Equity Insight
December 2024

Monthly Equity Market Topics

Author

Ross Cartwright
Lead Strategist
Strategy and Insights Group

Navigating the US Equity Party

The spotlight is firmly on the United States as markets have surged in the wake of the election, buoyed by anticipation of a Trump-led administration, boosting an already robust economy. We believe this optimism is rooted in the promise of lower taxes, deregulation and protective tariffs to bolster US manufacturing. The momentum is palpable, and it's become a popular consensus trade. Meanwhile, Europe seems to have missed the invitation, with sentiment on the continent significantly more subdued, primarily due to economic challenges in Germany and political stagnation in France. However, countries like Spain, Greece and parts of Eastern Europe are showing promising signs of economic health.

According to FactSet, the forward P/E ratio stands at 22x for the S&P 500 and 13x for the MSCI Europe. With the S&P 500 having rallied 26% over 2023 and a further 30% year to date, and with expected EPS growth of 14% next year, it's clear the US market commands a premium. However, with high expectations already baked into valuations, US investors should anticipate returns in the ballpark of 15% to 16% over 2025, aligned with growth in earnings and dividends. While US market momentum remains strong, the unfolding of the new administration's policies — and the influences shaping them — remain to be seen. It's a challenging landscape to navigate with certainty, particularly as we watch for potential shifts in 10-year yields.

On the other side of the pond, Europe's low expectations contrast with anticipated earnings growth of about 8% and an additional 3% in dividends for 2025, suggesting a total return of 11% to 12%. Several catalysts could potentially rerate European markets:

- A resolution in Ukraine might stabilize the region and reduce energy costs.
- Economic improvements in China could bolster European earnings, especially if accompanied by additional fiscal support.
- Upcoming German elections might lead to fiscal reforms, potentially relaxing stringent budget deficit restrictions.
- Positive real wage trends and potential ECB rate cuts could encourage consumer spending, which has been subdued.
- Lower ECB rates could benefit European companies as they have significantly higher exposure to floating rate debt that US companies.
- Attractive valuations could make European companies prime targets for M&A.

For US investors, the strength of the US dollar is a critical factor when considering non-US returns. Although the dollar has strengthened post-election, the broader implications of US policies, including the Federal Reserve's actions, will play a crucial role in shaping the dollar's trajectory. The status of the USD as the world's reserve currency, coupled with robust demand for US financial assets, may continue to exert upward pressure on the dollar, although a weaker dollar could improve the trade deficit, something the incoming administration are seeking to remedy.

US Manufacturing Poised for Liftoff

Last week we saw the Richmond, Dallas and Philadelphia Fed manufacturing expectations indices all move decisively upwards. In our opinion, this looks positive for a recovery in the US Manufacturing PMI. Recovering PMIs are typically a good sign for equities, specifically for riskier or higher beta, lower quality stocks. There has been some evidence of this, with small caps running higher on expectations of a recovery in earnings.

But as has been the case with many things in the wake of the pandemic, not everything seems to be following a "normal" path. Credit spreads are already extremely tight, markets have rallied with valuations expanding all year as they have priced out macro risks and focused on growth and earnings over inflation. All of this before we have seen any meaningful recovery in manufacturing PMIs to whet risk appetites.

Typically, it warrants caution when sentiment is so strong and the outlook for the US economy seems unanimous. We question the ability of the market to stage a further risk-on rally given where we stand today, with investors having seemingly discounted most concerns facing US equity markets. If the focus turns to inflation remaining higher than desired and driving 10-year rates higher, this could prove problematic for the equity market. The market can easily manage with inflation being in the 3-4% range, but there is uncertainty as to how the Fed will react. We also believe it is inappropriate, given the current set up, to be loading up on risk and beta in anticipation of multiples continuing to expand as is typical in a rising manufacturing PMI cycle. While there may be some additional incremental opportunities to be had across small, mid and large caps, it is important to focus on higher quality earnings and companies with stable and strong earnings outlooks and positive earnings revisions.

Equity Insight

December 2024

The views expressed herein are those of the MFS Strategy and Insights Group within the MFS distribution unit and may differ from those of MFS portfolio managers and research analysts. These views are subject to change at any time and should not be construed as the Advisor's investment advice, as securities recommendations, or as an indication of trading intent on behalf of MFS. No forecasts can be guaranteed.

Diversification does not guarantee a profit or protect against a loss. Past performance is no guarantee of future results.

GLOBAL DISCLOSURE

Unless otherwise indicated, logos and product and service names are trademarks of MFS® and its affiliates and may be registered in certain countries.

