A way to get more stock boom (or bust)

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Since the remarkable stock market recovery began in early March, Manulife Financial Corp. MFC-T has stood out as an overachiever.

While the benchmark S&P/TSX composite index has risen an impressive 36 per cent from its low point, Manulife shares have made that return look like a relative failure: The shares have risen 155 per cent.

This, according to analysts, is no coincidence. Manulife is incredibly sensitive to moves by equity indexes - not only the TSX, but the S&P 500 as well - making the stock a kind of leveraged bet on the direction of the broader market.

How leveraged? Some estimates suggest that Manulife will rise about twice as fast as the broader market - when the market is on the rise, that is. However, recent action suggests that this estimate might be a tad conservative. On Friday, the S&P/TSX composite index rose 2.5 per cent, but Manulife gained 7.4 per cent, or triple the index.

The reason for this unusual relationship is a little complicated, but relates to the fact that Manulife provides a guarantee on some of their clients' equity investments in exchange for a fee. When these investments fall, and stay down, the insurer has to make good on the guarantee some time down the road, which forces Manulife to put up reserves. But when the investments rise, the pain is reversed.

Manulife made these guaranteed investments a big part of their business in recent years, which is why Michael Goldberg, an analyst at Desjardins Securities, believes that the company now has the greatest exposure to equity market moves among life insurers.

By contrast, Sun Life Financial Inc. has about half the equity exposure that Manulife has, and Great-West Lifeco Inc. has very little exposure. While these two stocks have nearly doubled from their lows in March, their gains lag Manulife's by about 50 percentage points.

Of course, a leveraged bet can cut both ways: Just as Manulife shares will outperform stock market indexes on the way up, they tend to underperform indexes on the way down.

You could see this in action over the nine months after the S&P/TSX composite index hit a record high last summer. Between mid-June and March 9, when stocks were freefalling, the TSX fell 49 per cent after dividends were taken into account, and a basket of Canadian financial stocks fell 50 per cent. However, Manulife fell a stomach-churning 75 per cent.

Now, the new chief executive officer of Manulife is taking action to make the company more risk-averse, mostly by increasing its hedging on new products. Is the wild ride coming to an end?

"It'll change, but slowly," said **Ohad Lederer, an analyst at Veritas Investment Research**.

"They're tweaking and tinkering with the product, and they're hedging. That said, I don't think they want to change the direction they're going in."

Certainly, not when that direction is up.