

# Declining Interest Rates Have Historically Signaled Positive Relative Performance for Global Low Volatility

## Authors



James C. Fallon  
Equity Portfolio Manager



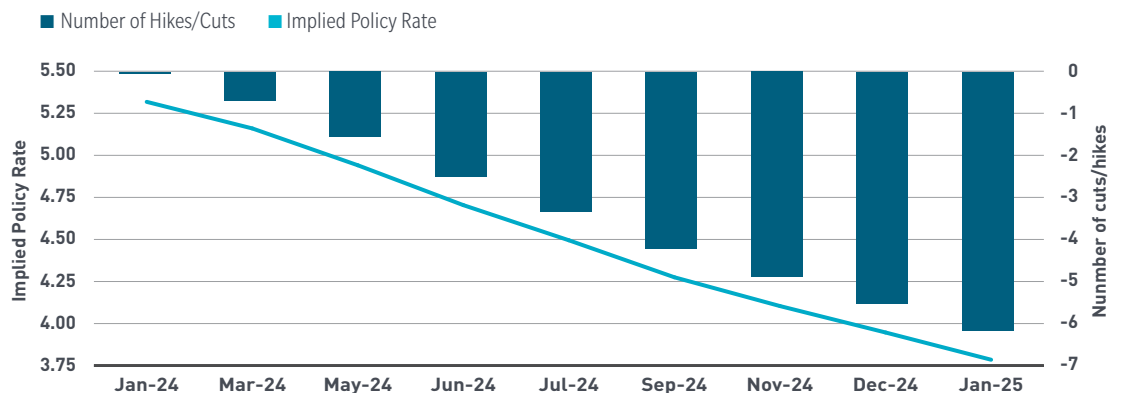
Molly O'Brien  
Quantitative Research Associate

## In brief

- Declining interest rates, particularly those that coincide with successive rate cuts, are typical of late economic cycles, when equity markets tend to behave more defensively, therefore favoring low volatility.
- In recent decades, higher dividend yields have not been clearly associated with a declining rate environment.

Capital markets are completing the transition from an environment that has featured quantitative easing, low interest rates and low inflation to one in which Treasury bond yields have reached levels not seen in 20 years. So this may be the time to set expectations for how global low-volatility strategies may perform in a declining rate environment. The market expects the US federal funds target rate to begin declining in Q1 2024 from the current level of greater than 5% to land below 4% by 2025.

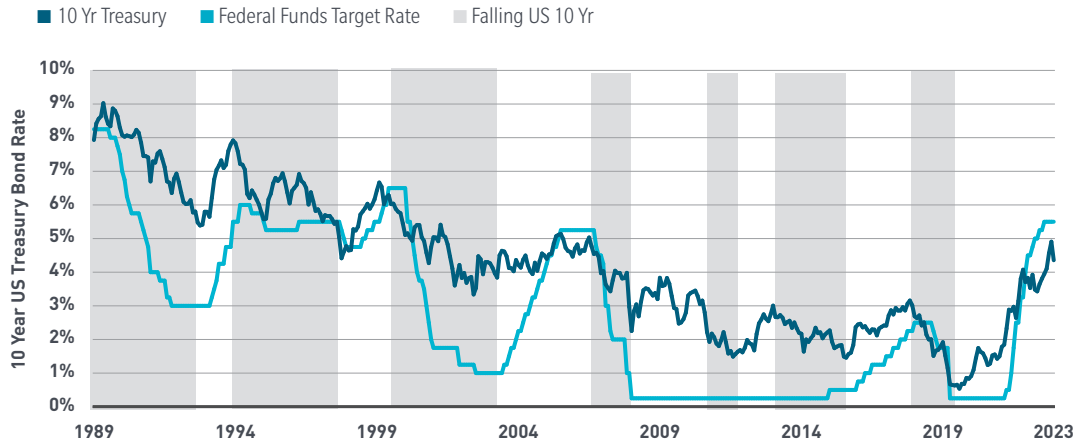
## Exhibit 1: Expectations for Fed rate cuts in 2024



Source: Bloomberg. Implied rate is derived from rate cut projections based on pricing of federal funds futures contracts on 9 January 2024.

We looked at the path of interest rates since 1990 and identified periods of increasing and decreasing rates based on US Federal Reserve action regarding the target federal funds rate. As shown in Exhibit 2, shifts in policy have historically corresponded with the direction of the US 10-year yield.

