

# The return of growth

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**Anthony Bolton**

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This presentation is for Investment Professionals only, and should not be relied upon by private investors

# Stock Market Outlook

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## ■ Three things I focus on, particularly at turning points:

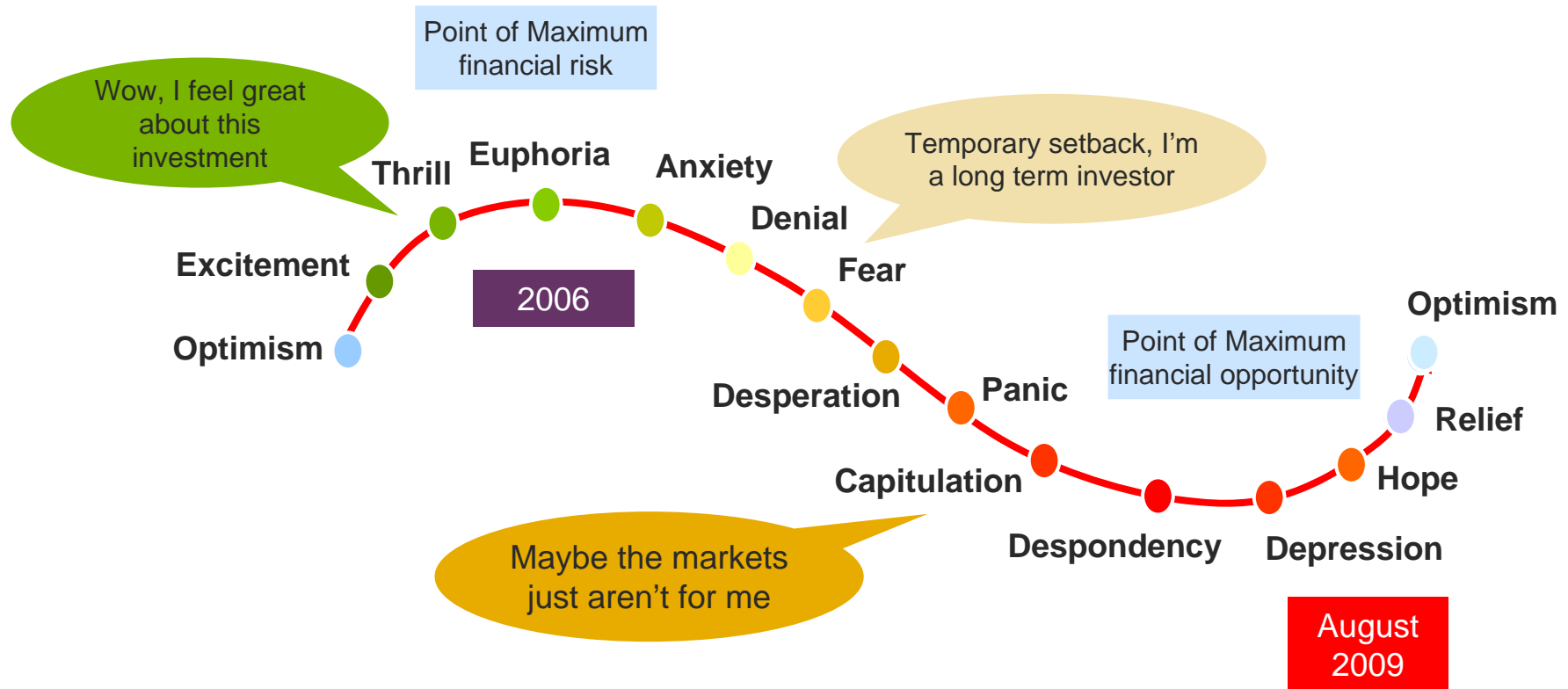
1. **Historical cycles**
2. **Sentiment**
3. **Valuations**

## ■ One thing I don't focus on:

1. **Economic outlook (Unprecedented financial crisis, matched by unprecedented Government action)**

# Sentiment is now improving from the lows

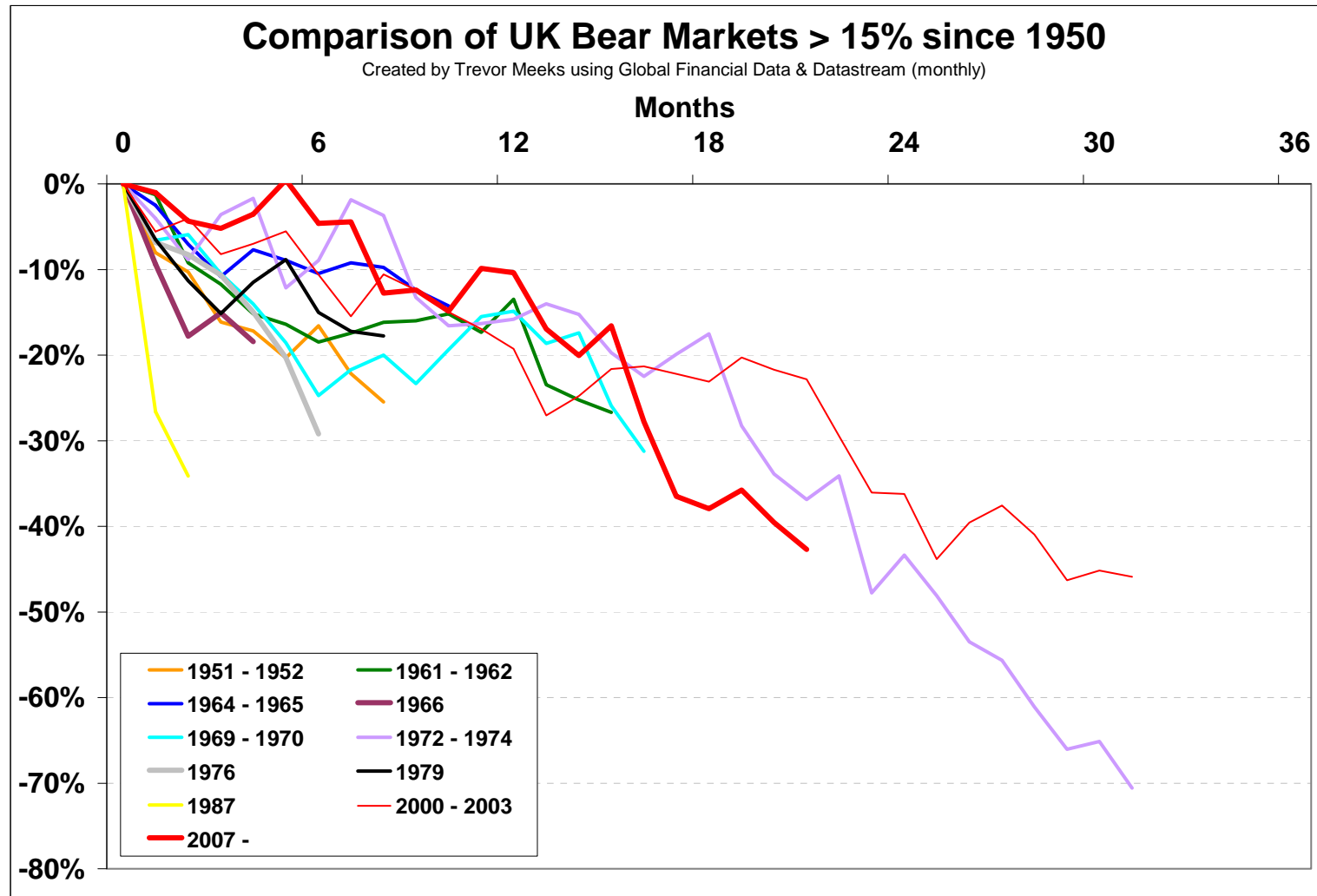
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Source Westcore Funds / Denver Investment Advisors LLC, 1998

