Fidelity INTERNATIONAL

Year in review
2021 – 2022

Investing with the future in mind

2021 sustainable investing highlights

Rated A+
across all categories by the UN Principles for Responsible Investment

12
new sustainable investing team members

Enhanced our proprietary sustainability ratings framework with **over 3,700** corporate issuers rated across equities, fixed income and private credit

CityWire Gender Diversity Awards:
Best Retention Rates Award
Judges' Choice Contribution to Gender Diversity

Named House of the Year at **Asian Private Banker Asset Management** Awards for Excellence

Named as a Responsible Leader by the **Responsible Investment Association Australasia**

Launched our Climate Investing Policy and our net zero strategy, setting the following targets:

2030
Halve the carbon footprint of our investment portfolios

Phase out thermal coal exposure for OECD countries

2040
Phase out thermal coal globally

2050
Reach net zero across all investment portfolios

Updated our voting Principles and Guidelines to include new policies on climate change and gender diversity

Signed the Finance for Biodiversity Pledge, which commits to protect and restore biodiversity

Commenced development of our proprietary climate ratings

Year in review 2021 – 2022

Alva Devoy
Managing Director
Fidelity International

Another financial year draws to a close and offers an opportunity for reflection. The environment we now find ourselves in is one of uncharted territory for many investors and market participants, with a war raging in Europe and the current rampant inflation. The dynamics of the Russia-Ukraine conflict are not only dominating world geopolitics but also now the fate of global growth, given the developments around gas and oil supplies. How the energy supply picture evolves will impact growth and inflation, which will, in turn, influence central bank policy well into 2023. There is no prospect of a quick win or quick fix, but rather the prospect of a long-drawn-out conflict and asset price volatility as a result.

So how do we maintain a productive perspective when faced with such uncertainty? As managing director of a funds management business, I do it by focusing on our people. The job of leadership has always been the creation of teams that can achieve their goals whatever the weather – a 'superteam' if you will, which combines diverse talent and is unleashed by great culture and governance to achieve outstanding results. Many of the ideas around superteams have been adapted from the sports field and, just like sport, investments are fundamentally a human-talent endeavour.

Building a superteam should start with diversity, with a focus on equity and inclusion. This approach, with belonging and group identity embedded into its cultural bedrock, makes the best of an organisation's cognitive diversity. It can transform a team, through stronger culture and higher levels of trust, from being just promising, into a high-potential state.

Building a superteam is also a collaborative effort, as is leading one. Every superteam is a team of leaders in which influencing and being influenced is distributed. While there are individuals whose leadership contribution to the team is large, enabling others to contribute is seen as more important. In addition, the team draws on different styles, with each playing a part and helping to establish the leadership configuration.

A superteam would be incomplete without adding the craft of governance. This requires the building of frameworks, underpinned by explicit beliefs and principles, for critical thinking and to support decisions. Frameworks also help to develop a collective-leadership mindset, which enables accurate judgement, accountability and consistency. Good governance provides the essential rigour to turn the sum-of-the-parts potential into an exceptional superteam.

We have observed that in the shift of knowledge and power from the individual to the collective, the investment industry has increasingly moved towards teams over individual 'stars' and has developed a dependency on these teams' collective intelligence. At Fidelity, we have reflected that zeitgeist and have been fortunate to be able to structure many of our strategies now with portfolio managers, co-portfolio managers and assistant portfolio managers, which will benefit our clients as we go forward. This is now combined with the might of the global Fidelity investment team, totalling 400 investment professionals worldwide.

By focusing on the team's bench strength and providing a rewarding environment (a prerequisite for regular winning) I think it's possible to 'stay in the zone' even when times are challenging.

Our investment expert views

Australian equities

Paul Taylor
Head of Investments, Australia and Portfolio Manager, Fidelity Australian Equities Fund

Unfortunately, it was a very pessimistic start to the year. Inflation, interest rates and market volatility were all on the rise, and we were not yet out of Covid and feeling the pinch from related supply chain issues. Today, expectations are still bearish. Markets have factored in official interest rates of around three to four per cent, with several rate hikes predicted over the next 12 months. Markets like the US and potentially the UK are seeing inflation at around 10 per cent, global trade is continuing to experience bottlenecks, the war in Ukraine seems likely to be prolonged, China is locked down and we're still getting Covid. All in all, a pretty dismal environment!

But there are reasons for some optimism, not least that all of this has already been well and truly priced into equity markets. Maybe reality might be slightly better? China may start to open up, official interest rates may not reach predicted levels (and even if they do, they're still low by historical standards), we're learning to live with Covid, and although inflation is higher than normal, that can actually work in favour of equity markets as long as it remains at a reasonable level.

