MFS Investment Management

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Market Pulse

Top-down and asset allocation perspectives over the next 12 months

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KEY TAKEAWAYS

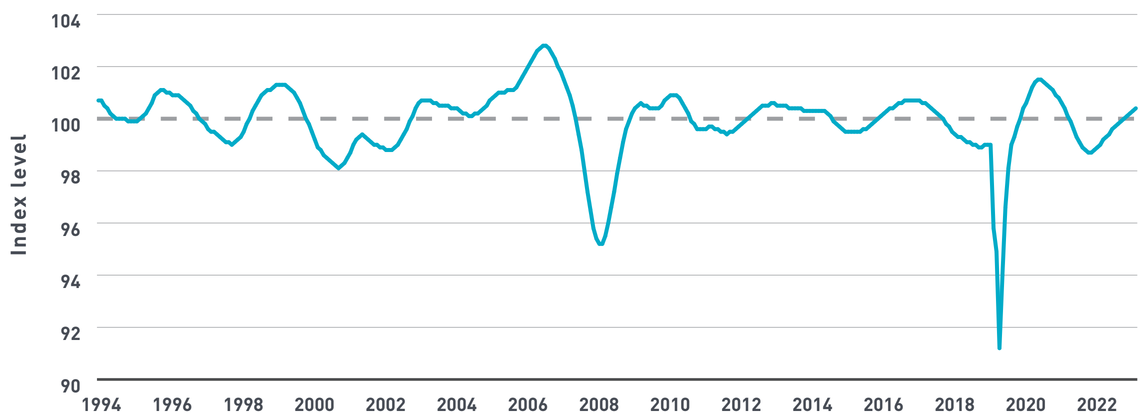
- Global growth is recovering, especially in Europe and pockets of emerging markets, potentially supporting risk assets.
- Resilient US consumers continue to drive services inflation, likely keeping the US Federal Reserve on hold for longer, albeit in the face of goods deflation.
- Net immigration into the US hit a 40-year high in 2022, and likely broke that record in 2023. This has aided population growth, and the mix of legal vs illegal immigration could help explain some of the puzzling figures within national labor and income data.
- The increase in rates, and high bar for the Fed to shift from a pause to a rate hike, favors fixed income over equities.

Economy & Markets

Global Growth

THE GLOBAL GROWTH OUTLOOK HAS RECOVERED

OECD Composite Leading Indicators



Source: OECD, Monthly data from 30 April 1994 to 31 March 2024.
A reading above 100 and rising predicts expansion, above 100 and falling a downturn, below 100 and falling a slowdown, and below 100 and rising a recovery.

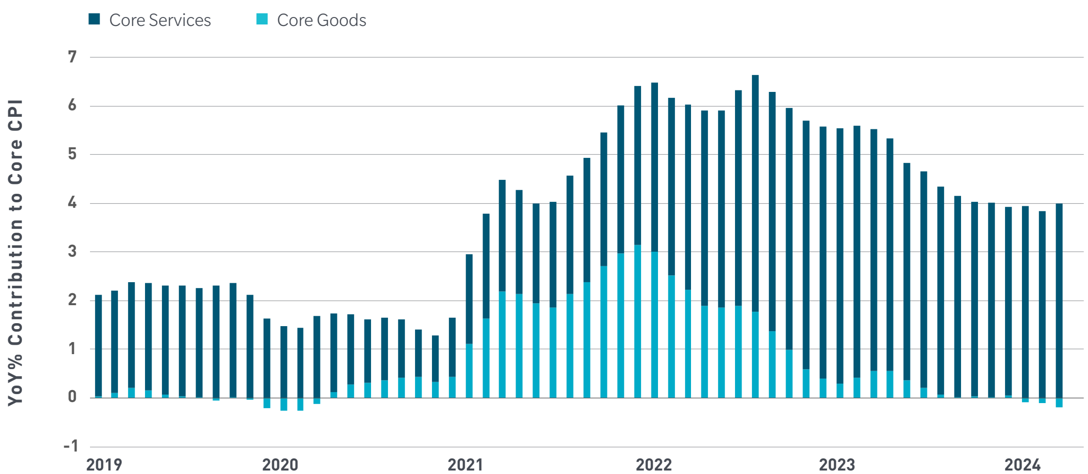
Fears of a Global Recession Have Receded

MFS PERSPECTIVE

- The growth outlook is recovering in many places, including the UK, the eurozone, Asia and Brazil.
- Stronger global growth tends to be supportive of risky assets, especially in non-dollar markets.