# UK Bear markets – a historical view

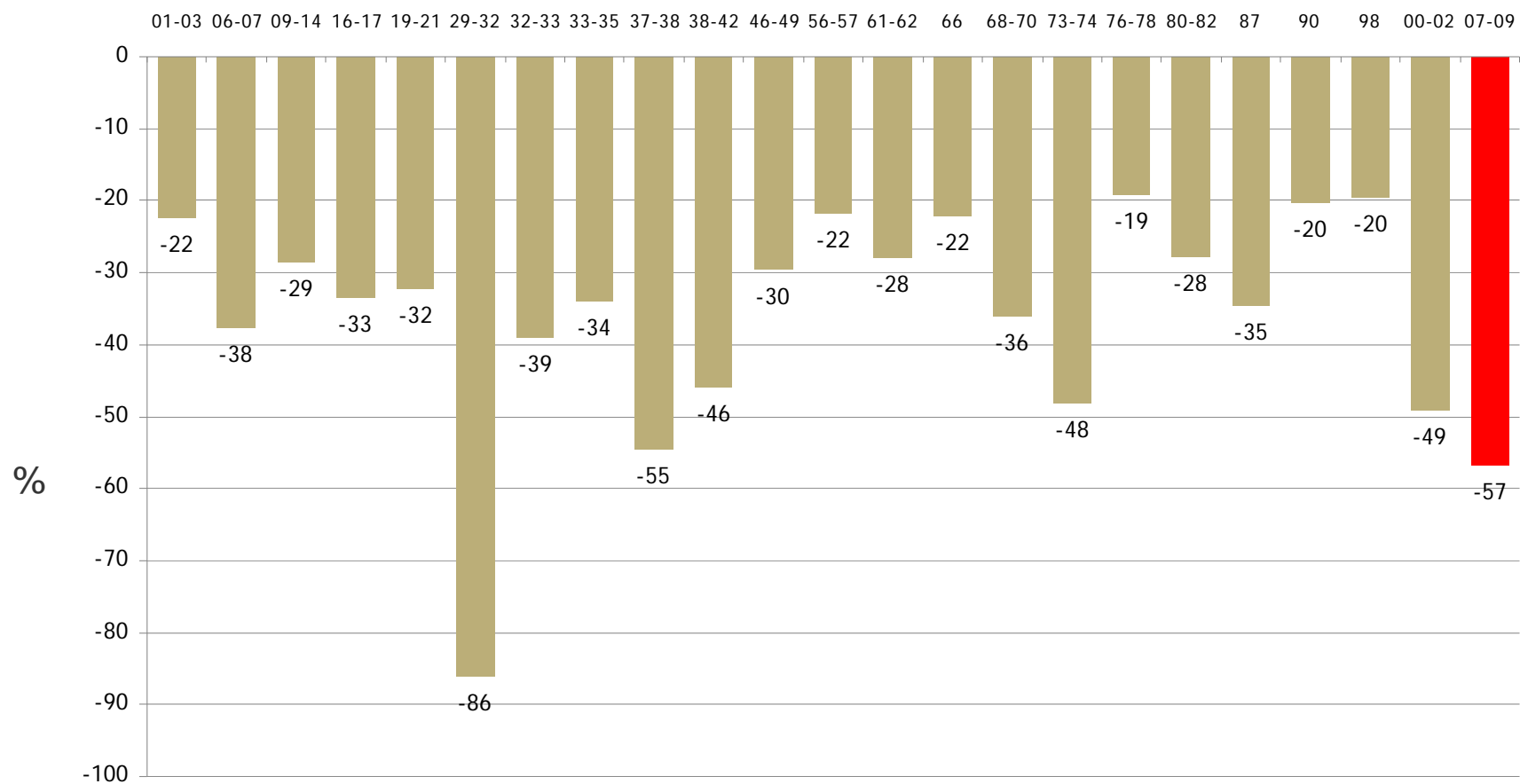
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Source: Datastream, as at 27/02/2009

# US Bear Markets: Since 1900

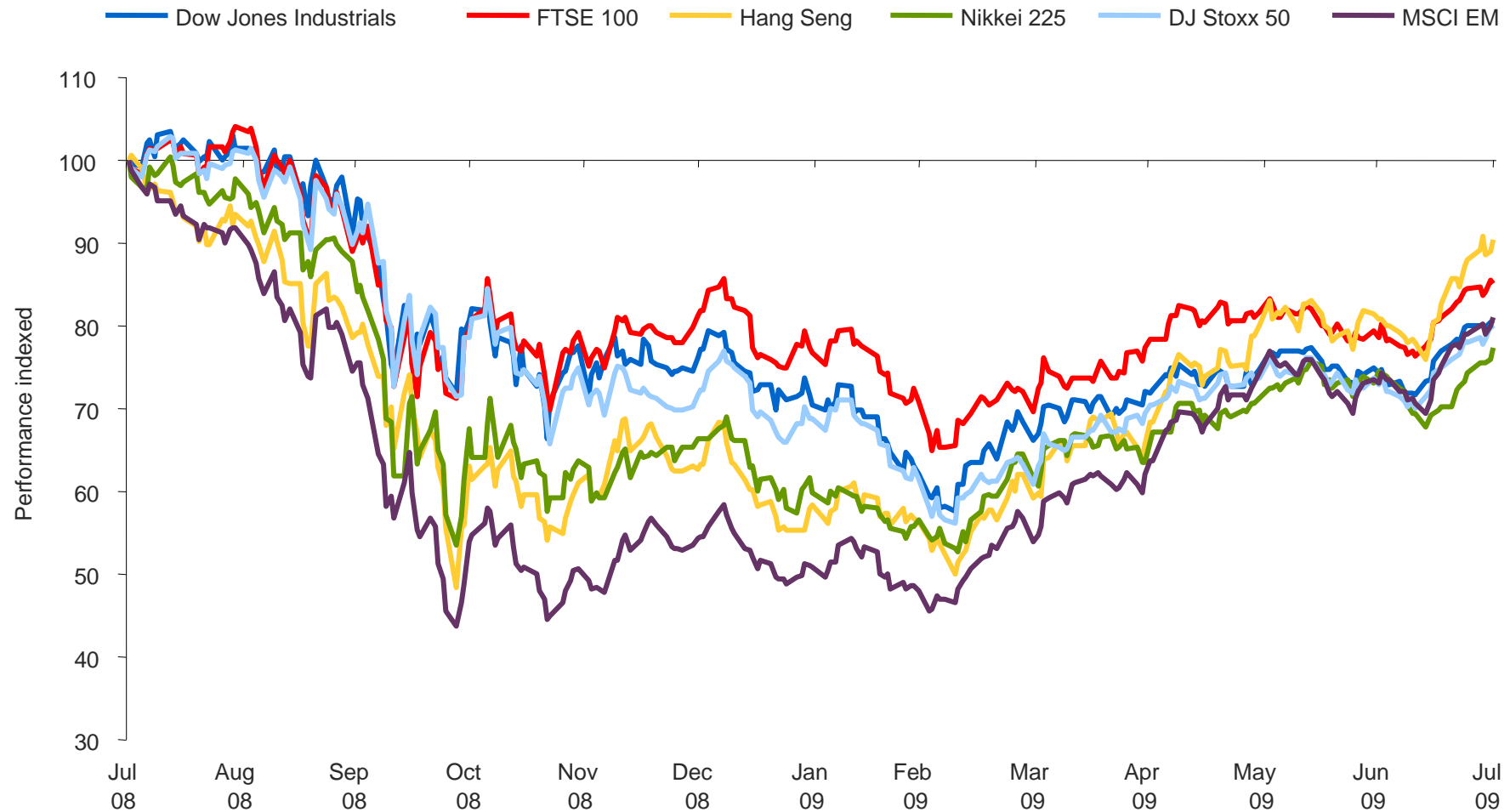
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Source: ASR Ltd./Thomson Reuters Datastream April 2009

# Bull market gains may be front-end loaded

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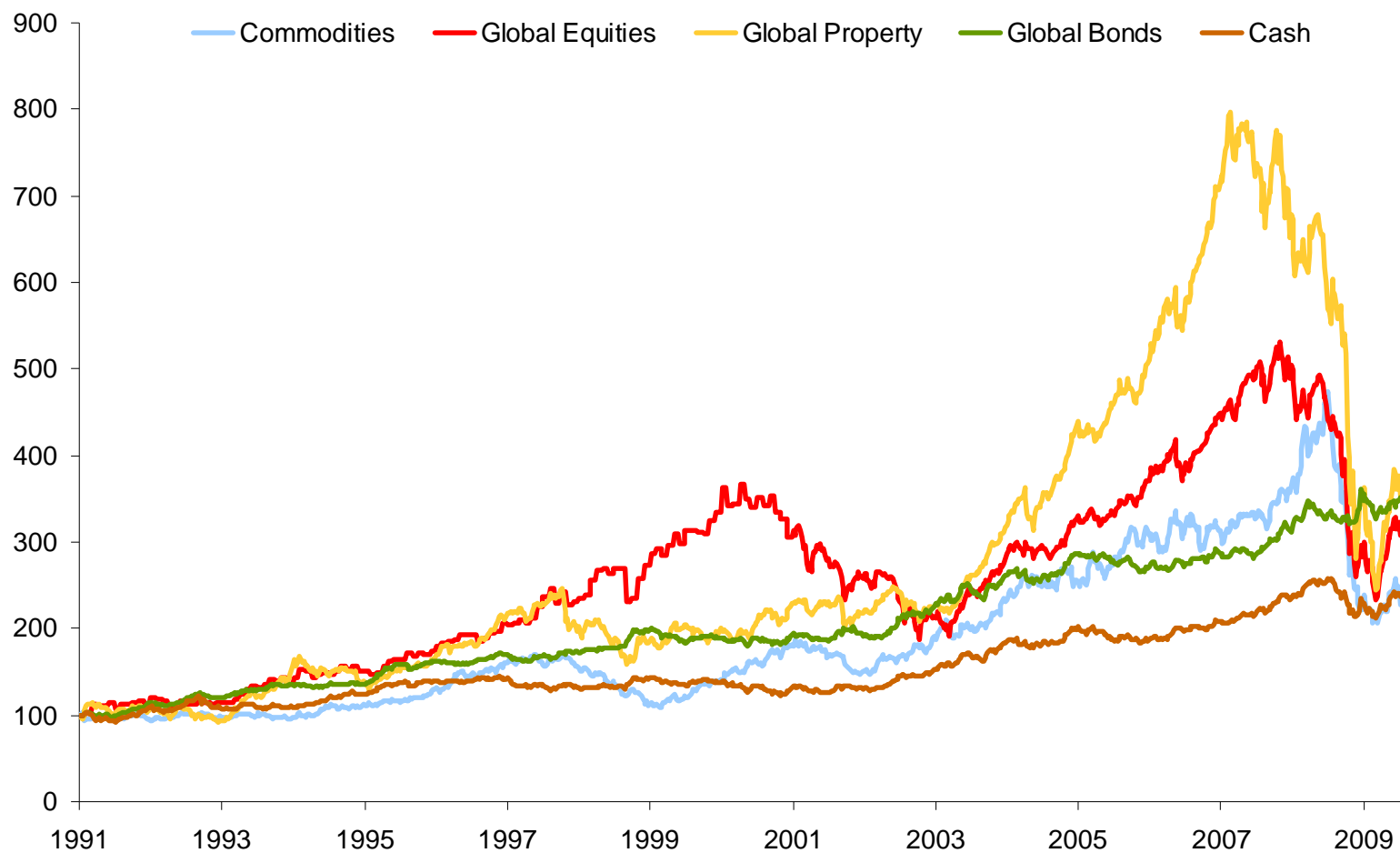


