We're squarely in phase two of our three-phase framework: the stallout

We introduced our three-phase recovery framework last July, outlining key pillars of the recovery—a road map to help navigate a complicated economic rebound. In our view, 2021 will be the year we transition out of phase two and move into phase three: the new normal. We expect global economies to make this transition at different times, with Asia and other manufacturing-based economies exiting the recessionary environments earlier in the year, before their Western peers and other services-based economies. The transition, however, will likely be bumpy, marked by challenges for global central banks and policy makers due to the structural scarring created by the COVID-19 recession.

Our 3-phase recovery framework

Phase 1 : the rapid rebound
(April to ~ September 2020)

- Upbeat economic data
- Release of pent-up consumer demand provides some support to the retail sector
- Extraordinary level of monetary easing
- Record level of fiscal transfers to households

Phase 2 : the stallout
(September 2020 to year-end 2021)

- Economic uplift from income support moderates
- Reduced operating capacity (due to social distancing requirements) hurts business income
- Unemployment in certain segments of the economy remains stubbornly high
- Geopolitical risks come to the fore

Phase 3 : the new normal
(From 2022)

- Structural changes amplified by the COVID-19 outbreak are brought forward
- The shift toward deglobalisation becomes increasingly observable
- Calls for austerity grow louder

A year of two halves

In developed markets, we expect much of the first half of 2021 to be very challenging—the winter months in particular could be uncomfortable, with fiscal spending acting as a critical stopgap until normalisation can begin. While our base-case scenario doesn't include a double-dip recession, we believe this period will be defined by soft economic data and we could even witness recession-like characteristics in some areas. However, we expect this period of weakness to be short-lived as the distribution effort for the various COVID-19 vaccines ramps up. In our view, a gradual return to a business-as-usual environment will create a very favourable outlook for the second half of the year.

Defining macroeconomic features by quarter

First quarter

- We could see periodic surges in infection cases, dampening aggregate demand while significant segments of the economy are subject to new lockdown measures.
- This period's likely to be defined by weak (and increasingly soft) economic data.
- The global economy's likely to experience it's most vulnerable stage during this recovery, igniting speculation about a possible double-dip recession.

Second quarter

- Market focus will likely turn to an expected jump in inflation levels, which will be largely driven by base effects, a weak U.S. dollar, and supply chain disruptions.
- The worst of the expected weakness in economic data should be over by this point, but economic activity such as hiring should remain muted.
- Crucially, economic data wouldn't have been strong enough to warrant anything other than extremely easy monetary policy.

Third quarter

- A combination of warmer weather and vaccine rollout should lead to stronger economic data as revenge spending, particularly in discretionary services, takes hold.
- The return of discretionary services could spur hiring in the services sector, enabling the sector to catch up with its manufacturing peer.
- Combined with the ongoing base effects from inflation, we believe this could be a point where talk of normalisation begins to materialise in the markets. Crucially, we expect monetary policy to remain extremely loose.

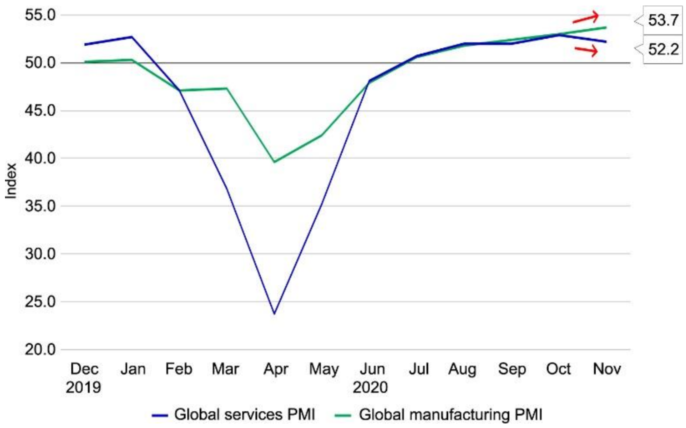
Fourth quarter

- This could be the first quarter that provides a reasonable sense of what the new normal could be like in a post-COVID-19 environment.
- Some economic distortions will likely persist, including favourable second-wave base effects, and residual pent-up demand in areas such as travel; however, the quarter should provide a baseline for what activity in 2022 could look like.

The recovery takes on a more prominent K shape

We expect the K-shaped nature of the recovery to become more accentuated in 2021 as global manufacturing sectors roar back to pre-COVID-19 levels early in the year while global services and hiring activities struggle to recoup 2020's losses even after taking into account likely growth in the next 12 months. This divergence will likely add to the disconnect between global equity markets—typically biased toward manufacturing and tech sectors—and the global economy. It also suggests that stock markets with a bigger manufacturing component (emerging markets) could see higher returns. Crucially, a K-shaped recovery could aggravate global income inequalities.

A growing divergence: global manufacturing and services Purchasing Managers' Index (PMI)[1]

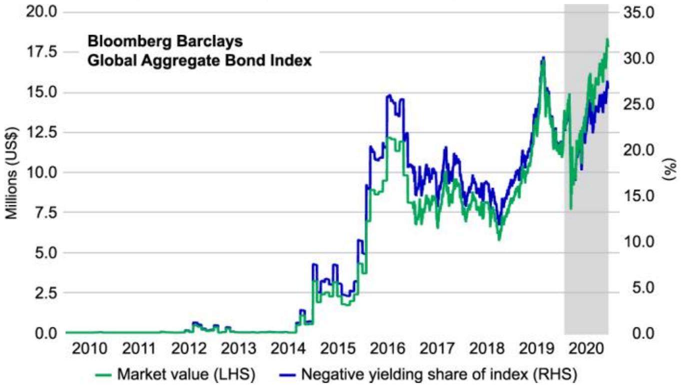


The new normal: very low interest rates and very high government spending

While the first half of 2021 will likely be focused on downside risks and growth challenges, we're confident that the global economy will continue to be supported in important ways: extraordinary accommodation from central banks and rising fiscal spending from national governments. These policies carry two important implications for investors in the year ahead: First, the search for yield narrative will continue to dominate, sending investors further out on the risk spectrum and deeper into alternative asset classes; second, as fiscal spending rises, so will government issuance (particularly at the long end of the curve), potentially driving up long-term rates, steepening the yield curve.

1. Source: Macrobond, Manulife Investment Management, as of 21 December 2020.

Share of global negative yielding debt[2]



U.S. Treasuries 2-year, 30-year

Hidden themes to watch in 2021

Our base-case expectations for 2021 contain no surprises—we think it's almost predictable given the context within which we're working, knowing what we know, even though we're still facing an incredible level of uncertainty. However, in light of the sizable policy responses to COVID-19, and the economic transformations and acceleration of macro trends in the months since the health crisis, we've identified some nascent themes that bare monitoring in 2021. To be clear, these themes aren't likely to be primary growth drivers in 2021, but they will, in our view, become increasingly relevant to investors.

Themes to monitor[3]**:**

1. Monetary policy and fiscal policy convergence, and the gradual rise in popularity of the modern monetary theory
2. An increased mainstream focus on cryptocurrencies as a reaction to massive central banking easing and the growing size of government
3. A shift in central bank focus toward broader social issues, including income and racial inequalities, climate change, and housing affordability
4. The continued rise of sustainable investing through the lens and the incorporation of green government spending

2. Macrobond, Manulife Investment Management, as of 11 December 2020. The gray areas represent recession.
3. Source: Chicago Board Options exchange, Manulife Investment Management, as of 28 September 2020.

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