A favourite quote of mine is from Mark Twain, who said, 'History does not repeat, but it does rhyme.' I think this applies nicely to markets.

We're now in a new environment of rising inflation and interest rates and I think it's useful to look back to see what happened in markets during similar economic environments. As the quote suggests, markets won't be exactly the same as last time, but there may be certain similarities.

So, if we look back at the times when interest rates were rising, we see that equity markets generally do reasonably well through these periods. At the early stages it seems markets focus more on *why* interest rates are going up rather than the fact that they *are* going up.

> Interest rates are rising because we're learning to live with Covid, the economy is recovering, and unemployment is very low.

They're going up because things are getting better. In environments when interest rates go up very quickly (current expectations) equity markets do not perform as well as when they are steadily going up, but returns are more often positive. Indeed, equities investments can help keep pace with inflation as many businesses actually benefit from this type of environment.

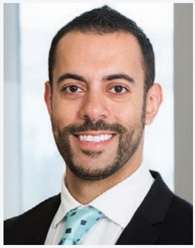
Once again, in terms of history, the businesses that tend to do well during inflationary periods are those linked to commodities (both soft and hard) as well as essential businesses that have pricing power. The opposite is true for businesses that have no pricing power or offer fixed-price contacts. Businesses such as contractors and building companies that have fixed price contacts and rising input costs see their margins significantly squeezed through inflationary periods.

Another interesting movement in the market is 'goods' versus 'services'. Pre-Covid, we saw a structural trend of services growth outstrip the growth in goods. During Covid, this completely reversed. Services took a significant hit. We could not travel, go to restaurants, go to the movies or get our hair cut, and were completely constrained in our movements. While we could not travel or eat out, we could buy lots of things online. Growth in goods accelerated, but services declined. As we learn to live with Covid, we're starting to see this reverse again.

As a quick example: if we have $100 in our wallet, let's assume for this exercise $50 is spent on the essentials (food, shelter, insurance, electricity, interest) and $50 is spent on discretionary items. Within the discretionary space, $30 is spent on goods and $20 is spent on services. As inflation enters the system, the $50 that is spent on essentials grows to $60 as prices increase. We now only have $40 for discretionary items. Of the $40 spent on discretionary items, services grow from $20 to $30 as we re-start travel, eating out, entertainment and leisure activities. This all means that discretionary goods will decrease from $30 to $10. We are likely to see good growth in services again but a decline in goods.

We may be entering a new phase in the economic environment. That change in environment has caused short-term volatility in markets and created some interesting opportunities in individual stocks, but also potentially a great long-term entry point for equity markets. I do believe we will see better returns from commodity businesses as well as businesses that sell essential services and have pricing power.

Global equities

James Abela and Maroun Younes
Co-Portfolio Managers
Fidelity Global Future Leaders Fund

Last financial year, the world's attention was gripped by Covid statistics, pressures on global supply chains, the differentiated scale of border-reopening across Asia and the West, and estimating the timing and scale of the US Federal Reserve's monetary policy tightening.

After witnessing a momentum-driven market see-sawing between panic and euphoria over 2020 and 2021, we expected investors to begin renewing their focus on fundamentals and disciplined valuations. We paid close attention to the inflationary dynamics that began to trickle amidst clear signs of global economic recovery and highlighted our expectation of a limited lifespan for the era of free money and abundant liquidity.

Looking at broader macroeconomic risks for 2022, there was little to suggest that geopolitics would assume centre stage with such immediacy. So, when the crisis in Europe intensified and energy and commodity prices began scaling upwards, speculation about an unexpected stagflation gained ground.

Our investment expert views

Global equities (continued)

Recently, the large-scale lockdowns in China to tackle the Omicron variant of Covid have only added to market nervousness.

Against this backdrop, momentum-driven areas of global mid-cap equity market, where fundamentals did not support valuations, have significantly de-rated over the last six months. Some of this was, in our view, a necessary valuation readjustment after a few years of risk being priced at inappropriately low levels, while in other cases this presents opportunities as the market shifts its focus to the immediate short-term and loses sight of what could be some of the structural winners of the future.

> The other side of these trends are new themes emerging, such as the structural growth of electric vehicles, which is creating significant demand across the value chain in resources, component parts, new materials and semiconductors.

Cyclical recovery is evident in earnings and multiples for the energy, financials and agricultural sectors. Furthermore, reasonably priced, high-quality businesses appear to be relatively strong in a market that is increasingly nervous and uncertain.

Investment portfolios will likely need to stay balanced between long-term growth winners and exposure to the strong economic recovery through energy, resources, industrials, consumer, financials and technology.

