EQUITIES OUTLOOK JUNE 2021

Tapering narrative becoming stronger

Fidelity International's outlook from the Equities investment team

For investment professionals only

Fidelity INTERNATIONAL

Executive summary

Inflation likely to be transitory, but tapering narrative will stay for some time

The narrative of economic recovery is increasingly being challenged by the risk of central banks tapering asset purchases. Recent monthly US core CPI and core PCE readings were their highest since the early 1990s and well above the Federal Reserve's target rate. The concern is that the Fed will reduce liquidity support sooner than expected.

The spike in inflation is likely to be transitory given the low base set during the lockdowns last year and as economies gradually normalise, but this is not to say that inflation cannot become more persistent later on. It's important to track economic data points including non-farm payrolls, jobless claims, PMIs, inflation and yields, and all these feed into the other great tension at the moment in equity markets between cyclicals and growth stocks.

Broadly speaking, prints that confirm a hotter economy support cyclicals while undershoots support growth stocks. Central bank communications will also have to tread carefully to avoid spooking the markets. In addition, a global corporate tax floor, agreed in principle by G7 members, will disproportionately affect multinational growth companies.

Equity markets look ahead, and they are currently watching early 2022 when tapering is expected to start. If central bankers can get equity traders accustomed to the idea, there could be a relatively benign effect from a reduction in monetary support, but it's a difficult balance. Stock pickers can protect themselves with companies that have the pricing power to withstand higher costs.

Toby Gibb
Global Head of Investment Directing, 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.

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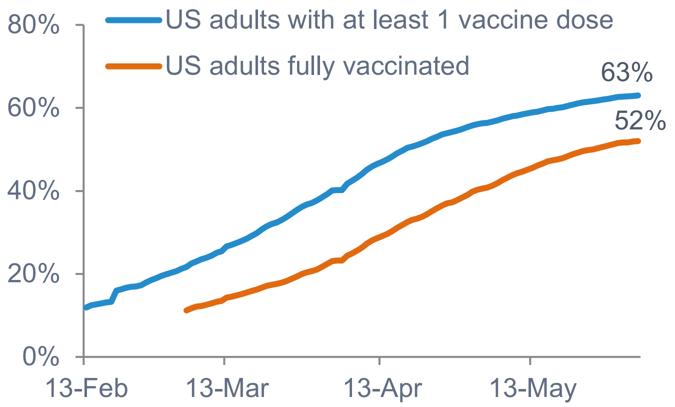
Trading desk update

Inflation debate intensifies amid a modest rise in the US equities

The S&P 500 was up a modest +0.6% in May and captured a new all-time high, while the Nasdaq fell 1.3% over the month. Better economic data including the highest US core CPI reading in around 30 years and good progress on the vaccination programme, with 40% of US adults now fully inoculated, enabled cyclicals to outperform secular growers by 7% and the broad value factor to outperform the growth factor by 5%. This did also intensify the debate around inflation and potential tapering from the Federal Reserve.

Progress on vaccinations in the US boost markets



Source: US Centers for Disease Control and Prevention, 3 June 2021.

IPO's pulled amid volatility

The IPO market faced challenges from the volatility in markets during May. After reaching all-time highs in February, the Renaissance IPO ETF, which tracks a basket of the most liquid newly listed public companies in the US, sold off aggressively, declining 29% to its May low. A handful of planned floatations were postponed due to market conditions.

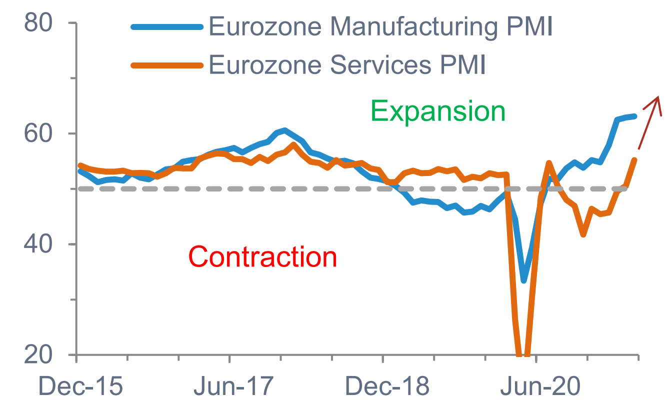
European macro data extending lead over US

Cyclicals and growth led strong gains in Europe over May. European macro data beat expectations and is outperforming the US with almost the widest differential we've seen in the last 5 years, making the investment case for Europe even more compelling.

