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Strategist’s Corner

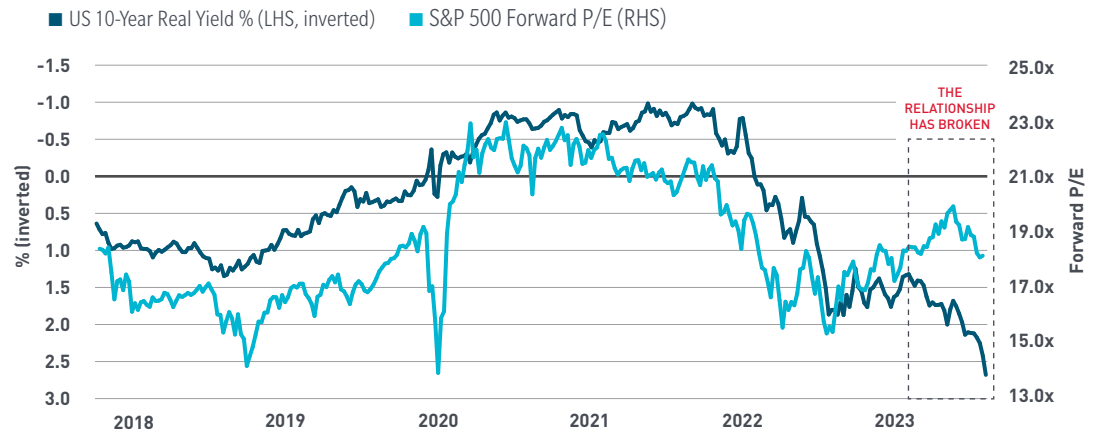
Either Stocks or Bonds Are Wrong

All risk assets, stocks or bonds, need to compensate investors for the possibility of loss, and also for time. Capitalism only works when investors are compensated for locking up their money. Interest rates represent the price of time, and they’re embedded in the value of every risk asset. This explains why there’s a relationship between interest rates and valuations.

That relationship has broken down

The dark blue line represents interest rates in the United States as measured by the yield of the US 10-year Treasury Inflation Protected Security (left-hand axis inverted). The light blue line is the forward price/earnings ratio of the S&P 500 (right-hand axis).

Which is it? Either yields or equity valuations are too high.



Source: Bloomberg. Weekly data from 5 January 2018 to 6 October 2023. Forward P/E is next-twelve-months. US 10-year real Treasury yield is derived from the US 10-year Treasury and an Inflation-Protected Security. S&P 500 Index measures the performance of the 500 largest US publicly traded companies in the US equity market.

The relationship is simple. When interest rates decline, the value of future cash flows rises and pushes equity valuations higher. This is evident in the chart above. Early in the pandemic, rates and yields fell and risk assets rose. The relationship works in the other direction as well. After the inflation ambush of 2022, stock valuations collapsed as yields rose. Yet in 2023, this general relationship broke down. (See highlighted area.) Either yields are too high at a more historically normal 2%, or equity valuations are well above fair value. In other words, the bond market is signaling something quite different from the equity market.



If the bond market is right, what's the equity market missing?

The decades of cheap capital, inexpensive labor and low capital spending that fueled profits has ended. Yet equity investors are assuming that those profit tailwinds will continue unabated. However, they are unfortunately now profit headwinds, in my opinion. Credit has become scarce and expensive. Capital costs are higher and high debt loads will likely need to be paid back. Labor, too, is now scarce and represents a significant expense that will affect future profits, and until these costs normalize, they will be a drag on returns. This year, the US is averaging a bankruptcy filing every one to two business days as companies fail under the weight of their debt or simply because their business models aren't viable in a capital-constrained world.

What if the bond market is wrong?

Perhaps the valuation gap is an artificial intelligence premium and the bond market is underappreciating its effects? While that is a possibility, history has shown that productivity gains are ultimately competed away. We would argue that while artificial intelligence may bring a step-function change in how society operates, it could allow for the emergence of an entire new group of companies at the peril of some of the existing enterprises. This is why we are unwavering in our conviction about the future value of active management. During the next period of financial strain, will central bankers return to financial repression and socialization of losses? Policy makers may "want" to repress rates, but can they? Compared with prior episodes, most advanced economies face all-time high debt-to-GDP ratios and ballooning budget deficits. The bond vigilantes clearly are back after years of dormancy. Governments, like risk assets, need to compete for savers' capital and they, too, are now at the mercy of the bond market.

