

MARKET INSIGHTS

Midyear 2026 Key Themes

JUNE 2026 | MFS MARKET INSIGHTS TEAM

SUMMARY

As investors look to the second half of 2026, several key themes — from AI disruption to supply-side pressures to dollar weakness — are expected to shape macro and market conditions. The case for broad diversification has strengthened. US large-cap returns have been heavily driven by a small group of mega-cap technology names, but growing signs of market broadening, including improving earnings prospects outside the US and a rally in SMID-caps, point to wider participation ahead. Non-US equities offer attractive valuations and different return drivers, while high-quality global credit, EM sovereign debt, and alternative strategies can enhance portfolio resilience. At the same time, the security landscape is broadening well beyond traditional defense. Global military spending is accelerating, with every NATO member now meeting its 2% of GDP target, and the “umbrella of security” is expanding to encompass energy, critical minerals, and supply chains. This kind of spending is typically deficit-financed and supportive of growth, though also modestly inflationary.

Artificial intelligence remains a defining force across markets, but selectivity is critical. Disruption is redistributing value across industries, rewarding firms with proprietary data and mission-critical workflows while threatening those exposed to commoditization and margin pressure. Valuation discipline is essential, as enthusiasm can overprice obvious beneficiaries and

obscure underappreciated opportunities. At the same time, the AI capex buildout is broadening beyond hyperscalers to benefit semiconductors, utilities, power infrastructure, and select industrials. In fixed income, however, funding structure and balance-sheet capacity are likely to drive outcomes as debt issuance rises.

Supply-side pressures add another layer of complexity. Labor scarcity, energy constraints, and infrastructure underinvestment are keeping production costs elevated, creating upside risk to inflation and pressuring corporate margins. Dispersion between companies with pricing power and those in commoditized markets is widening, making stock selection increasingly important. In this environment, a GARP approach — growth at a reasonable price — offers a disciplined way to navigate shifting leadership by focusing on quality compounders with durable demand, adaptability, and reasonable valuations. Meanwhile, dollar dominance is eroding at the margin as challenges to US exceptionalism strengthen the case for non-dollar assets, including gold, emerging market currencies and local debt. Finally, private credit is facing its first real stress test: BDC spreads have widened, non-accruals have risen, and the illiquidity premium has narrowed. While systemic risk remains contained, the repricing reinforces the relative appeal of public fixed income as a portfolio anchor.

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Diversification as a Defense – and an Opportunity

The case for diversification has strengthened as investors navigate a market shaped by elevated concentration, AI-driven enthusiasm, and shifting macroeconomic risks. In recent years, US large-cap returns have been heavily driven by a small group of mega-cap technology companies, increasing single-sector and single-company exposure in capitalization-weighted portfolios. With several large IPOs expected over the next year, market concentration could worsen even further. In this environment, broad diversification across asset classes and regions may help mitigate risks by spreading exposure across sectors, geographies, and return drivers that perform differently across economic cycles.

ACTIONS TO CONSIDER

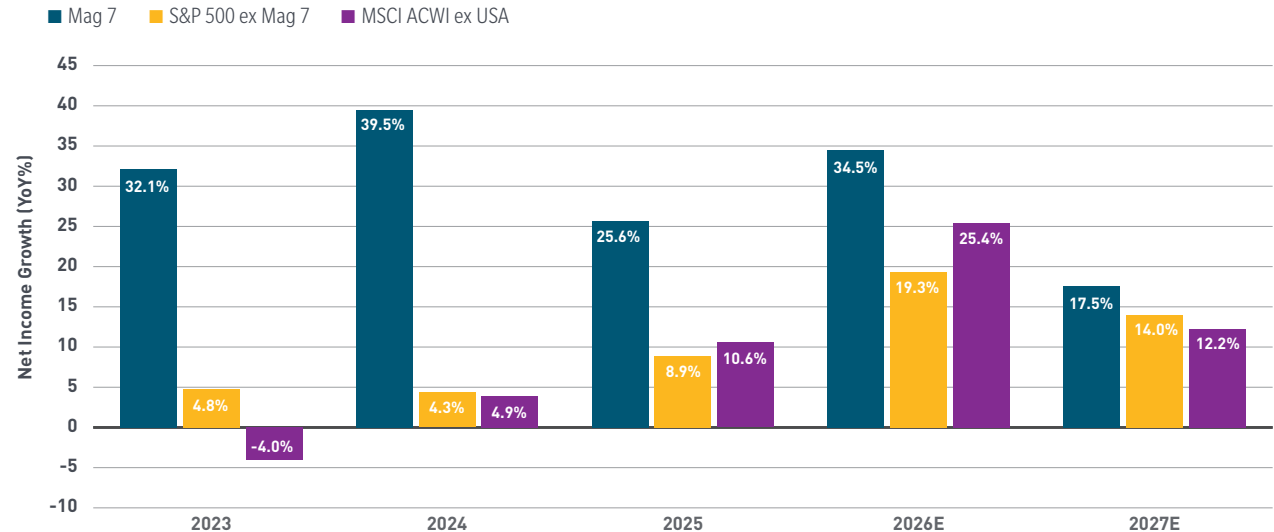
- ➔ Within US equities, diversify beyond mega-caps and into SMID-cap and value-oriented stocks.
- ➔ Broaden exposure to non-US developed markets — especially Europe and Japan — and to emerging markets, focusing on companies at the forefront of technological innovation and supply chain development, particularly in Taiwan and South Korea.
- ➔ Strengthen portfolio resilience and enhance risk-adjusted returns by allocating to high-quality global credit and alternatives such as commodities and REITs.

