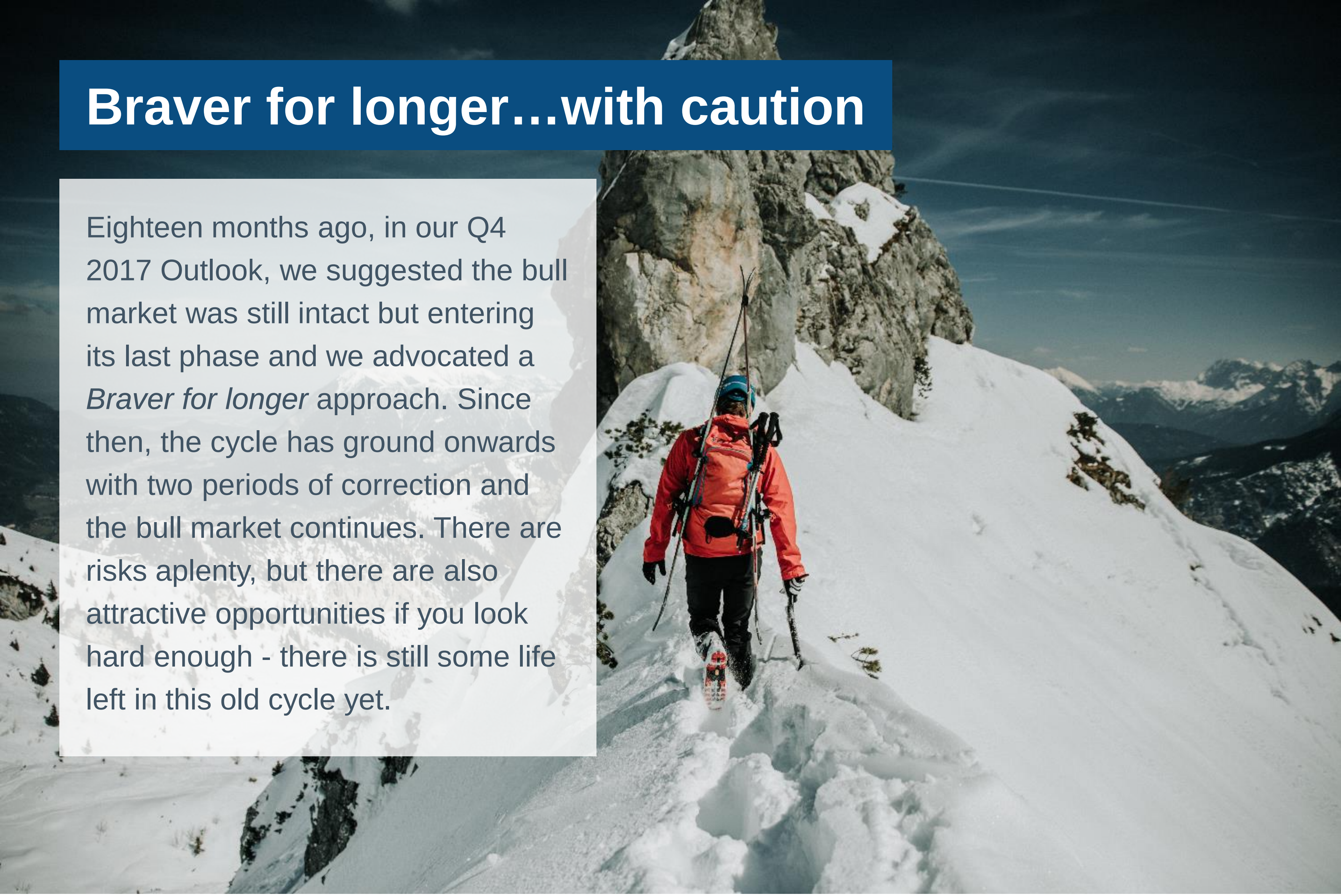
Braver for longer…with caution

Investment outlook

Q2 2019



Braver for longer…with caution

Eighteen months ago, in our Q4 2017 Outlook, we suggested the bull market was still intact but entering its last phase and we advocated a *Braver for longer* approach. Since then, the cycle has ground onwards with two periods of correction and the bull market continues. There are risks aplenty, but there are also attractive opportunities if you look hard enough - there is still some life left in this old cycle yet.

Key highlights

- **Macro:** Greater clarity on the economic cycle will only emerge towards the middle of the year, but in the meantime the overall picture suggests the global industrial slowdown is continuing. As a result, markets are back into a ‘bad is good’ mindset.

- **Equities:** Earnings growth expectations for 2019 have moderated and although we have reasons to be positive, we think consensus estimates may still be too high.

- **Fixed Income:** With US yields at around 2.5 per cent, and the market pricing in some chance of cuts this year, US treasuries have limited room to rally further.

- **Multi Asset:** Given the heightened volatility in markets and the uncertain direction of the global economy, now is the time to be active in every sense of the word.

- **Real Estate:** New capital deployment faces style-drift risks. It will be vital to recognise unintended strategy drifts early enough to adjust course and, therefore, to avoid an escalation of risk as the European real estate investment cycle unwinds.

Contents

Economic outlook

"The disconnect between economic fundamentals and markets is unlikely to be sustainable in the short term. Markets are poised for big swings in risk sentiment over coming weeks and possibly months."

Anna Stupnytska

Head of Global Macro and Investment Strategy

Fidelity INTERNATIONAL

GEARs: Tentative signs of stability

Current economic activity: No green shoots in DM, some promise in EM

What's changed

- The global economy stabilised over the past couple of months, after a volatile end to 2018. However, on a country-by-country basis, the picture is decidedly more mixed. All major developed markets are slowing, while emerging markets shows some signs of expansion.

Key takeaway

- The US has rolled over, but at 2.8% it is far from concerning. Japan is in contraction territory (-0.8%) and the Eurozone is not far behind (0.8%). DM average 1.1%, EM average 2.8%.

Investment implication

- The indicator is stabilising but there are several pockets of concern around growth. Growth is still positive overall and investors shouldn't panic; tilting portfolios towards higher quality assets may help build in some resilience.

Global GEARs suggest some stabilisation

Source: Fidelity International, March 2019
The Fidelity Gauges of Economic Activity in Real-time (GEARs) are monthly 'close-to-real-time' indicators of current activity across several key developed market and emerging market economies. They are a proprietary quantitative input to Fidelity's investment process, providing insight into economic activity that supports tactical decision-making in portfolios.

FLI: Near-term weakness ahead

Future economic direction: Red lights, not green shoots

What's changed

- The FLI cycle tracker plunged deeper into the 'bottom-left' quadrant (growth below-trend and decelerating), after remaining there for 11 months. This suggests that the global deceleration seen in late 2018 has intensified further and the current downturn may still have some way to go.

