

The Stars May Be Aligning for EUR Credit

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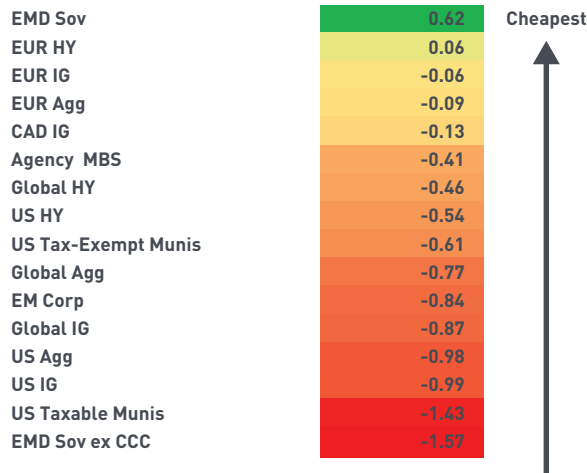


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With yields having corrected much higher over the past couple of years, global fixed income is once again a relevant asset class. The traditional value propositions of fixed income are well known, ranging from diversification benefits to de-risking characteristics. Within global fixed income, we highlight the attractiveness of European IG Credit (EUR IG), one of the most interesting segments of global fixed income from a valuation standpoint. The asset class is supported by strong fundamentals, a favorable macro environment and robust technicals. Overall, we encourage global investors to consider raising their allocation to European IG Credit. MFS® has been actively investing in EUR fixed income for well over the decade.

EUR Credit is among the most attractive segments of global fixed income, in our view. While spread compression has been a general phenomenon over the past few months in global fixed income, EUR credit spread valuation remains above its long-term fair value when looking at break-even spreads, in contrast to many other asset classes (Exhibit 1). There is no denying, however, that at about 110 basis points for the EUR Corp IG Index, the absolute level of spreads is considerably lower than in 2022, when central banks started their tightening cycles. With that in mind, spread compression may not necessarily be the key driver of total returns going forward. But it is important to highlight that the total yield valuation backdrop remains quite favorable (Exhibit 2). Specifically, the EUR Corp IG yield percentile rank over the past ten years currently stands at 88%, which means that yields were higher only 12% of the time during that period.

Exhibit 1: Break-Even Spread Valuation Scores



As of 6 June 2024. Based on 10-year Z-Scores, Break-Even Spreads

Source: Bloomberg. Data as of 6 June 2024. A z-score is a measure of deviation from long-term average in terms of units of standard deviation. A positive score indicates cheapness relative to long-term average. Break-Even spreads = spreads per unit of duration. US Agg = Bloomberg US Aggregate index. Global Agg = Global aggregate index. US IG = Bloomberg US Aggregate Corporate Index. US HY = Bloomberg US Corporate High Yield Index. EM Sovereign = J.P. Morgan EMBI Global Diversified Index. Europe IG = Bloomberg Pan-Euro Aggregate Corporate Index. Europe HY = Bloomberg Pan-European High Yield Index. Global credit = Bloomberg Global Aggregate Corporate Index. Canada IG = Bloomberg Canada Aggregate Corporate Index. US Agg-Eligible Taxable Munis = Bloomberg US Taxable Municipal Aggregate Eligible Index.

Exhibit 2: EUR IG Yields Still Elevated By Historical Standards



Source: Bloomberg EuroAgg Corporate yield-to-worst. Weekly data from 4 Feb. 2000 through 7 June 2024.

Given the current level of yields, the outlook for subsequent returns appears favorable. In the near term, the return outlook will depend on the expected moves for both rates and spreads (Exhibit 3). With the ECB signaling some policy easing in the pipeline, we believe that rates will likely move lower, thereby supporting expected returns for EUR IG in the process.

