

**Roger Hamilton**

Portfolio Manager

Manulife Asset Management (U.S.), LLC

Outlook buoyed by liquidity, economic recovery

U.S. equities have rallied since late 2011 and look set to continue doing so as economic gains, cheap valuations and massive global liquidity more than offset slowing earnings growth.

S&P 500 Index (Total return)	As of March 31, 2012	
	3 Months	12 Months
USD Return	12.6%	8.5%
CAD Return	10.6%	11.8%

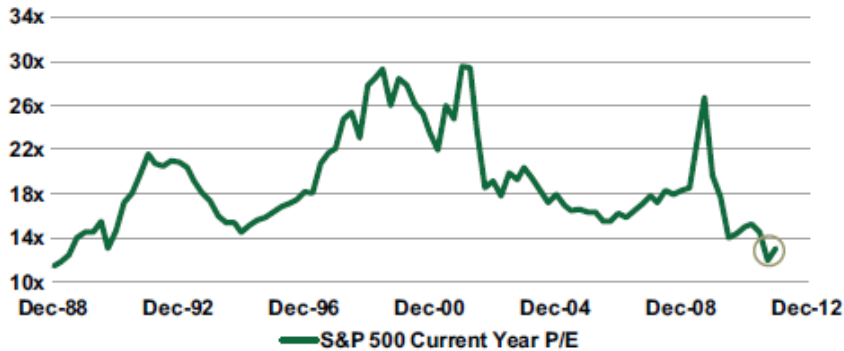
Source: Bloomberg. For illustration purposes only.

The S&P 500 roared out of the gate to start the year as a continuing economic recovery in the U.S. and massive easing by central banks around the world reduced investor fears. U.S. economic data has been improving for six months now since last year's soft patch. The most powerful monetary stimulus has come from the European Central Bank in the form of two Longer Term Refinancing Operation (LTRO)s worth a total of one trillion euros, which have reduced the liquidity risk in European banks.

The market also rose on the back of a roughly one and a half point increase in the market's 2012 price-earnings (P/E) multiple to approximately 13.5 times, but not on an increase in consensus earnings estimates. In fact, the earnings results for the December quarter were slightly disappointing as the number of companies beating their estimates was down from the prior few quarters. Cyclical sectors have generally performed best, but the market is not experiencing the pure risk-on (or risk-off) action that it had last year. Market volatility and stock correlations have declined as the market moves further away from the bottom of last year's trading range. The total rally from the S&P 500 Index's October 3rd low was 28 per cent through March 31.



Stocks rose in early 2012 on P/E expansion



Source: Standard & Poor's (March 22, 2012). For illustration purposes only.

Financials and technology have easily been the two best performing sectors. Banks have rallied on the improving U.S. economy and the generally positive outcome of the Federal Reserve's stress tests. In technology, one dominant consumer electronics stock has accounted for a good percentage of the sector's strong performance on stunning fourth quarter smart phone sales, the release of a new tablet computer and the announcement of a dividend. This company and its supply chain have grown so large that a stance on the technology sector almost requires an opinion on it. The company has recently accounted for over a quarter of the sector's operating income and, in recent releases, the sector's operating metrics excluding this stock have not been especially strong.

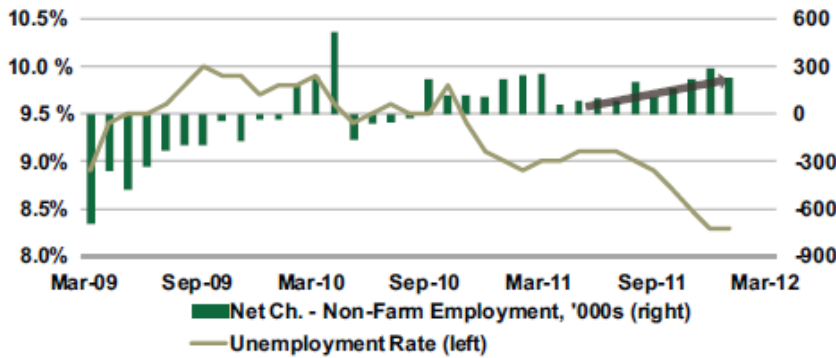
Multiples may expand further

The global easing and the U.S. economic recovery are the two most important factors for the U.S. stock market today. Together, they could drive further multiple expansion and the market a little higher, with the caveat that the market may need to take a breather after the strong rally it has had. Still, when central banks are easing as they are now, the easiest path for equity markets is usually higher. In numerous countries a year ago, many central banks were tightening because of rising inflation, which generally is not a problem yet.

