2023 Investment Outlook

Navigating the polycrisis

FIL Investment Management
November 2022

Danish Defence shows the gas leaking at Nord Stream 2 seen from the Danish F-16 interceptor on Bornholm, Denmark on September 27, 2022. (Photos by Danish Defence/Anadolu Agency, STR/AFP, Alfred Gescheidt, SERGEY BOBOK/AFP, Kevin Dietsch via Getty Images)

Three themes for 2023

Navigating the polycrisis

- Financial stability joins inflation and recession as a third pillar of risk. Aggressive Fed policy to control high inflation risks a severe recession and/or global financial instability, but overly tentative policy could allow inflation expectations to embed.
- We maintain our base case for recession in 2023, first in Europe, then the US. Severity will be influenced by Fed policy, gas flows and fiscal response in Europe, and China's recovery. We see a cyclical (shallow) recession in the US as most likely.
- We believe structurally higher inflation resulting from the energy transition, demographics and reshoring will continue to be a key driving factor throughout 2023, even as supply chains ease.

Implications of dollar dominance

- Interest rate differentials have driven the dollar ever higher, creating headwinds for countries dependent on trade, with large external debt burdens, and/or maintaining a currency peg. Vulnerability is highest among emerging markets.
- We see chances for a Plaza 2.0 type global accord on controlling the dollar as low in the absence of a full-blown currency crisis. In the meantime, central banks including the BOJ and HKMA must ramp up efforts to defend currencies.
- The strong dollar will have varying effects on corporates, with upside and downside risks for margins and earnings.

China transitions

- China's strict anti-Covid measures should begin to ease in 2023. However, we expect loosening to be gradual.
- Key meetings in December 2022 and in Q1 2023 should provide the first clues about the new Politburo's economic strategy. Areas to watch closely include the path of property sector reform, national security, decarbonisation, and digitisation.
- We expect increasingly accommodative policy in 2023, with higher levels of investment in targeted sectors and potentially more easing from the PBOC. However, stimulus will be subject to gov't priorities of reasonable growth and common prosperity.

Source: Fidelity International, November 2022

Key themes and their investment implications for 2023

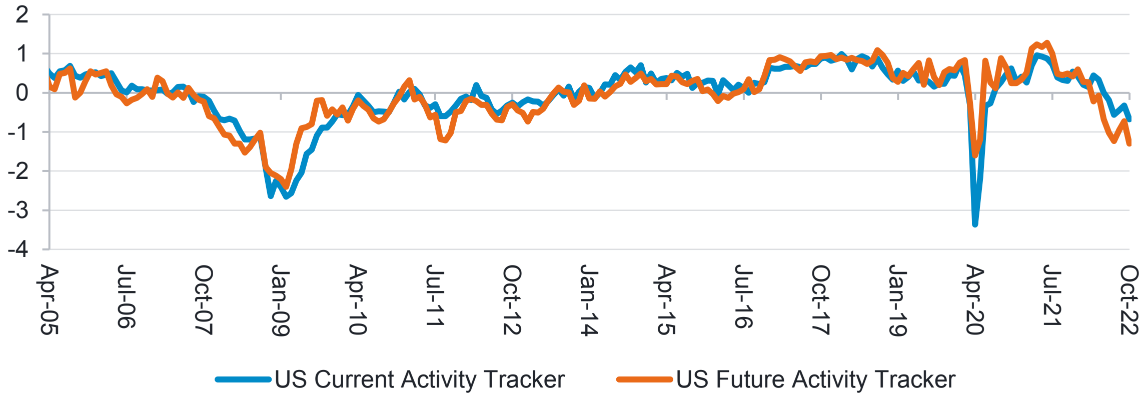
	Asset Allocation	Equities	Fixed income	Private markets	Real estate
Navigating the polycrisis	▪ Defensively positioned: underweight equities and credit, overweight government bonds and overweight cash. ▪ Prefer the safer haven of US equities to Europe. Neutral on the UK, Japan, EM. ▪ In credit, we prefer IG for defensiveness and better value; underweight EMD on strong dollar and rising real yields. ▪ Extreme vol and large tail risks leave us with less conviction on government bonds but we start the year with an overweight to offset the credit UW.	▪ Cautious on global equities. We are looking to invest in high quality stocks that are best placed to weather market volatility. ▪ It is a good time to remain highly selective with a strong focus on companies' balance sheets and funding positions as the economic downturn takes hold. ▪ Most bullish versus consensus in Asia Pacific ex Japan, particularly the Asean markets and India.	▪ Defensive and highly selective in the near-term, continued exposure to IG where valuations remain relatively attractive. ▪ US and core Europe duration are relatively attractive, considering hard landing risks in both regions. ▪ We remain neutral on UK duration given the extremely high level of volatility, dependence on future fiscal policy and the BoE's reaction function.	▪ Private markets are not immune to volatility but likely to fare better than other asset classes due to inherent features, such as floating rate structures that hedge against rising rates. ▪ Underlying credit metrics remain robust, with less exposure to CCC-rated credits than in previous downturns (e.g. 4% in Oct 2022 vs 10% in Jan 2007).	▪ We expect an economic hard landing in our regions, however this could allow more attractively-priced opportunities to emerge in the real estate market. ▪ We expect this Real Estate cycle to be shorter and shallower than previous cycles, due to greater transparency in the markets, so values will adjust more quickly.
Implications of dollar dominance	▪ Despite appreciation, dollar remains the key safe haven. Higher terminal rates, stubborn inflation and weak sentiment still support dollar strength. ▪ EMFX has not depreciated in line with other major USD crosses, suggesting more downside is possible. ▪ This, and Fed hawkishness, slowing global growth and RMB weakness, underlie our underweight in EMFX.	▪ Strong dollar remains detrimental to stocks, even US corporates, as dollar value of foreign profits shrinks. ▪ When the Fed eventually pivots, a weak US economy could result in a weaker dollar, which would be supportive for global equities. ▪ We remain cognizant that market volatility and tail risks could send markets lower if left unchecked.	▪ Policymakers will eventually re-prioritise growth, as inflation begins to ease. An inflection point would offer a significant reprieve to fixed income asset classes and support total returns. ▪ We believe rates will ultimately settle far higher than they have at any point over the past decade.	▪ Current valuations have priced in downside risks in excess of all-time lows, suggesting strong positive returns over a medium- term horizon. ▪ The market is dominated by defensive sectors, e.g. healthcare, services, & media/telecoms, but security selection remains key. ▪ The maturity wall is not an immediate risk. Default rates are likely to step up but not to the same levels seen in the GFC.	▪ The nature of the hard landing will cast an even sharper light on energy costs and as such, "green" buildings are already commanding higher rents. Demand remains strong given market conditions. ▪ With occupancy costs rising rapidly, we expect there to be more pressure among occupiers to rationalise their portfolios. ▪ Focus is on supply constrained markets where rental values look more resilient.
China transitions	▪ China is undergoing a transition phase. The gradual bifurcation of China and the West will continue. ▪ While this may be a growth drag for China, a reconfiguring of supply chains will provide opportunities as well, including in Mexico, Canada, LatAm, Thailand and Vietnam. ▪ We are underweight the RMB on the drivers outlined above.	▪ China offers a strong medium-term opportunity, though economic recovery will be gradual, with both sector and stock selection key drivers. ▪ Domestic earnings will improve, against the backdrop of renewed levels of investment in infrastructure. ▪ We are positive on consumer staples, financials, and healthcare.	▪ We have a constructive outlook on China, due to expectations of reopening and other supportive developments, such as easing in property market regulation and funding support for developers to ease liquidity shortages. ▪ Therefore we are selectively overweight China assets.	▪ Although little direct exposure to China, many credits in the private markets have faced supply-chain issues due to the Zero-Covid policy. Easing of restrictions will be beneficial, although the timing remains uncertain. ▪ Chinese growth is not expected to return to the strongest levels historically, but private markets are likely to be less impacted.	

Global Macro

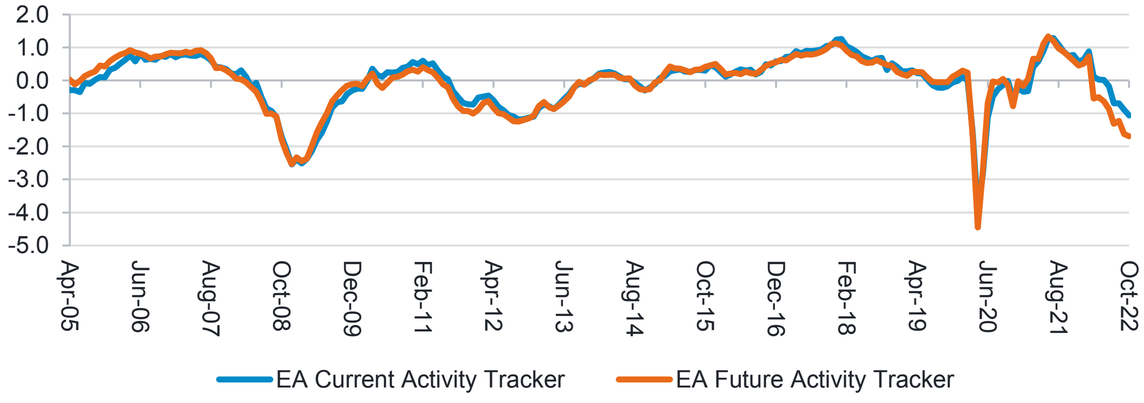
US and EU activity trackers

US activity resumed downturn in October; EU activity continues to deteriorate further

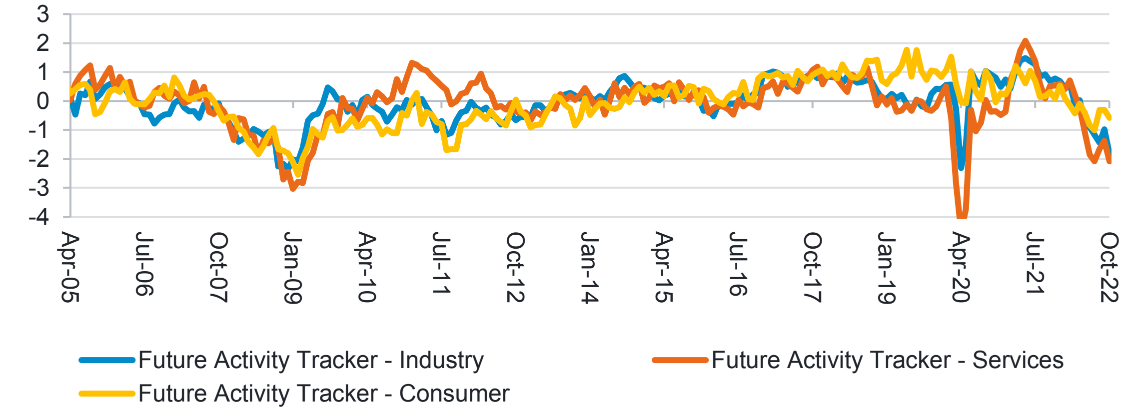
US current and future activity trackers



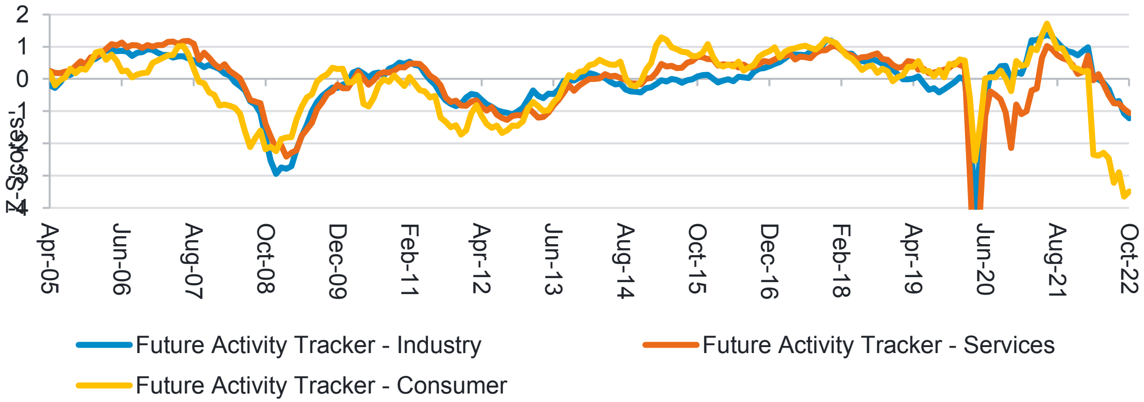
EU current and future activity trackers



US future activity tracker by sector



EU future activity tracker by sector



Source: Fidelity International, Fidelity Global Macro Research calculations, November 2022.

2023 growth forecasts

Broad downside risks to global growth, with some pockets of strength mainly in EMs

2023 Growth (Real GDP)	BBG consensus*	Fidelity upside case	Fidelity downside case	Risk assessment vs consensus
Global	**2.6**	**3.2**	**1.3**	Downside
Developed markets	**0.3**	**0.9**	**-1.3**	Downside
US	0.4	1.0	-1.0	Downside
Eurozone	-0.1	0.5	-2.0	Downside
UK	-0.4	0.0	-2.0	Downside
Japan	1.4	2.0	0.5	Balanced
Emerging markets	**4.3**	**4.9**	**3.2**	Downside
China	5.0	5.5	3.5	Downside
India	6.1	7.0	5.5	Balanced
Brazil	0.8	1.5	0.0	Balanced
Mexico	1.2	1.8	0.0	Downside
Turkey	3.0	3.5	2.0	Downside
Indonesia	5.0	5.5	3.2	Balanced

Source: Fidelity International, Bloomberg, November 2022. Note: these scenarios and risk assessment are not intended to be exact growth forecasts, but rather illustrations of potential outcomes based on particular assumptions about a number of variables, including the virus trajectory, monetary and fiscal policies and associated multipliers, corporate and consumer behaviour. Given significant uncertainties related to how the cycle might evolve in the aftermath of the pandemic, these scenarios are subject to change. DM, EM and global aggregates are calculated including only countries that appear in the table, giving rise to potential differences vs aggregate consensus numbers quoted on Bloomberg, which include a wider universe. We will be revising growth numbers and risk assessment continuously, as signals evolve and more information becomes available. *BBG consensus as of 1st November.

Macro scenario analysis

We see an 80% chance of a hard landing or recession, and a cyclical (shallow) recession as the most probable outcome

Global Macro Scenario Grid (0-12 months horizon)

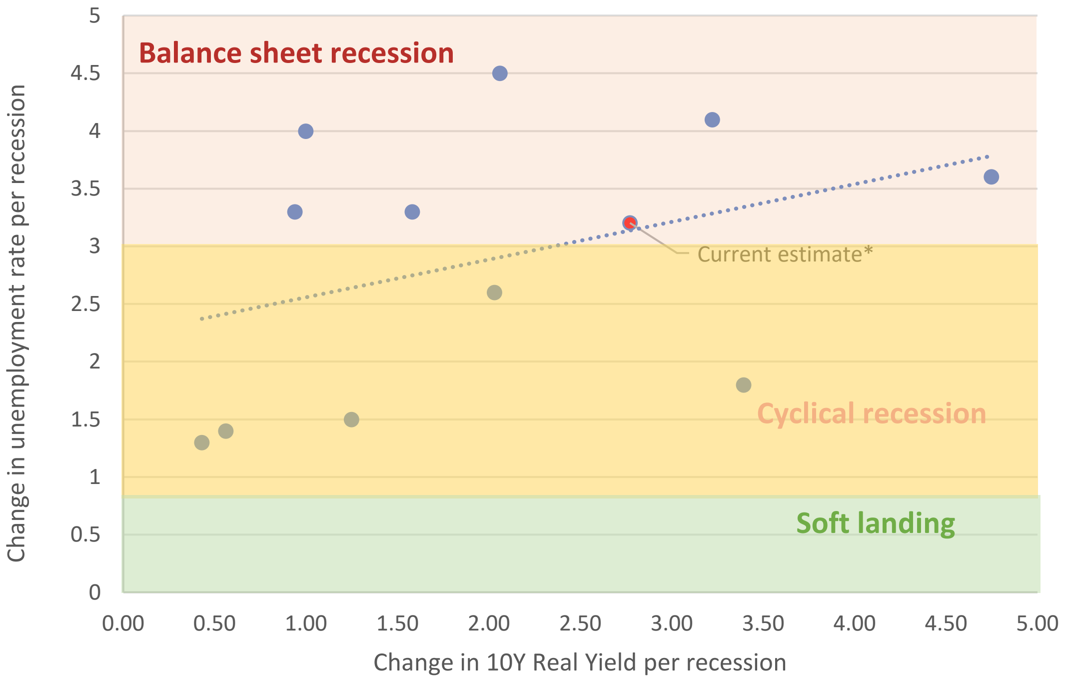
	Balance Sheet Recession	Cyclical Recession	Soft Landing	Stagflation
Time horizon	0-6m 6-12m	0-6m 6-12m	0-6m 6-12m	0-6m 6-12m
Growth/Inflation dynamics (delta)	Growth: ↓ ↓ Inflation: ↓ ↓	Growth: ↓ ↓ Inflation: ↓ ↓	Growth: ↓ ↔ Inflation: ↓ ↔	Growth: ↓ ↔ Inflation: ↑ ↔
Scenario narrative	US Fed overtightening driven by unrelenting inflation pushes the economy into a deep recession, damaging balance sheets and resulting a severe decline in demand.	US Fed tightening pushes the economy into a cyclical recession. However, an eventual pivot by CBs combined with stronger balance sheet positions in DM economies cushion the shock, preventing a severe downturn.	A combination of easing supply disruptions and a resilient consumer leads to avoidance of recession. CBs manage to successfully control inflation, with the economy remaining at near-trend growth.	Political/supply-side pressures mean Central Banks remain substantially behind the curve. This leads to de-anchoring in inflation expectations, which subsequentially damages growth/ leads to a recession.
Probability	25%	55%	10% (5%)	10% (15%)

Note: Brackets show last month's probabilities. Growth/inflation arrows indicate deltas from current levels.
*Source: Fidelity International, November 2022.

