Manulife Mutual Funds

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ASIAN FIXED INCOME

April 2012

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Strong fundamentals for credit, currencies

Asian corporate bonds and currencies are off to a strong start in 2012 and look set to continue the run, based on strong relative fundamentals and valuations.

J.P. Morgan Asia Credit Index	As of March 31, 2012	
	3 Months	12 Months
USD Return	4.0%	7.3%
CAD Return	2.2%	10.5%

Source: Bloomberg. For illustration purposes only.

Asia bond markets gained ground since the start of the year amid positive global market sentiment. The Eurozone debt crisis stabilized after Greece received a new bailout and the European Central Bank extended its Longer term Refinancing Operation (LTRO) program to record levels at the end of February. In China, the People's Bank of China cut its Reserve Requirement Ratio by 50 basis points (bps) in February, leading to a price recovery in riskier assets including property names.

With regard to currencies, most Asian ex-Japan currencies outperformed the U.S. dollar in early 2012. The strongest performing currency was the Indian rupee (INR), which rebounded following weakness in 2011. In contrast, the Chinese Yuan had a timid start to the year, following a 5 per cent gain against the U.S. dollar in 2011.

Indian rupee up sharply in early 2012

Source: Bloomberg (March 20, 2012). For illustration purposes only.

Asian credit markets had a strong start, mainly driven by high yield corporate bonds. Investment grade credit spreads also tightened to the tune of 50 bps*. New corporate bond issuance gained traction in dollar denominated Asian names but also in local currency markets. The CNH market (or "Dim Sum" bond market) continued to generate considerable interest from both investors and issuers – not just Chinese corporates but also multinational corporations with Chinese operations. U.S. car maker Ford announced its first ever Dim Sum bond issuance, hot on the heels of machinery company Caterpillar's third such issuance.

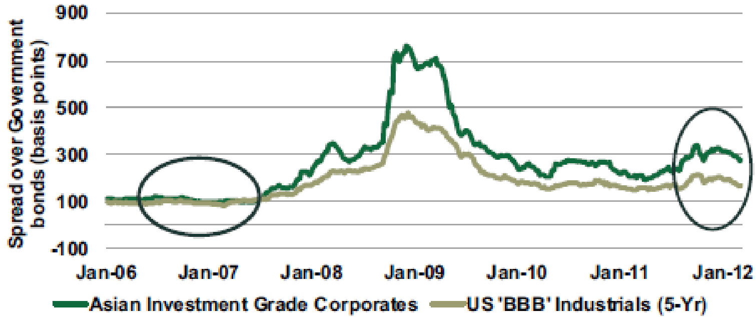
In interest rate markets, we see little value left in the core Asian government bond markets such as Hong Kong, Taiwan or Singapore. However, we still like long-dated government bonds in markets like the Philippines and Indonesia. These markets offer long term potential and we keep a strategic overweight position there, coupled with tactical re-positioning trades when markets experience short-term valuation distortions.

Credit favored over sovereigns

We still believe high quality corporate bonds offer a more attractive risk reward profile than sovereign bonds in the current environment. With improving investor sentiment, banks are fleshing out their lean balance sheets. We see this as a potentially strong wave of opportunities and are maintaining our strategy's overweight in corporate credit. More specifically, we like issuers in the "A"/"BBB" rating bucket because of the wider yields on offer and potential credit spread tightening. In the short to medium term, we will continue to monitor the supply and demand dynamics of these bonds as too much supply could lead to weaker valuations. With regard to high yield names, the strategy selectively focuses on the best-in-class Asian issuers, including Chinese state owned enterprises, leveraging our team's on-the ground research capabilities.

*Source: JP Morgan Asian Credit Investment Grade Index

Asian corporates still cheap vs. history, U.S. peers



Source: Bloomberg (March 16, 2012). For illustration purposes only.

Lastly, we look to maintain an overweight in local Asian currencies relative to hard currency bonds. We remain constructive on and continue to hold a large exposure to the Chinese Yuan through selective Dim Sum bonds. We notably successfully participated in Ford's new CNH issuance. This trade provides diversification benefits to the portfolio, attractive yield versus similar Ford USD paper and potential currency appreciation.

More broadly, the first few months of the year witnessed several upside macroeconomic surprises and a further bounce back in risky assets. We believe the recovery in Asian asset valuations can be sustained, but remain cautious and monitor potential event risk. The Asian growth outlook remains positive even with China slowing down to 7.5 per cent growth levels. The Asia ex-Japan region benefits from a distinctive mix of superior growth prospects, favorable demographics, undervalued currencies, supportive monetary policies and a strong fiscal position.