March/April 2025

Market Pulse

Top-down and asset allocation perspectives over the next 12 months

Market Insights Team

KEY TAKEAWAYS

- We see opportunity in value equities and down the market cap in the US but favor international developed over US and EM. In fixed income, the outlook for muni bonds remains strong, despite tax treatment headlines.
- Financial conditions remain supportive of risk assets, despite high rates, and the consumer has room to take on more borrowing, despite record high nominal levels of household debt.
- Gold continues to rally over increased uncertainty and central bank buying. While it is sought after for its inflation-hedging characteristics, there are other options such as TIPS.
- AI capital spending has surged the past few years, while software developer job postings have declined significantly.

Economy & Markets

Gold Price

AS RISKS RISE, SO DOES DEMAND FOR GOLD

Source: Bloomberg. Weekly data from 31 December 2015 through 14 February 2025. Inflation-adjusted gold price represents the spot gold price in USD terms divided by the consumer price index, NSA.

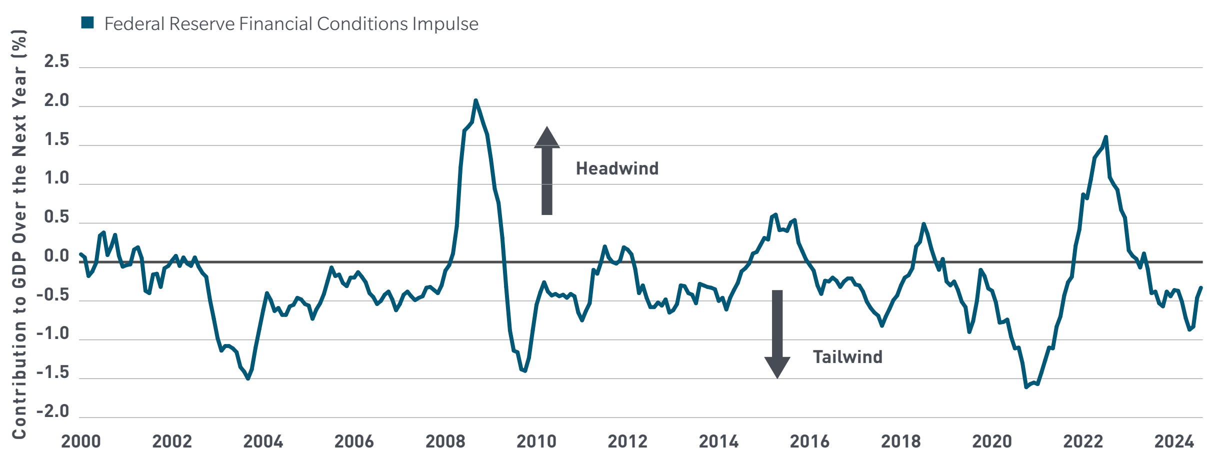
Renewed inflation risks and rising uncertainty

MFS PERSPECTIVE

- Gold is thought of as a defensive asset with inflation-hedging characteristics.
- Policy uncertainty, geopolitical risks, fiscal worries, along with central bank purchases, have pushed up gold demand.
- Other ways to enhance inflation protection in portfolios include TIPS, inflation swaps and inflation-friendly sector allocation.

US Financial Conditions

FINANCIAL CONDITIONS REMAIN A TAILWIND



Source: Bloomberg, Federal Reserve, US Federal Reserve Financial Conditions Monthly One-Year Lookback. Monthly data from 30 June 2000 to 31 January 2025. A zero value means that the cumulative effect on growth of current and past changes in all financial variables sums up to zero, while a reading of 1 percent above (below) the zero line means that financial conditions are a notable headwind (tailwind) to economic activity that is equivalent to a 100 basis point drag (boost) on GDP growth over the following year.

