Fidelity INTERNATIONAL

Year in review
2020 – 2021

Investing with the future in mind

A more active approach to sustainable investing

We understand that every investment decision we make has consequences for client portfolios and society as a whole. Engagement is at the heart of our approach and as one of the largest asset managers in the world, we use our corporate access, committed relationships and continuous work with companies to create lasting value for all.

Our proprietary sustainability ratings

We've created our own sustainable ratings system to provide a forward-looking assessment and fuller coverage of a company's ESG performance.

Why our own ratings?

We do not solely rely on public disclosures

Using insights from around 15,000 company meetings each year, along with industry analysis, competitor analysis and external ratings, our analysts determine an ESG rating for companies we cover relative to their peer group.

More forward-looking

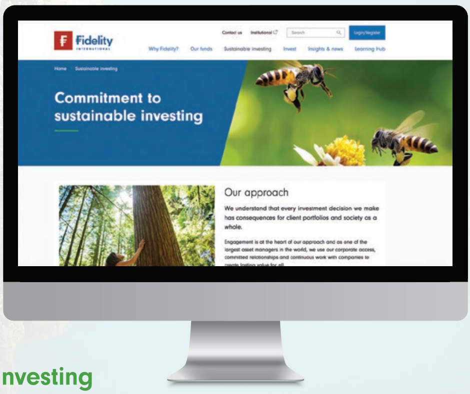
We provide an assessment on whether a company's ESG performance is improving deteriorating or stable. This helps inform our investment decisions, identify future opportunities and address key risks to address in our engagement.

Allows fuller coverage

Our ESG analysis does not rely solely on public disclosures and our ratings can only be used by the Fidelity investment team.

Want to learn more?

Sustainable investing isn't a new concept; however, for many investors it has become increasingly important when deciding on where and how to invest. To help, we've created a library of tools to help you make more informed decisions.



Learn more at fidelity.com.au/sustainable-investing

Year in review 2020 – 2021

Alva Devoy
Managing Director
Fidelity International

As another financial year draws to a close, I've been reflecting on just how much change we've seen over the past couple of years. In some ways it's been overwhelming and exhausting, but in others it really gives you pause to stop and think of just how much we can achieve when we focus on a common goal.

The fact that we've been able to find and produce a vaccine for COVID-19 harnessing relatively new mRNA technology in such a short amount of time is testament to our capabilities for rapid innovation, particularly when we're sufficiently motivated.

This innovation revolution hasn't been confined to medicine, though. We're seeing breakthroughs from diverse fields – quantum computing, synthetic biology, carbon capture, and even space technology. This new wave of 'deep tech' is still in its infancy, but has the potential to help us address the most urgent challenges of our time, and deliver financially viable outcomes along the way.

The looming climate crisis, for example, has inspired a mix of new endeavours: innovations in battery storage which make renewable energy much more feasible, carbon-based materials whose manufacturing process removes CO_2 from the atmosphere. We've even seen methods for creating lab-grown meat!

Due to the complexity and scale of these innovation projects and the scientific research needed to drive them, large scale investment is required from the early stages. And we're certainly seeing a few major early investors profit from their involvement. Indeed, growth of capital invested in deep tech quadrupled from US$15 billion in 2016 to more than US$60 billion in 2020 – although much of this remains heavily skewed towards artificial intelligence and synthetic biology and is also heavily concentrated in the United States, much like the original tech giants.

So where am I going with this?

There's clearly a compelling case for us to invest in innovation. We'll need to innovate to feed our population, tackle climate change, unlock the mysteries of space and ward off the next pandemic, but that's not the only point I want to make.

As the managing director of an investment management company, my remit is pretty clear – to generate returns for our investors. But there's a lot more to it than that, and the really interesting part of my job is the 'why' and 'how', and that's evolving all the time.

> We invest to build a better future for ourselves and those we love, but more and more we're conscious of the broader future – our collective future.

There are many opportunities of how we do this and investing in deep tech is just one of them, but it's exciting to be part of an industry that offers so many possibilities. It's been a difficult year, but it's a great time to be an investor.

Our investment expert views

Australian equities

Paul Taylor
Head of Australian Equities and Portfolio Manager, Fidelity Australian Equities Fund

Just recently in June, I celebrated the 18th anniversary of the Fidelity Australian Equities Fund. I have always managed the Fund for evolution rather than a revolution, and this has served us extremely well, particularly through crises like the COVID-19 pandemic.

