Global Market Outlook 2021

Navigating the new reality

Fidelity Asia Fund

Anthony Srom

Stay cautious and be selective

Surrounded by uncertainties in the markets, we stay cautious. While new investment ideas are harder to find in a challenging economic environment, we stay on the lookout for investment opportunities in situations where sentiment is very negative to the point where fundamentals are ignored.

What is your investment outlook for Asian equities in 2021? To what extent is this tied to virus-related developments?

The market outlook has become increasingly challenged, in our view. Return upside is tempered by valuation multiples which are above average. Return on capital and margins continue their long-term downward drift whilst leverage continues to increase. The virus is front and centre for everyone, so it is largely factored into investors' assessments and vaccine developments have also put a floor under stock prices of late. Consensus expectations would suggest excessive fiscal and monetary policy is likely to lead to inflation. The opposite may play out, given the marginal productivity of debt globally has diminished significantly. With subdued oil prices, falling rents etc, we may witness greater fears of deflation in the coming quarters. With interest rates at rock bottom levels, such an outcome would lead to rising real rates which is unlikely to be supportive to the market. With this backdrop, new investment ideas are harder to find.

What do you think could surprise the market in 2021 (either positively or negatively)?

We have observed a more acute tussle between growth/momentum versus value/cyclical stocks. Following the market rally since March, the perceived 'tier-one' internet tech names became over-owned, reaching a point where they have become so big that investors are hitting (or close to hitting) regulatory ownership limits, which may increasingly add some selling pressure at the margin. While we have been wary of the internet space as investors were not fully 'pricing in' the risks to these businesses, the Ant IPO suspension and heightened regulation risk has brought some more realistic thinking into the sector.

US-China relations will continue to make news in 2021 with anti-China rhetoric remaining regardless of who wins the US Presidential election. We may see some political push-back from China post US elections. Some Australian companies (such as Treasury Wines) and sectors (such as agriculture) are examples of potential retaliation.

Australia is a market that we have been watching. After entering its first recession in decades we are seeing quantitative easing for the first time, which may encourage individuals to lever up. Again, this increases the long-term risks around domestic consumption.

What themes, sectors or regions would offer opportunities or potential risks in a post COVID-19 world?

While new ideas are thin, there are selective stock opportunities in the technology space, especially in hardware such as memory and semiconductors. Long-term structural demand growth for leading-edge technology, as well as accelerated needs from businesses to be digital ready and normalisation of the work from home trend will bode well for such names.

Additionally, there are some attractive technology related opportunities in the IPO markets. Recent examples include Ming Yuan Cloud Group, a leading software solution provider for property developers in China. Another new position added at its IPO is Lufax, which is primarily a hybrid online/offline lending platform backed by China Ping An Group. It's applying extensive data analytics with AR/VR to speed up and enhance the loan application process for small and medium enterprises (SMEs), whilst tapping this under-penetrated market segment. It appears they have been savvy catering to ever-changing regulation adjustments. This has helped mitigate risk.

The pressure from the US on China is ‘structural’ and how this impacts a company’s operating environment and how a company is adapting, must be factored in when assessing fundamentals. This also means that we may see ongoing policy support from the Chinese government for industries that operate in strategically important areas like technology. This bodes well for a company like Hangzhou HikVision.

Within your portfolio, what areas have highest convictions and what areas are you avoiding?

Overall, the portfolio is currently in a holding pattern. Turnover has reduced post the ‘COVID crash’ whilst name count has consolidated into the longer-term structural winners.

The portfolio has a large overweight in tech although this is focused on hardware and the semiconductor segment. Conviction holdings include foundry and memory such as TSMC, a global semiconductor foundry leader. These companies are second derivative plays on the more popular areas of technology, and we believe the risk-reward profile looks better in this part of the market. Also, fundamentals of TSMC have improved with new revenue opportunities following Intel’s 7nm production delays, which could see them outsourcing production to the Taiwanese company.

Another key holding is vision equipment manufacturer surveillance company Hangzhou Hikvision. There are a lot of growth opportunities for Hikvision as their equipment and technology could be widely applied. Areas of examples include robotics, facial recognition for payments, body temperature checks, airport check-in and immigration. There is a long runway for domestic and international ex US growth and the management has a great track record in delivering.

The portfolio still has underweight exposure to the likes of Tencent and Meituan. This all comes back to our assessment of fundamentals, sentiment and valuation and the potential risk-reward. These well-known internet stocks have a lot of momentum behind them and have performed very strongly so far this year. Their valuations are looking excessive and we feel risk/reward on a multi-year view does not stack up.

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

ESG integration is carried out at the fundamental research level. Our investment approach focuses on bottom-up research. As well as studying financial results, we carry out additional qualitative analysis of potential investments alongside our analysts and ESG factors are embedded in this research process.

We will try to discern the different ESG risk factors when assessing the company. Any potential ESG concerns are then assessed and a view is taken as to whether these factors are priced into the valuation of the share price. This will impact the discount rate used when determining a valuation. There is always a focus on risk versus reward for an investment. Though an investment proposition may show ‘upside’, we may not act, specifically if the overall risk level is unjustifiable.

Reference to specific securities should not be construed as a recommendation to buy or sell the securities but is included for the purpose of illustration only. Performance of the security is not a representation of the Fund's performance. Views may no longer be current and may have already been acted upon by Fidelity. Past performance is not indicative of future performance.