Growing signs of equity market broadening strengthen the argument for global exposure. While the “Magnificent Seven” powered much of the early 2020s’ earnings growth, expectations are now shifting toward wider participation, with the rest of the S&P 500 projected to gain momentum. US SMID-cap stocks have rallied year to date as investors rotate away from mega-caps, supported by a narrowing valuation gap and improving earnings outlook. Although US companies continue to exceed earnings expectations, growth prospects have improved meaningfully outside the US — particularly in Europe and emerging markets. Europe and Japan are likely to benefit from ongoing structural and corporate reforms, while emerging markets are making notable advances in AI, manufacturing, and renewable energy.

Investors are placing greater emphasis on risk management amid heightened geopolitical uncertainty. US equities continue to benefit from AI

spending and strong profitability, but elevated valuations and market concentration remain risks. In contrast, non-US equities offer relatively attractive valuations and exposure to different economic drivers, policy dynamics, and currencies. At the same time, broader earnings leadership points to a healthier global economy, which is a constructive backdrop for fixed income, particularly global credit and EM sovereign debt. Despite geopolitical uncertainty, strong corporate fundamentals and improving free cash flows continue to support investment-grade bonds, especially higher-quality issuers. While yields have moderated since their 2022 highs, they remain attractive across global credit markets. Moreover, non-US assets are well positioned to gain from the potential continued weakening of the US dollar. Taken together, today’s complex environment reinforces the strategic importance of diversifying across asset classes, sectors, and regions to enhance long-term, risk-adjusted returns.

EXHIBIT 1: AS MEGA-CAP DOMINANCE EASES, GLOBAL EARNINGS MOMENTUM BUILDS



Source: FactSet Portfolio Analysis. Earnings estimates as of 31 May 2026. Annual earnings data is in USD and uses the year over year change in actual and estimated calendar year earnings results. Mag 7 (“Magnificent Seven”) companies represented by Alphabet, Amazon, Apple, Meta, Microsoft, NVIDIA, and Tesla. The information included above as well as individual companies and/or securities mentioned should not be construed as investment advice, a recommendation to buy or sell or an indication of trading intent on behalf of any MFS product.

The Umbrella of Security

Defense spending is no longer rising gradually — it is accelerating globally. For the first time in decades, every NATO member met its 2% of GDP target for defense spending in 2025. Europe is leading the shift amid the Ukraine conflict, with real defense spending up nearly 20% in both 2024 and 2025. The trend extends beyond Europe: Japan has increased defense spending at a pace of about 10% annually over the past two years despite a pacifist constitution, while the US remains central to the global defense architecture as both a NATO anchor and a major exporter of advanced weapons systems.

History suggests defense spending is cyclical — and we are entering a new upswing. Following decades of relatively muted conflict after the Cold War, a new defense cycle is underway. These periods are rarely funded through growth alone; instead, they typically lead to higher deficits, increased debt issuance, and greater pressure on social spending.

The macro impact is usually mixed: supportive for growth, but inflationary. Higher defense spending can stimulate economic activity, but it also tends to push inflation modestly higher. Today’s geopolitical backdrop reinforces this dynamic. The US is relatively insulated from major energy shocks due to its status as a net exporter of oil and gas, but Europe, which is structurally dependent on oil imports, remains more exposed.

Security now extends beyond military capability.

Access to critical resources — especially rare earth minerals used in defense, AI, and advanced technologies — has become strategically important. China’s 2025 export restrictions highlighted this vulnerability, prompting countries to seek alternative sources of strategic minerals. Supply chains themselves are now geopolitical assets, and countries without domestic resources must secure them externally, often at a higher cost.

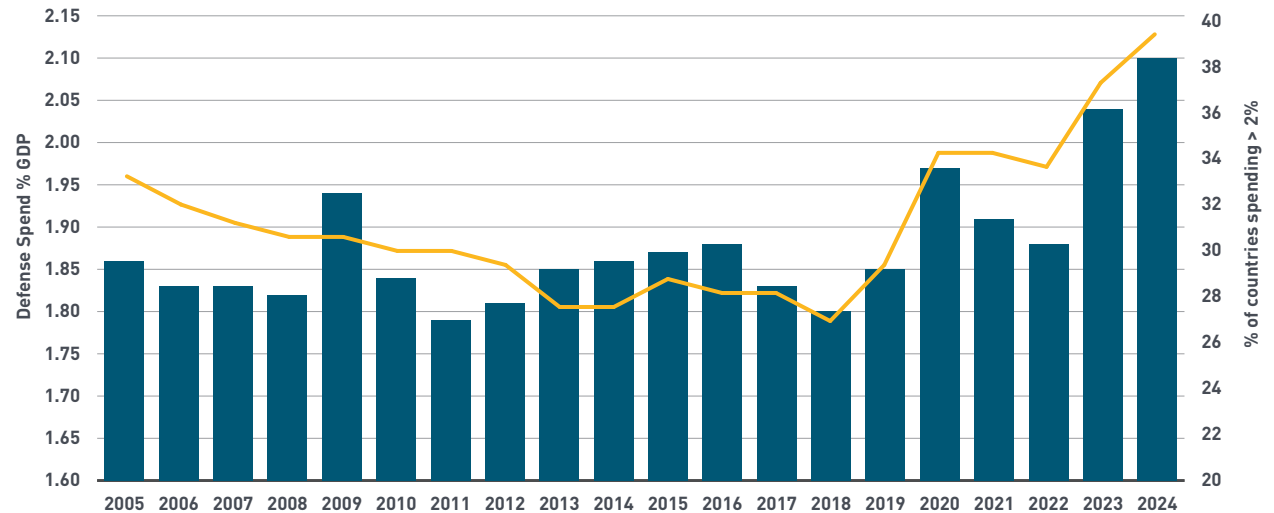
The “umbrella of security” is expanding — to energy, minerals, and supply chains. Maintaining it will require sustained spending, which will in turn require governments to make difficult choices about what projects to prioritize in budgetary spending. Geopolitics and fiscal policy are increasingly intertwined, and bond markets are responding.

