

MFS ASSET ALLOCATION UPDATE

Marketing material for professional, institutional and accredited investors

Remaining cautiously neutral to equities

- The expected rally we hoped for and saw into the end of 2023 has come and gone. The dovish pivot from the Federal Reserve (Fed) chair, Jerome Powell further propelled an already ebullient sense in the markets of a US economy heading towards a softer landing scenario and with that, key cuts in headline interest rates. The rates and inflation outlooks remain the most important determinants of market direction. Overall our view is that inflation is coming down, but we do not think the Fed will cut rates as quickly as currently implied in markets. With inflation expectations reducing and real rates starting to come down, growth expectations will also moderate and we could see the restoration of the 'old' normal where, as long-term rates come down, the economy slows. We observe the general trajectory heading towards a slightly more benign backdrop.

US

- There has been a huge amount of enthusiasm around ongoing developments in AI. The Magnificent Seven stocks in the AI space (Apple, Microsoft, Google parent Alphabet, Amazon, Nvidia, Meta and Tesla) are aptly named in our view, with strong revenue streams coming from very solid businesses. We see this as a secular trend capturing innovation over time and delivering higher return on equity, although it could be argued much of this is now in the share prices. This remains an area to which we have overweight allocations.

Asia Pacific/Emerging Markets

- We continue to focus on the structural growth which can come from emerging market (EM) and Asia-Pacific (AP) stocks as we believe they have the capacity to thrive in a low growth environment. As such, we see potential in the long-term for these regions, but short to medium-term concerns remain as a result of the protracted stalemate in the war in Ukraine. With that said, there is much dispersion within AP/EM, with those countries that export oil benefiting while those that import commodities are suffering. We remain constructive on China in the long term. It still offers a decent level of growth relative to the Western world and is under-represented in investor portfolios. China was supposed to be the big story of 2023, and that never quite materialised, but some of the economic data has been promising and valuations look appealing.

UK

- We continue to maintain our long-term underweight to UK equities. The cost of living crisis is the steepest the UK has faced in over a century and there remain continuing political headwinds impacting investment decisions. Recessionary risks are knocking on the door for the UK economy and better entry points are still some way off. Within the portfolio, where we hold UK assets, we are tilted solely to large-cap equities given the continual pressure on sterling in the medium term.

Fixed Income

- We remain overweight fixed income, particularly in short-dated instruments such as US T-bills. Overall we think the outlook for plain vanilla bonds looks good for next year, picking up both attractive yields with the prospect of capital appreciation from here under a softening global economy. Cash levels still remain at relatively high levels and are a comfortable resting place for risk free returns – with the current returns now on offer finally returning to attractive levels after many years of paucity.

Key risks

- **Geopolitics** – The situations in Ukraine and the Middle East are ongoing, with neither looking likely to reach an immediate conclusion. But markets seem somewhat oblivious to them at present; they have not been weighing on sentiment even though they probably should be. The oil price mechanism has so far not been affected. In the US, the possibility of Donald Trump being re-elected as president is a potential issue and something to consider from a risk management perspective.
- **Fixed income and credit** – We are comfortable with a positive allocation to fixed income, viewing short-dated instruments as a good capital preservation tool at present. We have been taking positions in very short-dated US Treasuries. We are also looking to add some longer-dated duration for crash protection and in the event of long-term super secular falls in yields due to stagnation.
- **China** – If China starts to underperform that would be a risk and could hinder performance in our portfolios.

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