

Buying the Whole International Race

Since international exposure usually represents only a small part of investors' assets, it is most often concentrated only in the style that has recently outperformed as advisors rarely have the capacity to offer more diversification. Recognizing that demand for style-specific non-US investing will grow, MFS has bundled together its five flagship international products to provide an easy and cost-effective access to truly global markets.

Q: What's the investment concept of your fund?

A: The MFS International Diversification represents a fund of funds. We've bundled together a product that utilizes our five flagship international products in one fund - core, growth, value, small and mid-cap, and emerging markets.

We started this fund with the success of the underlying funds and the realization that most financial advisors would be perplexed in diversifying investment styles from a non-US standpoint. They have neither the resources nor the time to make the allocation process as they do for the US markets. The idea is that going forward, investors will want to have style-specific investing in non-US markets in a similar manner to what they have in the US.

So we decided to package a diversified product that allows investors or financial advisors to not really chase the hottest international product out there. Over the last five years many investors found themselves holding an international small-cap value fund because that's

been the sweet spot of the market.

An individual who has decided to put 10% to 15% of his client's assets into an international allocation, would most likely invest in small-cap value stocks because small outperformed large and value outperformed growth on a global scale. They would never hold just a small-cap value fund in the US, yet they think nothing of holding only a small-cap value fund on the international side. With this fund you're not taking a bet on just one portion of the market, but you're spreading the risk amongst the various styles.

The beauty is that you're not buying one horse but the whole race. We allow clients to efficiently access non-US markets with one vehicle that is also favorable from a cost standpoint because we've not added a management fee. Additionally, we buy the institutional shares to keep the expense ratio low. It has been a tax effective way of accessing these markets because we're continuously getting cash flow and buying our share of the underlying fund.

FUND FACTS

Symbol	MDIDX
Website	www.mfs.com
Address	MFS Investment Management 500 Boylston Street Boston, MA 02116
Tel. No.	800-343-2829
Inception	9/30/2004

PORTFOLIO

Total Net Assets *	\$1,232
Avg Mkt Cap (\$ Weighted) *	\$48,500
Average Price/Earnings Ratio	12.3x
Average Price/Book Ratio	2.3x
Turnover Ratio	0.82%

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	N/A
Beta	N/A
R-Squared	N/A
Ann Std Deviation	N/A
Sharpe Ratio	N/A

RETURNS VS. MSCI AC WORLD EX US

	MDIDX	Index
1 Year (Cum.)	29.52%	28.40%
3 Year (Ann.)	N/A	25.78%
5 Year (Ann.)	N/A	11.85%

RETURNS VS. S&P 500

	MDIDX	Index
1 Year (Cum.)	29.52%	8.63%
3 Year (Ann.)	N/A	11.22%
5 Year (Ann.)	N/A	2.49%

FEES AND EXPENSES

Max Sales Charge - Front	5.75%
Max Sales Charge - Deferred	1.00%
Max Redemption Fee	1.00%
Total Expense Ratio	1.69%

PORTFOLIO MANAGER

Thomas Melendez	9/30/2004
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* millions

Data through: 7/31/2006

Source: Company Documents; Lipper



Q: How many companies do you look at and what benchmarks do you use?

A: The benchmark is MSCI World that includes everybody outside of the US, including the emerging markets. Our playing field is any non-US company and, in some instances, a US-listed company with disproportionate share of its business coming from non-US markets. A good example is Manpower International, a merger of an international and a US company, which ended up keeping the US domicile but has 70% of its business outside of the United States. But that is only one name in a portfolio with over 300 names.

Q: Are the underlying securities mostly ADRs or do you also have local exposures?

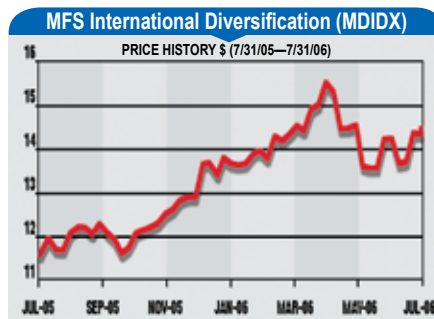
A: We try to take on local exposure whenever possible. We only buy ADRs if they're the most efficient or the only way to access local markets. For example, if you want to invest in the local Chilean market, there are capital restrictions. You have to leave the money in Chile for a set period. Within that period you can buy and sell whatever stocks you want, but you can't repatriate that money for one year. I can't tell my client that he can't get money back because we decided to put some money into Chile. Many of the bigger or better Chilean companies have ADRs so that foreign investors can still access the local market.

Q: How do you decide on the allocation between the five underlying funds?

A: The allocation in these five funds is static. Prior to launching the product in October 2004, we did significant back testing, utilizing the various indices to come up with what we thought was the optimal mix. Once we found the optimal mix, we inserted our funds into that distribution and found that our funds did better than the index throughout any period.

We're not trying to be momentum players or to time the markets. We're not trying to say when it's a good time to buy growth versus value or small versus large or increase the emerging markets exposure. We want to be invested in this proportion throughout the market cycles so that if growth starts to outperform value, you're in the game, but if value continues to outperform, then you're still in the game.