Source: DataStream. Daily data from 31.07.2008 to 31.07.2009, based in local currency.

# Asset class performance since 1991

## Risk assets still attractive after the lost decade

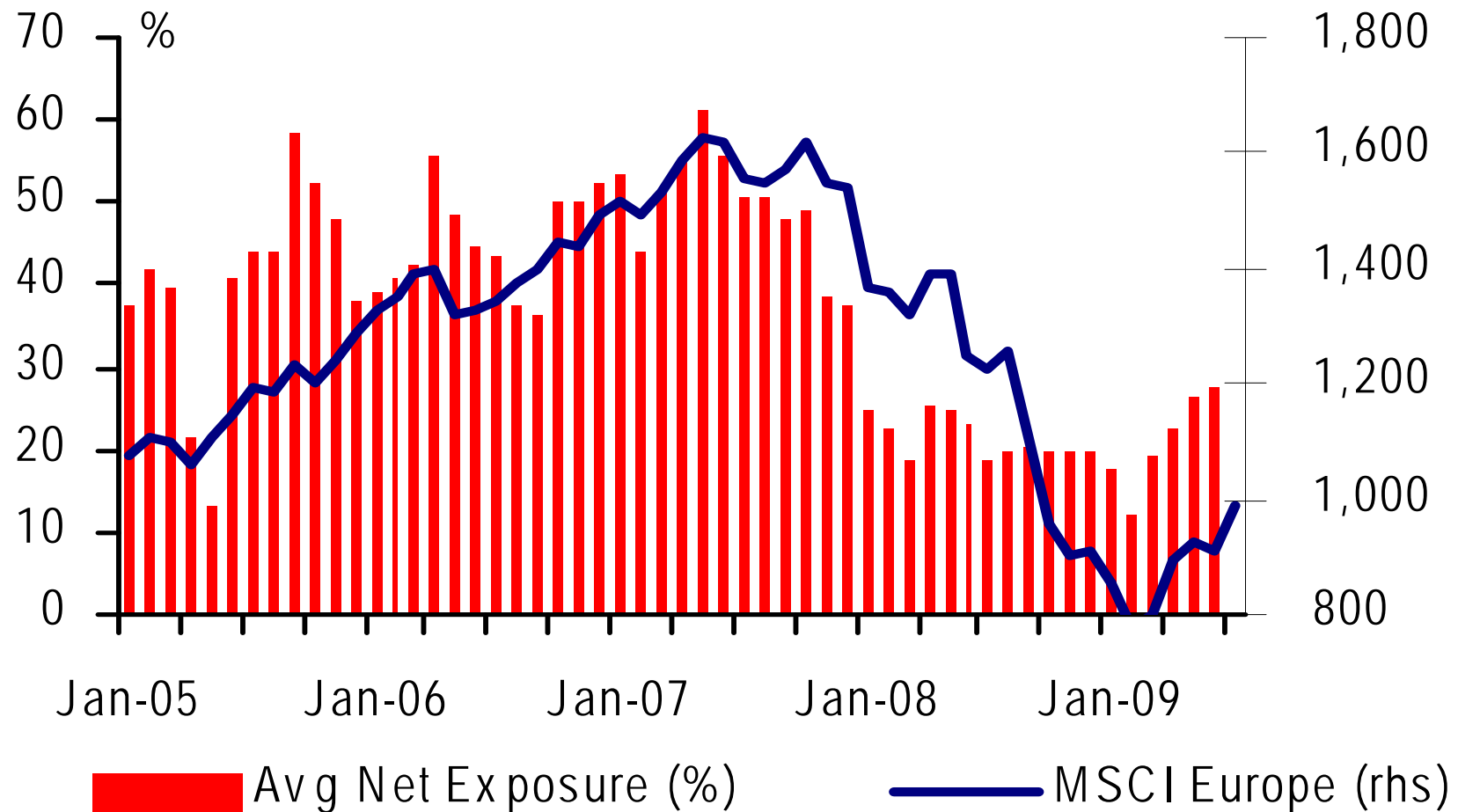
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Source: Datastream as 19/08/2009

## European Hedge Funds – Net Exposure

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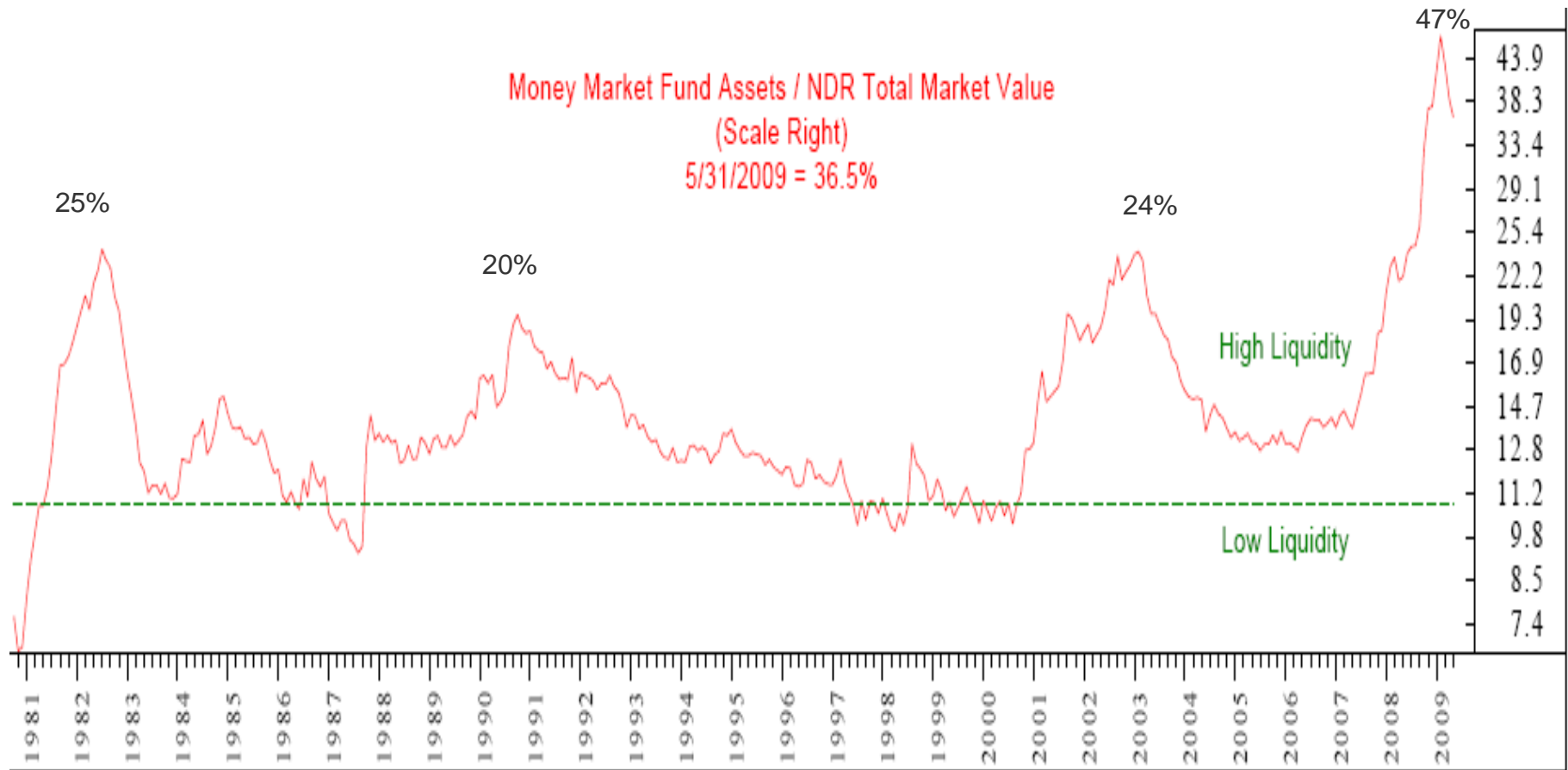


