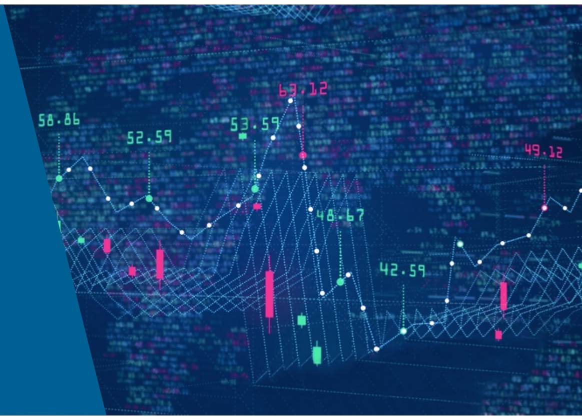
Global Market Outlook 2022

Catch-2022

Fidelity Future Leaders Fund

James Abela



Focus on sustainable quality amid recovery euphoria

2022 will likely be a strong market for recovery-led opportunities. We will see inflation from tight labour markets, elevated commodity prices, and rising costs of capital. Also, we expect higher volatility and increasing competition. As such, we prefer quality stocks with strong market positions.

Key points

- Companies with strong pricing power and robust market positions will be the winners in 2022.
- Businesses that cannot pass on rising costs will struggle to maintain their margins with increasing competition from higher economic activity.
- Future failures will likely be those with weak market positions or market structures and low customer entrenchment, as well as companies that have significantly benefited from the generously low cost of capital. We see profit pressures among the manufacturers, retailers, and construction suppliers that face significant challenges when passing through higher prices.

What is your investment outlook in 2022?

A strong economic recovery is underway alongside a wave of innovation, which is creating cyclical winners, structural growth compounders and innovation leaders. Earnings growth is evident in many sectors, such as consumer (retail recovery), industrials (activity recovery), healthcare (a resumption of structural growth and innovation), and financials (strong equity markets). Also, real estate, where asset values remain solid. Globally, some major markets show signs of a late recovery, while Australia seems to be in an earlier expansionary phase for 2022.

What do you think could surprise the market in 2022, either positively or negatively?

Strong equity markets are likely to continue, as cash flow and earnings growth should still produce surprises. Business confidence, as well as consumer confidence, remain supportive of capital investment and high employment growth. However, the likely outcomes for markets will be increased volatility and dispersion of performance. The benevolent equity market of 2021, with its forgiving valuations, generous risk tolerance, high liquidity, and record-low capital costs will likely become more discerning and less euphoric.

Which themes, sectors, or regions offer opportunities or potential risks?

In light of the above, we expect valuations to be recalibrated. Our QMTV (Quality, Momentum, Transition, Value) lens continues to deliver a clear perspective of the risk and reward available in the investment universe, which is reflected in the following table.

	Opportunity Feature	Concerning Features
Quality	High returns on capital Reasonable valuations Structural growth ***E.g. Healthcare Sector***	Returns on capital weakening Excessive valuations Earnings stumbling ***E.g. Software Sector***
Momentum	Cyclical recovery Below-peak cycle earnings and valuation Upgrades to come ***E.g. Copper, EV, Net Zero***	COVID-19-driven cyclical winners Valuations fading Earnings uncertain ***E.g. E-Commerce, BNPL, Loss making***
Transition	Milestones to recovery underway Positive balance sheets and the earnings outlook Constructive market sentiment ***E.g. Construction***	Uncertain cyclical outlook Sentiment and valuations are unclear Return profile changing ***E.g. Bricks and Mortar retail***
Value	Earnings, sentiment, valuation weak Low risk of balance sheet issues The company has a path to recovery ***E.g. Media***	Balance sheet risks are high Valuation and earnings outlook unclear Structural challenges ***E.g. Office real estate***

Source: Fidelity International, 2021

Within your portfolio, where do you have the highest levels of conviction, and which areas are you avoiding?

We continue to rely on our three-pronged investment philosophy of seeking businesses that offer viability, sustainability, and credibility. Therefore, we consistently focus on opportunities across the investment universe that reflect strong viability of returns that are expected to continue, and high sustainability across environmental, social, and governance (ESG) considerations. We also look at financial position, market structures, cash generation, and supportive credibility in terms of financial accounts, management, leadership, governance, and industry reputation. Our high conviction holdings sit across a range of consumer services, financial services, commodity, and software services names.

Do you expect sustainability factors to influence returns, and how is this reflected in your portfolios?

Sustainability is one of the three key pillars we use to assess companies, and our focus is on finding companies that operate under sustainable business models. In our view, businesses that severely harm the environment don't respect their employees, customers, or society at large. What's more, companies that do not honour the rights of minority shareholders are often filled with executives whose primary aim is to enrich themselves at the expense of the owners and, as such, have finite corporate lives. Within the context of the portfolio, we think about ESG holistically. This also applies at an individual stock level. The strategy's carbon footprint at a total portfolio level is a fraction of that seen in the benchmark, and it has a better ESG rating than the investment universe.