Flash PMIs continued getting stronger supporting the re-opening rebound and lifting cyclicals. Global central bankers are also continuing to push back against inflationary risks, which resulted in yields falling somewhat and the rebound in growth from depressed levels versus value showed signs of slowing down.

The last week of May produced the largest weekly inflow into European equities since February 2018 with a pervading 'buy the dip' mentality particularly as the EU Recovery Fund nears ratification. UK names starting to see a lot of bid speculation with four deals totalling more than US$1 billion in the final week of May and in Germany a multi-billion euro real estate combination between two Dax 30 constituents.

Easing restrictions in Europe spark revival in services



Source: Markit, Refinitiv DataStream, May 2021.

Weakening US dollar offsets infections and inflation in Asia

The MSCI Asia-Pacific ex Japan index rose 1.2% in May, performing in-line with MSCI AC World. Faster than expected inflation data from the US at the start of the month hurt equities before a weakening US dollar helped drive a solid recovery. However, there was a drag on returns from a resurgence in Covid-19 infections in countries including Taiwan, Singapore, Thailand and Malaysia, a slow vaccine roll-out, and regulatory risks in China's tech sector.

The commodities market played an outsized role in the performance of Hong Kong equities. Rising concerns over margin erosion from the spike in commodity prices and global inflation gave way to Chinese regulators stepping up efforts to curb soaring commodity prices. The Hang Seng ended the month gaining 1.5%.

In China, the unwinding of internet names was a key drag for the first half of the month, but this was offset later as excess liquidity was driven into equities as the government addressed commodity prices and cracked down on cryptocurrencies, and the Yuan rose sharply against the US dollar.

US

Close to all-time highs but inflation worries cap gains

US equities gained marginally over the month as major indices traded close to all-time highs. A highly stimulatory fiscal and monetary policy environment and a swiftly recovering economy supported markets. The US Congress also appears to be reaching a consensus on the massive infrastructure bill. Strong corporate earnings have also supported returns, however, inflation concerns, rising input costs and a tight labour market led to uneven performance over the month.

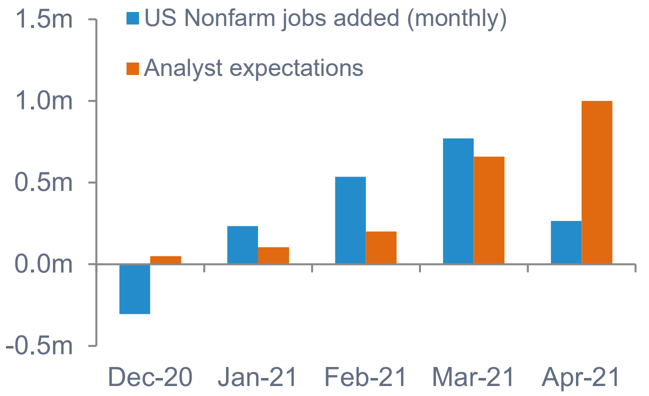
A combination of supply shortages, price normalisation in certain sectors and pent-up demand contributed to a strong headline inflation reading in April. Inflation expectations appear to be surging but it remains to be seen if pricing pressures are merely transitory or if they could develop into a more lasting impact once supply bottlenecks normalise.

Solid data despite jobs disappointment

Roughly 40% of the US population has been fully inoculated and the economy has mostly reopened, with many states ending isolation and reintroducing standard working hours. Business surveys are at multi-decade highs, supported by re-openings.