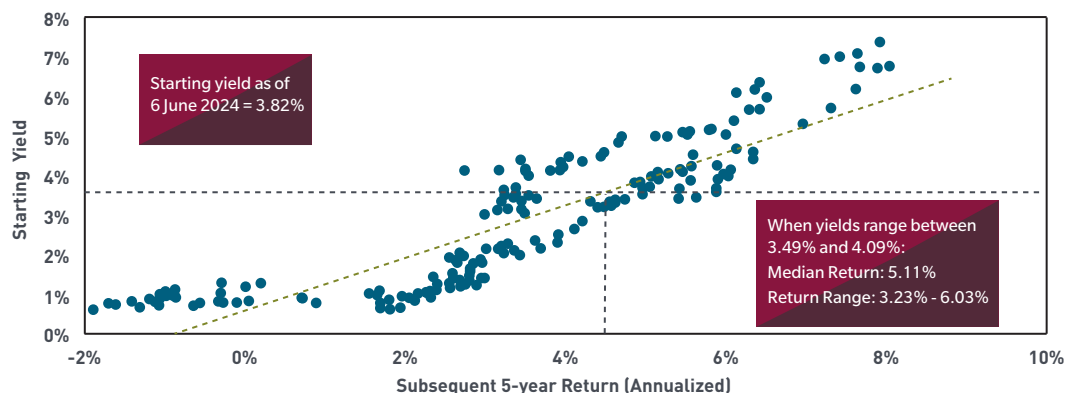
Exhibit 3: 1-Year Return Projections for EUR IG Under Various Rate and Spread Move Scenarios (%)

EUR IG	Spread Moves Over the Next Year (basis points)									
	-45	-30	0	+30	+60	+90	+120	+150	+180	+210
+150	-0.90	-1.57	-2.92	-4.27	-5.61	-6.96	-8.31	-9.65	-11.00	-12.35
+120	0.45	-0.23	-1.57	-2.92	-4.27	-5.61	-6.96	-8.31	-9.65	-11.00
+90	1.80	1.12	-0.23	-1.57	-2.92	-4.27	-5.61	-6.96	-8.31	-9.65
+60	3.14	2.47	1.12	-0.23	-1.57	-2.92	-4.27	-5.61	-6.96	-8.31
+30	4.49	3.82	2.47	1.12	-0.23	-1.57	-2.92	-4.27	-5.61	-6.96
0	5.84	5.16	3.82	2.47	1.12	-0.23	-1.57	-2.92	-4.27	-5.61
-30	7.18	6.51	5.16	3.82	2.47	1.12	-0.23	-1.57	-2.92	-4.27
-45	8.53	7.86	6.51	5.16	3.82	2.47	1.12	-0.23	-1.57	-2.92
-90	9.88	9.20	7.86	6.51	5.16	3.82	2.47	1.12	-0.23	-1.57
-120	11.22	10.55	9.20	7.86	6.51	5.16	3.82	2.47	1.12	-0.23
-150	12.57	11.90	10.55	9.20	7.86	6.51	5.16	3.82	2.47	1.12

Source: Bloomberg; EUR IG = Bloomberg EUR Agg Corporate Index. Starting yield and duration as of 6 June 2024. 1-year return projection is estimated as current yield + net change between rate and spreads x duration. Hypothetical returns represent a range of outcomes and are for illustrative purposes only and should not be considered an indication of future performance. The table illustrates a range of return using the yield to worst and applying incremental changes in interest rates and/or credit spreads. This analysis assumes that if interest rates and credit spreads are unchanged, the index’s published yield-to-worst becomes the dominant factor for determining realized return over the next year, which allows for the full capture/earning of the starting yield-to-worst. This analysis assumes that no bonds default, come in or out of the index, and that all bonds are held until maturity. Changes in interest rates represent a parallel shift in the yield curve occurring at the end of the period and measures for duration and spread duration are option-adjusted. These hypothetical calculations are meant to depict how a fixed income index might behave in different market environments given the (1) current level of yield-to-worst, (2) option-adjusted duration (3) and spread duration. This analysis assumes that if interest rates and credit spreads are unchanged, the index’s published yield-to-worst becomes the dominant factor for determining realized return over the next year. The analysis also assumes that changes in interest rates represent a parallel shift in the yield curve occurring at the end of the period, which allows for the full capture/earning of the starting yield-to-worst. Duration and spread duration are measures of price sensitivity to changes in yield and spread, respectively.

Over the medium term, we believe the outlook for expected returns is supported by the attractive level of entry yields. Entry points matter in fixed income. Given the attractive level of current yields, the outlook for expected returns has improved considerably. This is because there has historically been a strong relationship between starting yields like today’s and subsequent returns. For instance, at a starting yield of 3.82% for EUR IG, the median return for the subsequent five years — using a 30-basis-point range around the starting yield — stands at 5.11%, with a return range of 3.23% to 6.03% (Exhibit 4).

