EQUITIES OUTLOOK APR 2021

# Equities continue ascent

**Fidelity International's outlook from the Equities investment team**

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Fidelity INTERNATIONAL

# Executive summary

## Balance of risks to the upside, but don't count on a smooth ride

US equities posted new highs, demonstrating some degree of adjustment to higher bond yields and some faith in central banks because short dated yields have remained contained. But investors should be cautious.

In the short term, the picture looks rosy. Earnings are expected to surge this year, vaccines are doing their job in slowing the rate of infections and liquidity is abundant. The VIX - a measure of volatility in the S&P 500 - has even dipped below 20 for the first time since the start of the pandemic.

However, the unprecedented level of fiscal spending from governments is not a fix without risks and central banks are trapped in a low rate regime for fear of triggering waves of defaults given the mountain of debt in the financial system. This is creating the potential for longer term excesses.

The vaccine is not a panacea either. Further mutations of Covid are almost certain and a number of countries are facing third waves of the virus. With less than 2.5% of the global population fully vaccinated, we can expect Covid to be with us for years not months.

As investors shift attention over time to other concerns - debt, inflation, fiscal imbalances, tensions with China - we expect bouts of choppiness. Overall, the balance of risks in the near term for equities is to the upside, but don't count on a smooth ride.

**Romain Boscher**
Global CIO, Equities

The Equities Outlook provides an overview of our investment team's views and positioning in each of the key markets. Each of our portfolio managers has discretion over the positioning and holdings of their portfolios, and, as a result, there may at times be differences between strategies applied within a fund and the views shared in this document.

# Contents

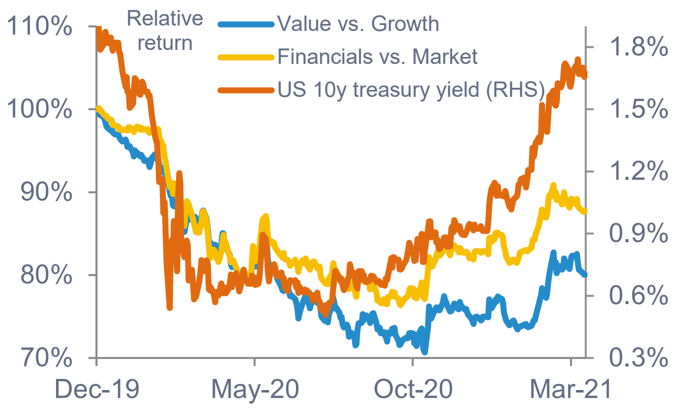
# Trading desk update

## New equities high and flood of SPAC IPOs

The S&P 500 finished March +4.2%, posting a new all-time high despite US rates continuing to rise. The yield on US 10-year treasuries pushed through 1.7% to finish the month 35 basis points higher.

Growth and 'stay at home' stocks were sold to fund purchases of value and 'reopening stocks' as vaccine rollouts gain momentum; long value outperformed secular growth by 13.5%.

### Surging yields support recovery stocks




**Source:** Refinitiv DataStream, Bloomberg, 7 April 2021. Indices data for MSCI AC World and its sub-segments.

The first quarter saw a record issuance of US$ 226 billion, surpassing the previous high of US$ 174 billion set in Q2 2020. Perhaps more surprising was the surge in interest in SPAC vehicles. A total of 278 SPAC IPOs raised US$ 90 billion - more than the whole of 2020 - compared to US$ 26 billion from 65 traditional floatations. Investor positioning is positive, demonstrated by the market's impressive capacity to absorb supply from issuance, tax selling, and several significant block trades.

Investors will now be looking towards US President Biden's infrastructure proposal and tax reforms and the readthroughs to inflation. Fading volatility (the VIX has dipped below 20) should awaken demand from systematic funds.