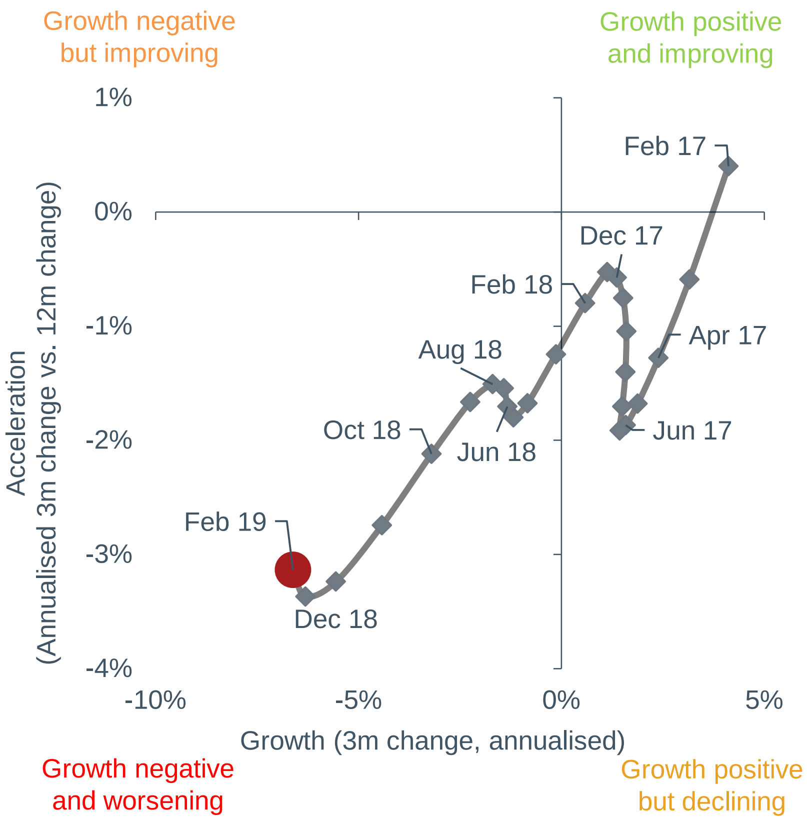
Key takeaway

- Four out of five FLI sectors are now mired in the 'bottom-left' quadrant where growth is negative and worsening. The key drivers of global growth are still negative on balance, despite some signs of policy easing.

Investment implication

- As risk assets have rebounded significantly, and sentiment is no longer oversold, it may be time to sell the rally and to maintain duration hedges.

FLI is unmoved despite dovish central banks



Source: Fidelity International, March 2019
The Fidelity Leading Indicator (FLI) is a proprietary quantitative tool, used as an input into shorter-term asset allocation decisions by Portfolio Managers. It is a model designed to anticipate the direction and momentum of global growth over the coming months, and - importantly for investors - identify its key drivers.

Data & Policy: Fears of a US recession may be overdone

Contrarian position on Fed policy

What's changed

- Markets are interpreting data showing the US economy is slowing as marking the end of the Fed's hiking cycle and the Fed confirmed that data is not pointing to a move either way. The ECB delivered a dovish surprise, committing to holding rates in 2019 and more bank financing.

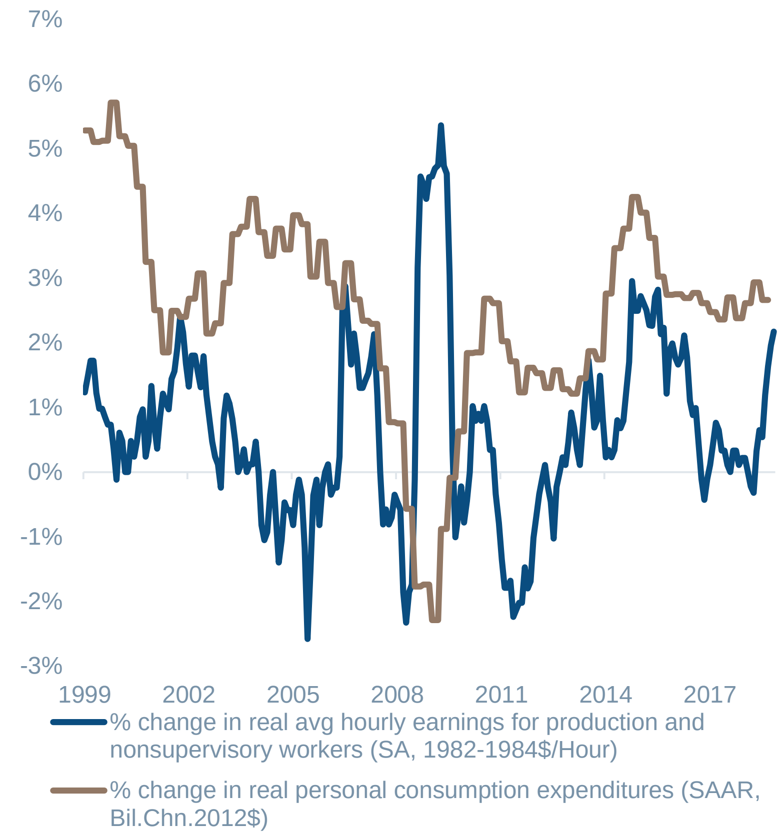
Key takeaway

- Despite the negative market sentiment around economic growth, a combination of easier US financial conditions, a tightening labour market and some improvement in growth and inflation later in the year could push the Fed back into a normalisation path.

Investment implication

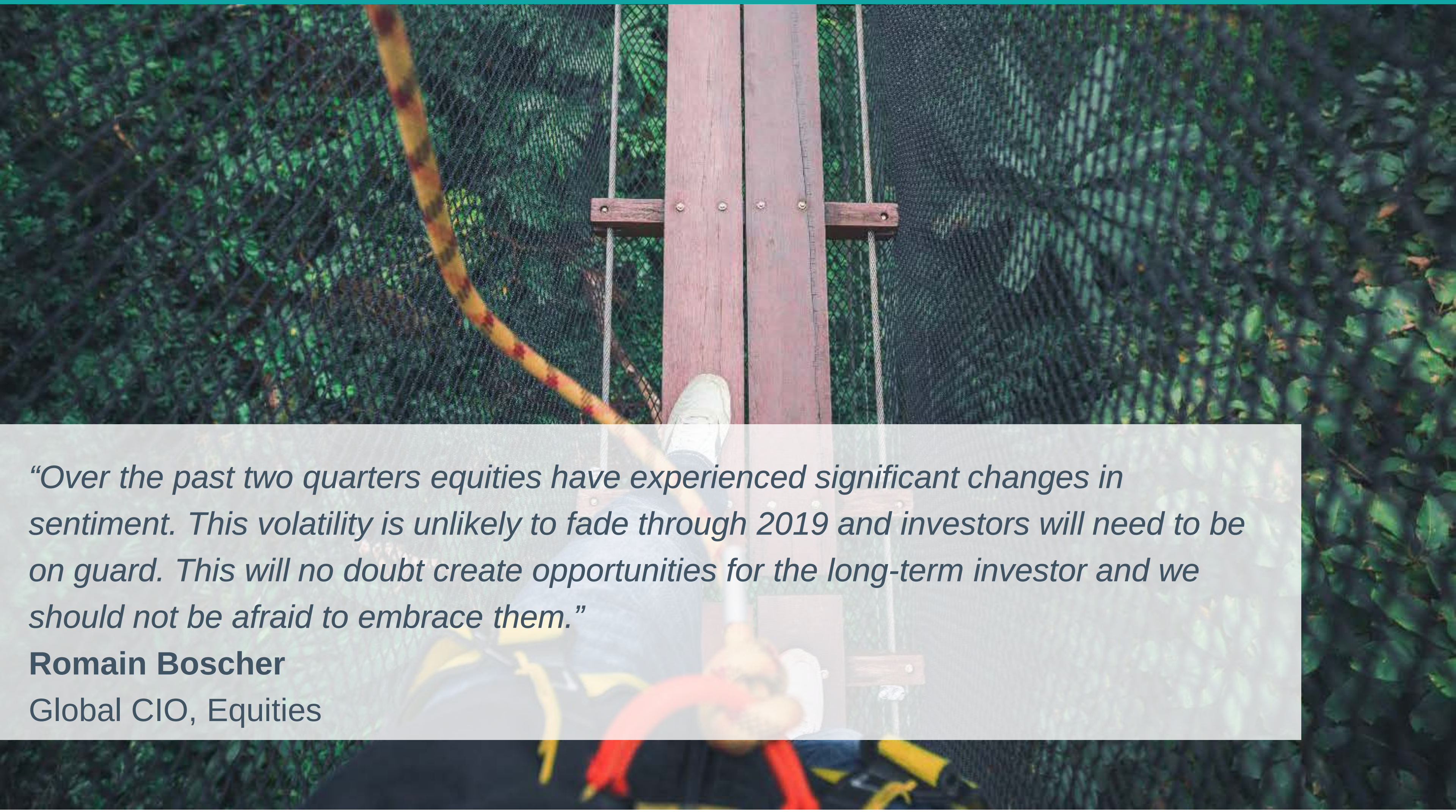
- Markets are back into a 'bad is good' mindset, where conventional interpretations of data may not necessarily have the expected impact.