The IHS manufacturing Purchasing Managers' Index (PMI) rose to 62.1 in May, up from 60.5 in April. Although most economic indicators suggest a rebound in business activity, the lacklustre rise in monthly jobs added disappointed investors despite jobless claims falling significantly from pandemic highs.

US added fewer jobs than expected in April



Source: Bureau of Labor Statistics, Bloomberg, April 2021.

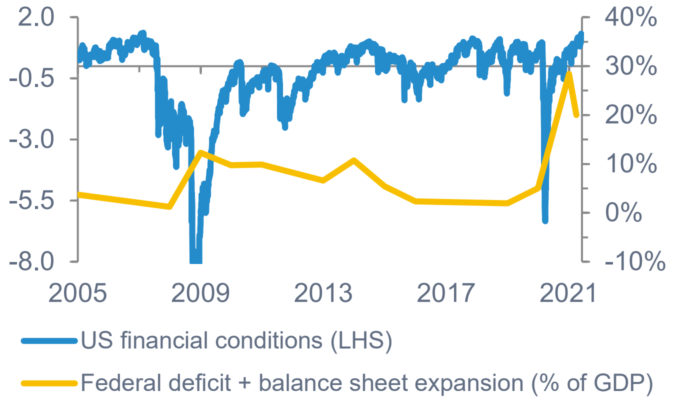
Easy financial conditions improve the growth outlook

US financial conditions are the easiest they have been in many years, supported by massive stimulus packages. Together with the accelerating vaccination campaign and the re-opening of state economies, the economic growth outlook has been boosted.

Easier financial conditions are positive for growth in the near term because they encourage borrowing and spending by companies and consumers. The OCED recently noted it expects the US economy to grow 6.9% this year, up from the previous forecast of 6.5%.

However, inflation fears have started to make investors nervous about a potential shift in the Federal Reserve's dovish stance. Rising yields, a rebound in the dollar and increasing commodity prices may be starting to feed into tightening global financial conditions. Nevertheless, there appears to be some leeway for the Fed to continue with their current policy stance as the rise in yields is yet to materially tighten domestic financial conditions and has not hurt the broader markets or economy.

Massive stimulus led to easiest financial conditions on record



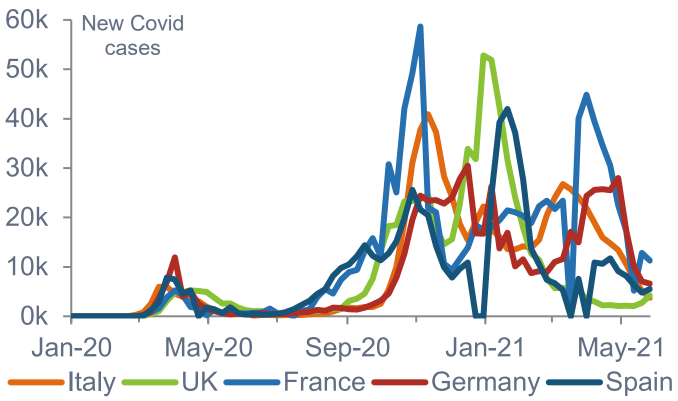
Source: Bloomberg, 31 March 2021.

Europe

Sentiment improves as economies reopen

European equities rose in May supported by improving sentiment around economic reopening, strong economic data and upbeat corporate earnings. A decline in new Covid cases and faster vaccine rollouts led to restrictions being gradually lifted across the region. However, with the global recovery accelerating, worries about inflation and tapering of asset purchase programmes by central banks kept markets in check.

Covid cases falling quickly in Europe



Source: Refinitiv DataStream, 28 May 2021.

All sectors reported flat to positive returns, with cyclicals outperforming defensives. Expectations for stronger economic growth and inflation favoured value names, but growth stocks marginally outpaced value towards the end of the month after the ECB downplayed inflation worries. In the UK, investor sentiment was dampened by an unexpected rise in inflation, a spike in commodities prices and the Bank of England slowing asset purchases.