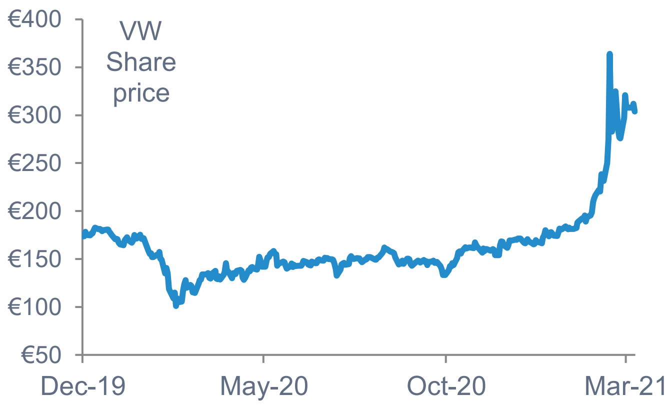
## Europe outpaces the US

In Europe, the Stoxx 600 rallied 6.1%, outperforming US equities and delivering 8.3% so far this year. The market looked past rising Covid infections however, it was choppy - the real moves seemingly happened beneath the surface with pivots in themes almost from day to day. Fund data at the end of March shows the largest weekly inflow into Europe since the start of February. Outflows since the start of the year have now been completely offset.

The month ended strongly with the focus on congressional passing of the US fiscal plan, solid European PMI data and an uptick in vaccine roll outs. Reflation, vaccine and cyclical stocks all performed well.

Autos were the standout industry posting a 17% gain from cheap valuations, a reduction in US/European trade tensions and ongoing interest in the electric vehicle/ESG theme.

### Upbeat EV forecast and retail interest boost Volkswagen




**Source:** Refinitiv DataStream, 7 April 2021.

Banks did well seeing both institutional and hedge fund demand as the ECB signalled a faster pace of PEPP purchases, but the broader financials sector was dragged down by large a decline in LSE, following US$ 1 billion placing, and Credit Suisse after the impact of the Archegos liquidation.

## Asia dragged down by tighter Chinese policy and geopolitical concerns

The story in Asia was very different to Europe and the US. Tightening monetary policy in China, with a dip in onshore margin trading transactions, and a worsening geopolitical outlook following a contentious meeting between the Biden administration and their Chinese counterparts, meant that the MSCI Asia ex Japan index fell 4.3%.

We also saw meaningful volatility in Asian ADRs after a series of block trades in specific Chinese tech names. These stocks will be under scrutiny in the second quarter amid escalating talk of US delistings and greater domestic oversight.

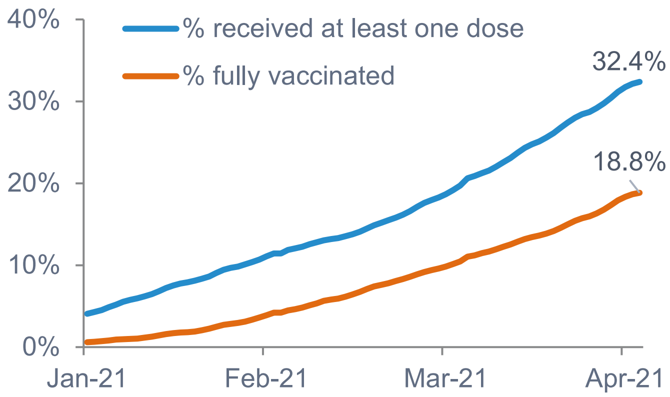
# US

## Boost from vaccinations and stimulus, but bond yields remain high

US equities continued to rise in March, boosted by fresh stimulus measures and ongoing vaccinations, although rising bond yields and inflation concerns dampened sentiment. The month started weak on fears of inflationary pressures and a lack of clarity from the Federal Reserve over whether Operation Twist would be used to stabilise long-term rates. However, by mid-March the rally resumed after Congress approved President Joe Biden's US$1.9 trillion Covid-19 relief package. The momentum continued as the Biden administration announced a US$2 trillion infrastructure plan.