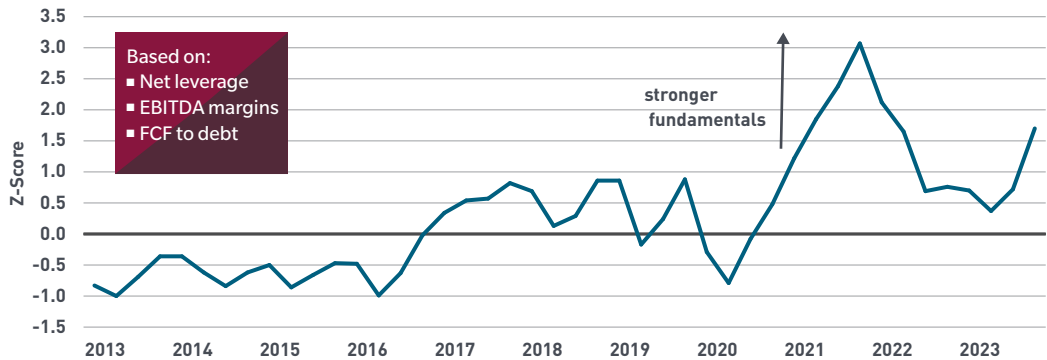
Exhibit 4: EUR IG – Starting Yield versus Subsequent 5-Year Total Return



Source: Bloomberg. EUR IG = Bloomberg EUR Agg Corporate Index. Monthly data from Jan. 2005 through May 2024. Returns are gross and in USD. Past performance is no guarantee of future results.

EUR IG credit remains supported by strong fundamentals. Despite the macro challenges that the eurozone has faced in the recent past, it is remarkable to see that the asset class fundamentals are still robust. We base our fundamental health indicator on three key variables: net leverage, EBITDA margin, and free cash flow to debt. Overall, our fundamental score indicates that the asset class fundamentals are healthy, having recovered markedly over the past six months (Exhibit 5).

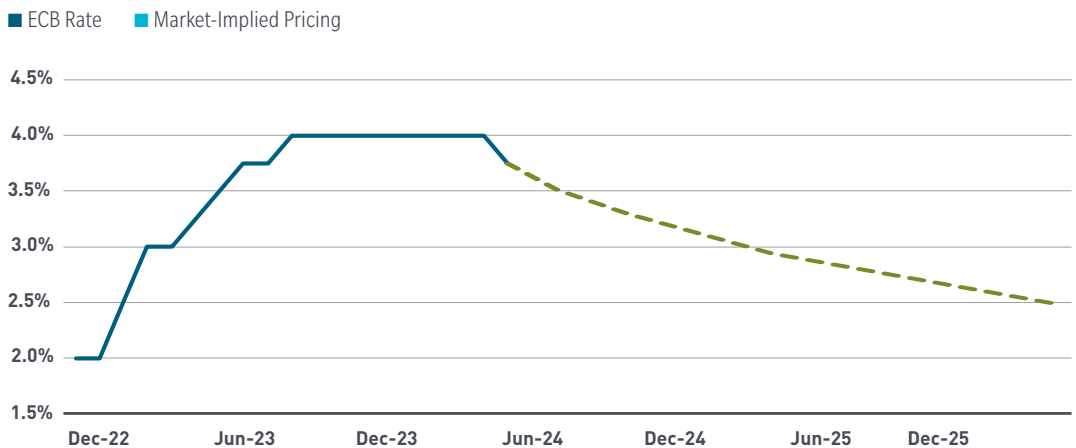
Exhibit 5: EUR IG Fundamental Score



Source: Morgan Stanley. Quarterly data from March 2013 to Dec. 2023. The fundamental score is the simple average of the individual z-scores for net leverage, EBITDA margins, and free cash flow to debt using a rolling 10-year window. A z-score is a measure of deviation from long-term average in terms of units of standard deviation.

The macro environment is turning more supportive for EUR fixed income. There are two key factors supporting a more constructive backdrop: 1) the easing cycle by the ECB and 2) improving eurozone growth fundamentals. On the policy front, after delivering a first cut in June, the ECB is expected to keep easing its policy, which is likely to support the case for establishing a long duration position for the long-term fixed income investor (Exhibit 6).

