Fidelity Multi Asset

Asset allocation view

May 2019

The first month of Q2 has seen a continuation of mixed messages from markets. US equities reached all-time highs in late April, making up the ground lost since the previous high-water mark was set back in late September 2018. The earnings season appears to be a contributing tailwind so far, with most companies beating relatively muted expectations, and volatility has declined for the fourth straight month. As the rally continues, US dollar strength is again back in play, albeit at lower levels than 2018, and yields have dipped further.

As a result, the team has retained its neutral view on equities as fundamentals are still lagging risk assets and current equity market momentum is unlikely to continue. Within equity, we continue to favour value versus growth, particularly in the US, and are overweight emerging Asia to participate in the positive data fuelling markets. We have also shifted our view from overweight duration to underweight, given the team’s consensus that yields are more likely to trend upwards rather than the cuts priced into the market. This positive allocation leaves us overweight cash, although where possible we are investing this allocation to ‘cash plus’ and alternative strategies, avoiding the drag associated with cash.

According to our proprietary Fidelity Leading Indicator (FLI), tentative signs of cycle stabilisation have begun to emerge, but we are a long way from any sustained move out of the ‘growth negative and worsening’ quadrant. With this in mind, we continue to keep a close eye on the activities of the world’s major central banks as they maintain course down the dovish path, with the major story in recent weeks coming from China as credit growth was an upside surprise. This has acted as a tailwind for China as well as emerging Asia more broadly. We maintain that caution is warranted, however, and believe that there is a limit to the efficacy of central bank policy after a decade of support.

Political uncertainty has not receded, and the recent ‘Brextension’ has not given investors much in the way of hope for a positive resolution in the near term. Meanwhile, the Eurozone remains vulnerable to longer-term downward trends in Chinese growth, and Italy remains in recession. With this backdrop in mind, we continue to leverage the deep resources of the Fidelity Multi Asset team to find select shorter-term value opportunities across the capital structure to deliver performance in an increasingly competitive market environment.

Yours faithfully,

James Bateman

Chief Investment Officer - Multi Asset

In brief

Equity

Fixed income

Cash

Key themes

China stimulus positive for emerging markets: Coordinated policy action in China is starting to feed through into the data, and while we see this as stabilisation rather than the ‘big bang’ stimulus of years past, things are noticeably positive compared to recent months and a tailwind for emerging markets, especially in Asia.

Walking back duration but favouring the US: We have moved underweight duration as we believe the next move in yields is likely up, and we do not see an imminent recession. For downside protection we are biased to US duration (including TIPS) vs. the rest of the world as there is more room for US bonds to rally. Some of our PMs have reduced gold exposure.

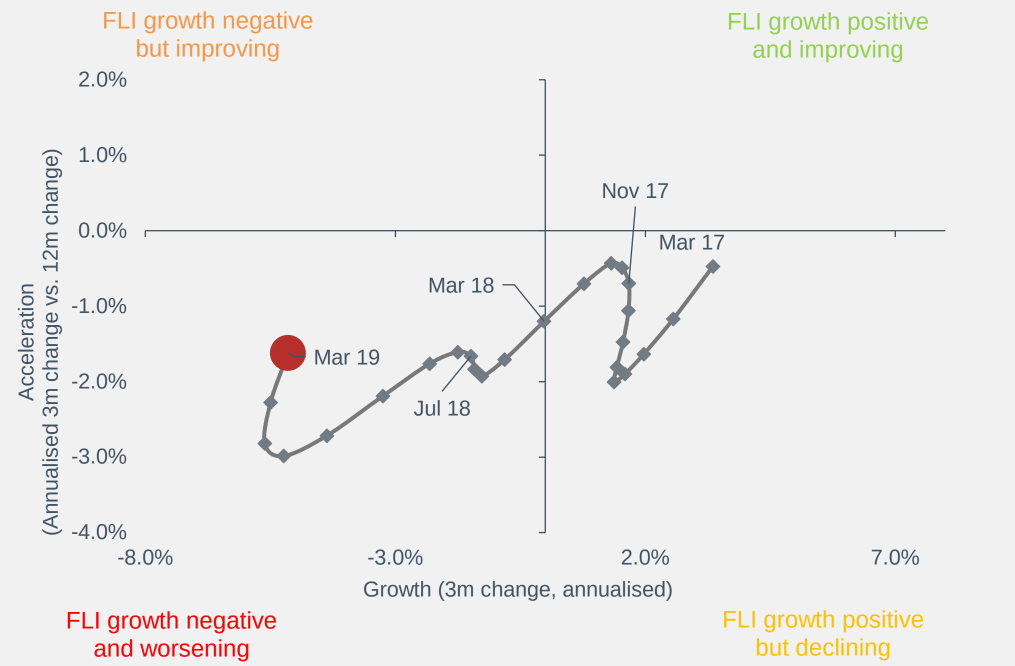
Macro

The Fidelity Leading Indicator implies some stabilisation, but it’s still too early to call for a sustained pick-up.