The vaccine drive is also progressing well with roughly 32% of the population receiving at least one dose and 19% fully inoculated as of 6 April. Fears of vaccine shortages appear to have been dispelled as the government confirmed 90% of all adults will be offered the injection by mid-April.

### Rapid vaccine roll out in the US boosts market



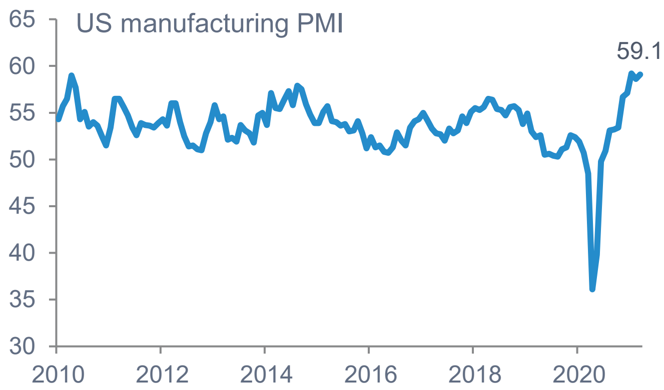

**Source:** Our World in Data, 6 April 2021.

Utilities, industrials and consumer staples were the best performers, value stocks significantly outperformed growth and quality, and large-caps outpaced small and mid-cap names.

## Encouraging economic data

Manufacturing activity continued to expand amid a surge in new orders and supply constraints, data. The Purchasing Managers' Index (PMI) rose to 59.1 in March - the second strongest improvement since records began in May 2007. Manufacturing activity grew for the ninth consecutive month and the pace of growth for factory activity further increased.

### US macro indicators point to speedy recovery




**Source:** Refinitiv DataStream, March 2021.

## Macro support as the we enter Q2

The macro climate has solid support as we enter the second quarter. Stimulus payments of US$1,400 have started to roll out and will continue through April to back the fragile economy. Vaccinations will help in reopening businesses, while hopes of another US$2 trillion targeted at the US's aging infrastructure should boost economic growth and create jobs.

However, concerns over the steepening yield curve and long-term interest rates continue to weigh on investor enthusiasm. Inflationary headwinds are a concern as they translate into higher yields, which could hurt investment and affect the recovery. Shortages in microchips could also impact more industries. We continue to believe that the move into cyclicals and out-of-favour value names has further scope, particularly in tandem with news on slowing infections and greater vaccine coverage, but a more lasting structural shift will depend on sustained economic growth and further reduction in virus-related uncertainty.

# Europe

## Strong earnings and economic data lift Europe

Strong corporate earnings and improving economic data supported equities despite the continued rise in US bond yields. In the face of renewed lockdowns in France, Germany and Italy, investors remained optimistic focussing on US fiscal stimulus and the progress made in vaccine roll outs.

Uncertainties around the medium-term growth outlook have settled, with the ECB's announcement to continue purchasing assets under the pandemic emergency purchase programme (PEPP) until at least the end of March 2022 stabilising real interest rates. The ECB is likely to step-up asset purchases in the coming months.

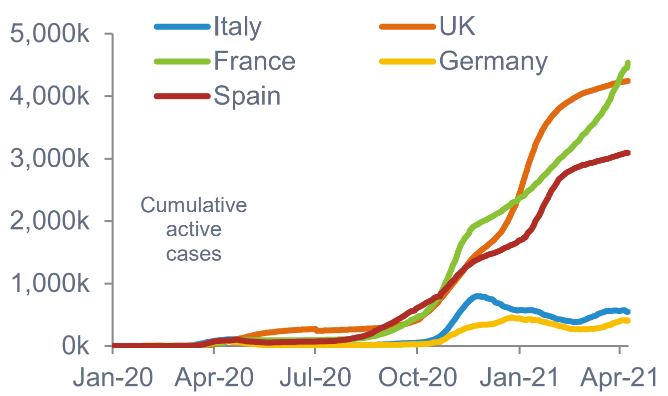
Eurozone business activity returned to growth in March, supported by a sharp acceleration in manufacturing output given a revival in global demand. However, extended virus-related restrictions continued to hurt the service sector, although the scale of the decline this month was the lowest since last August. The flash eurozone composite output index rose to 52.5, reaching an 8-month high.

