Choppier waters ahead

Investment outlook

Q2 2018

Fidelity Editorial

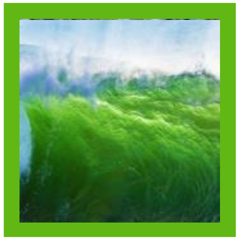
Choppier waters ahead

- Markets are returning to more normal levels of volatility
- The macroeconomic landscape remains supportive, and even though developed world growth is easing, it is still robust
- Rising volatility means it is important to be more selective in how you take risk; and active security selection could provide additional value
- In our opinion, we are at the beginning of the end of the current economic cycle

Contents

Themes for Q2 2018 4

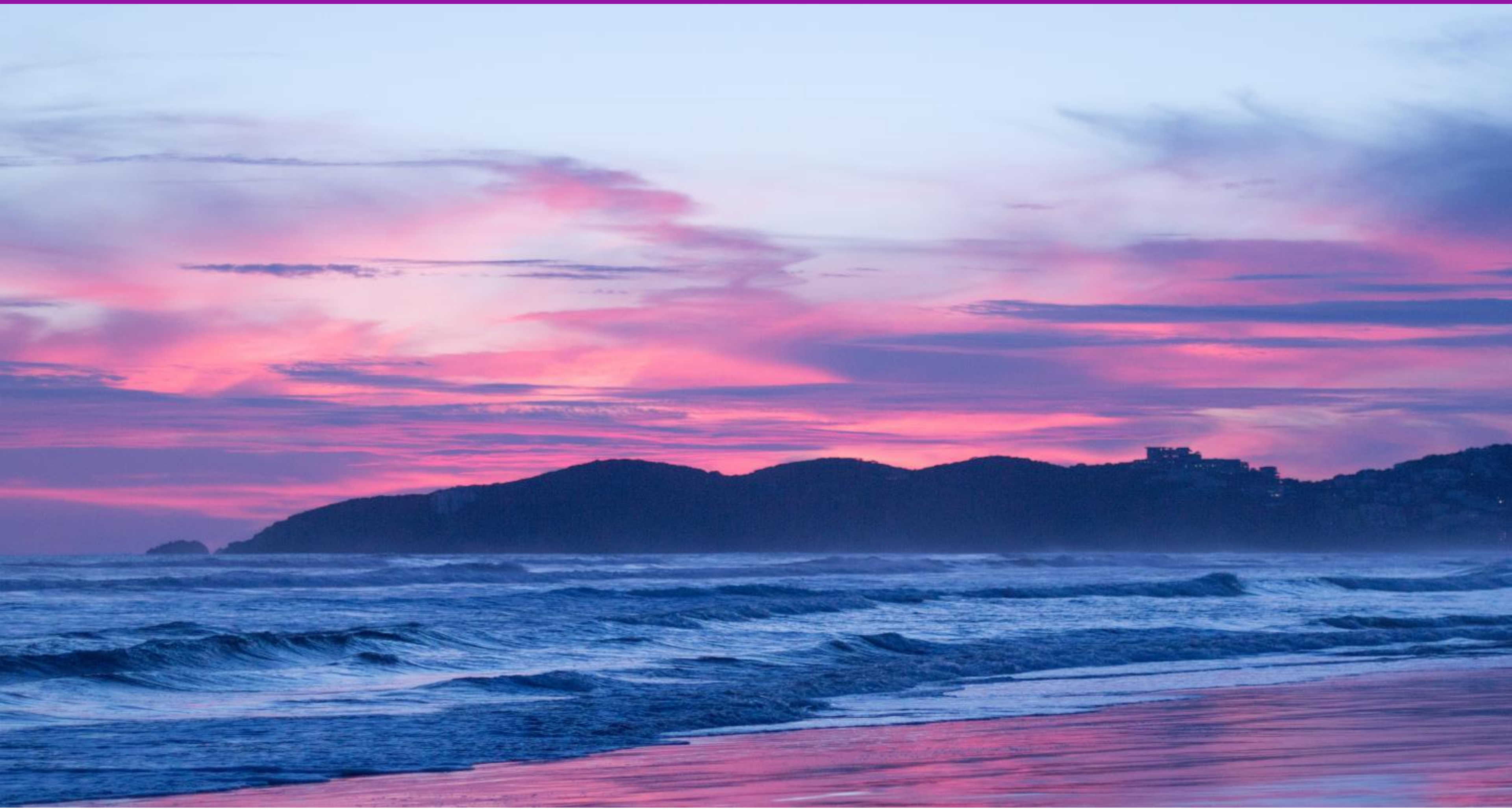
Equities 8



Fixed income 12

Alternatives 16

Themes for Q2 2018

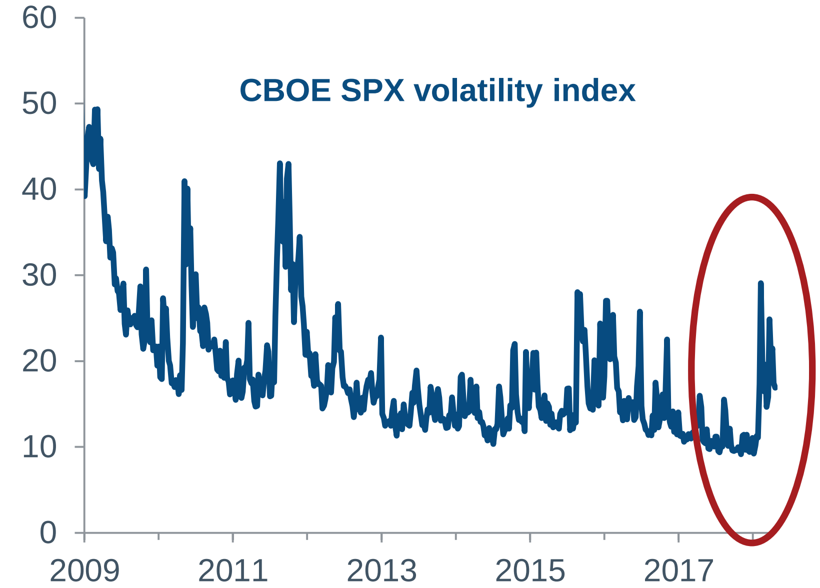


1: Volatility returns to normal

Low volatility levels made the recent spikes more dramatic

- Volatility spiked in the first quarter, initially in February following inflationary concerns and then in March around trade protectionism.
- But this rise in volatility is only back to relatively ‘normal’ levels after two years of a steadily declining trend.
- Given the unusually calm conditions in recent years, the volatility spike has shocked investors.
- We are near the peak of the cycle and we expect volatility to be more pronounced as investors react to data and news flow.