**Exhibit 2: Fed policy and the direction of rates since 1990**

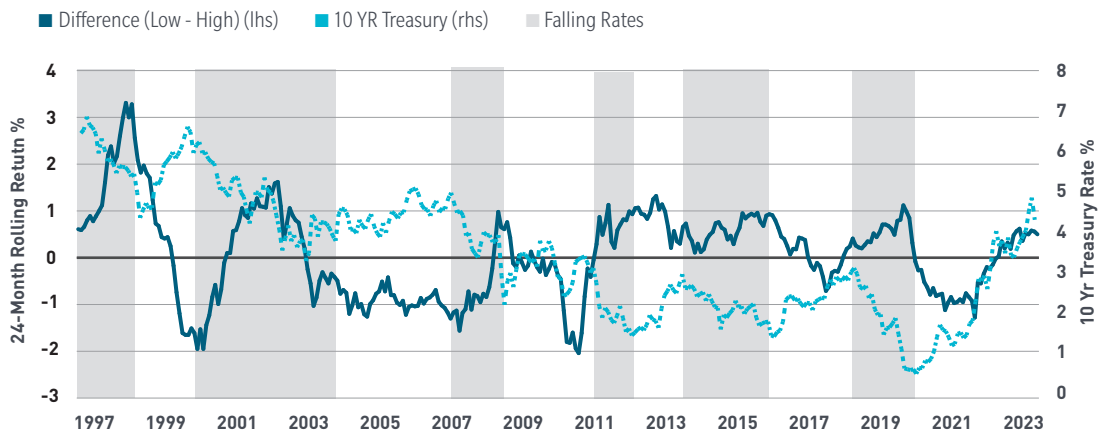


Source: Bloomberg. The Federal Open Market Committee (FOMC) meets eight times a year to determine the federal funds target rate. This rate influences the effective federal funds rate through open market operations or by the buying and selling of government bonds.

**How have low-volatility stocks behaved in recent declining rate environments?**

Exhibit 3 below compares the rolling 24-month performance for the lowest-volatility quintiles (“Q1 + Q2”) to the highest-volatility quintiles (“Q4 + Q5”) of stocks within the MSCI ACWI and it demonstrates the tendency, since 2004, of lower-volatility stocks to outperform as rates decline (darker shaded periods).

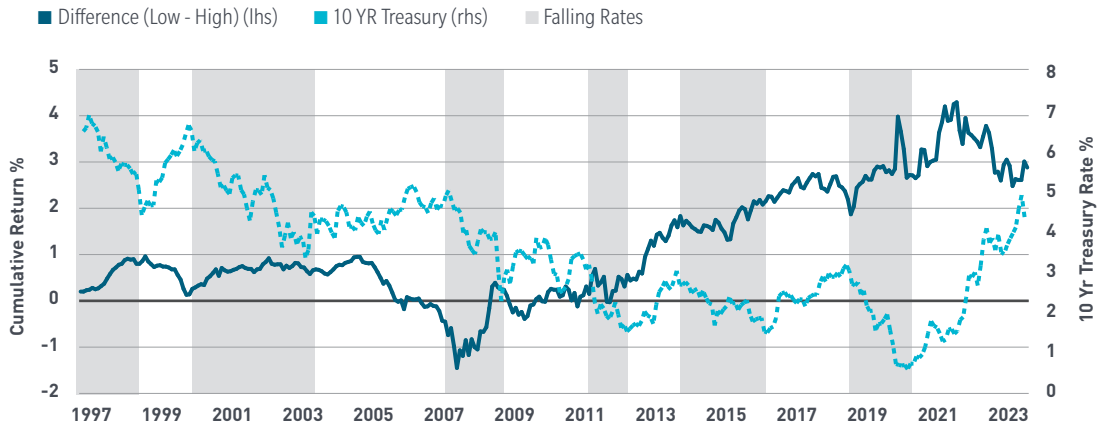
**Exhibit 3: Low-volatility stocks tend to outperform high as rates fall**



Source: FactSet. Monthly data from 31 January 1997 to 30 November 2023. Low-volatility stocks are the stocks within the two lowest-volatility quintiles within the MSCI ACWI. High-volatility stocks are the stocks within the two highest-volatility quintiles within the MSCI ACWI. Shaded areas indicate declining 10-year treasury rates.

Exhibit 4 shows us that despite the relative strength of low-volatility stocks during 2022, high volatility has sharply outperformed since the latter half of 2020.