While the impact of coronavirus on people's lives has been much more negative than originally thought, the impact on the economy and markets has been much more limited than expected.

> Australia was relatively resilient over the last year and I believe it will remain a preferred geography in which to invest, work and study.

We saw the acceleration of existing trends such as e-commerce, digital delivery of food and beverages, cashless transactions, work from home, and a preference for active versus formal wear. These trends have expanded the universe of investment opportunities as more innovation and business models have come to the market.

The divergence we are seeing between the severity of the pandemic and the impact on the economy is due to government and central bank stimulus. Both responses have been extraordinary and created strong tailwinds behind the economy and asset prices.

However, a full recovery will be dependent on the vaccination rollout and the re-opening of national borders. As the economy grows and demand strengthens, inflation is creeping up. However, I believe that the recovery will need to be sustained for a couple of years, for demand to reach pre-pandemic levels and therefore it will take some time for inflation to reach a meaningful level.

We have seen central banks try to keep interest rates as low as possible for as long as possible to ensure strong growth. High growth and low interest rates should also help with the natural repayment of government debt, which has significantly increased through the pandemic.

Our own Reserve Bank of Australia (RBA) has also highlighted that they do not believe they will have to significantly increase interest rates until 2024 – which is when they think we will start to see real wage growth. It is fair to say that the market does not believe them, and has priced in higher interest rates sooner.

My view is that interest rates will go up, but because of the current temporary inflation, we'll see volatility increase and interest rates take on a shark-tooth type of trajectory. I am much more in the longer-term camp that says official interest rates will increase over an 18-month to two-year period.

The recovery is well underway, and I think in five years' time we will look back on this period as having been an excellent time to have invested in the equity market for the long term. Having said that, investors should not expect this to be without volatility along the way.

Global equities

James Abela and Maroun Younes
Co-Portfolio Managers
Fidelity Global Future Leaders Fund

The best description for the financial year of 2020/21 is 'a tale of two halves.' The year began with justified despair and fear over the outcomes from COVID-19 and has ended with near-euphoria in equity markets.

Lately, we have seen significant asset price appreciation and liquidity stemming from record low interest rates, record government welfare payments, vast asset buying, record residential house prices, robust bounce-back in construction activity and high confidence levels from consumers as well as businesses.

We witnessed dramatic and widespread earnings downgrades in the first four months of calendar 2020; the world struggled with border closures, supply chain disruptions, hospitalisations, virtualisation of the workforce as most of us started working from home. Dull cash registers at downtown coffee shops were a tip of the iceberg of the low confidence that all consumers and businesses were experiencing.

However, once government stimulus measures kicked in and we saw progress with vaccines development, earnings upgrades resumed, and financial markets began to recover sharply. Initially, this was driven by sectors such as consumer, financials, energy and construction. Following this phase, the economic improvement began to broaden out to technology, resources, industrials and the broader economy.

> Phenomenal change is emerging and presenting some amazing investment opportunities.

Many of the exciting and innovative themes and trends changing our world came into the limelight as well, and these will continue to accelerate over the years ahead. In technology, we are seeing software continue to 'eat the world' as Marc Andreessen once said, with the Internet of Things, artificial intelligence, data centres, 5G and subscriber content models driving so much change and productivity.

The sustainability theme is a clear opportunity available in global mid-cap stocks that will likely persist in the future across the energy and resources sectors. Net Zero, decarbonisation, solar, wind and renewables are terms we are hearing everywhere.

Investment portfolios will likely need to stay balanced between long-term growth winners and exposure to the strong economic recovery through energy, resources, industrials, consumer, financials and technology.

Our investment expert views

Global equities (continued)

Some of the crucial considerations over the next 12 months include pricing power (given rising input costs, inflation, increasingly tight labour markets), sustainability (as credit costs rise and competitive pressures intensify), valuation discipline (given there are either high or record asset prices in many sectors) and duration (what is really driving company growth – is this cyclical or structural?).

As we consider the high debt levels as well as asset prices worldwide, let us not forget that free money will not last forever for consumers, businesses, or governments. Stock picking will likely become more critical and valuation discipline will return across the market. The earnings upgrades and higher confidence of business to invest will likely drive the market higher during financial year 2021/22, despite concerns of inflation and higher interest rates.

