Agenda

- A Diverse History of Asset Allocation
- Asset Allocation in Practice
- How it Fits in Today’s Market
A Diverse History of Asset Allocation
My asset allocation? 40% 'ying' and 60% 'yang'."
A Diverse History of Asset Allocation

93.6%

Asset Allocation explained 93.6% of the variation in a portfolio’s quarterly returns.

Determinants of Portfolio Performance

Brinson, Hood, and Beebower, 1986

91.5%

A follow up study in 1991 confirmed the results of the original study.

Determinants of Portfolio Performance

Brinson, Hood, and Singer, 1991
What The Study Really Means?

Canadian Neutral Balanced
5 Year Return = 6.6%

- Cash, 6%
- Canadian Equity, 32%
- US Equity, 15%
- International Equity, 5%
- Fixed Income, 40%
- Other, 3.10%

Global Neutral Balanced
5 Year Return = 7.6%

- Cash, 6%
- Canadian Equity, 16%
- US Equity, 22%
- International Equity, 12%
- Fixed Income, 40%
- Other, 4.80%

Source: Morningstar.ca as of December 31, 2016
“The Asset Allocation Hoax!”

“Asset allocation should be viewed as a dynamic process. It should take into consideration both pension obligations (or, in the case of the individual investor, investment goals) and capital market opportunities, including risk.

“...The idea that the most important investment decision should be fixed at some arbitrary point in time is strange advice. The advocates of fixed weight allocations often rely on historical returns to determine the allocations.

“...the unfortunate result for many investors who buy into the fixed-weight asset allocation policy argument will be the failure of their asset allocation and savings program to achieve their financial goals, because they are not forced to evaluate realistic investment return opportunities and their financial planning implications.”

William W. Jahnke, February 1997
There is a Difference between Diversification and Asset Allocation

DIVERSIFICATION

Static
Risk-based
Unchanging
“Set it and forget it.”

ASSET ALLOCATION

DYNAMIC
GOALS-BASED
TACTICAL
“GO WHERE THE PUCK IS GOING.”
There are windfalls and shortfalls to every asset class

Let’s Assume:

Between 1975-2016

$1,000 investment monthly in a balanced portfolio
60% stocks/40% bonds
(S&P 500 Index/US Aggregate Bonds)
dividends reinvested and rebalanced

How did you do over 20 years?

Source: Manulife Investments & Bloomberg – For Illustration Purposes Only
Asset Allocation in Practice
The beauty of diversification is, when some stocks go down, others go up and vice versa. That way, over time, the value of the whole portfolio...goes...um, nowhere.
Investors are their own worst enemy!

DALBAR QUANTITATIVE ANALYSIS OF INVESTOR BEHAVIOUR
FOR PERIOD ENDED: 12/31/2015
ANNUALIZED RETURNS

Investor Equity Return
Investor Asset Allocation Fund Return
S&P 500 Index
Barclays Aggregate Bond Index

Identify the Relative Opportunity through Macro-Economic Factors that Support Valuation and Earnings

- Economic Factors
- Valuation
- Earnings

The larger the circle, the larger the weight

US Equities

Canadian Equities

Asia ex-Japan Equities

EAFE Equities

Manulife
Changes in asset allocation over time, shifting to the better relative opportunity set offers the potential to enhance returns over a static asset allocation benchmark.

Source: Manulife Investments & Bloomberg as of December 2016 – For Illustration Purposes Only
2017
The Year the Markets Push the Boat Out
The Trumpification of America

1. Corporate tax cuts
2. De-regulation
3. Repatriation of foreign profits
4. Fiscal spending
The Global Economy is Improving
Global Trade is Starting to Improve

Year-over-year Export Growth By Country
(2010 - current)

China Exports (USD) YOY
US Exports YOY
Japan Exports YOY
South Korea Exports YOY
German Exports YOY

Source: Manulife Investments, Bloomberg. As of February 28, 2017

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Current U.S. Economic Expansion
4th Longest Since WWII

Average expansion lasts 58.5 months, current has lasted over 90 months

Economic expansions have a shelf-life, we are nearing the end of this one

The current expansion has been weaker in terms of growth than past expansions, but that doesn't necessarily mean it will last longer