Inflation

SERVICES KEEPING INFLATION ELEVATED



Source: Bloomberg. Monthly data from 31 May 2019 through 31 March 2024. Core services and goods shown are year-over-year contributions to US core CPI. Core CPI is consumer price index excluding food and energy.

Inflation Remains Too High

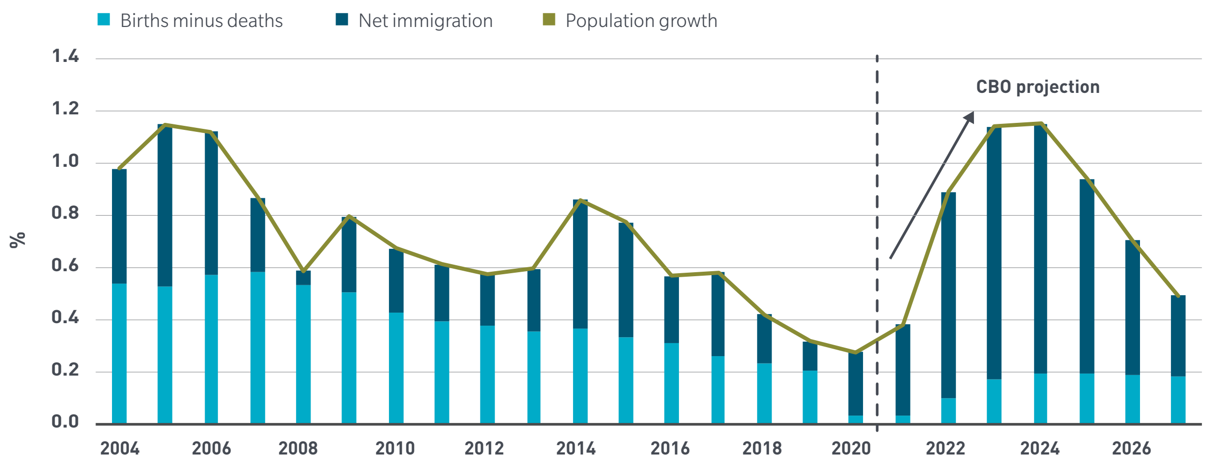
MFS PERSPECTIVE

- While goods inflation is down significantly, services inflation is getting stuck.
- Wage growth and consumer demand for services are primary contributors.
- Fed cuts may be fewer and later than expected.

Economy & Markets

Immigration

NET IMMIGRATION SETTING RECORDS AND CLIMBING



Source: Congressional Budget Office (CBO). January 2024 report, The Demographic Outlook: 2024–2054.

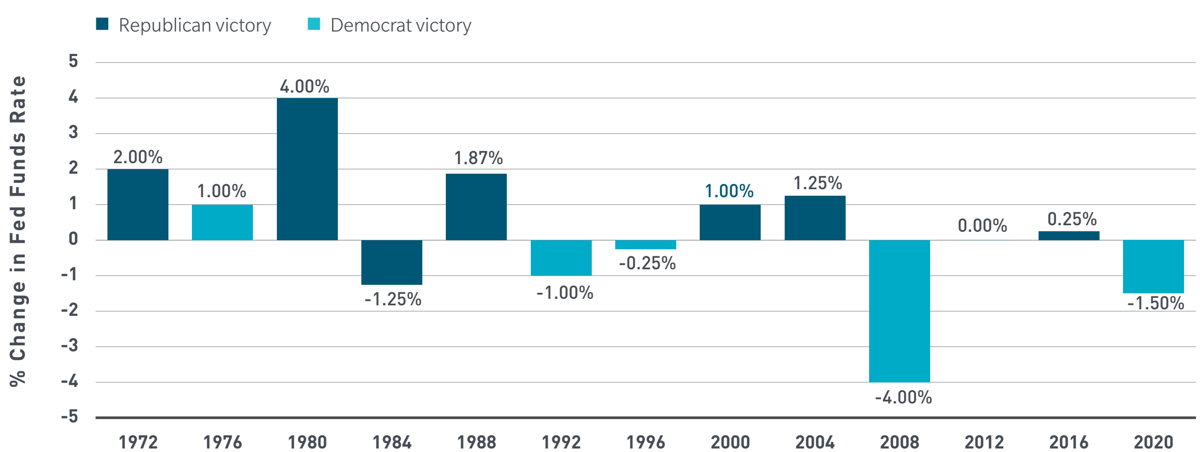
Net Immigration Driving Population and Economic Growth

MFS PERSPECTIVE

- A surge of immigration has likely increased potential GDP, a measure of what the economy should be producing.
- Immigration trends could also explain discrepancies in labor and income data supporting a stronger economic backdrop.