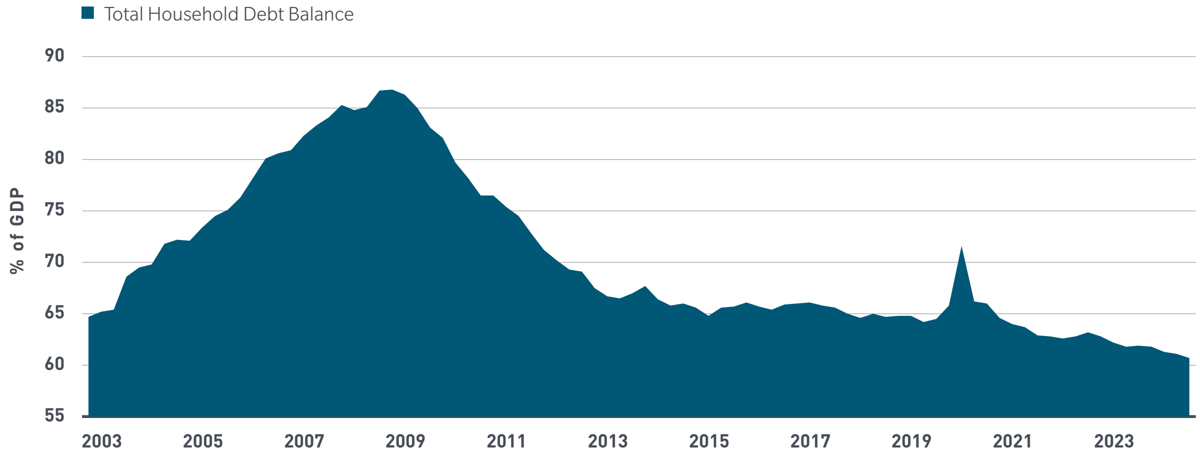
Financial conditions remain supportive of US growth

- Higher rates and a strong dollar raised fears that the market was tightening for the Fed.
- But that's not the case. Even though the Fed has turned more cautious, financial conditions remain supportive, helped by recent USD weakness and drop in yields, which is a positive for risky assets.

Economy & Markets

US Household Debt

US HOUSEHOLD DEBT IS AT ITS LOWEST SHARE OF GDP IN DECADES



Source: Bloomberg, New York Fed Consumer Credit Panel/Equifax. Quarterly data from 31 March 2003 through 31 December 2024.

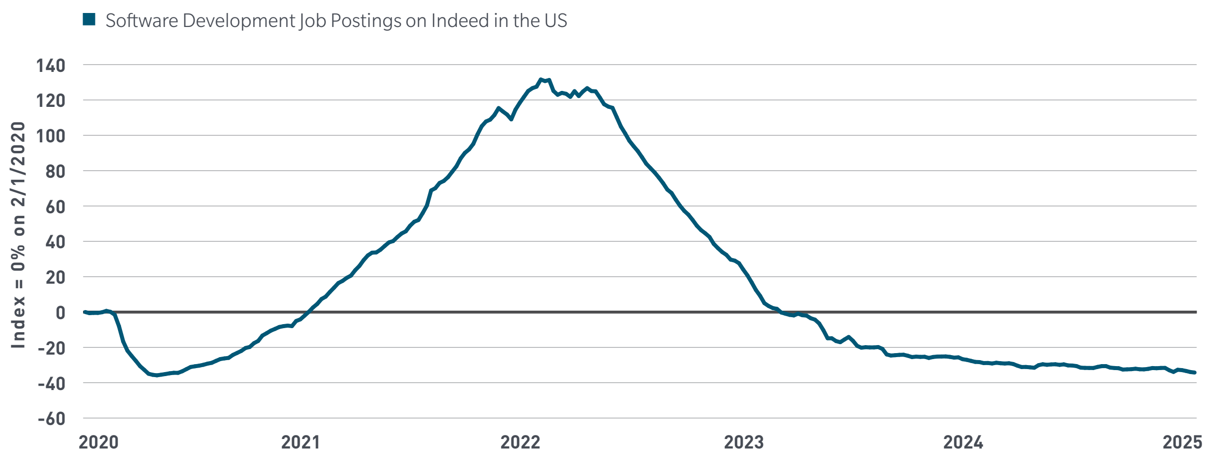
The US consumer remains unleveraged

MFS PERSPECTIVE

- While the nominal US household debt balance has continued to rise, reaching a peak of $18 trillion at end-2024, the debt profile of the consumer remains favorable, helped by strong economic growth.
- There is plenty of room for the consumer to take on more debt, if needed.
- Consumer health is a positive for the macro outlook.

Information Technology

THE ECONOMIC COSTS OF AI: HIGHER INFORMATION TECHNOLOGY UNEMPLOYMENT



Source: Indeed, retrieved from Federal Reserve Bank of St. Louis (FRED) on 20 February 2025. Weekly data from 1 February 2020 to 14 February 2025.