- Simply buying beta has worked well in the last two years, but may be less effective from now given more jittery markets.
- Selectivity, across all the major asset classes, could provide additional value.

Volatility is back



Price return, 12 months to:	CBOE SPX VOLATILITY VIX
30/04/2018	47.2%
30/04/2017	-31.1%
30/04/2016	7.9%
30/04/2015	8.5%
30/04/2014	-0.8%

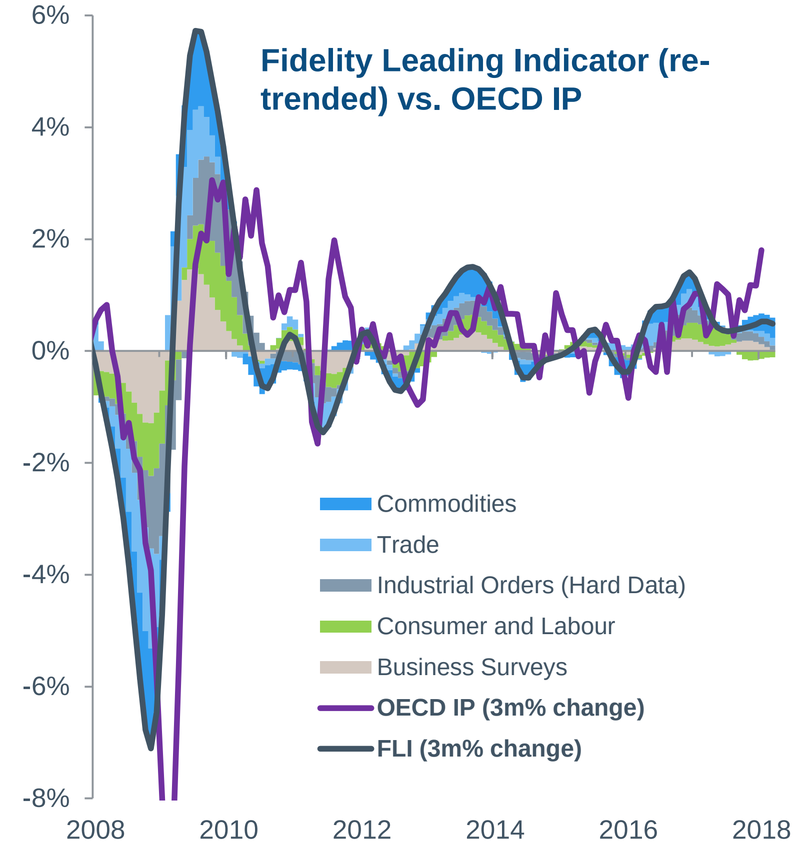
Source: Fidelity International, DataStream, April 2018

2: Macroeconomics still look good

Growth is peaking and starting to roll over, but is still robust

- Macro data is still positive but we have most likely seen the cyclical peak in growth and it is starting to turn over.
- The Fidelity Leading Indicator is still in positive territory but decelerating, essentially signalling a neutral stance on risk.
- Only two of the five sub-sectors are positive and accelerating, suggesting momentum is not broad-based.
- We think the beginning of the end of the cycle is apparent, with the market turn perhaps 6-18 months away.
- There are several factors that could drive growth more sustainably or materially downward from here: i) Fed liquidity withdrawal putting pressure on credit conditions, ii) China's ongoing financial and fiscal clampdown denting global growth, iii) a return of inflation, and iv) a genuine trade war.

