MFC Global Investment Management®

ASSET ALLOCATION VIEW

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Tactical Asset Allocation Committee

Asset and Market Survey

Economy — Continued strength implies earlier monetary tightening

As we foretold in recent months, economic data has been beating consensus estimates, though not consistently across indicators or geography. US data has been most disproportionately ahead of expectations, although that underlying trend may be temporarily obscured by the effect of severe winter weather in February. Positive surprises have also been registered in Europe, though mostly in non-eurozone countries such as Switzerland and Norway.

The better than expected numbers mean some global central banks (though not the US Federal Reserve) are now seen tightening monetary policy earlier than previously expected. Some have already started, such as Australia's, which raised its policy rate another 25 basis points this week. Strong GDP data helped prompt the Bank of Canada to drop references to deflation concerns in its latest statements and could see that bank raise rates as early as the summer. The global improvement in economic fundamentals is already slowing, though, so the downside risk will be whether the improvement actually reverses course.

Fixed Income — Positive on high yield in short and long term

High yield bonds continue to offer one of the best expected risk-adjusted returns over the short and long term*. Ongoing economic improvement continues to reduce the risk of default. Further tightening of credit spreads is expected to be minimal, but yields are high enough to offer the possibility of very high single-digit returns over the next 12 months even against a backdrop of gradually rising treasury yields.

Equities — Selectively negative short term

The negative view on equities remains in place, although the drivers for a correction appear to be losing steam. Improving economic fundamentals are once again boosting risk appetites and credit conditions have improved dramatically. High-yielding equities in some markets, like EAFE (Europe, Asia and the Far East) look attractive. But the weakening of the bearish case against equities is a very market-specific phenomenon. For example, the US market faces the prospect of further multiple contraction in 2010 and sentiment, though less bullish, is not yet flashing a buy signal.

Emerging Markets — Positive short term

Emerging market equities have been among the hardest hit so far this year and now look attractive over the short term. These markets will tend to react more to sovereign debt jitters, though, and still face greater risk than developed markets in the case of a broad equity market pullback over the longer term.

Currency — Positive short term on commodity, trade plays

The rally in commodity currencies is expected to continue. Currencies leveraged to rebounding global trade, like the Korean won, should also do well. The U.S. dollar is expected to come under growing pressure on a rise in risk appetites/flight from safety and as other currencies benefit from earlier central bank moves to tighten monetary policy.

*"Short term" </= 6 months, "Long term" > 6 months

Commodities — Short-term positive on non-oil natural resources

Partly as a reflection of expected weakening in the US dollar and partly on a strengthening global economy, select commodities such as industrial metals are expected to rally in the short term.

REITs — Short-term neutral; long-term positive

Sector fundamentals are expected to continue to weaken in 2010, but prices should find support from an investor focus on 2011-2012, when renewed demand is expected to come up against an expected dearth of new supply and send values higher.

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