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Portfolio Manager
MFS Investment Management® (MFS®)

P&I: Can you describe MFS' blended approach, and how you combine fundamental and quantitative investment indicators?

Jonathan Sage: In general, fundamental and quantitative strategies behave differently in different market cycles. They have complementary strengths and weaknesses, and each is more effective in different market environments. Fundamental research assesses company, industry, growth and valuation characteristics in a qualitative, subjective and more forward-looking manner. Fundamental analysts can react more rapidly to changes in conditions and investor sentiment, and their evaluations can better reflect market sentiment during asset bubbles and at major inflection points.

Quantitative models, on the other hand, are based on long-term historical data and provide a systematic and objective appraisal of a company's fundamentals and valuation. This allows us to exploit the persistence of various investment factors, such as valuation, quality, momentum, and others, over time. We have a long-term investment horizon in our quant models which pairs nicely with the long-term view of our fundamental platform.

So, we start with these two independent research signals, which have both added value through market cycles at MFS. We utilize the ratings of our fundamental research analysts and our quantitative models to provide an investment signal for every stock in our universe. Then the portfolio management team combines the two separate views into a single, holistic blended research score that employs a subjective constituent, drawn from our fundamental analysis, and a systematic and disciplined investment rigor, derived from the quantitative research. By utilizing both signals in a systematic way, we believe we can provide a consistent more stable outcome.

We work on a broad set of custom separate account strategies that reflects our clients' risk, return or strategy objectives, and each has its own defined benchmark. At the same time, we offer commingled vehicles with traditional growth strategies that are relative to traditional benchmarks and a traditional risk-return profile. Our goal is always to outperform those benchmarks through a full cycle with a controlled tracking error.

P&I: How do you construct your portfolios?

Jonathan Sage: We build portfolios from the bottom up,

A Blended Approach

MFS has developed a sophisticated approach that blends fundamental and quantitative investment signals to evaluate stocks and build strategic portfolios for the long term. Portfolio Manager, Jonathan Sage, and Institutional Portfolio Manager, Dino Davis, explain how it's done.

and we have focused on stocks which have a positive view from both the quantitative and fundamental investment processes. The first stage has been to develop that single view on every stock that we can across the world, which is a continuous process. Apple, for example, is covered by a fundamental technology analyst that rates it a buy, hold or sell. At the same time, the quantitative team has built a model specific to technology stocks that ranks Apple relative to other technology-sector stocks. Our blended strategy looks at Apple from both a fundamental and a quantitative perspective relative to its technology counterparts. So when we have considered it in a portfolio, it has been assigned a blended score, based on research from two entirely different points of view. Say there is a positive view from the quantitative side, and a neutral view from the fundamental side, we still might own Apple, but it wouldn't likely be one of our largest positions relative to the benchmark. For the second stage, we construct a portfolio that seeks to maximize return for a certain level of risk, based on the blended scores. Our larger active weights, or benchmark-relative positions, have tended to be those names that have positive views from both sides. Our process mitigates risks associated with industry, sector, size and region, so that stock selection drives active returns. Most risk is therefore stock specific and very little is allocated towards common factors. We typically have rebalanced portfolios on a four-to-six week cycle as we monitor appropriate timing and turnover.

P&I: How do your clients generally utilize your strategy?

Dino Davis: Some investors use our strategy to move to active from passive, because our approach allows us to take on some incremental risk for a commensurate amount of return. Our Blended Research U.S. Core strategy is a nice first step into an active, risk-monitored portfolio. Others are looking for a disciplined core equity strategy that adheres to style and size disciplines—for example, a risk-managed, large-cap growth portfolio. We also have mandates for unique requirements, like low volatility or higher yield. In regards to low volatility, there is also interest from investors for an absolute risk-mitigation approach where we see our global low-volatility approach coming into play. Our focus there is to decrease volatility relative to the global benchmark by one-third. The appetite for yield and the concern about volatility has driven requests for bespoke solutions as well.

P&I: What distinguishes your approach from other factor-based styles of investing?

Dino Davis: We have a unique, conviction-weighted way of assessing the value and investability of a company that comes from two independent opinions with full transparency. We don't do serial processing. We use parallel processing. We look at each stock concurrently, get two evaluations and combine them in a systematic, holistic and conviction-weighted fashion. The blended score for each stock reflects the relative long-term effectiveness of the fundamental analyst covering the stock as well as the effectiveness of the customized sector model in picking stocks, so within a sector, you could end up with a little bit more weighting on the quant side or on the fundamental side based on which type of analysis has shown more efficacy, which is different than if you were to take a quant manager and a fundamental manager and simply equal weight the two. In the end, we believe leveraging—rather than averaging—those two strategies can lead to much better portfolio efficiency and stronger alpha outcome.

P&I: How do you incorporate risk factors and alpha factors?

Jonathan Sage: First, our fundamental analysts have a deep understanding of each stock they cover, including the risks involved with each company. Second, our blended research portfolios are managed to a targeted level of risk, which is achieved by setting relatively tight parameters at the sector, industry and region levels, so that benchmark risks are managed. We monitor our factor exposures continuously, and we consider the alpha factors as well as those considered risk factors—and in some cases, we allow some of those factor exposures where they're aligned with our alpha models. For example, value can be considered a risk factor, but over a long period of time, it's also an alpha factor, and most of our strategies will have exposure to the value factor. So we balance the tradeoff between the two, and we're sensible about where we allow those exposures.

