MFC Global Investment Management®

TACTICAL ASSET ALLOCATION COMMITTEE

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ASSET ALLOCATION VIEW

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Tactical Asset Allocation Committee

Asset and Market Survey

Economy — Recovery intact, but slowing

The global economic recovery remains intact, but is slowing, as shown by leading indicators virtually worldwide. In the short term*, continued weak job creation has emerged as the biggest risk because of the critical direct link between consumer spending and jobs. The United States is seeing robust hiring in the manufacturing sector, but the overall impact is muted because services account for 70% of U.S. GDP.

Elsewhere, Europe faces a prolonged period of relatively weak economic performance because of austerity measures imposed in connection with an International Monetary Fund rescue package. At the other end of the spectrum, China still faces a danger of overheating – and an eventual hard landing – as evidenced by a recent surge in imports and the related shrinking of the country's trade surplus.

Fixed Income — Short term risk-reward balance tilts in favor of public debt

Weakening risk appetites and the slowing of the cyclical expansion have undercut the short-term attractiveness of high yield bonds. Emerging market debt – often a leading indicator for high yield – is selling off.

The expectation now is that government bonds could outperform other fixed income sectors in the short term as investors push earlier expectations of late-2010 interest rate hikes into 2011. Overall, bonds are expected to outperform equities in the short term, but upside is limited by the already low levels of interest rates and narrowness of credit spreads.

Equities — Japan stands out as potential short term outperformer

Most markets are now characterized by growing bearishness, weakening fundamentals and stretched valuations. The one major exception among developed markets could be Japan, which is enjoying a broader and better recovery than most of its peers not just in its export sector, but also domestically.

Equity markets in general face growing downside risk toward year end as a maturing economic cycle provides less underlying support just as economic surprises could begin to turn negative.

Emerging Markets — Short term negative as recovery more advanced

These markets are generally ahead of their developed peers in a slowing of their economic recoveries and therefore likely to underperform developed market equities in the short term.

Currency — Negative on U.S. dollar, recovery plays

The U.S. dollar faces renewed secular weakness because of deteriorating fundamentals. Commodity currencies that rode the global recovery higher, like the Canadian and Australian dollars, also face a weaker short term outlook due to the deceleration in that recovery.

Commodities — Generally negative; gold benefiting from risk aversion

With the dollar confronting fundamental weakness, gold is the beneficiary of the current flight to quality. Other commodities like oil will weaken in line with demand, although that trend will only be confirmed later in the year.

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

REITs — Negative on debt rollover, liquidity risks

The current flight from risk hurts the real estate investment trust sector in two ways. One, potential investors are again demanding a higher liquidity premium. Two, REITs are expected to have much more difficulty rolling over debt than they did earlier in the recovery.

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