US wage inflation rising



Source: BLS, BEA/Haver, Fidelity International, March 2019

Equities



“Over the past two quarters equities have experienced significant changes in sentiment. This volatility is unlikely to fade through 2019 and investors will need to be on guard. This will no doubt create opportunities for the long-term investor and we should not be afraid to embrace them.”

Romain Boscher

Global CIO, Equities

Equities: Overview

Market swings create pockets of opportunity

What's changed

- Equity markets have rallied year to date. Driven by the US Federal Reserve's dovish turn and positive news flow around the US and China trade dispute, equities rebounded from oversold and bearish levels in late December to more sensible valuations as the first quarter progressed.

Key takeaway

- After very strong earnings growth in 2018, expectations are more moderate for 2019. Although we have reasons to be positive, we think the consensus estimate of 6 per cent earnings growth in the US is still too high.

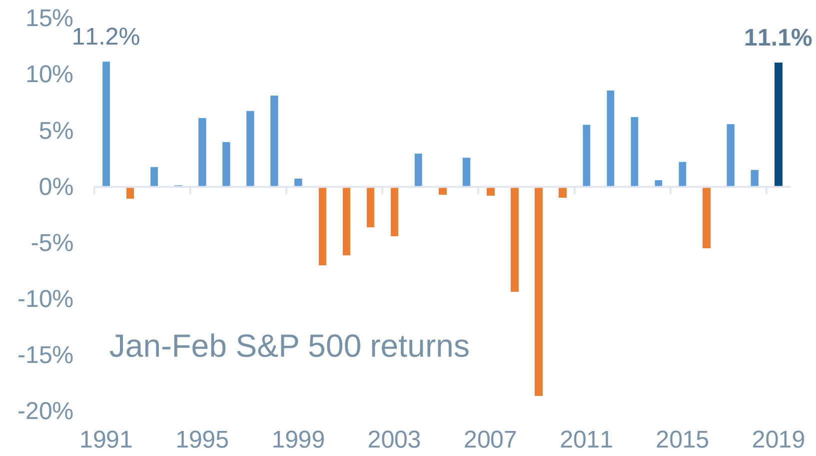
Investment implication

- While corporate earnings growth forecasts remain too optimistic, our analysts continue to find opportunities on a regional and sectoral level, particularly in Japan and among cyclical stocks with Chinese exposure.

Fidelity global forecasts

	2019	2020
Earnings growth	3.0%	8.9%
Return on equity	13.9%	14.3%
Dividend yield	2.7%	2.9%
P/E valuation	14.7x	13.4x
P/B valuation	2.0x	1.9x

Best start to the year for over a quarter of a century



Top - Source: Fidelity International, 19 March 2019
Bottom - Source: Refinitiv, March 2019

Equities: Regions

Influential central banks

US: Conditions supportive in the near-term

- We expect no further rate hikes until at least September, which could support equities as fears around a policy mistake leading to recession fade.
- Autos could offer contrarian opportunities. The sector is getting negative attention because of loan delinquencies and tariffs, but the time to buy autos is when the picture is very bad and about to turn a corner – we could be approaching this point.

Europe: Continuing to slow

- We anticipate the European economy will continue to decelerate. However, this could remove pressure for the ECB to raise rates, supporting equity valuations.
- In this environment, structural growth companies typically perform well.

Fidelity earnings growth forecasts

	2019	2020
US	2.7%	10.9%
Europe	2.4%	7.0%
Asia ex Japan	4.5%	9.9%
Japan	1.3%	3.5%
Emerging markets	3.4%	7.2%

Fidelity capital market assumptions

	3 years	5 years	10 years
US equities	7.2%	6.6%	5.2%
European equities	5.3%	5.8%	5.1%
Japanese equities	4.4%	4.7%	3.9%
Developed market equities (US$)	7.4%	7.4%	6.2%
Emerging market equities (US$)	8.7%	8.6%	7.5%

Top - Source: Fidelity International, 19 March 2019
Bottom - Source: Fidelity International, November 2018
These are estimates of return per year in USD, based on our proprietary modelling, for illustrative purposes only. They reflect the views of investment professionals at Fidelity International. Indices used for calculation: US equities - S&P 500, European equities - MSCI EMU, Japanese equities - TOPIX, DM equities - MSCI World, EM equities - MSCI EM.

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Equities: Regions

Slowdown offers areas of value

Asia ex Japan: Not all bad

- Slowing consumption in China is driving fears about its economy but the gloominess should not be exaggerated.
- There is appetite for some sort of stimulus, focussed on the consumer through tax breaks for individuals and companies, rather than on supporting the property market.

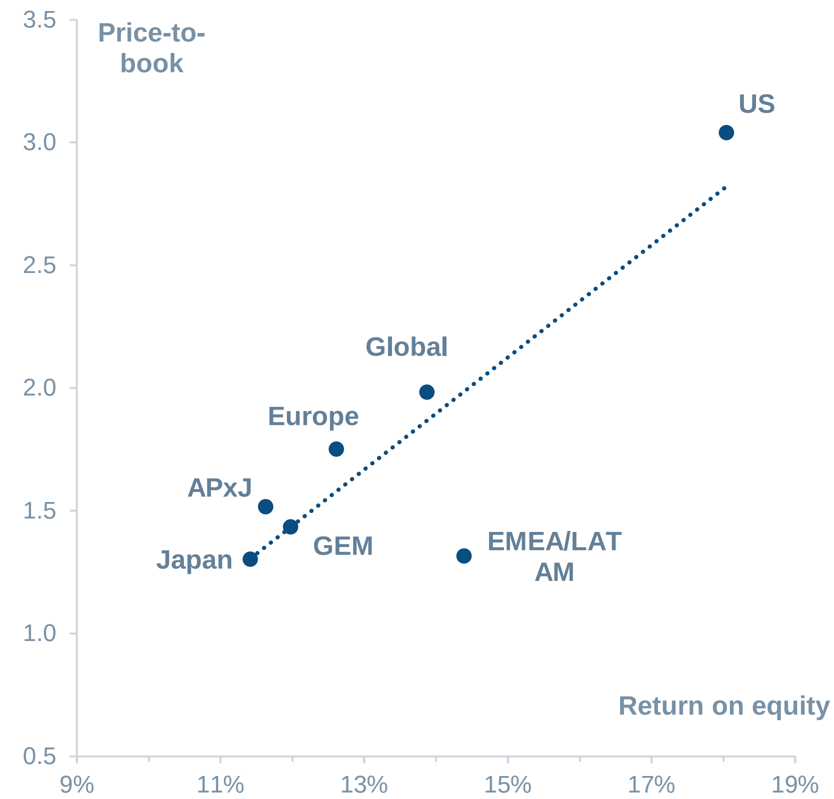
Japan: Rich pool of ideas

- Had a bad earnings seasons and sentiment is sombre, but the country presents bargains for the selective investor.

EM: Trade news and dovish Fed offset by currency weakness

- We are positive on Russian and Mexican banks, but high expectations in Brazil leaves room for disappointment.

