

Investment outlook: Summary

A delicate balance

Fidelity International's outlook for the global economy, equities, fixed income, multi asset and real estate



House view

We have adjusted our house view in equities, government bonds and credit to reflect the increasing risk-off sentiment among our portfolio managers. In the near-term we have downgraded equities and cash, and upgraded US Treasuries.

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Economic outlook

While the bond market asserts its gloomy forecast, the US equity market has broken to new highs, banking on an accommodative Fed and positive developments in US-China trade. This latter view is too optimistic in our opinion - the Fed won't be as accommodative as the market expects and trade tensions will continue.

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Equities

Overall valuations are higher than normal but not yet in bubble territory. Positive global growth and Fed dovishness should support valuations in the long term with good opportunities in Japanese stocks and selective tech stocks.

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Fixed Income

In the short term, we have marginally increased credit exposure in our portfolios based on the dovish tone from policymakers and some sign of appeasement on the trade front. However, our long-term view of de-risking and seeking quality yield remains in place.

[Read more p8](#) →

Multi Asset

Despite the risk of disappointing fundamentals, the Fed's dovishness will support asset prices and so we are neutral on equities. We continue to take a nuanced view at a regional level however, and are keeping a close eye on central bank policy.

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Real Estate

While real estate pricing remains attractive in relative terms, the mispricing of risk is becoming a major challenge. Style drift risks are growing and are evident across most markets and sectors, with pricing premiums between prime and secondary assets and geographies also narrowing.

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Q3 outlook overview

Over the past few quarters we've seen some wild swings in sentiment. After ending 2018 in a gloomy mood, markets spent the first half of 2019 finding their animal spirits again, notwithstanding the hiccup in May. Now, as we enter the third quarter, we are in a finely balanced position epitomised by an overly pessimistic bond market on the one hand, and an optimistic equity market on the other. We think we are somewhere in between those views.

The bond market, egged on by dovish central bank rhetoric and US-China trade war concerns is fearing recession, and the equity market, taking the same themes is hoping for continued dovishness and progress in trade disputes. The US economy is slowing down but we don't think it will slip into recession, so the extent of dovish Fed expectations may be overdone. And trade talks will rumble on, at least in the short to medium term - this is not a fleeting battle, it's a drawn-out war. Barring any exogenous shocks, we could find the market in a sort of limbo for some time, albeit with bouts of volatility as investors latch on to the latest event looking for direction.

The good news is that late cycle dynamics and punchy valuations offer areas of the market for investors to exploit, but it requires a nuanced approach. For example, in the short term, equities are richly valued so we are moderately underweight but in the long term it's still an attractive market supported by global growth. In government bonds, in the short term the market could still go higher but long-term risk-adjusted returns may underwhelm.

Central banks are attempting to extend a cycle that has already gone on for a long time, and this ratchets up the potential volatility we could see as investors weigh up data, policy and political developments. The best defence for investors is maintaining clear-eyed, sober analysis and focussing on the long term.

Paras Anand

Head of Asset Management, Asia Pacific



House view

Shifting macro sands



Wen-Wen Lindroth
Lead cross-asset strategist

Market conditions are a potentially combustible mix, and this has driven our shift to more defensive positioning. Macro risks arising from unresolved US-China trade tensions, a still-tentative bottoming in global macro data and exogenous shocks all have the potential to derail the fragile stabilisation in global growth. Despite bullish signals from our proprietary indicators and a fairly rosy corporate earnings outlook from our analysts, we are heeding numerous warning signs. These include late cycle dynamics, nervous bond markets, rich valuations and complacency in some parts of the market.

We have adjusted our house view in equities, government bonds and credit to reflect the increasing risk-off sentiment among our portfolio managers. The key changes are:

- Equities: near-term downgrade to moderate underweight
- US Treasuries: near-term upgrade to moderate overweight; medium-term upgrade to neutral
- Credit: near-term downgrade to neutral; medium-term downgrade to neutral

Asset class breakdown

Equities

From a bottom up perspective, we see positive, albeit materially lower, corporate earnings growth in 2019. The moderation in growth is due to the roll-off of US tax reform impacts, slower sales and the combined effects of wage growth, cost inflation, higher taxes and higher interest rates. Valuations have been supported by central bank easing, more than offsetting political noise. Capital inflows, particularly purchases by the Bank of Japan and other central banks, and corporate buy-backs have boosted equities.