Fidelity INTERNATIONAL

Macro backdrop

Fidelity Leading Indicator (FLI)

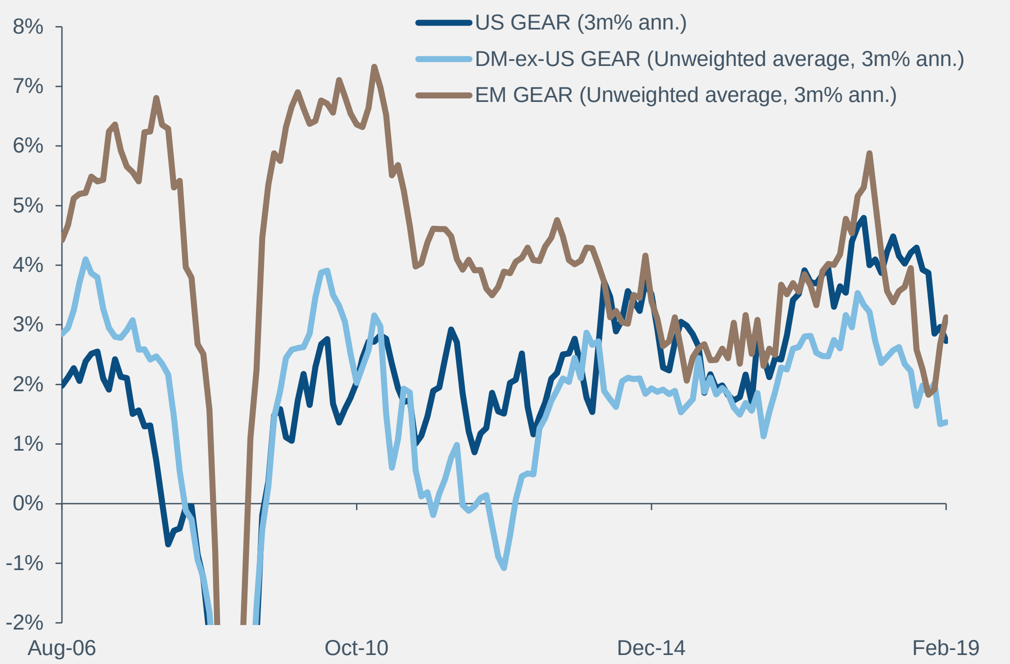


Source: Fidelity International, April 2019.

The FLI is a proprietary quantitative tool, designed to anticipate the direction and momentum of global growth over the coming months, and - importantly for investors - identify its key drivers. In practice, it is designed to lead global industrial production and other global cyclical variables by around three months. It is also available in a timelier manner than the bulk of official economic statistics.

The FLI is at a crossroads. It suggests very weak but tentatively improving growth into H2, with potentially plausible but not-yet-convincing drivers. The FLI has seen similar tick-ups to this in previous quarters, which have all proven short-lived. Last month, we called for actual data to confirm whether the Fed 'pausing' and China accelerating easing was enough to truly reverse the negative momentum in the global economy; this month's reading is a positive step. But it is still too early to determine whether 2019 will bring a genuine and meaningful reacceleration, or still-subdued growth and disappointment.

Gauges of Economic Activity in Real Time (GEARs)



Source: April 2019. The GEARs are a proprietary indicator of Fidelity International. 'Ex-US' includes.

The GEARs are a proprietary quantitative model monthly 'close-to-real-time' indicators of current activity across several key developed market and emerging market economies. Unlike the FLI, the GEARs are country-by-country instead of global in nature, and are intended as more of a 'nowcast' for activity levels, whereas the FLI explicitly aims to lead economic growth by several months.

The US still looks to be 'catching down' somewhat to the rest of the world, while Japan and the Eurozone are just about finding a foothold after a torrid time. The most notable improvement this month is undoubtedly China. Having finished 2018 with a weak showing, the GEAR has absolutely surged in March. A good portion of this will be 'excess seasonality' as it emerges from Lunar New Year, but the bounce is strong enough that much of it cannot be dismissed. This warmth has been felt widely across Asia, with Korea having a sharply better month despite a rough Q1 overall.