Most regions fairly valued in equities except US, which looks slightly expensive



Based on FY19 results. Source: Fidelity International Insight, 19 March 2019

Equities: Sectors

Healthcare leads the way

Top three sectors

Healthcare: Product cycle drives opportunities

- In the US and Europe, we expect a strong product launch cycle among large cap pharmaceutical companies which should offset pricing pressures.

Communication Services: Further monetisation to come

- US internet companies benefitting from growth in digital advertising. Media and entertainment starting to see clarity in future structure of the industry.

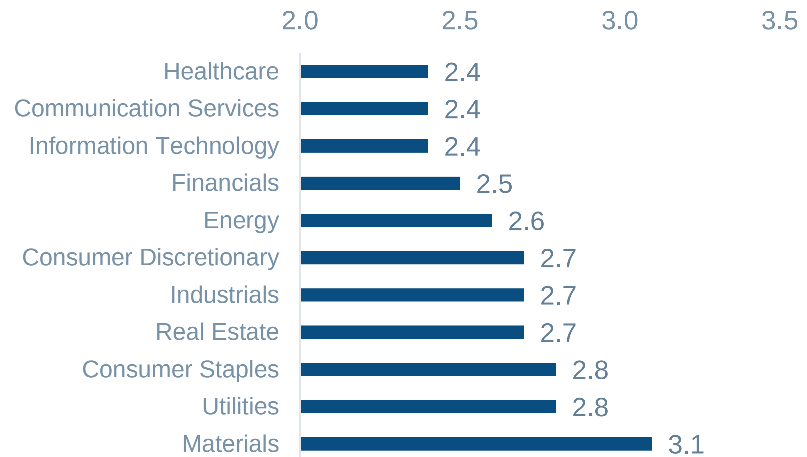
Information Technology: Still innovating

- Industry innovation continues to drive our overall positive view on technology. US IT spending continues to look robust driven by the shift to cloud services.

Favoured sectors	Less favoured sectors
Healthcare	Materials
Communication Services	Utilities
Information Technology	Consumer Staples

Fidelity analyst ratings most positive in Healthcare

Cap weighted average rating
(1=strongly positive, 5=strongly negative)



Source: Fidelity International, 25 February 2019.

Equities: Sectors

China a drag, for now

Bottom three sectors

Materials: China dominates the story

- Weak construction demand and deteriorating credit conditions in China, a strong US dollar and lingering uncertainties around the US-China trade war are driving our view.
- There could be some scope for China to turn a corner, but we are not there yet.

Utilities: Expensive, given the headwinds

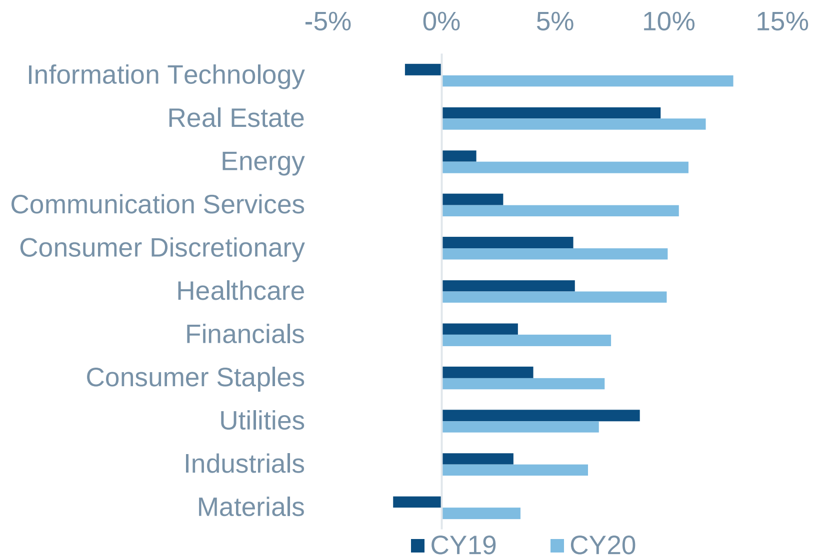
- Asia ex Japan have expensive valuations and face earnings headwinds from high coal prices, forming our negative view.

Consumer Staples: Gloomy across the sector

- US dealing with higher interest rates, European retail faces ecommerce threat and China consumer sentiment has peaked.

Favoured sectors	Less favoured sectors
Healthcare	Materials
Communication services	Utilities
Information technology	Consumer staples

Fidelity earnings growth forecasts on two-year view



Source: Fidelity International, 25 February 2019.

Fixed Income

"The Fed's dovish turn has helped risk assets. As we get closer to the end of the credit cycle, however, investors should keep a watchful eye and prefer quality over income at any cost."

Steve Ellis

CIO, Fixed Income

Fixed Income: Overview

Fed's dovish turn has helped risk assets

What's changed

- The US Federal Reserve's December pivot towards dovishness was unexpected and the March meeting reinforced this new direction. Having stuck to a hawkish stance and raised benchmark interest rates nine times since December 2015, this was a significant shift for the central bank.

Key takeaway

- We see the Fed resuming its hiking path either later this year or in 2020, which compares with rate cuts currently expected by the market as early as Q1 next year.

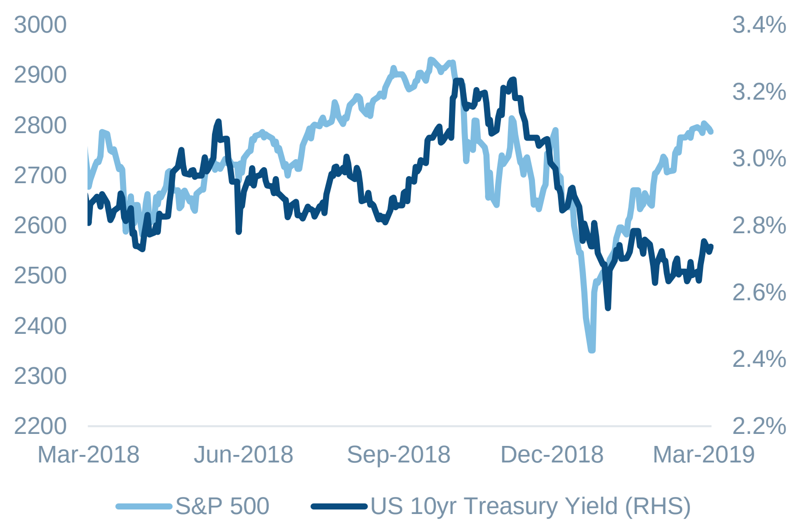
Investment implication

- With US yields at around 2.5 per cent, and the market pricing in some chance of cuts this year, US treasuries have limited room to rally further. We favour a tactical short position, expecting US rates catch up to the equity bounce.