P&I: What resources do you have available?

Jonathan Sage: We have a collaborative and communicative environment at MFS, and the Blended Strategy investment team has been together for about 14 years now. It's our culture of collaboration across the global research platform, which includes inputs from portfolio managers and analysts from both fundamental and quantitative disciplines that leads to a competitive advantage—particularly with the ability to design risk-specific, benchmark-specific, bespoke solutions for clients. Our global research platform is organized into eight global sector teams that include fundamental equity, quant, and fixed-income analysts, located in nine offices around the world. Their investment focus is holistic, comprised of equity, fixed-income and quantitative analysts' views. They travel together, meet weekly via video conference and communicate daily on an informal basis. We are convinced that this collaboration and communication is in our clients' best interests. Our quantitative team constantly monitors and evolves our stock selection models, which are organized along sectors and regions. We leverage the full global platform to customize those components based on the type of strategy we're looking to manage.

P&I: What distinguishes MFS from other managers?

Dino Davis: Our global research platform is a key differentiator. This structure facilitates information based relationships among the equity, quantitative and fixed-income analysts and results in a unique level of collaboration and teamwork that adds significant value for our clients. Our research teams are highly integrated and work closely together to develop a comprehensive view of the companies we follow. This structure allows our analysts to share information broadly about companies and industries, to evaluate regional trends, to compare growth rates, business characteristics, relative valuations and capital market considerations of companies competing in the same sector from a global perspective.

There is a lot of discussion in the market regarding the term 'blending.' A number of managers use it to describe a process that involves developing two lists and seeing what the overlap is, or using a quantitative process with a fundamental overlay, or maybe a quantitative screen prior to doing fundamental research, for example. Our approach is truly a blend of our quantitative and fundamental research. Our team has been working closely together, developing a specific philosophy and adhering to it very successfully since 2001. ♦

Read, print, and email this Q&A to a colleague at www.pionline.com/InvestmentInsights_MFS

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A Collaborative Approach

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MFS® is an active, fundamentally-driven, global investment manager. We employ a uniquely collaborative research process to build better insights for our clients and to deliver superior long-term performance. Our approach rests on three guiding principles: integrated research, global collaboration and active risk management.

Integrated Research

We look at investment opportunities around the globe by integrating fundamental equity, quantitative and credit disciplines in our analysis.

Global Collaboration

Our team philosophy and incentive structure ensure strong collaboration across the firm.

Active Risk Management

We take a holistic approach to actively managing risk, with reviews in place at security, portfolio and firm levels and a clear focus on generating alpha for our clients.

MFS At A Glance

\$424.0

Total AUM (\$Billion)
as of 9/30/14

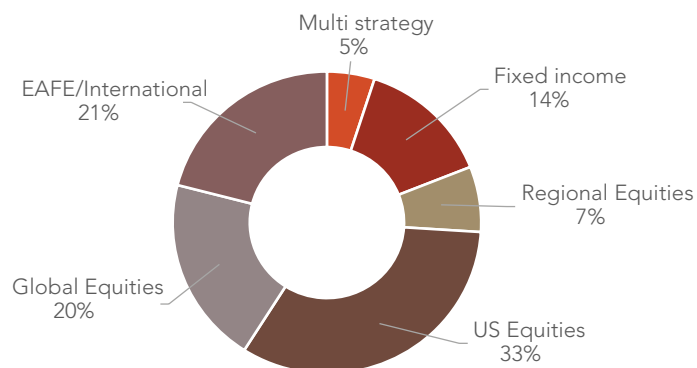
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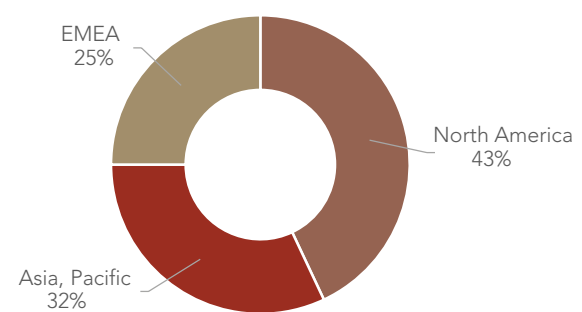
Business Profile (USD)

Diversified asset base (%)¹



¹Data is rounded to the nearest figure

Institutional clients by region



as of 9/30/14

A Fully Integrated Global Research Platform

8 global sector teams organized by region and sectors; cross-border collaboration across equity and fixed income

76 portfolio managers with significant industry experience in value, core, growth, quantitative and fixed income

86 fundamental research analysts - 25 U.S. equity analysts and 34 non-U.S. equity analysts; 27 credit analysts; backed by 18 research/investment associates

Quantitative research team - 10 quantitative analysts provide proprietary research models, quantitative stock rankings and scenario testing; backed by 15 quantitative research associates



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