WHITEPAPER

Built for What Comes Next: The Power of Diversification

Diversification is often discussed in broad terms — stocks versus bonds, domestic versus international — but meaningful diversification does not end there.

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It is crucial that proper diversification also occurs beneath the surface of these broad asset classes — across equity styles, market capitalizations, duration profiles, credit exposures, and other underlying sources of risk and return. As multi-asset investors, this is an extremely important consideration in our portfolio construction process.

This deeper layer of diversification matters because assets that appear similar at a high level can produce very different investor experiences over time. Even within highly correlated risky assets, long-term outcomes can diverge sharply, leadership can rotate unpredictably, and concentrated exposures can remain out of favor for years. In this paper, we examine how diversification within risky assets may improve the investor experience by reducing the substantial risk of being concentrated in a lagging market cohort and mitigating the severity and duration of market stress events.

High Correlation Does Not Mean Similar Outcomes

We begin by examining four US equity cohorts: large-cap value, large-cap growth, mid-cap, and small-cap. These ostensibly similar market segments have (unsurprisingly) exhibited highly correlated monthly returns, as shown in Exhibit 1.

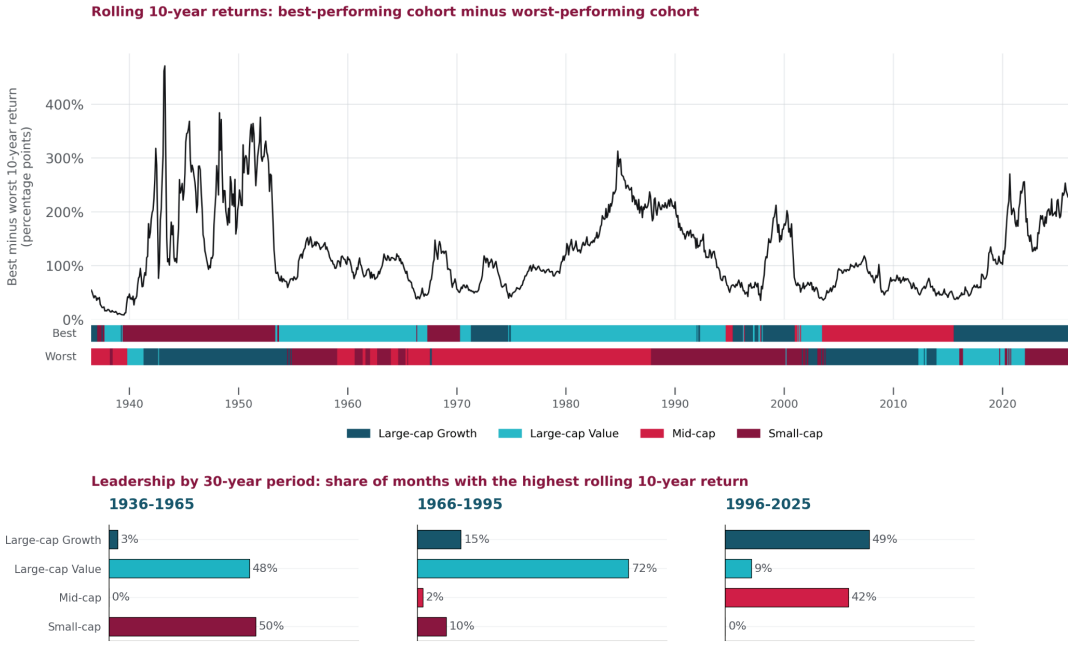
Exhibit 1: Monthly Returns Have Been Highly Correlated Across US Equity Cohorts

	Large-cap Growth	Large-cap Value	Mid-cap	Small-cap
Large-cap Growth	1.00			
Large-cap Value	0.89	1.00		
Mid-cap	0.92	0.96	1.00	
Small-cap	0.84	0.89	0.95	1.00

Sources: Kenneth R. French Data Library, FactSet and MFS Calculations.[1] Past performance is no guarantee of future results. It is not possible to invest directly in an index.

Importantly, however, one should not see these correlations and assume these market segments are interchangeable. Over longer-term horizons, realized returns within equity market cohorts like these can diverge widely, and relative leadership can shift substantially. For those saving for the future, these long-horizon returns are what truly matter, more so than the month-to-month similarities in price movement. We provide further analysis in regards to long-term return differentials and leadership changes in Exhibit 2.