Fidelity Leading Indicator is turning neutral



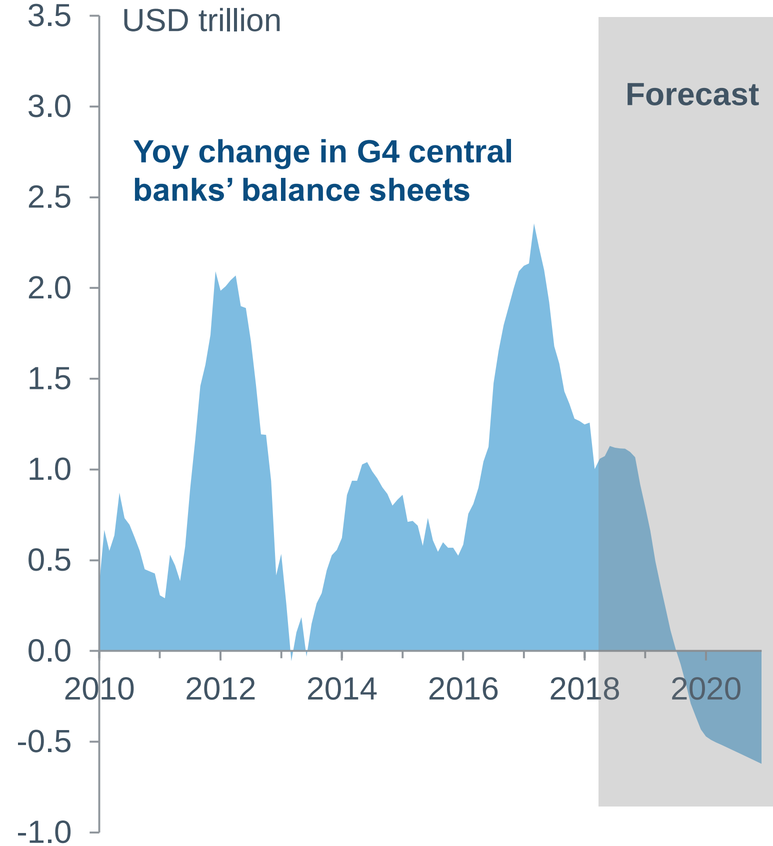
Source: Fidelity International, April 2018

3: Watch central bank policy closely

CB policy will have potentially significant impacts on markets

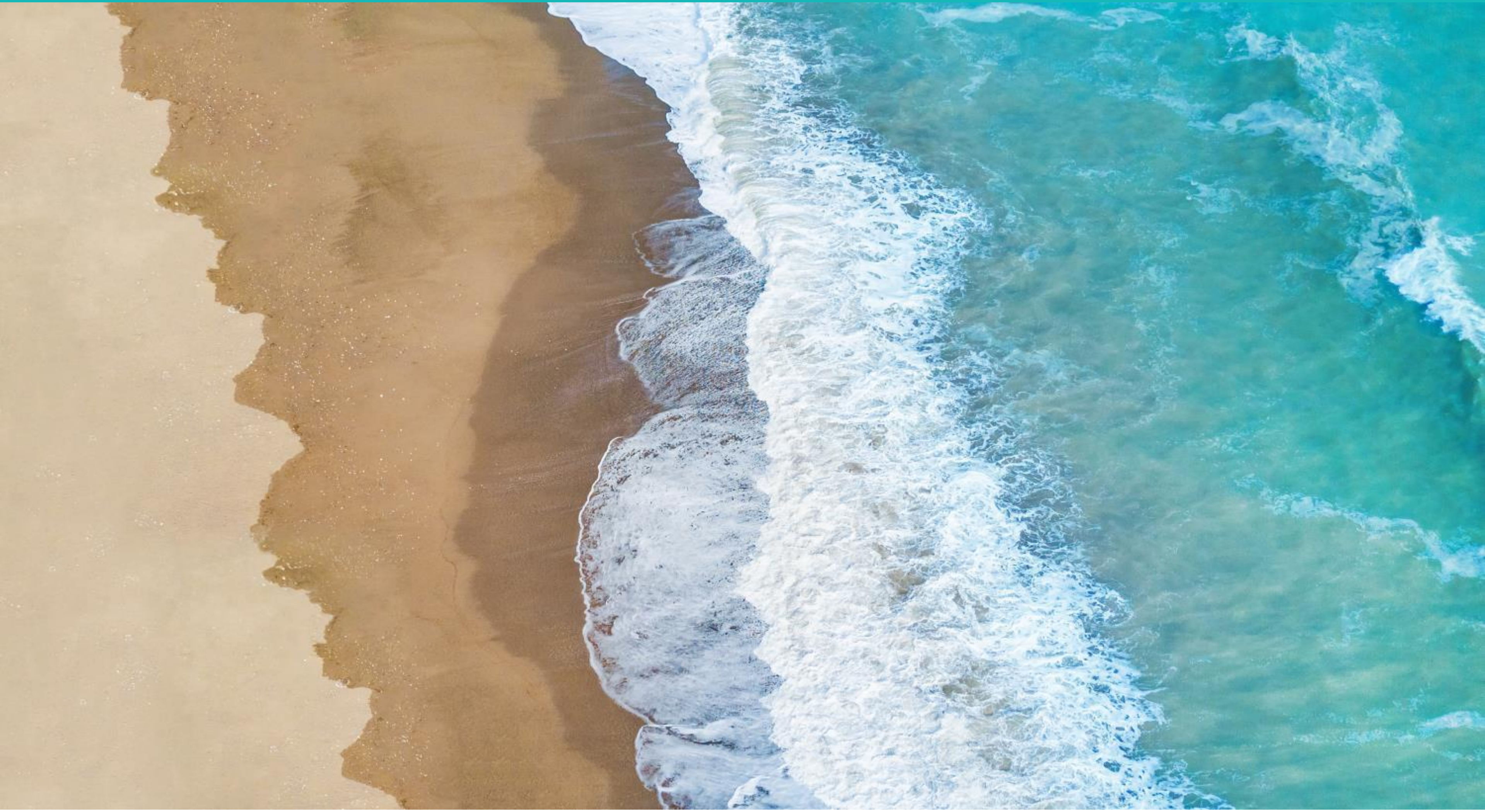
- Key central banks are shifting towards tighter monetary policy and the US Federal Reserve may be less inclined in future to act to support equity markets.
- It's unclear how central banks' unwinding of monetary stimulus will affect economies, and whether withdrawal is feasible in practice given its magnitude.
- Even small interventions by central banks could have a significant impacts on sentiment-driven markets that are near the top of the cycle.
- As monetary policy begins to diverge more meaningfully over the short to medium term, there could be continued dispersion across asset classes.
- We expect three Fed rate rises this year.