Growth and defensive names underperformed, while economically sensitive sectors outperformed. Consumer discretionary, consumer staples and industrials led. Large-cap stocks outperformed small and mid-caps.

## Any delay in reopening could spark volatility

In the EU, vaccine supply challenges and rising caseloads have triggered fresh lockdowns in places, but the overall outlook for European equities is cautiously optimistic.

### Rising Covid cases led to more restrictions




**Source:** Refinitiv DataStream, 8 April 2021.

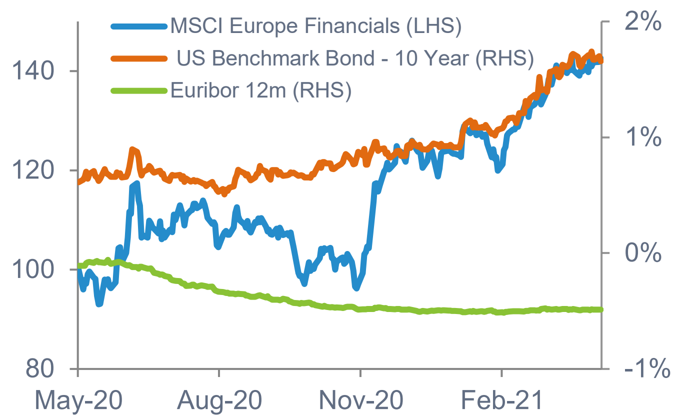
Investors expect 2021 to be a year of recovery and this has translated into strong market performance, but much of the recovery has already been factored into share prices. This makes us somewhat cautious as any disappointment or delay in reopening economies in Europe could spark further volatility.

## Reflation trade in US may not be replicated in Europe

European financials, particularly banks, have risen sharply driven by expectations of higher US interest rates. But rising yields in the US as the reflation trade plays out will not necessarily translate in to increased rates in Europe. Indeed, the relevant benchmark for pricing European loans, 12-month Euribor, has hardly moved. If it does, the debt levels of Euro member states may not be serviceable at interest rates over 1% and would need very high GDP growth rates compared to the last 20 years to support them.

Higher rates could also jeopardise banks' fee income from asset management services. In the absence of a meaningful rise in European interest rates, we expect lower bank net interest income as most banks have to reinvest their bond portfolios at a time when most sovereign debt is offering negative yields.

### Higher yields in US may not translate to higher rates in Europe



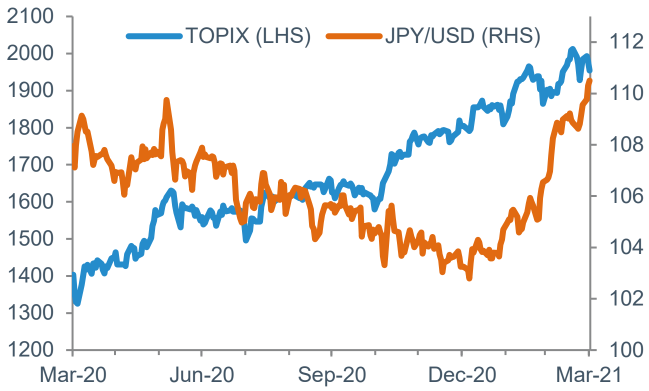

**Source:** Bloomberg, Refinitiv DataStream, March 2021.

# Japan

## Equities rise on global vaccination drive and weaker yen

Japanese equities advanced in March as a weakening yen, continuing vaccinations globally and a large Covid relief package in the US supported buying interest. The widening foreign-domestic yield differentials led to weakening in the yen, which crossed the JPY 110 mark against the US dollar.