Source: UBS – Aug 2009



# US Money Market Assets to Total Market Value

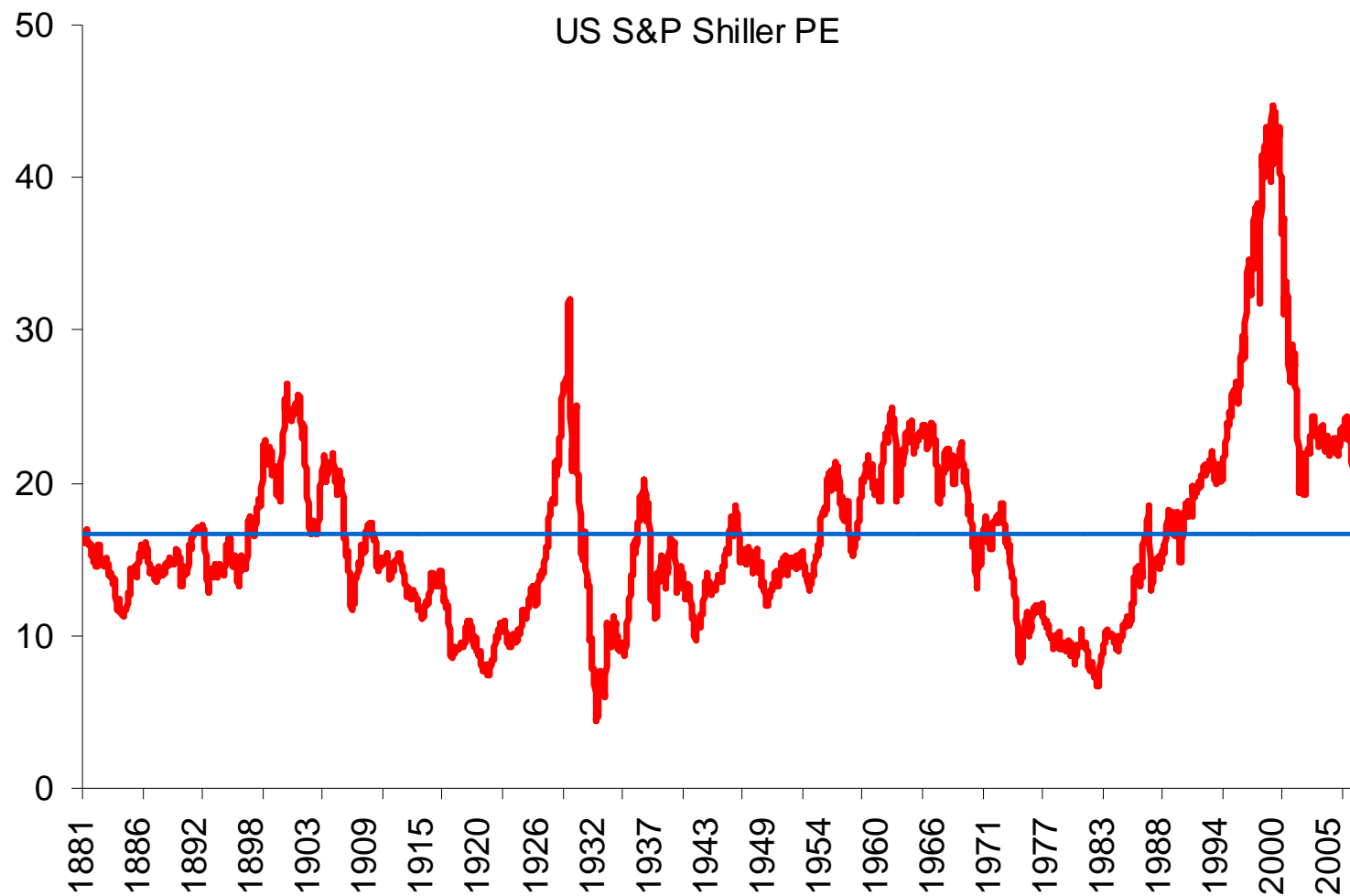
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Source: Ned Davis Research May 2009

# US Price Earnings multiple

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Source: Bloomberg, Stock Market Data Used in "Irrational Exuberance" Princeton University Press, 2000, 2005, updated, Morgan Stanley Research

# Global Equity Price to Book Valuation

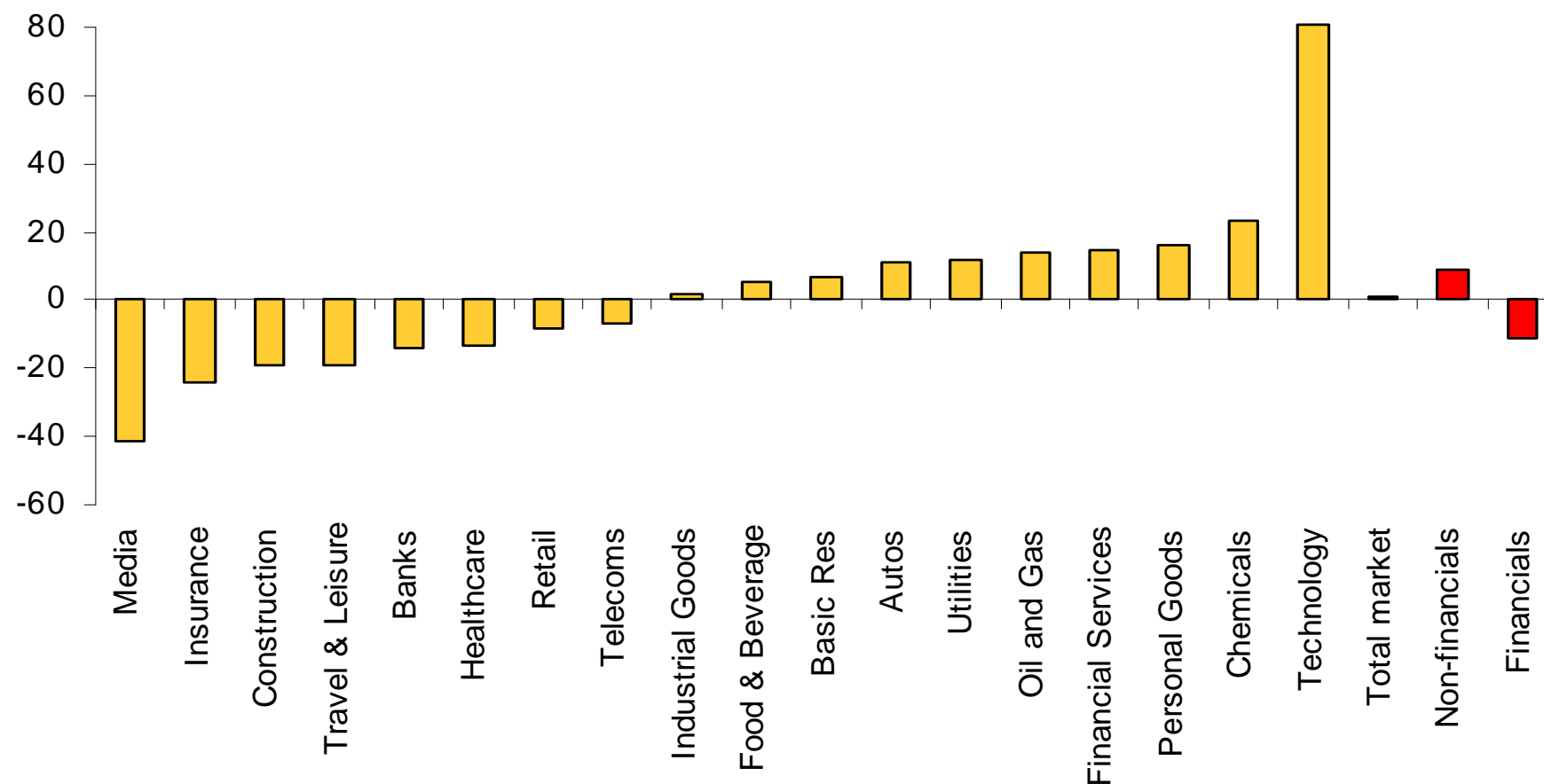
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Source: Datastream, 19 August 2009