Policy support fading precipitously in 2018



Source: Fidelity International, Bloomberg, December 2017. Assuming €30bn per month in ECB support (PSPP) from January to September 2018, dropping to €15bn per month from October to December 2018; Fed balance sheet shrinking at $10bn per month from October 2017, increasing $10bn per quarter to a maximum of $50bn; and BoJ purchases slowing at a rate of 0.25% year-on-year.

Equities



Equities overview

Returning to 'normal' volatility

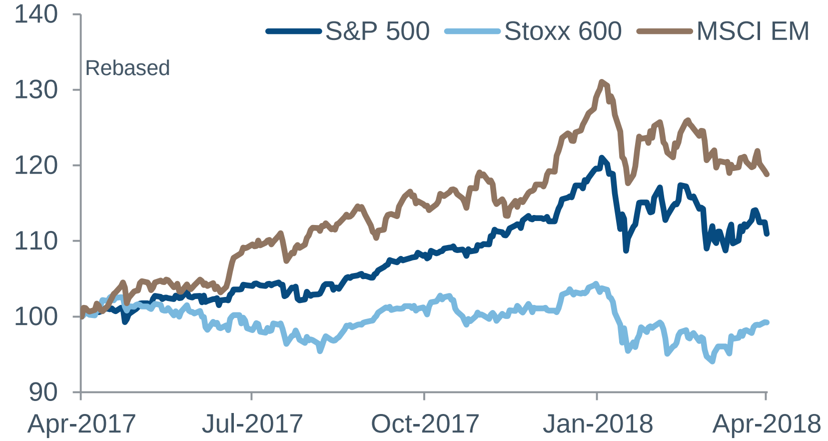
- Markets are returning to more 'normal' levels of volatility, which has shocked investors after an exceptional period of calm.
- But importantly, developed market growth is still supportive, and inflationary concerns have eased through the quarter.
- The 'Goldilocks' scenario is therefore still largely in tact, indicating the end of the economic cycle has not arrived yet.
- But it is coming into view, with a market turn perhaps 6-18 months away.

Price return, 12 months to:	S&P 500 COMPOSITE % change	STOXX EUROPE 600 E % change	MSCI EM U$ % change
30/04/2018	11.8%	-0.5%	19.1%
30/04/2017	14.7%	13.4%	16.4%
30/04/2016	-0.4%	-13.7%	-19.8%
30/04/2015	10.4%	17.1%	5.3%
30/04/2014	19.3%	13.9%	-4.2%

Fidelity global forecasts

	2018	2019
Earnings growth	15.2%	9.4%
Return on equity	14.3%	14.7%
Dividend yield	2.6%	2.8%
P/E valuation	15.6x	14.1x
P/B valuation	2.2x	2.0x

Bumpy start to the year



Source: Fidelity Insight, Fidelity International, Datastream, April 2018

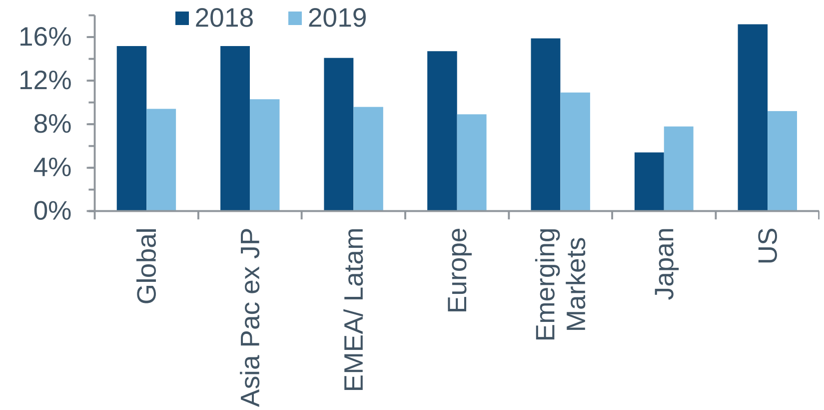
Thematic
Equities
Fixed Income
Alternatives