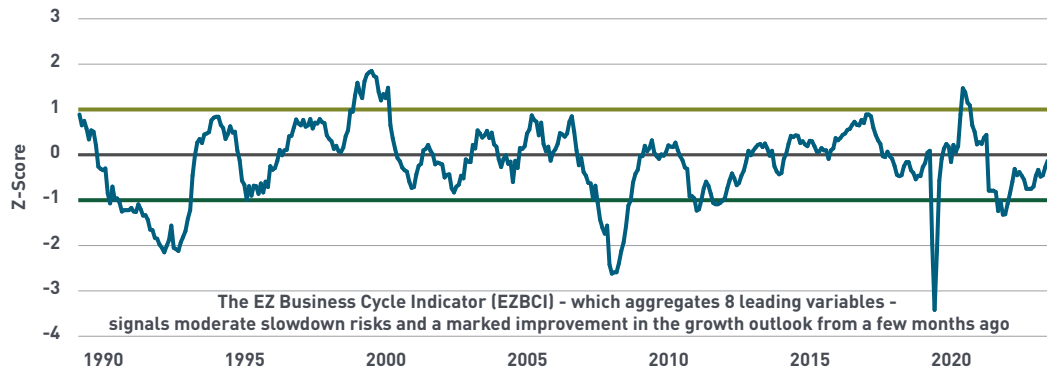
Exhibit 6: ECB Policy Rate and Market-Implied Expectations



Source: Bloomberg. Based on the forward EUR cash curve. Data as of 7 June 2024.

On the growth front, recession risks in the eurozone appear to have receded. A stronger growth backdrop is likely to be supportive of risky assets in the region, including credit risk. Our business cycle indicator for the eurozone indicates that the outlook appears brighter in the period ahead (Exhibit 7), mainly reflecting an improvement in business sentiment.

Exhibit 7: Eurozone Business Cycle Indicator



Source: Bloomberg, IFO, Sentix, France’s INSEE, German Ministry for the Economy, ZEW, European Commission, S&P Global, and Spain’s INE. The EZ BCI is the simple average of the individual z-score for eight variables: Germany’s business expectations, the Sentix sentiment on eurozone expectations, France’s consumer confidence, Germany’s manufacturing orders, ZEW eurozone expectations, the EC economic sentiment, the eurozone Composite PMI, and Spain’s capital goods turnover. A z-score is a measure of deviation from long-term average in terms of units of standard deviation. Monthly data up to April 2024.

The technicals backdrop for EUR IG remains favorable. We have observed that the demand for credit in the eurozone remains robust, as reflected by the subscription of new issuance and a solid pickup in cumulative flow dynamics since the beginning of the year (Exhibit 8). The strength of technicals is not a surprise given the supportive macro environment and anticipation of further ECB rate cuts.

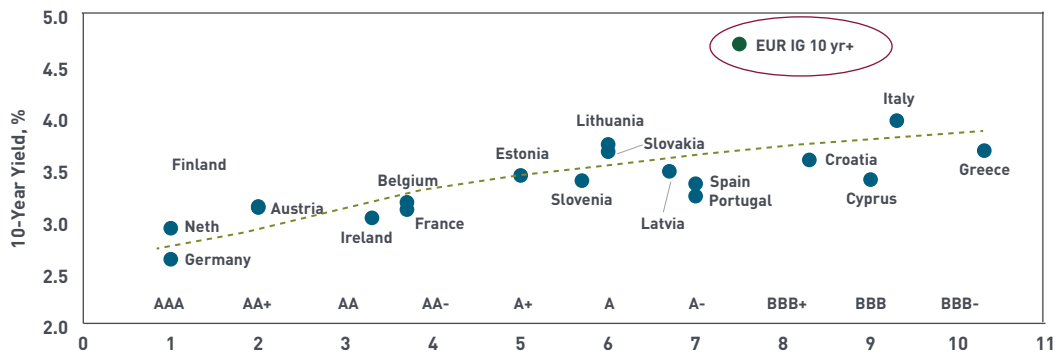
Exhibit 8: European IG Mutual Fund Flows



Source: Bloomberg, Morgan Stanley. Weekly data up to 17 May 2024.