Elections

FEDERAL FUNDS RATE MOVES DURING ELECTION YEARS



Source: Bloomberg, Federal Reserve. Annual data from 31 December 1972 to 31 December 2020. Fed Funds Rate is the upper target. % change in Fed Funds Rate = fed funds rate at the end of the year minus fed funds rate at the beginning of the year for each election year.

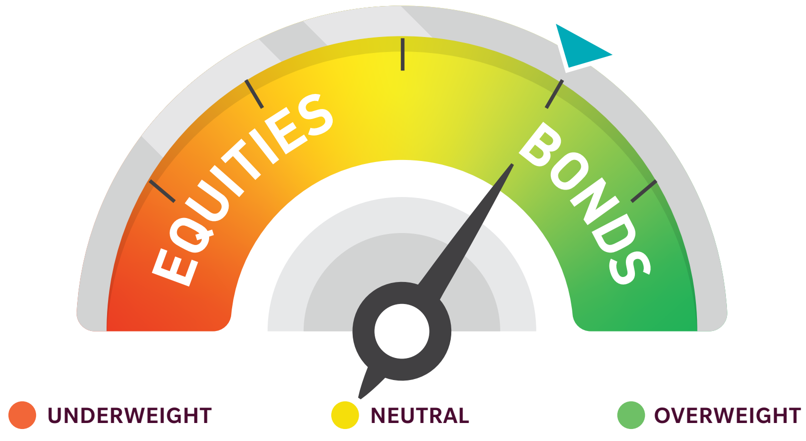
Election Years Do Not Dictate Fed Policy

MFS PERSPECTIVE

- History suggests the Fed largely insensitive to the political calendar.
- The Fed has both eased and tightened in years when Republicans and Democrats have won. These cycles tend to be multi-year efforts driven by economic conditions.

Asset Allocation

Relative to investor's strategic asset allocation



A more favorable economic backdrop suggests a move closer to a neutral portfolio positioning, with a slight bias toward fixed income due to the risk-adjusted appeal.

MFS PERSPECTIVE

1 The recent topline GDP print disappointed, but we believe the economy is still healthy, as evidenced by the strong services contribution in the last round of inflation data. This should keep the Fed on pause and is an overall positive for risk assets.

2 Given valuation risks in US equities, we maintain a slight underweight with a preference for large value, which offers an attractive downside capture, valuation and dividend profile.

3 Fixed income continues to offer meaningful yields across the risk spectrum and all-in yields drifted even higher due to the rate selloff this year. However, credit spread compression is unlikely to be a significant contributor to returns.

4 From a risk/reward perspective, there is a wider range of outcomes in equities versus fixed income. The worst-case outcome for fixed income would likely be if the Fed hikes, but the bar is high and the timeline extended for that to occur.

Approach and methodology: The *Market Pulse* provides an outlook over a 12 month investment horizon for major asset classes as well as considerations of the prevailing market conditions. Views are driven by both quantitative and qualitative inputs including, but are not limited to, macro-economic data, valuations, fundamentals and technical variables.

US Equity

UNDERWEIGHT NEUTRAL OVERWEIGHT

- US company earnings have been mixed so far, with aggregate expectations of 9% earnings growth for S&P 500 companies.
- Weaker than expected Q1 headline GDP and higher rates weighed on equities at the end of April, but underlying domestic economic activity remains resilient.
- Equity markets are beginning to digest the likelihood that Fed cuts will be fewer and later than expected given inflationary pressures and strong labor markets.

MFS CONSIDERATIONS			
LARGE CAP	**SMALL/MID CAP**	**GROWTH**	**VALUE**
▪ Large technology companies reported solid earnings and revenue growth. ▪ Despite some price correction, pockets of tech look rich.	▪ Small and midcaps are under pressure from higher rates. ▪ Small caps carry significantly more floating and/or short-term debt versus than large caps. ▪ Relative valuations are beginning to look compelling for small versus large caps.	▪ The excitement and activity around AI bolstered cloud revenue growth for technology companies. ▪ Technology is more than 53% of the Russell 1000® Growth Index, up from 45% a year ago, so concentration risk in passive is growing.	▪ Bank earnings were mixed, with investment banking and trading firms faring the best. ▪ Utilities companies are showing strength on strong demand as economic activity remains high.