Equities outlook

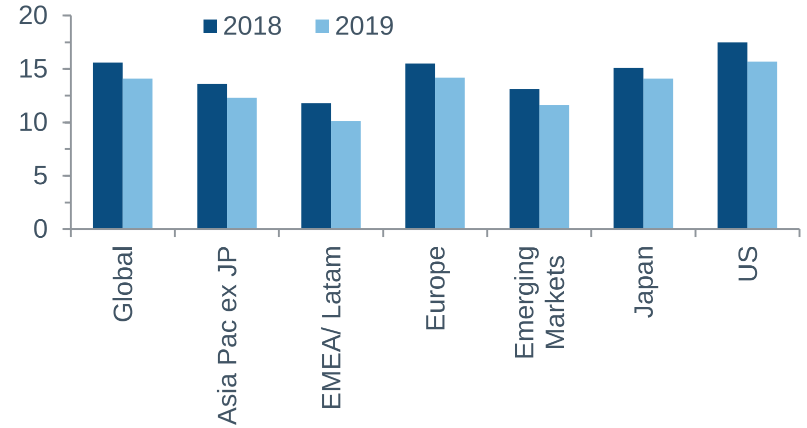
Near the top

- The main concern is that central banks are shifting towards tighter monetary policy. This could pose risks in markets accustomed to monetary support.
- Similarly, unexpected changes in macroeconomic data could rock markets because of the dependence on momentum - this is typical late-cycle behaviour.
- Recent earnings reports show the effects of rising wages and higher oil prices, particularly in the US. This strengthens our view that cyclicals will not be able to maintain their outperformance over defensives.
- In this environment, being more selective about where and how you take risk is prudent.

Forecast earnings growth peaking



Forecast P/E valuations



Source: Fidelity Insight, Fidelity International, April 2018

Equity sectors and regions

‘Goldilocks’ still intact but…

FAANG-led risks

- FAANGs remain richly valued, and led in to, and out of, the recent market corrections. The reliance on FAANGs could pose risks if sentiment shifts quickly.

Europe more stable, Japan more volatile

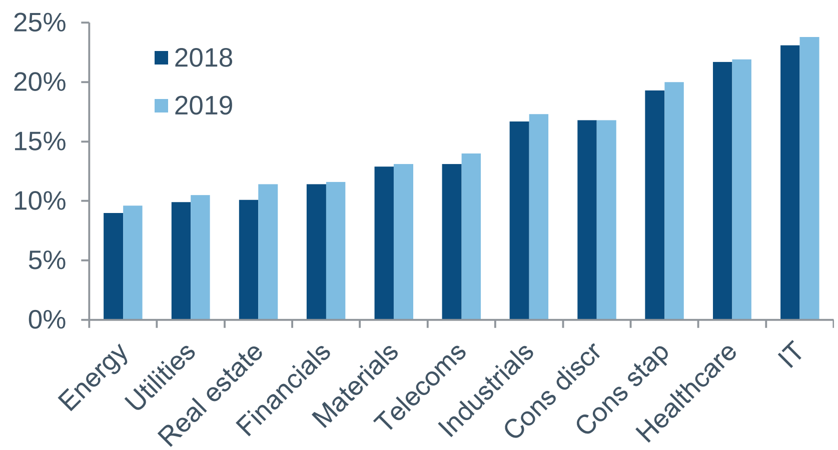
- European markets have a broader base of support than the FAANG-dominated US, so should be more robust.
- We expect China to slow gradually, but this has been largely priced in, and the government has historically carefully managed the economy.
- Japan’s high exposure to global trends leaves it vulnerable to sentiment shifts.

Negative on consumer discretionary

- Autos profits are peaking and finances deteriorating, and retailers face more restrained consumer spending, leading to our negative view on consumer discretionary.
- We don’t expect any undersupply or oil price shocks, so energy prices should be range-bound

Sectors ranked by forecast return on equity

Favoured sectors	Less favoured sectors
Technology	Energy
Healthcare	Utilities
Consumer Staples	Real Estate



Source: Fidelity Insight, Fidelity International, April 2018.

Fixed Income

Fixed income overview

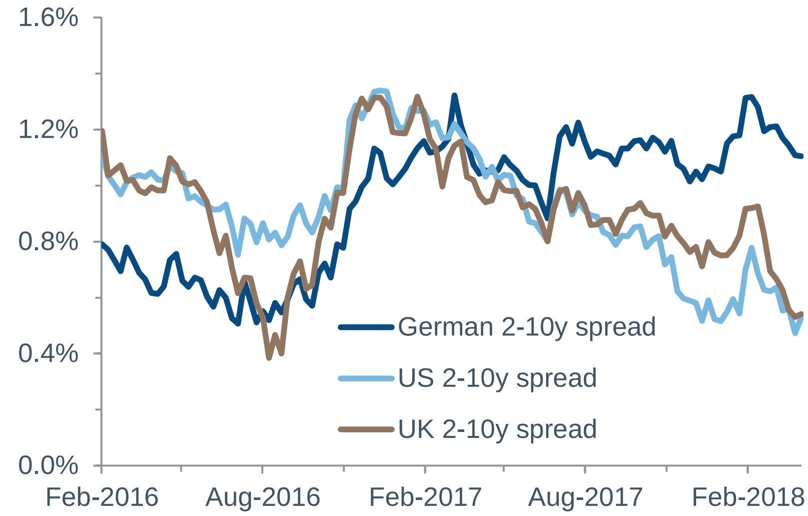
Geopolitical risks reignite

- Despite volatility in US treasuries, global government bonds ended the first quarter higher on a hedged basis, primarily supported by strengthening eurozone peripheral debt.
- Importantly, government bonds benefitted from a flight to quality as geopolitics reignited in March.
- US treasuries are caught between opposing secular forces of lower growth and higher debt, and cyclical forces of higher growth of around 3 per cent and normalising central bank policy.

