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TACTICAL ASSET ALLOCATION COMMITTEE

MAY 25, 2010

ASSET ALLOCATION VIEW

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Tactical Asset Allocation Committee

Asset and Market Survey

Economy – Global recovery slowing; Europe is the weak link

Global leading indicators are now broadly signaling that the economic recovery, which accelerated in the 11 months through November, is now decelerating as we appear to be in the early stages of a down cycle. Economies continue to improve, but comparisons with year-earlier data are looking less favorable. Economic numbers are now expected to deteriorate starting in the fall.

The U.S. continues to produce strong economic numbers. Concerns now focus on Europe, where an International Monetary Fund rescue package has come with severe austerity measures that are expected to slow growth for the foreseeable future. Social unrest is rising and a scheduled formal review of implementation of the IMF package this fall is expected to produce serious headline risk.

Fixed Income – Opportunities in both credit and public debt

The massive sell-off of risky assets that has taken place in May has put many such assets in oversold positions. Although widening credit default swap spreads reflect renewed credit jitters, U.S. high yield bonds are again looking attractively valued. However, the buying window could be narrow because high yield is expected to be one of the hardest hit assets if economic data begins to deteriorate in the fall.

Despite the rapid shift in valuations back in favor of riskier credit, lower risk public debt in some developed markets like Canada still looks attractive because revised expectations for less aggressive monetary tightening still aren't fully priced in.

Equities – Seen benefiting from renewed risk appetites

Equity markets generally look set to benefit through late summer from revived risk appetites and continued recovery in corporate profitability. Markets like Europe and Canada could see inflows now that the recent weeks' outflow from their currencies into U.S. dollar assets seems to have abated.

Emerging Markets – Expected to outperform in any rebound

Having been more heavily sold off in the recent flight from risk, these markets are expected to outperform their developed market peers in any upcoming rebound.

Currency – U.S. dollar's flight-to-quality gains may have peaked

After gaining on the recent flight to quality, the U.S. dollar is now expected to plateau. Renewed risk appetites are expected to again favor currencies linked to global demand, like the Canadian dollar, and to the extent that sovereign risk jitters ease, the euro.

Commodities – Positive as play on global demand

These assets are expected to benefit from ongoing economic expansion, renewed risk appetites and the leveling out of the U.S. dollar, in which many are denominated.

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

REITs – Positive as liquidity concerns ease

REITs also benefit from any shift to more bullish risk sentiment as the liquidity constraints that real estate is so sensitive to typically ease in such an environment.

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AAV1-MC-0525