Authors

MFS INVESTMENT MANAGEMENT

Victoria Higley
Institutional Equity
Portfolio Manager

Owen Murfin
Institutional Fixed Income
Portfolio Manager

Vishal Hindocha
Global Head of
Sustainability Strategy

THE EURASIA GROUP

Lucy Eve
Senior Strategist
Global Macro Geoeconomics

Henning Gloystein
Director, Energy, Climate &
Resources

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Beyond the Headlines: Accelerated Risk and Opportunities for Investors

Overview

So that we can get a full picture of investment risks and opportunities, our bottom-up global research process is supported by top-down macro and geopolitical insights from partners such as Eurasia Group. Here are the key insights from a roundtable event featuring equity and fixed income experts from MFS, geopolitical experts from Eurasia and a range of investors.

The energy transition and security

Negative headlines do not reflect reality at companies. Although headlines present a dire picture of the transition to net zero, our investment team is seeing companies invest large sums in technology solutions offered by private, start-up and existing companies. It will be a long journey, with step changes rather than linear progress as new technology — such as carbon capture and hydrogen as an alternative power source — becomes available at scale.

Pension schemes are debating divesting versus funding the transition. Pension schemes are required to show their commitment to meeting climate goals; however, they are increasingly debating the best investment path for doing this. While divesting presents an attractive option, it is unlikely to bring about the real-world changes needed to meet 2030 and 2050 targets. Investors will find opportunities if they are willing to have a dialogue with companies.

Valuation discrepancies between regions are emerging within sectors. The European Union aims to be a leader in the energy transition, which impacts EU-domiciled companies. BP has committed 20% of its capex budget to renewables and is trading on six times the price/earnings multiple with 7% dividend yield as well as a commitment to share buybacks due to its large cash position. Investors will get their money back in 10 years. US companies are trading at double the P/E multiple, committing less to dividends, and with a much lower capex budget for renewables. There could be opportunities if investors are motivated to apply premiums to companies supporting and financing the transition while managing the assets they already have. Additionally, some companies have divested from carbon assets to improve their sustainability profile and raise their earnings multiples.

Policy is moving from emergency management to long-term adaptation. Following the invasion of Ukraine, there was an effort to manage energy supply to avoid losing industrial output. The policy combination of incentives alongside penalties and bans has quickly led to a reduced reliance on fossil fuel, and there is also a lower risk of EU supply shortages going forward. Contrary to the headlines of deindustrialization, industries across Germany and Japan managed to raise output despite sharp declines in energy use. The energy crunch and government subsidies continue to provide incentives for companies and households to become more efficient and invest in domestic capacity. Governments hope these will lead to economic productivity gains in the latter half of the decade.

Massive stimulus measures are fostering opportunities to invest in US and Europe. The size of the US Inflation Reduction Act and the EU's Chips Act and Green Industry Act has shifted the mindset of companies and incentivized them to reduce their reliance on fossil fuels. US policy has a big advantage over the EU due to its structure, bringing direct tax benefits and creating jobs in the green sector versus more onerous EU subsidies that do not bring an immediate tax benefit and must be applied for each year.

Expect energy inflation to fall over the longer term, but food prices are concerning. Energy price shocks led to a spike in inflation, but prices remain elevated even as the cost of energy has fallen. The cost of the energy transition is likely to cause "greenflation" over the next few years. However, energy prices may fall over the longer term as new technology is developed and scaled. There is uncertainty over demand for hydrocarbons, and oil and gas prices may stay high even if demand falls, as seen by coal usage versus prices. Food inflation is an underappreciated risk given increasing food insecurity due to weather and the possibility of net exporters such as India becoming net importers.

The biggest risk is that central banks will overtighten. Lower energy prices have brought relief, but central banks continue to fight inflation on other fronts. Eurasia sees a big risk of overtightening in monetary policy in the United States, European Union and particularly the United Kingdom. Eurasia's base case is for subpar growth globally.

Artificial intelligence and emerging technology

US-China relations enter a new phase, impacting the world. Geopolitical tensions from deglobalization and strategic competition between the US and China present new risks and opportunities for investors. New geopolitical alliances are arising due to China's push for technological self-reliance. In terms of rare earths needed for emerging technology, supply is available from other countries, but processing is a bigger issue as China dominates this expensive and dirty business. Indonesia is building up its processing capacity, but it will take time to replace China.

AI has the potential to improve financial metrics. There is a lot of hype around artificial intelligence, which has driven strong share price gains for a number of companies. It is still early days for generative AI, so there are still questions to answer around its long-term impact on companies, geopolitics and society. MFS' investment team sees conversations today around improving efficiency, revenues and profits for companies. Only a few companies are talking about direct investment in AI R&D; most are still trying to figure out which areas will see product developments.

What AI's impact on workers will be is unclear. It is clear that AI can help improve productivity across a range of industries, but what the short- and long-term impact on workers will be is up for debate. Comparisons have been made to the industrial and Internet revolutions and the changes these brought to the labor force. AI presents an opportunity to spin off new services and companies requiring more workers but also brings the risk that some jobs will become automated or obsolete. Inequality is a big discussion point, including the need for governments and regulators to try to remedy it.

AI is a double-edged sword. Innovation in AI presents new investment opportunities, but regulators struggle to keep up with technological advancements. As a result, advances in AI will stoke disinformation, interfere with elections, empower authoritarian regimes and fuel polarization. So while it will be a force for good, bad actors can misuse it.

Data present attractive opportunities. Data is becoming commoditized and will be a foundation of the AI revolution. This presents challenges around privacy, copyright and the verification of ownership of the data used by AI. Opportunities already exist relating to the need to store, manage and protect data, and MFS is finding attractive data center and hardware companies to invest in. The increased availability of data also helps investors interested in understanding consumer trends gain quicker access to credit card spending patterns and get ahead of asset allocation trends by monitoring global sentiment and flows between regions and asset classes.

Regulations will vary by region and regime. Privacy and transparency are key concerns for regulators. There is unlikely to be global regulation because there are different regimes around the world. Access to, and control of, data will be strictly handled in China, which has opportunities on account of its size but also risks on account of its authoritarian government. Eurasia expects lighter regulation from the US as it needs to compete with China and has a vested interest in supporting its technology sector.