Summary 2024

MFS® Commentary

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Strategist's Corner - April 2024

Inflation Surprise? No, Not Really

Several inflation readings have taken the market by surprise in April. It wasn't a surprise, however, for those who buy food, pay utility bills or pay rent. Commodity prices have surged year to date, but the acute pain for households has been the cost of things they need, such as eggs, milk, electricity or shelter, which are not deflating.

The market's changed assumptions

Financial assets, including US Treasury bills and sovereign bonds, represent weighted probabilities about future outcomes. When new information changes on those probabilities, asset prices adjust. When financial price volatility is high, it's the market correcting for mistaken assumptions but also expressing increased uncertainty.

In the final months of 2023, investors took their cues from central bankers. They began to discount that inflation would recede to desired levels, allowing for a loosening of monetary policy and softer sovereign yield curves. Obviously, those assumptions were too strong.

As readers of Strategist Corner and clients of MFS® know, this wasn't our base case. Our analysts were hearing from company management teams that labor remained in short supply. We expected this would keep aggregate demand elevated and restrict the type of policy loosening the market wanted. So, what now?

Looking ahead

Our world is shifting from one of artificially suppressed interest rates and cheap manufacturing to something else. A world with greater needs for capital, specifically spending on equipment and labor, will prevent a return to abnormally low inflation and suppressed rates.

A pandemic, multiple wars and rising geopolitical tensions exposed the risks of stretched supply chains and outsourcing. Globalization is not going away, but it's being rerouted due to the risks of not having goods when needed, and that has financial implications.

We currently have an aging workforce at the same time demand for workers is rising due to reshoring. The give in that equation is price, in the form of higher sustained labor costs. While this may lead to higher wages, consumer spending, overall economic growth and inflation versus the 2010s, it will come at the expense of profits and valuation that investors are willing to pay for those profits. This is the opposite of the 2010s paradigm.

Conclusion

To be clear, we're not suggesting monetary policy will be tightened or yield curves will steepen. We think the market underappreciated the implications of this paradigm change. And while rates will ultimately fall, it probably won't be a straight-line decline like the market anticipated. Our world isn't that simple. More importantly, as the world adapts, businesses, whose profit streams were primarily sourced via cheap debt and labor, will succumb to balance sheet stress. Unlike during the low-cost regime, companies unfit for purpose will likely deliver disappointing financial results. We believe that avoiding those financial assets may prove beneficial to discretionary managers and advisors.

For the latest news and views on world economies and financial markets, visit mfs.com

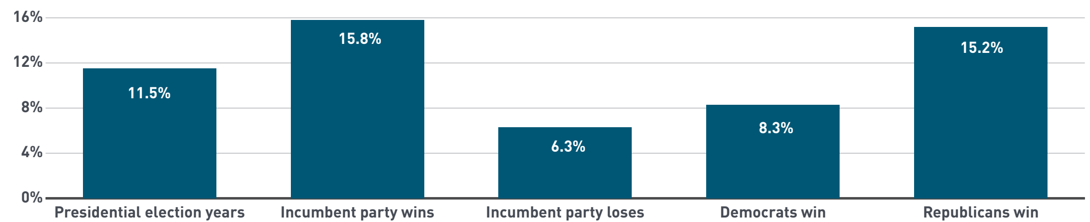
Market Insights

Primaries, Caucuses and Elections — Oh My!

Americans (and most of the world) will spend a lot of time up until November 2024 watching political ads, newscasts and debates leading up to Election Day. The question many have is, “What does it mean for me (and the stock market) if (insert name/party) wins?” While no one knows how the market will actually perform in any year, the charts below may offer some historical perspective on election years.

The market during election years: 1928–2020

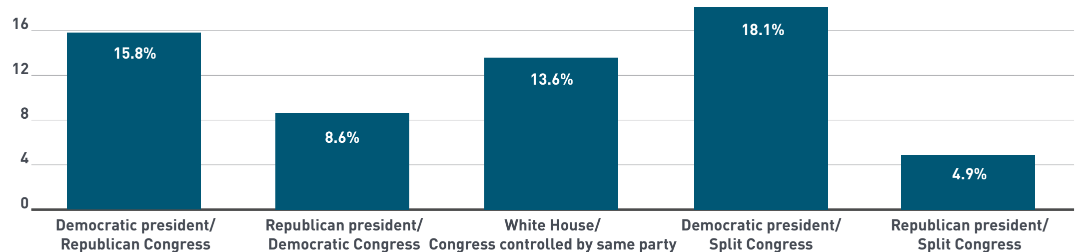
The market (S&P 500 Index) performed better on average when the incumbent party won the election, regardless of whether it was the Democratic or the Republican party.