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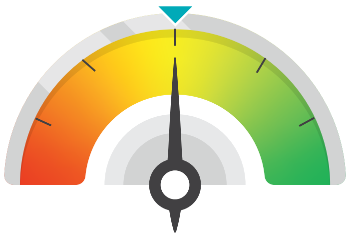
International Equity

DEVELOPED INTERNATIONAL EQUITY

- Japan equities have remained strong performers, rising double digits to date. A weak yen remains a tailwind to exports.
- Developed international equities have begun to show momentum, with 11 European stocks leading the way.

EMERGING MARKET EQUITY



- Emerging market equities continue to trade sideways, although there are significant pockets of opportunity for security selection across countries.
- Despite a bounce off its January lows, Chinese equities continue to be a drag on the overall EM market.

MFS CONSIDERATIONS

- The European stocks faring best include luxury goods makers as well as pharmaceutical manufacturers, which are benefiting from the growth in GLP-1 drugs.
- Strength in Japan equities have been the biggest driver of gains. Japan remains the largest country weight in the MSCI EAFE index at more than 23%. In March, Japan abandoned its negative interest rate policy.
- India's economy, as well as its stock market, have been on a steady growth trajectory over the past three years as it benefits from changing global trade flows and a growing domestic consumer base.
- Other pockets of Asia, including Taiwan, have benefited from increased demand for semiconductor supply chain components as AI-related demand remains robust.

UNDERWEIGHT NEUTRAL OVERWEIGHT

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Fixed Income

UST/DURATION

- The macro-fundamentals and the potential for rate cuts are supportive of long duration, but the disinflation process is less smooth than anticipated, creating more uncertainty over the timing and magnitude of policy easing.

MUNICIPALS

- Municipals' fundamentals, including state finances, remain robust and may provide some protection in the event of a growth shock.
- The expected decline in cash rates may be supportive of inflows back into the asset class this year.

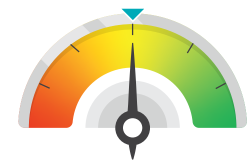
SECURITIZED (MBS)

- Prospects for agency MBS appear robust in view of strong fundamentals and a potential recovery of the housing sector.
- An expected decline in rate volatility is also likely to be supportive in the period ahead.

US INV-GRADE CORP

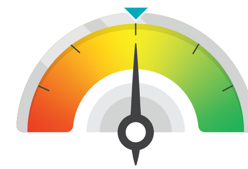
- The US macro backdrop remains supportive, but asset class fundamentals have weakened.
- While total yields remain fairly attractive, support from potential rate cuts is needed for future returns to be above average, especially given the spread valuation.

US HIGH YIELD



- US HY fundamentals remain resilient, helped mainly by low levels of leverage by historical standards and strong earnings.
- Other positive factors include low default rate projections, healthy breakeven yields, and an upgraded macro outlook.

EMERGING MARKET DEBT



- EMD fundamentals continue to be adequate, especially on the growth front.
- A potential weakening of the US dollar may also act as a supportive driver, although uncertainty over the dollar outlook has risen.

MFS CONSIDERATIONS

UST/Duration

- The yield curve is likely to steepen in time, which will help support the relative attractiveness of the long end.

Municipals

- Longer duration and high-yield municipals look attractive on a relative basis given a supportive growth environment and shape of the municipal yield curve.

Securitized (MBS)

- Agency MBS offer diversification and defensive benefits as well as attractive spreads over treasuries.

US Inv-Grade Corp

- We have turned more cautious toward US IG in the near term, reflecting eroding fundamentals and a more challenging spread valuation backdrop.

US High Yield

- The risk/reward is fairly attractive for investors with a high-risk tolerance who may consider deploying credit risk exposure.
- While we are not concerned about the maturity wall, spread valuation looks stretched, so security selection is key.

Emerging Market Debt

- EMD valuation is now less compelling than a few months ago, but total yields remain attractive.
- EMD remains an interesting asset class, but given the more challenging valuation backdrop, robust sovereign credit selection is paramount.

UNDERWEIGHT | NEUTRAL | OVERWEIGHT

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