From a top down view, we are monitoring downside risks from a slowdown in global growth, trade war uncertainty, spiking volatility and/or a relapse in US economic data. The global economy is in late cycle and punchy valuations could be undone by a trade shock.

Fixed Income (government bonds)

Despite positive economic growth in the US and stronger data from China since the beginning of the year, the risk of our macroeconomic

bear case is rising. Indeed, the rapid change in US Federal Reserve policy from hawkish to dovish since the last quarter of 2018 shows that we are not the only ones with concerns. The market consensus now anticipates four to five rate cuts (103 basis points) over the next 12 months compared with two to three rate hikes last November.

The pivots in Fed policy and US-China trade negotiations have caused our view to shift from underweight duration to a near-term overweight in US Treasuries and neutral positions in Bunds and Treasuries. We think a recession in the US remains highly unlikely over a 12-month horizon, even incorporating the knock-on effects from higher tariffs. As a result, we have moved to neutral in US Treasuries. We are overweight Chinese government bonds.

Fixed Income (corporate credit)

In developed markets we have reduced risk and have downgraded both investment grade and high yield credit to neutral. Within each of these we have moved up in quality and reduced duration. China and emerging markets however, are still attractive based on valuations, global central bank dovishness and lower political risk in emerging markets than last year.

Fidelity's Global Asset Allocation process combines the granular, on-the-ground views of our research analysts together with a macroeconomic and quantitative framework driven by our strategists.

Each quarter, we bring together our regional and thematic experts from across the world to participate in the Quarterly Investment Forum (QIF), where we discuss macroeconomic and geopolitical conditions and how they will impact markets. Each asset class division incorporates this shared understanding into their respective investment and asset allocation decisions.

Every month, we hold Global Asset Allocation meetings where divisional Chief Investment Officers (CIOs), global portfolio managers and strategists share and debate views on macro conditions, markets and cross-asset allocation to produce the house view.













Fidelity's Global Asset Allocation process is led by: Paras Anand, Head of Asset Management, Asia-Pacific, Anna Stupnytska, Head of Global Macro and Investment Strategy (GMIS) and Wen-Wen Lindroth, Lead Cross-Asset Strategist.

House view

House view on asset allocation

June 2019

Strongly negative  Strongly positive

Asset class	Near term (3-6 months)	Medium term (12-18 months)	Long term (2+ years)	Key views
Cash	 Change: 0	 Change: 0	 Change: 0	Our position on cash is neutral. In the near-term, this is driven by expected underperformance of cash versus US Treasuries and higher quality credit. Over the medium- and long-term horizons, risk assets should outperform cash.
Equities	 Change: -1	 Change: 0	 Change: 0	<p>Near term: We are downgrading equities to underweight from neutral. Many market segments are overpricing global growth prospects, while trade war tensions could catalyse a sell-off. We continue to take a nuanced view at a regional level, however.</p> <p>Medium term: We remain neutral on equities. We are cautious due to late cycle dynamics and increasing risks posed by populist policies globally. On the other hand, technicals remain supportive in the form of central bank purchases, corporate buybacks and the 'Japanification of Europe'. Importantly, central banks appear ready to intervene once again, should the global economy show signs of a recession.</p> <p>Long term: We remain overweight, as equities should continue to be supported by global growth and valuations.</p>
Government bonds	 Change: 2	 Change: 1	 Change: 0	<p>Near term: We are upgrading US Treasuries to overweight from underweight, as the rapidly escalating US-China trade tensions have tipped the Fed from a hiking to an easing bias. Expect tighter financial conditions to persist amid extended rhetoric. We upgrade Gilts to neutral; remain underweight Bunds and overweight Chinese government bonds.</p> <p>Medium term: We are upgrading US Treasuries to neutral from underweight. Downside macroeconomic risks related to the trade tensions are growing, this is balanced by un compelling government bond valuations. We remain underweight in Bunds and Gilts and overweight CGBs in the medium term.</p> <p>Long term: We remain underweight, as risk assets should provide better risk-adjusted returns in the long run.</p>
Credit	 Change: 1	 Change: 0	 Change: 0	<p>Near term: We are downgrading both IG and HY credit to neutral from overweight, due to trade tensions, political uncertainty and signals of a global slowdown. We continue our trend of moving up in credit quality and prefer shorter duration in credit.</p> <p>Medium term: We are downgrading both IG and HY credit to neutral from overweight, for the same reasons as above. We believe these risks are likely to persist over a 12-18 month horizon.</p> <p>Long term: We remain overweight, as credit risk assets should outperform government bonds and cash over the long term.</p>