**Exhibit 4: High-volatility stocks have outperformed in recent years**

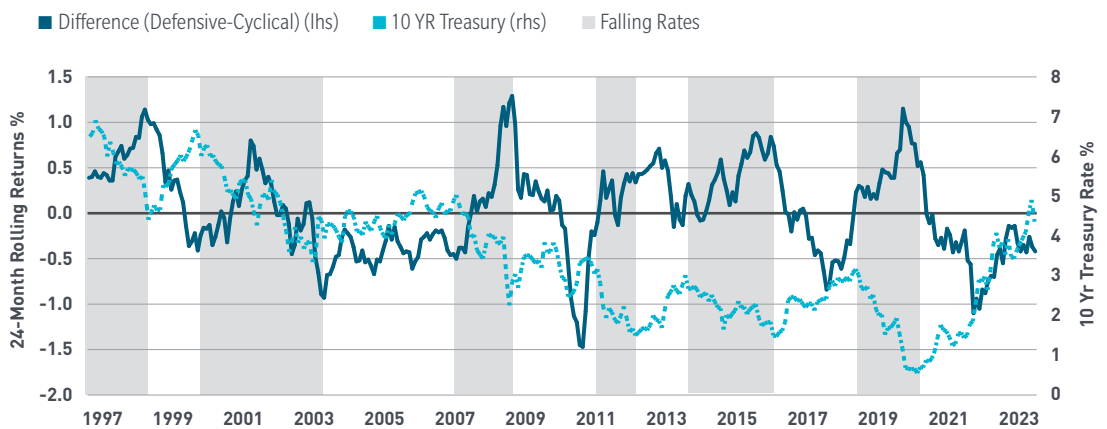


Source: FactSet. Monthly data from 31 January 1997 to 30 November 2023. Low-volatility stocks are the stocks within the two lowest volatility quintiles within the MSCI ACWI. High-volatility stocks are the two highest-volatility quintiles with the MSCI ACWI. Shaded areas indicate declining 10-year treasury rates.

**Why has lower volatility outperformed during declining rate environments?**

Cyclical sectors such as retailing, autos, housing, and materials tend to experience relative weakness after rates reach their cyclical peaks and economic growth slows. Comparing rolling 24-month performance, history suggests that companies with more cyclical exposure tend to underperform during periods of declining rates. This was the case from 2008 to 2009, from 2012 to 2013, from 2015 to 2016 and from 2019 to 2020. During periods of rising rates from 2004 to 2023, cyclical sectors outperformed defensives.

**Exhibit 5: Defensives have tended to outperform when rates decline**



Source: FactSet. Monthly data from 31 January 1997 to 30 November 2023. Cyclical sectors within the MSCI ACWI include energy, financials and materials. Defensive sectors include consumer Staples, health care and utilities. Shaded areas indicate declining 10-year Treasury rates.

### Conclusion

Our analysis was conducted to address how low-volatility stocks may perform considering the market consensus rate assumptions, which currently anticipate rates cuts, and a declining rate environment for 2024. In this environment, recent cycles suggest that low-volatility stocks have typically outperformed higher-volatility stocks and going forward may provide diversification to portfolios with exposure to higher-volatility and cyclical stocks. ▲

Index data source: MSCI. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, reviewed or produced by MSCI.

**The views expressed are those of the author(s) and are subject to change at any time. These views are for informational purposes only and should not be relied upon as a recommendation to purchase any security or as a solicitation or investment advice. No forecasts can be guaranteed. Past performance is no guarantee of future results.**

Unless otherwise indicated, logos and product and service names are trademarks of MFS® and its affiliates and may be registered in certain countries.