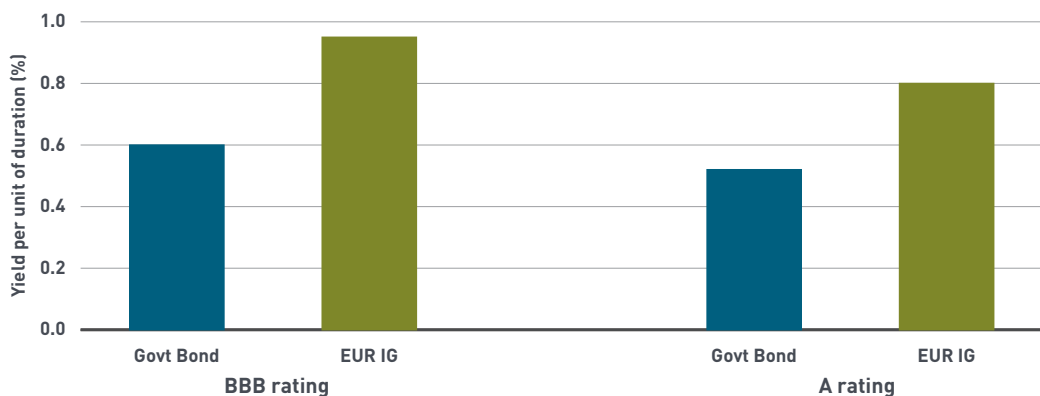
We believe that EUR IG is well positioned against its peers. Relative to US IG, EUR IG’s break-even yield — the yield per unit of duration — is more attractive, at 0.88% against 0.76% for its US counterpart. It is also worth highlighting that EUR IG volatility averaged 4.8% over the past 10 years, considerably lower than US IG’s 6.9%. Away from the US, EUR IG’s valuation compares well with that of European sovereign credits with similar credit ratings. The EUR IG index carries ratings of A3/Baa1, which is broadly similar to that of Spain and Portugal. 10-year yields for Spain and Portugal’s government bonds currently stand at 3.35% and 3.23% respectively, compared with 4.70% for the 10-year+ yield of EUR IG (Exhibit 9). The valuation landscape also looks favorable for EUR IG when analyzing break-even yields relative to the yields of eurozone government bonds with the same credit rating (Exhibit 10). Finally, we also believe that EUR IG is set to outperform EUR cash in the period ahead given where we are in the ECB rate cycle as cash returns are likely to move lower reflecting the impact of future ECB rate cuts. In contrast, the longer duration of EUR IG means that the asset class’s future returns should benefit from policy easing.

Exhibit 9: EUR IG – Relative Value Against Euro Sovereign Bonds



Source: Bloomberg. EUR IG 10 yr+ = Bloomberg EUR IG Corporate Index for the maturity of 10 years +. 10-year Eurozone generic government bonds. Ratings are from Moody’s, S&P and Fitch. The ratings have been converted into a numerical scale as follows: AAA = 1; AA+ = 2; AA = 3; AA- = 4; A+ = 5; A = 6; A- = 7; BBB+ = 8; BBB = 9; BBB- = 10. Data as of 7 June, 2024.

Exhibit 10: EUR IG – Relative Value Against Euro Sovereign Bonds, Break-Even Yields per Rating



Source: Bloomberg. EUR IG = Bloomberg EUR IG Corporate Index. Breakdown by credit rating. Govt bond = Eurozone Treasury bond, breakdown by credit rating. Data as of 20 May 2024. Break-even yield = yield divided by duration.

MFS has a long history of being active in EUR fixed income.

MFS has a deep history and expertise in fixed income that dates back to 1970. The firm was an early pioneer in the development of credit-oriented active bond management and started managing dedicated, credit-focused strategies in 1974.¹ MFS has been investing in European credit for over a decade, with a London-based fixed income team in place since 2013.

In addition, the MFS Meridian Euro Credit Fund launched in February 2019. The Fund's objective is total return, with an emphasis on current income but also considering capital appreciation, measured in Euros. Focusing primarily on European corporate bonds, the fund seeks to deliver attractive levels of fixed income return from a diversified set of alpha sources. Portfolio Managers work with our credit analysts across our global research platform to ensure that preferred security selection ideas from our bottom-up research are aligned with top-down portfolio allocation decisions.