Source: Bloomberg, Manulife Investments. Average does not include current cycle. As of March 31, 2017
Typical Signs Of Recession Are Not Present

<table>
<thead>
<tr>
<th>Sign of Recession</th>
<th>Present today</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inverted Yield Curve</td>
<td>No</td>
</tr>
<tr>
<td>ISM Manufacturing PMI Below 45</td>
<td>No</td>
</tr>
<tr>
<td>Positive Inflationary Trends</td>
<td>Yes</td>
</tr>
<tr>
<td>Capacity Utilization above 80% and peaking</td>
<td>No</td>
</tr>
<tr>
<td>Housing Starts Declining</td>
<td>No</td>
</tr>
<tr>
<td>Labor Market Weakening</td>
<td>No</td>
</tr>
<tr>
<td>Leading Economic Indicators Negative</td>
<td>No</td>
</tr>
</tbody>
</table>

- There are usually leading indicators to a recession, the most prevalent is an inverted yield curve.
- Currently, we do not have any of the typical signs of recession and as such, we continue to believe recessionary risks through 2017 remain low.
- Most bear markets coincide with recessions and therefore we do not anticipate the current market volatility to result in a bear market.

Source: Manulife Investments

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The North American Opportunity
TSX Earnings YoY Follows WTI YoY

Change in Oil Price (YOY) vs Change in S&P/TSX Earnings per Share Lagged 3 Months (YOY)
1995- current

Oil at $45 or higher will result in higher S&P/TSX earnings growth through Q1 2017

(shaded area is an estimate of yoy change based on $45US/bbl)

Source: Bloomberg, Manulife Investments. As of April 30, 2017
Rig Count Is Picking Up, But…Still A Long Way Off Of Highs

Production lags rig count by approximately 6 months. New (and more productive) rigs are being added which is likely to keep oil prices range bound. US production may offset OPEC cuts.

Source: Manulife Investments, Bloomberg. As of April 21, 2017
P/E – Inflation Relationship Implies Full Valuation


+1 Standard Deviation = 24.7
Avg. 1 Year Forward Return = -0.3%

-1 Standard Deviation = 16.6
Avg. 1 Year Forward Return = +16%

Source: Manulife Investments, Bloomberg. As of March 31, 2017
ISM Manufacturing PMI Indicates
A Healthy Rebound To Earnings Growth Near-term

At current levels the PMI would imply positive earnings growth for the S&P 500 Index through the first half of 2017

Source: Bloomberg, Manulife Investments. As of March 31, 2017

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Is “Lower for Longer” Still Relevant?
Source: Global Financial Data and Manulife Investments. As of December 2016. For illustration purposes only.
The Fed is Fully Justified to Continue Tightening

Federal Funds Rate vs Inflation Indices
1971 - Current

Source: Manulife Investments, Bloomberg. March 31, 2017
Wage Inflation Will Continue to Build

As Unemployment Falls, Wages Rise (lagged 6 months)
2000 - Current

Source: Manulife Investments, Bloomberg. April 30, 2017
Inflation Isn’t As Transient As Some Believe

Assuming US$50 Oil, Wages, and Owners’ Equivalent Rent and DXY Remain on Trend, CPI is Forecast to Stay Above 2.0% through most of 2017.

Source: Manulife Investments, Bloomberg.  April 30, 2017
Investors Will Not Be Satisfied With a Negative Real Yield

Term Premium - US 10 Yr. Yield less CPI YoY
1971 - Current

Source: Manulife Investments, April 30, 2017
Outlook for 2017
What to Expect in 2017

- Higher confidence in the global economy but continued modest expected equity returns
  - Earnings are set to improve
  - Valuations are already reflecting that
  - PE ratios always fall when the Fed raises rates
  - Valuation & earnings will offset each other

- Yields have hit an inflection point
  - The Fed will continue to raise rates
  - Inflation will continue to move higher
  - Bonds will continue to underperform

- Defense takes on a whole new meaning
  - Shift from fixed income back into equities on the dips
Capital Markets & Strategy Model Portfolio

Source: Manulife Investments. As of March 31, 2017

- Sovereign & Investment Grade Corporate Bonds, 30%
- High Yield Bonds, 10%
- International Equities, 15%
- Canadian Equities, 20%
- US Equities, 25%

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Thank you
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