Cyclical (shallow) recession appears the most likely outcome in 2023

Real yield tightening vs balance sheet resilience

The historical relationship between tightening financial conditions and the economy suggests a deep contraction is ahead…

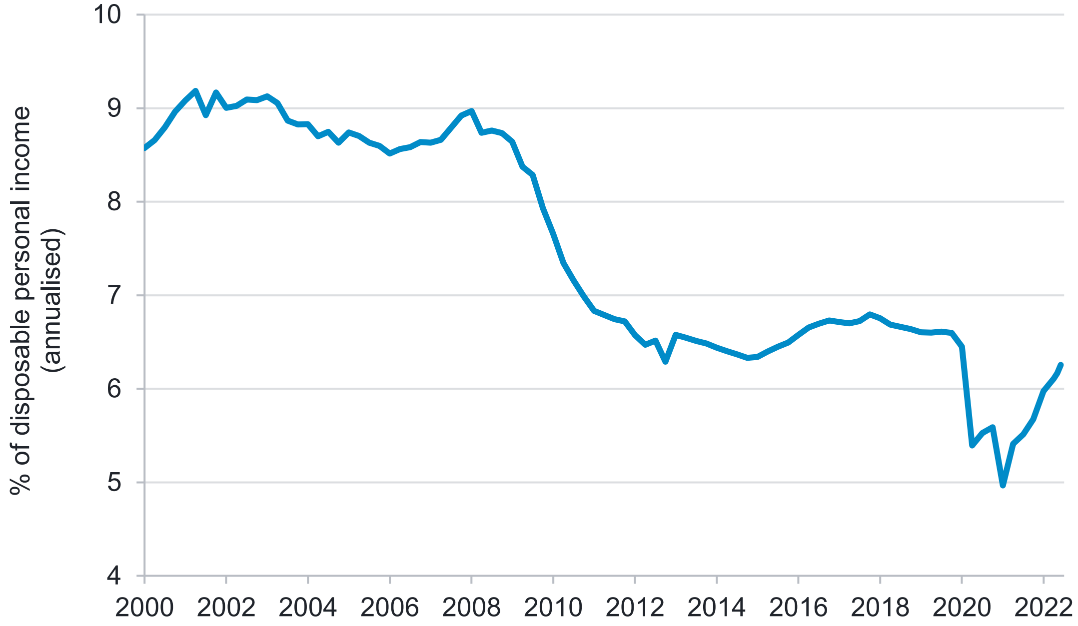


Note: Real yield delta calc - Delta from max RY around a recession to T-12 months from the peak; *estimate based on observed simple linear relationship between unemployment changes and RY changes. Cyclical recession bounds: 0.9% <= Change in UR <= 3%.

Source: Fidelity International, Fidelity Global Macro Research calculations, November 2022.

…but the strength of balance sheets makes us more sanguine

US consumer revolving credit drawdowns as % of disposable income



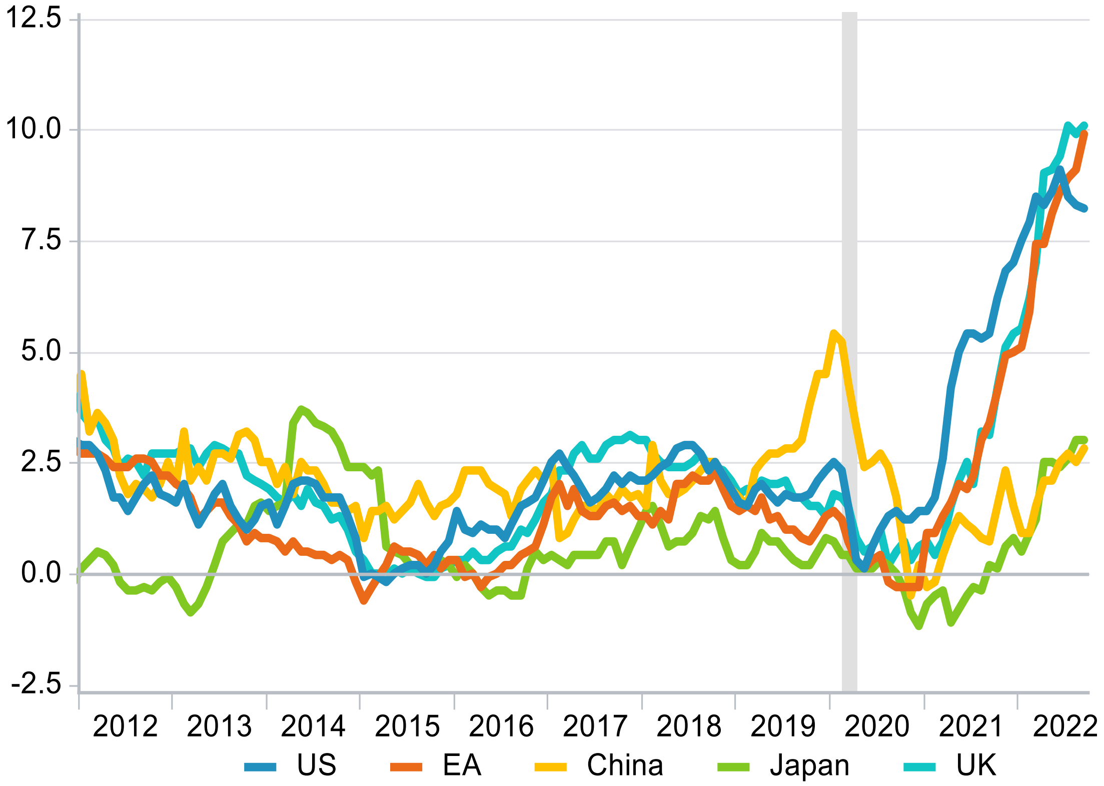
Source: Fidelity International, Haver Analytics, November 2022.

Fidelity INTERNATIONAL

High and persistent inflation remains a priority for the Federal Reserve

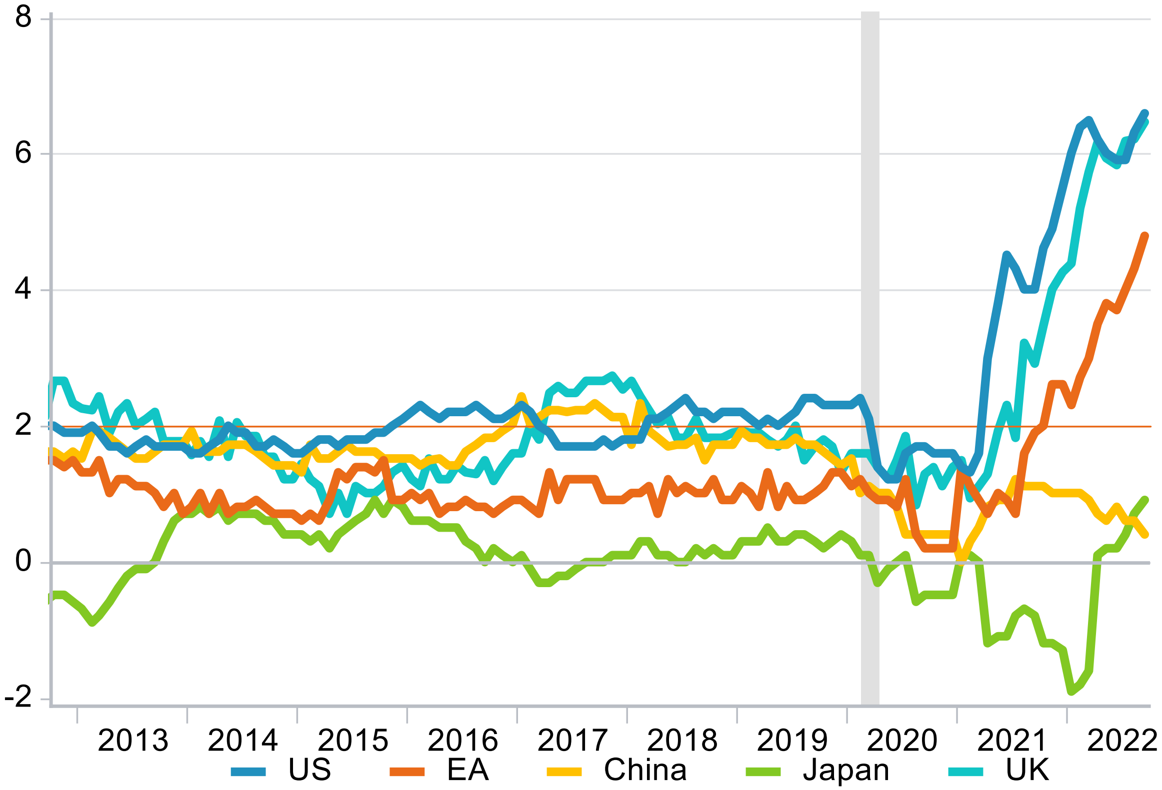
DM core inflation has continued to surge higher

Global headline CPI rates (% YoY)



Source: Fidelity International, Haver Analytics, November 2022.

Global core CPI rates (YoY)

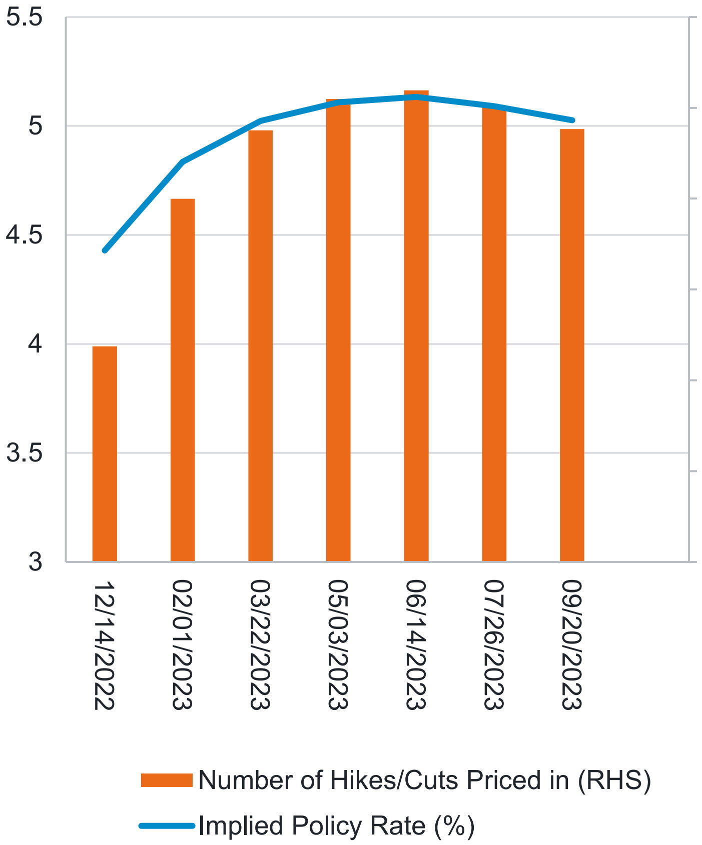


Source: Fidelity International, Haver Analytics, November 2022.

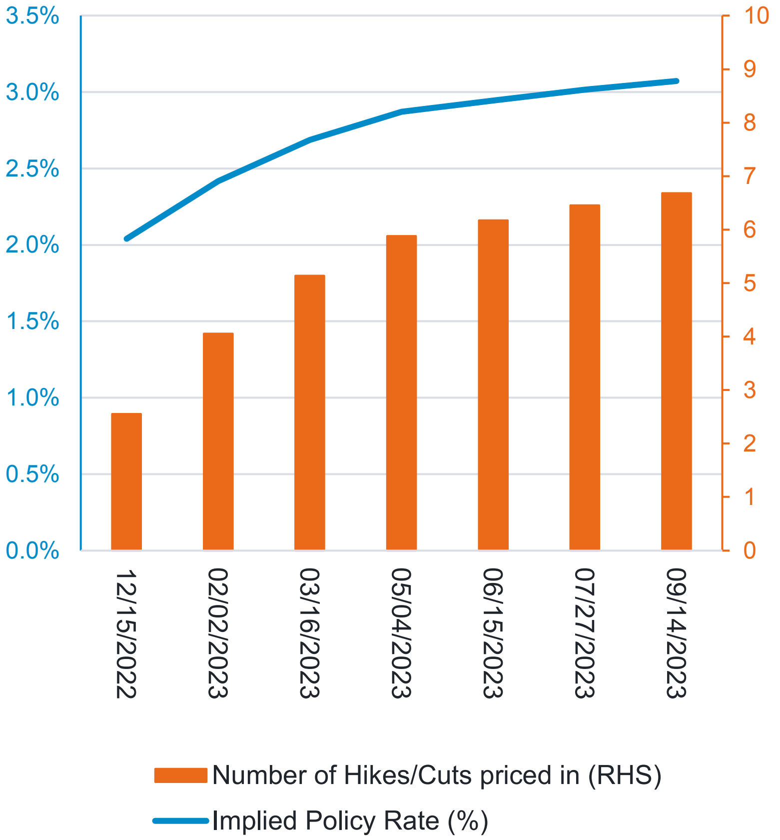
DM central banks: To pivot or not to pivot?

Powell's Fed is in "resolutely" hawkish mode, while the window for ECB and BOE tightening is rapidly closing

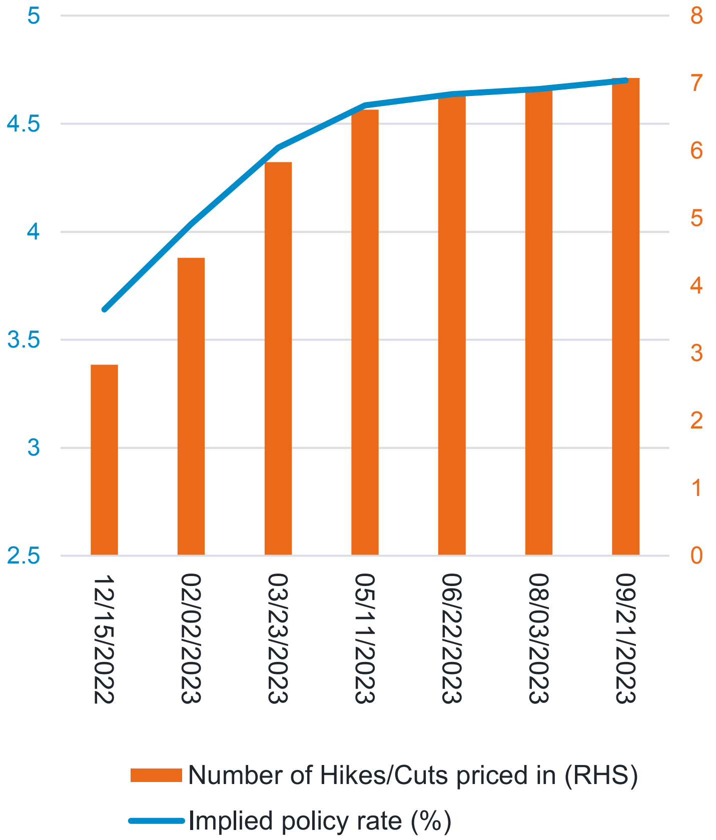
Federal Reserve



ECB



Bank of England



Source: Fidelity International, Bloomberg, October 2022.

