdowns.

Significantly, the breadth of OECD leading indicators, which was near historical highs at the start of 2018, has progressively weakened throughout the year. Only 10% of countries currently see year-on-year rises in their leading indicators as compared with over 70% in January 2018. Normally policy easing occurs at these levels. Investors will continue to hang on every move and utterance from the US Federal Reserve, while hoping for further stimulus from the Chinese administration.

In one sense, investors appear to have already priced a recession into global equities during 2019. While global growth is likely to decelerate modestly, many economies should benefit from lower oil prices and it would seem unlikely that EM central banks will tighten policy aggressively in response to muted inflation concerns.

While markets remain concerned about the growth outlook, consensus forecasts for the coming year suggest that global growth will remain above the 3.5% mark, although US GDP growth is forecast to slip from the expected 2.9% rate in 2018 to 2.3% for 2019. With other DM economies moving further into the late cycle phase, resources will get more stretched which will increasingly constrain growth prospects. EMs, by and large, have maintained a favourable policy mix, which should enable them to maintain stable domestic growth. Although China's growth continues to moderate, the country's policymakers are continuing to try to strike a balance between its financial clean-up/structural reform efforts and managing the pace of growth. Emphasis remains on stabilising growth by stimulating consumption as reflected by the series of monetary, fiscal and property easing initiatives announced during the second half of 2018. Furthermore, recent concessions point to a somewhat more conciliatory tone to pivotal trade discussions, which may point to some alleviation in tensions.

As a result, we believe that GDP growth and earnings differentials may begin to move in favour of EM versus DM as the year progresses. Meanwhile, absolute and relative valuations have de-rated in EM sufficiently to compensate for many of the considerable risks/uncertainties that loom large as we enter the New Year.

Top Contributors and Detractors in Manulife AM EM Equity Strategy for December 2018[3]

Contributors	Total Effect (bps)	Detractors	Total Effect (bps)
Lojas Renner S.A.	21	Ping An Insurance (Group) Company of China, Ltd.	-21
Anglo American Plc	20	Baidu, Inc.	-21
AIA Group Limited	18	Sinopharm Group Co., Ltd.	-20
Colgate-Palmolive (India) Limited	10	LandMark Optoelectronics Corp.	-17
China Resources Beer (Holdings) Co. Ltd.	7	3SBio, Inc.	-16

Source: Factset, as of 31 December 2018.

Top Contributors and Detractors in Manulife AM EM Equity Strategy for Q4 2018[3]

Contributors	Total Effect (bps)	Detractors	Total Effect (bps)
Lojas Renner S.A.	52	Baidu, Inc.	-44
Itau Unibanco Holding S.A.	39	Ping An Healthcare and Technology Company Limited	-38
Colgate-Palmolive (India) Limited	28	CNOOC Limited	-37
ICICI Bank Limited	27	Focus Media Information Technology Co., Ltd.	-35
PT Astra International Tbk	21	3SBio, Inc.	-28

Source: Factset, as of 31 December 2018.

[3] *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 Manulife AM clients.* Past performance does not guarantee future results. *Contact your Manulife AM 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 returns used in the total effect calculation are in GBP.*

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