Conclusion

For many reasons, equity markets are typically late in discounting unwelcome financial outcomes. While rates, short or long, may fluctuate to a degree, the paradigm has shifted, and we find it highly unlikely that rates will return to prepandemic lows. This paradigm will be different from the last. The least-fit businesses were able to survive due to suppressed costs. But costs are no longer suppressed and continue to rise, introducing strain. In this new paradigm, the least fit will fail and cede their share of revenue and profit pools to the most fit. Investors who can understand which enterprises possess real value — and those that do not — will find themselves in an enviable position compared with the broader market. ▲

Retirement Basics

Making the Most of Medicare Part Two: What You Need to Know

In the first part of our series on Medicare, we covered the major components of Medicare Parts A, B and D. Next up, we will explore the differences between a Medicare Advantage plan and a Medicare supplement plan, often called Medigap.

A Medicare Advantage plan, also known as a Part C plan, is a private alternative to Medicare and may be similar to a group health plan you have or had when you were employed. They replace Parts A and B of Medicare and often have a drug plan rolled into their coverage. They may also have more benefits than traditional Medicare, such as vision and dental insurance.

DIFFERENCES BETWEEN MEDICARE ADVANTAGE AND SUPPLEMENT

	Medicare Advantage (Part C) Plans	Medicare Supplement Plans
Cost	Part B premium; no other premium. Pay deductible, copay, coinsurance for health care received.	Part B premium; plus additional monthly premium.
Prescription drug coverage	Included in most plans.	Not included.
Doctors and hospitals	Use doctors and hospitals within the plan network.	Choice of doctors and hospitals.
Referrals	May need referrals to see specialists.	Can meet with specialists without a referral.
Networks	Generally restricted to in network.	No restrictions/nationwide coverage.
Enrolling	Restricted to certain enrollment periods.	Apply after you turn age 65 and enroll in Medicare Part B.

Looking at an example is a useful way to explore the differences between traditional Medicare, an Advantage Plan and a Supplement Plan. Let's say that you slipped and fell and needed to have surgery as a result. With traditional Medicare, you can see any doctor that accepts Medicare and would pay the Part A and B deductible before Medicare would assist with the costs. With an Advantage Plan, you would see a doctor that participates in the plan's network. There would be a separate deductible and copay/coinsurance for the procedure afterward. With a supplement plan, you could see any doctor that accepts Medicare, and the supplement plan would pick up many of the remaining costs.

Medicare can be complex. Please work with your financial advisor, investment professional and Medicare Insurance Specialist to understand the costs to determine what plan could make the most sense for you.

This material should be used as helpful hints only. Each person's situation is different. Medicare and any insurance coverage you choose should correspond to your financial needs and goals. MFS does not provide tax, legal, accounting, Social Security or Medicare advice. Clients of MFS should obtain their own independent tax and legal advice based on their particular circumstances.

Source: Medicare.gov.

Financial Basics

Fraud Alert: Common Scams to Avoid

Each year consumers lose billions of dollars to scammers. Scams often work because they catch people off guard. So recognizing a scam is one of the best ways to lessen the odds of becoming a victim. Below are some of the most common scams that the FBI encounters.

Business and investment schemes will try to lure you in with the promise of low- or no-risk investments. Scammers often ask for upfront cash in exchange for guaranteed future returns. There is no such thing as a guaranteed return on investment. If it sounds too good to be true, it could be a scam. Do your homework and thoroughly research any investment opportunity independently of what any salesperson provides you. Never rush into an investment opportunity. If you are rushed or told not to discuss it with others, that's probably a red flag.

Charity and disaster schemes seek donations for organizations that do little or no work. Instead, the money goes to the fake charity's creator. While these scams can happen at any time, they are especially prevalent after high-profile disasters, exploiting your desire to help others in need. Charity fraud scams come in many forms: emails, social media posts, crowd funding platforms and cold calls. Always use caution and do your research before you donate. Give to established charities and beware of organizations with copycat or similar sounding names.

After a natural disaster or other emergency, unethical contractors and other scammers may commit insurance fraud, targeting people whose homes or businesses have been damaged. Sometimes these fraudsters even pretend to be affiliated with the government. If you need any postdisaster repairs, research any contractor before hiring.