The intersection of quality and value is where we think there will be some attractive opportunities. We are still believers that the focus will shift towards the following over the next 12 months:

(1) Pricing power (given rising input costs, inflation, and potentially increasingly tight labour markets);

(2) Sustainability and ESG (as society expectations rise, credit costs rise, and competitive pressures intensify);

(3) Valuation discipline (given there are currently either high or record asset prices in many sectors); and

(4) What is really driving company growth – is this cyclical or structural?

We believe that it will be less common to see widespread earnings upgrades over the next 12 months if competition for capital and customers intensifies, as it would raise cost pressures and confidence of business to invest increases. However, we would caution that given the rapidly changing macro conditions, a heightened level of volatility may persist for the remainder of 2022. Quality-focused stock picking remains critical led by a strong valuation discipline to find businesses that are positioned to withstand the current multiple macro-economic challenges.

Asian equities

Anthony Srom
Portfolio Manager
Fidelity Asia Fund

The last 12 months have been a tough period for Asian markets. Turmoil in the Chinese property sector, global rate hikes, strong inflation, the Russia-Ukraine conflict, higher commodity prices, China's zero-Covid policy, and further global supply chain concerns have all weighed on sentiment.

Markets have fallen, with China A-shares suffering the most with strongly negative sentiment following Covid lockdowns of major cities. Amid this backdrop, stocks with long duration growth expectations have generally struggled versus companies with more defensive revenue streams, while commodity-consuming companies have underperformed commodity producers. While China has struggled, the Indian market has held up despite having many long duration growth companies at expensive valuations, being a commodity consumer and facing higher inflation.

Looking ahead, the issues potentially facing investors remain largely similar. Downward earnings revisions for the market will likely increase, thereby questioning the price investors are prepared to pay for this income stream. However, there are some stock opportunities with a select number of areas of the market having faced significant selling pressure to the point where risk/reward looks attractive.

Despite the macro issues facing China, some mainland listed A-shares are looking interesting. The market is currently very short-term focused, so we can expect more volatility. However, we think the most likely outcome may be that each mutation of Covid exhibits less virulence, to the point of allowing China to exit its zero-Covid policy. This could possibly be later this year or next calendar year. Any such easing of mobility restrictions may result in a material stock market rebound.

For instance, a company like Focus Media is in a sector that is not directly impacted by regulation. It is a leading display advertising company in China, with screens in offices and shopping malls, operating in a duopoly market structure. Its stock price valuation is now looking very attractive versus its long-term listed history, and it has net cash on the balance sheet, which will help see it through a tough macro environment. It still has scope for growth via expansion into lower tier cities.

Building materials companies are another area of interest. Amid unpaid invoices by beleaguered developers and rising commodity costs, the industry is facing consolidation as smaller players exit. Companies with strong balance sheets that can withstand the pain are currently gaining market share, potentially giving them greater future pricing power and growth if the cycle turns. SKSHU Paint and waterproofing materials group Beijing Oriental Yuhong are two such companies.

Outside of China, Asian technology firms with a leading global position also offer opportunity. Although demand is likely to fall for technology products, areas like foundries are still undersupplied, which offers a degree of pricing power.

Our investment expert views

Global emerging markets

Amit Goel and Punam Sharma
Lead Portfolio Manager
and Co-Portfolio Manager
Fidelity Global Emerging Markets Fund

Global emerging markets (GEM) experienced a challenging series of events in the past financial year with global monetary tightening and Russia's invasion of Ukraine. A slowdown in China due to rising Covid cases and well-intended but disruptive regulations, not to mention the delisting risks for Chinese American depositary receipts (ADRs) also spooked investors. Overall, with these risks potentially at their peak presently, we believe GEMs are better placed for sustainable market returns over the medium to long term.

A more persistent inflation has been caused by an inability to re-balance demand and supply globally, exacerbated by social and political tension, has brought forward monetary policy normalisation. Central banks globally are facing a growth-inflation trade-off. Hiking interest rates rapidly risks triggering a recession, while not tightening enough risks causing unanchored inflation expectations so there remains a risk of policy error.

However, emerging central banks are better placed and have positive real rates given they moved early and aggressively in tightening monetary policy over the last year.

The Russia and Ukraine conflict has caused substantial volatility in GEM equities. Since the war began in February, risk aversion grew and the period that followed saw weak stock performance. Given that Russia is a large exporter of commodities, the conflict also led to dislocation in commodity prices, which for GEMs has resulted in some winners and some losers this year. The emerging European (Hungary, Poland, Czech Republic, Greece, Turkey) and Egyptian equity markets have been some of the worst performers given their dependence on Russian energy, grains, and tourism. On the other hand, with Russia no longer part of the MSCI Emerging Markets Index, producer economies of the Latin American region have benefited from higher commodity prices. Beyond Latin America, Saudi Arabia and South Africa have also recorded strong performance as they have the next-largest market exposures to commodities.