ACTIONS TO CONSIDER

- ➔ Deficit-financed defense and security projects are expected to be a tailwind for global growth but also come at the cost of modestly higher inflation over the medium term.
- ➔ Higher deficits and inflation will likely see global yields settle at a structurally higher level than was seen in the prior business cycle.
- ➔ Opportunities may exist in historically under-invested sectors that are deemed a strategic importance by governments. Risks are skewed towards a weaker consumer if these projects are more heavily financed by budget reconciliation than new debt.

EXHIBIT 2: DEFENSE SPENDING IS ON THE RISE

■ World Average Defense Spend (LHS) ■ Percent of Countries With Military Spending > 2% of GDP (RHS)



Source: IMF World Economic Outlook, Gethin 2024, SIPRI Military Expenditure Database, World Human Capital Expenditure Database. As of 15 April 2026.

Navigating AI Disruption

Artificial intelligence is reshaping competitive advantages across industries, creating both powerful opportunities and meaningful risks for investors. Navigating this disruption requires a rigorous analytical process to separate durable winners from vulnerable incumbents. The key question is not simply which companies use AI, but which companies can convert AI into stronger economics. Potential winners may include firms with proprietary datasets, mission-critical software, strong customer relationships, pricing power, or the ability to successfully embed AI into existing products to improve productivity and retention. Potential losers may include businesses exposed to automation, commoditization, margin pressure, or customer disintermediation. Investors should evaluate how AI changes revenue growth, cost structures, barriers to entry, capital intensity, and long-term returns on invested capital.

ACTIONS TO CONSIDER

- ➔ Evaluate companies where AI reinforces economic moats while avoiding companies that may experience commoditization or cost pass-through.
- ➔ Target structural beneficiaries, including data-rich platforms, power, and infrastructure.
- ➔ Look for mispriced opportunities where AI upside is underappreciated or where disruption risk is overstated.

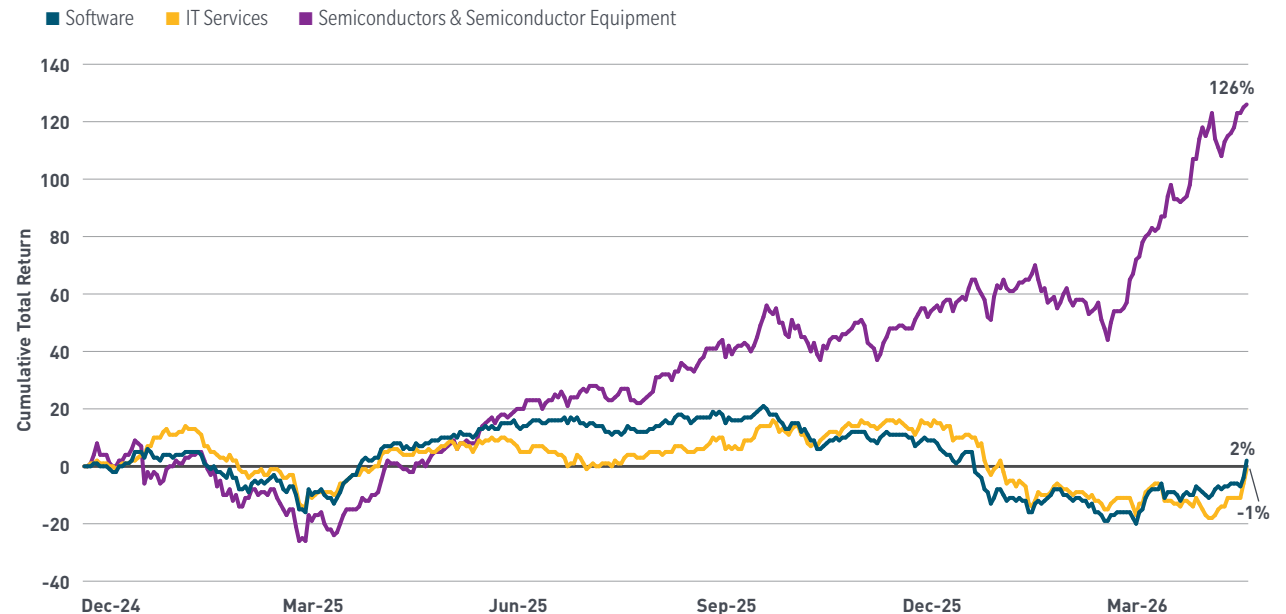
As AI lowers the cost of prediction, automation, and content generation, the market is likely to reward businesses that own scarce, high-quality data assets, control proprietary workflows, or provide critical AI infrastructure. Data-rich businesses can become increasingly strategic because their datasets may improve model performance, deepen customer insight, or reinforce competitive moats. In a world where algorithms are becoming more widely available, differentiated data, distribution, trust, and domain expertise may matter more than the technology itself.