Political control and the market: 1926–2023

In the years 1926 to 2023, the S&P 500 Index was up 15.8% per year (total return on average) under Democratic presidents and a Republican-led Congress, almost two times the 8.6% annual return achieved under Republican presidents when both houses of Congress were controlled by Democrats.

When both the White House and Congress were run by the same political party, the S&P 500 gained 13.6% per year. When Congress was split, with one party controlling the House and the other controlling the Senate, the S&P 500 gained 18.1% under Democratic presidents and 4.9% under Republican presidents.



Source: Bespoke Investment Group LLC Research, as of December 31, 2023, used with permission.

Perspective

Presidential elections tend to evoke a range of emotions and discussion topics around the stock market, including unwarranted concern. As an observer, focus on what matters to you. As an investor, consider distancing yourself from the rhetoric and hype and remember that the long-term trends in company earnings, worker productivity and global competitiveness may matter the most.

Past performance is no guarantee of future results. It is not possible to invest directly in an index. This has been provided for informational purposes and reflects the current opinion of the author, which is subject to change without notice, as are statements of financial market trends, which are based on current market conditions. Bespoke Investment Group LLC Research is not affiliated with MFS® Investment Management nor any of its subsidiaries.

Investor Basics

Back to Bonds: Why It Might Be Time to Make the Move

Without a doubt, cash was king in 2022 and into 2023. But markets have changed substantially. This year may be a pivotal point for investors sitting in cash, certificates of deposit (CD), short-term Treasuries or money market funds, one you don't want to look back on and ask, "Why didn't I move out of cash?" or "Why did I wait so long?" We believe now is the time to consider moving into bonds. Markets have moved quickly at pivot points in the past, and opportunities to capitalize on changing dynamics disappear quickly as well.

Comparing a 5-year bond to a 1-year CD

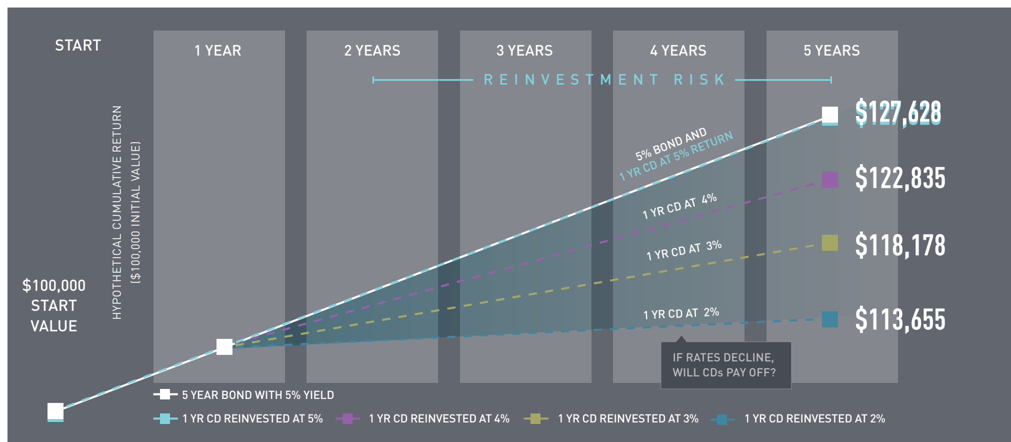
At first glance, yields on cash and bonds suggest a similar return potential. You might even think that a slightly higher return for bonds isn't worth the risk. But it's important to understand what those yields mean, the time period they represent and how it could impact returns. So, let's compare how a hypothetical five-year bond and a short-term cash equivalent vehicle such as a CD might perform over time.

