MFS Digest

February 2024

Key Market Themes and Investment Insights

All eyes on the Fed We see as many as four upcoming rate cuts from the US Federal Reserve. The data will determine when they occur, but the first will probably come midyear. **Market Pulse**

What to watch in 2024 Reglobalization, geopolitics and AI are among the topics that are top-of-mind as 2024 gets underway. **2024: Six Key Themes**

After a strong 2023, future equity returns down slightly MFS' current long-term nominal return expectations for global equities are slightly lower than our mid-2023 view. **MFS *Long-Term Capital Markets Expectations***

FOMO in fixed income? There have already been plenty of fears in global markets recently, but we believe fixed income investors will soon face a new, albeit useful, one: the "fixed income fear of missing out" (FIFOMO). Given the much-improved macro backdrop, including stronger central bank signals and a favorable valuation landscape, this may be a good time to increase allocations to the asset class. **The Big Mac on Fixed Income Allocation: FIFOMO**

How might investors think about the year ahead? The capital cycle fuels the engine of progress, but it can also create excesses and inefficiencies. Rob Almeida examines why that's relevant today and going forward. **Strategists Corner: How the Capital Cycle Could Impact 2024**

Didn't see that one coming! The markets humbled many investors and strategists in 2023. As we enter the new year, markets are rerating thanks to falling yields and anticipation of a dovish Fed pivot. But are falling rates and strong earnings expectations compatible? **Monthly Equity Market Topics**

Economic outlook

Rate markets have moved past discounting peak policy rates from the world's largest central banks and are now pricing in aggressive monetary easing, perhaps as early as this spring. We believe that in any soft-landing scenario, US markets may be too aggressive in their pricing and at risk of a correction if the hoped-for Goldilocks scenario proves elusive or inflation ends up stickier than expected. Europe and the United Kingdom enter 2024 on the cusp of technical recessions as persistently high energy costs restrain economic activity and the demand for exports, particularly from Europe, remains sluggish. China's economy remains stuck in neutral as its property sector struggles amid a monumental debt overhang and continuing low investor confidence as concerns mount over the country's unpredictable regulatory regime. Markets will be on guard for any signs that the global disinflationary trend, so firmly in place in 2023, is beginning to wane. However, with China experiencing several months of deflation, global goods prices are likely to remain subdued, so the services sector will remain in the spotlight amid tight global labor markets.

Equity markets

Moderating global inflation pressures, signs that central banks will begin cutting interest rates in 2024 and growing hopes for a US soft landing helped spark a sharp rally in global equities in late 2023. For the 2023 calendar year, developed market equities rose just over 21%, led by solid gains in US and Japanese shares. The growing view that easier Fed policy is likely in 2024 has helped end an episode of dollar strength, which could provide a tailwind for the earnings of US-based multinationals. Given international equities' lower earnings multiples, the 2023 rally brought valuations back in line with their 10-year average. However, with the market's aggressive pricing of easier global monetary policy this year, there is the heightened risk of disappointment if inflation proves stickier than expected. There is also a risk that the late-2023 rally pulled forward returns that otherwise might have been realized in 2024.

Fixed income

Rates Valuation and the macro fundamentals, including the timing and size of rate cuts, are both supportive of long duration.

Credit Investment-grade fundamentals appear to be deteriorating, especially with respect to profit margins and cash positions, though US investment-grade total yields remain attractive by historical standards even with tight spreads. In high yield, the risk/reward is attractive for healthy breakeven yields and the upgrade in the US macro outlook, especially in the face of low default-rate projections. In addition, refinancing risks appear limited for the year ahead.

Munis The massive municipal fund outflow from 2022 has slowed, and a reversal of inflows would provide a welcome technical tailwind for the asset class. Muni fundamentals remain solid and may provide protection in the event of a growth shock.

Please see ***MFS Capital Markets View Summary*** for our view of the global equity and global fixed income markets.

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