

## MFS Total Return A

### Fund Facts

Symbol	MSFRX
Website	<a href="http://www.mfs.com">www.mfs.com</a>
Address	MFS Investment Management, 500 Boylston Street, Ste 300, Boston, MA 02116
Tel. No.	800-225-2606
Inception	10/06/70

### Portfolio

Total Net Assets *	\$5,600
Avg Mkt Cap (\$ Weighted) *	\$54,900
Average Price/Earnings Ratio	20.74
Average Price/Book Ratio	2.88
Turnover Ratio	86%

### Investment Information

New Investment	Open
Min Initial Investment	\$1,000
Min Subsequent Investment	\$50
Min Initial IRA Investment	\$250

### Risk (Against S&P 500 - 3 Years)

Alpha	0.6910
Beta	0.3969
R-Squared	0.6982

### Returns vs. Lipper Balanced Fund Index

	MSFRX	Index
1 Year (Cum.)	13.70%	17.19%
3 Year (Ann.)	2.66%	-1.78%
5 Year (Ann.)	5.91%	3.62%

### Returns vs. S&P 500

	MSFRX	Index
1 Year (Cum.)	13.70%	24.40%
3 Year (Ann.)	2.66%	-10.13%
5 Year (Ann.)	5.91%	1.00%

### Fees and Exp

Max Sales Charge - Front	4.75%
Max Sales Charge - Deferred	0.00%
Max Redemption Fee	0.00%
Total Expense Ratio	0.92%

### Portfolio Manager

Management Team	---
* millions	Data through: 9/30/03

Source: Company Documents; Lipper

# Stability Pays

**R**unning a consistent top-quintile performer over the past 10-year, 5-year, and 3-year periods by sticking to the textbook principles of portfolio construction is what Ed Baldini's team is doing at the MFS Total Return Fund. The manager told Ticker how the classic 60% stocks over 40% bonds structure never goes out of fashion, as long as you are into the right stocks and bonds.

**Q: What are the philosophy and the strategy of the fund? How is your fund different and unique from the other funds?**

**A:** The MSF Total Return Fund is a balanced portfolio and in a most general sense our objective with the portfolio is to provide stable equity exposure for long-term investors that produces good equity market results but with much lower volatility and higher yield, in order to have a good source of income from the portfolio. And so we do that through a couple of different things. The first part of the strategy is that the asset allocation stays pretty fixed at 60/40 over time. We are not actively managing the asset allocation of the portfolio, rather we are actively rebalancing back to 60/40. So our belief and our experience is if you simply do that over time, take the steps to rebalance, and stay at a 60/40 throughout volatile periods, then by definition you are selling into strengths whether that strength is in bonds or equities and buying into weakness. And you know there are quantitative studies that show that doing that in and of itself helps to mitigate some of the volatility. So, asset allocation stays fixed and we actively follow that, but it helps to lower some volatility in buying with relative weakness.

The second piece of it is the quality orientation of the portfolio. On the equity side, the equities are managed with a value orientation so we are looking for stocks with low expectations built into the price and that means that typically there is less price risk in the equities that we are looking for, based on the research that we do. Retirement has proved to be a great strategy for managing equities both in terms of generating good returns, but also just managing some of the volatility that comes during market peaks. There is a strong yield emphasis in the equities portfolio, so there is a strong bias for stocks that pay dividends or increase dividends over time, and a strong bias for good management team. We have 46 analysts that we work with in addition to the five portfolio managers on the team. It is a pretty deep team in terms of spending time going out meeting companies, meeting with competitors and suppliers, and developing a conviction about the sustainability of earnings, cash flows, dividends, the basic quality measures of the business going forward. They also assess balance sheet risks, which we take very seriously and which have been a big issue in the last couple of years.

The third component is within the bond portfolio. It is a high quality bond portfolio, so we are not investing



below investment grade, we are not investing in emerging market debt, we are investing in investment grade securities, and we don't take big interest rate bets in the portfolio. There is a sixth portfolio manager who is the head of the bond piece and they keep duration within plus or minus a year of the Lemman Aggregate benchmark. What they really focus on is adding value through sector overweighting and underweighting, and the bonds they are picking within those sectors. For example, today there is an underweight in treasuries and an overweight in investment-grade corporate debt.