Will 1-Year CDs Pay Off? Exposing Reinvestment Risk

In the hypothetical example below, if the bond doesn't default, the investor would receive a total return of 5% for five years. While the 1-year CD also has a 5% return in the first year, the investor would have to reinvest that money at the prevailing interest rate each subsequent year. Whether CD rates average 4%, 3% or 2% over the next five years is up for debate, but when the Fed has cut rates in the past, CD rates have fallen in tandem. Locking in attractive bond yields today will help you manage future reinvestment risk — such as the risk of having to reinvest proceeds in lower-yielding CDs.

Understanding the Hypothetical Return Streams

5-Year Bond versus 1-Year CDs Reinvested at Varying Rates 5%–2% (Years 2–5)



Source: MFS research. This example is for illustrative purposes only and is not intended to predict the returns of any investment choices. Compounding is the process where money earned from investments such as interest or dividends is reinvested to earn more.

Important Risk Information. Bond: Investments in debt instruments may decline in value as the result of, or perception of, declines in the credit quality of the issuer, borrower, counterparty, or other entity responsible for payment, underlying collateral, or changes in economic, political, issuer-specific, or other conditions. Certain types of debt instruments can be more sensitive to these factors and therefore more volatile. In addition, debt instruments entail interest rate risk (as interest rates rise, prices usually fall). Therefore, the portfolio's value may decline during rising rates. Portfolios that consist of debt instruments with longer durations are generally more sensitive to a rise in interest rates than those with shorter durations. At times, and particularly during periods of market turmoil, all or a large portion of segments of the market may not have an active trading market. As a result, it may be difficult to value these investments and it may not be possible to sell a particular investment or type of investment at any particular time or at an acceptable price. The price of an instrument trading at a negative interest rate responds to interest rate changes like other debt instruments; however, an instrument purchased at a negative interest rate is expected to produce a negative return if held to maturity.

Industry Info

A Century of Wealth Creation for All

A century ago, we launched the US' first open-ended mutual fund, sparking a global industry. As we celebrate our anniversary, we know it wouldn't be possible without you. Serving our investors is our "why," and 100 years from now, that commitment will still guide us. We'd like to thank you for your continued support and share a quick history that shows how our investors are at the heart of the decisions we make.

In 1924, MFS launched Massachusetts Investor Trust, a fund that allowed ordinary investors to buy and sell shares at will. For around $250 dollars, investors were able to buy a share of Massachusetts Investor Trust (MIT), a fund that exists today. For the first time, average people had access to a diversified portfolio of blue chip stocks and professional management. MIT weathered the Stock Market Crash of 1929 and the Great Depression, consistently paying dividends for investors.

However, trust in Wall Street was shaken. To instill confidence, MFS started publishing "goldfish bowl" reports for shareholders, showing sales charges, portfolio changes and performance. These reports were the first of their kind and set an industry standard. In 1932, MFS created one of the industry's first in-house research teams that analyzed company data, visited factories and talked to company management, like we do today, to understand a company's financial strength and earnings potential. MFS helped draft the Investment Company Act of 1940, a piece of legislation that still governs mutual funds. The requirements set forth in the legislation nearly mirrored the MFS bylaws.

In the 1950's, MFS became one of the pioneers of the modern growth fund. In the early 1970s, MFS revolutionized bond investing, bringing active management to what had been a buy and hold strategy and established a fixed income research team. In 1976, MFS launched one of the first municipal bond funds and in 1981 launched the first global fixed income mutual funds for US investors.

The MFS® Meridian Funds were launched in 1989, one of the first fund families for non-US investors. As the world continued to open, MFS opened its first international research office in 1995, and expanded into the Asia-Pacific region in 1997. In 2010, MFS was one of the first signatories of the United Nations' Principles of Responsible Investing. As we celebrate our anniversary, MFS looks forward to the next 100 years of creating value responsibly for investors like you amid many different market environments.

Definitions. Bond: When investors buy bonds, they are making loans to a company, government or institution. In return, the company promises to make regular interest payments at a set rate (coupon) and repay principle at a set date (the maturity). **Certificate of deposit:** A CD is a savings product that holds a fixed amount of money for a fixed period of time at a fixed interest rate. CDs are considered to be a safe investment options, but they do come with early withdrawal penalties.

The views expressed are those of the author(s) and are subject to change at any time. These views are for informational purposes only and should not be relied upon as a recommendation to purchase any security or as a solicitation or investment advice from the Advisor. No forecasts can be guaranteed.

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