John Hancock
ASSET MANAGEMENT

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John Hancock Asset Management comments on the market impact of the US election results

As Barack Obama wins a second term as US President, John Hancock Asset Management's portfolio managers and economists assess market reactions and the longer term implications of the election result.

Economic Summary

Megan Ellis,
Associate Economist

President Obama's relatively narrow victory in the popular vote gives him another four years in the White House, but facing the same challenging political conditions he began with four years ago. Republicans retained control of the House of Representatives, while Democrats maintained a narrow majority in the Senate. The challenge will be finding a way to break the gridlock that has consumed Washington to address issues like the looming fiscal cliff.

Until the fiscal cliff is resolved, economic uncertainty remains. The most likely scenario is "kicking the can down the road" with a last minute agreement to push deadlines back to sometime in 2013 – although the risk of failing to reach a compromise is real and dangerous. The ultimate challenge is finding a long term solution to government finances that most likely involves either a combination of higher revenue and reduced government spending, particularly on health programs and Social Security.

In Obama's second term, we would expect to see an increase in capital gains and dividend taxes – which may have an impact on equities, especially those paying dividends. On the other hand, we know that policies enacted during Obama's first administration will likely stick around – giving investors a bit more confidence in plans and projections.

One thing is clear. Obama has a tough road ahead, and will have to balance supporting economic growth now with developing a long term solution to rein in the country's budget and reduce debt. Cutting spending by too sharply could push us into another recession, reducing tax revenue with a smaller economic pie to take a slice out of – even if tax rates remain the same.

Continuing with current policies could propel us even further towards fiscal insolvency. Raising taxes is politically unpopular – although is likely necessary. Economists and investors will be looking for a compromise that slowly brings government expenditures back in line with revenues – but not so sharply that it pushes us off an economic cliff. It's a very narrow tightrope.

Global Markets View

Wendell Perkins,
Senior Portfolio Manager, International Value Equities

For investors in international equities, the election results are moderately positive. Perhaps most importantly, there is relief that there is a clear winner in the election. A repeat of the 2004 election would have sent the markets sharply lower, given the looming 2013 fiscal cliff. While the spectre of the fiscal cliff is likely to continue to dampen the global appetite for equities for some time to come, we expect that a workable resolution to this issue would drive a continuation of the current global bull market.

Global pharmaceutical stocks may be modest beneficiaries of the election results, based on expected stronger drug volumes as the full implementation of the Affordable Care Act moves forward. Non-US financials may also see a boost as the Obama administration will likely keep a tight rein on regulation through Dodd-Frank, providing non-domestic competitors with a potential edge.

It's worth also bearing in mind that US companies have amassed US$1.7 trillion in cash. With the election uncertainty now in the past, corporate spending may improve, aiding US economic growth and global growth.

Tom Goggins,
Senior Portfolio Manager, Global Fixed Income

The most significant outcome of Obama's re-election for bond markets is the continuation of easy monetary policy by the Fed which will likely translate into a weakened US dollar for some time to come.

The current trajectory of the US economy has been a slow but steady route out of the financial crisis. With an extension of tax deadlines until a more permanent solution can be found being the most likely outcome to the fiscal cliff issue, we believe the economy will continue on this path. Unemployment remains an ongoing challenge, however, and we expect it to remain stubbornly above 7%.

We believe that the extraordinary policies deployed by the Fed, such as QE1, 2, and 3 and Operation Twist will provide a supportive environment for owning US corporate credit. In addition, the fiscal problems in the US highlight the opportunities we see in more stable, developed markets, (ie Australia, New Zealand, Sweden, Norway, and Canada).

Meanwhile, continued sluggish economic growth in US and Eurozone is drawing attention to the faster-growing economies of the emerging markets, especially Asia, where the improving economic profile of many countries will likely tighten their credit spreads as they get upgraded by the rating agencies. This happened in Indonesia last year and an upgrade is expected in the Philippines in 2013. In addition, local currencies in this region tend to be undervalued and we also see opportunities opening up in Asian corporate bond markets as they continue their rapid development.