### Japan equities helped by yen depreciation




**Source:** Refinitiv DataStream, 31 March 2021.

There was some pressure for share prices later in the month due to a renewed spike in bond yields, profit taking, an increase in infections in Europe and an announcement by the Bank of Japan's (BoJ) that it would limit purchases of Nikkei-linked exchange-traded funds.

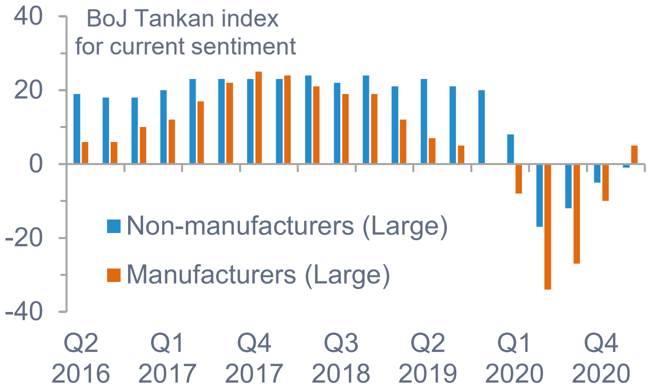
Value names continued to outperform growth, while small-caps outpaced their mid and large-cap counterparts.

### Large manufacturers' sentiment improves

The BoJ's closely watched Tankan survey showed growing optimism. The quarterly survey's headline index for large manufacturers' current sentiment stood at +5 in March, a considerable improvement from the -10 reading in December. Current sentiment among large non-manufacturers also improved but remained in negative territory, illustrating a far slower rebound compared to manufacturers.

Industrial production fell in February as an earthquake and semiconductor shortage led to declines in the production of cars and electrical machinery. Official data showed that industrial production shrank 2.1% from the previous month in February, however, the au Jibun Bank's manufacturing PMI rose to 52.0 in March from a final reading of 51.4 in February after new order volumes expanded at the fastest pace since October 2018.

### Divergence in sentiment between manufacturers and non-manufacturers




**Source:** Bank of Japan, Tankan - Business Conditions - Diffusion Index, March 2021.

## BoJ tweaks policy

The BoJ maintained its negative interest rate and tweaked its monetary easing programme. The adjustment, which marginally expands the acceptable range of fluctuation in long-term rates for 10-year bonds, could be a forerunner to further modifications in policy. The bank also said it would allow more flexibility in its stock purchases, dropping an annual target for its intervention in the Tokyo stock market, which has strongly recovered since early 2020.

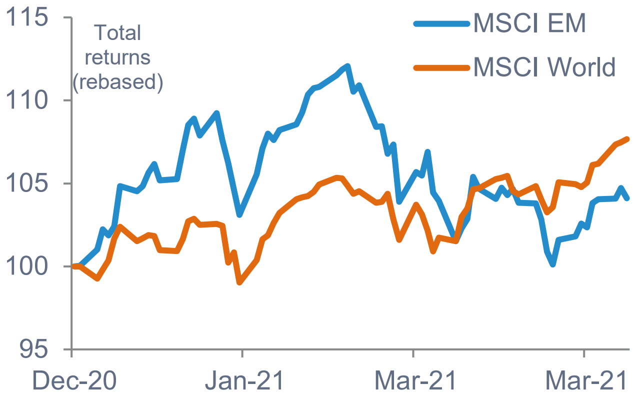
The central bank's yield curve control policy has been in place to keep short-term interest rates at -0.1% while guiding the 10-year Japanese government bond yield around 0%. After the review, the BoJ said the yield can move around 25 basis points in either direction from zero, slightly wider than the previous 20bps limit. The BoJ believes that interest rates should remain low as the pandemic drags on, but fluctuations within the range will not hurt the overall objectives of its easing policy.

# Emerging markets

## Higher US yields weigh on emerging markets

Emerging markets fell and underperformed developed markets as risk assets faced pressure from higher US treasury yields. Rising Covid cases and potential renewed lockdowns in some countries further hurt sentiment. US dollar strength sent emerging market currencies down and oil prices were weaker despite OPEC extending supply cuts into April with Saudi Arabia committing to maintaining its 1 million barrel per day cut.