Current and implied government bond yields

10 year implied yield	Current	Mar-2020	Mar-2021
US	2.43%	2.51%	2.60%
Germany	-0.03%	0.12%	0.26%
UK	1.02%	1.16%	1.28%

US treasury yields failed to follow US equities higher



Top – Source: Bloomberg, 22 March 2019
Bottom – Source: Fidelity International, Goldman Sachs, Bloomberg, 5 February 2019

Fixed Income: Inflation-linked

Moving to neutral on US

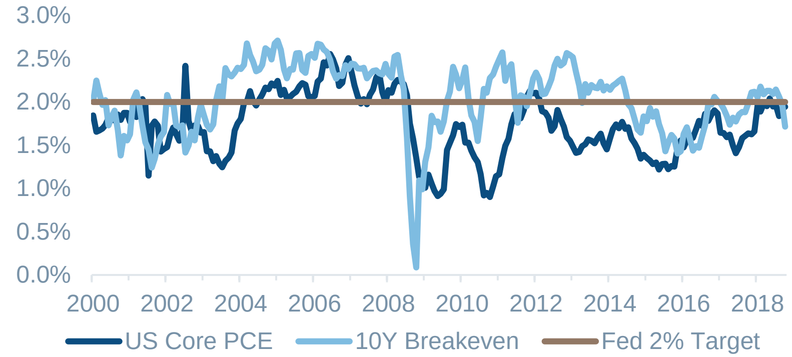
US inflation to pick up later in the year

- This should be the last negative monthly contribution from falling oil prices and headline US CPI should remain here for the next six months (assuming no further declines in oil) before picking up in the latter stages of the year.
- The structural tailwinds from a tight labour market and rising wages remain. Valuations in US breakevens however, largely reflect the benign market environment. Having been long since the beginning of the year, we now move to a more neutral stance.

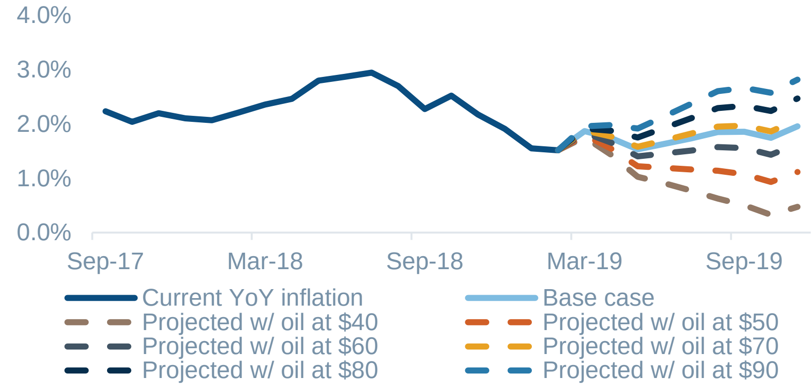
Brexit uncertainty

- With the Brexit deadline fast approaching, and no agreement in sight just yet, we have reduced our shorts in UK breakevens, waiting for more clarity before reengaging.

Fed's inflation measure has remained below target



Fidelity US CPI inflation forecasts conditional on oil prices



Top – Source: Fidelity International, as at 31 December 2018
Bottom - Source: Fidelity International, February 2019

Fixed Income: Investment grade

Neutral stance on US IG

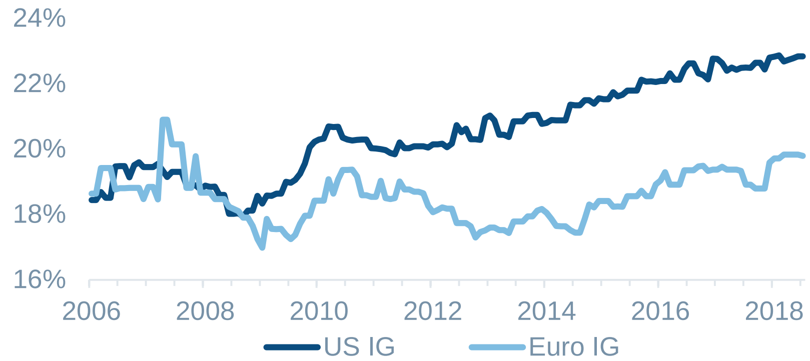
Leverage is a worry

- In the US, rising fundamental risks have been on our radar for some time. Leverage levels have ticked higher, partly to pay out rewards to equity holders, and the share of US BBB-rated bonds has now reached a multi-year high.
- High valuations and a lack of ‘safe-havens’ amid a plethora of risks characterised US investment grade for most of 2018.
- The future direction will be swayed by macro trends and Fed policy. If economic data is solid enough to support a further rate hike this year, it’s unlikely that spreads can tighten much more, driving our shift to a neutral stance.

Economic concerns in Europe

- Although we are positive on the backdrop for European corporates, the region is susceptible to recent slowing in the Eurozone economy so we expect to reduce exposure in response to any further tightening of spreads.

US IG corporate margins elevated



US BBBs have been under the spotlight

Top – Source: Fidelity International, Bloomberg Barclays bond indices, February 2019
Bottom - Source: Fidelity International, Bloomberg Barclays bond indices, 5 February 2019

Fixed Income: High yield

Strong start to the year but vulnerable

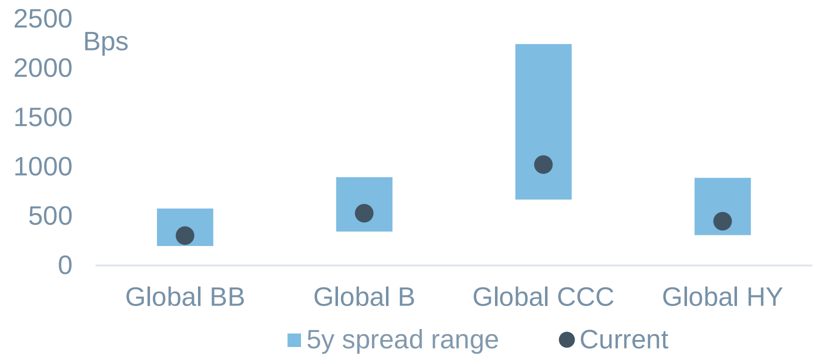
Exposed to economic slowdown

- While market momentum and a supportive interest rate backdrop may tighten spreads further, this asset class is particularly vulnerable to the slowing global economy.
- We are neutral on high yield with the weak valuation support tempered by our view that a recession is unlikely in 2019, carry should keep total returns cushioned and our quantitative models indicating favourable seasonal and momentum factors.

Looking for quality

- In the US, while we are neutral for now, we are looking for opportunities to increase the average quality of our exposure and marginally reduce risk.

Room for spreads to tighten in some areas



Global default rates are still low historically

Top – Source: Fidelity International, ICE BofA Merrill Lynch, ICE BAML Indices (HW1C,HW2C,HW30,HW0J), 28 February 2019
Bottom - Source: Fidelity International, Moody's Investor Service, BAML (H0EN, H0A0), February 2019

Fixed Income: Emerging markets

Lowering US growth expectations has been typically supportive for EM

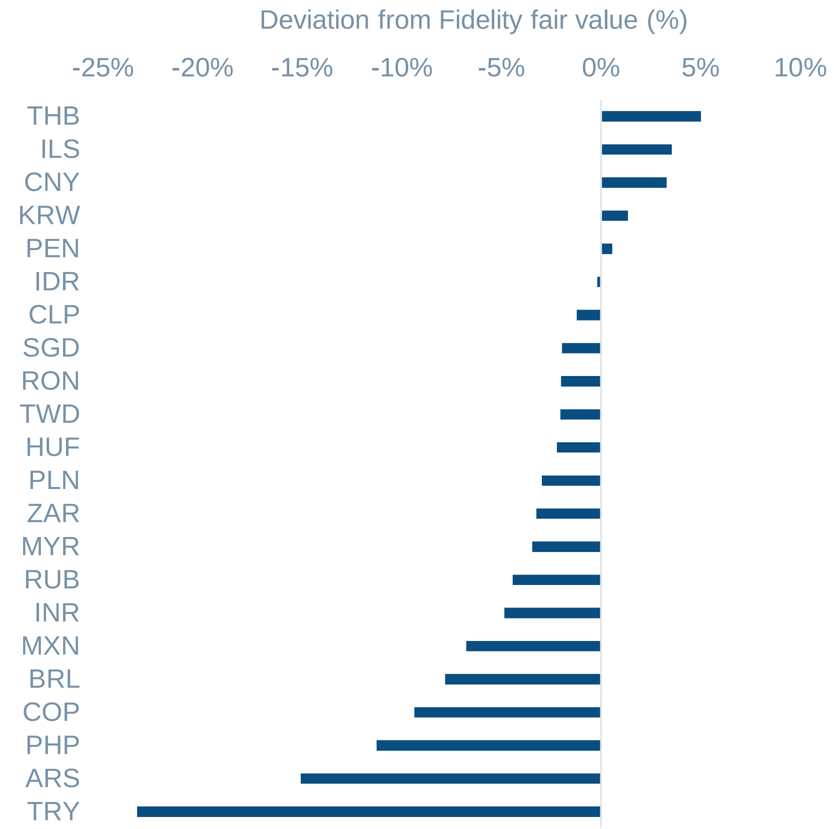
Tailwinds from Fed and China stimulus

- We maintain our bullish stance on EM debt given the tailwinds that support our thesis - a more dovish Fed and Chinese stimulus - continue to play out.
- There are risks, however, particularly from politics. Numerous elections in 2019, including in Argentina, Nigeria, South Africa, India and Indonesia coupled with the possibility of increased issuance, present risks to current valuations.