Distributed by: **U.S. –** MFS Institutional Advisors, Inc. ("MFSI"), MFS Investment Management and MFS Fund Distributors, Inc., Member SIPC; **Latin America –** MFS International Ltd.; **Canada –** MFS Investment Management Canada Limited. **Note to UK and Switzerland readers:** Issued in the UK and Switzerland by MFS International (U.K.) Limited ("MIL UK"), a private limited company registered in England and Wales with the company number 03062718, and authorised and regulated in the conduct of investment business by the UK Financial Conduct Authority. MIL UK, an indirect subsidiary of MFS®, has its registered office at One Carter Lane, London, EC4V 5ER. **Note to Europe (ex UK and Switzerland) readers:** Issued in Europe by MFS Investment Management (Lux) S.à r.l. (MFS Lux) – authorized under Luxembourg law as a management company for Funds domiciled in Luxembourg and which both provide products and investment services to institutional investors and is registered office is at S.a r.l. 4 Rue Albert Borschette, Luxembourg L-1246. Tel: 352 2826 12800. This material shall not be circulated or distributed to any person other than to professional investors (as permitted by local regulations) and should not be relied upon or distributed to persons where such reliance or distribution would be contrary to local regulation; **Singapore –** MFS International Singapore Pte. Ltd. (CRN 201228809M); **Australia/New Zealand -** MFS International Australia Pty Ltd ("MFS Australia") (ABN 68 607 579 537) holds an Australian financial services licence number 485343. MFS Australia is regulated by the Australian Securities and Investments Commission.; **Hong Kong -** MFS International (Hong Kong) Limited ("MIL HK"), a private limited company licensed and regulated by the Hong Kong Securities and Futures Commission (the "SFC"). MIL HK is approved to engage in dealing in securities and asset management regulated activities and may provide certain investment services to "professional investors" as defined in the Securities and Futures Ordinance ("SFO").; **For Professional Investors in China –** MFS Financial Management Consulting (Shanghai) Co., Ltd. 2801-12, 28th Floor, 100 Century Avenue, Shanghai World Financial Center, Shanghai Pilot Free Trade Zone, 200120, China, a Chinese limited liability company registered to provide financial management consulting services.; **Japan -** MFS Investment Management K.K., is registered as a Financial Instruments Business Operator, Kanto Local Finance Bureau (FIBO) No.312, a member of the Investment Trust Association, Japan and the Japan Investment Advisers Association. As fees to be borne by investors vary depending upon circumstances such as products, services, investment period and market conditions, the total amount nor the calculation methods cannot be disclosed in advance. All investments involve risks, including market fluctuation and investors may lose the principal amount invested. Investors should obtain and read the prospectus and/or document set forth in Article 37-3 of Financial Instruments and Exchange Act carefully before making the investments ; **Bahrain -** This document has not been approved by the Central Bank of Bahrain which takes no responsibility for its contents. No offer to the public will be made in the Kingdom of Bahrain and this document is intended to be read by the addressee only and must not be passed to, issued to, or shown to the public generally. The Central Bank of Bahrain assumes no responsibility for the accuracy and completeness of the statements and information contained in this document and expressly disclaims any liability whatsoever for any loss howsoever arising from reliance upon the whole or any part of the contents of this document. The Board of Directors and the management of the issuer accepts responsibility for the information contained in this document. To the best of the knowledge and belief of the board of directors and the management, who have all taken all reasonable care to ensure that such is the case, the information contained in this document is in accordance with the facts and does not omit anything likely to affect the reliability of such information.; **Kuwait -** This document is not for general circulation to the public in Kuwait. The information has not been licensed for offering in Kuwait by the Kuwait Capital Markets Authority or any other relevant Kuwaiti government agency. No private or public offering of the information is being made in Kuwait, and no agreement relating to the information will be concluded in Kuwait. No marketing or solicitation or inducement activities are being used to offer or market the information in Kuwait.; **Oman -** For Residents of the Sultanate of Oman: The information contained in this document does not constitute a public offer of securities in the Sultanate of Oman as contemplated by the Commercial Companies Law of Oman (Royal Decree 4/74) or the Capital Market Law of Oman (Royal Decree 80/98). This information is being circulated on a limited basis only to corporate entities that fall within the description of sophisticated investors (Article 139 of the Executive Regulations of the Capital Market Law). The recipient acknowledges that they are a sophisticated investor who has experience in business and financial matters and is capable of evaluating the merits and risks on an investment.; **South Africa -** This document, and the information contained is not intended and does not constitute, a public offer of securities in South Africa and accordingly should not be construed as such. This document is not for general circulation to the public in South Africa. This document has not been approved by the Financial Sector Conduct Authority and neither MFS International (U.K.) Limited nor its funds are registered for public sale in South Africa.; **UAE -** This document, and the information contained herein, does not constitute, and is not intended to constitute, a public offer of securities in the United Arab Emirates and accordingly should not be construed as such. The information is only being offered to a limited number of exempt investors in the UAE who fall under one of the following categories of non-natural Qualified Investors: (1) an investor which is able to manage its investments on its own, namely: (a) the federal government, local governments, government entities and authorities or companies wholly-owned by any such entities; (b) international entities and organisations; or (c) a person licensed to carry out a commercial activity in the UAE, provided that investment is one of the objects of such person; or (2) an investor who is represented by an investment manager licensed by the SCA, (each a "non-natural Qualified Investor"). The information and data have not been approved by or licensed or registered with the UAE Central Bank, the Securities and Commodities Authority, the Dubai Financial Services Authority, the Financial Services Regulatory Authority or any other relevant licensing authorities or governmental agencies in the UAE (the "Authorities"). The Authorities assume no liability for any investment that the named addressee makes as a non-natural Qualified Investor diligence on the accuracy of the information relating to the securities. If you do not understand the contents of this document you should consult an authorised financial adviser.; **Saudi Arabia -** This document may not be distributed in the Kingdom except to such persons as are permitted under the Investment Funds Regulations issued by the Capital Market Authority. The Capital Market Authority does not make any representation as to the accuracy or completeness of this document, and expressly disclaims any liability whatsoever for any loss arising from, or incurred in reliance upon, any part of this document. Prospective purchasers of the securities offered hereby should conduct their own due diligence on the accuracy of the information relating to the securities. If you do not understand the contents of this document, you should consult an authorised financial adviser.; **Qatar -** This material/fund is only being offered to a limited number of investors who are willing and able to conduct an independent investigation of the risks involved in an investment in such material/fund. The material does not constitute an offer to the public and is for the use only of the named addressee and should not be given or shown to any other person (other than employees, agents or consultants in connection with the addressee's consideration thereof). The fund has not been and will not be registered with the Qatar Central Bank or under any laws of the State of Qatar. No transaction will be concluded in your jurisdiction and any inquiries regarding the material/fund should be made to your contact outside Qatar.