Views from Fidelity Multi Asset

Strongly negative ● ● ● ● ● Strongly positive

Asset class	View	Rationale
Regional equity		
US	○○○●○	The S&P 500 hit all-time highs in late April, with technology back leading the pack as it did for much of 2018, and volatility has declined for a fourth straight month. We favour value stocks and maintain our overweight position.
Canada	○○●○○	While the rally in oil has been a positive, there are still major issues with production exceeding pipeline capacity, and the housing market has softened significantly. A strong US continues to act as a tailwind, however.
UK	○○●○○	Despite an extension to Brexit, uncertainty remains. Long-term valuations remain fairly positive, and many FTSE 100 firms earn revenue outside of the UK, but we still think neutral is the most prudent position.
Europe ex. UK	○●○○○	The Eurozone remains highly sensitive to external factors, and to turn our view around, we would need to see more sustained signs of positivity out of China. ECB policy moves in 2019 have had muted impact so far.
Japan	○○○●○	We remain positive on Japan given attractive valuations and supportive policy despite some underperformance in recent months. Japan remains a defensive play on the Asia growth story.
Pacific ex. Japan	○○●○○	Hong Kong markets are becoming more attractive as the Chinese economy stabilises. The outlook on Australia is still negative given housing market weakness and consumption growth running ahead of wage growth.
EM	○○○●○	We remain positive on emerging markets given the dovish Fed and China credit growth, as well as better policy making by some EM central banks. It remains highly important to be discerning in such a diverse asset class.
EM - Asia	○○○●○	Chinese credit growth is a major tailwind for the region, but we are watching closely for any moderation after possible distortions from the New Year. Valuations remain attractive and fundamentals are also holding up.
EM - EMEA	○○●○○	Turkey is in recession, and questionable monetary policy and political decisions persist. Elevated oil prices and robust macro fundamentals in Russia are partly offset by sanctions risk. We remain neutral on emerging EMEA.
EM - Americas	○○●○○	Investor optimism is being hurt by political reality in Brazil. We expect growth to disappoint given slow reform and structural headwinds. Muted growth and political risks persist in Mexico, but newsflow has been positive.
Fixed income		
US Treasuries	○○○●○	Despite a high level consensus reducing our positive outlook for duration assets, we remain biased towards US duration assets as a defensive position in the event of any return to equity market volatility.
Euro core (Bund)	○●○○○	Very low yields persist, and our view is that there is little upside potential in the near and medium term. Bunds do maintain their status as an important defensive asset in Europe, however.
Euro periphery	○●○○○	While TLTRO extensions from the ECB are a positive sign for periphery banks, Italy is still heavily indebted and in recession. Our income range portfolios are short Italian government bonds to further hedge our underweight.
Inflation linked bonds (US TIPS)	○○○●○	Inflation hedging is still important after a prolonged period of easy monetary policy, despite signs of inflation remaining subdued.
Investment grade bonds	○○●○○	Quality remains a focus, and our income portfolios prefer short maturity USD denominated issues. The BBB space remains vulnerable to downgrades, and is an area we are watching closely in the late-cycle environment.
US high yield	○●○○○	We remain underweight given our belief that the rally is due to sentiment rather than fundamentals. We see more value in other regional markets, and see the US market vulnerable to any change in tone by the Fed.
European high yield	○○●○○	We maintain our neutral position as major headwinds in 2018 have started to reverse and TLTROs are a positive. However, we would have to see some improvement in Italy in order to add further.
Asian high yield	○○○●○	We remain positive on Asia high yield. Fundamentals remain resilient, and spread per-turn-of leverage ratio remains attractive. The strength of CNY and improvement in liquidity have turned headwinds into tailwinds.
Hard currency emerging market debt	○○○●○	We moved to overweight back in March, and have maintained this view due to continued Fed dovishness and a view that USD strength is unlikely to return to its aggressive appreciation like it did in 2018.
Local currency emerging market debt	○○○●○	A dovish Fed has continued to act as a tailwind for local currency EM debt. We maintain our conviction in this trade, and have not added back to the FX hedges that our income funds had in place for much of 2018.
Emerging market corporate debt	○●○○○	Given the late stage in the credit cycle at a global level, we prefer gaining selective exposure to emerging markets debt via government issuance, both USD denominated and local currency.
Currency		
USD	○●○○○	The Fed's abrupt end to rate hikes and 'QT', combined with slowing growth, falling core inflation, 'twin deficit' headwinds, and expensive fundamental valuations has us bearish on the USD against select currencies.
EUR	○○●○○	While the Eurozone remains challenged and the ECB is trapped at negative interest rates, the Euro now prices a lot of investor pessimism. An upturn in the external cycle could catch consensus off-guard, boosting EUR.
JPY	○○○●○	JPY remains attractive as a very cheap 'defensive' asset. There is upside potential as interest rate differentials decline as markets increasingly price in the next US downturn.

Source: Fidelity International, as at May 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.

Investing with 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 $42bn[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 March 2019.

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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