EM central banks could unwind rate hikes

- As the US dollar weakens, countries such as Turkey, Mexico, Indonesia and South Africa may look to unwind the rate hikes from last year and ease financial conditions. If this is done responsibly, it should support local currency bonds and not lead to a major weakening of EM currencies

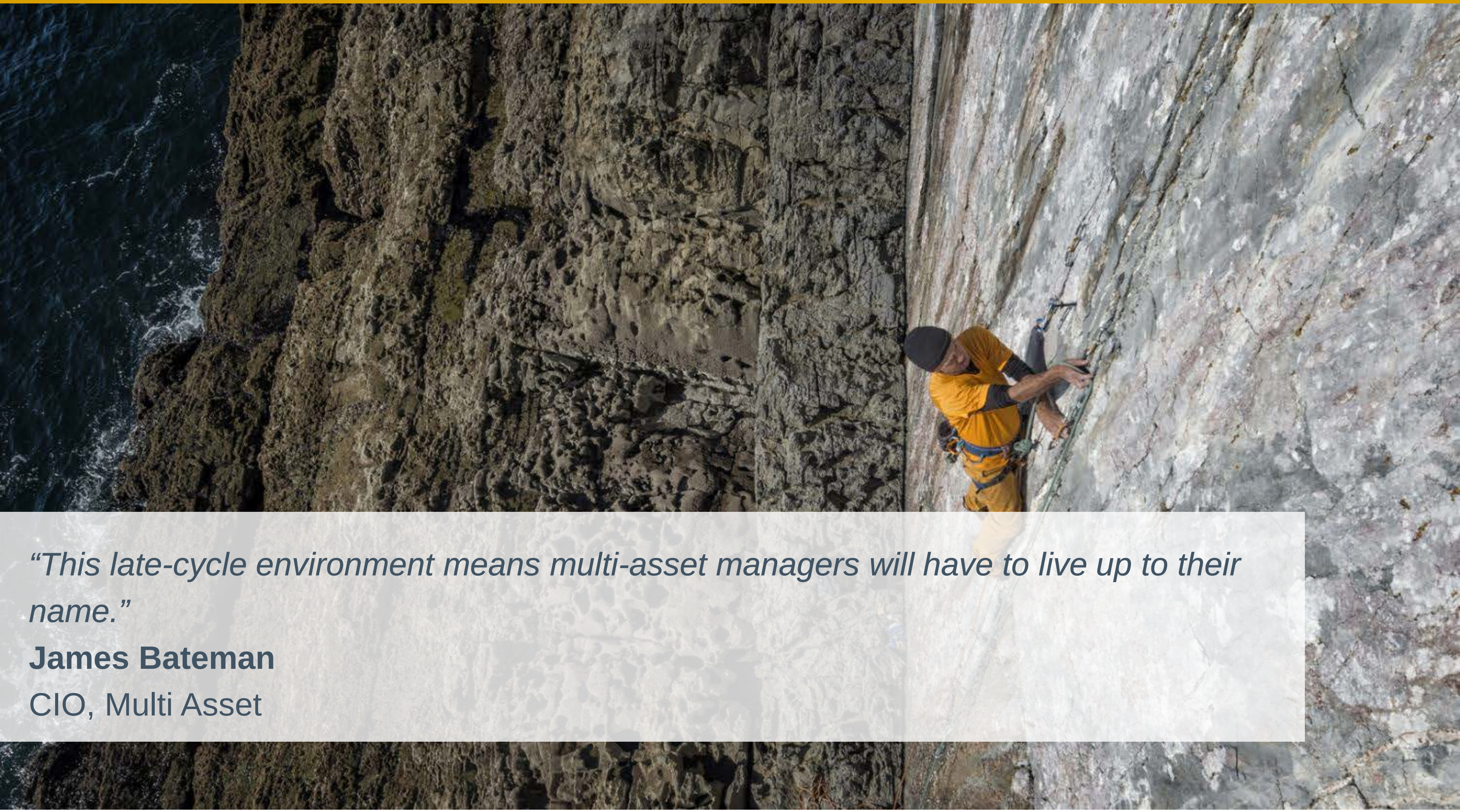
EM currencies look cheap relative to fair value



Source: Fidelity International Quantitative Research, March 2019

Economic outlook | Equities | Fixed Income | Multi Asset | Real Estate

Multi Asset



“This late-cycle environment means multi-asset managers will have to live up to their name.”

James Bateman

CIO, Multi Asset

Multi Asset: Overview

Unconvincing risk-on rally

What's changed

- The broad-based risk rally that started after Christmas has not yet subsided, driven by the Fed signalling a slower pace of monetary tightening, and by positive signs on the trade talks between the US and China.

Key takeaway

- If the market was fully convinced of a return to risk, then defensive assets like US treasuries and gold would have faltered by now. Instead, they have continued to perform, leading us to believe that market participants remain open to the possibility of global growth faltering.

Investment implication

- Given heightened volatility and the uncertain direction of the global economy, now is the time to be active. We are overweight equities, preferring value stocks in the US, defensive assets like US treasuries and are biased to high quality in credit.

Volatility spiked at the end of 2018

Source: Refinitiv, March 2019

Multi Asset: Equities

Overweight equities but regionally selective

What's changed

- We are now reassured by China stimulus and the Fed 'pause' but are selective given regional disparities in attractiveness.

Investment implications for selected markets

- **US –** We favour value stocks over the technology-heavy growth areas of the market. While a dovish Fed has improved the picture substantially, we are closely watching corporate earnings and the growth trajectory for signs of weakness.
- **Europe ex UK -** Germany has at least temporarily avoided a recession. All eyes are on the direction of growth in China given the region's EM export dependence, but we are not optimistic in the medium term despite a short-term bounce in January. Italy's recession is weighing on sentiment for the Eurozone.
- **Asia Pacific ex Japan** - Positive signs on the US / China trade talks are positive for the region. After a difficult 2018 for China, total social financing hit record highs in January, showing that liquidity provision is beginning to kick in – a boon for markets.
- **Global emerging markets** - We maintain our overweight position and continue to believe that emerging markets have significant upside potential. A more dovish Fed will allow easier EM central bank policy, and supports EM currencies against the USD. While oil has risen materially it is still well off its multi-year highs reached in 2018, another key boost.

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Multi Asset: Fixed Income

Biased to high quality

What’s changed

- To balance our overweight position in equities, we continue to like fixed income over cash, and are biased to quality across regions.