These two factors also make it likely that cyclical stocks continue to outperform for now, and they make it more difficult for the market to roll over hard this year as it did a year ago. It is key that the U.S. recovery is on firmer footing this year. Helped partly by a mild winter, both the employment picture and the housing inventory overhang have improved. While high oil prices are an issue again, the U.S. economy's increased strength should make it better able to withstand the current oil prices. If oil prices moved much higher from here, that would be worrisome, but at least a partial offset to that is that natural gas and coal prices are lower this year.



Job gains put recovery on firmer footing

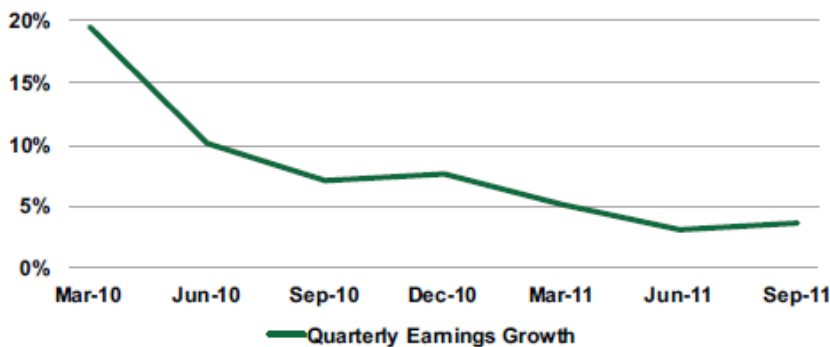


Source: FactSet (March 22, 2012). For illustration purposes only.

Potential multiple expansion for now is probably limited to not much more than another point. That is because the excessive budget deficits and debt of the governments of the developed world that dampen their long-term growth prospects also tend to lower potential stock market valuations. For multiples to move much higher this year would require either credible roadmaps laid out by Western governments for dealing with their obligations, investor exuberance or positive earnings surprises due to a surprisingly large burst in the U.S. economic recovery or a broader Western recovery.

Earnings estimates for the overall market, outside of the surprisingly strong economic growth scenario, will tend to be held in check by waning productivity growth. In addition, some companies are facing foreign exchange and commodity headwinds. In fact, the consensus estimate for 2012 S&P 500 Index per share earnings has already come down from a peak of over \$112 last year to approximately \$104 today. This implies current consensus for earnings growth this year of 7 per cent versus 15 per cent last year.

Earnings face headwinds



Source: Standard & Poor's (March 22, 2012). For illustration purposes only.

Risks include fiscal woes, China growth

Downside risks include the impact of the automatic austerity in the U.S. in the absence of action toward the end of this year. Measures due to kick in include, but are not limited to automatic across-the-board budget



cuts next January and the expiration of tax cuts introduced by previous president George W. Bush at the end of this year. Another issue is the rate of overall growth and of infrastructure spending growth in China, although weak growth would beget more monetary easing. A major issue further down the road is what will be the impact when the global stimulus is reined in.

Whatever the ups and downs of the market are this year, we continue to believe that the long term outlook for U.S. equities is solid. Valuation is undemanding. The combination of relatively stable, subdued long term growth with low interest rates (even with the occasional market shock) provides an environment where investments in secular growth and in managements willing to return extra cash flow to shareholders can thrive. There have been numerous examples of stocks that have done well when managements have surprised the market with an increased cash return. A couple of examples include pharmaceutical company Amgen Inc. and derivatives exchange operator CME Group Inc.

Technology remains our favorite sector from a risk/reward perspective. It offers secular growth and the potential to return more cash. The ongoing shift to mobile and cloud computing is powerful and durable. Finally, the sector is sitting on well over a third of all the cash held by market constituents (ex-financials), yet pays out only 15 per cent of that in dividends, a pay-out ratio that is about half that of the broader market.

FOR MORE INFORMATION, PLEASE CONTACT YOUR ADVISOR OR VISIT MANULIFEMUTUALFUNDS.CA



 **Manulife Mutual Funds**
 | **For your future™**

This commentary reflects the views of the sub-advisor(s) of Manulife Mutual Funds. These views are subject to change as market and other conditions warrant. Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated. Manulife Funds, Manulife Corporate Classes and Manulife Leaders Portfolios are managed by Manulife Mutual Funds. Manulife, Manulife Mutual Funds, the Manulife Mutual Funds For Your Future logo, the Block Design, the Four Cubes Design, Strong Reliable Trustworthy Forward-thinking and Manulife Leaders Portfolios are trademarks of The Manufacturers Life Insurance Company and are used by it, and by its affiliates under license.