House view

Strong conviction views

June 2019

Asset class	Near term (3-6 months)	Medium term (12-18 months)	Key views
Equities	<ul style="list-style-type: none"> Tech (bottom-up equity call) EM Asia Energy (bottom up equity call) 	<ul style="list-style-type: none"> Europe Materials (bottom-up equity call) 	<p>Tech: Highest aggregate stock ratings amongst our analysts and fastest 2020E earnings growth.</p> <p>EM Asia: Chinese credit growth is a major tailwind for the region, but we are watching closely for any moderation after possible distortions from the New Year. Valuations remain attractive and fundamentals are also holding up.</p> <p>Europe: Consensus has been bearish on Europe given a sharper than expected growth slowdown since the start of 2018 which has carried over into this year. While recession remains unlikely, it is still too early to call the 'all clear', given the challenging external backdrop and domestic risks.</p>
Fixed Income	<ul style="list-style-type: none"> UST (near-term) China Rates Higher quality IG/HY credit (vs. lower quality) EM 	<ul style="list-style-type: none"> Lower quality IG/HY credit Gilts 	<p>US Treasuries (near term): Rapidly escalating US-China trade tensions have tipped the Fed from a hiking to an easing bias; we are upgrading UST to a near-term overweight and a medium-term neutral view.</p> <p>IG/HY Credit: We downgraded credit to neutral from overweight and are moving up in credit quality (BBBs to As; Bs and CCCs to BBs). We are being highly selective, given escalating trade tensions, late cycle dynamics and rich valuations; amongst sectors we prefer US IG, China IG and Asia HY.</p> <p>EM hard currency sovereign debt: We remain overweight based on global central bank dovishness, China stimulus, valuation and lower EM elections risk compared with 2018.</p>
Currencies	<ul style="list-style-type: none"> JPY 	<ul style="list-style-type: none"> EUR RMB 	<p>USD: We are negative on USD over the medium-to-long-term on valuation. However, still weak global growth is giving the relatively high yielding USD a 'risk off' bid. This should keep USD range-bound for now, leaving us close to neutral on a trade-weighted basis.</p> <p>JPY: Soft global growth should keep JPY bid as a fundamentally cheap safe haven. Rate differentials are also closing with other economies, given the BoJ's limited ability to lower rates.</p> <p>RMB: Rich valuation and the need for an offset to US tariffs, combined with more dovish and less interventionist rhetoric from the PBoC Governor, will allow downside risks to the RMB to play out.</p>
Commodities	<ul style="list-style-type: none"> Brent oil Diesel Copper PGMs 	<ul style="list-style-type: none"> Natural Gas (Henry Hub) Iron ore High Sulphur fuel oil 	<p>Brent (positive): 'Saudi First' oil policy, Iran sanctions, Venezuela woes create upside risks in 2H19 possible.</p> <p>Natural Gas (negative): Ramping up in US shale oil results in higher US gas supply as a by-product.</p> <p>Copper (positive): Short-term copper is equity-like, but in the longer term, supply side is struggling.</p>
Real Estate	<ul style="list-style-type: none"> Last mile logistics in major European cities 	<ul style="list-style-type: none"> UK retail assets 	<p>EUR Logistics: E-commerce is strong driver of demand growth, combined with supply shortages in major conurbations, it will deliver strong rental growth.</p> <p>UK Retail: Re-valuation of sector has only just begun – oversupply, disruption and taxation will continue to drag on demand.</p>

Economic outlook

“The global economy has turned a corner - but it’s heading into the slow lane. The good US GDP figure for the first quarter was deceptive, and the US economy will continue its slowdown in the second half of 2019. However, this won’t be enough to stop a recovery emerging in the rest of the world.”

