Global Market Outlook 2022

Catch-2022

Fidelity Global Future Leaders Fund

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Robust performance expected from mid-sized companies

We expect global mid-cap equities to generate sustainable and healthy returns, with investors paying more attention to fundamentals versus the momentum-driven recent past. In 2022, we will consider the risks posed by inflation and continue to seek strong industry structures, capable management teams with capital discipline, and clear valuation-driven opportunities.

Key points

- The Global Future Leaders strategy scans the global small and mid-cap universe for the leaders of tomorrow and explores a range of themes that are expected to experience structural growth. We have an acute focus on sustainability, pricing power, market structures, brand strength, product differentiation and valuation discipline.
- Within the portfolio context, we think about environmental, social, and governance (ESG) factors both holistically and at an individual stock level to find businesses with a long runway of growth that can underpin robust outcomes for our clients.

What is your investment outlook in 2022?

We expect global mid-cap equities to continue generating healthy returns for investors. That said, we expect more moderate and sustainable gains relative to the bottom of the pandemic-induced crash of March 2020. The initial phase of a market upturn is usually driven by expansion, as investors anticipate the recovery. This period usually produces explosive gains. However, as the economy recovers and business fundamentals improve, the earnings recovery takes over as the primary driver of shareholder returns. This is where we are now. There is usually some increase in volatility, too, as we move into this phase, and it is quite typical to have mild drawdowns from time to time.

The benefit that the equity market still holds is its real earnings recovery and growth outlook relative to low-yielding bonds.

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

In our 2021 outlook, we cautioned that inflation was likely to pick up, and it did. Some of this was due to temporary or transient factors that would subside over time once the lockdowns ended and manufacturing and global supply chains normalised. In recent weeks, company management teams have warned about rising labour costs, which tend to be sticky. Labour cost is a key component of inflation, alongside housing. Bond markets have already anticipated that central banks will need to act sooner than they had previously communicated. However, equity markets have yet to adjust, as rising yields impact equity valuations, while increased labour costs can impact corporate profit margins. This could lead to some choppiness and volatility as the equity markets digest this new reality.

Our holistic investment approach in 2022 will consider the risk of broad-based inflation, higher debt costs, rising commodity and property prices, and tighter labour markets, as well as increasing wages and higher levels of competition.

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

The Global Future Leaders strategy scans the global small and mid-cap universe for the leaders of tomorrow and explores a range of themes that are expected to experience structural growth. The table below provides insight into the sectors and associated themes that we are exploring.

Sector	Global Future Leaders' Themes
Technology	▪ Software as a service ▪ Data centres and cloud ▪ Subscription-led content models ▪ Connectivity enablers and 5G ▪ Artificial Intelligence
Energy, Resources, and Utilities	▪ Solar ▪ Wind & hydro ▪ Other Renewables ▪ Electric vehicles ▪ Green steel
Consumer	▪ Online retailers ▪ Environmentally conscious ▪ Plant-based foods ▪ Social gaming ▪ Mass market luxury
Financials	▪ Fintech services ▪ Virtual banking ▪ Global exchanges ▪ Trust and advisory ▪ Customised insurance
Healthcare	▪ Medical technology ▪ Contact development outsourcing ▪ Managed care ▪ Pharmaceuticals

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

We believe that some of the best opportunities lie in high-quality companies with competitive advantages in good industry structures. These are managed by competent individuals and bought at reasonable prices. Such businesses will have some inherent pricing power, allowing them to protect margins by passing on increases in labour costs to consumers. Areas that we would deem vulnerable are loss-making businesses or those with valuations that exceed their peers. The former require access to outside capital to keep funding their aggressive growth ambitions at a time when this funding is becoming more expensive. At the same time, the latter may experience significant corrections in their stock prices as discount rates continue to increase.

We will maintain an acute focus on sustainability, pricing power, market structures, brand strength, product differentiation and valuation discipline to manage 2022 well.

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 (the other two being viability and credibility). In looking for the future leaders of tomorrow, we are primarily interested in finding firms that operate under sustainable business models. In our view, businesses that severely harm the environment *fail* to respect their employees, customers, or society at large. Furthermore, these companies do not honour the rights of minority shareholders and are filled with executives whose primary aim is to enrich themselves at the owners' expense. In our view, these names have a finite corporate life. Within the context of the portfolio and at an individual stock level, we think about ESG factors holistically. For example, we will refuse to invest in harmful corporations that include tobacco or cluster munitions whilst simultaneously investing in businesses that enable clean energy (e.g. solar). Our carbon footprint at a total portfolio level is a fraction of that seen in our benchmark. In aggregate, our portfolio's ESG rating is relatively superior to that of our universe.