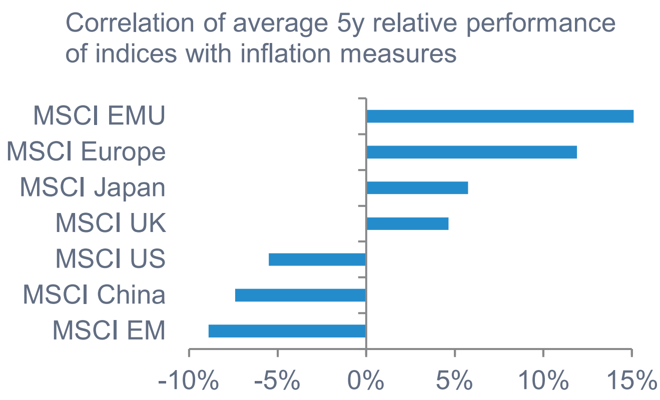
Robust Eurozone activity

Eurozone business activity grew strongly in May. Flash PMI rose to 56.9 compared to the April reading of 53.8. Strong manufacturing momentum led the increase but there was also a strong rebound across service sectors as the easing of virus-related restrictions sparked a revival in demand. With demand outstripping supply for many goods and services, inflation rose in May to 2%, the first time it has surpassed the ECB's target since 2018. Employment also rose for a fourth consecutive month.

Pricing power is key in an inflationary environment

Inflation may prove to be the next major concern, yet early indications suggest it is not a priority for central bankers. Nevertheless, European markets have been relative beneficiaries of higher inflation because of the proportion of high-quality businesses in Europe. Pricing power is a component of a good quality business and in an inflationary environment, it is likely that businesses with established market positions, true innovation and the ability to pass on price increases are most likely to be able to maintain their competitive advantage. We are already seeing some inflation in input prices - partly due to the higher commodity prices - and stock picking is likely to become more important in such an environment. Companies able to absorb or pass on higher costs have an advantage over competitors that lack the scale, brand strength and profitability to do so. Additionally, as an inflationary environment continues, the benefits of pricing power compound and there will be an increasing divergence in the performance of companies. Given the market expects a robust recovery, companies that fail to deliver after enjoying rises in share prices on hopes of growth, could be severely penalised.

Europe a relative beneficiary of inflation



Source: MSCI, Refinitiv DataStream, Morgan Stanley Research, April 2021. Note: Inflation measures are US 10y yield, European 10y yields, 10s2s yield curve, 5y5y inflation expectations, CPI and PMIs.

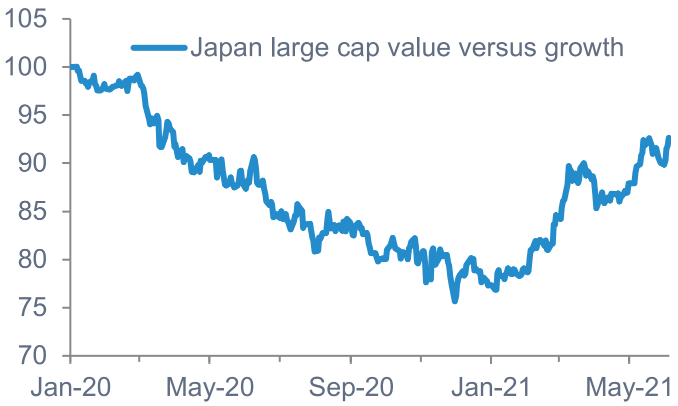
Japan

The start of mass vaccinations boosts sentiment

Japanese stocks overcame a sharp decline in the first half of May to close the month in positive territory. US inflation concerns and gains in treasury yields weighed on technology and other growth stocks. The Japanese government's decision to extend the state of emergency and the slow vaccine rollout also hit sentiment. Shares rebounded towards the end of the month, however, supported by expectations for economic normalisation and the receding of excessive inflationary fears.

