Fidelity Multi Asset

Asset allocation view

February 2019

Last month, we shifted to overweight from neutral in both equities and fixed income, while moving underweight cash. We have maintained this allocation, and given the heightened volatility in markets, we believe that now is the time to be active in every sense of the word. In doing so, we take a nuanced approach, which seeks to avoid being complacent to the risks of overdoing a risk-on posture, but also not missing out on what may prove to be a last leg in this bull market.

In addition to maintaining our overweight allocation to emerging market equities, in recent weeks we have also increased our exposure to the US equity market. But this does not mean we are adding to tech-heavy growth areas of the market. After muted returns in recent years, value stocks look attractive, and we see strong upside with limited downside in this trade. Even if a significant re-rating does take place, this area of the market will likely be the most defensive. However, we remain attuned to the risk of value traps, and are closely watching for signs of vulnerability in our exposure to the financials sector across portfolios.

We are also cognisant of the risks inherent in a defensive posture. Missing out on upside is an obvious concern, but perhaps less obvious are the risks in investment grade fixed income. In recent months, we have seen a return to risk premium in BBBs, and as a result, we are focusing on gaining exposure to high quality, shorter-dated investment grade issues. This speaks to the importance of active management at this juncture, where simply buying the index will not offer the downside protection required in the event of a risk-off move.

In the coming months, we believe that multi asset managers will have to live up to their name. The nuanced asset allocation approach required by this late-cycle environment demands the use of a wide range of investment instruments, and access to the best underlying active managers. With this in mind, we continue to focus on taking advantage of opportunities arising out of volatility, but are also prepared to de-risk when the cycle does finally come to an end.

Yours faithfully,

James Bateman

Chief Investment Officer - Multi Asset

In brief

Equity

Having initially bought the excessive sell-off in risk assets, we are now emboldened by China stimulus and Fed ‘pause’, but are selective given regional disparities in attractiveness.

Fixed income

We ‘barbell’ our increased weight to equities with high-quality fixed income. Duration can perform well in certain regions if the global economy surprises to the downside, but divergent credit fundamentals imply that selectivity within credit markets is warranted.

Cash

We are underweight as opportunities are arising out of market volatility. The negative after-inflation returns from cash and lack of duration ‘hedge’ have us overweight fixed income to balance our equity position.

Macro

The Fidelity Leading Indicator (FLI) remains in the ‘decelerating below-trend growth’ quadrant for the tenth consecutive month, and has posted its worst reading since 2012. Global Trade is the worst performing sub-sector.