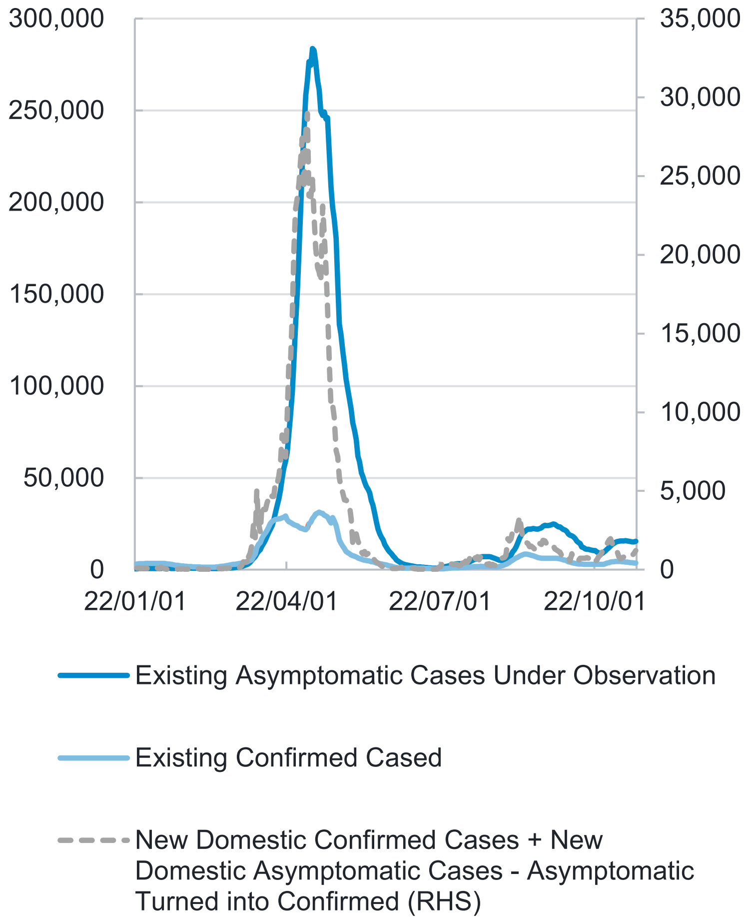
China turns a page with the 20th Party Congress

Economic meetings in Q4/Q1 should provide more clarity on key policy areas for 2023

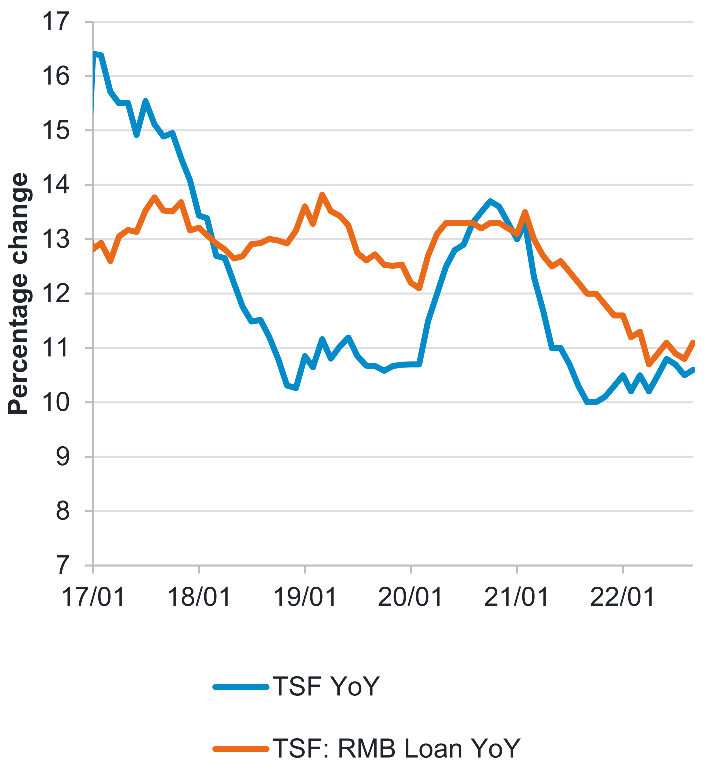
New Politburo Standing Committee

Position	Member
General Secretary	Xi Jinping
Premier	Li Qiang
National People's Congress	Zhao Leji
Chinese People's Political Consultative Conference	Wang Huning
First Secretary of the Central Secretariat of the CCP	Cai Qi
Secretary of the Central Commission for Discipline Inspection	Li Xi
Executive Vice Premier	Ding Xuexiang

Zero Covid Policy



Economic Policy

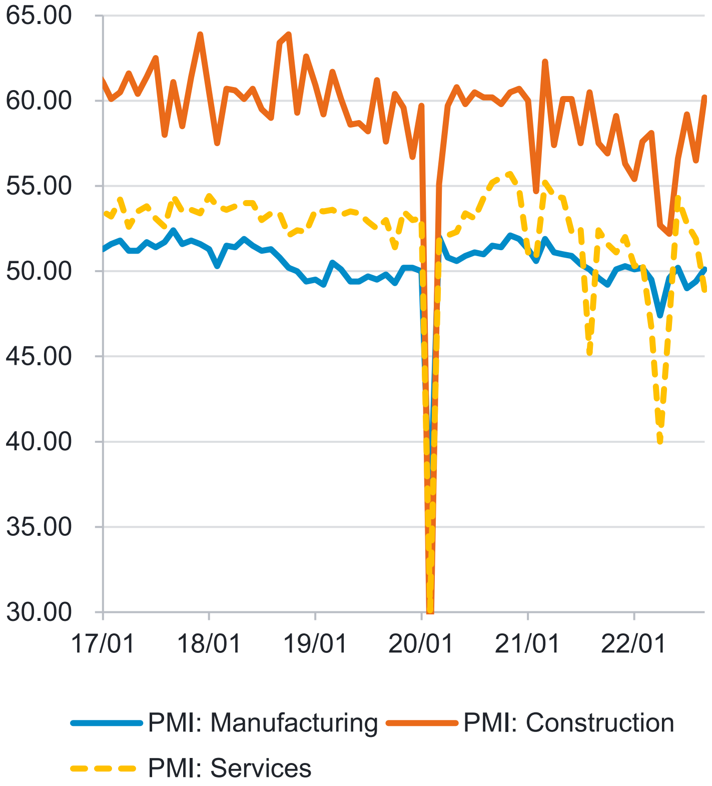


Source: Fidelity International, government sources, Wind, GS, CREIS, Gao Hua Securities Research, November 2022

Key drivers of China growth

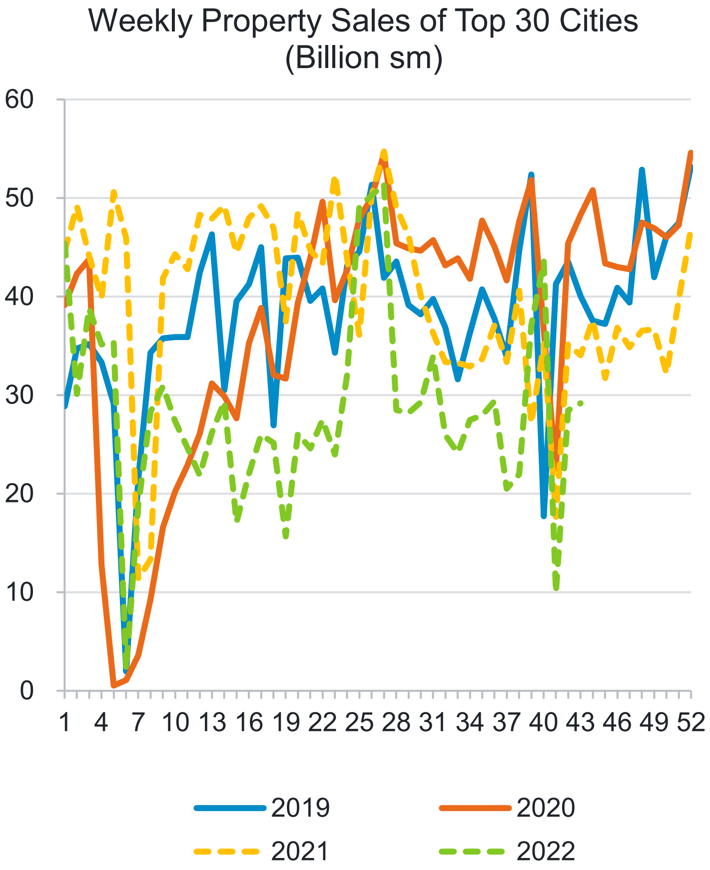
The pace of re-opening, property sector reform and investment in infrastructure and strategic sectors

Halting economic recovery so far



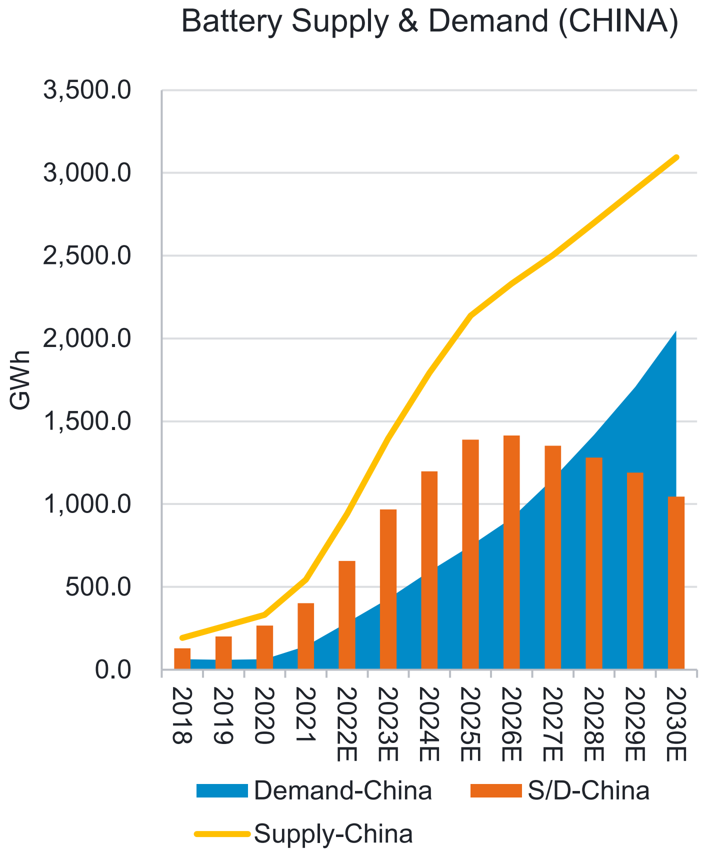
Source: Fidelity International, Bloomberg, November 2022.

Challenges remain in property



Source: Fidelity International, NBS, Wind, November 2022.

Internal circulation and sustainable growth

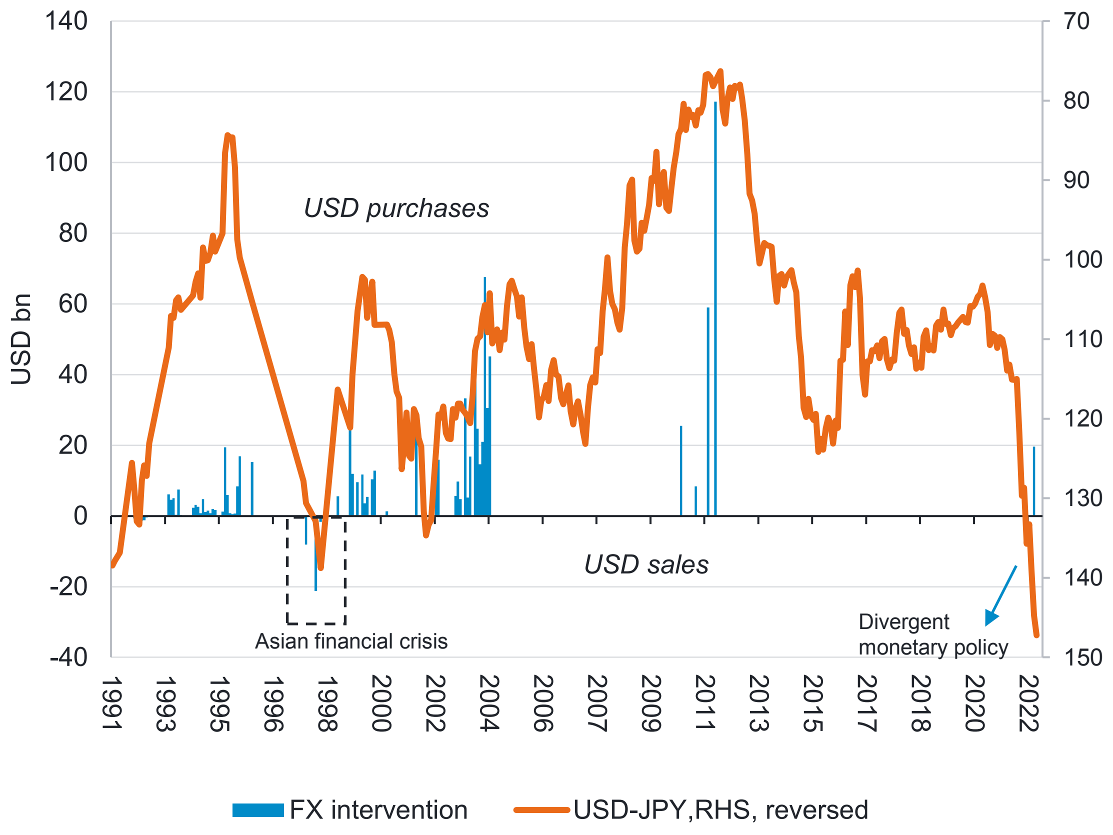


Source: Fidelity International, NBS, Wind, November 2022.

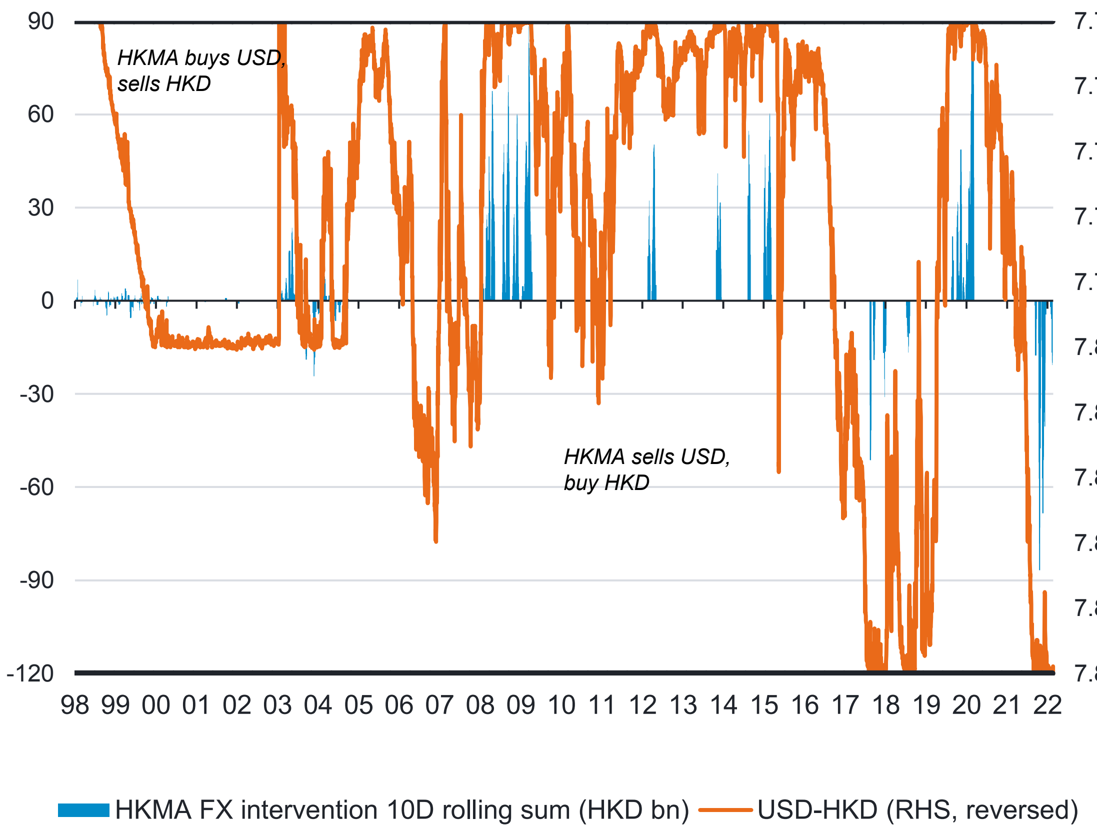
Dollar strength is driving FX instability

Rate differential driving dollar higher, causing upward pressure on USD-JPY and USD-HKD

BOJ FX intervention



USD-HKD peg under pressure



Source: Fidelity International, Bloomberg, November 2022.