Exhibit 2: Long-Term Outcomes Have Diverged, and Leadership Has Shifted



Sources: Kenneth R. French Data Library, FactSet and MFS Calculations.[1]
Color strips identify the best- and worst-performing segment at each month end.

The top panel of Exhibit 2 shows the difference between the 10-year rolling returns of the best and worst of these four US equity asset classes, highlighting how even highly correlated market segments can deliver meaningfully different outcomes when measured over longer periods of time. Put simply: do not be fooled by a roughly 90% correlation in monthly returns; the gap between the best- and worst-performing cohorts' cumulative 10-year returns has frequently exceeded 150 percentage points, and at times been considerably higher.

The middle panel of Exhibit 2 is a "leadership bar" that visually demonstrates which segments delivered the best (and worst) trailing 10-year returns at any point in time. This offers another important takeaway, though perhaps a more subtle one: while each of the US equity cohorts spends time at both the top and bottom of the leaderboard, any meaningful pattern, persistence, or trend is difficult to identify. No single cohort dominates the top of the leaderboard, and very often, the winners of the past are the laggards of the future.

This lack of trends, patterns, or persistence is further detailed in the bottom panel of Exhibit 2, which displays each cohort's share of time spent atop the leaderboard for all three 30-year periods across our sample. Very often, the shining star of one period becomes a relative laggard in the next. And, just as often, an out-of-favor cohort stages some redemption in a future period.

An investor who extrapolates from the prior experience might be in for some disappointment. With leadership changes difficult to predict and return dispersion having the potential to be meaningful, a disciplined asset allocator may be wise to avoid concentrating exposure in a single cohort. The cost of being wrong, it should be obvious by now, can be substantial, as we will examine next.

The Cost of Being Concentrated — and Wrong

In our view, a key benefit of diversification is reducing the risk of being concentrated in the weakest-performing segment. Exhibit 3 quantifies what we call "regret avoidance," which we define as the degree to which an equally weighted portfolio of these four US equity cohorts outperforms the worst individual segment over a 10-year period. This difference represents the degree to which diversification would have helped an investor avoid the pain of being concentrated in the worst-performing cohort.

Exhibit 3: Regret Avoidance: Equally Weighted Portfolio vs. Weakest-Performing Cohort



Sources: Kenneth R. French Data Library, FactSet and MFS Calculations.[1] As of November 1, 2026.

The diversified portfolio outperformed the worst-performing cohort by approximately 60 percentage points (on average) of cumulative 10-year returns over this timeframe, and at times, this outperformance surpassed 100%. In other words, the unfortunate investor who concentrated in the wrong risky asset cohort would have dug themselves a massive hole. While it can be tempting to attempt to identify the strongest-performing cohort ex-ante, the risk of being wrong is substantial. Avoiding this risk is a meaningful benefit of diversification.

Exhibit 4 shows that none of these asset classes have avoided being the laggard of the group, and each has spent meaningful time in last place (as measured by their share of periods with rolling 10-year returns ranked last, shown in the first column). Importantly, the second column shows that an investor experiencing unfortunate concentration should not count on a quick recovery, as most assets have demonstrated an ability to remain in last place for a decade or more. The third column shows that an investor concentrated in the wrong cohort can lag a diversified portfolio for exceptionally long periods of time.

Exhibit 4: Lagging Assets Can Stay Out of Favor for Decades

Segment	Share of rolling 10Y periods ranked last	Longest continuous run as 10Y laggard (years)	Longest continuous run below equal weight on a trailing 10Y basis (years)
Large-cap Growth	27%	12	15
Large-cap Value	11%	3	15
Mid-cap	32%	20	39
Small-cap	31%	12	21

Sources: Kenneth R. French Data Library, FactSet and MFS Calculations.[1] As of November 1, 2026.
Note: Runs are based on consecutive monthly rolling 10-year observations.

The key takeaway from Exhibits 3 and 4 is that the risks of concentration are steep: being wrong can have a dramatic impact on returns that can persist for substantial periods of time. Diversification can help investors avoid significant setbacks that may be difficult — even impossible — to overcome.

Diversification During Drawdowns and Recoveries

The benefits of diversification are not limited to long-term outcomes. They are also present during acute periods of market stress, when drawdown severity and recovery time become especially important for investors.

To illustrate this, we will now broaden the investment opportunity set beyond the US equity cohorts to include international equities, REITs, and commodities, creating a diversified portfolio that resembles a risky asset mix that might be used in multi-asset strategies.