Views from Fidelity Multi Asset

Strongly negative ●●●●● Strongly positive

Asset class	View	Rational
Regional equity		
US	○○○●○	We have shifted to overweight to take advantage of recent volatility and more attractive valuations, while the US economy outperforms. This is a nuanced view, however, and we favour 'value' over 'growth' investments.
UK	○○●○○	The UK's Brexit saga marches on, and we remain neutral, positioning for any number of possible outcomes. Politics, rather than economics or fundamentals, continues to drive UK equity markets.
Europe ex. UK	○●○○○	Our negative outlook is driven by growth concerns in Germany, and the impact of a slowing China. Despite some promising signs on the Italian budget in December, we don't believe we have heard the last of the issue.
Japan	○○○●○	We are maintaining our overweight given Japan's status as a defensive equity region, and stable political backdrop relative to other equity regions. Robust domestic wage growth, improving governance, and loose monetary and fiscal policy are also supportive of equity markets.
Asia Pacific ex. Japan	○○○●○	After a challenging 2018 for Chinese growth, we are watching closely for signs of meaningful stimulus. The long-term growth prospects for the region remain positive, however, and valuations are more attractive after a weak 2018 for Chinese equity markets.
EM	○○○●○	We maintain our overweight as the prospects of a weaker USD and a slower pace of hiking from the Fed increase. Combined with lower oil prices and better valuations, we think emerging markets are coming out of a difficult 2018 with significant upside potential.
EM - EMEA	○○●○○	A depressed oil price has negatively impacted Russia as a major oil exporter, and Turkey is increasingly looking to be in a deep and difficult recession. We remain neutral as a result.
EM - Americas	○○●○○	Brazil's Bovespa index reached record highs in January, but we believe that political exuberance is overdone. Brazil still needs significant, and painful, reform to escape structurally weak growth and fiscal issues. Mexico, conversely, continues to underperform, which we believe is partly due to negative sentiment overshooting.
Fixed income		
US Treasuries	○○●○○	We still prefer US duration exposure and believe that US Treasuries are an effective defensive play given continued equity market volatility.
Euro core (Bund)	○●○○○	Compared to the Euro periphery Bunds remain defensive, but we are not positive given the ECB's path to tightening in 2019, and the resulting muted upside potential for Bunds.
Euro periphery	○●○○○	We do not believe that the situation in Italy has stabilised enough to demand a change in view, despite the budget agreement late in 2018, and further instability is more likely than not.
Inflation linked bonds (US TIPS)	○○○●○	As a decade of loose monetary policy is unwound, US TIPS hold an important place in portfolios as a defensive position in the event inflation rears its head.
Investment grade bonds	○○●○○	We maintain our bias to high quality, USD denominated short maturity issues as we have seen spreads widen between BBBs and higher quality investment grade issues.
US high yield	○●○○○	We have not improved our outlook after the asset class began to struggle late in 2018. Low oil prices and elevated refinancing costs continue to present headwinds.
European high yield	○●○○○	Growth prospects become more muted after Germany's weak showing in 2018, and political uncertainty continues. With yields holding at their current low level, we have not changed our negative outlook.
Asian high yield	○○○●○	Relative to other regional high yield markets, Asia HY is still attractive on a relative basis, and fundamentals / leverage continue to hold up despite ongoing trade tensions between China and the US.
Hard currency emerging market debt	○○●○○	Tightening financial conditions still weigh on sentiment despite a softer US dollar being likely in 2019. We upgraded our view from underweight in December, but are not yet ready to move overweight despite valuations becoming more attractive.
Local currency emerging market debt	○○○●○	After facing headwinds for much of 2018, the asset class has exhibited strong performance in recent months, and the outlook is promising as the Fed has turned more dovish and USD softens. The asset class is an important source of yield for our income strategies.
Emerging market corporate debt	○●○○○	We are not ready to move to neutral just yet, despite our view that the US dollar is likely to weaken in 2019. Outweighing the likely positives on currency are the tensions building in credit markets globally.
Currency		
USD	○●○○○	The Fed has already significantly softened its rhetoric and hiking plans, and expectations are rising of an outright 'pause' given much-tightened financial conditions. With the domestic economy to slow in 2019, and 'twin deficits' coming back into focus, expensive fundamental valuation makes the dollar a sell.
EUR	○●○○○	Disappointing core inflation compounded by poor PMI surveys, the ECB on hold until at least late 2019, rising political risks, and slowing external demand all add to downward pressure on the Euro.
JPY	○○○●○	JPY remains attractive as a very cheap 'defensive' asset class. There is upside potential as BoJ tries to normalise domestic policy, or from interest rate differentials declining as markets start to price in the next US downturn.

Source: Fidelity International, as at February 2019.

These are the broad-based views arrived at during our monthly Asset Allocation Group meeting, which includes portfolio managers and senior research personnel from Fidelity Multi Asset. The views reflect a time horizon of 12–18 months, and provide a broad starting point for asset allocation decisions. However, they will not necessarily be used as a direct input into portfolio construction for investment strategies where portfolio managers have greater discretion on asset allocation.

Fidelity Multi Asset

Fidelity has a significant history in multi asset investment, having managed multi asset portfolios since the 1980s. Today, Fidelity Multi Asset manages $40bn[1] of assets for institutional and retail clients, with a team of investment professionals spread across global regions. These investment professionals are supported by dedicated implementation, operations and client servicing teams, working to deliver the optimal outcomes for clients through time.

	Client outcomes	Example funds and strategies
Outcome focused		
Income	Stable income distribution with capital stability	▪ Fidelity Global Multi Asset Income Fund ▪ Fidelity Greater China Multi Asset Growth & Income Fund ▪ Fidelity Asia Pacific Multi Asset Growth & Income Fund ▪ Fidelity Multi Asset Income range
Risk Rated and Open Architecture	Range of strategies with a spectrum of risk/return profiles	▪ Fidelity Multi Asset Open range ▪ Fidelity Multi Asset Allocator range
Volatility Targeted	Capital growth with controlled volatility	▪ Fidelity Systematic Multi Asset Risk Targeted (SMART) Funds ▪ Fidelity Diversified Growth Fund ▪ Fidelity Diversified Markets Fund
Absolute and Total Return	Capital growth with focus on downside protection	▪ Fidelity Global Multi Asset Tactical Funds ▪ Fidelity Patrimoine Fund
Benchmark-aware		
Strategic Benchmarked	Adding value versus a given benchmark or strategic asset allocation	▪ Fidelity Euro Balanced Fund
Equity Multi Manager	Equity-benchmarked global and regional funds using Fidelity underlying managers	▪ Fidelity International Fund
Target Date / Rolldown	Progressive decrease in volatility	▪ Regional target date strategies in Europe and Asia

[1] Fidelity International. Assets and resources are shown as at 31 December 2018.

In addition to these pooled fund solutions, Fidelity Multi Asset manages a number of customised and advisory mandates. Drawing on our global investment resources, we work closely with clients to deliver intelligent multi asset strategies, designed to provide specific outcomes through time.

Please contact your Fidelity representative for further details regarding Fidelity's multi asset offerings.

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