With Great Uncertainty Comes Great Opportunities

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What's happened? Goldilocks is gone

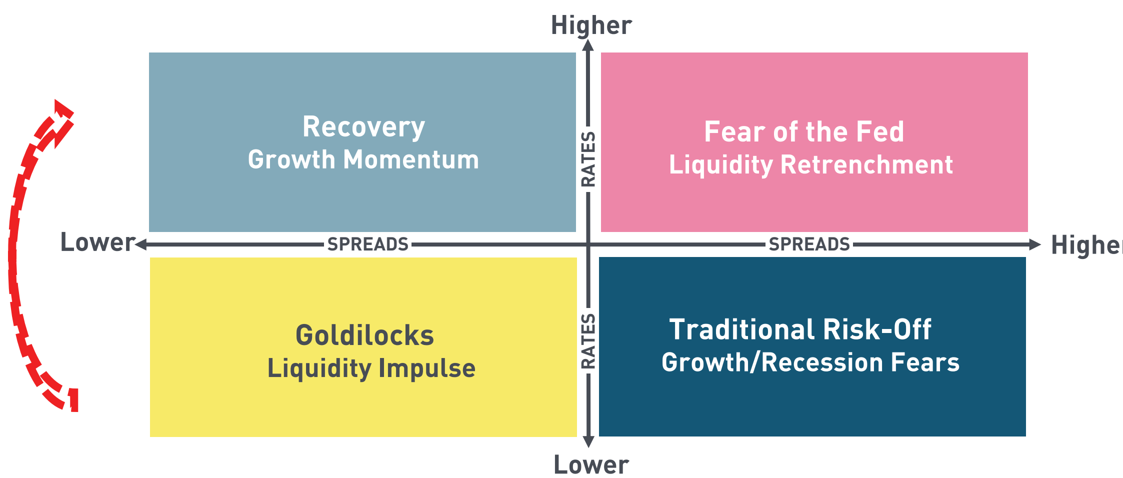
Global fixed income appears to have exited its "Goldilocks" regime for a new macro regime. There is some uncertainty about which new macro regime will ultimately prevail. Our baseline scenario is that we will transition to the "Recovery" regime, but as tail risks we cannot rule out landing in either "Traditional Risk-Off" (growth left tail) or "Fear of the Fed" (growth right tail).

Driven by the anticipated impact of the policy agenda under the new Trump presidency, this new regime is characterized by a

01 mild deterioration in macro fundamentals

02 further erosion of the valuation landscape

03 worsening risk appetite backdrop



Source: MFS. For illustrative purposes only. The four regimes are defined by the direction of changes in both rates and spreads.

Why is it important? Volatility is back

This transition will likely increase market volatility, reflecting the risks associated with greater policy uncertainty and reduced visibility over the impact of a Trump 2.0 agenda as well as future US Federal Reserve policy.

While conditions still appear supportive, we see two risks associated with fiscal policy:

01 Near-term risk that the economy might overheat due to expansionary policies

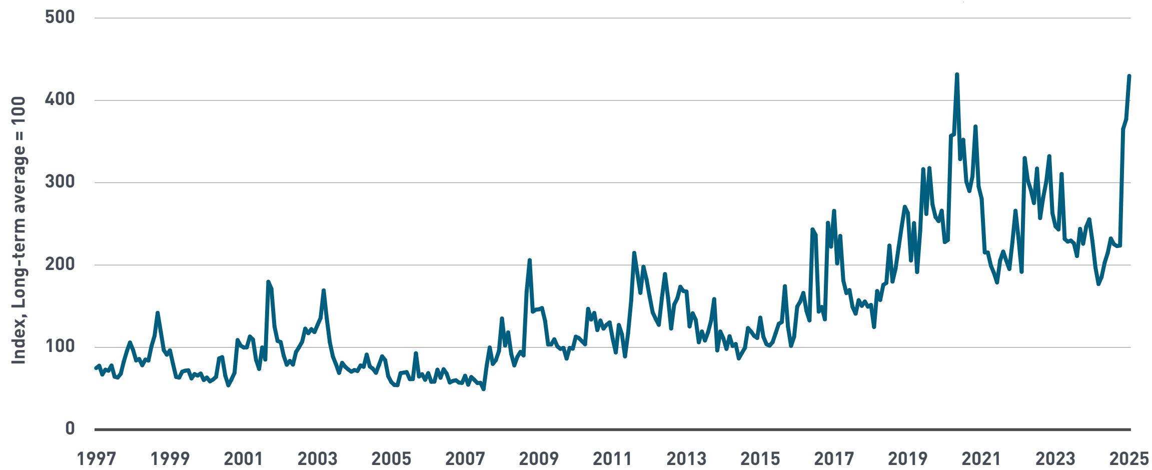
02 Medium-term risk of a market crisis resulting from a persistent lack of fiscal discipline undermining confidence in the US dollar

How does it impact investors? Keep calm and stay active

The higher the uncertainty, the greater the volatility, and ultimately, the greater the opportunities for an active asset manager to take advantage of potential dislocations.

Risk management is an essential part of the investment process given the significant range of risks. The risk of trade war escalation stands out as the key item to watch at this juncture.

