

International Equity Fund (SLI)
Manulife SLI International Equity Fund
Standard Life Investments Ltd.

March 31, 2017

Lead manager(s):	Kevin Troup	Investment style:	Core
Investment objective:	To provide the long-term capital growth of equities of issuers mainly located outside of North America by investing primarily in units of the Standard Life Global Fund.		
Last meeting date:	Q3 2016	Next estimated meeting date:	Q3 2017
Current rating:	ON-WATCH		

Annual fund performance (%)

	2013	2014	2015	2016	2017	YTD	5 yrs
International Equity Fund (SLI)	14.14	28.82	7.21	-7.24	8.53	6.14	9.68
MSCI EAFE TRI (\$Cdn) ⁽¹⁾	13.64	28.49	14.20	-5.79	15.28	6.55	12.61
Value added (+) / lost (-)	0.50	0.33	-6.99	-1.45	-6.75	-0.41	-2.93

Short-term performance analysis

- In the first quarter of 2017, the Fund slightly underperformed its benchmark, the MSCI EAFE index.
- Security selection was the main detractor from relative performance, particularly within the Industrials sector. Holdings in Babcock were the largest detractor within Industrials as the stock fell following a profit warning from peers, which the Manager doesn't view as meaningful. However, the Manager is closely monitoring the holding following a canceled contract from the UK government. Other large detractors included Danish Jewellery manufacturer Pandora and BT Group. With Pandora, the Manager believes that their investment thesis is still sound amid confused market perceptions on growth. As for BT Group, the Manager sold the position after a profit warning. On the positive side, stock selection in the Financials and Health Care sectors slightly added value.
- Sector allocation produced a slightly positive effect primarily due to an underweight allocation to the underperforming Energy sector and an overweight allocation to the outperforming Information Technology sector.
- The Manager believes that the global economy is improving and deflationary risks have faded, but uncertainties exist around policy and politics. Meanwhile, the strong rally in cyclicals at the beginning of 2017 and investors' focus shifting to company earnings should be favorable to the Manager's fundamental bottom-up approach. At the end of March 2017, the portfolio's largest overweight allocations were in the Information Technology sector while moderate overweight allocations remained in the Consumer Staples, Materials and Energy sectors. During the first quarter, the Manager purchased Carnival, expecting top-line growth and margin improvements based on supply/demand balance for the cruise industry. The Manager also purchased Brazilian bank Banco Bradesco amid improved fundamentals.
- Based on the MSCI EAFE style indices, growth stocks outperformed in the first quarter of 2017. Given the Fund's core investment bias, its style had no impact on short-term performance.

Long-term performance analysis

- The Fund underperformed in each of the last three years which led to significant underperformance relative to its benchmark on a five-year annualized basis.
- Security selection detracted significant value in 2016 and 2015 and was the main detractor of relative performance on a five-year annualized basis.
- Sector allocation also produced negative results over the long term.
- Based on MSCI EAFE style indices, value and growth stocks performed in line with one another on a five-year annualized basis. Given the Fund's core investment bias, its style had no impact on long-term performance.

Significant corporate events

Corporate

- In March 2017, Standard Life Investment ('SLI') and Aberdeen Asset Management announced their intention to merge their respective businesses. SLI is to acquire Aberdeen for approximately £3.8bn, a deal that would create a £660bn asset manager and one of Europe's largest fund managers. The merger is expected to be an all equity transaction in which Standard Life shareholders will become the majority owners of the combined firm. The firms believe the deal will bring financial stability, shared resources, global reach and a diversified asset base. Shareholder and regulatory approval is still forthcoming but recommendations by the firms are for investors to vote favourably on the deal.
- In March 2017, following the announcement of intended merger with Aberdeen Asset Management, Standard Life Investment ('SLI') announced that David Cumming, Head of Equities, had chosen to leave SLI to pursue other interests. Stan Pearson, Head of European Equities has assumed the role of Acting Head of Equities; Andrew Millington, Director of Equity Research, resumed the role of Acting Head of UK Equities. Mr. Pearson has 32 years of industry experience and has been with SLI for 10 years. Mr. Millington has 13 years of industry experience and nine of them at SLI.
- In September of 2014, Manulife Financial Corp. announced the acquisition of Standard Life PLC's Canadian operations. This transaction was closed on January 30, 2015 and the company is now part of Manulife. This transaction had no impact on the Fund as it remains sub-advised by the Global Equity Team of Standard Life Investment out of their U.K. operations.