### Emerging markets underperform on pandemic worries




**Source:** Refinitiv DataStream, 7 April 2021.

## South Africa stands out as it keeps rates steady

Emerging Europe, Middle East and Africa (EMEA) was the best performer within EM, followed by Latin America. South African stocks rallied as the rand counterintuitively strengthened against the US dollar after the former's central bank held interest rates at a historic low of 3.5% in contrast to Russia, Turkey and Brazil, which increased interest rates amid higher yields in the US. While there's no obvious catalyst to the rand's resilience, South Africa's current account surplus and overall commodity price strength are supportive.

In Latin America, Mexico, Chile and Brazil all performed well. Mexican equities rose in line with the strengthening peso, while Brazil was supported by better-than-expected Q4 GDP.

Emerging Asia was weighed down by weakness in China. Indian equities outperformed as the country expanded its vaccination campaign and the economy returned to growth in the December quarter. Bank stocks did particularly well after the supreme court decided against extending the loan-repayment moratorium implemented last year.

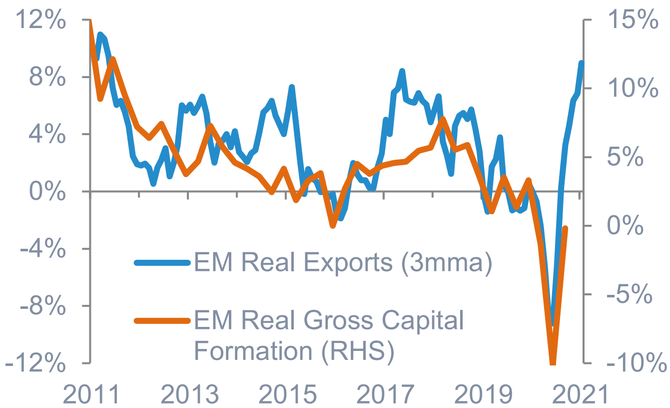
## EM run can continue

Emerging markets equities reached a new high in early 2021 having cast aside pandemic woes. There are reasons to suggest that the strong run can continue.

Encouraging macroeconomic indicators point to a synchronised recovery in global growth that emerging markets could benefit from. EM exports in January 2021 touched the highest level since 2017 and China and Korea export data for February and early March confirm the strength. Domestic demand shows signs of accelerating in Brazil and India where demand for is rising. Consumer spending in Russia has also been trending upwards.

From a valuation perspective, the discount in emerging market stocks to developed markets is still wide with several countries positioned to benefit from a closing of the gap. Indeed, the balanced nature of emerging markets means that as markets have rotated towards cyclicals, EM has fared well. In addition, structurally low interest rates and a substantial fiscal deficit in the US are potentially negative for the US dollar and positive for emerging markets.

### Export strength and capex cycle recovery




**Source:** Morgan Stanley Research, March 12, 2021, Haver Analytics, national sources, IMF, MS.

# Asia Pacific ex Japan

## Fears around tighter policy in China

Asia Pacific ex Japan equities ended down in March due to tighter liquidity in China alongside messaging from authorities that cooled investor sentiment, a stronger US dollar, weaker vaccination trends and a shift away from dominant ‘growth’ areas of the market. In China, the US Securities and Exchange Commission’s (SEC) new Holding Foreign Companies Accountable Act led to fresh fears of delistings from US exchanges.

Chinese factory activity in March expanded at the slowest pace in almost a year on weaker overall domestic demand. The March PMI dropped to 50.6, the lowest level since April 2020. The government also announced its economic growth target of "above 6%" in 2021.

### China's factory output slips to 9-month low


**Source:** Refinitiv DataStream, March 2021.

There was also greater caution around growth stocks as valuations become increasingly stretched. Communication services and consumer discretionary were among the weakest performers, while utilities and industrials were among the leading gainers.