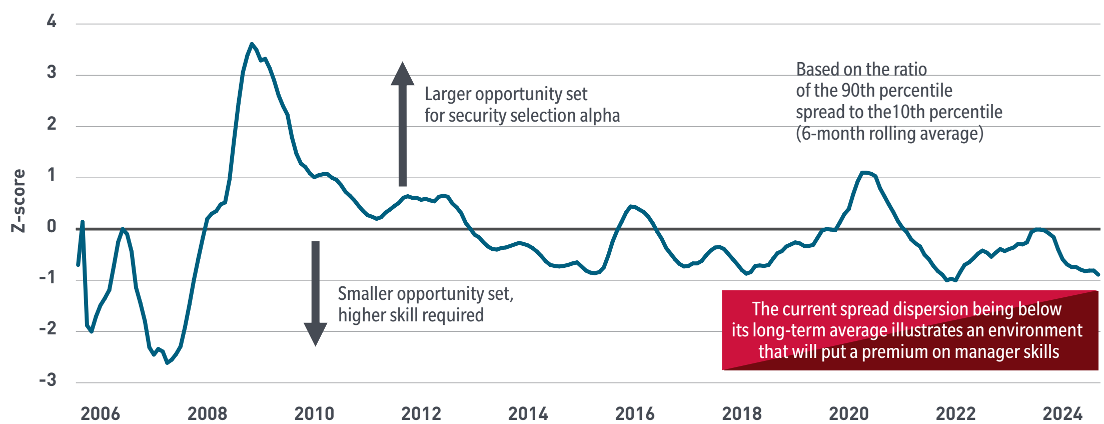
Exhibit 1: Global Economic Policy Uncertainty at Extreme Levels



Source: Bloomberg, Baker, Bloom & Davis. Monthly data from January 1997 to January 2025.

Tight spread dispersion should support the importance of relying on strong fundamental analysis. The tighter the spreads, the greater the probability that credit fundamentals are being mispriced. In other words, the bigger the opportunity for skillful active managers to generate alpha through fundamental security selection.

Exhibit 2: US IG Spread Dispersion Below Long-Term Average



Source: Bloomberg. US IG Credit = Bloomberg US IG Corporate Index. US IG Spread Dispersion = spread z-score using monthly data from January 2006 to February 2025 on a 6-month rolling basis, using an expanding window. A z-score is a measure of deviation from long-term average in terms of units of standard deviation.

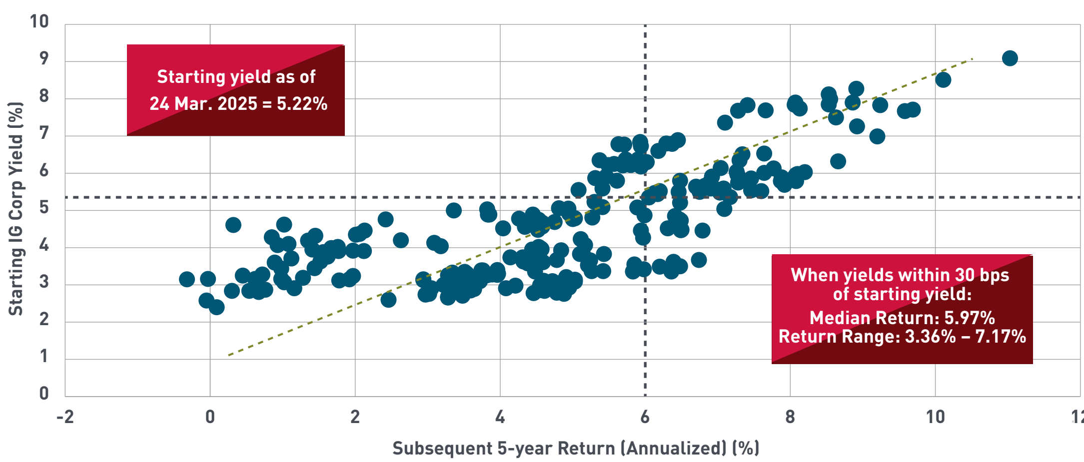
Fixed income may regain status as a portfolio diversifier if the equity-bond correlation normalizes lower.

Exhibit 3: Two Year Rolling Correlation of US Treasury and S&P 500 Returns

Source: Bloomberg. Monthly data from 30 May 1992 to 28 February 2025. Correlation coefficient is based on 2-year rolling correlation of monthly returns for the UST and the S&P 500 total returns. UST = Bloomberg US Treasury Index. S&P 500 = S&P 500 Total Return Index.

At a more strategic level, fixed income is well positioned as an attractive de-risking asset class. Fixed income is back to providing attractive income and remains compelling given its risk-adjusted expected returns.

Exhibit 4: Starting Yield Versus Subsequent Five Year Total Return for US IG Corporates



Source: Bloomberg. US IG = Bloomberg US Corporate Index. Yield = yield to worst. Monthly data from January 2000 through February 2025. Returns are gross and in USD. Past performance is no guarantee of future results. It is not possible to invest in an index.

SUMMARY: OPPORTUNITIES IN UNCERTAINTY

Under the new US administration, the outlook for macro and markets has become more uncertain.

Fixed income offers investors the potential to diversify and de-risk portfolios as well as provide attractive risk-adjusted returns.

We believe an active approach is best to make the most of opportunities and manage risks.