## Price to book value versus the 1993 trough (Global)

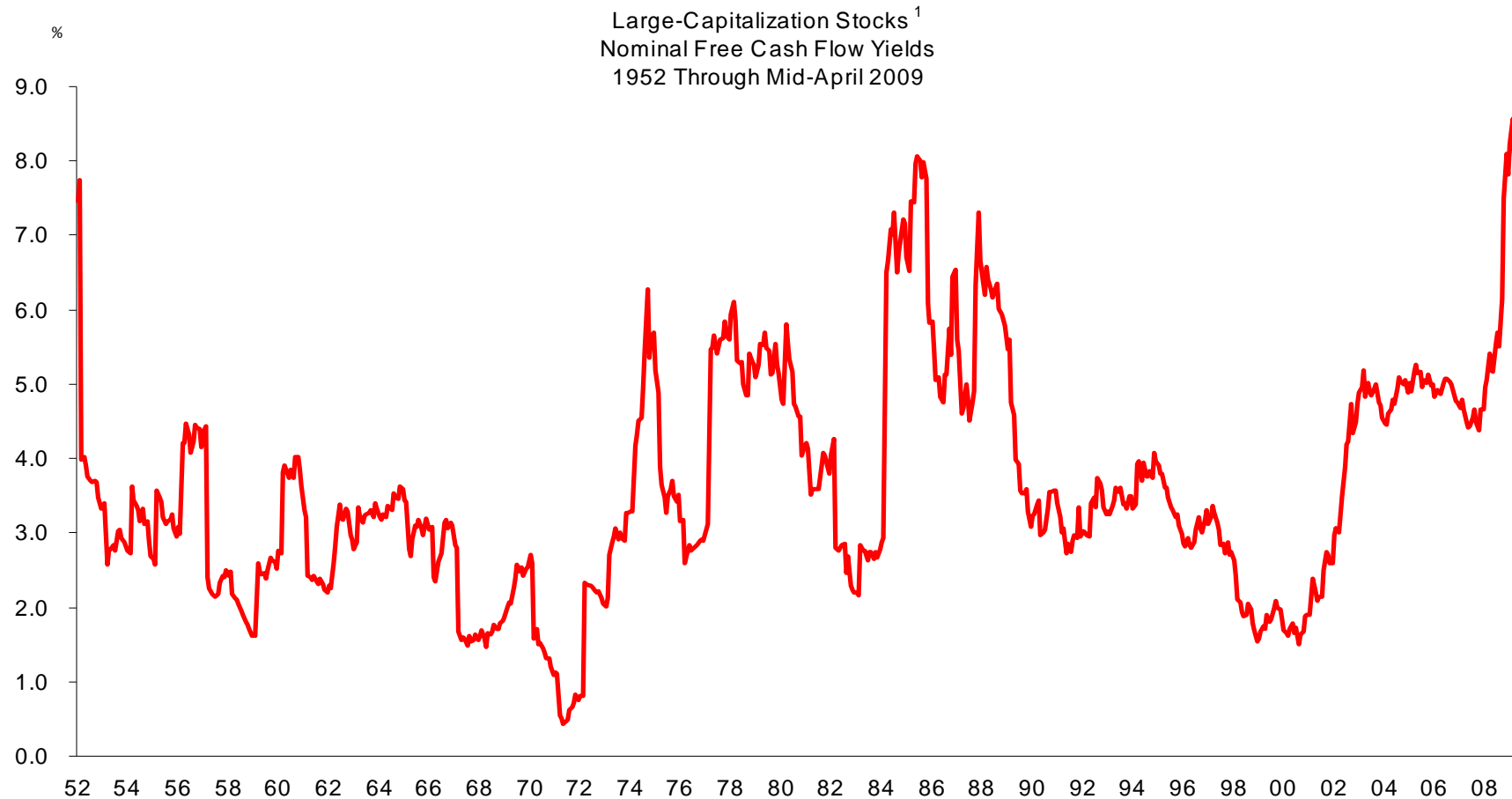
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Source: Absolute Strategy Research August 2009

# S&P Nominal Free Cash Flow Yields

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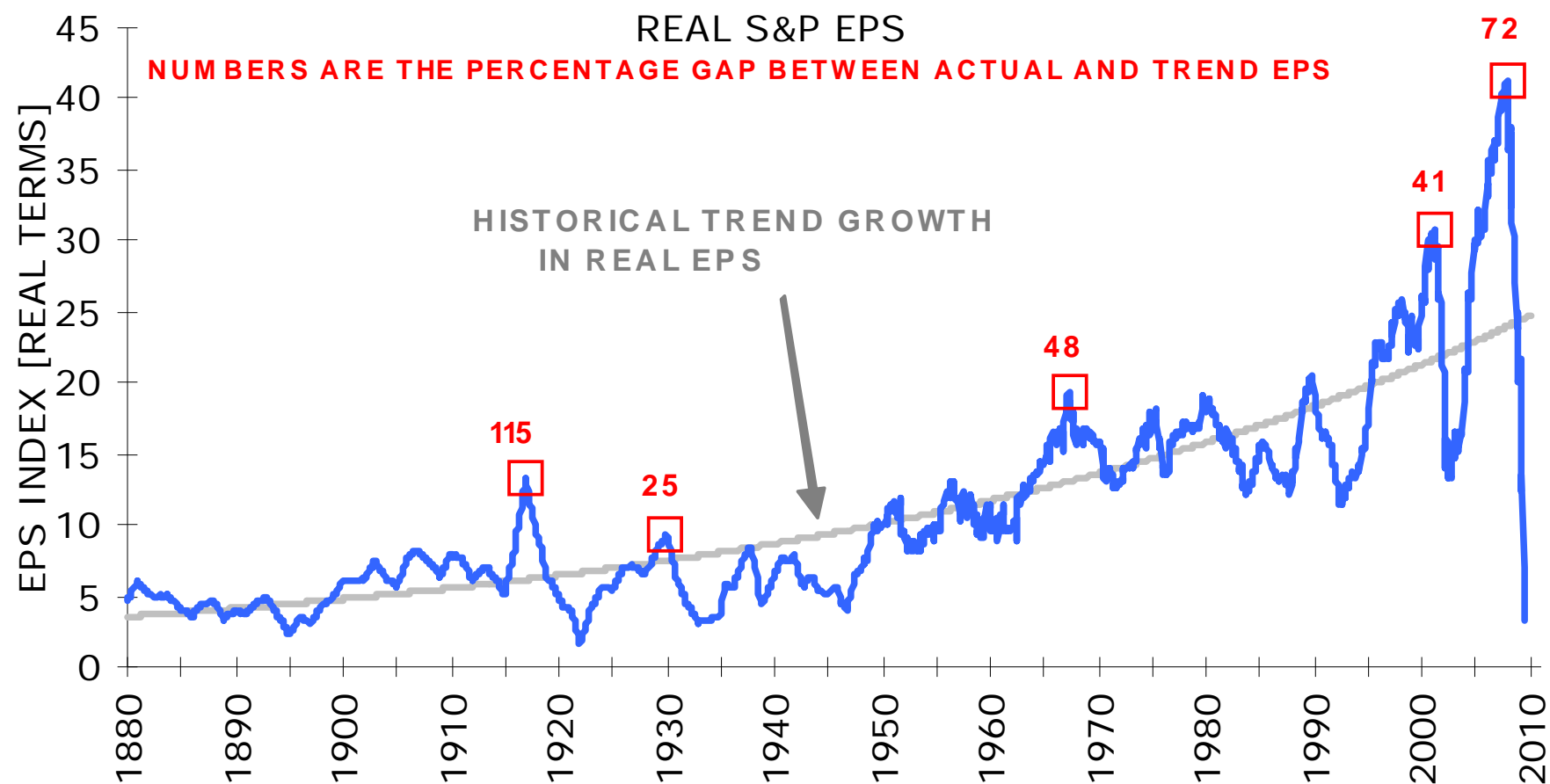


Source: Corporate Reports, Empirical Research Partners Analysis.

<sup>1</sup> Capitalization-weighted data.