Ian Samson, Markets Research Analyst

A slow, ambling recovery

It looks like we are moving past the trough of the global economic cycle and into a recovery phase. However, a slow, ambling improvement looks more likely than a sharp bounce back. Headwinds that we faced last year, such as tightening financial conditions, the strengthening US dollar, a slowing China, and surging oil prices, have eased and turned into crosswinds. Still, this picture of subdued growth warns us against complacency.

Despite the unexpectedly positive outcome from the US-China trade talks at the G20 meeting, the trade war is set to rumble on. While it will delay and damage the global recovery, it is not enough to derail it. Ultimately, China’s fiscal and credit policy, and US monetary policy, are more important drivers. China has initiated a stimulus package, and we are yet to see the full effects feed through into activity. When they do, they should support growth not only in China but also in Europe, which relies heavily on Asia for external demand.

The US is slowing steadily, ‘catching down’ after its economic outperformance last year. With the US fiscal boost now fading and unlikely to be renewed in the short to medium-term, US Federal Reserve policy is the only game in town for the world’s biggest economy. The Fed is set on a dovish course, and the market expects three rate cuts in 2019 and four to five in the next 12 months. In our opinion that will prove unnecessary. The US economy is unlikely to slip into recession and two rate cuts this year should suffice to stabilise growth around trend levels.

Data is positive but nuanced

Our proprietary data is more positive than last quarter. The Gauges of Economic Activity in Real-time (GEAR), which measures global growth across countries and regions, has bottomed and moved off recent lows. This global figure masks important divergences between countries and particularly between the US, Eurozone and China. The Chinese economy still looks vulnerable, with its GEAR only slightly above its January trough. If it moves lower from here it would point towards a slowing of global trade, but the strong stimulus we saw in Q1 should provide some support.

The Fidelity Leading Indicator (FLI) is a forward-looking predictor of global industrial production and GDP, with a lead of about three months. It now shows promising global activity ahead, indicating that positive and accelerating growth is likely by the fourth quarter of this year. However, like the GEAR, it is signalling a mixed picture at the granular level. Moreover, we must also be wary of base effects - easy comparisons to a weak start of the year - flattering quarter-on-quarter results.

Market pessimism (and optimism) is overdone

While we preach caution at this time, we are more positive on global prospects than some areas of the market, with US Treasury yields at the lowest levels since November 2016 and Bund yields negative. While the bond market asserts its gloomy forecast, the US equity market has broken to new highs, banking on an accommodative Fed and positive developments in US-China trade. This latter view is too optimistic in our opinion - the Fed won’t be as accommodative as the market expects and trade tensions will continue.

Equities

Overview

What's changed

US Federal Reserve policy and rhetoric around trade tensions both continue to buffer equities. Concerns around global growth and escalating trade tensions in May gave way to Fed dovishness and a mildly positive outcome in the US-China trade talks in June to leave the S&P 500 at a new record high.

Key takeaways

- Despite flat corporate earnings, global equities have performed strongly this year due to a re-rating.
- Disconnects are appearing, examples being energy stocks decoupling from the oil price and fixed income and equities in seeming contradiction.
- Quality stocks are still valued above long-term averages, signalling that fear is influencing the market.
- Chinese data looks promising, but we caution against assuming a full China recovery in the second half of the year.

“Despite US stocks reaching new record highs, this remains a challenging environment for equity investors. Disconnects are appearing amid quick, sharp bouts of volatility. This uncertainty creates opportunities, but it requires discipline to profit from them.”

Romain Boscher Global CIO, Equities

Investment implication

Overall valuations are higher than normal but not yet in bubble territory. Positive global growth and Fed dovishness should support valuations in the long term with good opportunities in Japanese stocks and selective tech stocks.

Fixed Income

Overview

What's changed

The US Federal Reserve and European Central Bank are seeking to extend this cycle with further monetary easing. Both central banks are indicating rate cuts, which has led to a resurgence in the search for yield. The G20 meeting brought more conciliatory tones between the US and China. However, trade-related uncertainty is unlikely to completely subside, amid slowing US growth that is converging towards global levels. In Europe, signs of macro stabilisation could be a false dawn against trade headwinds and the political impasse around Brexit.