Valuation discipline is equally important. AI enthusiasm can lead to overvaluation for some more obvious beneficiaries while overlooking companies where AI upside is underappreciated or where disruption fears may be excessive. Attractive investment opportunities may emerge where the market misprices

the timing, magnitude, or distribution of AI-related benefits. Conversely, high expectations can create risk if valuations already assume flawless execution and rapid monetization.

AI disruption also introduces broader risks and opportunities. Regulatory scrutiny, data privacy worries, intellectual property concerns, cybersecurity threats, model reliability, and implementation costs could all affect adoption and profitability. At the same time, AI can also expand addressable markets, improve productivity, enhance decision-making, and create new business models. The investment challenge is to avoid thematic speculation and instead apply fundamental analysis to identify where AI strengthens — or erodes — competitive advantages and where valuation provides a margin of safety. The opportunity lies not in owning AI broadly, but in understanding how disruption can redistribute value.

EXHIBIT 3: DRAMATIC BIFURCATION IN IT SECTOR RETURNS



Source: FactSet SPAR. Daily returns from 31 December 2024 to 29 May 2026. Industry groupings based on GICS. Total returns are net and in USD.

AI Capex is Reshaping Markets

The AI capex buildout is one of the largest corporate investment cycles in modern US history, with implications reaching far beyond technology.

As hyperscalers, semiconductor companies, utility companies, industrials, and infrastructure providers invest to support AI workloads, the opportunity set is widening. The growth case remains constructive for compute, connectivity, power, cooling, and the data center buildout. Semiconductor and semiconductor equipment manufacturers are the clearest beneficiaries, but as AI capacity continues to scale, the opportunity spillover is broadening to encompass electrical equipment, power infrastructure, grid modernization, and select industrials.

ACTIONS TO CONSIDER

- ➡ In equities, look beyond the hyperscalers and large model providers. Exposure to materials, utilities and industrials will also benefit from the AI datacenter buildout.
- ➡ In fixed income, the level of capex financing expected from debt markets continues to rise, which may put some modest pressure on spreads.
- ➡ In the short term, this level of capex is highly stimulative to economic growth, but over the longer term there may be concerns about overcapacity.

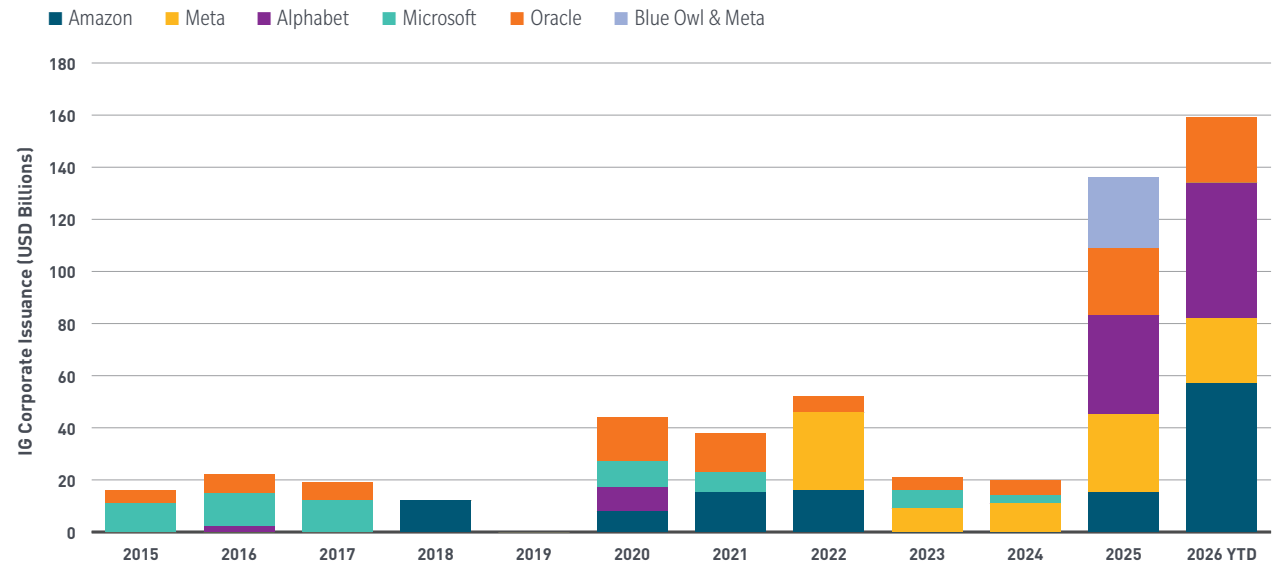
Hyperscaler spending looks durable because these companies combine strategic urgency with the financial capacity to keep investing. They benefit from strong cash flow, dominant cloud platforms and deep customer relationships. Their scale also creates advantages in procurement, infrastructure efficiency, data access, and model deployment. AI spending is capital intensive, but few companies are better positioned to fund it through the cycle. If AI lifts cloud demand, software adoption and new platform revenues, today's capex could translate into durable growth.

The funding side of the AI buildout, however, matters just as much. The required investment is enormous, and not every participant has the same flexibility as the largest platform companies. Data center developers, utilities, telecom providers, and other infrastructure-linked borrowers may need to lean more on debt, project finance, private capital, or equity

issuance. That raises the risk of wider dispersion between companies that can self-fund growth and those facing higher leverage, higher funding costs, or execution risk.