Distributed by: **U.S.** – MFS Institutional Advisors, Inc. (“MFSI”), MFS Investment Management and MFS Fund Distributors, Inc., Member SIPC; **Latin America** – MFS International Ltd.; **Canada** – MFS Investment Management Canada Limited. **Note to UK and Switzerland readers:** Issued in the UK and Switzerland by MFS International (U.K.) Limited (“MIL UK”), a private limited company registered in England and Wales with the company number 03062718, and authorised and regulated in the conduct of investment business by the UK Financial Conduct Authority. MIL UK, an indirect subsidiary of MFS®, has its registered office at One Carter Lane, London, EC4V 5ER. **Note to Europe (ex UK and Switzerland) readers:** Issued in Europe by MFS Investment Management (Lux) S.à r.l. (MFS Lux) – authorized under Luxembourg law as a management company for Funds domiciled in Luxembourg and which both provide products and investment services to institutional investors and is registered office is at S.a r.l. 4 Rue Albert Borschette, Luxembourg L-1246. Tel: 352 2826 12800. This material shall not be circulated or distributed to any person other than to professional investors (as permitted by local regulations) and should not be relied upon or distributed to persons where such reliance or distribution would be contrary to local regulation; **Singapore** – MFS International Singapore Pte. Ltd. (CRN 201228809M); **Australia/New Zealand** - MFS International Australia Pty Ltd (“MFS Australia”) (ABN 68 607 579 537) holds an Australian financial services licence number 485343. MFS Australia is regulated by the Australian Securities and Investments Commission.; **Hong Kong** - MFS International (Hong Kong) Limited (“MIL HK”), a private limited company licensed and regulated by the Hong Kong Securities and Futures Commission (the “SFC”). MIL HK is approved to engage in dealing in securities and asset management regulated activities and may provide certain investment services to “professional investors” as defined in the Securities and Futures Ordinance (“SFO”); **For Professional Investors in China** – MFS Financial Management Consulting (Shanghai) Co., Ltd. 2801-12, 28th Floor, 100 Century Avenue, Shanghai World Financial Center, Shanghai Pilot Free Trade Zone, 200120, China, a Chinese limited liability company registered to provide financial management consulting services.; **Japan** - MFS Investment Management K.K., is registered as a Financial Instruments Business Operator, Kanto Local Finance Bureau (FIBO) No.312, a member of the Investment Trust Association, Japan and the Japan Investment Advisers Association. As fees to be borne by investors vary depending upon circumstances such as products, services, investment period and market conditions, the total amount nor the calculation methods cannot be disclosed in advance. All investments involve risks, including market fluctuation and investors may lose the principal amount invested. Investors should obtain and read the prospectus and/or document set forth in Article 37-3 of Financial Instruments and Exchange Act carefully before making the investments; **Bahrain** - This document has not been approved by the Central Bank of Bahrain which takes no responsibility for its contents. No offer to the public will be made in the Kingdom of Bahrain and this document is intended to be read by the addressee only and must not be passed to, issued to, or shown to the public generally. The Central Bank of Bahrain assumes no responsibility for the accuracy and completeness of the statements and information contained in this document and expressly disclaims any liability whatsoever for any loss howsoever arising from reliance upon the whole or any part of the contents of this document. The Board of Directors and the management of the issuer accepts responsibility for the information contained in this document. To the best of the knowledge and belief of the board of directors and the management, who have all taken all reasonable care to ensure that such is the case, the information contained in this document is in accordance with the facts and does not omit anything likely to affect the reliability of such information.; **Kuwait** - This document is not for general circulation to the public in Kuwait. The information has not been licensed for offering in Kuwait by the Kuwait Capital Markets Authority or any other relevant Kuwaiti government agency. No private or public offering of the information is being made in Kuwait, and no agreement relating to the information will be concluded in Kuwait. No marketing or solicitation or inducement activities are being used to offer or market the information in Kuwait.; **Oman** - For Residents of the Sultanate of Oman: The information contained in this document does not constitute a public offer of securities in the Sultanate of Oman as contemplated by the Commercial Companies Law of Oman (Royal Decree 4/74) or the Capital Market Law of Oman (Royal Decree 80/98). This information is being circulated on a limited basis only to corporate entities that fall within the description of sophisticated investors (Article 139 of the Executive Regulations of the Capital Market Law). The recipient acknowledges that they are a sophisticated investor who has experience in business and financial matters and is capable of evaluating the merits and risks on an investment.; **South Africa** - This document has not been approved by the Financial Services Board and neither MFS International (U.K.) Limited nor its funds are registered for public sale in South Africa.; **UAE** - This document, and the information contained herein, does not constitute, and is not intended to constitute, a public offer of securities in the United Arab Emirates and accordingly should not be construed as such. The information is only being offered to a limited number of exempt investors in the UAE who fall under one of the following categories of non-natural Qualified Investors: (1) an investor which is able to manage its investments on its own, namely: (a) the federal government, local governments, government entities and authorities or companies wholly-owned by any such entities; (b) international entities and organisations; or (c) a person licensed to carry out a commercial activity in the UAE, provided that investment is one of the objects of such person; or (2) an investor who is represented by an investment manager licensed by the SCA, (each a “non-natural Qualified Investor”). The information and data have not been approved by or licensed or registered with the UAE Central Bank, the Securities and Commodities Authority, the Dubai Financial Services Authority, the Financial Services Regulatory Authority or any other relevant licensing authorities or governmental agencies in the UAE (the “Authorities”). The Authorities assume no liability for any investment that the named addressee makes as a non-natural Qualified Investor diligence on the accuracy of the information relating to the securities. If you do not understand the contents of this document you should consult an authorised financial adviser.; **Saudi Arabia** - This document may not be distributed in the Kingdom except to such persons as are permitted under the Investment Funds Regulations issued by the Capital Market Authority. The Capital Market Authority does not make any representation as to the accuracy or completeness of this document, and expressly disclaims any liability whatsoever for any loss arising from, or incurred in reliance upon, any part of this document. Prospective purchasers of the securities offered hereby should conduct their own due diligence on the accuracy of the information relating to the securities. If you do not understand the contents of this document, you should consult an authorised financial adviser.; **Qatar** - This material/fund is only being offered to a limited number of investors who are willing and able to conduct an independent investigation of the risks involved in an investment in such material/fund. The material does not constitute an offer to the public and is for the use only of the named addressee and should not be given or shown to any other person (other than employees, agents or consultants in connection with the addressee’s consideration thereof). The fund has not been and will not be registered with the Qatar Central Bank or under any laws of the State of Qatar. No transaction will be concluded in your jurisdiction and any inquiries regarding the material/fund should be made to your contact outside Qatar.