## Some of the cyclical sectors drove earnings way above trend – but are now well below trend

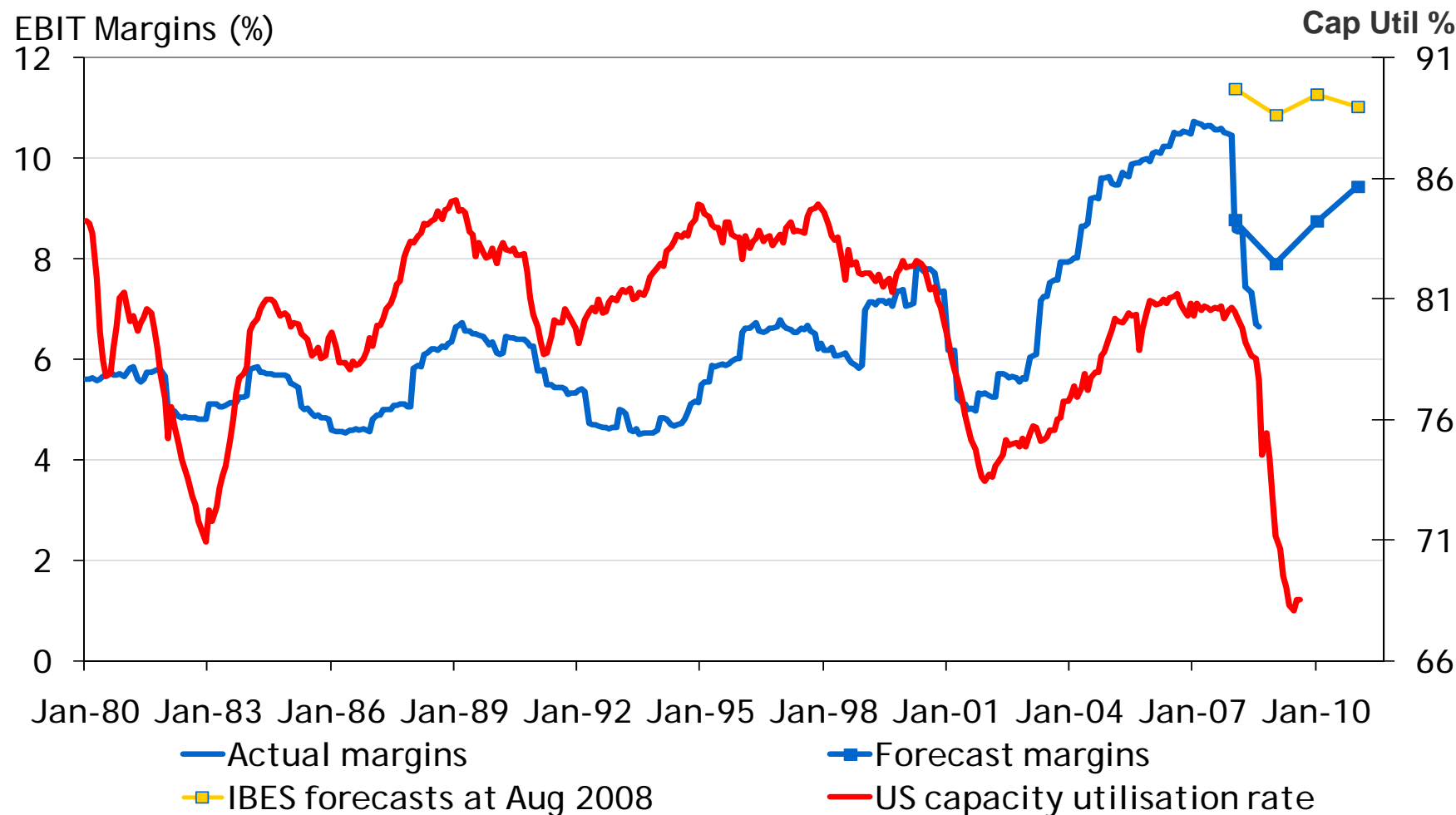
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Source: Morgan Stanley Aug 2009

# World industrial margins vs US Capacity utilisation

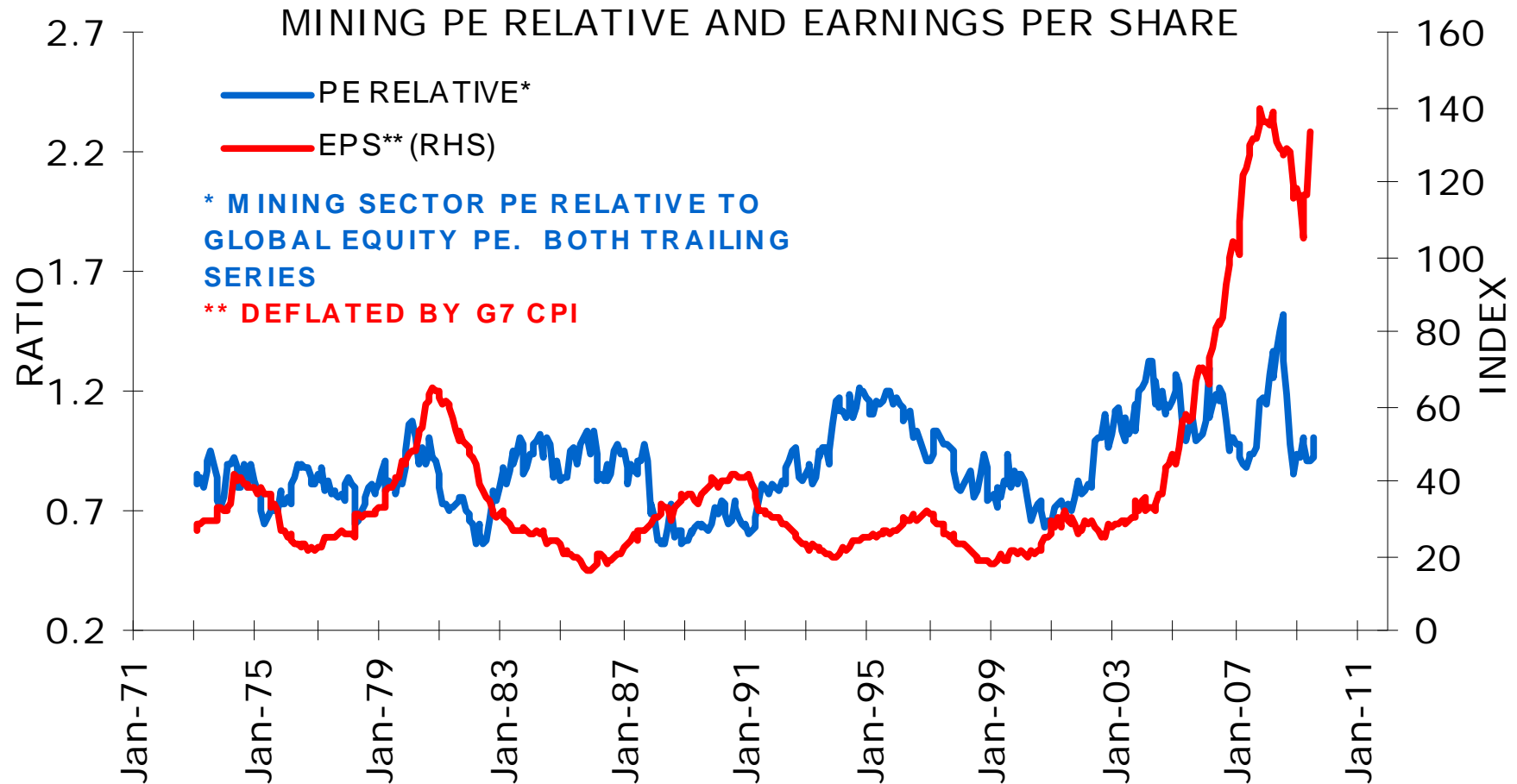
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Source: ASR, Thomson Reuters Datastream August 2009

# Mining - peak P/E on peak earnings

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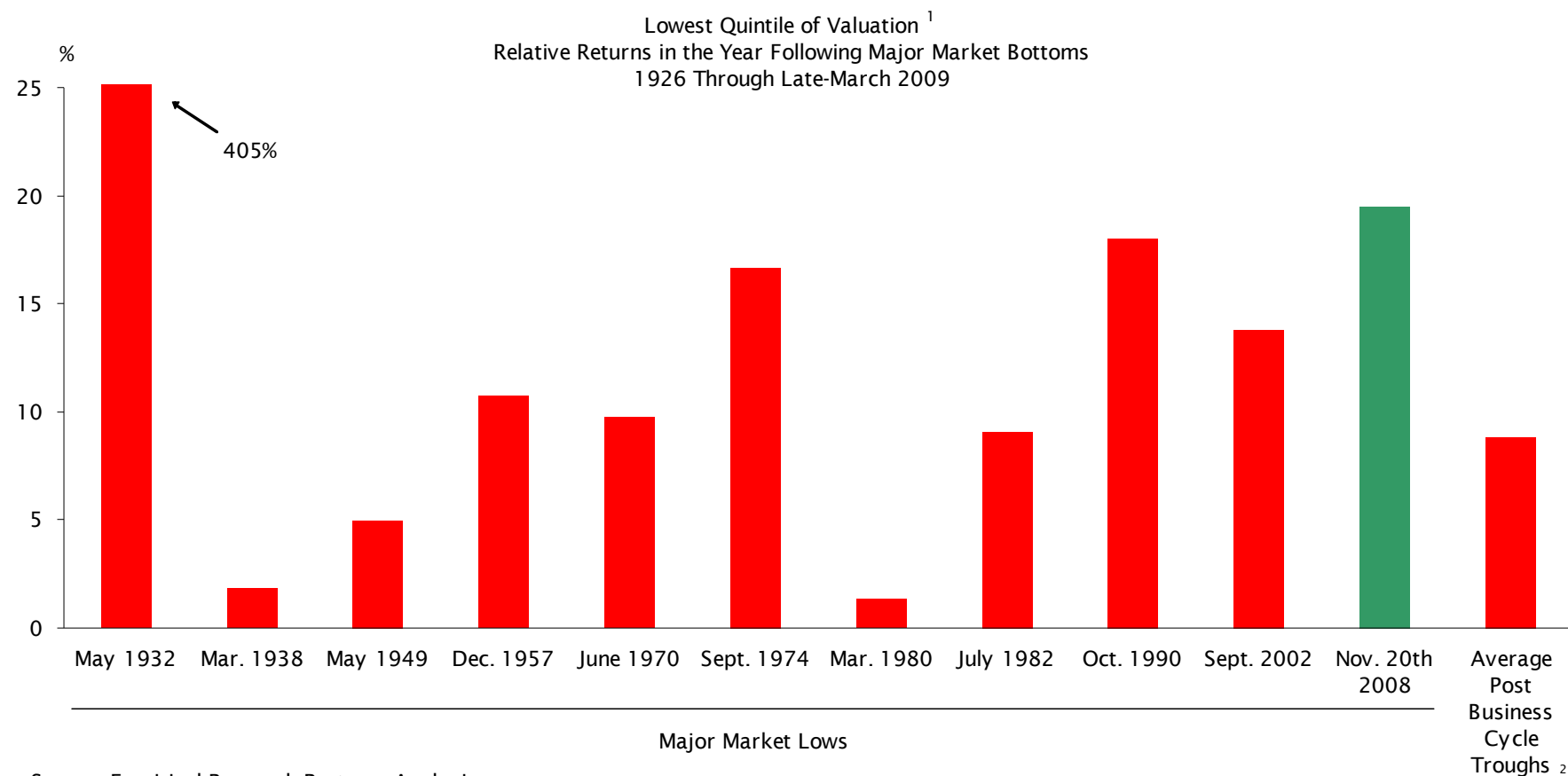
Source: Morgan Stanley August 2009. Mining sector PE relative to Global equity trailing PE; Real EPS deflated by G7 CPI