Within fixed income, AI capex is viewed primarily through the lens of funding and technicals rather than growth. Heavier issuance from infrastructure-related borrowers could pressure spreads if supply outpaces demand, especially where leverage is rising. So far, demand for AI-linked deals has remained strong enough to keep the market in balance and support valuations. Selectivity is critical, however. Investors need to separate the borrowers funding durable, cash flow-backed infrastructure from those pursuing more speculative expansion. While AI capex is a bullish theme for equities, in credit, the story is more selective, with funding structure, balance sheet capacity, and supply technicals likely to drive outcomes.

EXHIBIT 4: AN EXPANSION OF DEBT ISSUANCE TO FUEL CAPEX



Source: Bloomberg. Annual data from 31 December 2015 to 12 May 2026. YTD 2026 as of 12 May 2026. The information included above as well as individual companies and/or securities mentioned should not be construed as investment advice, a recommendation to buy or sell or an indication of trading intent on behalf of any MFS product.

When Supply Meets Scarcity: The Risk of a Production Cost Crisis

Supply bottlenecks have re-emerged as a defining feature of the current macro environment. This has challenged the post-Global Financial Crisis playbook, which relied on stable costs and expanding margins. As MFS Global Investment Strategist Rob Almeida notes, profits ultimately reflect revenues minus costs — and today, the cost side of that equation is becoming increasingly uncertain.

Labor scarcity is a key risk. Years of underinvestment in physical capacity, combined with rising demand for skilled workers tied to infrastructure and technology deployment, has tightened labor markets. This is pushing wages higher and contributing to structurally elevated cost bases for companies, particularly in sectors reliant on specialized talent.

ACTIONS TO CONSIDER

- ➔ Favor companies with pricing power that are positioned for scarcity.
- ➔ As dispersion is likely to rise, focus on firms with lasting competitive edges.

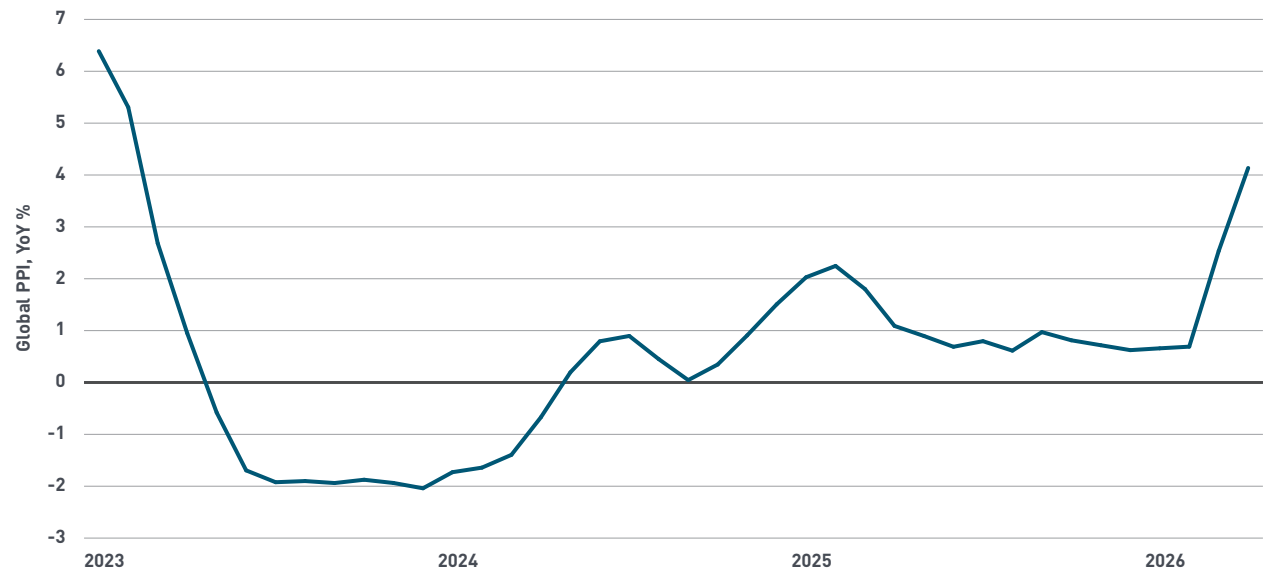
At the same time, energy and infrastructure constraints are amplifying production costs. The shift toward a more capital-intensive economy — requiring investment in power generation, transmission, and industrial capacity — means companies are increasingly exposed to higher input costs across energy, materials, and logistics. These pressures are not temporary; they reflect a system that entered this cycle underbuilt and is now playing catch-up.

Together, these forces may create upside risk to inflation. Even as demand moderates, supply-side frictions keep cost pressures elevated, limiting the pace at which inflation can normalize. Historically, though inflationary bursts may support pricing power in the short term, they also often embed higher costs that tend to persist, ultimately weighing on margins.

This backdrop calls the resilience of corporate earnings into question. As growth slows and revenues moderate, rising fixed costs — labor, energy, and cost of goods sold — become harder to absorb. Negative supply shocks may simultaneously pressure revenues and raise costs, a combination that accelerates margin compression and can lead to faster-than-expected earnings deceleration.

The implications for investors are uneven. Companies that control scarce resources, own critical infrastructure, or have strong pricing power may be better positioned to protect margins. In contrast, firms operating in commoditized or highly competitive markets may struggle to pass through higher costs. The result is a widening dispersion between winners and losers — making stock selection, rather than broad market exposure, increasingly important in a supply-constrained world.

