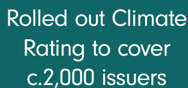
Year in review

2022 – 2023

50+ years' investment expertise

Sustainable investing highlights in 2022



Rolled out Climate Rating to cover c.2,000 issuers

Introduced quarterly sustainability reviews (QSR) of funds*

Launched our Deforestation Framework to guide engagement and stewardship

Commenced our thermal coal engagement programme

Provided training to employees and clients on key ESG topics including biodiversity, deforestation and ESG regulations

Winner of **15 sustainability-related awards** globally

Rated 4 and 5 stars across categories by the **UN Principles for Responsible Investment****

Achieved the **fifth highest** ranking financial institution from Northern Europe and **fifth highest** ranking asset manager in the **World Benchmarking Alliance's inaugural Financial System Benchmark 2022**

Named as a Responsible Leader by the **Responsible Investment Association Australasia** for the second year running

Source: Fidelity International, 31 December 2022.

* QSRs rolled out only for Article 8 and 9 funds in 2022.

**We completed the PRI questionnaire in 2021 based on 2020 AUM. Due to an overhaul of the previous PRI questionnaire, there were delays in the results which were shared in 2022.

Year in review 2022 – 2023

Lawrence Hanson
Managing Director
Fidelity International

Since I took over the role as Managing Director of Fidelity's Australian business late last year, I've really been struck by the sophistication and vibrancy of this market. Supported by the superannuation system and an innovative ecosystem, there's opportunity to both participate and co-create in a number of different ways, which I find really exciting.

Moving down to the firm level, I've come into a business with extremely solid foundations, a best-in-class investment team, and I'm surrounded by people who both care about their clients and want to drive the business forward. I have to keep pinching myself...

But that aside, there's no getting away from the fact it's a difficult operating environment. High inflation and interest rates are presenting challenges and there's been net outflow across numerous parts of the financial system over the past 12 months.

What we're hearing from clients is that they're looking for increasingly differentiated products to help address specific gaps in their portfolios, and there's a lack of credible options in certain areas of the market. The general consensus is that Fidelity as a firm has a role to play here, not only in bringing world-leading solutions to the Australian market but also, importantly, sharing expertise to help investors navigate current conditions, which are very different to what we have been exposed to over the past decade.

These partnership and co-creation discussions are really important and we're keen to understand how we can add value to clients' investment platforms and help them deal with a range of complex issues.

We will be looking to 'lean into' the investment trends around managed accounts, ETFs and increasing allocations to private markets, and will continue to bring best-in-class and differentiated product to the market. We'll also continue to expand structures that make accessing Fidelity strategies as frictionless as possible.

As we look ahead to the next 12 months, I think market conditions are still going to be challenging, but there's also a lot to be positive about. The Fidelity Australian Equities Fund recently celebrated its 20-year anniversary and Portfolio Manager Paul Taylor reminded me that, over that time, he'd seen 10 crises or market downturns. Each was a little bit different and from each he learnt something new, but the case for investing remained the same. If you had invested $10,000 in the fund twenty years ago, today it would be worth $81,660*.

This conversation has stayed with me as although I'm excited about lots of things – continuing to build a differentiated product set, positioning Fidelity as an employer of choice, and building our brand – the thing I'm most excited about is that, fundamentally, investing can make a real impact to people's financial futures, and we want to partner with clients on that journey.

*As at 30 June 2023.

Our investment expert views

Australian equities

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

Australian equity market conditions remain volatile, with relatively high levels of inflation and rising interest rates – although there are indications that we're getting close to the peak for both. In terms of interest rates, the Reserve Bank of Australia (RBA) could continue to increase rates but there's now a more balanced case to pause.

Volatility in markets, I always think, is the market struggling to value companies in a changing economic environment. If we move into a 'pause' environment, markets are likely to become less volatile. Higher interest rates are also the key catalyst for concerns around a recession. Our view is that global developed markets will likely head into recession this year.

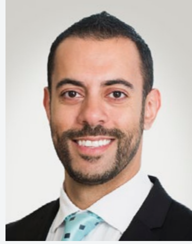
Australia, however, will likely avoid recession but grow at a slower rate. This view is consistent with bond yield curves around the world. Australia's links to better performing Asian countries, as well as higher population growth from immigration will likely put us in a much better position. And while the consumer will remain vulnerable, commodities and, in particular, critical minerals are positive from a structural growth perspective.

As an investor, my job isn't to try to eliminate risk, but rather to correctly price it. In fact, within the portfolio, I need to take on risk – but at the right price. I've been thinking quite a lot about this concept over the last 12 months as more and more risk has entered markets. Today, markets need to consider geopolitical risk, financial contagion risk, interest rate and inflation risk, risk from recession and regulatory risk, as well as the risk from increased taxation – much of which has now been priced in.

But with this as a backdrop, equity markets now present a much more interesting opportunity. History teaches us that when significant risks are priced into equity markets, they're more likely to provide better longer-term investment returns. There's plenty to worry about, but that also presents better opportunities for the future.

