Fidelity INTERNATIONAL

Global Market Outlook 2022

Catch-2022

Fidelity Global Emerging Markets Fund

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New opportunities in emerging markets

It is hard to predict how markets will behave in a year's time. Still, we believe that most emerging economies' underlying structural growth trends will continue to drive corporate earnings and returns for investors over the medium-to-long term. While we remain aware of what is happening on the macroeconomic and political fronts, we will stay focused on the companies we either own or want to include in the strategy to drive alpha for our investors.

Key points

- The slowdown in China is allowing us to buy some very competitive industrial and consumer businesses at relatively attractive prices.
- Furthermore, strong opportunities are emerging in digital businesses across Latin America and EMEA (Europe, the Middle East and Africa) that stand to benefit from an increase in internet penetration and usage.
- While our sustainability considerations prevent us from owning energy businesses, we are actively looking for opportunities in the alternative energy space.

What is your investment outlook in 2022?

Emerging market equities saw a lot of volatility over the past year, and we expect this to continue in 2022. It's hard to predict how markets will behave in a year's time, but we continue to believe that the underlying structural growth trends in most emerging economies will keep driving corporate earnings and returns for investors over the medium-to-long term. As economies recover from COVID-induced disruptions and growing vaccine coverage makes global governments more confident about lifting mobility restrictions, this structural trend will receive a boost.

We will continue to follow our bottom-up research-driven process and philosophy of owning high-quality companies in sectors where structural growth opportunities exist. Top-down macroeconomic views will remain relevant for our assumptions as we assess factors such as drawdown risk, the cost of risk, discount rates, and hurdle rates. What's more, we will monitor macroeconomic and political developments while focusing on the details of the companies that we either own or want to include in the strategy to drive alpha for our investors.

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

One area that could surprise negatively is the future capital allocation policies of dominant and systemically important Chinese internet businesses. A large part of their dominance is state-driven, and we sense that it may not be favourable for these firms to be perceived as making a lot of money out of their position. In the past few months, many of these companies have been talking about investing back in society and common prosperity. Hence, while these businesses may continue to generate a lot of returns, this might not come back to minority shareholders.

On the positive side, we could see some favourable policies in China that support growth when the economy is going through a cyclical slowdown. Increased mobility, as COVID-induced restrictions are eased, could also be supportive in 2022.

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

We do see risks and opportunities for equity markets and the strategy in 2022. From a top-down perspective, the slowdown in China, driven by multiple factors including issues in the property sector, lower credit impulse, supply chain disruptions, and localised COVID outbreaks, remain a concern, and we think this backdrop will continue for the next few quarters. However, we also believe that this trend is healthy and will make long-term growth more sustainable.

Inflation continues to persist across the emerging and developed world and, unless there are coordinated rate hikes, is expected to remain high. But both these scenarios would have implications for emerging markets. We are pleased with the serious approach to inflation control via aggressive rate hikes (Brazil) and modest increases in other geographies. Higher energy and commodity prices are generally positive for emerging markets, but we need to see if this will hurt demand as some of the price increases are led by supply disruptions.

Also, we are in the middle of a two-year election cycle, and political noise will lead to volatility. It is always difficult to remain abreast of political change, so we will stick with our bottom-up approach and reflect the risks in our cost of equity instead. The good thing is that many of these risks are being reflected by valuations. Overall, we think that emerging market valuations are reasonable and in line with their long-term averages, as well as versus developed market equities.

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

From a bottom-up perspective, we see opportunities in China, where the cyclical slowdown is being reflected in share prices. This is allowing us to buy some very competitive industrial and consumer businesses at reasonable prices. Secondly, we remain bullish on large-cap technology companies in Asia, where valuations are attractive versus their long-term growth prospects. Thirdly, we remain overweight in Indian financials, as they are inexpensive for the structural growth opportunities on offer. Finally, strong opportunities are emerging in Latin American and EMEA-based digital businesses that stand to benefit from the increase in internet penetration and usage across these regions.

On the contrary, higher energy prices are a risk to the strategy, given our inability to find energy businesses that fit our process. We are averse to owning large, state-owned companies where environmental, social, and governance (ESG) policies are a concern or that are based in countries with higher political risks. To counter this, we are spending more time looking at opportunities in the alternative energy space.

Overall, the strategy is in good shape, and we believe there are more opportunities over the medium term to drive both absolute and relative returns for our investors.

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

Sustainability factors are important drivers of long-term returns, as well as for managing portfolio risk. Therefore, we focus on judging a company’s management quality and its ESG practices alongside fundamentals as a part of our basic due diligence process. For us, ESG factors are key to a company’s competitiveness and cost of capital. As a result, they form an integral part of our stock-selection process.

Given that emerging markets are at an early stage of the ESG journey, ethical disclosures are thin. However, in our experience, companies are willing to learn and improve as they realise how sustainability factors impact their cost of capital. Customers are also becoming ESG aware and keep such factors in mind while making their purchases. Companies that understand this trend will accelerate.

We work closely with our investee companies, encouraging them to improve on sustainability factors. Our portfolio compares positively with the benchmark on MSCI ESG ratings, with over 60 per cent of the strategy invested in businesses rated BBB and above.