EXHIBIT 5: THE GLOBAL PRODUCTION PRICE INDEX HAS RISEN SHARPLY



Sources: Bloomberg, IMF. Monthly data from 31 January 2023 to 30 April 2026. Based on PPI data for the following individual countries/regions: US, UK, the eurozone, Japan, China, Korea, Brazil, Mexico, India, Indonesia. Data up to April 2026. The aggregated index uses IMF nominal GDP values for 2024 to determine the weight of each country.

GARP: Finding Resilient Growth in a Changing Market

Growth at a reasonable price, or GARP, is an approach to investing in growth businesses where durability of earnings, capital allocation and valuation all matter. That means focusing on quality compounders at a reasonable price. This approach is especially relevant in a market where leadership has been narrow and investor attention has gravitated toward a small set of dominant narratives, leaving other high-quality businesses underappreciated.

The market is changing in ways that look more structural than cyclical. Technology is lowering barriers to entry, accelerating competitive shifts and redistributing profit pools, while AI-driven capital spending, higher funding costs, and supply-chain resilience are changing where capital flows and redefining market leadership. Some of these forces are cyclical, but the bigger point is that the sources of return are evolving. This may widen the gap between businesses that can sustain returns through change and those whose outcomes

remain more dependent on the cycle. A key risk is mistaking cyclical strength for durable growth and paying too much for earnings near a high point. As highlighted below, quintile 5 valuations swung from 84x in 2021 to 11x in 2023 and back to 36x today, the kind of multiple whiplash that underscores why GARP’s focus on durable earnings and valuation discipline can offer a steadier path to compounding.

Opportunities may lie in businesses with durable demand, pricing power, balance-sheet strength, and management teams that can adapt as conditions shift. Many of these businesses are unloved by the market, but their long-term returns can often be driven more by earnings compounding than by sentiment. In many cases, their relevance has not diminished; they are simply attracting less attention in a market focused on a narrower set of winners. These are the kinds of businesses that may be able to compound through change rather than rely on the cycle.

Narrow leadership can obscure a wider group of businesses better equipped for a market defined by faster disruption and broader return drivers.

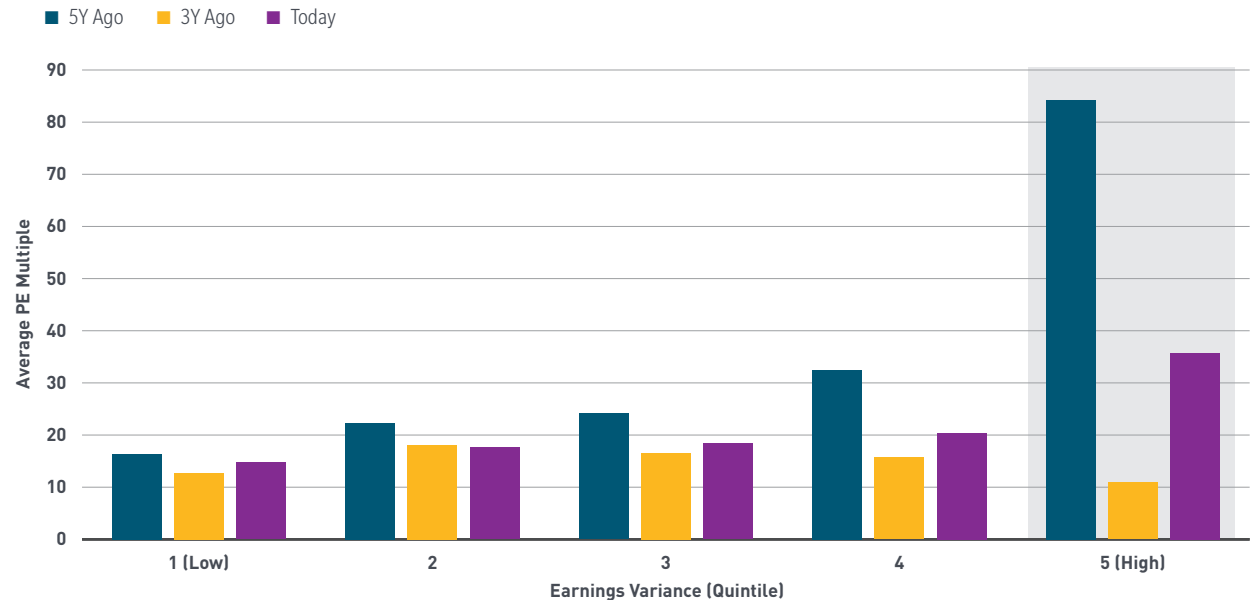
As competitive advantages become more contested, adaptability may matter just as much as scale. Investors can still participate in powerful structural themes while owning underappreciated quality outside the dominant narrative. This can broaden return drivers and reduce dependence on a single market story.

For investors, GARP offers a way to stay anchored in quality, adaptability, and valuation as the market changes. Cycles still matter, but the stronger case is structural: GARP can help build a more resilient portfolio as leadership, competition, and sources of growth evolve. This in turn might offer a more balanced way to access growth without relying too heavily on the market’s current favorites.

ACTIONS TO CONSIDER

- ➡ Focus on businesses with durable earnings, pricing power, balance-sheet strength and the ability to adapt as conditions change.
- ➡ Balance exposure to dominant market themes with underappreciated quality that can broaden return drivers.

EXHIBIT 6: THE VOLATILITY PREMIUM IS BACK: PE MULTIPLES FOR UNSTABLE EARNERS HAVE TRIPLED FROM THEIR 2023 LOW



Source: FactSet. Earnings Variance is defined as the standard deviation of the last 4 quarters of Net Income/Total Assets. Today as of 11 June 2026, 3 yr ago as of 11 June 2023, 5yr ago as of 11 June 2021.