North American Market View

Pat McHugh,
Equity Strategist

The re-election of President Obama means fewer surprises for investors. Canadian equities, gold and commodities are likely to be the primary beneficiaries of 'business as usual' at the White House. Meanwhile, the US dollar is likely to come under pressure and US domestically-focussed stocks may suffer due to a weaker currency and continued, subdued consumer confidence. In our opinion, the S&P 500 is attractively valued and we see only modest downside from current levels as we head towards the end of the year.

With Bernanke's position at the Fed seemingly assured, the expectation is for a continued dovish stance and further quantitative easing. This will put pressure on the greenback, primarily benefitting export-oriented and defensive stocks. On the flip side, we expect financials, industrial and energy stocks to come under pressure.

Overall, market multiples are likely to remain depressed as investors await the return of normalized earnings. Over the next 12 months, we expect that US equities will outperform other major markets, albeit not by a significant margin.

European Market View

David Hussey,
Head of European Equities

European markets greeted the morning's news of Obama's re-election with muted enthusiasm. Relieved that political uncertainty has at least now been removed from the picture, European investors seem to be reacting positively to the 'status quo' result, in expectation that it means Bernanke will carry on supporting markets with quantitative easing and a dovish stance on interest rates.

European investors had been concerned about Romney's more protectionist rhetoric on trade and so, from a political perspective at least, world and European trade worries will have been smoothed by the election result.

However, home-grown dangers such as a possible Spanish bailout and another Greek vote on austerity measures aside, the biggest risk to nascent and fragile recoveries in Europe and elsewhere remains the possibility of US politicians failing to agree a solution to the fiscal cliff issue.

Asian Market View

Ronald Chan,
Head of Equities, Asia

Asian markets had largely priced in an Obama win which, most significantly for Asia, supports the theory that quantitative easing is here to stay (so called QE infinity). This means that we are likely to continue to see a weak US Dollar, excess liquidity and a continued risk appetite for some time to come. All of these are likely to bolster Asian equity markets. Continued QE is likely to also support commodity prices (except oil), potentially of benefit to net commodity producing countries such as Indonesia and Malaysia.

Clearly, the major issue concerning markets, Asian markets included, in the next few months is the looming fiscal cliff in the US. This is a real challenge for Obama and investors are preparing themselves for further uncertainty and political gridlock in the weeks ahead. Our central scenario is that the 'cliff' may simply be delayed and the market should expect between 1-1.5% fiscal drag in 2013 as a result.

Today's news is likely to be positive for China as the US/Chinese relationship normalizes thanks to expectations that exchanges between the two countries will be less hawkish under a continued Obama administration. We also expect RMB appreciation may slow as a result. Chinese exports may be affected by increased banking regulations in the US as banks' willingness to lend remains subdued. However, the impact on Chinese exports should be limited given that they have already slowed and become more diversified. Investors should now focus on China's own elections, which may give some pointers as to how China can transform its thus-far export-led growth into more domestic demand-driven growth.

Endre Pedersen,
Managing Director, Asia Fixed Income

As the election results emerged, the US dollar weakened and US Treasuries yields fell in overnight trading in Asia. This is due largely to expectations that quantitative easing will remain a major feature of US economic policy for some time to come.

Meanwhile, there was little meaningful reaction from Asian markets overnight and nor do we expect any significant longer term market impact from the US election results themselves. The markets are anticipating no substantial economic policy shifts in the near term and so we expect the hunt for yield to continue. Asia is likely to be a key destination for yield-chasers and this should provide longer term support for the region's bond markets.

With today's political certainty comes a refocusing on the economic uncertainty of the US fiscal cliff. Ambiguity about this issue is likely to weigh on Asian currencies and the closer we get to the cliff edge, the more likely investors are to run back from the brink towards the relative comfort of safe haven assets such as US treasuries. Short term, this may negatively impact Asian currencies but longer term we still expect to see significant potential for returns from local currency denominated bonds in the region.

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John Hancock Asset Management

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