Investment implications for selected markets

- **US treasuries** - We have moved overweight US treasuries, which we see as an effective hedge should equity market volatility return, and we continue to like US duration exposure.
- **Euro core** - Bunds remain a defensive asset relative to the Euro periphery, but we are not optimistic on the outlook for the asset class over the course of 2019 given the current low yields and intention of the ECB to normalise policy.
- **Investment grade** - High levels of selectivity are required in this asset class given the risk of downgrades, and we prefer high quality, USD-denominated issues with short maturities.
- **US high yield** - The ‘Fed pause’ has driven a rally in US high yield. However, we believe that sentiment has overshot in a search for yield, and don’t believe the strong performance shown so far in 2019 is sustainable.
- **Emerging market corporate debt** - While there are promising signs for emerging markets, we don’t believe that corporate debt is the most prudent way of gaining exposure. Global pressure on corporate credit continues to outweigh the positive signs.

Multi Asset: Currency

Short the US dollar and euro, long the yen

Investment implications for selected markets

- **US dollar -** The Fed has already significantly softened its rhetoric and hiking plans, signalling an outright ‘pause’ on rate hikes and perhaps even an end to ‘Quantitative Tightening’. With the domestic economy slowing, and ‘twin deficits’ still a concern, expensive fundamental valuation makes the dollar a ‘sell’ against select currencies.
- **Euro -** Disappointing core inflation is compounded by plunging PMI surveys and the ECB turning even easier at the margin. Combined with rising political risks and slowing external demand, this will likely exert further downward pressure on the euro.
- **Japanese Yen -** JPY remains attractive as a very cheap defensive asset. There is upside potential resulting from the decline of interest rate differentials as markets start to price in the next US downturn.

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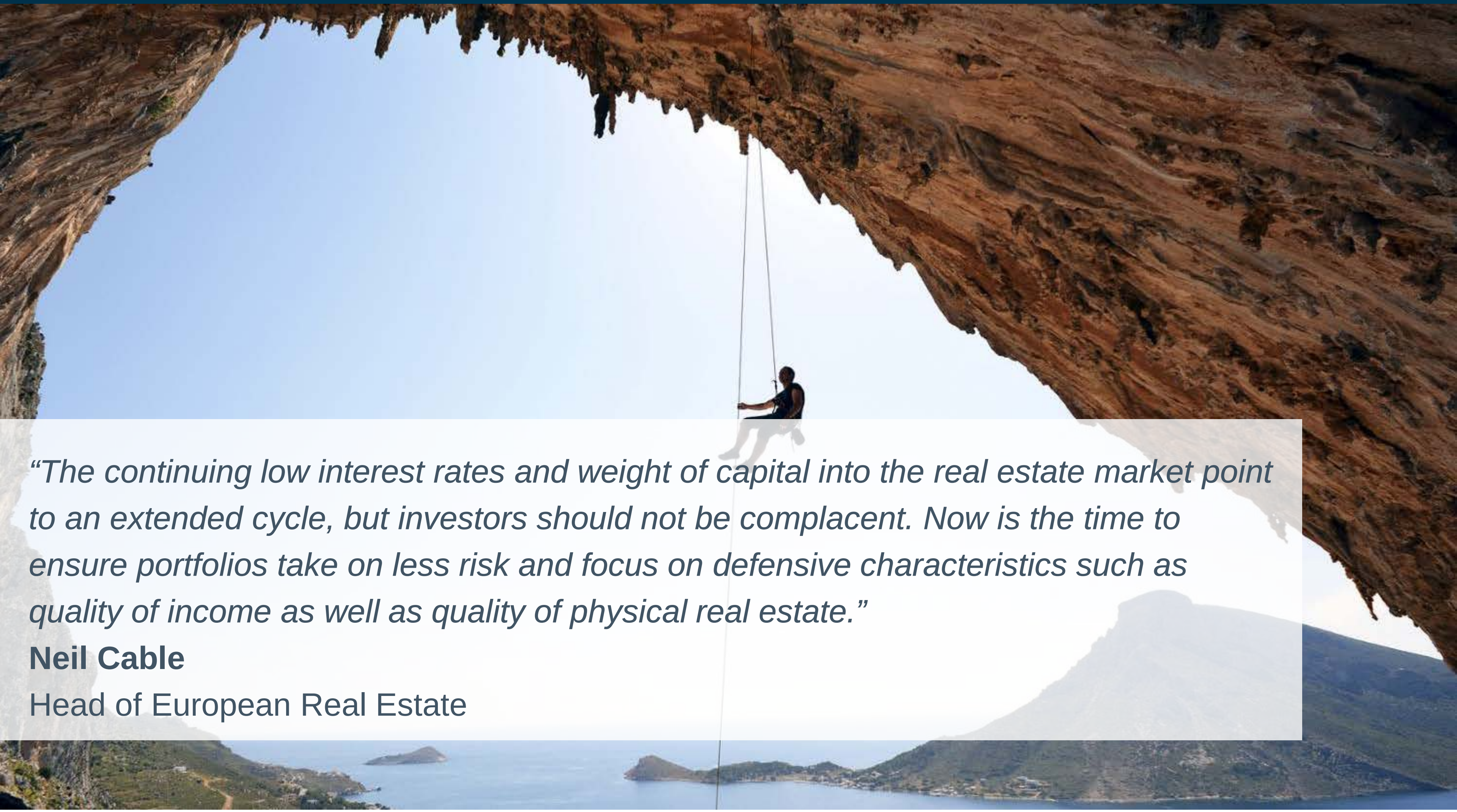
Real Estate



"The continuing low interest rates and weight of capital into the real estate market point to an extended cycle, but investors should not be complacent. Now is the time to ensure portfolios take on less risk and focus on defensive characteristics such as quality of income as well as quality of physical real estate."

Neil Cable

Head of European Real Estate

Real Estate: Overview

Mismatch between price and fundamentals

What's changed

- There have been several disruptions to the Eurozone economy, such as Germany narrowly avoiding technical recession and the French Gilets Jaunes protests. The near-term Eurozone economic outlook is underwhelming, but stable. In the UK, retail valuations are starting to reflect the weak fundamentals.

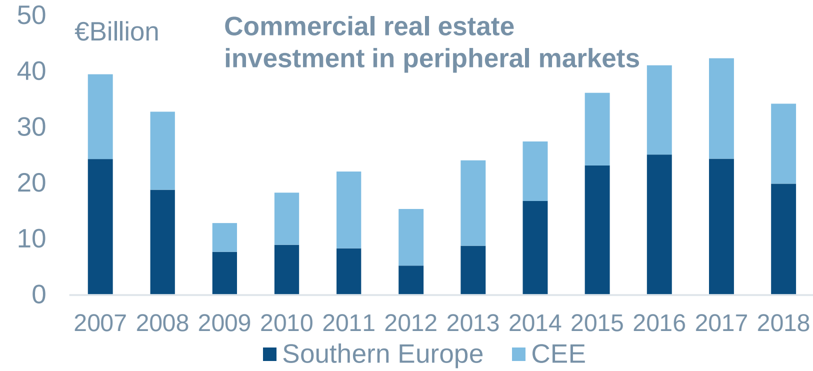
Key takeaway

- The macro slowdown is clashing with market optimism. The mismatch between weak economic fundamentals and unabated real estate market strength is expected to be especially pronounced this time.