No risky asset is immune to severe drawdowns, which not only stress portfolio value but also test investor behavior. Drawdowns can both destroy wealth and drive suboptimal investor behavior — such as capitulation at the wrong time. Reducing drawdown severity and shortening recovery time are crucially important in the savings journey, as both can help investors remain committed to their long-term allocation when market stress is most difficult to endure. We find that diversification helps along both of these dimensions.

Exhibit 5 compares the 10 largest drawdowns across risk assets since 1972, when data for the broader opportunity set become available. All seven asset classes appear at least once among the 10 observations. For each episode, we also show the performance and recovery time that would have occurred using a diversified portfolio of risk assets.[2] The hypothetical diversified portfolio experienced meaningfully smaller drawdowns and faster recoveries on average than the individual assets' episodes. Diversification resulted in meaningful improvements in drawdown severity (-22% diversified portfolio vs. -62% individual-asset average) and recovery time (3.0 years vs. 4.8 years). This is a significant improvement for investors, both economically and psychologically.

Exhibit 5: Largest Drawdowns and Diversification Effects

Asset / Period	Asset Drawdown	Diversified Portfolio Return (Same Period)	Asset Recovery (Years)	Diversified Portfolio Recovery (Years)
Commodities 6/2008 - 4/2020	-74%	83%	N/A	N/A
Real Estate 1/2007 - 2/2009	-70%	-51%	4.1	2.2
Large-cap Growth 3/2000 - 2/2009	-69%	-41%	5.8	1.2
Real Estate 11/1972 - 12/1974	-64%	-39%	7.9	3.3
Small-cap 4/1972 - 12/1974	-62%	-35%	3.6	2.0
International Equities 10/2007 - 2/2009	-57%	-54%	5.3	3.9
Large-cap Value 5/2007 - 2/2009	-57%	-54%	4.1	3.9
Commodities 10/1980 - 7/1986	-57%	69%	18.2	N/A
Mid-cap 5/2007 - 2/2009	-56%	-54%	2.2	3.9
Mid-cap 11/1972 - 9/1974	-56%	-42%	5.8	3.6
Average	**-62%**	**-22%**	**4.8**	**3.0**

Sources: LSEG DataStream and MFS calculations.[2]
Note: Recovery averages include only episodes with both recovery measures. N/A indicates no drawdown to recover from or no recovery by the end of the sample. This hypothetical example is for illustrative purposes only. It does not represent any MFS product.

Conclusion

Risky assets, even highly correlated ones, are not created equal. Diversification efforts should extend beyond the broad "stocks versus bonds" decision and into the underlying exposures that shape portfolio outcomes over time. Being overly concentrated in a single area of risk assets can lead to meaningful underperformance, prolonged return disappointment, deeper drawdowns, and longer recovery periods.

As multi-asset investors, the practical implication is clear: diversification should be intentional at multiple levels of portfolio construction. By maintaining a broad mix of underlying exposures, investors can reduce reliance on any single source of return and seek a more stable investment experience through time. In our view, the objective is not to consistently own tomorrow's winner, but to build portfolios that remain resilient through a broader range of market conditions, regardless of which market segments lead or lag.

Endnotes

[1] Exhibits 1–4 use monthly returns from the Kenneth R. French Data Library from July 1926 through December 1984 and Russell index returns from FactSet from January 1985 through December 2025, net of the one-month risk-free rate. Large-cap growth, large-cap value, mid-cap and small-cap are represented by the Russell 1000® Growth, Russell 1000® Value, Russell Midcap® and Russell 2000® indexes, respectively; earlier series are authors' calculations using Kenneth French data. Rolling 10-year measures use trailing 120-month cumulative returns.

[2] Exhibit 5 uses monthly excess returns beginning in 1972. The diversified portfolio comprises 17.5% large-cap growth, 17.5% large-cap value, 20% mid-cap, 5% small-cap, 30% international equities, 5% commodities and 5% real estate. Large-cap growth, large-cap value, mid-cap and small-cap, international equities, commodities, and real estate are represented by the Russell 1000® Growth, Russell 1000® Value, Russell Midcap®, Russell 2000®, MSCI EAFE, Bloomberg Commodity, and FTSE® Nareit All REITs Indexes, respectively. Portfolio return is measured over each asset's peak-to-trough period. Asset recovery is measured from the asset trough until the asset regains its prior peak; portfolio recovery is measured from the same trough until the diversified portfolio regains its value on the asset's peak date.

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