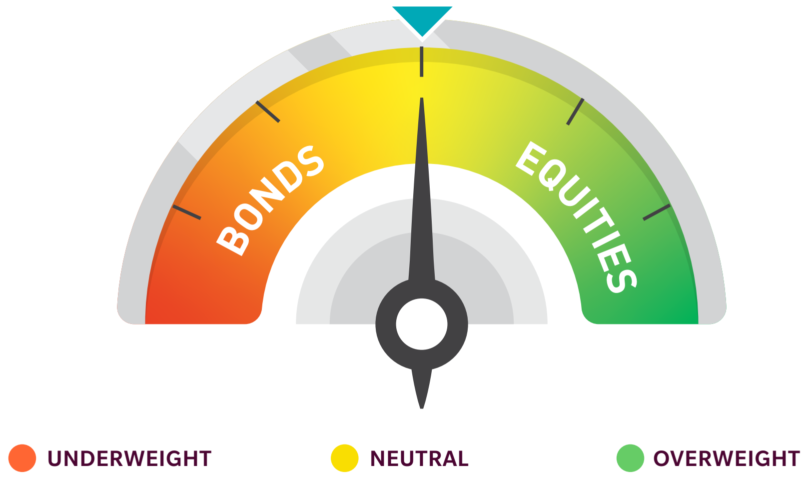
Time to rethink our approach to Artificial Intelligence

MFS PERSPECTIVE

- Many companies are downsizing their IT workforces while ramping up investment in AI.
- AI advances have reduced the need for coders and is likely to lead to improvements in productivity and efficiency.
- Security selection will be crucial in sorting out AI winners and losers.

Asset Allocation

Relative to investor's strategic asset allocation



Rotation and increased breadth in equities are certainly positive developments, although concentration cuts both ways at the index level, as we have seen this year. Rates seem range bound and spreads remain well behaved, supporting fixed income.

MFS PERSPECTIVE

1. Lofty valuations and expectations for US tech stocks continue to weigh on S&P 500 returns YTD. Increased breadth and strong gains in defensive sectors such as health care, staples and utilities continue to support value over growth.

2. Defensive sectors have outperformed cyclicals as investors price in economic growth fears, as evidenced by lower rates. This year, the path of GDP growth and equity sector leadership will likely hinge on volatile trade, regulatory, monetary and fiscal policy.

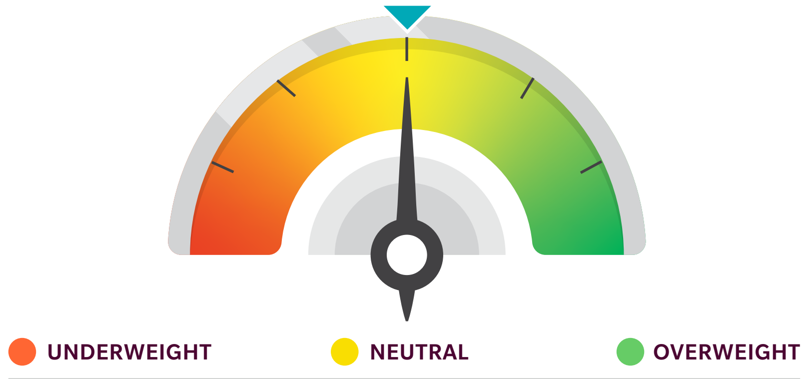
3. For bonds, the pain from 2022 continues to manifest in high all-in yields today. Absent a 2025 recession, bond spreads could remain at or near their current rich levels for an extended period.

4. If bond spreads hold steady, the greatest risk to the outlook would be rising inflation expectations (and subsequently, interest rates) sparked by pro-growth Trump 2.0 policies. This has yet to be priced into bond markets.

Approach and methodology: The *Market Pulse* provides an outlook over a 12 month investment horizon for major asset classes as well as considerations of the prevailing market conditions. Views are driven by both quantitative and qualitative inputs including, but are not limited to, macro-economic data, valuations, fundamentals and technical variables.

The views expressed herein are those of the MFS Strategy and Insights Group within the MFS distribution unit and may differ from those of MFS portfolio managers and research analysts. These views are subject to change at any time and should not be construed as MFS' investment advice, as securities recommendations, as portfolio positioning, or as an indication of trading intent on behalf of MFS.

US Equity



- Valuations remain above long-term averages, but earnings are strong and growth firm.
- Sticky inflation and policy uncertainty are likely to limit further multiple expansion.
- Index performance will continue to be driven by the Magnificent Seven, but their earnings growth rates are slowing while capital intensity is rising.
- We expect earnings, not multiple expansion, to drive performance from here.

MFS CONSIDERATIONS

LARGE CAP	SMALL/MID CAP	GROWTH	VALUE
▪ Valuations remain the biggest risk to large cap. ▪ Solid earnings growth remains supportive. ▪ A firm growth outlook should continue to support breadth as well as cyclicals such as financials and industrials. If growth stalls, defensive sectors could continue their YTD leadership.	▪ Policy uncertainty and inflation/rates concerns are keeping the market focused on large over small. ▪ However, lower tax and regulatory burdens remain in play as a potential boost to SMID earnings. ▪ SMID valuations remain undemanding. Ongoing economic strength and uptick in PMIs are tailwinds.	▪ Mag 7 underperformance has been a drag on growth returns. ▪ DeepSeek has caused a recalibration of views and shifted expectations on AI-related ROIs and multiples. ▪ Mega-cap tech remain great businesses, with strong cash flows, balance sheets and earnings, but may be digesting very elevated expectations.	▪ Value stocks continue to do well on the back of economic growth driving industrials and financials higher. ▪ Successful implementation of Trump's policy agenda should be beneficial for value. ▪ Investors should remain focused on value and not price.