Current and forecast government bond yields

10 year yield	Current	Dec-18	Dec-19
US	2.82%	3.16%	3.54%
Germany	0.51%	0.99%	1.36%
UK	1.45%	1.83%	2.17%

Global curves continue to flatten



Forecast source: Fidelity International, Bloomberg, 12 April 2018. The above forecasts are market-implied. Chart source: Fidelity International, Bloomberg, 31 March 2018.

Fixed income outlook

Safe haven characteristics should support

Three Fed rate hikes in 2018

- Against a backdrop of secular and cyclical forces, the Fed will continue to raise rates if conditions remain conducive to tightening, but they are unlikely to surprise with more hawkish commentary
- We expect three rate rises this year, in line with market consensus. But note that the market is pricing in 1.5 hikes next year versus the three implied by the Fed 'dot plot'. We suspect that slowing growth may prompt a slower pace of tightening by the Fed in 2019.

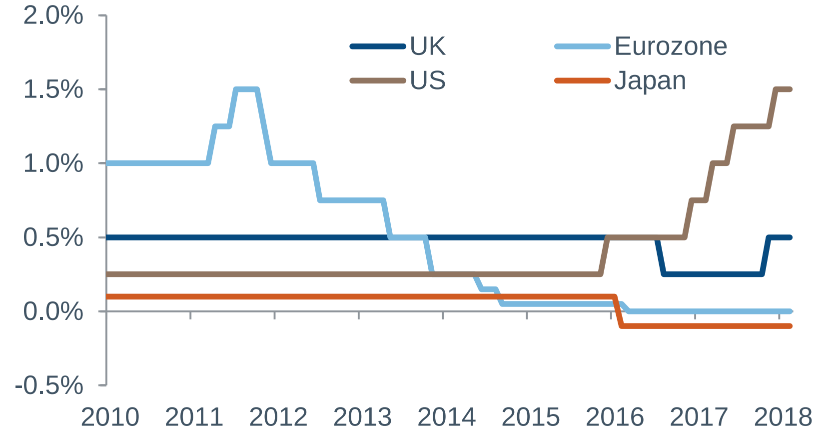
Inflation staying above 2 per cent this year

- Tight labour markets and strong survey data suggest a risk of higher inflation. We see core US CPI rising to 2.7 per cent by late summer.
- Upward pressure on US yields remains in place, but safe haven qualities in a world marked by geopolitical risks should cap yields.

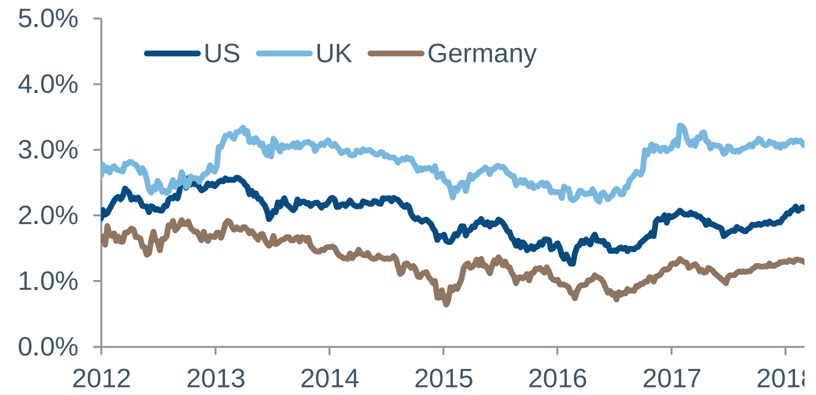
Value in Europe

- Despite some recent flattening, the yield curve in Europe remains steep on a relative basis. We see value in core eurozone government bonds.

Some key interest rates rising



10y breakeven rates indicate rising inflation



Top: Source: Datastream, April 2018.
Bottom: Source: Fidelity International, Bloomberg, 30 March 2018.

Fixed income sectors

Almost-perfect backdrop could change

Comfortable about credit

- We have become increasingly comfortable about credit over the last six months as the global economy has maintained strength and the corporate landscape is robust.
- We see more opportunity in European investment grade than the US or Asia due to strong credit fundamentals and ongoing support by the European Central Bank.

