Manulife Investments
MUTUAL FUNDS

Market Insight

MFC Global comments on market events

As at October 15, 2008

‘Unprecedented Times’ – Four Perspectives on the Canadian Equity Landscape

Lead managers for MFC Global Investment Management’s four key Canadian equity strategies provide their perspectives on market events to date, the impact on the respective strategies they manage and how they are positioning their strategies to the benefit of securityholders.

Pat McHugh, MA, CFA
Vice President & Senior Portfolio Manager
Manulife Canadian Core Fund
Manulife Core Balanced Fund

■ While we continue to hold the view that our market is attractively valued (and becoming even more so with every passing month), consensus opinion is now questioning the prospects of a global recession. While the fundamentals of the Canadian economy are on a solid footing, it is highly unlikely that our economy will not be impacted by a decline in global aggregate demand. The good news though is that history has shown that the stock market recovers most dramatically after bear markets and that returns in excess of 20% are not uncommon.

■ As of September 30th, the Canadian stock market traded at a price-to-book (P/BK) multiple of 1.8x, down most dramatically from the 2.5x figure of merely three months ago. The trailing price/earnings (P/E) ratio is 11.4x; and 8.8x if based on 2009 consensus estimates. These multiples are historically attractive, rivaling levels not seen since the late 1980’s. In addition, the trailing P/E ratio is more than one standard deviation less than the 20-year median figure – an attractive opportunity seldom offered to investors.

■ Consensus estimates for 2009 call for a 24% increase in earnings with ten GIC sectors expected to show positive earnings growth. However, the spread of estimates are widening with some strategists now calling for a low single-digit rate earnings growth (and some question even those estimates as too optimistic). Given that expectations of a global recession are building, we expect current estimates to decline in the not-to-distant future. As such it is clearly an academic exercise to put forward any return expectation under conditions of weakening consensus estimates and fragile valuations. We need further evidence of a solid consensus and a valuation measure before we dare stick our neck out.

■ Nonetheless the market is attractively valued on a P/BK value basis and a P/E basis. In addition, the S&P/TSX Index rewards the patient investor with exceptional performance post crashes and corrections (after the 1987, 1998 and 2002 periods the stock market index advanced 19%, 37% and 20% respectively). We are confident the next cycle will be no exception.

■ We are encouraged by the market performance of our financial services stocks, especially the banks and insurance companies, and feel that this positive performance is a harbinger that a bottoming process in the Canadian equity market is beginning.

Alan Wicks, CFA
Vice President & Senior Portfolio Manager
Manulife Monthly High Income Fund
Manulife Dividend Fund
Manulife Canadian Value Fund

■ This is a financial crisis in proportions that we haven't witnessed before. The combination of evertightening credit markets and a weakening global economy have prompted central banks and governments around the world to take unprecedented action. Initiatives such as the Commercial Paper Funding Facility proposed by the US Federal Reserve, the Troubled Asset Relief Program proposed by the US Treasury, the co-ordination of a global interest rate cut, and the trillion dollars set aside by foreign governments to bail-out banks, are only now starting to appease investors as evidenced by Monday and Tuesday's rally.

■ Despite the market sell-off, Canada is in a much better position than our neighbours to the south. And it is unlikely that Canada could experience similar events. There is no "subprime" market in Canada as there is in the U.S. As well, Canada has safety backstops such as non-deductible mortgage interest, minimum down payment requirements and CMHC mortgage insurance requirements that ensure homeowners have a vested interest in their property.

■ Over the past year we have maintained an underweight in the materials and energy sectors, due to a combination of excessive valuations and more recently, expectations of a global slowdown. We have preferred to be overweight consumer staples and financials where companies continue to trade at, in our opinion, deep discounts. The funds have benefited as of late due to that positioning.

■ Equity valuations across the board are extremely attractive and are at levels that have not been seen in decades. Expectations for further economic weakness in the United States are likely to carry negative implications for Canada. That, in combination with continued investor uncertainty will keep volatility at heightened levels over the near term.

Shauna Sexsmith, CFA
Vice President & Senior Portfolio Manager
Manulife Canadian Equity Fund
Manulife Global Leaders Class

■ We continue to maintain our strategy of buying good companies that will benefit from strong long term fundamentals in their respective industry.

■ Going into this turmoil we were very underweight the financial sector (about 8% below benchmark) while being overweight "real economy sectors" - energy and materials. Our financial underweight was based on our research showing the inherent risks within the financial system and the over leverage/under capitalization of the banking market. Our overweight in "real economy sectors" reflected our view of secular growth in emerging markets raising demand and global prices for raw materials and infrastructure around the globe.

■ Currently, our strategy has not changed. We are still very underweight the financials sector with a modest overweight in the energy sector and a significant overweight in materials.

■ Some of our materials sector overweight is attributed to our position in gold, which we have taken up throughout this crisis, given its role as a safe haven, but overall, we still believe we are in a secular bull market for commodities. The emerging markets may slow a bit, but will continue to demand record amounts of raw materials resulting in a boon for Canadian commodity producers. China for example can grow at half of what they

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did back in 2004, but still demand more tonnes of steel given the law of absolute numbers. Commodity producers are now trading at exceptional valuations (2-4P/E and cash flow in some cases). Furthermore, if you look back at history, commodity cycles are wrought with sharp corrections. In this cycle alone, oil has corrected more than 40% three times since 1999, yet each time it has not been the end of the bull market.

■ Our underweight in the financial sector is still attributed to further deleveraging of banks globally, alongside more capital raising (thus a further dilution of shareholder equity). We view the business models of a lot of these financial institutions as broken and should see a sector-wide decline in return on equity.

Ted Whitehead, CFA
Vice President & Senior Portfolio Manager
Manulife Growth Opportunities Fund

■ The recent events have been unprecedented. Confidence in the financial system globally has deteriorated. Fear has reached new heights as measured by the VIX index (volatility) and the TED spread (the spread between 3 month US treasuries and the LIBOR rate).

■ The US Federal Reserve and Treasury Dept. have taken steps to bailout the troubled financial companies. The US treasury advocated a $700 billion bailout package to effectively remove ‘troubled assets’ from balance sheets of financial institutions and put them on the government’s balance sheet, freeing up capital and providing stability to the marketplace. The approved legislation represents a start to providing real solutions to the problem. In addition, the Federal Reserve intends to participate in the Commercial Paper market to ensure commercial borrowers can refinance and extend credit.

■ Canadian small-cap stocks have fallen dramatically and continue to underperform large cap stocks. The sell-off in equity markets has been widespread with no sector spared. The energy and materials sectors which had outperformed in the first half of the year declined dramatically since midsummer.

■ Equity markets appear to be pricing in a severe slow down. Although a global economic recession appears inevitable, we are more optimistic on the equity markets. The markets appear to have discounted a lot of bad news. Small caps are cheap relative to large caps and in fact, are as cheap now as they have been in 15 years on a relative price to book ratio. The key moving forward will be a return of confidence in the financial system. Once sentiment begins to change equity markets may find their footing with a fourth quarter rally possible.

For more information, please contact your financial advisor.

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