Structural long-term themes in 2023

Demographic transition begins in China and Germany; Strategic asset allocation and the return of inflation

Est. first year of population contraction

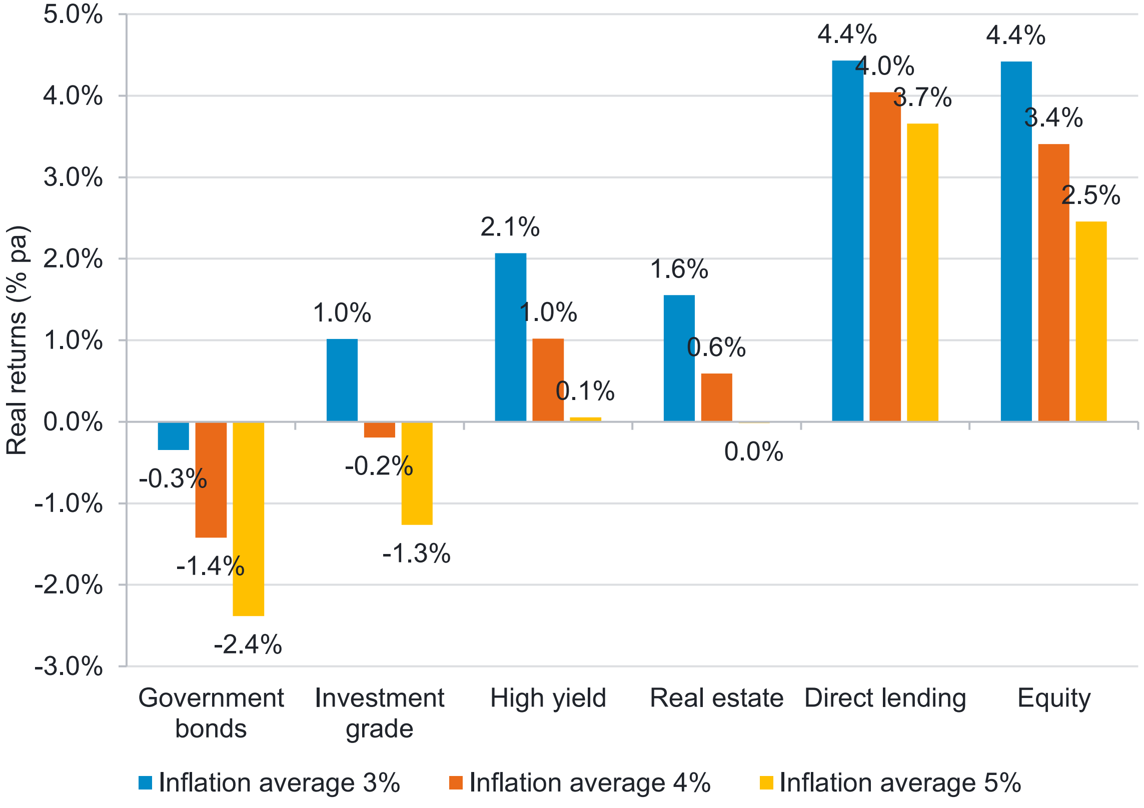
Population growth rate	Low growth	Medium growth	High growth
Japan	2010	**2010**	2010
Germany	2022	**2022**	2044
China	2022	**2023**	2036
UK	2032	2056	N/A
US	2041	N/A	N/A
World	2054	2087	N/A

Total population growth by decade

	US	China	Japan	Germany	UK	World
1950s	19%	20%	12%	3%	5%	21%
1960s	14%	26%	12%	7%	6%	22%
1970s	11%	19%	12%	-1%	1%	20%
1980s	11%	17%	5%	2%	2%	20%
1990s	14%	10%	3%	3%	3%	16%
2000s	10%	7%	1%	0%	7%	14%
2010s	8%	6%	-2%	2%	7%	12%
2020s	5%	-1%	-5%	-1%	3%	9%
2030s	4%	-3%	-6%	-2%	2%	8%
2040s	2%	-5%	-7%	-3%	1%	6%
2050s	1%	-8%	-7%	-4%	0%	4%
2060s	2%	-10%	-8%	-3%	0%	2%
2070s	1%	-10%	-7%	-3%	0%	1%
2080s	0%	-11%	-6%	-2%	-1%	0%
2090s	0%	-11%	-6%	-2%	-1%	-1%

Source: Fidelity International, UN, World Prospects 2022: Summary of Results, 2022.

Ten-year average real return projections by inflation rate

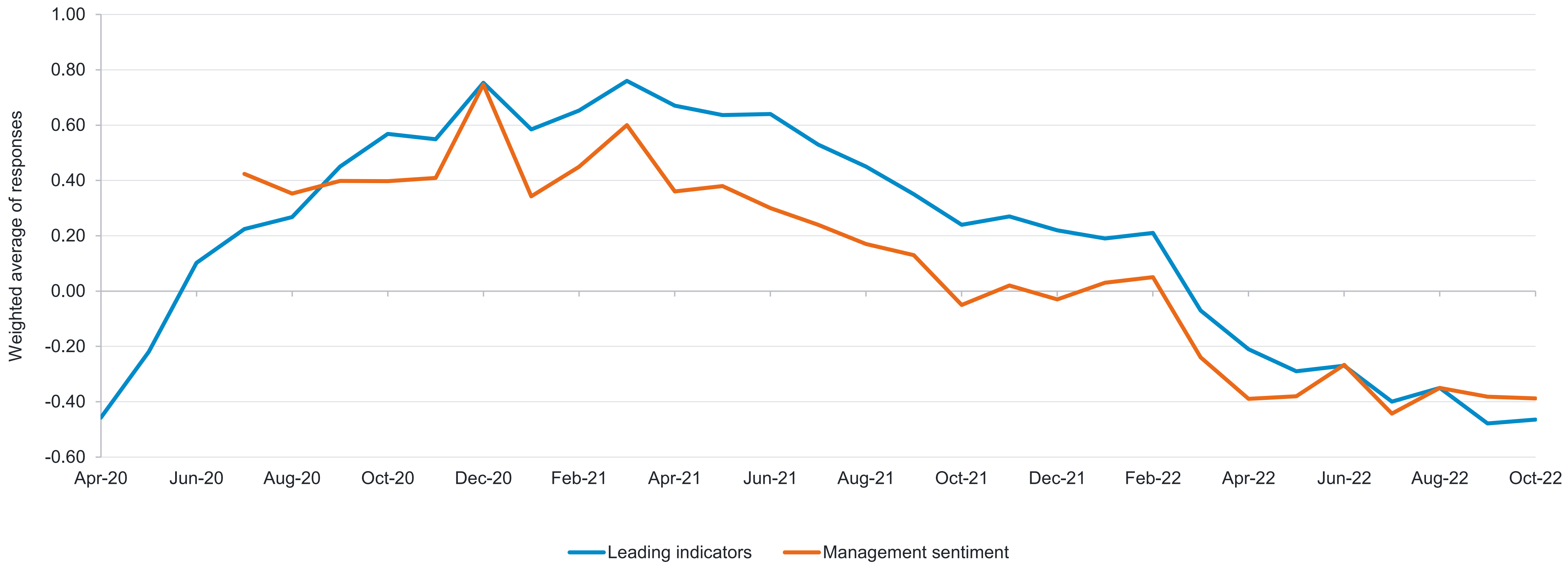


Assumptions are based on proprietary modelling and reflect the views of investment professionals at Fidelity International. Assumes a terminal real interest rate of -0.25%. Indices used: ICE BofAML US Treasury Index, ICE BofA US Corporate Index, ICE BofA US High Yield Index, S&P 500 Index, MSCI US Property Index, direct senior loan data modelled from Pitchbook and LCD. Source: Forward-looking estimates are based on proprietary models by Fidelity International. Valuation baseline date: 29 July 2022

Global Investment Research

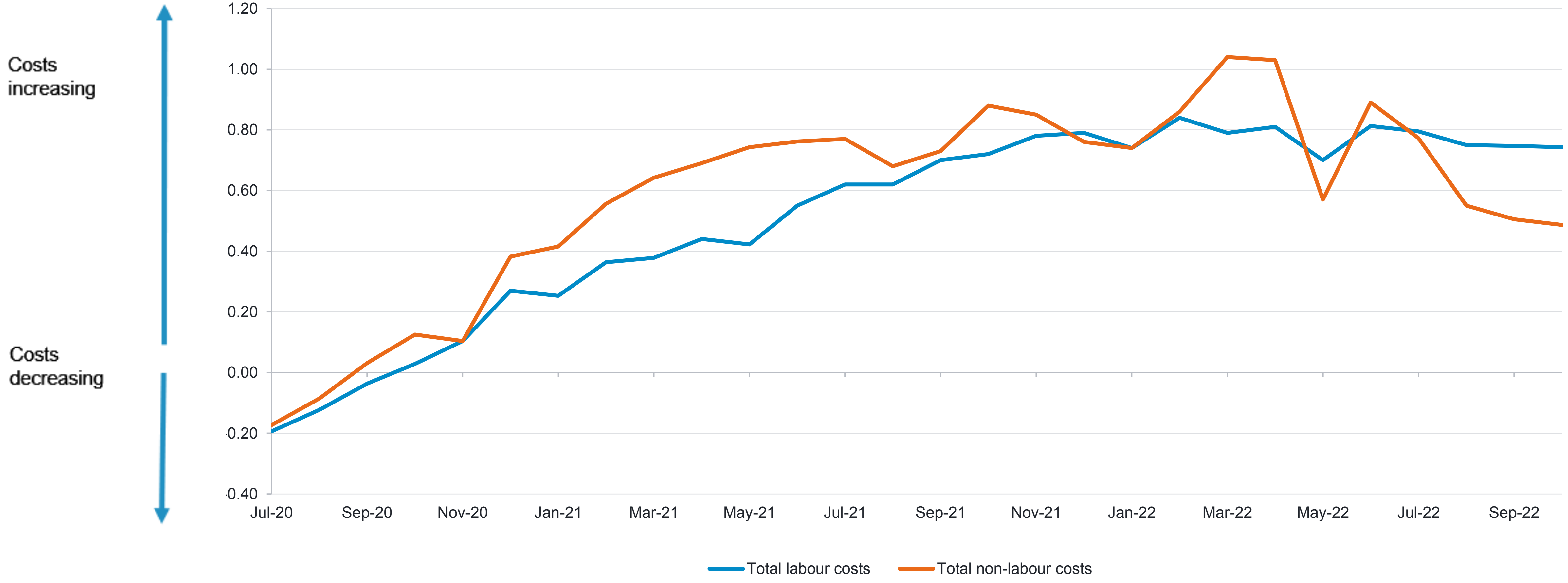
Global corporate indicators remain near pandemic lows

Monthly survey of Fidelity analysts shows aggregated investee companies' confidence has yet to return



Source: Fidelity International Global Investment Research, October 2022 Analyst Survey.

Costs continue to rise, but acceleration is slowing for non-labour costs and stabilising for labour

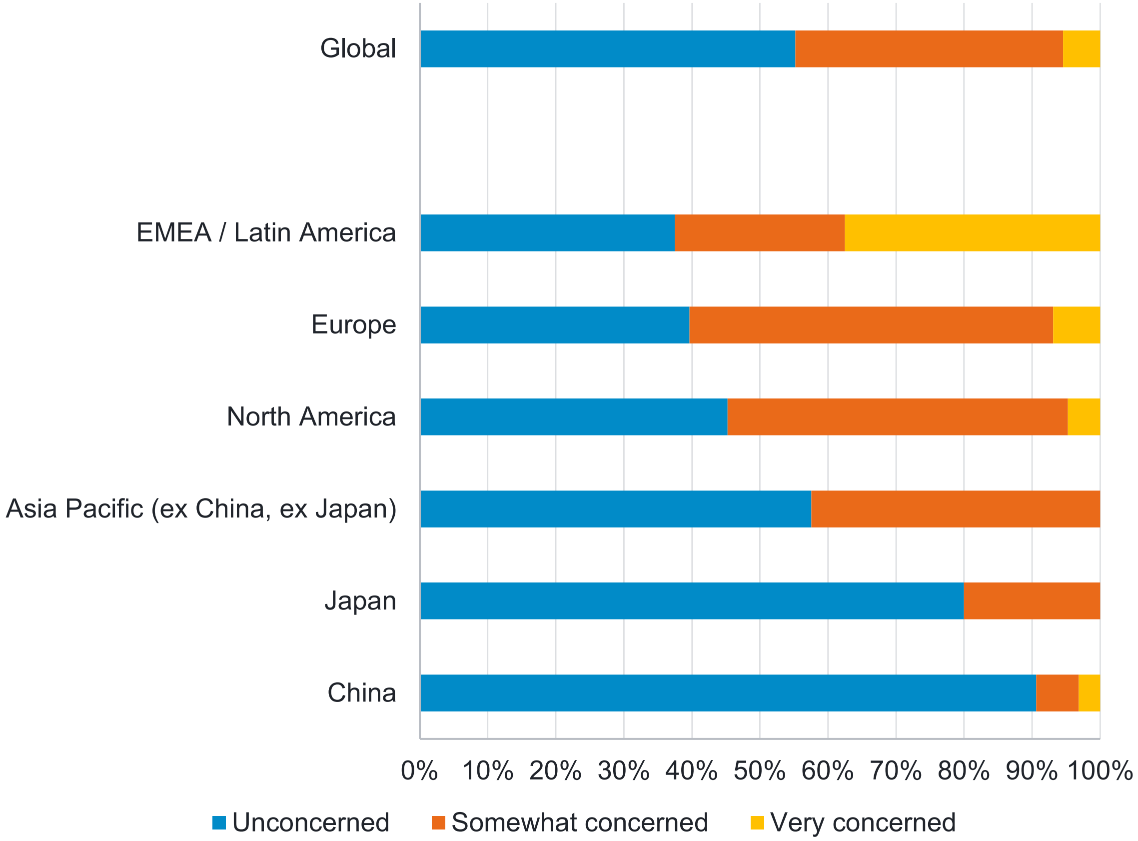


Source: Fidelity International Global Investment Research, October 2022 Analyst Survey.

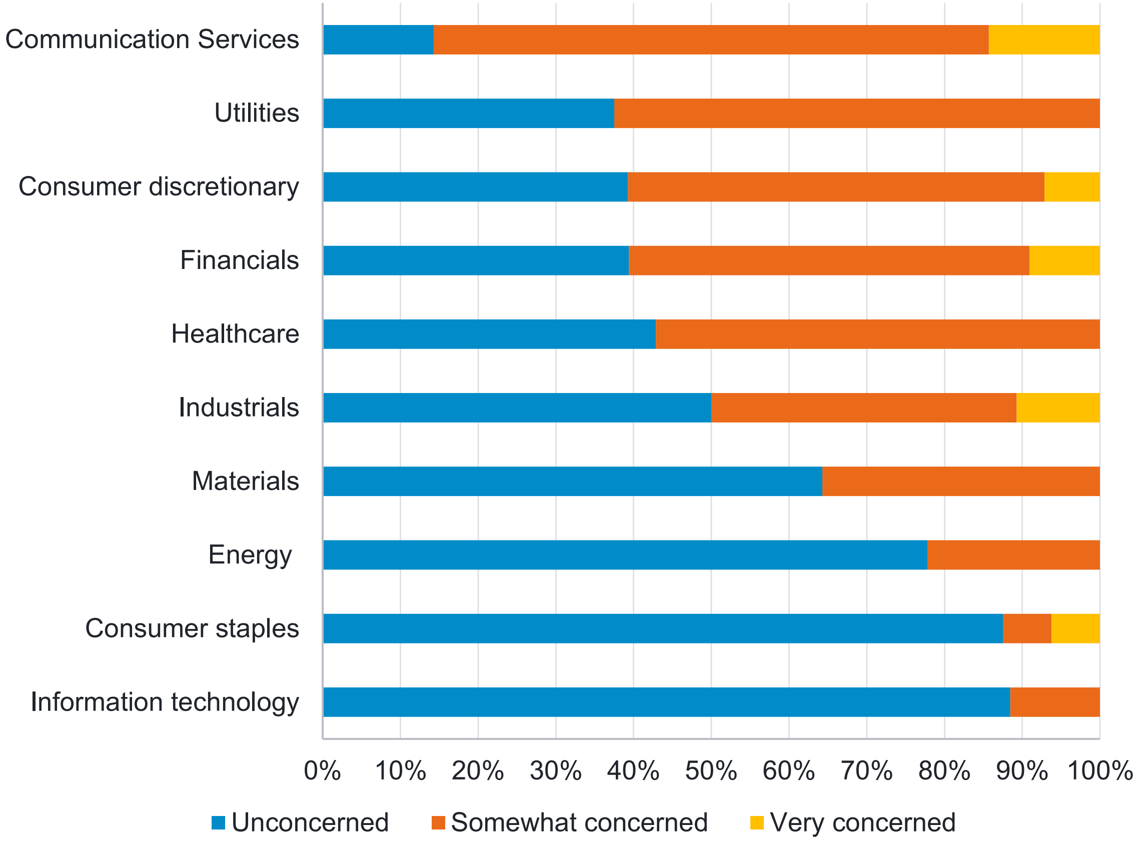
Most analysts unconcerned by debt affordability as real yields rise

Companies from the IT, consumer, staples, and energy sectors are the most sanguine, while companies in Asia are calmer than those in Europe and the US

Region



Sector

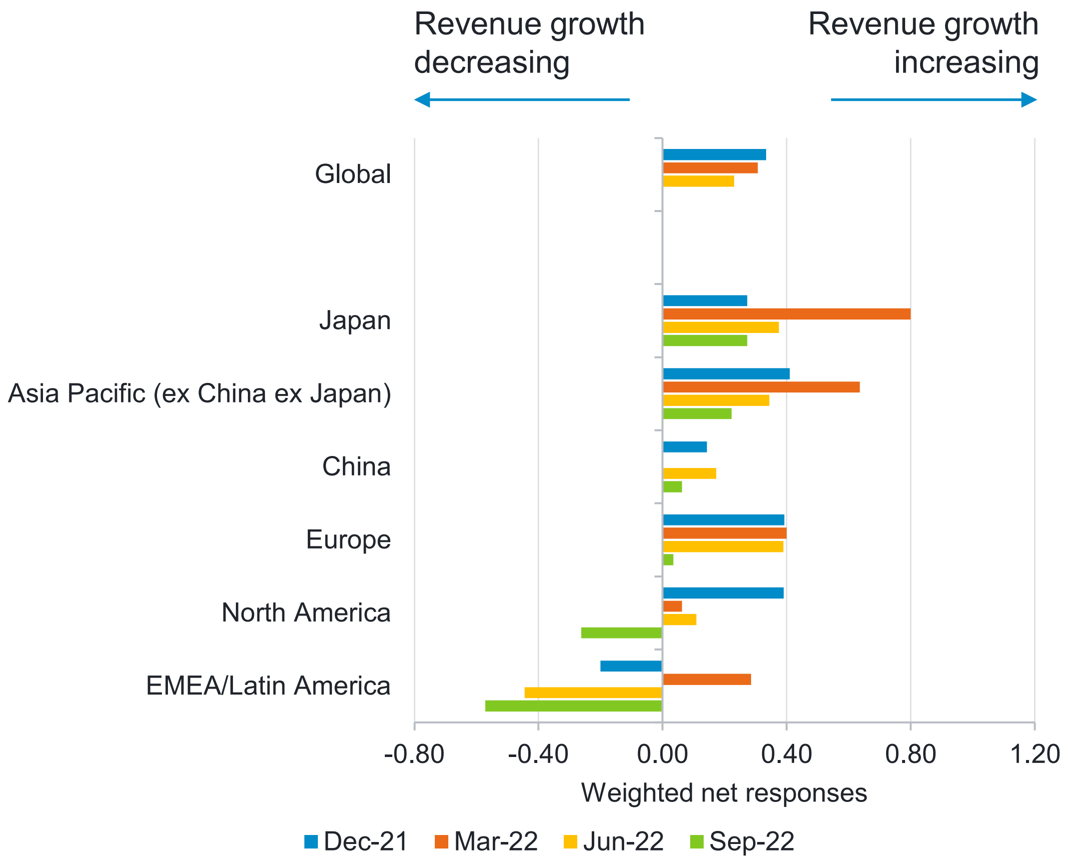


Source: Fidelity International Global Investment Research, October 2022 Analyst Survey. Question: “How concerned are you about real yields impacting debt affordability for your companies?”

