

Portfolio Manager Insights

Manulife U.S. Regional Bank Trust



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Market Environment

U.S. bank stocks surged in the fourth quarter, with much of the gain occurring after the surprising Republican sweep in the U.S. elections in November. The period also saw stronger economic data in the U.S. The U.S. Federal Reserve Board raised interest rates by 25 basis points in December for the second rate increase of this tightening cycle, and increased expectations for future increases. In addition, the yield curve steepened.

Portfolio Review

The Fund's overweight allocation to equities was the largest contributor to performance. Most of the bank names in the portfolio had strong performance after the U.S. elections. Among the standouts were The Washington Trust Company, Heritage Financial Corporation and Camden National Corporation, with each increasing over 40% in the quarter. Security selection within fixed income also positively contributed to the Fund's performance. The Fund's underweight allocation in fixed income securities detracted from performance. Our alternative asset manager holdings also negatively impacted performance. Shares of Blackstone Group, L.P., Intermediate Capital Group plc and KKR & Co. L.P. declined on concerns that market volatility and Brexit could negatively affect their business activity.

Many of the Fund's non-common equity and non-bank holdings detracted from the Fund's overall performance. Individual detractors from performance included The Blackstone Group L.P. ("BX") and Fifth Street Finance Corp. BX was weaker than the Fund's overall equity sleeve amid concerns about the tax treatment of its limited partnership structure under a new administration. Fifth Street Finance Corp., a business development company, underperformed following adverse credit performance.

During the period, we added a new position in Heritage Commerce Corp. based on its attractive relative valuation. We decreased the Fund's existing holdings in BX and Hancock Holding Company. The Fund's position in BX was reduced as our thesis on the company was taking longer than anticipated to play out. The Fund's allocation to Hancock Holding Company was decreased in order to capture gains in the position.

Outlook

Although the U.S. banking industry performed strongly during the quarter, we still remain optimistic about its prospects. A period of rising interest rates and a stronger economy leading to better loan growth are a very positive backdrop for banks. Further, as U.S. banks tend to pay high corporate tax rates, a lower U.S. tax rate, as discussed by the U.S. President-elect during the election campaign, could have a positive impact on banks' earnings. In addition, a loosening of the strict post-financial crisis regulatory environment may lead to lower expense growth and higher capital returns for banks. Finally, merger activity, which had been somewhat sluggish in the late summer and early fall, increased after the U.S. election, and we remain optimistic that this consolidation trend will continue in 2017.

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