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# Cheap stocks perform well in year following trough (US)

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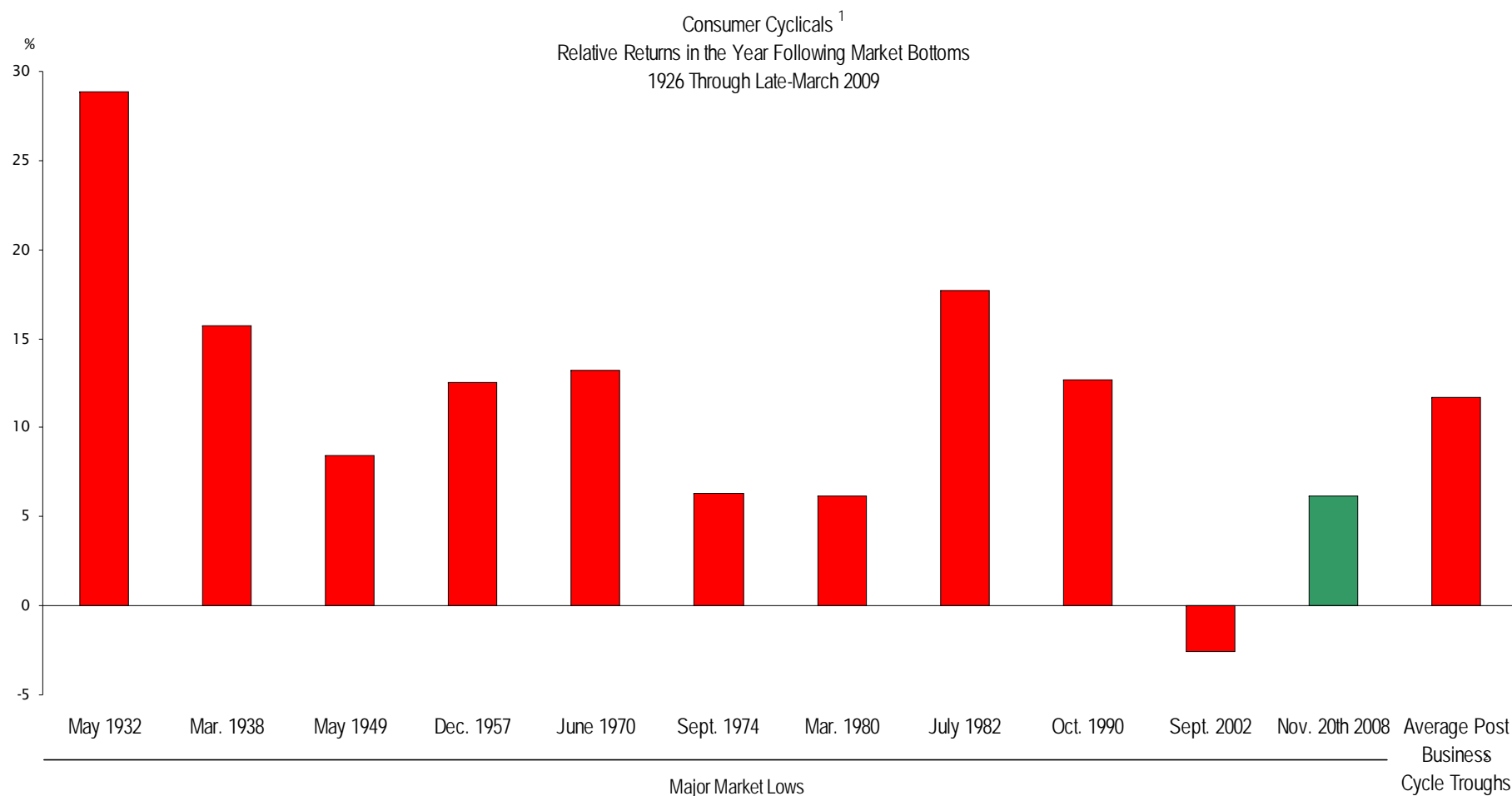
Source: Empirical Research Partners Analysis.

<sup>1</sup> Large-capitalization stocks; equally-weighted data based on a multivariate framework. Lowest quintile of price-to-book pre-1950.

<sup>2</sup> Average of 14 cycles.

# Consumer cyclicals do well in the recovery (US)

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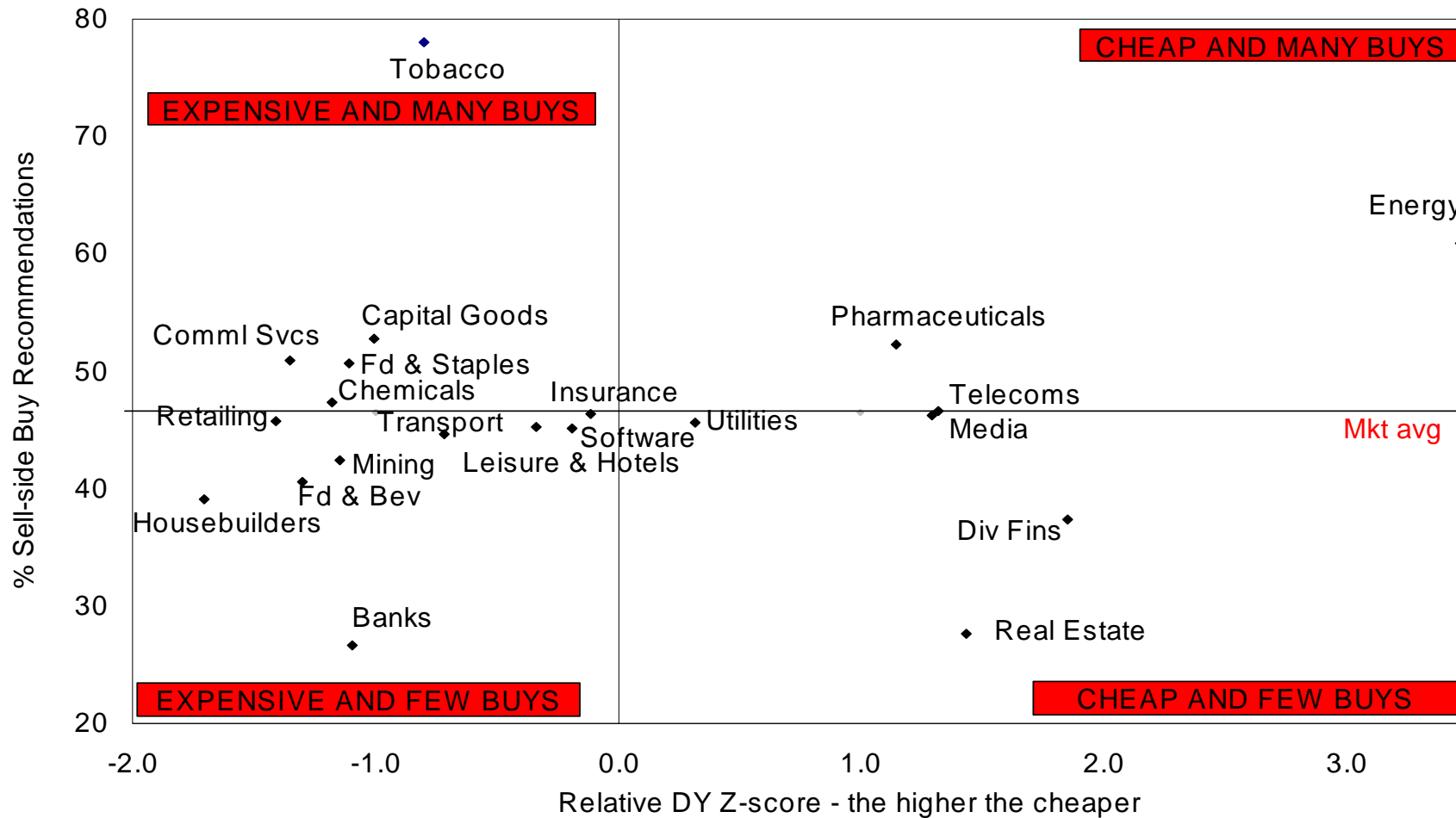
Source: Empirical Research Partners Analysis.