Revenue growth will continue to ease in most places, having seen a significant drop-off since March

Revenues in energy, consumer discretionary, IT, and materials companies are expected to fall

Region



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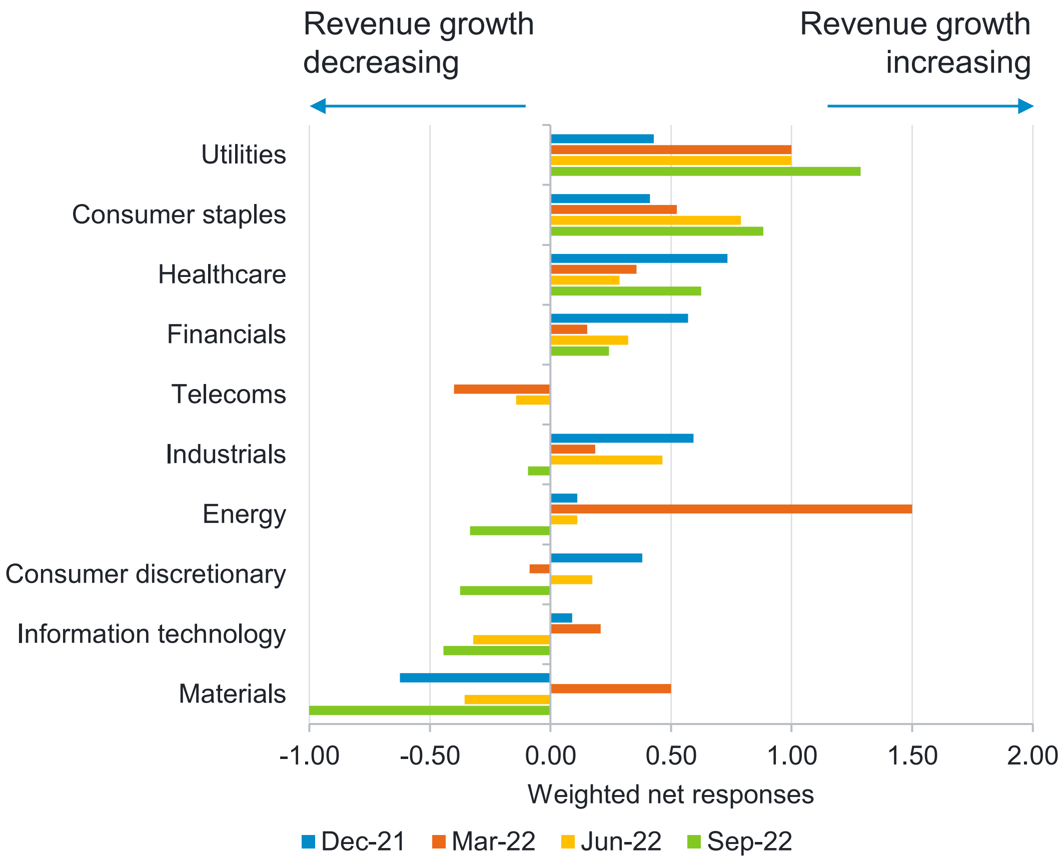
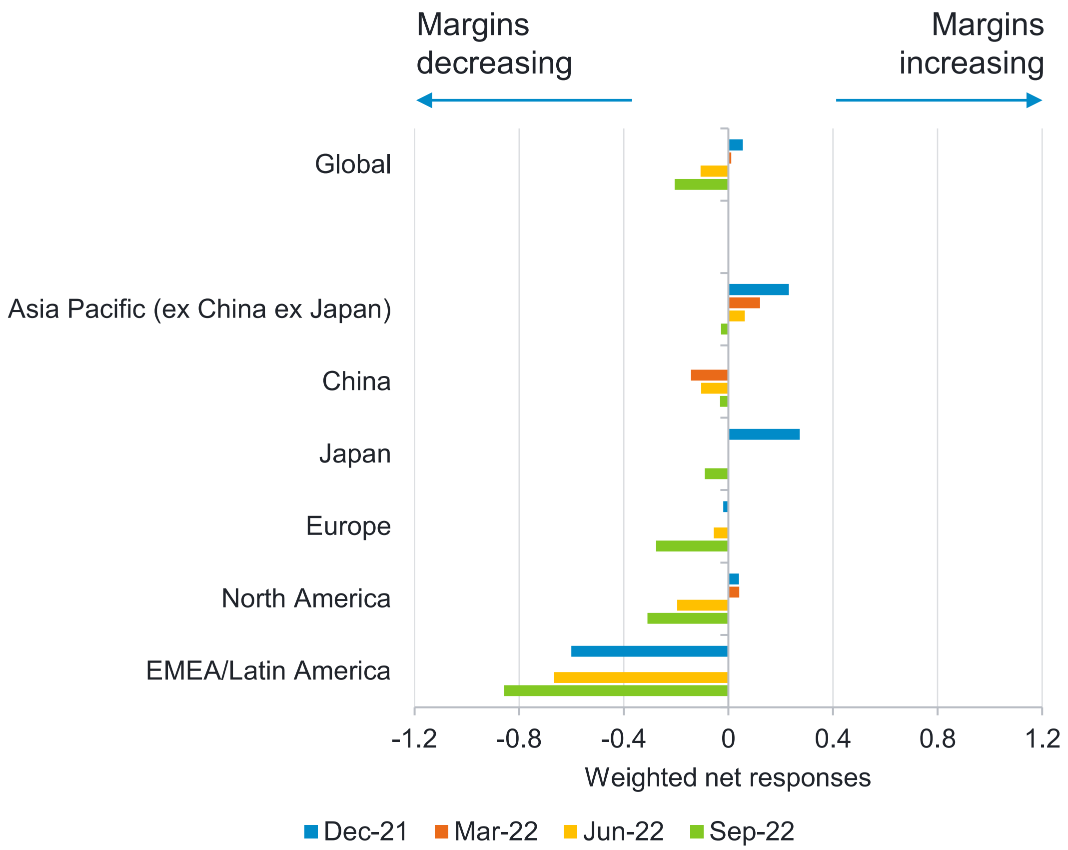


Source: Fidelity International Global Investment Research, September 2022 Analyst Survey. Chart shows weighted average of responses. Question: "What are your expectations for YoY revenue growth over the next 12 months compared to current levels?" Note: Readings of zero appear as no bar on the chart.

EBITDA margins are expected to decrease across the globe

Region



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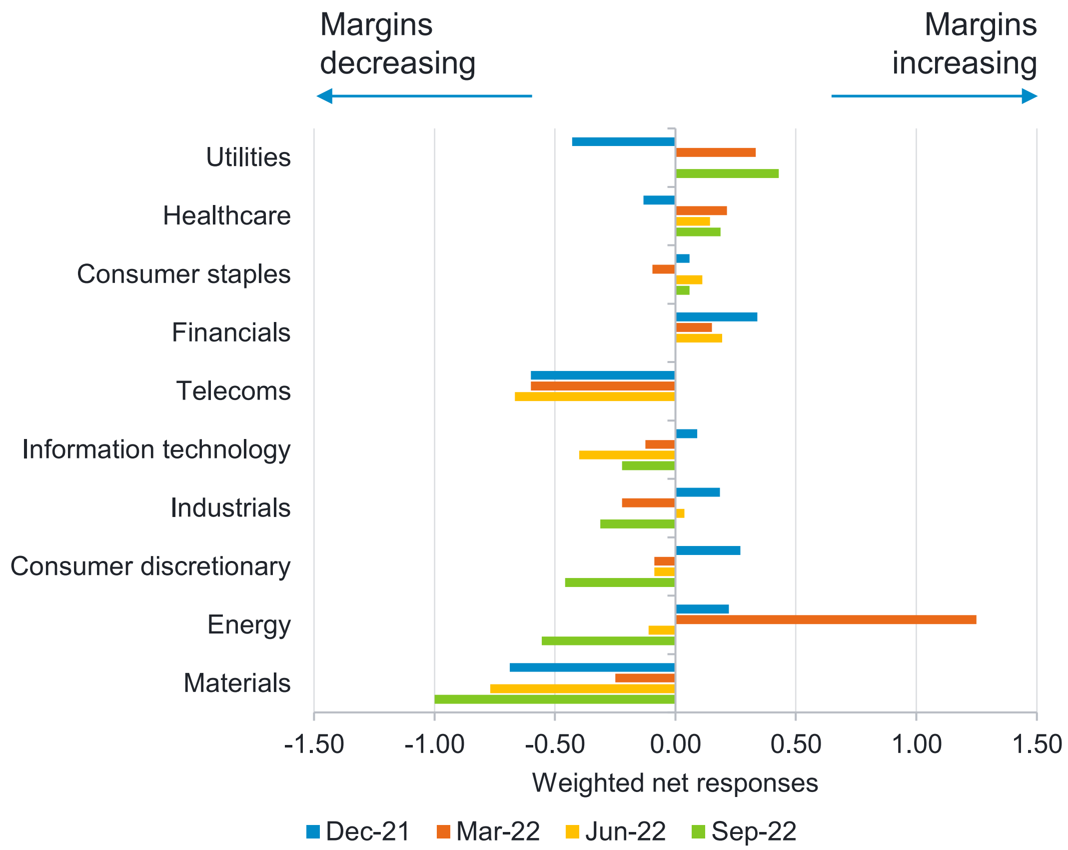
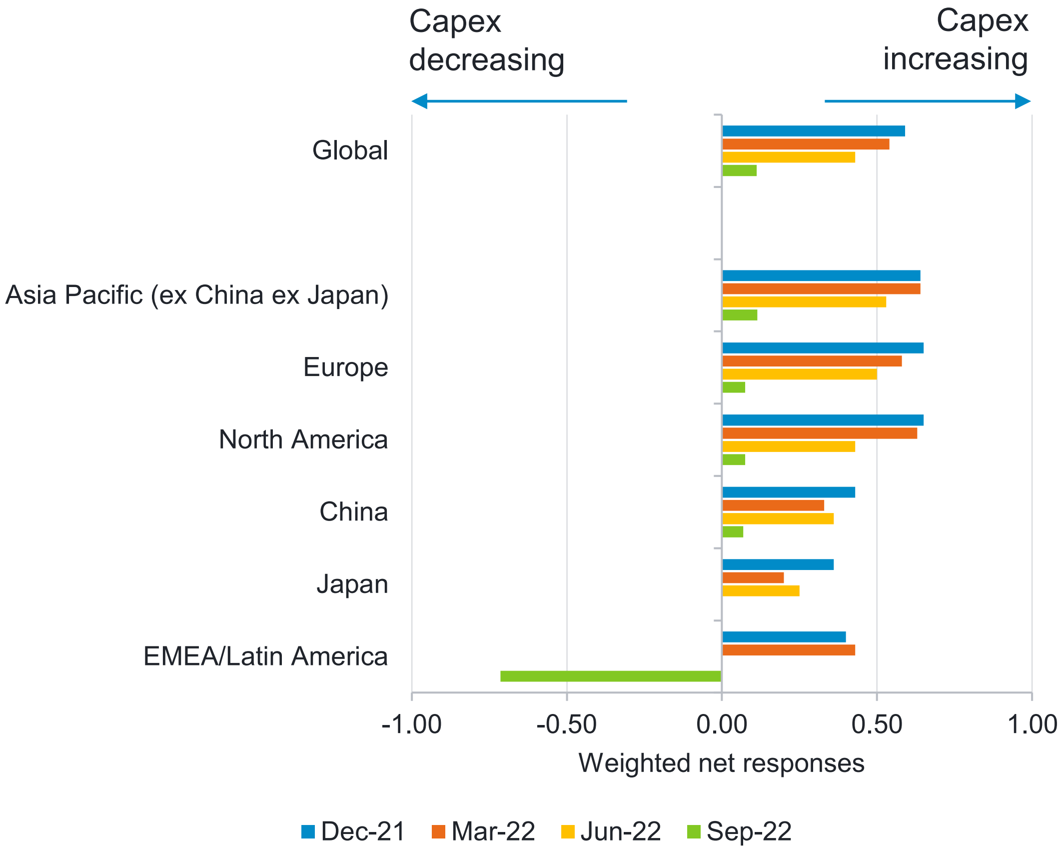


Source: Fidelity International Global Investment Research, September 2022 Analyst Survey. Chart shows weighted average of responses. Question: “What are your expectations for EBITDA margins over the next 12 months compared to current levels?” Note: Readings of zero appear as no bar on the chart.