In my view, you always want to invest in equities for at least a five to seven-year investment horizon, preferably 10. If you need the cash in 12 months, or even three years, there's too much volatility in equity markets for short-term investments. But as we worry over the short term, I can't help but get excited that I can now buy the market at a much better risk-adjusted price, which will likely deliver much better longer-term returns.

Global equities



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

Global mid-cap equity valuations de-rated significantly over the past 12 months amidst a sharp rise in inflation and the surge in cost of capital hurdle. The MSCI World Mid Cap index's valuation fell to a decade-low level of 14 times price-to-earnings.

Notwithstanding the valuation pressure seen in late 2022, the IT sector stood out, generally delivering strong earnings and optimistic outlooks. This reflects the potential for structural growth in this sector, largely due to global themes that persist in our daily lives and the corporate world – data centres and the cloud; networks and connectivity enablers; software to create productivity or critical information management; artificial intelligence and content platforms. Consequently, technology was the best-performing sector.

Industrial stocks were also strong performers over the period, delivering the second highest return given positive earnings in construction and engineering services; robust passenger airlines demand and solid related travel activity. Within this sector, strong employment growth and corporate spending activity lifted commercial services.

Consumer strength in the luxury goods segment was supported by confidence from the wealthier pockets of the world, which was unusual as the rest struggled with a cost-of-living crisis.

Insurance was a beneficiary of a hardening rate cycle, lower capital in the financial system and higher returns on capital investments.

Other sectors such as real estate, utilities, energy and healthcare were all in the red. The Silicon Valley Bank collapse in March 2023 stoked financial system concerns and led to conservative funding across the market. This has set a cautious tone as exuberance and momentum fade and are replaced by the harsh reality of a nervous investor seeking earnings, yield, certainty, and visibility.

Earnings, earnings, earnings

'If you can follow only one bit of data, follow the earnings ... What the stock price does today, tomorrow, or next week is only a distraction.' —Peter Lynch

We've had cheap money for nearly 10 years and allowed for stories and concepts to be generously valued independent of earnings. With inflation at 6% and government bond yields at 4%, earnings will be a significant driver of share prices during the next 12 months. The drivers of sustainability of earnings will also be important considerations such as pricing power, market structures, embedded purpose of the product for people or corporate processes, and the critical or discretionary nature for consumers.

As the risk of recession or economic slowdown transcend across the economy, these considerations will become top of mind for investors and determine valuations that the market will bear. This market will test our understanding of investments and conviction in management to navigate a challenging economic environment. Stock picking will be critical.

Our investment expert views

Asian equities

Anthony Srom
Portfolio Manager
Fidelity Asia Fund

Over the last 12 months, the Fidelity Asia Fund has returned 3.18% vs 2.12% for the index*, with some significant swings in performance as sentiment has been volatile.

The end of Covid-19 lockdowns, especially in China, has been a major story. In the second half of 2022, the Fund was positioned for China reopening, and consumer-orientated stocks like Trip.com and Yum China have subsequently been strong contributors to returns. However, these positions were trimmed or exited throughout 2023 due to concerns that the market was too optimistic on consumer sentiment bouncing back strongly. More recently, the market is catching up to the view that China has a few issues to deal with, including high youth unemployment and lack of stimulus to get the economy going, while the psychological hangover of Covid-19 lockdowns has held consumers back.

The China property sector, in particular, has borne the brunt of the market's concerns. Property-related stocks have been de-rated with a lack of stimulus measures coming through and our holdings in building material stocks have detracted. However, the industry structure is undergoing significant change as weaker players exit the market, and those who survive have gained market share, which will translate into better margins in the future.

* MSCI AC Asia ex-Japan Index NR.

Rising rates are also in the spotlight. Inflation and rates are higher globally, and we continue to think it will be this way for a while. This has had an impact on markets due to concerns of what higher rates will mean for corporate refinancing costs and the impact on consumer demand for property and higher end consumption.

Key contributors over the last 12 months have been from China reopening linked names, although this has largely played out as a theme. However, the A-share market continues to produce individual stock ideas and there are many good companies trading at low valuations. India is increasingly coming into focus as valuation multiples for segments of the market have de-rated.

Holdings in the IT sector have been a good source of returns. The Fund has been adding to IT semiconductors as we see the market cycle bottoming out in areas like memory, as the industry digests inventory build-up. Stocks like Samsung Electronics and SK Hynix were de-rated late last year to below 1x price-to-book due to these cyclical concerns, but the long-term demand for semiconductors is solid, driven by high-end computing, AI, and electric vehicles.

Overall, the market outlook appears challenging as there is no clear pathway for Chinese GDP growth, overall valuations aren't attractive, and we expect interest rates and inflation to remain higher for longer. This creates a challenging backdrop for companies to operate in and requires deep understanding of businesses and valuations to generate returns for shareholders. We believe a concentrated portfolio with a laser focus on stock selection will remain critical.