In China, the economy struggled amid a fluid Covid situation, regulatory crackdown on property and technology giants in the name of common prosperity, and delisting fears of Chinese ADRs in the US. A broad-based slowdown in demand raised economic growth fears. We expect a flood like stimulus in China but that is yet to be seen. Despite this downcycle, we see a good opportunity to buy quality businesses that may be trading at cheaper valuations. While China is slowing, its policies are favourable to promoting more sustainable growth to the world's second largest economy.

Overall, despite these challenges, we believe that GEMs are in a better shape to withstand inflationary headwinds than in the past. Valuations and growth expectations have adjusted as decades of disinflation, easy monetary policy and asset inflation gave way to inflation/ monetary tightening and lower growth expectations. GEMs offer the opportunity to create a diverse portfolio for any macro backdrop.

> Looking ahead, we think this is an opportune time to invest in emerging markets – its equity index is now more competitive and at a healthier starting point in terms of valuations versus developed markets.

That said, we need to separate the wheat from the chaff by using active stock selection, based on fundamental analysis, to construct a portfolio of what we consider to be high-quality companies that can generate sustainable returns over the medium to longer term.

Sustainable investing

Daniela Jaramillo
Director
Sustainable Investing

Engagement is the key to achieving real world outcomes

The core part of our approach to sustainable investing is to work with investee companies to achieve positive outcomes in the real world. We do this through our engagement program. Engagement in sustainable investing comes in different shapes and sizes. Over the last year, we have been implementing different tools to achieve change in how companies operate.

1 Implementing our climate and diversity proxy voting policy

Our new proxy voting policy allows us to vote against directors of companies who are not meeting our minimum expectations regarding the diversity of their boards or management of climate risks.

(a) Climate change: We vote against companies that are highly exposed to climate risks and have not demonstrated through their disclosures that they are managing those risks appropriately.

(b) Board diversity: We vote against companies that don't have a minimum of 30% female representation on the board in developed markets and 15% in emerging markets.

Our investment expert views

Sustainable investing (continued)

This policy has helped us have better conversations, which have resulted in meaningful change – specifically in the diversity of some boards' composition or climate change risk management. We believe these changes will help those companies deliver better financial and sustainable long-term outcomes for investors.

2 Helping companies navigate the evolution in sustainability

The speed at which sustainability has evolved has taken many companies by surprise, with many of the directors we speak with indicating that this is something their companies and boards specifically grapple with. In response, we have sought new ways to communicate more effectively with company directors through our 'ASX Director Webinar Series'. Topics so far have included investor sentiment post COP-26 and the implications for asset managers like Fidelity, as we seek to de-carbonise portfolios, as well as company director remuneration and how asset managers will be looking to vote on these issues going forward.

Another development in the Australian market has been the 'Say on Climate', where companies are encouraged to adopt an annual shareholder vote at their Annual General Meeting (AGM) on their climate strategies. Whilst there are mixed views in the industry about the effectiveness of this tool, we think it is an opportunity to have more robust conversations with companies on their approach. We recognise that placing a binary vote (for/against) is a simplistic way to categorise these climate plans which are complex and nuanced, therefore we aim to provide detailed feedback to companies on the strengths and gaps in their plans following our vote.

Our goal is to create a feedback loop between companies and investors ahead of and after votes, to ensure we are aligned in our goal to achieve net zero, in a way that best benefits companies, shareholders and the world.

3 Enhancing how we integrate sustainability: climate ratings

This year, we launched enhanced versions of our sustainability and climate ratings. Our ratings seek to take ESG to the next level by providing a forward-looking view of the extent to which a company's performance on material sustainability issues will support, or impair, long-term value creation for investors.

A key strength of the ratings is that they follow a comprehensive and nuanced framework which applies 'double materiality'. This concept focuses on an evaluation of the financial risk of the social and environmental factors for companies. But beyond that, it also looks into the actual and potentially far-reaching impacts of a business on people and the planet. Our ratings also allow us to have more expansive conversations with companies. We can share how they compare to peers, how we assess them on multiple issues, and provide them with insights into how we make investment decisions.

A core component of our net zero emissions targets is our new climate ratings. The ratings aim to highlight how a company aligns with our net zero targets by categorising companies in five buckets depending on the strength of their approach to climate related risks. These ratings strengthen our engagements with companies as we can share with them their strengths and weaknesses, and where we expect to see more progress.

It's easy to invest with us

You can invest with us directly, via the ASX, via an mFund or via a platform.
To find out how, visit our website or speak to your financial planner or broker.

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