<sup>1</sup> Largest 1,500 stocks, capitalization-weighted data.

<sup>2</sup> Average of 14 cycles. Consumer cyclicals outperformed in 12 of them.

# Cheap and unloved sectors – financials and TMT

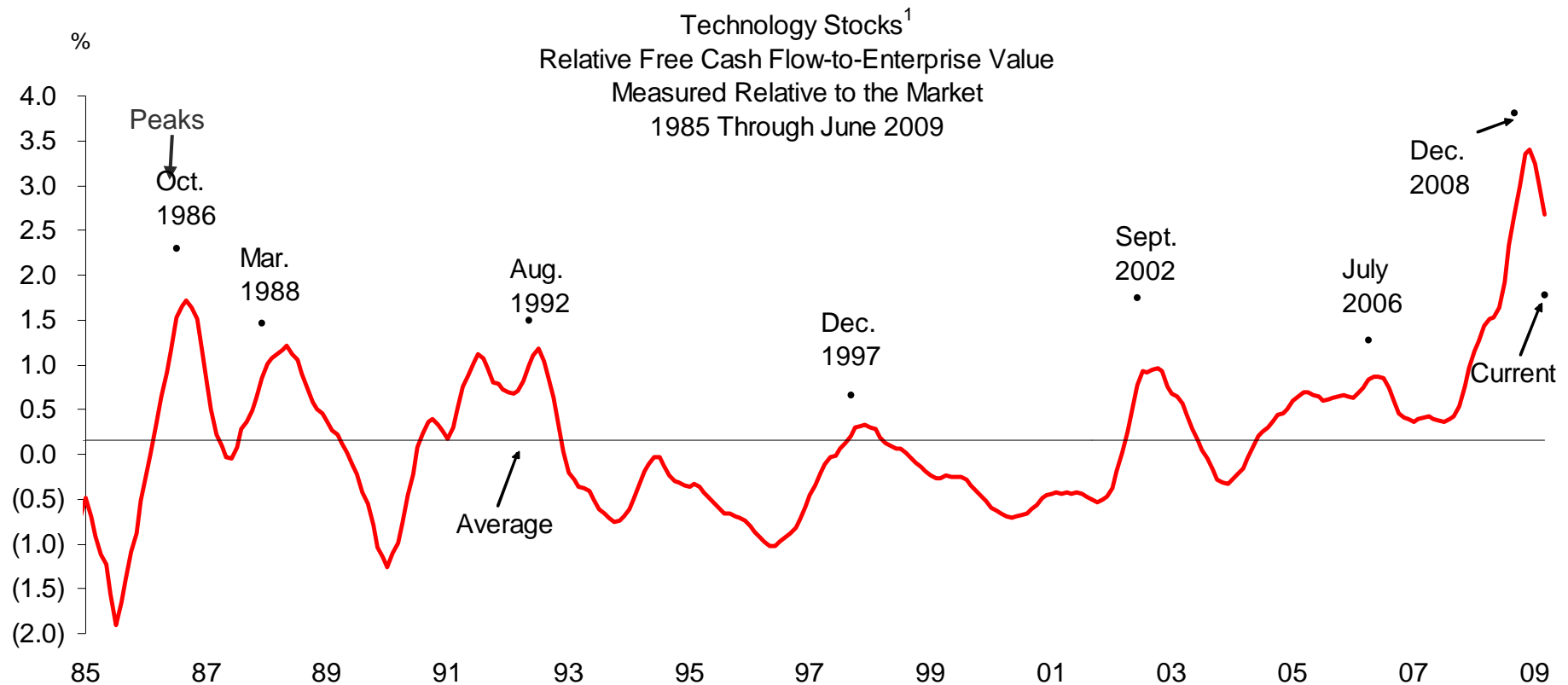
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Source: Morgan Stanley Aug 2009 UK

# Technology – Cheap growth in a low growth world

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Source: Corporate Reports, Empirical Research Partners Analysis.

<sup>1</sup> Largest 1,500 stocks, capitalization- weighted data smoothed on a six- month basis.

Source: Empirical Research –June 2009

# Key risks

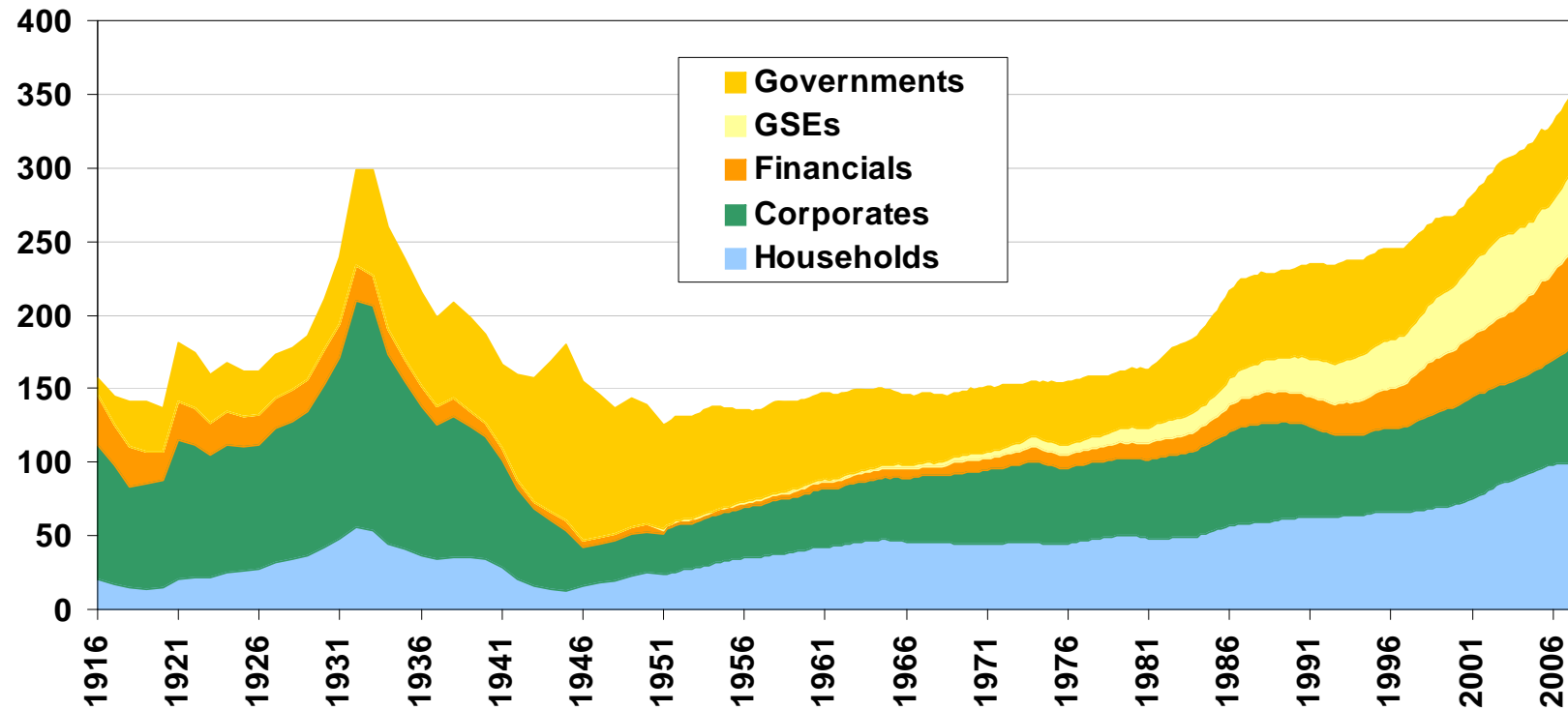
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- ▶ **Leverage overhang**
- ▶ **Higher interest rates**
- ▶ **Return of inflation**
- ▶ **Regulation**

# US system leverage

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US Credit Market Debt Outstanding To GDP %



Source: Federal Reserve, BEA, Haver, Morgan Stanley Research

# Summary

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## ▸ Where I would overweight

Technology

Consumer cyclicals

Value Stocks

Financials

## ▸ Where I am cautious

Commodities

Industrial cyclicals

Shift from cyclicals to growth  
stocks over medium term

## Summary

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- ▶ **Bull market rally may be front-end loaded**
- ▶ **Valuations still attractive versus previous troughs**
- ▶ **Growth rates will differ markedly between sectors and regions**
- ▶ **True quality organic growth will be rewarded**
- ▶ **Never forget the stock market is an excellent discounting mechanism and is already reflecting an improvement**



# Compliance information

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