A key feature of the fund is that, while it has always maintained an average credit rating that is investment-grade,² it has made tactical use of off-benchmark securities with differing risk attributes such as high-yield,³ government-related and overseas corporate debt (currency hedged to euros). Flexing the opportunity set in this fashion has supported the fund in seeking attractive levels of return but with more diversified sources of risk.

Credit Quality¹ as of 30 April 2024

MFS [®] Meridian Funds - Euro Credit Fund	Portfolio %
AAA	7.3
AA	10.6
A	27.8
BBB	45.3
BB	2.4
B	0.3
CCC and Below	0.7
Cash	0.8
Other Not Rated	5.1
Total	100.0

Source: Bloomberg PORT based on market value exposure. 1MFS has applied its own rating methodology, please see disclosure page at the end of this presentation for full credit quality rating methodology. The Average Credit Quality (ACQR) is a market weighted average (using a linear scale) of securities included in the rating categories.

MiFID II Performance Standard

MFS Meridian[®] Funds – Euro Credit Fund

	30-Jun-20	30-Jun-21	30-Jun-22	30-Jun-23	30-Jun-24
Portfolio	2.25	6.15	-14.95	2.52	8.94
Bloomberg Euro Aggregate Corporate Index	-0.42	3.61	-12.39	0.14	6.45

Portfolio Performance – Calendar Year

I1EUR shares average annual rates of total return

	Morningstar Category: EUR Corporate Bond			
	Portfolio (%)	Bloomberg Euro Aggregate Corporate Index (%)	Rank percentile	Rank/# of funds
2020	5.56	2.77	2 nd	24/1376
2021	0.36	-0.97	9 th	112/1420
2022	-15.03	-13.65	81 st	1197/1503
2023	10.75	8.19	2 nd	24/1509

It is expected that the Fund's deviation from the benchmark will be significant. Start of Class Performance Record: 15 February 2019. Fund Inception Date: 15 February 2019. Please note this is an actively managed product. Other share classes are available for which performance and expenses will differ. **Past performance is not a reliable indicator for future results. All financial investments involve an element of risk. The value of investments may rise and fall so you may get back less than originally invested.** Investors should consider the risks, including lower returns, related to currency movements between their investing currency and the portfolio's base currency, if different. The Markets in Financial Instruments Directive (MIFID) is the EU legislation that regulates firms who provide services to clients linked to financial instruments.

The I1 EUR share class has outperformed the benchmark over rolling 3-year periods on 100% of occasions since inception, with an average excess return of +73 bps per annum. The MFS Meridian[®] Funds - Euro Credit Fund I1EUR shares outperformed the benchmark (Bloomberg Euro Aggregate Corporate Index) 29 out of 29 rolling 3-year periods and 39 out of 53 rolling 1 year periods. Source: Benchmark performance from SPAR, FactSet Research Systems Inc. It is not possible to invest directly in an index. Index performance will differ from our actively managed strategies, which may involve a higher degree of risk. **Past performance is not a reliable indicator for future results. All financial investments involve an element of risk. The value of investments may rise and fall so you may get back less than originally invested.** Investors should consider the risks, including lower returns, related to currency movements between their investing currency and the portfolio's base currency, if different. Performance results reflect ongoing charges and any applicable expense subsidies and waivers in effect during the periods shown. All historic results assume distributions within the fund and/or the share class are reinvested. **Class I shares are only available to certain qualifying institutional investors.** For all time periods, results were calculated on a rolling basis, measured monthly. All returns are annualized.

In our approach to fixed income credit investing, we often cite the importance of “being early to not being late” as part of our long-term investment horizon. The fund has a proven track record of successfully navigating periods of heightened volatility and taking advantage of market dislocations for the longer-term benefit of the portfolio. The I1 EUR share class has outperformed the benchmark over rolling 3-year periods on 100% of occasions since inception, with an average excess return of +74 bps per annum.⁴

Our euro credit capability is open to institutional investment through dedicated separate accounts or to retail investment through the Meridian Euro Credit Fund. The strategy is managed by lead portfolio managers Pilar Gomez-Bravo and Andy Li.

Overall, we believe that the stars are getting aligned for EUR IG Credit, and we suggest that global fixed income investors should consider the asset class. MFS has been active in EUR fixed income for well over a decade, with a London-based fixed income team in place since 2013.