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Source: All data on page, FactSet, 7 November 2024.

International Equity

DEVELOPED INTERNATIONAL EQUITY

- Europe is outperforming despite political uncertainty and a slower growth outlook. Valuations look reasonable.
- Japanese domestic demand growth remains strong amid reflation and structural reform.

EMERGING MARKET EQUITY

- USD strength is expected to be an ongoing headwind, along with rising trade tensions
- China's stimulus measures have helped boost markets, AI developments have propelled China's tech sector, but real estate woes persist.

MFS CONSIDERATIONS

- Potential catalysts for European re-rating include a Ukrainian peace deal, fiscal stimulus and improving Chinese consumption. Unemployment remains low, real wages strong and rates are falling. The dollar may not be as strong a headwind from current levels.
- Trump is forcing Europe to reassess multiple issues ranging from defense, to trade, to lagging productivity.
- Faster-than- expected BOJ policy normalization could be a risk if rates rise faster than expected.

- Against an uncertain international backdrop and large disparities between countries, selectivity is especially important.
- Valuations remain undemanding and further Chinese stimulus could be supportive, but deflationary and tariff headwinds remain.
- North Asia is facing a semiconductor slowdown.
- A US manufacturing recovery should be supportive for EM ex China.

UNDERWEIGHT | NEUTRAL | OVERWEIGHT

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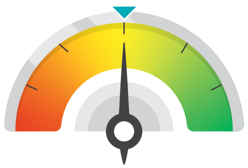
Fixed Income

DURATION



- The recent resurgence in inflation has muddied the outlook for rate cuts, creating a less supportive environment for duration.
- There is a risk that rate volatility may rise because of Trump 2.0 policies and the more cautious monetary policy stance.

MUNICIPALS

- Fundamentals, including state finances, remain adequate while the valuation backdrop looks favorable.
- However, one risk to watch for is potential federal tax cuts which could undermine the tax advantages of munis.

SECURITIZED (MBS)

- The outlook for agency MBS remains broadly positive in view of recovering fundamentals and an improving technical backdrop.
- A combination of more compelling relative valuations along with a return of institutional buyers to the marketplace could support MBS.

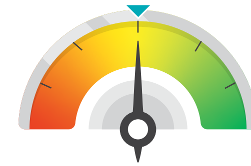
US INV-GRADE CORP

- The macro environment remains positive for credit, and the fundamental backdrop is satisfactory.
- However, the valuation landscape is challenged, mainly reflecting the impact of rich spread valuation.

US HIGH YIELD

- Fundamentals remain solid, helped by historically low levels of leverage and strong earnings.
- Other positive drivers include low projected default rates, attractive breakeven yield valuation and a supportive macro outlook.

EMERGING MARKET DEBT



- While the threat of tariffs looms large, we believe robust fundamentals and flexible EM currency regimes should help offset some of their adverse impact.
- On the positive side, the technical backdrop is supportive, with many investors appearing to be underinvested in EM.

MFS CONSIDERATIONS

Duration

- After recent cautious signals from the Fed, the case for duration has weakened, hence our neutral bias.
- The yield curve is likely to steepen further, which will help support the relative attractiveness of the long end

Municipals

- Given their low credit risk and their favorable tax treatment, municipals represent a great alternative to cash.

Securitized (MBS)

- Agency MBS offer diversification and defensive benefits as well as attractive spreads over Treasuries. With improving valuations and technicals, a favorable stance appears appropriate.

US Inv-Grade Corp

- We have turned more cautious towards IG, mainly owing to the historically low spread level. Nevertheless, expected returns are likely to remain robust from attractive carry.

US High Yield

- We believe that the risk/reward for US HY total returns is favorable, especially in relation to other asset classes.
- With HY, security selection remains a critical part of the investment process, given the credit risk involved.

Emerging Market Debt

- While total yield valuation remains compelling, country spreads are tight and EM remains exposed to global risks, including geopolitics.
- There are still attractive opportunities within EM, but sovereign credit selection is paramount.

UNDERWEIGHT | NEUTRAL | OVERWEIGHT

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MFS® Investment Management

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