Winner – Global Emerging Market Equity Fund of the Year 2023
Money Management Fund Manager of the Year Awards

Global emerging markets

Amit Goel
Portfolio Manager
Fidelity Global Emerging Markets Fund

Global emerging markets (EM) have been volatile over the past 12 months with events such as the Russia–Ukraine conflict and Covid-19 lockdowns in China causing turbulence. In late 2022/early 2023, we saw some encouraging signs after China's surprise reopening and some favourable global economic trends. Unfortunately, this was short-lived, and sentiment reversed again following concerns over tighter financial conditions indicated by the US Federal Reserve (Fed) and the solvency of notable US regional banks. Rising geopolitical tensions between the US and China, and apprehension from China's slow recovery, further soured market sentiment.

Volatility is likely to remain, but despite this, we believe there are better times ahead for EM. As developed markets (DM) wrestle with recession concerns, many EM countries find themselves relatively well positioned thanks to healthier finances, proactive central banks, and significantly cheaper equity markets by comparison.

Banks and IT are top performers

Notably, the financials sector, particularly banks, have fared well. In EM, most countries have banks with strong liability franchises and a well-diversified depositor base which is stickier in nature. In addition, their funding costs are low, due to a higher proportion of funds coming from both current accounts (predominantly business accounts) and savings accounts. This means banks can be much choosier when deciding whom to lend to, and can focus on quality customers who are less likely to default.

Additionally, we believe that the risk of contagion from DM banks to their EM counterparts is limited, and EM are typically well positioned from healthy balance sheets and good levels of assets quality.

The IT sector also emerged as a standout performer after battling strong macroeconomic and geopolitical headwinds in 2022. The sector received renewed impetus as signs of further easing in US inflation raised hopes that the Fed may pause its monetary policy tightening cycle. Developments around artificial intelligence also lifted sentiment higher.

Emerging markets remain strong

Medium- to long-term fundamentals are reasonable today compared to the past, which leads us to believe that EM are well-placed to provide positive returns. At a time when there is a cost-of-living crisis in DM, EM economies have been ahead of the curve in raising rates. When the Fed has pivoted, EM central banks have had a lot of room to cut rates.

The growth profile of EM is also strong. For example, in India, ongoing investment into infrastructure and manufacturing is supporting the country's rate of growth and in Korea and Taiwan, technology companies have already gone through an inventory destocking cycle which is expected to normalise going forward. Furthermore, EM valuations are much more reasonable, with regional equities trading at a discount to DM that is close to 20-year highs.

Our investment expert views

Sustainable investing

Daniela Jaramillo
Director
Sustainable Investing

Pathway to decarbonisation

Over the past 12 months, one area of focus for us has been high-emitting sectors and their decarbonisation plans. In particular, the oil and gas sector is facing greater investor scrutiny and has been subject to more shareholder action. Investors have targeted companies where they feel that there has been insufficient climate transition planning. Locally, we saw this occur when a company director at Woodside received an unprecedented 34.8% 'against' votes for not meeting investors' expectations on its decarbonisation plans. Internationally, BP and Shell saw greater support from investors for activist shareholder resolutions that urged tougher climate targets.

Furthermore, the Australian Government is also placing greater emphasis on high-emitting sectors and has reformed the Safeguard Mechanism to reduce emissions at Australia's largest industrial facilities. The reforms create economic incentives to reduce carbon emissions on an annual basis, and the natural gas industry was a key target. Globally, the oil and gas sector will also be in the spotlight at COP28 in Dubai later this year, aptly coined the Oil and Gas COP.

Following publication of our *Decarbonisation and Mining Paradox* paper last year, we have seen increased interest in critical minerals and their role in decarbonisation.

The uptake of electric vehicles (EVs), coupled with policies like the *Inflation Reduction Act* in the US, highlighted the importance of ensuring appropriate supply of critical minerals.

We have also seen the Australian Government respond with the launch of the Critical Minerals Strategy and the announcement of the Australia–US Compact. This remains a key focus area for Fidelity as we have seen increased interest from institutional investors for exposure to this thematic.

The 'S' in ESG

Modern slavery continues to be a pertinent issue. This year, we published our first mandatory report and strengthened how we capture modern slavery related risks in our proprietary ESG ratings. These enhancements will help support our engagement with companies.

Another area of focus has been on 'culture-based financial risks' which are created by systemic harmful behaviours in the workplace, like bullying or sexual harassment. Movements like #MeToo have shone a spotlight on these risks and have demonstrated that societal expectations have evolved and are even being incorporated into regulation, such as Australia's new Respect@Work bill. We are exploring how we can better understand and consider these risks in our stewardship efforts.

An eye on regulation

Globally, we are seeing regulators focus on standardisation. For example, the International Sustainability Standards Board (ISSB) is consolidating and driving consistency across ESG reporting. Locally, we are seeing interest from the Government to develop mandatory climate disclosures. Additionally, regulators are closely monitoring greenwashing from corporates and investors, and we anticipate more enforcement activity over the next 12 months.

Fidelity Sound Bites

A straight-to-the-point podcast with two of Australia's leading investors

Sound Bites with Paul Taylor

Sound Bites with James Abela

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