Fidelity INTERNATIONAL

Companies' investment plans had remained strong over early 2022, but most sectors are now slowing down or even contracting their plans

Region



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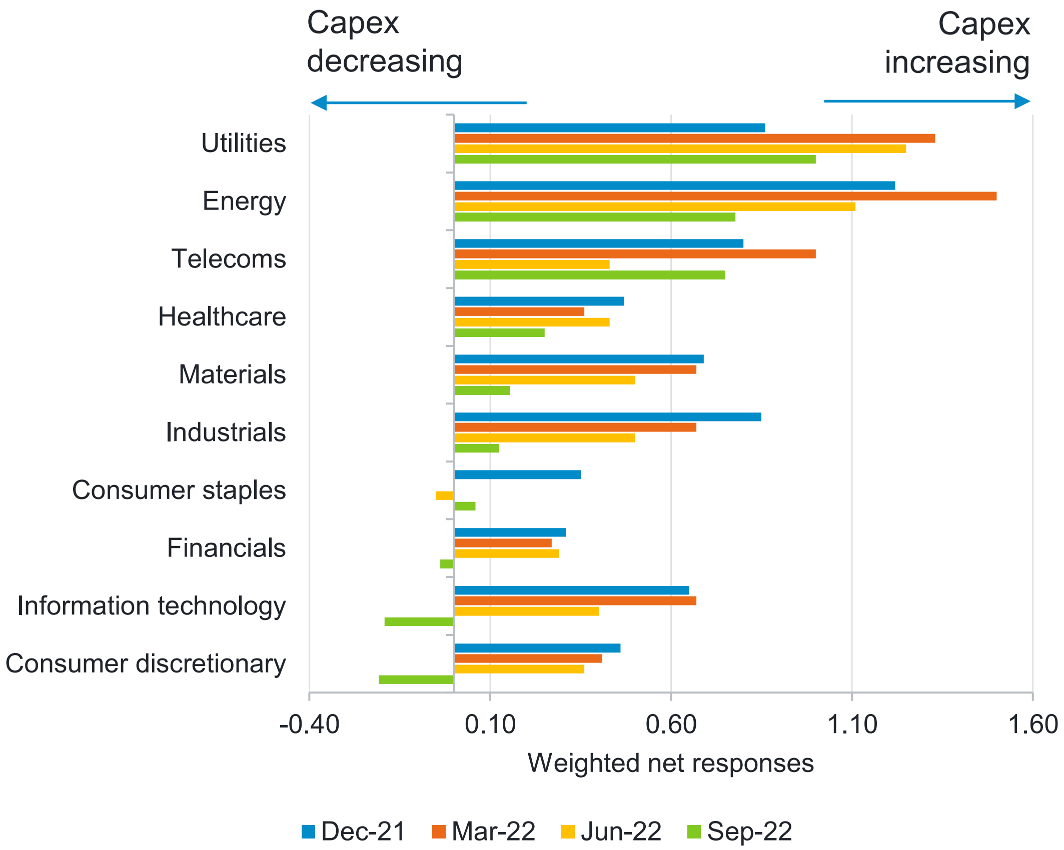
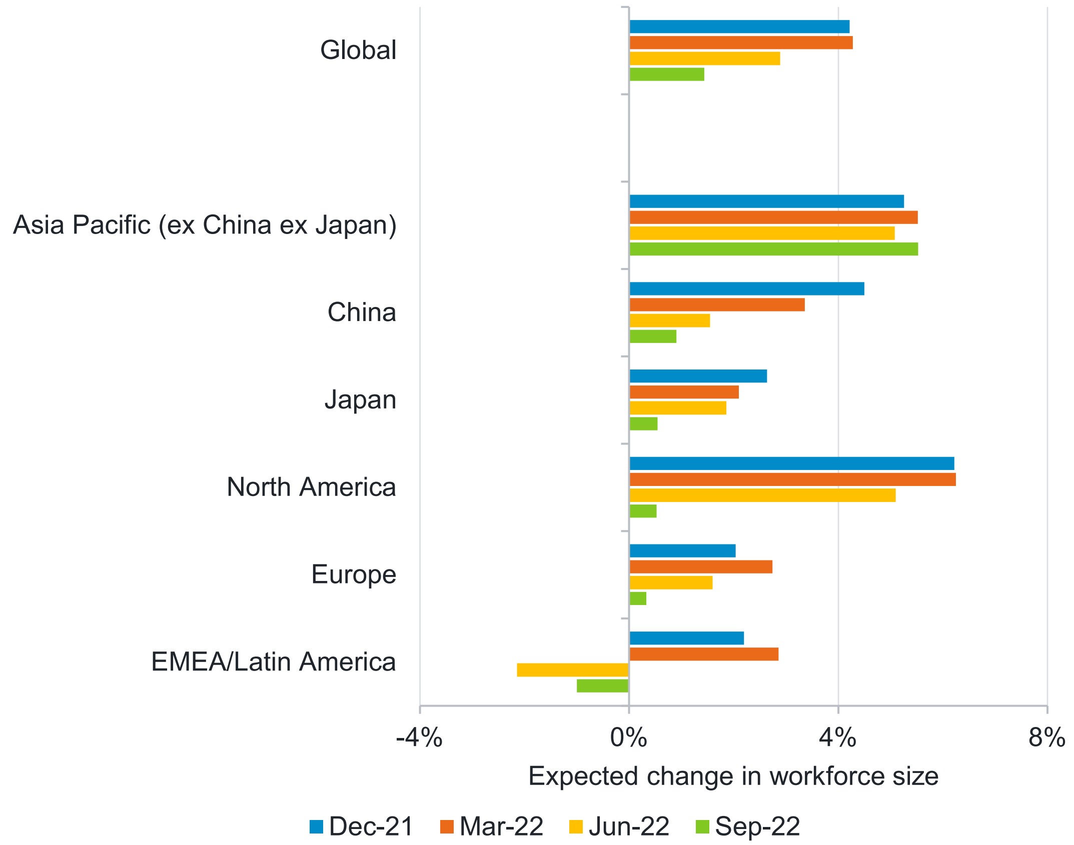


Source: Fidelity International Global Investment Research, September 2022 Analyst Survey. Chart shows weighted average of responses. Question: "What are your expectations for capex over the next 12 months compared to current levels?"
Note: Readings of zero appear as no bar on the chart.

Analysts expect workforce growth to slow over 2023

Region



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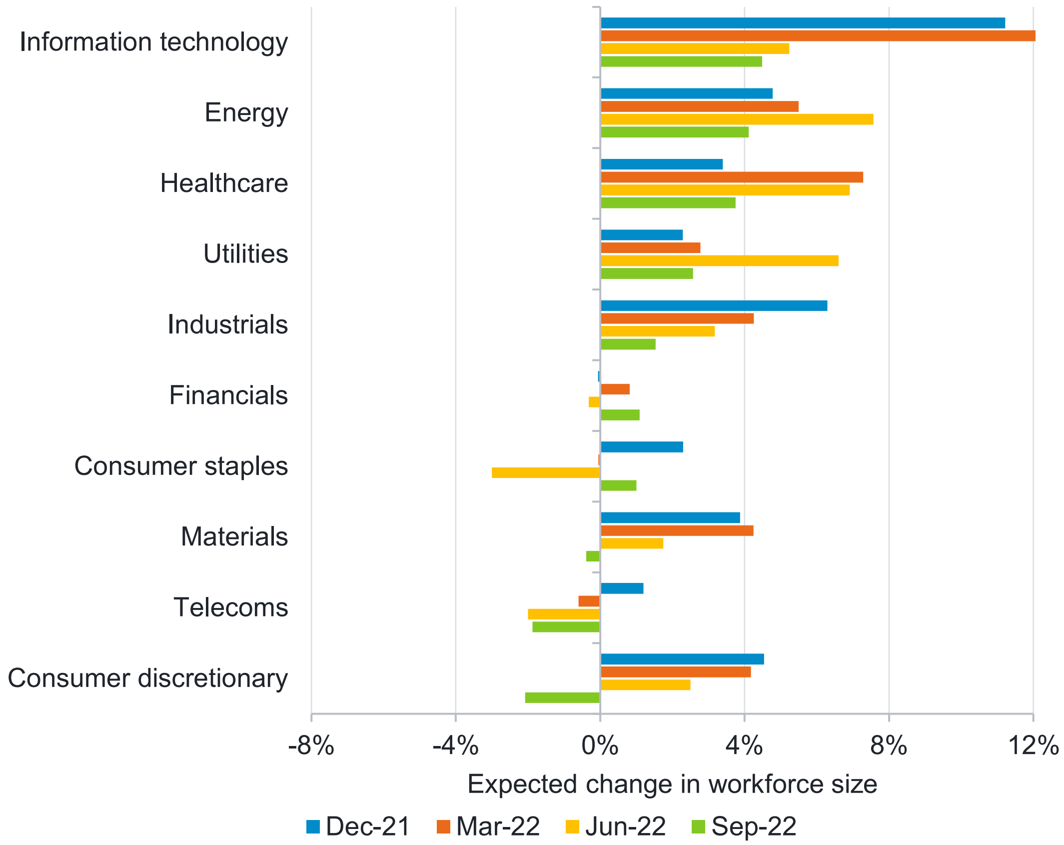
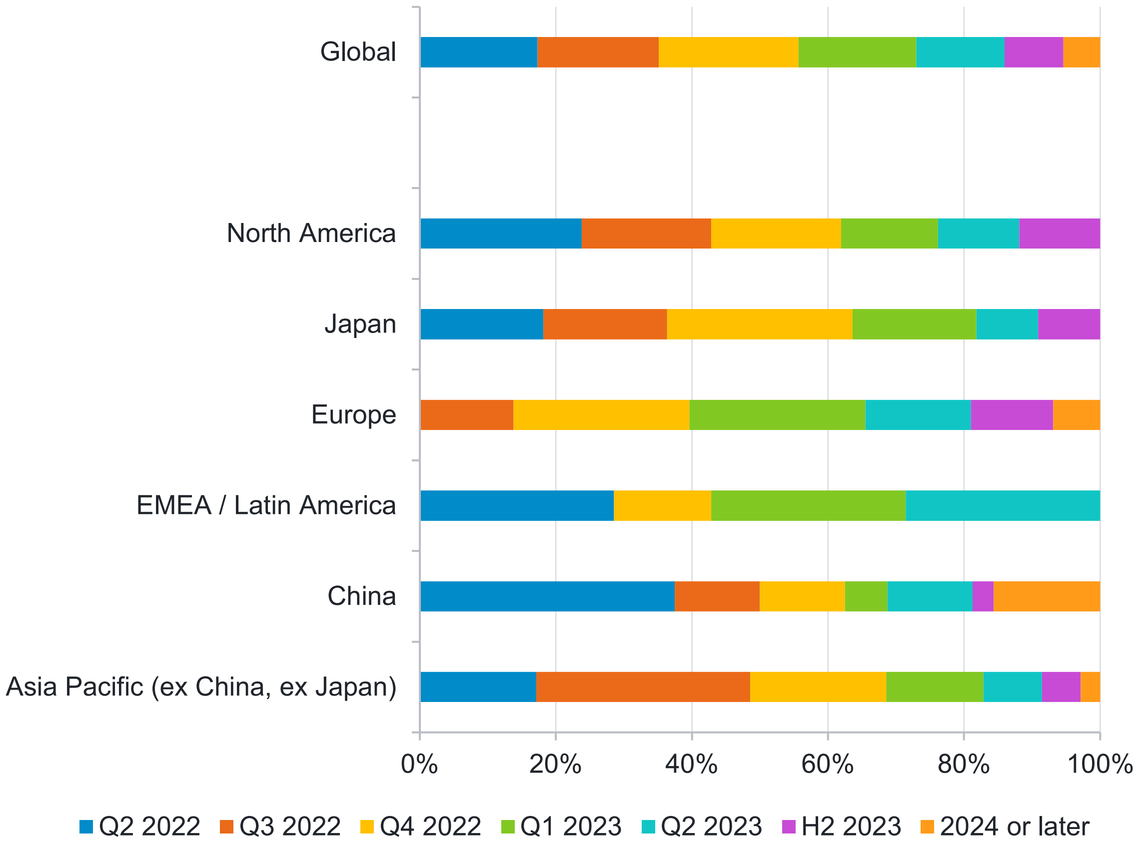


Source: Fidelity International Global Investment Research, September 2022 Analyst Survey. Chart shows average of responses. Question: “How, if at all, do you expect workforce sizes at your companies to change from current levels over the next 12 months?”

Opinion is split over when inflation will peak (or whether it already has)

Region



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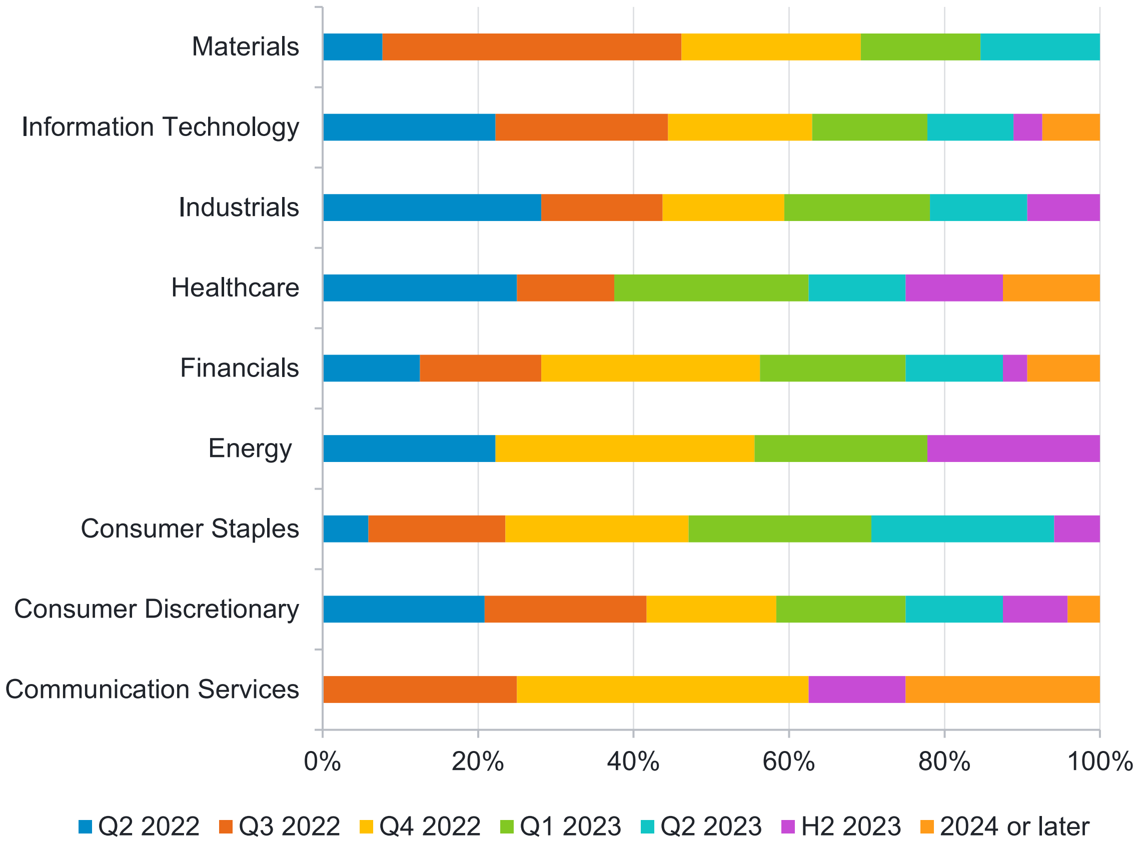


Source: Fidelity International Global Investment Research, September 2022 Analyst Survey. Question: “When do you expect input cost pressure will peak (or has peaked) for companies?”

Multi Asset

Multi Asset: Key takeaways

Staying defensive in preparation for a hard landing

- We are expecting a hard landing in 2023 as growth slows and central banks tighten to control inflation. We believe that the deteriorating macroeconomic outlook is not yet fully reflected in earnings forecasts or valuations, suggesting further downside to come. We are positioned defensively, underweight equities and credit.

Government bonds will play a role in 2023

- Bonds of all stripes have had a challenging 2022. But in a hard landing scenario in 2023 that sees growth fall and central banks turn less hawkish, duration, and in particular government bonds, could have an important role to play to diversify multi asset portfolios. This will be especially true if stock/bond correlations turn negative again.

Dollar strength to continue for now

- Although a Fed pivot will arrive some time in 2023, as we begin the year it does not look likely in the near term. Higher terminal rates, stubborn inflation, and weak sentiment suggest continued upwards momentum for the dollar for now. This could cause pressure on EM FX and EMD, especially given weakness in China.

Deglobalisation will create winners and losers

- We believe the trend of deglobalisation and re- or near-shoring will continue in 2023. The reconfiguring of supply chains and global trade will produce winners and losers and create new trading blocs around the centres of gravity of the US and China.