Fund specific

- In December 2016, Standard Life Investment (SLI) announced that Stephen Weeple, Portfolio Manager and Director of Equity Research for the SLI Global Equity Team, had left the firm effective immediately. Jaime Ramos Martin, an investment director for SLI's US Equities Team, joined the Global Equity Team and assumed Mr. Weeple's Portfolio Manager role for the Manulife Global Equity Unconstrained Fund with immediate effect. Mikhail Zverev, Head of SLI Global Equity Team, retains portfolio management responsibilities for all equity strategies managed by the team. Kevin Troupe continues to be the Portfolio Manager for the Manulife SLI International Equity Fund.

Following the announcement of this team change, IMS has recommended that the Manulife SLI International Equity Fund be placed on-Watch.

IMS commentary

- The International Equity Fund (SLI) is a bottom-up, core international equity mandate that invests in a diversified portfolio of stocks that adhere to its investment philosophy of Focus on Change. The Focus on Change approach looks for undiscovered or mispriced fundamental changes at a company level in order to exploit market inefficiencies and pricing in these material changes. As a core mandate, the Fund is expected to outperform its relative benchmark on a consistent basis across various market environments.
- The Fund underperformed its benchmark in each of the last three years and failed to add value on a five-year annualized basis.
- In addition, the Fund underperformed significantly in 2016 and the magnitude of underperformance has been a major concern. Since July 2016, IMS has met with the SLI Global Equity Team on multiple occasions to review the investment process and performance. In the third quarter of 2016, IMS recommended the Fund be placed under Increased Scrutiny as we were concerned with the negative security selection across multiple sectors and regions and the portfolio's large risk exposure to macro events.
- In December 2016, following Stephen Weeple's departure from the SLI Global Equity Team, IMS recommended the Fund be placed on-Watch as the loss of expertise and experience from the investment team requires close monitoring.
- In February 2017, IMS met with the Team including Mr. Martin. While Mr. Martin's 10-year analyst tenure within SLI's investment process and his past experience managing portfolios and working with the Global Equity Team make him a sensible replacement for Mr. Weeple, more time is needed to monitor the team's stability. Furthermore, the Manager has indicated that a new risk management system will be implemented to allow them to more actively monitor and control factor risk, which was addressed as a main detractor from relative performance in 2016.
- In March 2017, SLI announced the intended merger with Aberdeen Asset Management. Shortly afterwards, SLI also announced the departure of David Cumming, Head of Equities. As Head of Equities, Mr. Cumming's role in working with six equity teams was primarily to provide vision and direction and to ensure consistent execution of the firm's Focus On Change investment philosophy across various strategies. IMS has discussed this departure with SLI and believes that Mr. Cumming's departure will not have an immediate impact on the daily portfolio management activities of the equity funds on the i-Watch platform. However, we will monitor the situation closely as it highlights the significant uncertainty within the firm following the recent announcement of the merger between SLI and Aberdeen.
- Given the nature of the existing concerns - the significant underperformance in 2016, the change to the team, the modification to the Fund's risk monitoring system, and the heightened uncertainty at the firm level following the merger announcement - close monitoring is required to evaluate the team's ability to consistently add value while staying within their investment philosophy and style, the team's future stability and the potential impacts of the significant organizational event.

Conclusion:

- Significant concerns remain with the Fund due to the fact that 1) the recent team change is a significant event and more time is needed to assess the impact on the implementation of the investment process, 2) the magnitude of underperformance in 2016 and the Manager's ability to consistently add value through positive security selection require close monitoring, and 3) the renewed uncertainty at the team and organization level due to the recent merger announcement also require close monitoring.

⁽¹⁾ The source of benchmark returns are utilizing the Bank of Canada end of day for currency exchange. This change may result in minor differences from otherwise listed benchmark returns.

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