Manulife Investment Management

2020 Outlook Series: Manulife Global Fund - Preferred Securities Income Fund

Jan
2020

With the Federal Reserve (Fed) on pause, the US economy on a positive growth path, and interest rates that are expected to be “lower for longer”, the environment for preferred securities looks favourable in 2020. This is good news for investors seeking a higher yield than the global corporate bond market can deliver. Furthermore, the economic backdrop should allow companies to cut debt, we will be looking for a series of ratings upgrades that can drive the outperformance of a high-quality preferred securities portfolio, with a notable overweight position in North American regulated utilities.

Global macro outlook

As we move towards the end of 2019, we see the following characteristics in global markets[1]:

I. In the near term, the US is on a sustainable growth path with a strong labour market and strong consumption.

II. The world’s central banks are engaged in monetary policy easing. The Fed itself appears to have “normalised” following three rate cuts.

III. We see stable ratings, credit spreads and fundamentals in the preferred securities market.

IV. Globally, interest rates are expected to remain low, which should result in the continuing demand for yield from an ageing population

This environment is expected to prevail in 2020. As a result, preferred securities may benefit as investors seek a higher level of income yield than they can find in the global corporate bond market.

Investment strategies

Preferred securities have historically performed well in periods of easing, or when the Fed is on pause (Chart 1). As rates have fallen globally, the demand for preferred securities is likely to continue. Viable growth in the US provides a favourable environment for companies seeking to improve their balance sheets by reducing debt. As fundamental bottom-up investors, we see the potential for rating upgrades among our holdings, and given the solid US economic backdrop, there should be many of these in 2020.

Chart 1: The performance of preferred securities when rates in the US are flat or moving lower

US Fed Fund rate trend	Period	ICE BofAML Fixed Rate Preferred Securities Index (Annualised price return %)
Flat	16/5/2000 - 2/1/2001	22.82
Lowering	3/1/2001 - 29/6/2004	6.41
Flat	29/6/2006 - 17/9/2007	5.07
Lowering	18/9/2007 - 16/12/2008	-32.39*
Flat	16/12/2008 -15/12/2015	10.95
Flat + Lowering	19/12/2018 -23/9/2019	20.66

Source: Bank of America Merrill Lynch and Bloomberg, as of 23 September 2019. Annualised total returns in US dollars. Past performance is not indicative of future performance.

*Preferred securities returned negatively during global financial crisis.

[1] Source: Bloomberg, September 2019

Overweight in North American utilities

Moving into 2020, the Fund maintains a notable overweight position in preferred securities issued by North American regulated electric & gas utilities (33%)[2]; As a reference, utility issuers make up just 8% of the overall preferred securities marketplace[3].

We also maintain a favourable credit outlook for most North American electric & gas utilities. Capital spending levels for utilities are setting new records, and the regulatory environment in North America is enabling these companies to earn a regulated return on future spending. Accordingly, we believe that the sector benefits from a high degree of stability and visibility of future-year operating cash flows. We also think that this will prove favourable in a world of elevated tariffs, global trade risks, and a prevailing risk-off environment.

Our diversified approach

Despite financial institutions being the main issuers of preferred securities, we believe in a diversified offering consisting of securities from a variety of sectors. Admittedly, US bank capital ratios are the highest in decades[4], but a more balanced approach should be beneficial. For example, our regulated utility positions have historically acted as a defensive buffer during volatile times.

From an economic standpoint, we favour global insurance companies over European securities. Among the P&C companies (Property and Casualty Insurance), we appreciate the benefits of lower catastrophe activity and higher premiums along with favourable investment trends.

Non-investment grade preferred securities may outperform in a growth environment

Although over a third of preferred securities are non-investment grade, it should be noted that many of the below-investment-grade securities we own are issued by investment-grade companies. Indeed, the Fund has a higher weighting to investment-grade issues relative to the market[5]. We believe that economic growth in the US will lead many companies to reduce debt, which may result in the outperformance of securities rated below investment grade.

However, the potential headwinds we face are the political environments in the US and Europe, global trade war concerns, and geopolitical tension in the Middle East. These could trigger heightened fears of an economic slowdown, which would then cause credit spreads to widen. Balancing out those headwinds is our focus on high-quality issuers. A high-quality portfolio with its emphasis on defensive US-regulated utilities should help us to outperform the market.

Conclusion

Our investment team's goal continues to provide a high level of income while focusing on the preservation of capital and total return in 2020. Also, we have an emphasis on risk management by focusing on credit, liquidity and call risks. Through our differentiated strategy, we provide investors with a more defensive approach to the preferred securities market since inception.

[2] As of 21 October 2019, information about the asset allocation is historical and is not an indication of the future composition.
[3] Source: Manulife Investment Management and Bloomberg, as of 21 October 2019. The weighting of the overall preferred securities marketplace is represented by ICE BofAML US All Capital Securities Index.
[4] Manulife Investment Management, November 2019.

[5] Manulife Investment Management and Federal Deposit Insurance Corporation (FDIC), as of 31 March 2019.

Important Information

Manulife Global Fund (the “Company”) is an open-ended investment company registered in the Grand Duchy of Luxembourg. The Manulife Global Fund - Preferred Securities Income Fund (“the Fund”) is recognised under the Securities and Futures Act of Singapore for retail distribution. The Company has appointed Manulife Investment Management (Singapore) Pte. Ltd. as its Singapore Representative and agent for service of process in Singapore.

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Distributions are not guaranteed. Investors should refer to the Singapore prospectus for the distribution policy of the Fund. The Directors of the Company shall have the absolute discretion to determine whether a distribution is to be made in respect of the Fund as well as the rate and frequency of distributions to be made. Distributions may be made out of (a) income, or (b) net capital gains, or (c) capital of the Fund, or (d) gross income while charging all or part of the fees and expenses to capital, or (e) any combination of (a), (b) , (c) and/or (d). Past distribution yields and payments are not necessarily indicative of future distribution yields and payments. Any payment of distributions by the Fund is expected to result in an immediate decrease in the net asset value per share of the Fund.

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