## Investors look to global trends in India

Indian equities outperformed the broader Asia Pacific region with investors largely ignoring concerns over increasing Covid cases and building inflationary pressures in favour of a sustained recovery in economic activity, higher corporate earnings and increasing vaccinations. Taiwanese and Korean stocks remained resilient amid ongoing tech-cycle strength. South Korea’s exports rose to a 2-year high as gains in manufacturing activity continued.

Australian equities were lifted by financials, which climbed on higher bond yields. Indonesia fell after its currency slid to its lowest level in nearly five months as rising US yields hurt sentiment. Malaysia and the Philippines were also under pressure. Thai equities were supported by the country’s upbeat outlook with hopes of borders reopening soon.

## Attractive valuations as economic momentum builds

The outlook for Asia Pacific ex Japan is positive as economies rebound and excess liquidity drives corporate earnings higher. The region offers long-term earnings growth underpinned by structural growth prospects and attractive fundamentals compared to developed markets. The region trades on 12-month forward price to earnings ratio of 16x, well under 22x for the US and 20x for the MSCI World index. Price to book multiples are similarly attractive.

Despite the recent spike in infections in some countries, the suppression of the virus has been more effective in Asia than elsewhere and a successful vaccine roll out should further support the outlook. Expectations of an exit from the pandemic due to the rapid rate of vaccinations is still in play for markets and we continue to expect pent-up demand from domestic consumers and ongoing loose monetary policy to support economies.

### Asia relative valuation looks attractive


**Source:** Refinitiv DataStream, March 2021.

# Market Data

**GLOBAL**

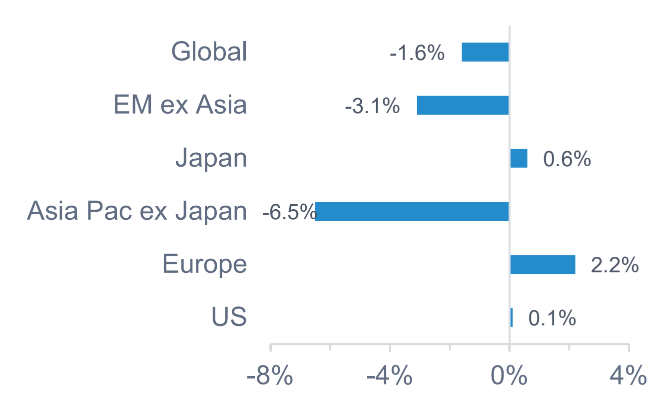
Absolute Returns (USD)

| | | 1 Month | 3 Months | YTD | 1 Year |
|---|---|---|---|---|---|
| INDEX | MSCI AC World | 2.7 | 4.7 | 4.7 | 55.3 |
| SECTORS | C Disc | 1.4 | 2.3 | 2.3 | 78.0 |
| | C Staples | 6.1 | -0.7 | -0.7 | 25.4 |
| | Energy | 2.2 | 18.0 | 18.0 | 51.7 |
| | Financials | 4.3 | 11.6 | 11.6 | 58.0 |
| | Health Care | 2.4 | 0.6 | 0.6 | 30.8 |
| | Industrials | 5.8 | 7.6 | 7.6 | 62.8 |
| | IT | 0.4 | 1.9 | 1.9 | 72.3 |
| | Materials | 3.5 | 6.5 | 6.5 | 77.4 |
| | Telecom | 0.3 | 6.7 | 6.7 | 57.9 |
| | Utilities | 7.5 | 0.8 | 0.8 | 23.8 |
| | Real Estate | 4.3 | 6.2 | 6.2 | 31.0 |
| MAJOR MARKETS | US | 3.8 | 5.5 | 5.5 | 59.3 |
| | Europe | 3.2 | 4.2 | 4.2 | 45.7 |
| | EM ex Asia | 4.8 | 2.9 | 2.9 | 52.1 |
| | Asia ex Japan | -2.5 | 2.8 | 2.8 | 57.8 |
| | Japan | 1.2 | 1.7 | 1.7 | 40.2 |
| STYLES | Value | 5.1 | 9.0 | 9.0 | 49.9 |
| | Growth | 0.2 | 0.3 | 0.3 | 59.3 |
| | Quality | 2.8 | 3.3 | 3.3 | 53.1 |
| | Risk | 2.7 | 3.8 | 3.8 | 46.2 |
| | Momentum | -2.5 | -1.1 | -1.1 | 54.4 |
| | Large Cap | 2.8 | 4.5 | 4.5 | 53.3 |
| | Mid Cap | 2.3 | 5.5 | 5.5 | 66.3 |
| | Small Cap | 2.1 | 9.3 | 9.3 | 82.7 |