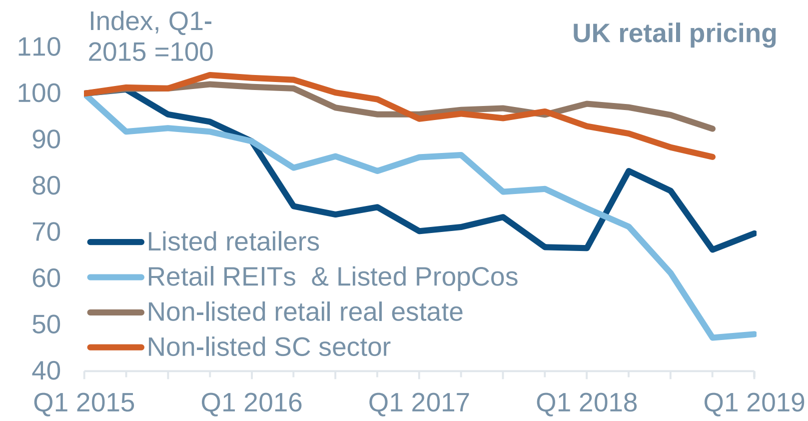
Investment implication

- New capital deployment faces style-drift risks. It will be vital to recognise unintended strategy drifts early enough to be able to change course as the European real estate investment cycle unwinds.

European allocations move South and East



Non-listed retail real estate tends to lag by 12-24 months



Top - Source: Fidelity International, Real Capital Analytics, January 2019
Bottom - Source: Fidelity International, MSCI UK Quarterly Index, Thomson Reuters Datastream, March 2019.

Real Estate: Continental Europe

Divergences becoming more pronounced

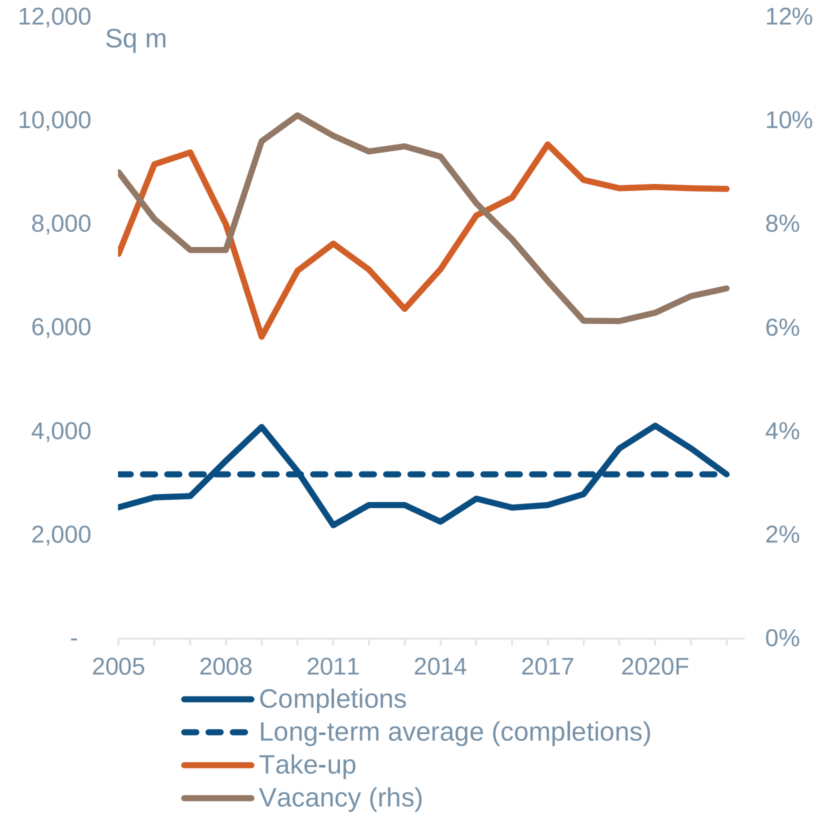
Differences between pricing

- Notable differences continue to emerge, especially with regards to pricing and some markets will be more vulnerable to economic changes than others.

Cycle could be prolonged

- The heightened external risks and weaker economic outlook could delay interest rate increases. This may prolong the current Eurozone real estate cycle further.
- It's important to note a continuing hardening of industrial yields and a softening of retail yields, reflecting the investor demand. However, both sectors hold risks and opportunities, and the ability to analyse risk by sub-sector, tenant's business model and affordability, alongside asset-specific risk assessments, will be crucial.

Eurozone: Robust occupier market fundamentals



Source: Fidelity International, JLL, February 2019. Long-term annual average completions over 2001-2017

Real Estate: UK

No let up in retail pressure

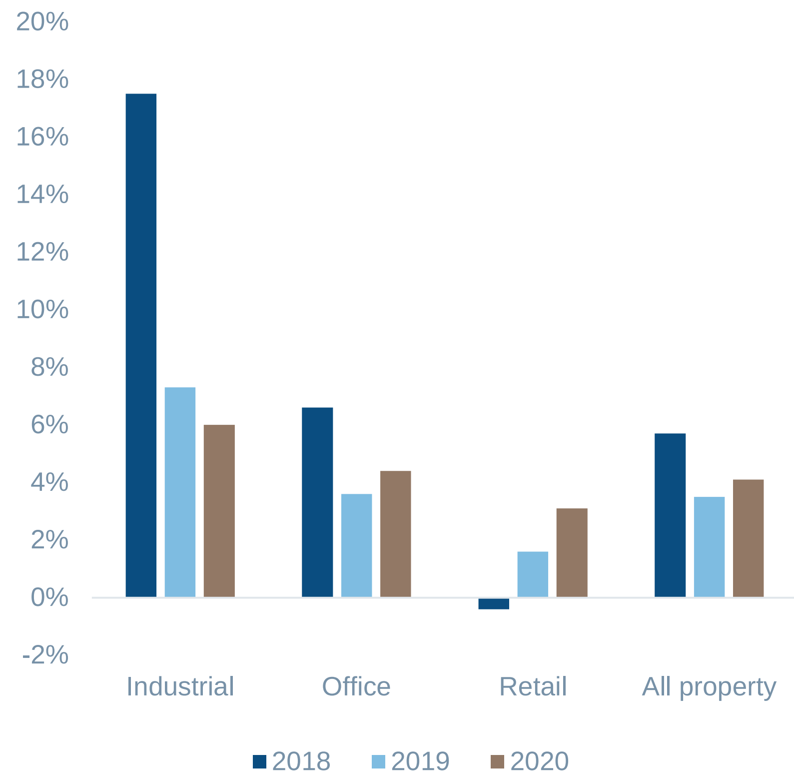
Be wary of retail

- We expect funds with the lowest retail allocations to continue outperforming.
- We have been cautious towards UK retail for a number of years now, gradually reducing retail weightings with no shopping centre investments in our portfolio.

Mispricing potential

- The sharp increase in industrial and logistic allocations has the potential to drive mispricing and there is already evidence that the pricing of secondary and higher-yielding segments is starting to converge with prime.
- We continue to be mindful of risks at this stage in the cycle, including risk factors such as depreciation and obsolescence, which are often underestimated during late-cycle price overshoots.

UK: Total return forecasts by segment (% per annum)



Source: Fidelity International, IPF UK Consensus Forecasts, RealFor, MSCI, January 2019

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Summary…

- **Macro:** Greater clarity on the economic cycle will only emerge towards the middle of the year, but in the meantime the overall picture suggests the global industrial slowdown is continuing. As a result, markets are back into a ‘bad is good’ mindset.
- **Equities:** Earnings growth expectations for 2019 have moderated and although we have reasons to be positive, we think consensus estimates may still be too high.
- **Fixed Income:** With US yields at around 2.5 per cent, and the market pricing in some chance of cuts this year, US treasuries have limited room to rally further.
- **Multi Asset:** Given the heightened volatility in markets and the uncertain direction of the global economy, now is the time to be active in every sense of the word.
- **Real Estate:** New capital deployment faces style-drift risks. It will be vital to recognise unintended strategy drifts early enough to adjust course and, therefore, to avoid an escalation of risk as the European real estate investment cycle unwinds.

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