The Erosion of Dollar Dominance

Dollar dominance is eroding at the margin. It is happening slowly and unevenly, but meaningfully. However, the greenback remains at the center of the global financial system, dominating trade invoicing, cross-border lending, international debt issuance, SWIFT payments and FX turnover. Across most major measures of international usage, its share has remained close to 50% over the past 15 years.¹

But reserve-currency leadership is not the same as currency strength. A currency can remain systemically important even as investors grow less willing to hold it at stretched valuations — a key distinction. The clearest sign of gradual de-dollarization is in official reserves, where the dollar’s share has fallen by roughly eight percentage points since 2015, while gold and smaller reserve currencies have steadily gained ground.² This is particularly true for emerging markets, though less so for developed economies.³

ACTIONS TO CONSIDER

- ➔ The bigger risk to the dollar is its role as a store of value due to challenges to US exceptionalism.
- ➔ Consider diversifying away from concentrated dollar exposure by increasing allocations to non-dollar assets as part of a broader diversified portfolio.
- ➔ Reassess emerging markets as a strategic allocation, particularly EM currencies and local debt, which could benefit from a softer dollar.

The greater risk to the dollar is not its role in global payments, but its role as a store of value.

That is where credibility matters most — and where the US backdrop has become more challenging. Tariffs, sanctions, geopolitical fragmentation, renewed nationalism, rising defense spending, and fiscal concerns have combined to weaken the narrative of US exceptionalism. The result is a stronger incentive for global investors and central banks to diversify away from dollar assets, testing the dollar’s traditional safe-haven status.

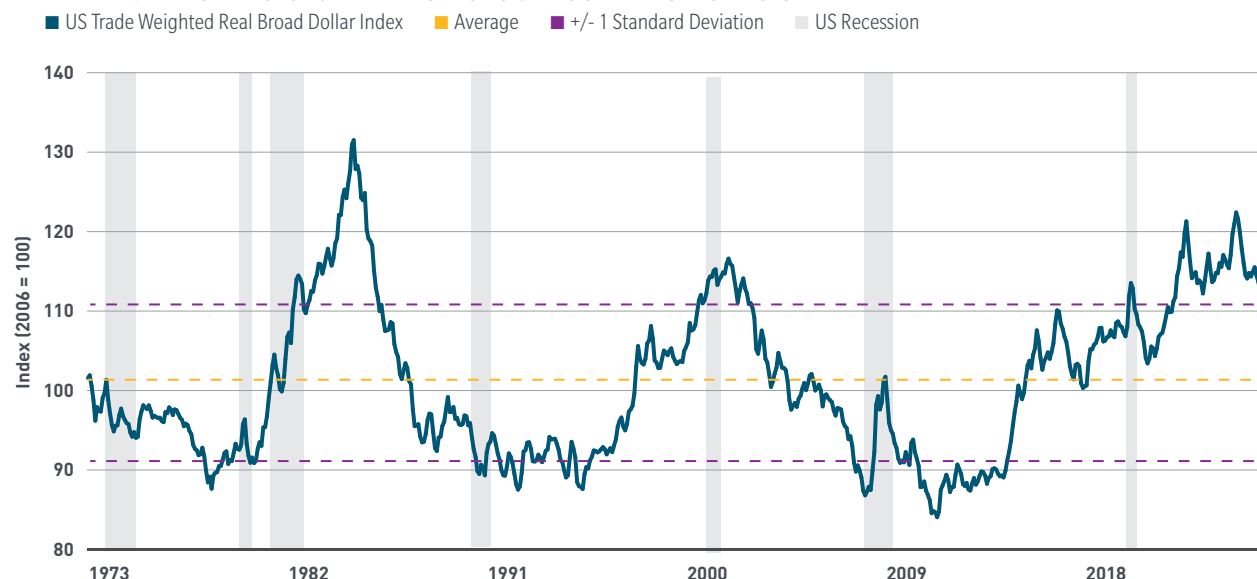
This makes the strategic case for a weaker dollar.

Not because the dollar is about to be displaced — it is not. No credible alternative is ready to take its place: Europe still lacks the fiscal union to support a true rival reserve currency, while China would need to open its capital account. But the absence of a successor does not prevent a gradual reallocation away from the dollar.

This backdrop strengthens the case for non-dollar assets in a diversified portfolio.

Gold remains a key beneficiary of reserve diversification, while non-US assets should benefit from any shift away from crowded dollar exposure. Emerging markets look especially well placed. A weaker dollar tends to support EM currencies and local debt, and sustained dollar weakness could become a meaningful tailwind for EM returns. In that context, EM should be seen not just as a cyclical trade, but as a strategic portfolio allocation.

EXHIBIT 7: THE DOLLAR'S LONG-TERM VALUATION SIGNALS OVERVALUATION RISKS



Source: Bloomberg; US Federal Reserve. Fed US Trade Weighted Real Broad Dollar Index. Monthly data from March 1973 through April 2026.

Private Credit: Repricing the Risk

Private credit is facing its first real stress test after years of rapid growth. Signs of strain are emerging across multiple fronts: BDC spreads have widened, non-accruals have risen, and redemption pressures have intensified, with some managers offloading troubled assets via secondary markets. At the same time, structural pressures are building, with AI disrupting software borrowers, who account for around 21% of direct lending, and triggering restructuring processes.⁴ The opacity inherent to private markets — infrequent marks, limited disclosure, and fragmented reporting — means the full extent of credit deterioration may not yet be visible. Highlighting growing systemic risks, the ECB has warned of potential contagion risks to European insurers.