Asian equities

Anthony Srom
Portfolio Manager
Fidelity Asia Fund

Markets have witnessed a strong rally over the past 12 months, driven by massive fiscal and monetary stimulus, expectations of a 'return to normal' and a focus on segments of presumed growth. It is not a huge surprise to see this strong rebound, especially considering where valuations were during the COVID-19 downturn, but we must now be cautious of where markets and valuations currently stand.

There have been numerous bouts of quantitative easing (QE) and the mother-of-all fiscal stimulus in the last 12 months, which have helped to inflate asset prices, but have had very limited impact on the real economy. We are now seeing high valuations for limited returns, and I am concerned that we could see a decrease in margins and returns, and rising debt. As the rubber band is stretched further, markets become less stable.

> Markets are currently debating whether we will see transitory bouts of inflation, and how long it will hang around.

I am in the camp that inflation will come through. As a result, companies with pricing power and capex-light business models will be preferred.

Another area to watch is geopolitics, particularly with respect to Taiwan and the tensions between the US and China. A third challenge is US dollar strength; the dollar weakness anticipated by many at the beginning of the year has not played out, and I would be erring on the side of further dollar strength. Investors should also consider what is on the opposite side of the US dollar – the Chinese renminbi. A strong US dollar implies continued downward pressure on the renminbi, especially amid tight financial conditions. A weaker renminbi is something the market is not heavily focused on, but something I think should be considered by investors.

Given my cautious market view, I believe that the primary way to generate performance is careful stock picking and there are opportunities. The portfolio is exposed to the tech sector, especially in semiconductors, where there is a clear structural supply/demand gap. I think we are still early in the cycle and our analysis offers comfort around the industry structure.

As in previous years, stock selection drove the Fidelity Asia Fund's outperformance versus the index (47.08% versus 29.94% for one year as at 31 May 2021*). The common thread we see here is that these companies have strong products, continued to invest in the business during a tough period and ultimately managed to position themselves well versus competitors.

The year ahead promises more unknowns, and as mentioned above, I feel the market is generally looking fully valued. A laser focus on stock selection will be required to navigate the uncertainty.

*Total net returns represent past performance only. Past performance is not a reliable indicator of future performance. Benchmark: MSCI AC Asia ex-Japan Index NR.

Global emerging markets


Amit Goel and Punam Sharma
Lead Portfolio Manager and Co-Portfolio Manager
Fidelity Global Emerging Markets Fund

It has been an interesting year for emerging markets (EM) and for the portfolio. In May of this year, we took over the responsibility for managing the Fund from Alex Duffy and although we were very sorry to see him go, we're really excited by the opportunity.

The Fund's investment philosophy remains unchanged and we continue to focus on identifying companies with quality attributes through a rigorous bottom-up stock-picking approach. We're also committed to expanding our sustainable investing credentials as we believe this will provide stronger outcomes for investors, and we look forward to helping our clients build better financial futures in the coming years.

Many emerging economies have reopened faster than developed nations post-COVID-19 shutdowns, so the case for investing in EM remains strong. And while there is little doubt we'll be living in the shadow of COVID-19 and market volatility, we're seeing an increased focus on recovery.

Our investment expert views

Global emerging markets (continued)

Although it's important to point out that this recovery isn't equal, as different regions remain significantly impacted by the virus.

For many emerging economies, the human cost of the pandemic has been catastrophic; however, the resulting stimulus measures have created opportunities in sectors that were previously less favourable. An increase in infrastructure spending, for example, has positively impacted industrials. This additional funding, coupled with attractive valuations and favourable commodity prices, has seen demand really pick up.

> The rise of the internet and persistent technological advancement have been increasingly important drivers of growth in emerging markets.

We saw digitisation really accelerate during the pandemic, particularly in the areas of fintech and e-commerce. Tech stocks also performed strongly driven by supply bottlenecks, stimulus-driven demand, and the ESG boom for decarbonisation and alternative energy.

Despite unprecedented synchronised government stimulus measures enacted to support consumption, headwinds persist, and we've seen a slowdown in global growth. This is true even for countries that have been less impacted by the pandemic, such as China, which recorded a 44-year low.

Inflation has also begun to inch up in many regions, which has potential implications for resources and financial-based stocks. With this in mind, our focus is to buy businesses with better pricing power, market share and valuation comfort to mitigate these pressures – something the breadth and depth of the EM universe allows us to do.