Global cyclicals and value stocks were the standout performers in the first half of May, spurred by gains in US long-term interest rates and expectations of economic recovery. This was reflected in the outperformance of export-oriented sectors such as rubber products, transportation equipment and precision instruments. As the uptrend in US yields moderated, however, large-cap growth stocks took the lead. Laggard sectors were largely those with a domestic focus.

Value continues to outperform in 2021



Source: Bloomberg, 4 June 2021.

Manufacturing data remains positive

Industrial output extended gains in April as manufacturers benefited from a recovery in the appetite for capital goods, especially in key overseas markets. Official government data showed that factory output grew 2.5% from the previous month, supported by higher production of general-purpose and electrical machinery.

The au Jibun Bank's PMI dipped in May with services accounting for much of the decline and the overall pace of expansion in new orders slowing, but the reading was still solid amid reports of better demand conditions as companies adjust to operating under Covid restrictions.

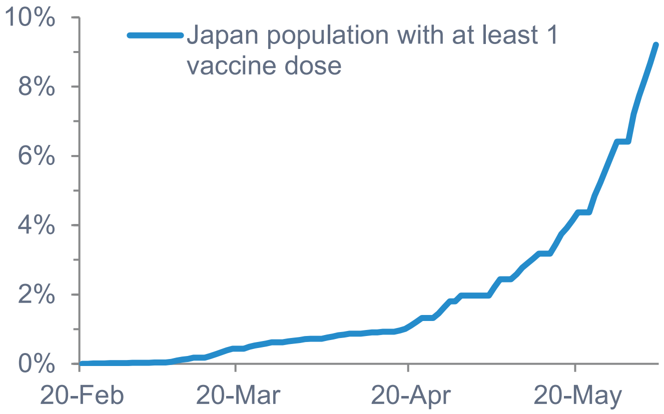
New orders for manufacturers also rose but again the overall pace of growth slowed compared to April.

Vaccination rate shows improvement

Real GDP fell 3.9% on an annualised basis in the first quarter of 2021 as renewed restrictions hurt consumer spending. This marked a contraction after the economy expanded in the second half of 2020. We could see further sluggishness in the second quarter reading as extended emergency measures remain in place.

The prospects for the second quarter will also depend on the number of infections and pace of vaccinations. Encouragingly, the number of new infections is showing signs of declining, and there reports of progress in the vaccination programme through measures such as expanding those qualified to administer the shots, mass vaccinations at workplaces and widening availability to different age groups. As the government addresses the logistical issues that have constrained the vaccine rollout since its start in February, vaccinations could become widespread by late summer and help put the economic recovery back on track.

Vaccinations gather pace in recent weeks



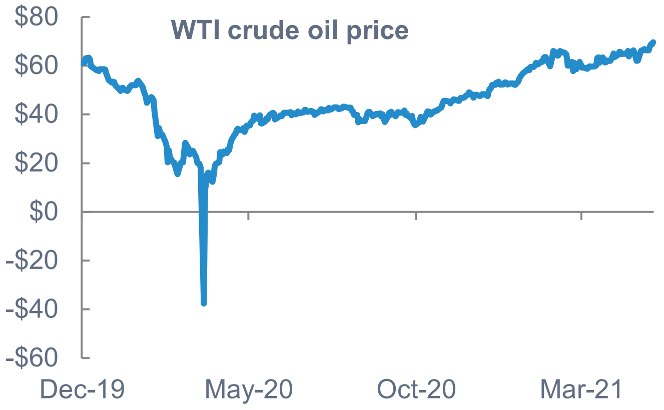
Source: Our World in Data, 3 June 2021.

Emerging markets

US dollar weakness buoys emerging markets

Emerging markets advanced during the month outperforming developed markets and supported by a positive global economic outlook and US dollar weakness. Oil prices were boosted by strong demand from China, while OPEC projected a strong recovery in oil demand this year keeping sentiment high.

Oil prices continue recovery on strong demand outlook



Source: Refinitiv DataStream, 4 June 2021.