The fourth part is a strong risk management process focused on the equity, the fixed income, and on the total portfolio. One is risk at the individual security level, whether that is equity or a bond. Having analysts to verify the sustainability of the business is the most important risk control we have. Second, at the sector level there are both fundamental as well as portfolio construction elements to the discipline. We maintain a strong focus on industry fundamentals in the extent to which that impacts companies changes of pricing, changes of regulatory structure, and what types of risks that can add to the picture. And then we have in the equity portfolio for example a maximum of 25% invested in any one industry at any point in time and we typically have a very diversified portfolio in terms of the numbers securities, well over 100 securities in the equities side.

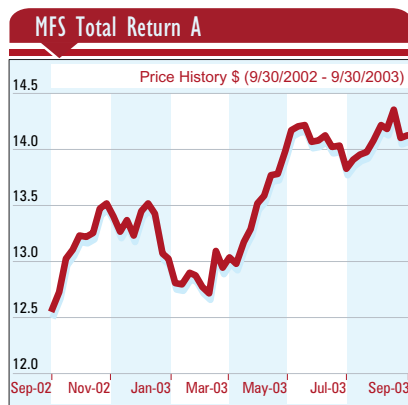
We have been managing the portfolio since 1970, so there is a long record of managing in this style in the firm and a lot of focus in maintaining that consistency over time.

**Q: The 60/40 allocation, is that mostly management of the volatility or is it also to achieve better returns?**

**A:** It is mostly the volatility component. You can think about it in the other direction which is that we are not trying to time markets, trying to time markets in our view is a very difficult and potentially risky thing. Markets are

very hard to predict and we have found over time that simply rebalancing is a much better strategy in terms of helping to manage risk and helping to maintain the return consistency over time rather than trying to forecast for the next three months or six months where markets are going to go. We believe that at the margin it adds some value to be doing this regular rebalancing versus doing nothing at all.

We have little confidence in the ability of investors to guess where the market is going consistently over time and getting that wrong can have huge risk. We have a bunch of exhibits that go through the risks in getting it wrong



and every time we look at it, it just seems not to make a lot of sense, especially when we have the level of resources focused on buying stocks that we do at the firm. We have 46 analysts, five portfolio managers, and one strategist. The focus really is on driving value through picking stocks.

**Q: Those 46 analysts are exclusively focused on this fund or they do other things as well?**

**A:** They are focused on their industry, so they support us and they support other portfolio managers at the firm. Philosophically, what complements our portfolio manager skills best are industry experts, not value experts. We have five value experts on the portfolio. What we really need is someone who can evaluate the business. At the end of the day I think we are pretty comfortable in making that decision as to what the right valuation level is to

maintain the consistency of the strategy in the portfolio, so we really look to the analysts to be true industry experts and to give you an example, early in the year we spent a lot of time looking at grocery stores, the Safeways of the world. The analysts, covering those stocks, also cover Wal-Mart which is not a value stock, but Wal-Mart is incredibly important to the future of Safeway and other grocery stores. So, it is most helpful to us to be talking to someone who is very familiar with all those businesses rather than just exclusively focused on one segment of that industry.

**Q: Right now, interest rates are so low it will be hard to expect them to go any lower than this, any risk that is there is that interest rates will go higher, do you look at those things and still maintain a high exposure in the bond market or how do you handle those kinds of situations?**

**A:** We do. The allocation to bonds stays right around 40% over time so we don't try and guess on the bond side either where rates are going to go over the next three or six months. The implication of sticking with that 60/40 mix is that you are buying into the weaker asset class over time. Within the bond portfolio, the portfolio manager and his team of analysts have a lot of flexibility in terms of not only which corporate bonds to buy but also how they are positioning the interest rate exposure and the yield curve exposure given their outlook for the economy and rates.

