

Market **view**

WINTER 2003

Canadian Markets

with **Michael Hatcher**



Michael Hatcher

AVP & Portfolio Manager
Canadian Equities

Throughout 2002, the Canadian economy benefited significantly from a “strong consumer” and the economic fundamentals supporting the consumer remain strong going into 2003. In particular, personal disposable income increased 1.0% during the third quarter, and 5.2% for the year. Consumer confidence, as measured by the Conference Board of Canada, remains above average.

From January to November 2002, 502,000 new jobs were added to the economy and employment growth continues to be strong. The housing market and the auto sector continue to grow and business sector profits continue to improve, with third-quarter operating profits up 2.6% and an annual growth rate of 12.9%.

Three major items that may impact the equity markets in 2003 are: interest rates, world industrial production, and corporate profits. Improvement in these areas should bode well for the equity markets. Of course, geopolitical events

could have significant impacts on short-term returns for the equity markets. Barring an extraordinary event, the long-term impact should be minimal. With the economy operating in a 2.5–3.5% growth range, the equity markets should be in a position to outperform bonds in 2003. After three difficult years for the equity markets, it is reasonable to expect that returns in 2003 will be close to the long-term average.



Fixed-Income Markets

with Gary Stewart



Gary Stewart
Vice-President
Fixed-Income

As the fourth quarter opened, North American interest rates were under upward pressure, due primarily to very strong equity performance. However, on November 6, the Federal Reserve lowered interest rates by 50 basis points. This action, combined with increased global political tension, the persistent threat of further terrorist attacks, and falling stock prices, subsequently drove interest rates lower. The ten-year U.S. Treasury ended the quarter 20 basis points higher, while the 30-year U.S. Treasury was higher by only 8 basis points. Canadian bond yields outperformed U.S. yields, ending the quarter lower by 11 and 7 basis points, respectively. Canadian bonds had substantially underperformed U.S. bonds throughout the rally during the summer, but outperformed the U.S. market in the sell-off. Canadian bonds were also positively affected in the fourth quarter by large seasonal cash inflows into the Canadian bond market.

Over the quarter, Canadian credit spreads narrowed about 15 basis points, ending the year virtually unchanged. In the U.S., credit spreads narrowed over 40 basis points, but still ended the year materially

wider. U.S. credit spreads remain sensitive to general credit concerns, exacerbated by investors' loss of confidence in U.S. corporate accounting procedures and corporate governance.

U.S. Markets

with **Mark Schmeer**



Mark Schmeer

Managing Director
North American Equities

We expect double-digit returns this year, and we believe that if there are any surprises, they are more likely to be positive surprises. Real disposable income was up 6% in the year ending November 30, and we expect consumer spending to remain healthy. Payroll employment turned positive in May, and it appears we are poised for yet another mortgage refinancing boom.

Business spending increased by 0.6% in the third quarter, the first increase in two years; IT spending as a percent of depreciation bottomed in the first quarter and has moved higher since. In a recent survey of CIOs, 44% said they expected to spend more on PCs in 2003 than in 2002. Capital spending is closely tied to earnings and cash flow, and both have turned up.

And finally, the Bush administration's economic stimulus plan will likely add something close to \$100 billion in tax cuts and additional spending in its first year. If passed, the plan will increase the relative attractiveness of stocks, compared to bonds and REITs, and the relative attractiveness of high-dividend-yielding stocks and growth stocks, compared to value stocks.

There are a number of risks, including accounting fraud and the possibility of war with Iraq, however there have been no significant new accounting fraud stories in months and we believe this issue has been laid to rest. War and terrorism are persistent concerns and the stock market's record during wars is mixed, ranging from 0.6%, annualized, during the Vietnam War to 16%, annualized, during WW II. The most appropriate comparison, however, is likely to be the Gulf War, during which the market returned 10%, annualized. So we conclude, that stocks are a pretty good buy at this time.



Global Markets

with Robert Lutzko



Robert Lutzko
VP &
Senior Portfolio Manager

After a sharp sell off in the first nine months of the year the Dow Jones World Stock Index rallied to finish up 6.8% in the fourth quarter. This marked the third consecutive year that global equity markets finished lower as the Dow Jones World Stock Index finished down 20.0%. While there was little to cheer about this year, we are encouraged by the strong finish to the year.

Regionally for the quarter, Europe was the strongest finishing up 11.2% while the Americas finished up 8.3% and Asia/ Pacific finished down 3.1%. In the quarter the weakest regions through the first nine months posted the best returns from the October bottom.

The main issues that pressured the markets in 2002 are largely behind us with the exception of Iraq. Fraudulent accounting issues have subsided, and while the global economy continues to run hot and cold, we note that the IMF forecasts accelerating global growth in 2003.

Our outlook for 2003 includes some early volatility until the Iraqi situation becomes more clear. Iraq aside we are positive on the markets. We see the global economy strengthening, led by the Americas. We see earnings growth returning and stocks are at their cheapest level relative to

bonds in almost 20 years. We note that interest rates are near record lows across the globe and inflation is low. Our message is one of optimism.

Weak equity prices across the globe brought to a close one of the worst quarters ever for equity investors; the Dow Jones World Stock Index finished down 18%. While no region escaped the sell-off, Japan was the best-performing of the G7, finishing the quarter down 11%. Canada, the U.S., and the U.K. trailed slightly, with a return of -17%, while mainland Europe was particularly weak, with a return of -22% in Italy, -28% in France, and -36% in Germany.



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