Latin American stocks continue to perform

On a regional basis, Latin America was the best performer, followed by Emerging Europe, Middle East and Africa (EMEA) and emerging Asia. Overall, Latin American equities were helped by currencies strengthening against the US dollar and a favourable commodity environment lent support to the region. Colombian equities declined after rating agency Standard & Poor's downgraded its sovereign bonds to sub-investment grade. Brazil's central bank increased its benchmark interest rate by 75 basis points to 3.5%, to ease inflationary pressures. In EMEA, the South African rand rallied against the US dollar and Russian equities gained on rising oil prices and a strong rouble.

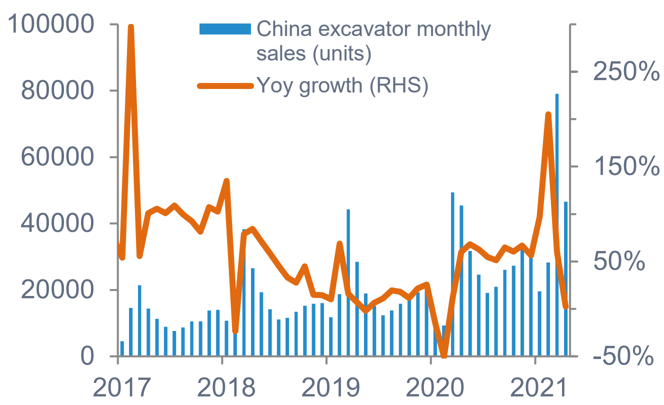
In emerging Asia, Indian equities improved due to a steady decline in daily Covid cases although the pace of vaccinations remains slow. Chinese equities were volatile as investors continued to unwind holdings in internet names in the first half of the month, although this trend subsequently reversed.

Tightening in China could hurt capital goods demand

China's construction machinery and heavy-duty truck demand is expected to soften in 2021 given 2020's high base and moderation in new infrastructure project starts. With monetary policymakers seemingly on a tightening path this year, there could be a decline in broad credit growth, which could weigh on infrastructure projects. Excavator sales, often used to gauge construction activity in China, particularly as infrastructure projects play an important part in GDP growth, fell in April from March.

In 2020, domestic and international excavator sales performed strongly, mainly supported by a recovery in infrastructure investment following government stimulus, replacement demand and labour substitution. Heavy-duty trucks also saw strong growth thanks to stricter execution on the China III truck phaseout, curbs on overloaded trucks, and postponed demand. But these factors may fade as the China VI upgrade is unlikely to affect full-year sales. Demand could slow due to lower quality products and higher costs, while manufacturers may experience margin pressure from higher raw material costs. The medium-term outlook for capital goods remains resilient as infrastructure continues to track economic growth.

Excavator demand in China rapidly slowing



Source: Refinitiv DataStream, China Construction Machinery Association (CCMA), April 2021.

Asia Pacific ex Japan

Equities rose on positive global cues

Asia Pacific ex Japan equities rose in May helped by assurances from global central banks on liquidity and firmer global equity markets. There are concerns that rising Covid cases in some countries could lead to more curbs on economic activity.

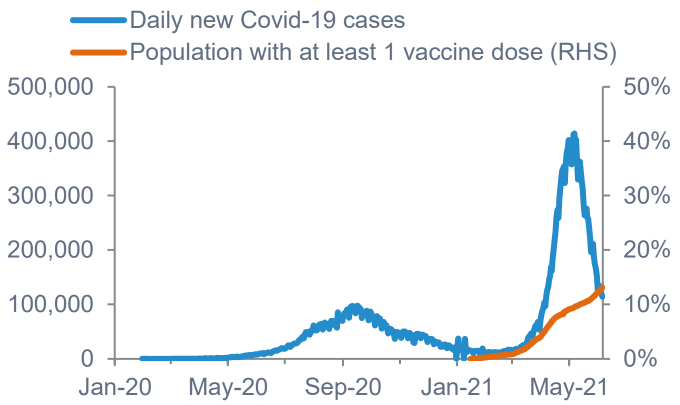
Chinese equities posted gains as domestic economic data eased worries over policy tightening while a stronger currency boosted foreign inflows. Chinese regulatory headwinds on commodities and cryptocurrencies capped gains however, the crackdown on internet companies continued with the launch an anti-trust investigation into domestic tech giant Meituan.

