Manulife Follow up - Capital Markets Update with Philip Petursson

Submitted by Anar on March 17, 2016 - 10:40pm

3 Key Contributors to Market Volatility

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1. OIL:

- Oil prices and general commodity weakness has been and will continue to be a drag on the overall economy and a cause of market volatility.

- Most of the excess supply coming from US Shale producers. We expect US production to decrease in the back half of 2016 as US shale wells near the end of their 3 yr life span.

- 0.85 correlation between CAD and oil. If oil prices increase, CAD will rise. This creates a headwind for assets owned outside of Canada, especially in the US.

Our target range for the CAD over the next 12-18 months is $0.77 to $0.80. A rising CAD will create a headwind for assets owned outside of Canada, especially in the US. Therefore, we have hedged most of our USD exposure in our US equity and balanced funds back to CAD.

2. US INVENTORY CORRECTION:

- No signs of a recession in US: No inverted yield curve, no labour market contraction, no inflation spike, no housing slowdown. Instead, what we are seeing is a mid-cycle slowdown.

- Inventory glut in the US manufacturing system is putting pressure on profit margins. Negative earnings growth leads to the re-pricing of stocks which further leads to short term market volatility.
- We expect the inventory re-balancing to last another quarter.

- Potential for mid-single digit positive returns in 2016. However, with the S&P trading at 18X earnings, there is less upside potential than what we saw in 2011-2012 (12X earnings).

- More opportunities in US High Yield. Attractive yields. Full upside capture with half the volatility of equities.

For a de-risking opportunity, consider shifting some US Equity into US high yield (ex Energy) to reduce risk without giving up returns.

3. DEVALUATION OF CHINESE YUAN:

- China is slowly shifting from an export-based economy to one that is consumption-based. However, consumption growth has not kept up with the drop in exports. Global export numbers are negative YoY.

- With the Yuan pegged to the US Dollar, exports have become less competitive relative to its Asian and European competitors due to the strengthening of the USD. Chinese goods are costing 35-40% more today than in 2010.

- To compensate, the Chinese government will aggressively continue to devalue the Yuan which will drive capital outflow and increase equity market volatility.

IN SUMMARY:

We have seen a brief rally in the markets the past couple of weeks. However, we feel this does not reflect a change in fundamentals. Rather, the recent run has been more a function of short covering in what we see as a mid-cycle slowdown. (Please see attached Week in Perspective: Keeping Score).

For an opportunity to de-risk a portfolio, consider shifting some US Equity into US High Yield (ex energy). HY currently offers a very attractive yield and offers investors full market capture with half the volatility of US equities.

For global exposure, consider de-coupling the assets into hedged US exposure + unhedged international exposure to protect your portfolio in the event of a rising CAD. See sample portfolio below.

RECOMMENDED ASSET ALLOCATION: 50% Equity / 50% Fixed Income

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SAMPLE PORTFOLIO

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Mandates to consider:

Manulife Dividend Income Fund (Cdn Large Cap Equity)
Manulife US All Cap Equity Fund (US Equities - 100% Tactically Hedged)
Manulife Strategic Balanced Yield Fund (US Equities + Global Fixed Income - 100% Tactically Hedged)
Manulife Strategic Dividend Bundle (Cdn Large cap equities + global Fixed Income)
Manulife Yield Opportunities Fund(Cdn large cap equities + North American Corporate / High Yield)
Manulife Strategic Income Fund (Core Bond holding. 100% tactically hedged)
Manulife World Investment Class (International Equity ex Canada/USA)

**** Note: All of the above funds are available on our Seg Fund InvestmentPlus Platform ****

Attachment	Size	Type
MK3323EMarket Intelligence ReportQ1LR - PUBLIC.PDF	2.13 MB	application/pdf
Weekly Perspective - Keeping Score.pdf	270.93 KB	application/pdf