Key views and asset allocations

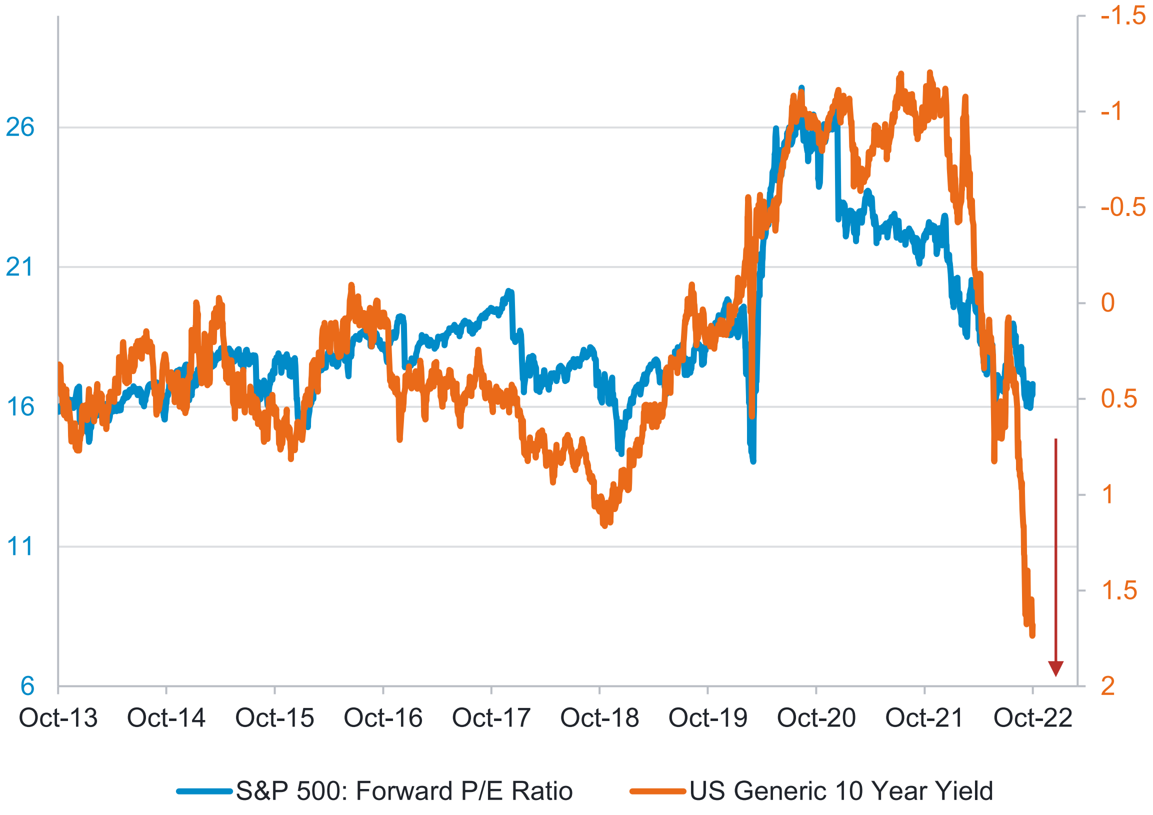
Core views	Core asset allocation	Other investment implications
Global centrals banks are doing ‘whatever it takes’ to fight inflation for now	▪ Prefer Cash vs Equity	▪ Buy European and US bank equities ▪ Allocate away from US Growth ▪ Prefer Australian government bonds vs. US, Europe ▪ Buy US Dollar, sell select Asia FX ▪ Avoid US Homebuilder equities ▪ Long Volatility
Hard landing is highly likely in 2023	▪ Prefer Sovereign Bonds vs Corporate Bonds ▪ Prefer Investment Grade vs EM $ Debt	▪ Prefer US Healthcare ▪ Prefer Spain Sovereign Credit vs. US IG Corporate Credit ▪ Prefer resilient economy equities (India, Singapore banks) ▪ Avoid Global Semiconductor equities
The energy price shock will continue to disrupt, especially in Europe	▪ Allocate away from European Equity (vs. e.g. US)	▪ Prefer European Staples vs European Industrials ▪ Prefer Korean equities vs German DAX, UK mid-caps ▪ Prefer Brazil, Indonesian Equities vs. World
China in transition - conditions remain challenging	▪ Buy USD, sell EM FX	▪ Prefer China A-Share Midcaps vs China CSI 300 ▪ Asian Electric Vehicle beneficiaries vs China equity index ▪ Longer-term structural trends of re- and near-shoring

Source: Fidelity International, October 2022

Staying defensive in preparation for a hard landing

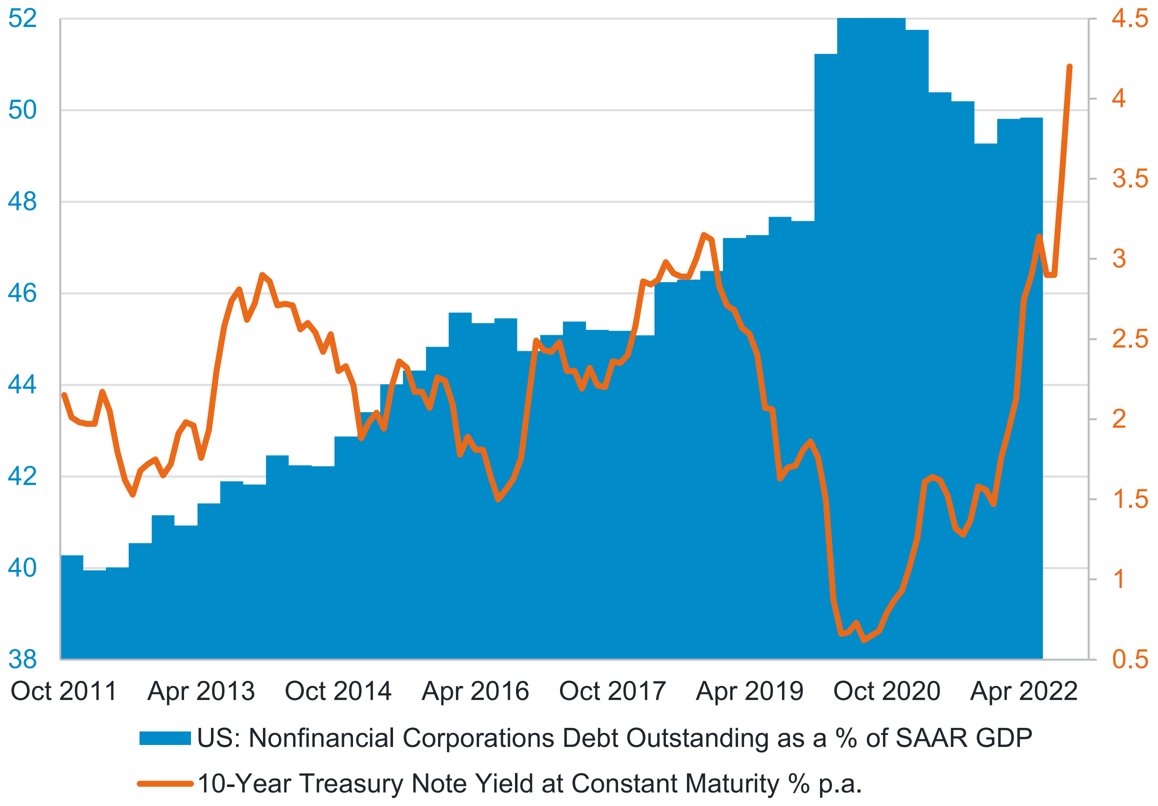
Remain underweight equities, and prefer sovereign bonds over corporate bonds

The tightening seen in monetary policy suggests equity market valuations should still be significantly lower



Source: Bloomberg, October 2022.

With debt levels so high, government bond yields at these levels may cause stress in credit markets

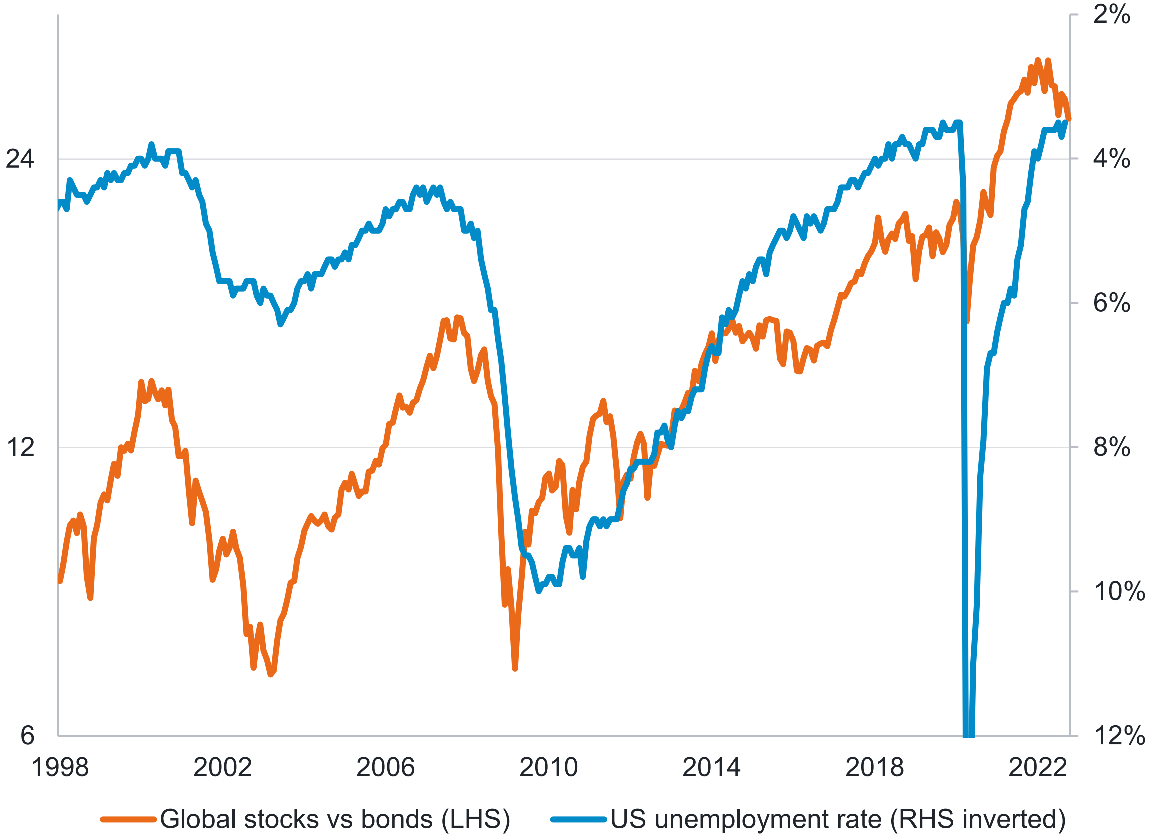


Source: Haver Analytics, October 2022

Government bonds should provide diversification in hard landing scenario

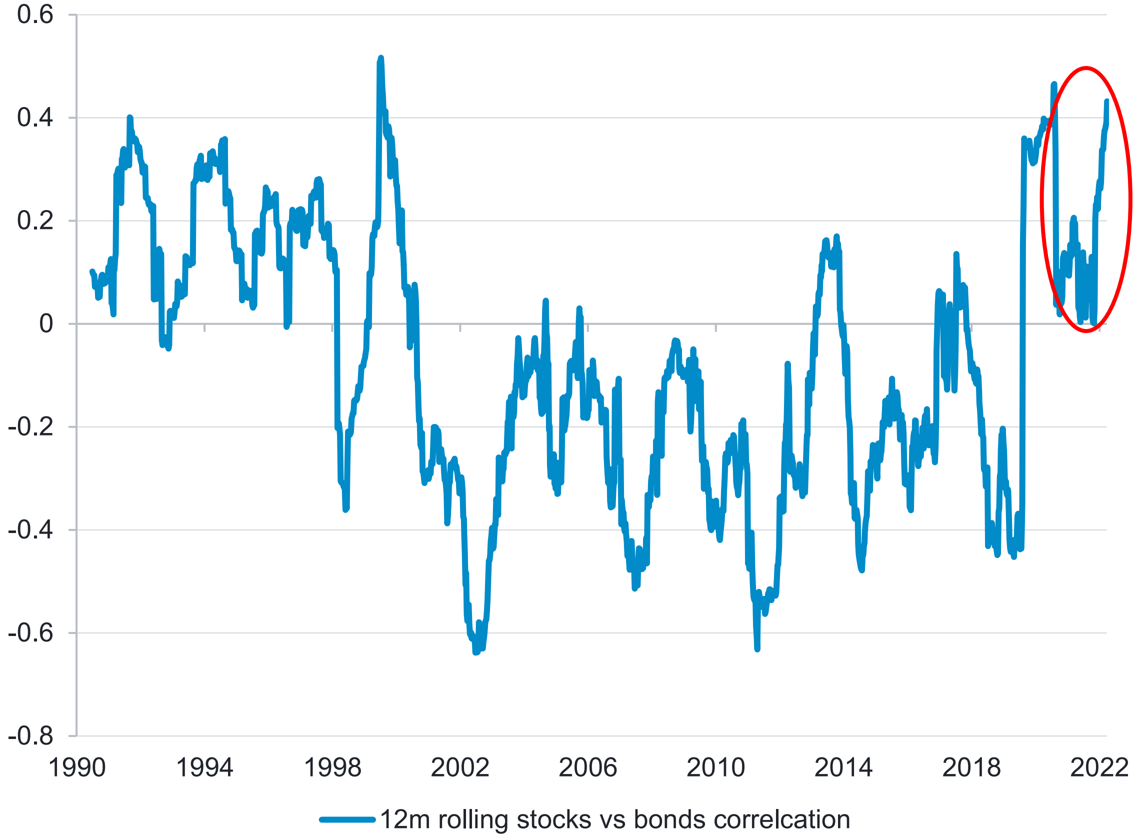
Duration has had a tough year but could play an important role in 2023

Bonds tend to outperform stocks when unemployment rises, as it is forecast to do in 2023



Source: Refinitiv, Fidelity International, October 2022.

Stock/bond correlation could turn negative again once central banks slow pace of hiking



Source: Refinitiv, Fidelity International, October 2022

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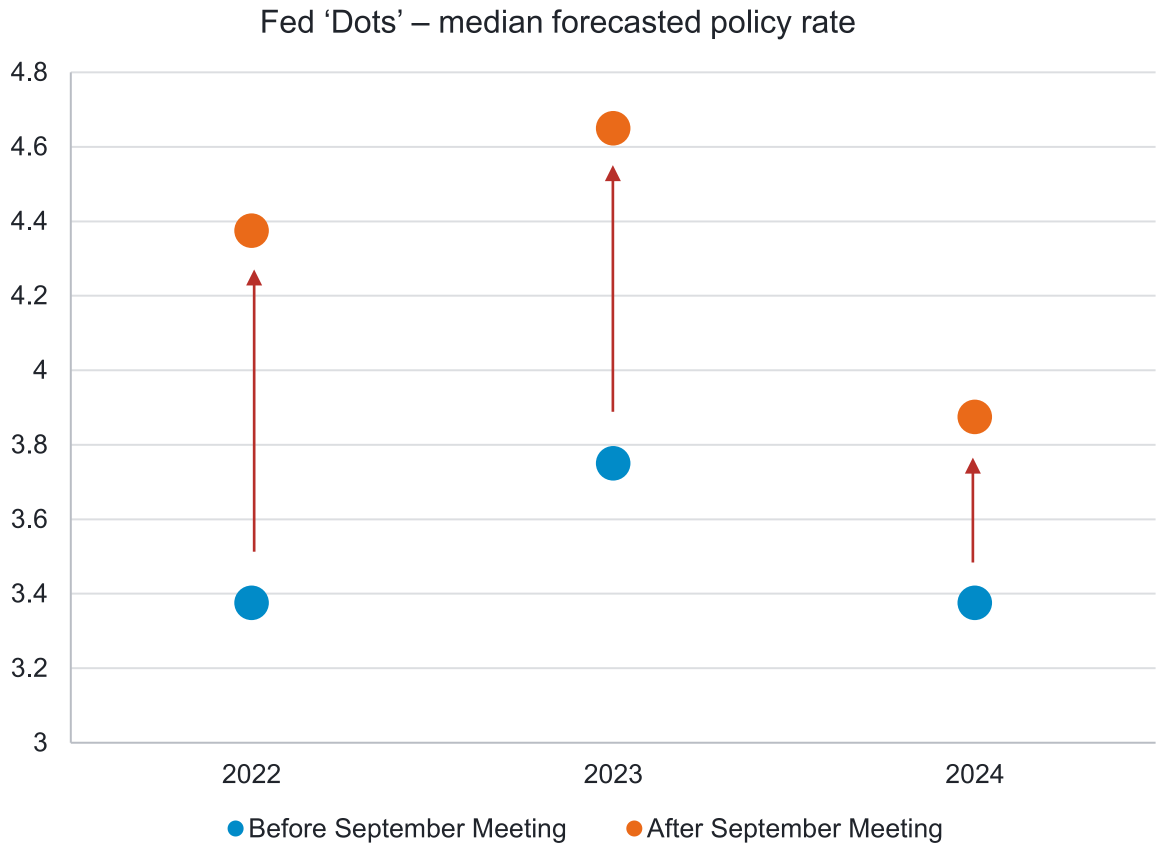
Strong dollar to continue for now, as Fed keeps ‘hiking for bad reasons’

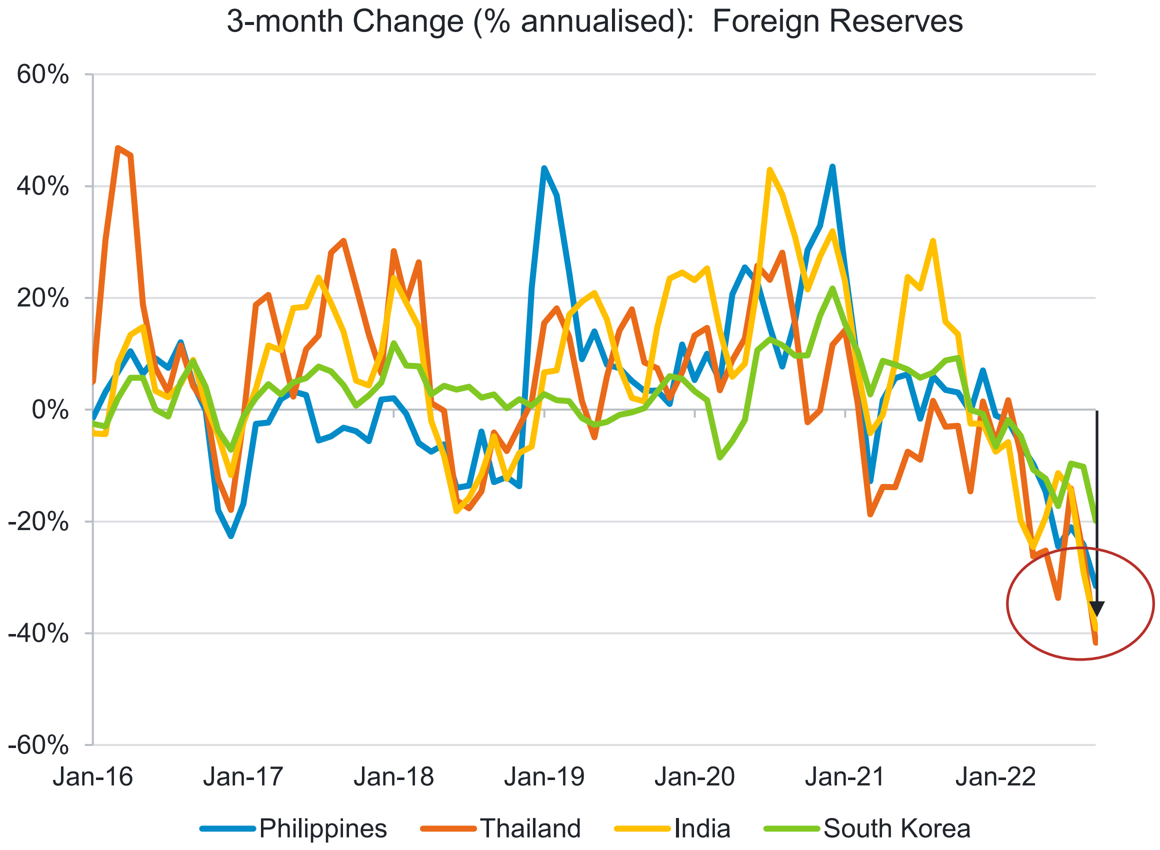
EMFX is not as cheap as G10 FX – but faces plunging foreign reserves and China fears

The US central bank greatly increased its policy tightening forecast in Q3, underpinning the strong US Dollar



Source: Bloomberg, October 2022.