New virus cases in India starting to recede

Indian equities improved as new Covid cases steadily declined. Fourth quarter GDP growth ending March 2021 was stronger than expected, led by manufacturing, construction and investment activity. Indonesian equities gained as its first quarter economic data reflected a mild recovery with GDP moderating after a sharp drop in the previous quarter.

National Australia Bank's business confidence index surged to a record high in April contributing to risk appetite. Korean stocks rose amid hopes for a faster economic rebound from the pandemic. Singapore, Taiwan, Malaysia and Thailand all faced headwinds from recent spikes in Covid infections.

Declining cases in India but vaccination pace is slow



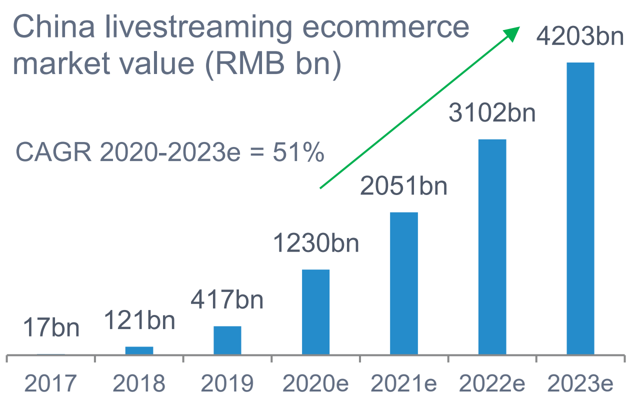
Source: Our World in Data, 5 June 2021.

Chinese innovators pioneer livestreaming ecommerce

China is on track to becoming one of the leading innovators in the world given its rising imprint of R&D and technology - this is particularly visible in social e-commerce. The demand for retail and service sectors to develop omni-channel operations is driving the rise of social commerce, where transactions occur on social networks instead of traditional platforms.

Unlike traditional platforms that have sophisticated infrastructure for merchants, decentralised social platforms often rely on external service providers to build the infrastructure. Providers such as Weimob and Youzan help merchants and businesses directly acquire and engage with customers, as well as managing across online and offline channels. Logistics partners and payment service providers such as Alipay are important too. Users visit social platforms such as Weixin, Kuaishou and Douyin to primarily connect with friends and families, but they are also increasingly using these platforms to buy goods and services without leaving the ecosystem. One important format is livestreaming ecommerce, where influencers or sellers conduct live shopping sessions. This segment is expected to grow by over 50% CAGR over the next three years.

Social ecommerce is set to explode in China



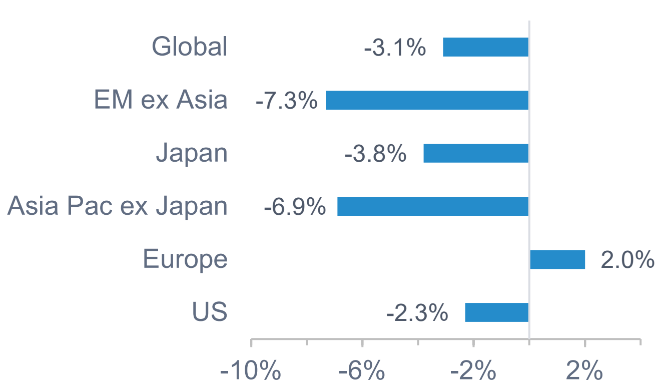
Source: iResearch, January 2021.