**Q: Within the equity portion, do you come up with some kind of industry breakdown, or work at the bottom level stock picking?**

**A:** It is all virtually a bottom-up stock picking. It is a stock-by-stock adding of good ideas to the portfolio, and selling stocks if they hit our price target or where the fundamentals in our view have deteriorated and that's what drives the sector weights over time. We don't have a macro view that drives all the different pieces in the portfolio. And we found that helps to manage

some of the risk. As strange as it sounds it's a lot easier to gain a level of confidence over the future of a business over the next two to five years because we have comfort and a level of intimacy with the different pieces then it is to have confidence about where a sector or an economy is going to go because there are so many different variables that impact that over time. If we are talking to energy companies and a lot of them are talking about initiatives that will improve returns on capital where they will benefit from higher commodity costs and so forth that will show up as typically as an overweighting in energy but it will be based on talking to Exxon, talking to Amoco, Mobile, a variety of individual companies that will make their way into the portfolio and that results in the overweight. There may be commonalities among those that imply a sector view as well, but it is really driven by the stock ideas.

**Q: And do those ideas arise on a thematic basis or on various discussions that you have with industry analysts?**

**A:** The ideas typically come out of our meetings with our analysts, and there are two typical instances. Now, we are going through second quarter earnings. The analysts are talking to companies going through the latest financial results - who is gaining share, who is losing share, what is going on with pricing. The more companies you talk to in a given industry, the more you get a sense of how the individual companies are faring in this environment. So, Citibank just reported their earnings. They came ahead of expectations, there is an additional billion dollars in provisions that are coming down which is helping earnings, and we think their positioning is improving and we think fundamentals are strong, and here is our view on valuation, and so forth. And those kinds of discussions will be the typical discussion. And the other is when companies come in and visit with us, there are probably five to twelve companies a day that as a team we are

meeting with, and so there is a lot of information that is driven off of those, and analysts are constantly updating us on their industry views. So it is a constant generation of ideas, concerns, whatever the issues are on a granular stock-by-stock basis.

**Q: Do you ever go out in the field and visit companies or do you just rely on the companies visiting you?**



Edward B. Baldini is a vice president of MFS Investment Management and member of the portfolio management team in the Value equity group. He is associate portfolio manager of MFS Total Return Fund. Ed Baldini joined MFS in July 2000. Previously, he was a senior vice president at Scudder Kemper Investments from 1995 to 2000. Prior to that, he was vice president, Portfolio Strategy at Aeltus Investment Management from 1993 to 1995. He earned a bachelor's degree from Occidental College and a master's degree in economics from Trinity College. He holds the Chartered Financial Analyst (CFA) designation.

**“Rebalancing is a much better strategy in terms of helping to manage risk and helping to maintain the return consistency over time rather than trying to forecast for the next three months or six months where markets are going to go.”**

**A:** We spend a lot of time as portfolio managers with our analysts meeting companies and that is a critical part for us both in terms of having a first-hand sense of the business and of the people running it. In fact we won't typically invest in a business until we have had a chance to meet with the people and that is just kind of a philosophical thing that seems to help a lot. The other element of this is that it is a very important part of developing the analysts and the relationship with the analysts. Our lifeblood is the communication we have

with our analysts, that is the primary source of ideas, the primary source of critique of ideas in the portfolio. It is not only part of the culture but it is built into compensation, and reviews, and so forth, in terms of the emphasis placed on the portfolio managers to participate in the process with the analyst. It is a very important part of the culture here. There are some other idiosyncrasies to it included in the fact that all the portfolio managers come from the analysts ranks here, so we don't hire managers from outside.

So, there is a shared experience based on this research effort that I think pays a lot of dividends in terms of the quality of results that we get from our analysts but we are very actively involved in the process with the analyst. The chances are any companies we are meeting with one of the team members has covered in the past.

**Q: You mentioned about the expected earnings and whether the companies are meeting them or not meeting them, which expectations are you looking at? Expectations set by your own in-house people or by the Wall Street people?**

**A:** For each company that an analyst is following, there is a full model of financial statements - income statement, cash flow statement, balance sheet, with a forecast going out at least two years in terms of those individual items. So, we do have our own in-house estimates of earnings, cash flows, and balance sheet items and so we are looking at those. We certainly do look at where the consensus is to get some expectation of what is built into the price of a stock today versus what we think the fundamentals really are worth. So, it has helped to understand where the consensus is, but the decision is based on where our thinking is versus where the stock is priced today which is the value of what the consensus is placing on that business. And so it is very much driven off the proprietary research that we have in house. ■

**Ticker Staff**