The fund may not achieve its objective and/or you could lose money on your investment in the fund.

Bond: Investments in debt instruments may decline in value as the result of, or perception of, declines in the credit quality of the issuer, borrower, counterparty, or other entity responsible for payment, underlying collateral, or changes in economic, political, issuer-specific, or other conditions. Certain types of debt instruments can be more sensitive to these factors and therefore more volatile. In addition, debt instruments entail interest rate risk (as interest rates rise, prices usually fall). Therefore, the portfolio's value may decline during rising rates. Portfolios that consist of debt instruments with longer durations are generally more sensitive to a rise in interest rates than those with shorter durations. At times, and particularly during periods of market turmoil, all or a large portion of segments of the market may not have an active trading market. As a result, it may be difficult to value these investments and it may not be possible to sell a particular investment or type of investment at any particular time or at an acceptable price. The price of an instrument trading at a negative interest rate responds to interest rate changes like other debt instruments; however, an instrument purchased at a negative interest rate is expected to produce a negative return if held to maturity.

Derivatives: Investments in derivatives can be used to take both long and short positions, be highly volatile, involve leverage (which can magnify losses), and involve risks in addition to the risks of the underlying indicator(s) on which the derivative is based, such as counterparty and liquidity risk.

High Yield: Investments in below investment grade quality debt instruments can be more volatile and have greater risk of default, or already be in default, than higher-quality debt instruments.

Geographic: Because the portfolio may invest a substantial amount of its assets in issuers located in a single country or in a limited number of countries, it may be more volatile than a portfolio that is more geographically diversified.

Please see the prospectus for further information on these and other risk considerations.

Endnotes

- ¹ In 1970, Keith Brodtkin came to MFS from New England Life Insurance Company to lead the newly established FI group and manage the bond sleeve of a balanced fund, MFS® Total Return Fund (MTR). It was one of the first funds of its kind to include bonds as an integral component. Up to this point, bonds were generally owned by wealthy individuals and insurance companies, which held bonds as an asset to match their liabilities.
- ² Credit Quality Rating Methodology: The Average Credit Quality (ACQR) is a market weighted average (using a linear scale) of securities included in the rating categories. For all securities other than those described below, ratings are assigned utilizing ratings from Moody's, Fitch, and Standard & Poor's and applying the following hierarchy: If all three agencies provide a rating, the consensus rating is assigned if applicable or the middle rating if not; if two of the three agencies rate a security, the lower of the two is assigned. If none of the 3 Rating Agencies above assign a rating, but the security is rated by DBRS Morningstar, then the DBRS Morningstar rating is assigned. If none of the 4 rating agencies listed above rate the security, but the security is rated by the Kroll Bond Rating Agency (KBRA), then the KBRA rating is assigned. Other Not Rated includes other fixed income securities not rated by any rating agency. Ratings are shown in the S&P and Fitch scale (e.g., AAA). All ratings are subject to change. The portfolio itself has not been rated by any rating agency. The credit quality of a particular security or group of securities does not ensure the stability or safety of an overall portfolio. The quality ratings of individual issues/issuers are provided to indicate the credit worthiness of such issues/ issuer and generally range from AAA, Aaa, or AAA (highest) to D, C, or D (lowest) for S&P, Moody's, and Fitch respectively. The index rating methodology may differ.
- ³ Bloomberg Euro Aggregate Corporate Bond Index.
- ⁴ The strategy outperformed 27 out of 27 rolling 3-year periods and 37 out of 51 rolling 1-year periods to 30 April 2024. Source: Benchmark performance from SPAR, FactSet Research Systems Inc. It is not possible to invest directly in an index. **Index performance will differ from our actively managed strategies, which may involve a higher degree of risk.**

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GLOBAL DISCLOSURE

Please note that this is an actively managed product.

Fund Regulatory Details: See the fund's offering documents for more details, including information on fund risks and expenses. For additional information, call Latin America: 416.506.8418 in Toronto or 352.46.40.10.600 in Luxembourg. U.K.: MFS International (U.K.) Ltd., 1 Carter Lane, London, EC4V 5ER UK. Tel: 44 (0)20 7429 7200. European Union: MFS Investment Management Company (Lux) S.à r.l. 4 Rue Albert Borschette, Luxembourg L-1246. Tel: 352 2826 12800.

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