That said, current stress in private credit is unlikely to pose a material risk to the broader economy. The sector remains relatively small, accounting for around 10% of lending to non-financial corporates, compared

ACTIONS TO CONSIDER

- ➔ Resize private credit exposure by adjusting allocations to reflect weaker compensation for illiquidity and a reassessed risk profile.
- ➔ Preserve flexibility by favoring liquid instruments that allow for timely repositioning as conditions evolve.
- ➔ Lean into public markets, where strong fundamentals, attractive yields, and liquidity support a greater role for public credit.

with 21% for high yield and leveraged loans.⁵ As a result, while a slowdown in new lending could place modest upward pressure on credit spreads, the likelihood of a broader credit crunch remains limited, and several factors further mitigate this risk. Committed dry powder provides a near-term buffer to lending activity, while banks retain the capacity to step in as credit providers to such middle-market companies if needed. In addition, excess bank capital is expected to rise following the finalization of Basel III Endgame rules, further supporting credit availability.

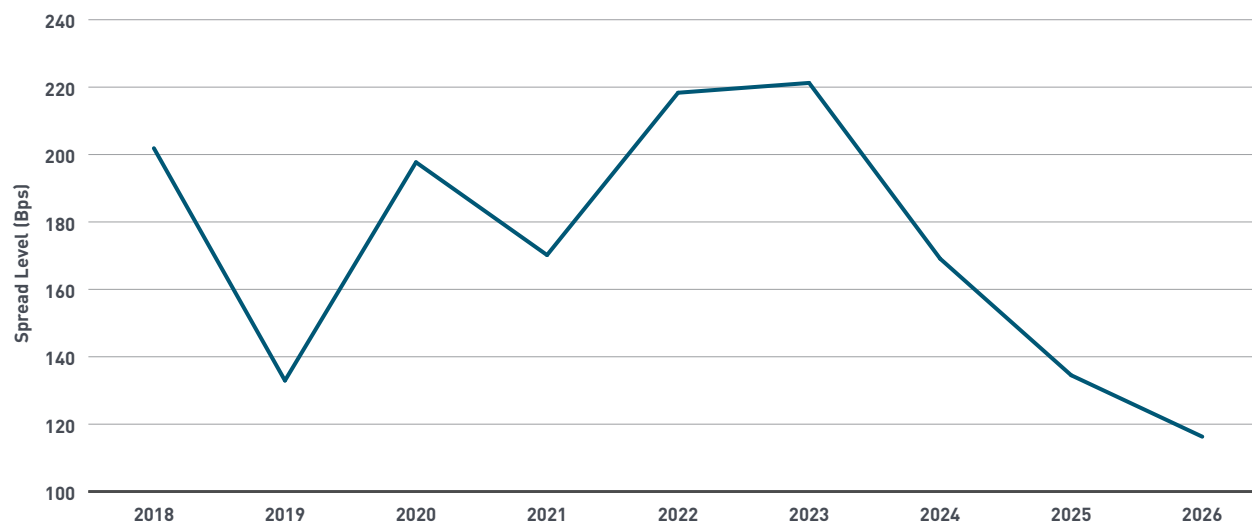
Private credit's repricing is bringing liquidity back into focus. As the illiquidity premium has narrowed, the case for sacrificing liquidity has weakened. In this environment of rising geopolitical uncertainty, liquidity has become increasingly important. The ability to

adjust exposures and respond to shifting conditions has become a risk management imperative rather than an afterthought. Private credit still has a role in diversified portfolios, but allocations should be carefully calibrated to reflect a risk profile that has materially repriced.

This reinforces the relative appeal of public fixed income as a portfolio anchor. Liquid credit markets have remained relatively resilient through recent stress, with yields still attractive despite tight spreads, inflows holding up in the face of heavy hyperscaler-led issuance, and corporate fundamentals showing exceptional strength. In this environment, active management is critical — not only to identify relative value, but to preserve liquidity, maintain flexibility, and adjust exposures as conditions evolve.

EXHIBIT 8: REWARD FOR ILLIQUIDITY RISK IN PRIVATE CREDIT IS SHRINKING

■ Direct Lending Over Syndicated Spreads



Source: Bloomberg, Pitchbook, LCD. Annual data from 31 December 2018 to 31 December 2025, then last 12 months through March 2026. Spread for B-minus rated LBO borrowers, comparing financing in the broadly syndicated loan market (the closest comparable public-market floating rate asset class) versus the direct lending market.

MIDYEAR 2026 KEY THEMES

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¹ Goldman Sachs. "Dollar Dominance and Dollar Depreciation – Moving on Different Tracks," September 2025.

² Goldman Sachs. "Dollar Dominance and Dollar Depreciation – Moving on Different Tracks," September 2025.

³ Deutsche Bank Research. "The Return of History: Gold, the Dollar, and the Monetary Future," April 2026.

⁴ Sources: JP Morgan. North America Economic Research, "US: Private Credit isn't a Public Problem." Abiel Reinhart, Michael Feroli, Nelson Jantzen, Kabir Caprihan, 01 May 2026.

⁵ Sources: JP Morgan. North America Economic Research, "US: Private Credit isn't a Public Problem." Abiel Reinhart, Michael Feroli, Nelson Jantzen, Kabir Caprihan, 01 May 2026.

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