Absolute Returns (Local)

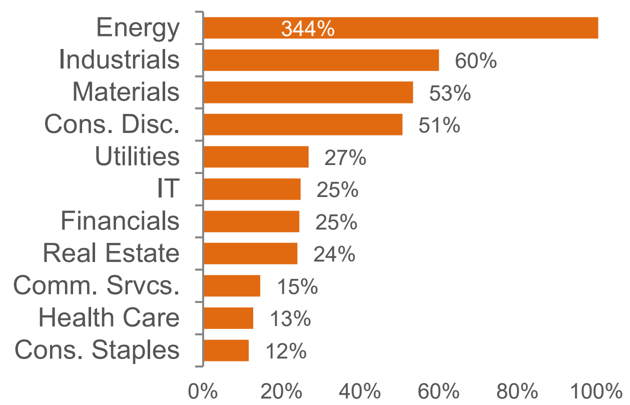
| | | 1 Month | 3 Months | YTD | 1 Year |
|---|---|---|---|---|---|
| INDEX | MSCI AC World | 3.6 | 6.0 | 6.0 | 51.8 |
| SECTORS | C Disc | 2.3 | 3.7 | 3.7 | 75.3 |
| | C Staples | 7.3 | 0.9 | 0.9 | 21.5 |
| | Energy | 2.9 | 18.9 | 18.9 | 45.1 |
| | Financials | 5.2 | 12.9 | 12.9 | 51.9 |
| | Health Care | 3.3 | 1.9 | 1.9 | 28.5 |
| | Industrials | 7.2 | 9.8 | 9.8 | 58.9 |
| | IT | 0.9 | 2.7 | 2.7 | 70.3 |
| | Materials | 4.7 | 8.4 | 8.4 | 68.0 |
| | Telecom | 0.8 | 7.6 | 7.6 | 56.3 |
| | Utilities | 8.5 | 2.1 | 2.1 | 20.3 |
| | Real Estate | 5.1 | 7.3 | 7.3 | 28.8 |
| MAJOR MARKETS | US | 3.8 | 5.5 | 5.5 | 59.3 |
| | Europe | 6.2 | 7.7 | 7.7 | 35.2 |
| | EM ex Asia | 5.0 | 6.0 | 6.0 | 46.1 |
| | Asia ex Japan | -1.8 | 4.0 | 4.0 | 53.1 |
| | Japan | 5.0 | 8.9 | 8.9 | 43.5 |
| STYLES | Value | 6.0 | 10.3 | 10.3 | 46.1 |
| | Growth | 1.1 | 1.7 | 1.7 | 56.0 |
| | Quality | 3.6 | 4.3 | 4.3 | 50.0 |
| | Risk | 4.0 | 5.9 | 5.9 | 39.5 |
| | Momentum | -1.9 | -0.3 | -0.3 | 51.0 |
| | Large Cap | 3.6 | 5.7 | 5.7 | 50.0 |
| | Mid Cap | 3.4 | 7.2 | 7.2 | 61.2 |
| | Small Cap | 3.1 | 10.9 | 10.9 | 77.1 |

## FIL earnings forecasts vs consensus (FY21)




**Source:** Fidelity International, 31 March 2021.

## FIL sector earnings forecasts (FY21)




**Source:** Fidelity International, 31 March 2021.

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