Looking ahead, we're seeing some good opportunities in domestic consumption in countries like China and India, where we own sportswear, dairy, premium auto dealers and digital businesses. We're also seeing potential in the industrial space in China, with opportunities across construction chemicals, heavy equipment and the electric vehicle value chain.

We're excited to be managing this high-conviction portfolio on behalf of investors and will continue to focus on identifying high-quality businesses characterised by robust balance sheets and corporate governance structures, that can deliver consistent returns for our clients.

Sustainable investing

Jenn-Hui Tan
Global Head of Stewardship and Sustainable Investing

The last year has seen monumental changes in how investors tackle sustainable investing – with what was once a 'nice-to-have' becoming a 'must-have' for many. Much of this has been catalysed by the pandemic, which has shone a spotlight on the relationship between sustainable business practices and economic resilience. At the same time, governments are facing global calls to direct economic stimulus required for our recovery to 'build back better' and to strive for collaborative solutions to global threats like climate change and social inequality.

At Fidelity, we continue to expand the ambition of our sustainable investing practices in three key areas: (1) deeper integration of environmental, social and governance factors in our investment process; (2) a focus on climate change; and (3) prioritising social issues exposed by the pandemic including inequality, employee welfare and online inclusion.

ESG integration

Our fundamental research teams deliver proprietary ESG analysis and ratings on our investment universe of over 4,000 issuers around the world, all with the aim of providing our portfolio managers with genuine assessments of current and emerging ESG risks and opportunities, and ultimately better-informed investment decision making.

> We are further enhancing our scoring framework through 2021. For example, to help identify climate risk and realise our climate ambition for net zero emissions from our investments by 2050, we are introducing a climate alignment score for each company that shows how far their business aligns or plans to align with a 1.5 degree warming pathway.

Climate change

We aim to reach our own operational net zero emissions target by 2040 and are working hard to speed this up. We're also providing greater transparency on our approach using the widely accepted framework of the Taskforce for Climate Related Financial Disclosures (TCFD) and publishing our first-ever Corporate Sustainability Report.

However, the biggest contribution we can make is through urging our investee companies to decarbonise more quickly, and in the last year, we have done just that – through direct engagement with some of the world's heaviest emitters and financiers of emissions, and through global investor collaboration initiatives such as ClimateAction 100+.

Our investment expert views

Sustainable investing (continued)

Through this active engagement, we have persuaded more banks to end coal financing, highlighted the social costs of climate change, and challenged companies to preserve our fragile biodiversity.

We also contributed as a founding signatory of the global Net Zero Asset Manager Initiative, which aims to support investing which will get us to net zero by 2050 or sooner, and which now has 87 signatories representing US$37 trillion in assets under management.

Finally, we have changed our voting policy to set minimum climate standards for investee companies, including board oversight of climate risks and emissions reduction targets. We've begun the communication of our expectations to boards and management teams and by next year, we will vote against the directors of companies that do not meet them.

> Climate change is a threat to all of us, and we will seek to play our part and much more in the years ahead.

Employee welfare and online inclusion

Other issues came to the fore over the last year, most notably how companies responded to COVID-19. Governments sought our advice on how best to assist companies financially, and we engaged with firms on supporting their employees and dealing with supply chain disruptions. This included spearheading a collaborative initiative aimed at addressing a humanitarian crisis at sea relating to the stranding of seafarers due to national border restrictions, potentially threatening the global supply chains upon which we all depend.

Together with other Australian investors, we co-founded and are now co-chairing Investors Against Slavery and Trafficking, a collaborative engagement initiative addressing modern-day slavery, labour exploitation and human trafficking in Asia Pacific supply chains and the Australian businesses reliant on those supply chains.

We also saw workforce inequality rise as a result of COVID-19. We regularly discussed with companies on how to narrow the social divide and improve gender diversity, setting ambitious targets for ourselves, but also in our investee companies. Later in the year, we called on companies to limit executive pay and bonuses if they had received emergency government support for their workforce, using our vote against management teams as a stick.

With half the world having no internet access, concerns about digital safety and inclusion increased as we saw 'work from home' become the norm. We therefore broadened our engagements on cyber security to include online welfare, accuracy of information and ethical AI design.

2020 was a year of global existential threat, and we have all had to adapt. But from it has emerged a near-universal desire for a more sustainable world. We just need to make it happen.

It's easy to invest with us

You can invest with us directly, via mFund or via a platform. To find out how, visit our website or speak to your financial planner or broker.

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