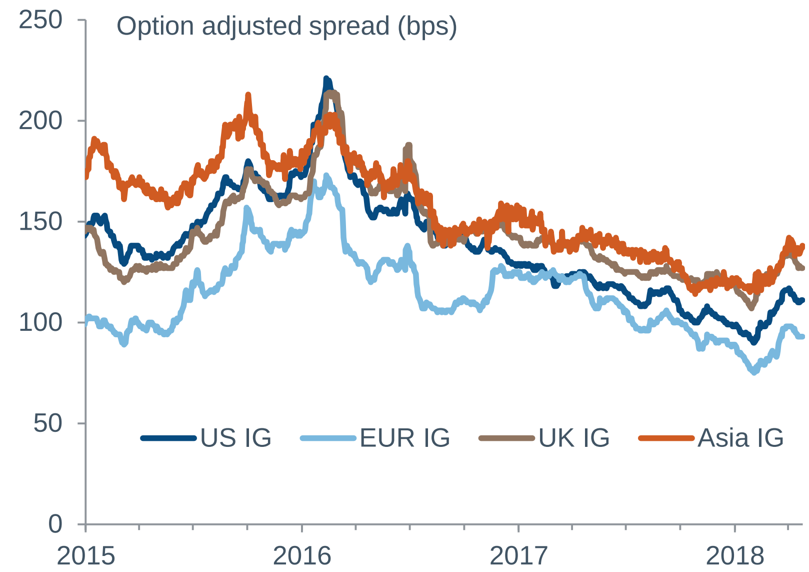
Cautious on high yield

- High yield has outperformed investment grade but we are cautious given the asset class remains highly correlated with equity markets and has less a attractive risk-return profile than investment grade debt or leveraged loans.
- We note signs of distress in US high yield in retail and telecoms.

EMD fundamentals remain solid

- EMD fundamentals are still good, but there is little opportunity for further spread compression in hard currency government bonds this late in the cycle.
- There are pockets of value in countries with higher yields and improving economic profiles such as Ecuador, Argentina and Angola

IG spreads moving wider in 2018



Price return, 12 months to:	ICE BofAML US Corporate	ICE BofAML EMU Corp Excl Banking	ICE BofAML Sterling Corp	ICE BofAML Asian Dollar IG
30/04/2018	0.8%	-0.8%	0.9%	0.4%
30/04/2017	3.0%	0.3%	10.7%	3.3%
30/04/2016	2.9%	-1.7%	2.7%	3.4%
30/04/2015	5.0%	3.1%	10.1%	7.4%
30/04/2014	0.9%	-0.4%	0.4%	0.3%

Source: Datastream, April 2018.

Fidelity INTERNATIONAL

Alternatives

Commercial real estate

Market remains buoyant

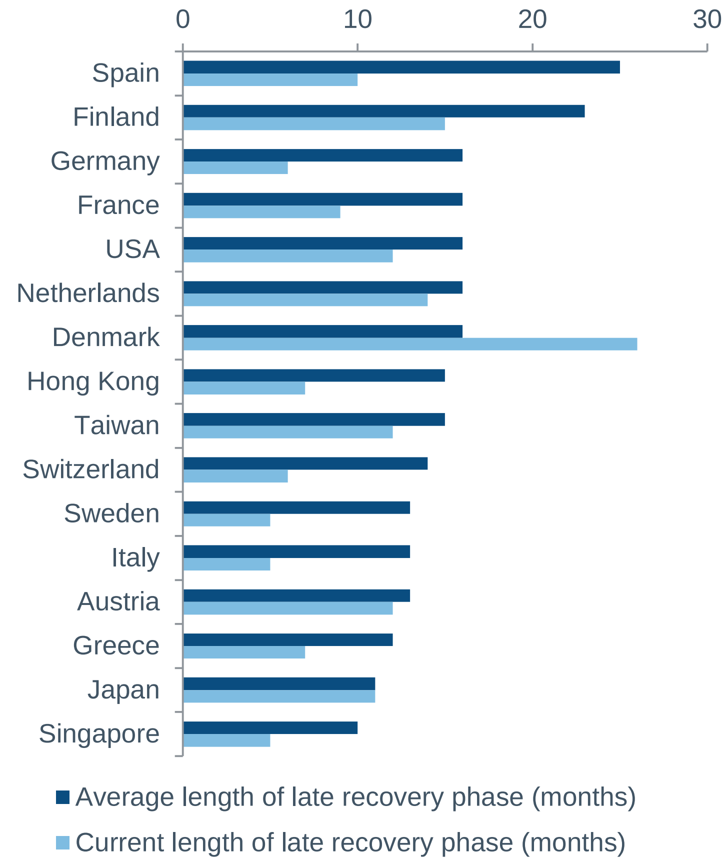
Europe is the hot spot

- Investors are increasingly favouring Europe because, although it is late in its cycle, data indicates US and some Asian markets are even more advanced.
- Europe continues to enjoy supportive monetary policy, healthy demand and corporate fundamentals are strong.

Prefer second-tier rather than prime

- Given record low yields in prime, we prefer careful asset allocation in established second-tier locations.
- But investors should be mindful that with competition for assets intensifying, there is greater potential for mispricing and a temptation for investors to shift too far away from their core strategy or move too far up the risk curve.