Market Data

GLOBAL						
Absolute Returns (USD)						
		1 Month	3 Months	YTD	1 Year
INDEX	MSCI AC World	1.6	9.0	11.1	42.5
SECTORS	C Disc	-1.1	4.8	5.7	50.4
	C Staples	3.4	12.9	5.6	23.1
	Energy	5.9	8.5	25.2	36.2
	Financials	5.1	14.7	22.7	59.8
	Health Care	2.3	8.9	7.0	19.7
	Industrials	3.0	12.2	14.1	50.5
	IT	-0.9	4.7	6.3	48.6
	Materials	4.1	14.2	17.5	62.1
	Telecom	-0.1	6.4	13.2	43.4
	Utilities	-0.2	10.3	3.5	17.7
	Real Estate	1.4	11.5	13.6	28.7
MAJOR MARKETS	US	0.5	9.9	11.8	41.8
	Europe	4.3	12.7	13.8	43.3
	EM ex Asia	6.7	15.0	12.8	45.8
	Asia ex Japan	1.2	1.1	6.6	52.0
	Japan	1.6	1.2	1.7	25.6
STYLES	Value	3.1	11.8	15.9	42.9
	Growth	0.0	6.1	6.2	41.5
	Quality	1.6	9.5	10.0	39.1
	Risk	2.9	8.9	10.1	38.9
	Momentum	-1.5	1.9	3.4	38.7
	Large Cap	1.6	9.0	10.8	41.4
	Mid Cap	1.8	8.9	12.3	47.9
	Small Cap	1.1	7.5	15.1	58.9

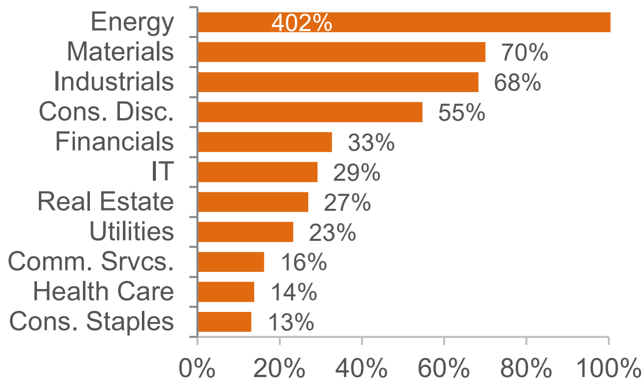
Absolute Returns (Local)					
		1 Month	3 Months	YTD	1 Year
INDEX	MSCI AC World	1.1	8.7	11.2	38.4
SECTORS	C Disc	-1.5	4.6	6.1	47.2
	C Staples	2.6	12.4	5.6	18.1
	Energy	4.9	7.4	24.1	29.6
	Financials	4.4	14.0	22.3	52.8
	Health Care	1.9	8.9	7.4	16.8
	Industrials	2.5	12.1	14.8	45.6
	IT	-1.1	4.6	6.4	46.1
	Materials	3.0	13.1	17.0	52.2
	Telecom	-0.3	6.4	13.6	41.5
	Utilities	-0.8	9.9	3.3	13.4
	Real Estate	1.2	11.6	14.1	26.3
MAJOR MARKETS	US	0.5	9.9	11.8	41.8
	Europe	2.5	11.6	13.1	29.3
	EM ex Asia	4.1	10.6	11.6	36.7
	Asia ex Japan	0.7	0.7	6.7	45.9
	Japan	1.7	3.9	7.8	27.5
STYLES	Value	2.6	11.4	16.0	38.4
	Growth	-0.5	5.8	6.4	37.7
	Quality	1.2	9.2	10.0	35.5
	Risk	2.0	8.3	10.2	31.0
	Momentum	-1.8	1.7	3.4	35.2
	Large Cap	1.1	8.7	10.9	37.6
	Mid Cap	1.2	8.6	12.5	42.4
	Small Cap	0.5	7.2	15.3	53.1

FIL earnings forecasts vs consensus (FY21)



Source: Fidelity International, 31 May 2021.

FIL sector earnings forecasts (FY21)



Source: Fidelity International, 31 May 2021.

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