Manulife Mutual Funds

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CANADIAN EQUITIES

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Earnings, global upturn support further gains

Canadian stocks have rallied on the improving global economic and risk backdrop. Rising earnings and bond yields bode well for further gains this year.

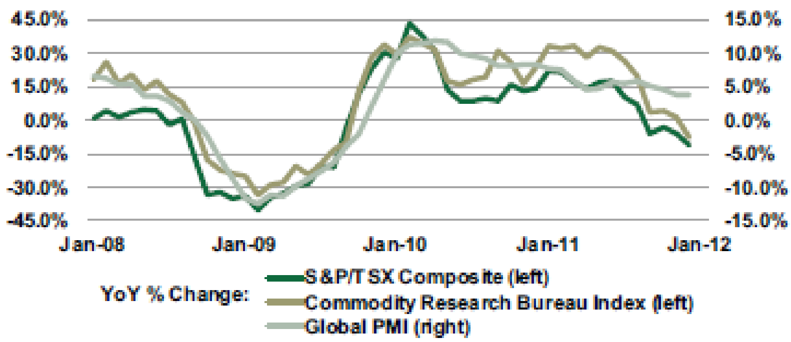
S&P/TSX Composite Index (Total return)	As of March 31, 2012 3 Months	12 Months
USD Return	4.4%	6.3%
CAD Return	-9.8%	-12.4%

Source: Bloomberg. For illustration purposes only.

The recovery in equity markets that got underway last October was confirmed in March, when the three major U.S. equity indices (Dow, NASDAQ and S&P 500) closed above 13,000, 3,000 and 1,400 points, respectively. Strong economic data, upbeat comments from the U.S. Federal Reserve's Open Market Committee (FOMC), good results in the Fed's stress tests of U.S. banks, and a hint of inflation combined to push 10-year Treasuries over the 2 per cent threshold and pull up equity valuations. Canada's S&P/TSX Composite Index was up 4.4 per cent in the first quarter and 8.1 per cent since the end of the third quarter. For the balance of this year, we expect Canadian equities to advance further, but only expect single digit returns between now and year end. Most of the risks to further returns are headquartered overseas, in the Middle East, Europe and China. Given the many risks and unknowns, large cap stocks are preferred over small caps. While Canadian equities are not expected to outperform U.S. equities, they should trounce cash and bonds.

The global economy is reaccelerating and the breadth of the recovery is improving as witnessed by recent strong economic data out of Japan, India and Mexico. While Europe is still in a recession, the risks have been significantly reduced by the successful Longer Term Refinancing Operation (LTRO). Meanwhile, earlier concerns about a possible stalling of the U.S. recovery have waned – last week was the 24th consecutive week of stronger U.S. economic data. Investor speculation about a third round of quantitative easing has greatly diminished as a result of the upbeat nature of the last Federal Open Market Committee (FOMC) commentary. Also importantly, 15 of 19 U.S. banks passed the Fed's recent stress test, with many increasing dividends and announcing share buybacks.

As global indicators turn, so should TSX



Source: Bloomberg (March 19, 2012). For illustration purposes only.

Economic data out of China has been mixed, but it should be noted that January and February data are seasonally less important due to the Lunar New Year holiday. March is a far more important month as it marks the start of the strongest period of industrial production, continuing through September.

Despite gains, stocks still cheap

Despite the rally that started last October, Canadian stocks remain cheap, albeit less so. The index is trading at a 28 per cent discount to the long-term pricebook multiple and a 39 per cent discount to the long-term forward price-earnings (P/E) multiple. Even the three largest components of the index, energy, materials and financial services, are at substantial discounts (15 per cent, 64 per cent and 19 per cent, respectively) to their long-term forward P/E multiples.

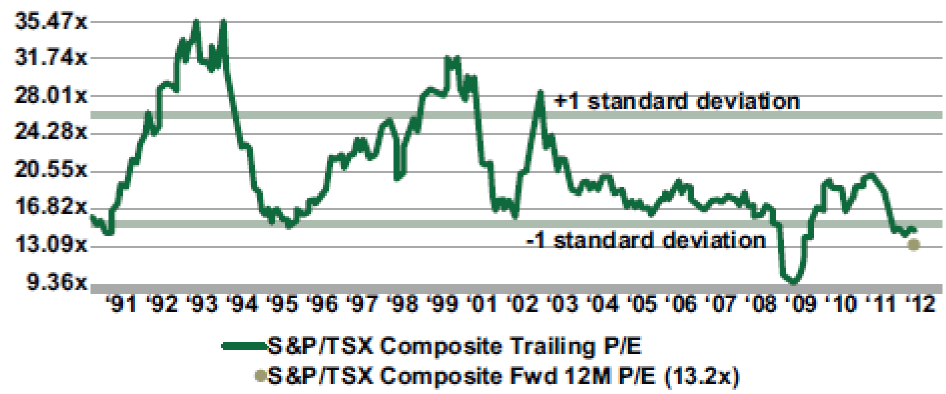
Main sectors trading at large discounts

Discount/Premium to History 2002-11			
Sector	P/B	Fwd P/E	ROE
Energy	-34.48%	-15.14%	-4.83%
Materials	-37.40%	-63.93%	8.61%
Financials	-23.16%	-19.14%	-1.61%
Industrials	27.91%	-29.01%	9.81%
Consumer Discretionary	-31.76%	-47.47%	2.60%
Consumer Staples	-27.08%	-24.28%	-0.27%
Health Care	32.91%	-17.39%	5.71%
Info. Technology	-65.19%	-69.63%	1.52%
Telecomm. Services	12.90%	-52.53%	13.95%
Utilities	-5.59%	-9.66%	0.01%
Median	-25.12%	-26.64%	2.06%
S&P TSX Composite	**-27.89%**	**-39.02%**	**0.88%**

Source: Morningstar Research Inc. consensus estimates (March 19, 2012). For illustration purposes only.

Currently, the forward P/E of the Canadian market based on 2012 consensus earnings is 13.x, more than one standard deviation below the long term average. Index earnings are forecast to grow by 12 per cent and 15 per cent in 2012 and 2013 respectively. While we fully expect negative revisions to the current forecast, the market still has the potential to advance much further based on historic trends.

P/Es still have substantial upside



Source: Morningstar Research Inc. (March 19, 2012). For illustration purposes only.

We expect Canadian equities to advance further but only single digit returns between now and year end. Equities and bond yields have displayed a strong positive correlation in recent years, and with the recent spike in the latter to above 2 per cent, we believe investors have seen the bottom in equity valuations. A further rise in yields should support relative equity outperformance, but absolute gains should moderate. Where appropriate in terms of an overall portfolio, investors are encouraged to add to equity exposures on dips or corrections, focusing on large cap stocks and avoiding extreme cyclical bets until further evidence warrants.