Key takeaways

- US Treasury yields edged to their lowest levels since November 2016 due to Fed dovishness, concerns about global growth and a deterioration in trade talks between the US and China.
- While the market is pricing in three rate cuts in the US in 2019, our base case is for only two given our expectation that the slowing US economy will avoid recession.
- In Europe, the scramble for safe haven assets and ECB dovishness pushed Bund yields to new lows and a worsening of the outlook drove us to revise our European duration exposure.
- In the UK, growing worries that Theresa May's successor, after her resignation, will pursue a no-deal Brexit further hampered risk sentiment.

“Central banks are back in the driving seat, driving yields lower across the board. While the search for income has resumed, investors should not be complacent, and focus on quality income rather than yield at all cost.”

Steve Ellis, CIO, Fixed Income

Investment implication

In the short term, we have marginally increased credit exposure in our portfolios based on the dovish tone from policymakers, and some sign of appeasement on the trade front. However, our long-term view of de-risking and seeking quality yield remains in place. In Europe, we pared back our duration exposure and are back to neutral given low inflation, renewed ECB dovishness, and the strong correlation between European core government bonds and US Treasuries.

Multi Asset

Overview

What's changed

The falling volatility seen in 2019 has reversed in the latter part of Q2 as trade tensions again came to the fore. The macro data in places looks reassuring but market valuations are high and vulnerable to exogenous events.

Key takeaways

- While the Fidelity Leading Indicator is showing modest acceleration, caution is warranted as trade tensions have again resurfaced.
- After a weak 2018, China stimulus is expected to feed through as we move into the second half of the year. While the trade dispute is affecting sentiment, this could result in more supportive policy. This would be a tailwind for China and emerging Asia more broadly.
- We have returned to a neutral view on equities due to central banks' willingness to support asset prices once again, but do not believe it is prudent to move to overweight given markets' stretched optimism and a slowing US economy.
- With an underweight duration view we maintain our positive view on cash. We do not see this as a structural overweight, but rather a tactical view to allow us to buy into opportunities as they present themselves.

“When valuations are stretched, the downside risk is high, and we are in that position today. There are clear, binary downside risks which could have a significant impact on markets given valuations.”

Multi Asset team

Investment implication

Despite the risk of fundamentals disappointing on the downside, the Fed's dovishness will support asset prices and so we are neutral on equities. We continue to take a nuanced view at a regional level, however, and are keeping a close eye on central bank policy.

Real Estate

Overview

What's changed

Style drifts tend to be exacerbated by the weight of capital, and this time around is no exception. As we move through the year, there is a growing evidence that investors in European real estate are venturing into secondary markets and geographies, and towards more specialist sectors in search of yield.

In the UK, the lack of progress on Brexit and weak economic fundamentals have extended the quiet period of investment activity, which started in Q4 2018, well into Q2 2019, although there are signs that more assets have been coming to the market in recent weeks. The build-up of pressures in the UK retail sector continues, and the recent signs of price softening in other sectors mean that 2019 will see lower returns across the board.

Key takeaways

- Deployment of capital has become a major challenge. Only around 50 per cent of equity raised for real estate investment in 2018 has so far been deployed¹ as investor competition intensified. An absence of willing sellers has led to a reduced supply of properties. This was a key factor behind slower investment activity across the globe, and in Europe in particular.
- The lack of progress on Brexit is extending uncertainty, leaving most UK real estate market participants unable or unwilling to make decisions. Adverse conditions in the UK retail sector continue, leading us to expect significant capital declines in the sector as the year unfolds.

“Macro factors - persistently low interest rates, currency volatility, politics - continue to be the tail that wags the real estate dog, drawing investors to property for its yield premium and perceived safe haven status. But fundamental real estate factors are starting to reassert themselves again - most notably in retail property in the UK, which is falling in value in some locations both quickly and significantly. Successful investors will be those who have already re-positioned portfolios over the past year.”

Neil Cable, Head of European Real Estate

Investment implication

While real estate pricing remains attractive in relative terms, the mispricing of risk is becoming a major challenge. Style drift risks are growing and are evident across most markets and sectors, with pricing premiums between prime and secondary assets and geographies also narrowing.

In the UK, investors with an already-low retail sector allocation should have a strong advantage, but the benefits of being overweight to the industrial sector appear to be fading. Specific asset characteristics irrespective of sector, such as lease length, tenant covenant, as well as active asset management, are likely to be key factors in delivering outperformance in what is likely to be a year of low total returns.

¹ INREV Capital Raising Survey, April 2019.

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