Countries in late cycle stage



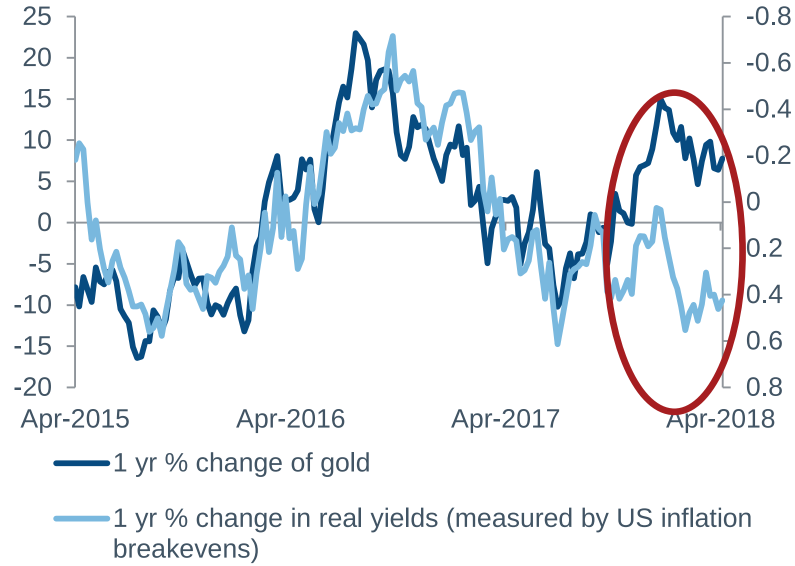
Note: Late recovery phase is where economic growth is positive and accelerating.
Source: Oxford Economics, February 2018. Period covered: 1993 -2017.

Commodities

Geopolitics clouds the outlook

- A strong beginning to the year was offset by risk aversion as markets turned more volatile across February and March.
- More recently, several commodities markets have been affected by geopolitical tensions, with oil prices benefiting from tensions in the Middle East, and aluminium prices spiking higher as the US announced new sanctions against Russia.
- But fundamentals for energy remain positive. OPEC/Russia have succeeded in restricting oil production, and demand growth has been strong.
- For gold, reduced political tensions would be negative, particularly considering its decoupling from the direction of real rates in recent months.
- Although fundamentals remain supportive for commodities overall, a stronger dollar could act as a headwind.

Gold price has diverged from real yields in recent months



Price return, 12 months to:	LBM Gold bullion
30/04/2018	3.6%
30/04/2017	-1.9%
30/04/2016	9.5%
30/04/2015	-8.7%
30/04/2014	-11.9%

Source: Datastream, April 2018.

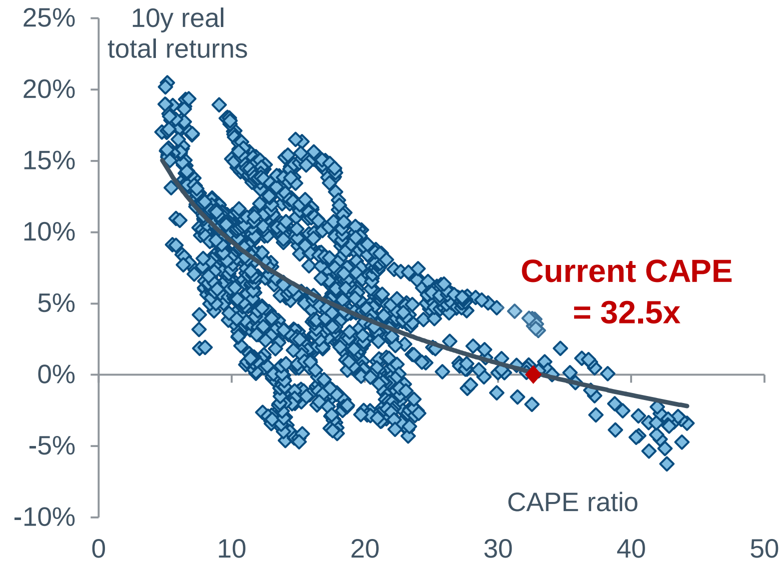
Fidelity INTERNATIONAL

Infrastructure and alternative strategies

Listed infrastructure and hedge funds offer opportunities

- Despite recent price declines, equity valuations remain elevated based on current earnings, and medium-term return expectations are relatively low.
- In this context, a listed infrastructure vehicle yielding around 4-5 per cent and able to deliver an uncorrelated return stream begins to look attractive in absolute terms.
- Long/short equity funds and global macro strategies could also become increasingly prominent as economic conditions cause asset classes to diverge in performance, creating more opportunities for nuanced directional bets.
- This environment should continue as monetary policy begins to diverge more meaningfully over the next few years and volatility remains relatively high.

US cyclically-adjusted P/E points to very low real returns



Price return, 12 months to:	S&P 500
30/04/2018	11.8%
30/04/2017	14.7%
30/04/2016	-0.4%
30/04/2015	10.4%
30/04/2014	19.3%

Note: S&P 500 cyclically-adjusted PE ratio vs next 10y real returns since 1921
Source: Robert Shiller, Fidelity International, Haver Analytics, Datastream, 2018.

Summary…

- Markets are returning to more normal levels of volatility
- The macroeconomic landscape remains supportive, and even though developed world growth is easing, it is still robust
- Rising volatility means it is important to be more selective in how you take risk; and active security selection could provide additional value
- In our opinion, we are at the beginning of the end of the current economic cycle

Important information