

## Manulife MFS Fixed Income Fund MFS Investments

December 31, 2016

<b>Lead manager(s):</b>	Fixed Income Team; Peter Kotsopoulos and Soami Kohly	<b>Investment style:</b>	Active
<b>Investment objective:</b>	To provide a moderate real rate of return, through income and capital gains, by investing in a diversified portfolio of primarily Canadian dollar debt and from time to time US debt.		
<b>Last meeting date:</b>	July 2016	<b>Next estimated meeting date:</b>	Q3 2017
<b>Current rating:</b>	<b>IN GOOD STANDING</b>		

### Annual fund performance (%)

	2012	2013	2014	2015	2016	5 yrs
<b>Manulife MFS Fixed Income Fund</b>	4.46	-0.73	9.42	3.04	2.56	3.70
FTSE Universe Overall Bond TR	3.60	-1.19	8.79	3.52	1.66	3.23
Value added (+) / lost (-)	0.86	0.47	0.63	-0.48	0.90	0.47
Quartile ranking <sup>(1)</sup>	3rd	2nd	1st	4th	1st	2nd

### Short-term performance analysis

- The Fund outperformed its benchmark in 2016 and ranks in the first quartile relative to its peers.
- The Fund also outperformed its benchmark in Q4 of 2016. Fund management added value through strong credit selection in Industrials as well as Provincial issues, along with an overall overweight allocation to corporate bonds. The Fund's short duration position also added value across a quarter in which yields rose and the index provided negative absolute returns.
- 2016 annual outperformance was mainly attributable to the Fund's positive security selection, particularly within the Energy and Financials sectors as well as in Provincials. The Fund's sector allocation and overweight exposure in corporates at the expense of Federal bonds further added value. Partially offsetting this outperformance was the Fund's shorter than benchmark duration across the first three quarters during which time government bond yields ended lower across the curve.
- The portfolio continues to have an overweight exposure to corporate bonds and an underweight allocation to Government of Canada and Provincial bond issues. The Fund also maintains an overweight allocation to the Energy, Financials and Industrials sectors. The Fund's duration is shorter than the benchmark and the Fund is currently overweight to lower quality bond securities, particularly to BBB rated issues.
- The manager has not made material changes to their investment thesis. They continue to expect moderate global growth with low inflation.
- Based on the FTSE TMX Canada Universe Bond sub-indices, Corporate Bonds outperformed the broad index. Given the Fund's credit-focused bias, its investment approach had a positive impact on short term performance.

### Long-term performance analysis

- The Fund outperformed its benchmark in four of the past five years and added value on a five-years annualized basis. This long-term performance ranks in the second quartile when compared to its peers.
- Sector allocation drove the majority of outperformance over the long term. Based on the portfolio's bias to be overweight credit, it is expected that the portfolio will excel when credit markets outperform other sectors of the fixed-income market and will underperform when credit markets lag. Security selection was mainly positive across the longer measured periods.
- The PMs continue to believe that valuations in the Canadian fixed income market are expensive. As a result, they remain below benchmark duration in their fixed income mandates. However, they reduced the degree of duration exposure in their universe and long-term mandates which benefited from curve steepening. Within credit sectors, exposure to corporates was increased through higher BBB allocations in all mandates.
- Based on the FTSE TMX Canada Universe Bond sub-indices, Corporate Bonds outperformed the broad index over the past five years. Given the Fund's credit-focused bias, its investment approach had a positive impact on longer term performance.

## Significant corporate events

### Corporate

- There were a series of significant corporate events in 2015:
- Effective January 1, 2015, the following senior management changes took place: Mike Roberge, president and chief investment officer was promoted to co-chief executive officer (co-CEO); Rob Manning, will work alongside Mike as chairman and co-chief executive officer (co-CEO). Kevin Beatty, director of Equity, North America, was promoted to chief investment officer, Global Equity, a newly created role that will assist in Mike Roberge's transition to Co-CEO. Bill Adams, MFS director of Fixed Income, was promoted to chief investment officer, Global Fixed Income, a newly created role also to assist in Mike Roberge's transition to Co-CEO.

On April 9, 2015, MFS announced that Tim Fagan, MFS' CCO, would resign as at the end of May 2015.

On June 1, 2015, Brent Farmer, Vice President, Director of Corporate Risk and Compliance was appointed the interim CCO for for MFS. Brent held this role until July 13, 2015, when Marty Wolin was appointed Senior Vice President and Chief Compliance Officer.

On July 15, 2015, the MFS Funds Board appointed Marty as the MFS Funds Chief Compliance Officer.

### Fund specific

- Paul Marcogliese, co-portfolio manager of the MFS Fixed Income and MFS Long Term Fixed Income Funds left the firm effective March 16, 2015. Soami Kohly, a co-portfolio manager on the MFS Long-Term Fixed Income team assumed additional co-portfolio manager responsibilities for the MFS Fixed Income Fund following Mr. Marcogliese's departure, joining Peter Kotsopoulos on the portfolio management team for both strategies. IMS regarded Mr. Marcogliese highly and considered his Fixed Income knowledge and expertise to be very strong.

## IMS commentary

- The Fixed Income Fund (MFS) practices active bond management strategies within a strict risk control regiment. The diversified strategies employed seek to add value through credit research, yield curve placement and active duration management. The investment approach comprises both top-down and bottom-up elements, with the top-down macroeconomic analysis driving decisions on interest rate exposure as well as sector allocation and the bottom-up credit decisions being based on fundamental research and the strength of their global research platform.
- Based on our due diligence, we are confident that the manager has remained within the stated investment philosophy and style.
- The Fund has added relative value over the long term. Outperformance has primarily been a factor of duration management and credit exposure, which is in line with manager's stated sources of excess return.
- Paul Marcogliese's departure from the firm in 2015 was a significant fund specific event that raised concerns as Mr. Marcogliese had played an important role in the day-to-day management of the fund with his focus on relative value and security valuations within the team. Those concerns have since abated. Over the past year, IMS has held a number of update meetings with the team, and gained a better understanding and have a growing comfort with how the changes in the team have impacted the Fund. There were no changes in the decision making process and the Fixed Income process is now in line with the firm's Equity platform, which also relies on global collaboration within the broader MFS firm. There have been additions to the team of analysts, and the firm is looking to add resources to the Emerging Markets Debt area of the team.

<sup>(1)</sup> Quartile rankings are based on the underlying fund's returns.

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- The concerns IMS had regarding the changes to the PM team have largely abated and the Fund's rating was upgraded to In Good Standing in Q3 of 2016.

**Conclusion:**

- Due to the fact that 1) the Fund has outperformed its benchmark over the long term, all the while remaining within its stated investment philosophy and style, 2) outperformance has been in part a factor of positive selection, 3) the Fund ranks in the higher quartiles when compared to its peer group, and 4) the concerns in regards to portfolio manager turnover have lessened, IMS continues to rate this Fund In Good Standing.

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