If you listened to most strategists, you would've started buying growth two years ago and that would've been the wrong thing to do. Market consensus would have said you need to move up in terms of small versus large and to move



right in terms of growth versus value. Yet, both decisions would've cost you money given the fact that small continued to outperform large and value continued to outperform growth.

Q: What's the actual allocation between those funds? Even though it's static, what would prompt you to alter it?

A: The Research International Fund, our core portfolio, represents 35% of the fund. It is an analyst-run portfolio with the best-idea concept. The analysts are making recommendations based on the situations which stand out relative to their peers. As a core portfolio it has amorphous tendencies as it focuses on whatever the analysts best ideas are at the time. Comparing the fund today versus a year ago, the portfolio has moved up in capitalization and more towards growth.

Then we have 25% of the portfolio

in International Value, 25% in International Growth, 10% in the International New Discovery fund, which is our small and mid-cap offering, and 5% in the emerging markets equity fund.

Despite that the allocation is relatively static, it has changed since we launched this fund and that's related to monitoring the risk in the portfolio. Initially, we had 10% in emerging markets and 30% in the core Research International product. In March 2005 we decided to lower the exposure to emerging markets from 10% to 5% and give the difference to Research International. It wasn't because we didn't like emerging markets but rather because we liked emerging markets too much. The aggregate exposure to emerging markets, including the exposure by the other underlying funds, was over 25% and we did not feel comfortable with that risk profile. So we decided to lower the dedicated emerging market weight to 5%, targeting a 15% to 20% overall exposure. Since then we've been averaging exposure of about 18%.

Q: What would lead you to the conclusion that you have too much exposure in emerging markets or in small caps? Do you hold a macro view?

A: No, we're strictly a bottom-up fundamentally focused shop so we're not taking any top-down macro views. We're basically building individual portfolios one name at a time.

We have bi-annual risk reviews, which involve comprehensive risk reports that are put together by our quantitative team. We meet with the CEO, the head of the global, international area, the head of the quantitative team, and the person who's running the product to see where the risk in the portfolio is coming from and control it. It's not an allocation tool but sometimes it makes you aware of bets that you're taking collectively. For example, if each fund is making a bet in Korea that doesn't look big on the individual level, when you look at the bets in

the entire portfolio collectively, you may realize that the bet is substantial. If 30% to 40% of your tracking error is coming from two names in Korea, then you need to decide if that makes sense and if you're comfortable with the inherent risk implied by holding those types of positions.

Q: So you review the bottom-up selection made by the other fund managers to see if it makes sense on a collective level?

A: As the portfolio manager of this fund of funds, I'm just taking my proportionate share in each individual fund based on the allocation percentages. It's about providing investors with the expertise of the various fund managers that we have for these particular styles and then packaging this all-in-one fund so that investors get access to this expertise.

The only time that I will change the allocation is if I feel we have too much exposure in any style or region.

Q: Could you describe in more detail the concept and the holdings of the Research International fund?

A: It's a sector-neutral portfolio because we realized that the bulk of the attribution was due to stock selection. Within each sector, the analysts make individual bets on where they can find opportunities. We don't care what the benchmark says although it is a sector neutral portfolio. It is a portfolio that measures the convictions of our analysts because it's run by the analysts.

Q: How do you approach researching the securities in emerging markets?

A: The Emerging Markets fund is based on the premise that we're looking for companies that are undergoing fundamental operation improvements. We define that as increasing revenues, expanding margins, decent returns on capital, and free cash flow generation that's sustainable and growing. More im-

portantly, we're looking to buy that at a discount relative to the respective sector.

It's a fairly diversified fund and I believe that emerging markets represent a part of the world that holds a lot of promise and opportunities. This part of the world makes up 80% of the world's population, has 20% of the world's con-

tribution to GDP, and yet, it only has 7% of the stock market capitalization. Today, emerging markets as a whole, sell at a discount relative to developed markets, while historically, they've sold at premiums. Yet, compared to where they were 15 years ago, emerging markets today are much more sound and in much better positions.

Q: We all thought we should expect scandals and dubious accounting practices in emerging markets but in the end it was Tyco, WorldCom, Adelphi and Enron in the US.

A: Exactly. Whenever anyone asks me if I can trust those companies, my question is, "Do you mean you can trust US companies?" In the most followed, most regulated market in the world, you have WorldCom, Tyco, Global Crossing, etc. Yes, the transparency or the accounting in some of the emerging markets can get better but we're a long way from where we were 15 years ago. These are still evolving markets but we have never had such scandals.

We aren't even close to seeing the emerging markets full economic potential. Yet, on a monthly basis Indian cellular companies sign up 4.5 million subscribers or for the first time banks in Eastern Europe offer mortgages or loans. It is a different era of consumers driving the economy in the emerging markets. **T**

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THOMAS MELENDEZ is Vice President at MFS Investment Management® (MFS®) and an associate portfolio manager of the firm's global equity portfolios.

He joined MFS in 2002 as an associate portfolio manager with more than ten years experience, including three years as an Emerging Market Product Specialist for Schroders North America, two years as a General Manager for Schroders Argentina, and another three years as a Vice President, Latin American Fund Manager for Schroders Capital Management International, London. Prior to that, he spent two years as a Vice President of Sales and Research for NatWest Securities.

Mr. Melendez earned a bachelor's degree from Long Island University and an M.B.A. from Columbia University.

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