Election Crimes happen when false voting information is spread to keep you from voting. Bad actors use various methods to spread disinformation about voting, such as social media, texting or messaging applications on smartphones. They may provide misleading information about the time, manner or place of voting. This can include inaccurate election dates or false claims about voting qualifications or methods, such as saying you may vote by text, which is not allowed in any jurisdiction. There are many reputable places you can find your polling location and registration information, including eac.gov and usa.gov/how-to-vote. Always consider the source of voting information. Ask yourself, "Can I trust this information?" Look for official notices from election offices and verify the information you found is accurate.

Skimming occurs when devices are illegally installed on ATMs, point-of-sale (POS) terminals or fuel pumps to capture data or record cardholders' PINs. Skimming devices store data to be downloaded or wirelessly transferred later. Criminals use the data to create fake debit or credit cards and then steal from victims' accounts.

Fuel pump skimmers are usually attached to the internal wiring of the machine and aren't visible. Choose a fuel pump that is closer to the store and in direct view of the attendant. These pumps are less likely to be targets for skimmers. Run your debit card as a credit card. If that's not an option, cover the keypad when you enter your PIN. Consider paying inside with the attendant, not outside at the pump.

ATM skimmer devices usually fit over the original card reader. Some ATM skimmers are inserted in the card reader, placed in the terminal or situated along exposed cables. Pinhole cameras installed on ATMs record a customer entering their PIN. Pinhole camera placement varies widely. In some cases, keypad overlays are used instead of pinhole cameras to record PINs. Keypad overlays record a customer's keystrokes.

Inspect ATMs before using. Look for anything loose, crooked, damaged or scratched. Don't use any card reader if you notice anything unusual. Pull at the edges of the keypad before entering your PIN and cover the keypad when you enter your PIN to prevent cameras from recording your entry. Use ATMs in a well lit, indoor location, which are less vulnerable targets. Be alert for skimming devices in tourist areas. Use debit and credit cards with chip technology. In the US, there are fewer devices that steal chip data versus magnetic strip data. Avoid using your debit card when you have linked accounts. Use a credit card instead. Contact your financial institution if the ATM doesn't return your card after your transaction. ▲

Source: fbi.gov.

Information Regarding the MFS Heritage Trust CompanySM ("MHTC") Trustee Fees

If you are an MFS Heritage Trust IRA shareholder, then you are subject to an annual trustee fee in the amount of \$25. MHTC assesses this fee based on accounts with a value lower than \$50,000. Your account value is determined by aggregating accounts within the same plan type registered to you. If invested in multiple plan types, you are assessed a fee for each.¹ For account values \$50,000 or greater, the annual fee is waived.

MHTC evaluates accounts for the assessment of the fee in January, April, July and December of each year. Upon assessment, if the value of the aggregated accounts is less than \$50,000, the fee is deducted from your account. If you have multiple accounts within one plan type, a portion of the fee is taken from each (e.g., \$12.50 taken from your traditional IRA and \$12.50 from your Roth IRA, totaling \$25). Although the MFS Service Center (MFSC) evaluates the value of your account each quarter, the fee is deducted only once a year.

If you prefer to prepay this fee and not have it deducted from your account balance, please send a check for \$25, payable to MFS Heritage Trust Company, to MFSC. Below are the 2024 "trustee fee sweep" deadlines. If you have an existing account as of January 2024, your payment must be received at least five business days before the January 17th deadline to avoid having it deducted from your account(s). If you set up a new IRA at any time during the year 2024, your payment must be received at least five business days before the next deadline.

January 17, 2024 | April 17, 2024 | July 17, 2024 | December 4, 2024

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¹Accounts within the same "plan type" include a Traditional IRA, Roth IRA or Rollover. An account in a SIMPLE Plan would be considered a separate plan type.

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Contact us

Website

mfs.com

MFS® TALK

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24 hours a day

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(Shareholders)
1-800-225-2606

(Financial advisors)
1-800-343-2829

Retirement plan services

1-800-637-1255

Mailing address

MFS Service Center, Inc.
P.O. Box 219341
Kansas City, MO 64121-9341

Overnight mail

MFS Service Center, Inc.
Suite 219341
430 W 7th Street
Kansas City, MO 64105 - 1407

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