EMFX has not yet fallen as much versus USD as most major crosses, suggesting further USD strength could hit EM more



Source: Haver Analytics, October 2022

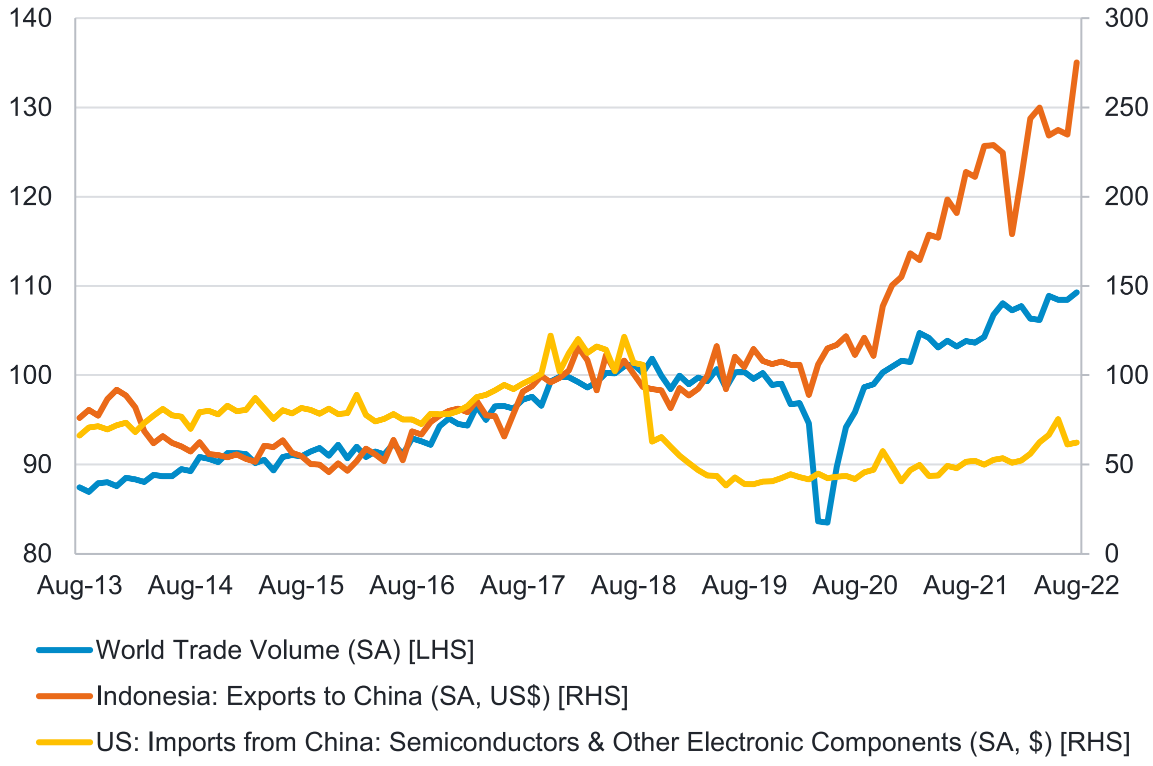
Deglobalisation and re-shoring trend will continue in 2023

World trade will grow, but supply chain reconfiguration will create winners and losers and new trading blocs

US-China trade tensions to continue - countries such as Mexico, Canada and Vietnam could benefit from increased US trade

2022 data to August. Source: US Census Bureau, Fidelity international, October 2022.

Whereas Indonesia could build on relationship with China

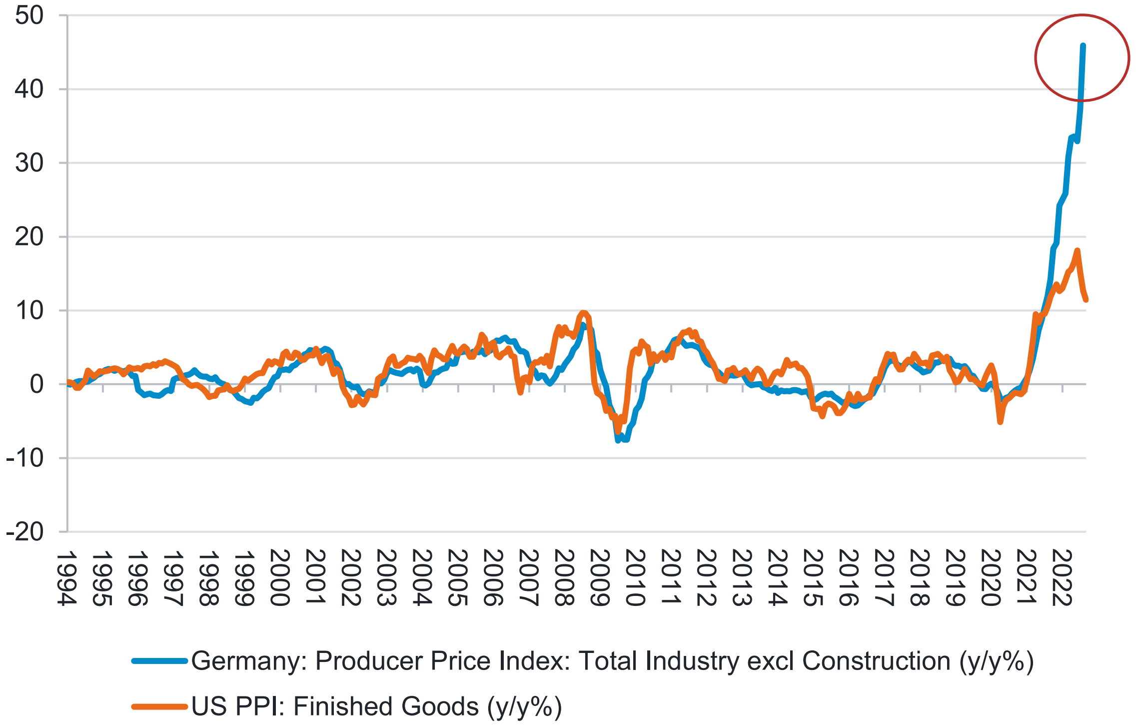


2018=100. Source: Bloomberg, October 2022

Equity Regions: prefer US to Europe

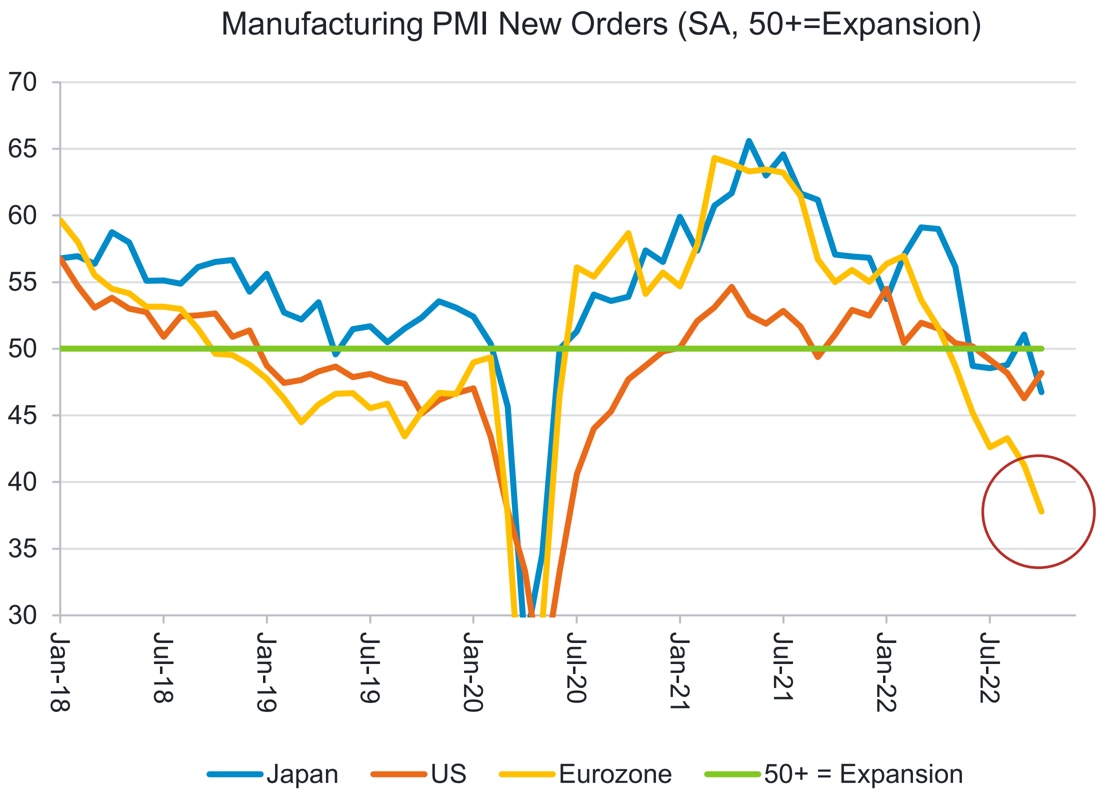
Europe likely faces a far worse winter than the rest of the world

European industry faces a price shock far greater than the rest of the world, which will hurt profits and limit production



Source: BEA, Bundesbank; Haver Analytics, October 2022.

European growth underperformance is already showing up in economic data



Source: Markit, Haver Analytics; October 2022

Tactical Asset Allocation (TAA) at a glance: Cautious short term, more constructive on medium-term outlook

Equity	○ ◉ ○ ○ ○
US	○ ○ ○ ◉ ○
Europe ex. UK	○ ◉ ○ ○ ○
UK	○ ○ ◉ ○ ○
Japan	○ ○ ◉ ○ ○
Pacific ex. Japan	○ ○ ◉ ○ ○
EM	○ ○ ◉ ○ ○

Credit	○ ◉ ○ ○ ○
IG Credit	○ ○ ○ ◉ ○
Global High Yield	○ ○ ◉ ○ ○
EMD $	○ ◉ ○ ○ ○

Government bonds	○ ○ ○ ◉ ○ ↑
US Treasuries	○ ○ ◉ ○ ○
Euro core (Bund)	○ ○ ◉ ○ ○
UK Gilts	○ ○ ◉ ○ ○
Japan	○ ○ ◉ ○ ○
US TIPS	○ ○ ◉ ○ ○

Cash / Currencies	○ ○ ○ ◉ ○ ↓
USD	○ ○ ○ ◉ ○
EUR	○ ○ ◉ ○ ○
JPY	○ ○ ◉ ○ ○
GBP	○ ○ ◉ ○ ○
EM FX	○ ◉ ○ ○ ○

Source: Fidelity International, September 2022. Note: Red is Underweight; Grey is Neutral, and Green is Overweight; arrows signify change in positioning vs previous month.

Other Key Views

Commodities
- Underweight commodities overall as macro headwinds have intensified.
- Energy still interesting, but recession risks are outweighing supply/demand fundamentals and make us neutral.

US Sectors
- Underweight consumer discretionary, communication services, materials, and info tech.
- Strong overweight healthcare, overweight industrials, and real estate.

Thematics
- Long renewables/climate; long-term sustainable theme meets near-term demand from ongoing inflation/energy crisis. Policy support.
- Long healthcare - Pricing power. Earnings resilience in downturn. Only staples and healthcare sectors had positive EPS growth in past 6 recessions. Defensive style.

Equities

Equities: Key takeaways

We remain cautious on global equities

- Market volatility remains high as rate tightening at the expense of growth will result in a hard landing.
- Strong dollar remains detrimental to stocks, even US corporates as dollar value of foreign profits shrinks.
- Potential tail risks could send markets even lower if left unchecked.

Earnings need further adjustment to reflect outlook

- Higher discount rates will continue to deflate multiples.
- Valuations are likely to come down further and net downgrades are likely to spill over into H12023.
- However, readjustment of earnings expectations in the first few quarters can turn caution into opportunity.

Diverging regions create selective entry points

- China offers a strong medium-term opportunity, though an economic recovery will be gradual, with both sector and stock selection key drivers.
- We are positive on Asia Pacific ex Japan, particularly the Asean markets and India, amid robust multiyear growth, underpinned by favourable demographics.
- US markets appear insulated with earnings cycle in a "slowing but not contracting" mode. But a sudden slowdown in growth could send stocks lower.
- European markets will remain underwater with no end in sight with the energy crisis still on its doorstep.

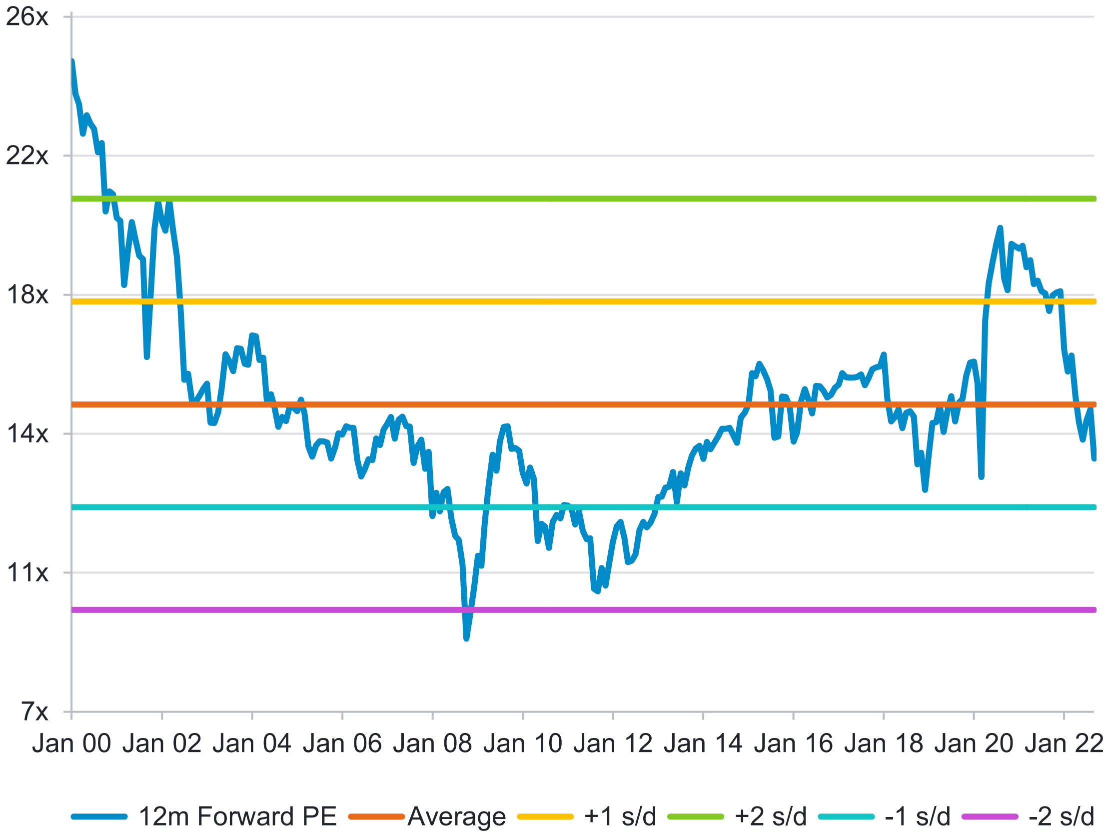
Relief may be on the horizon

- Rate hike pivots from the Fed and ECB could provide the catalyst to support growth and earnings.
- Weaker US employment data could result in a weaker dollar, supportive for global equities.

Valuations likely to come down further, net downgrades set to spill over into H1 2023

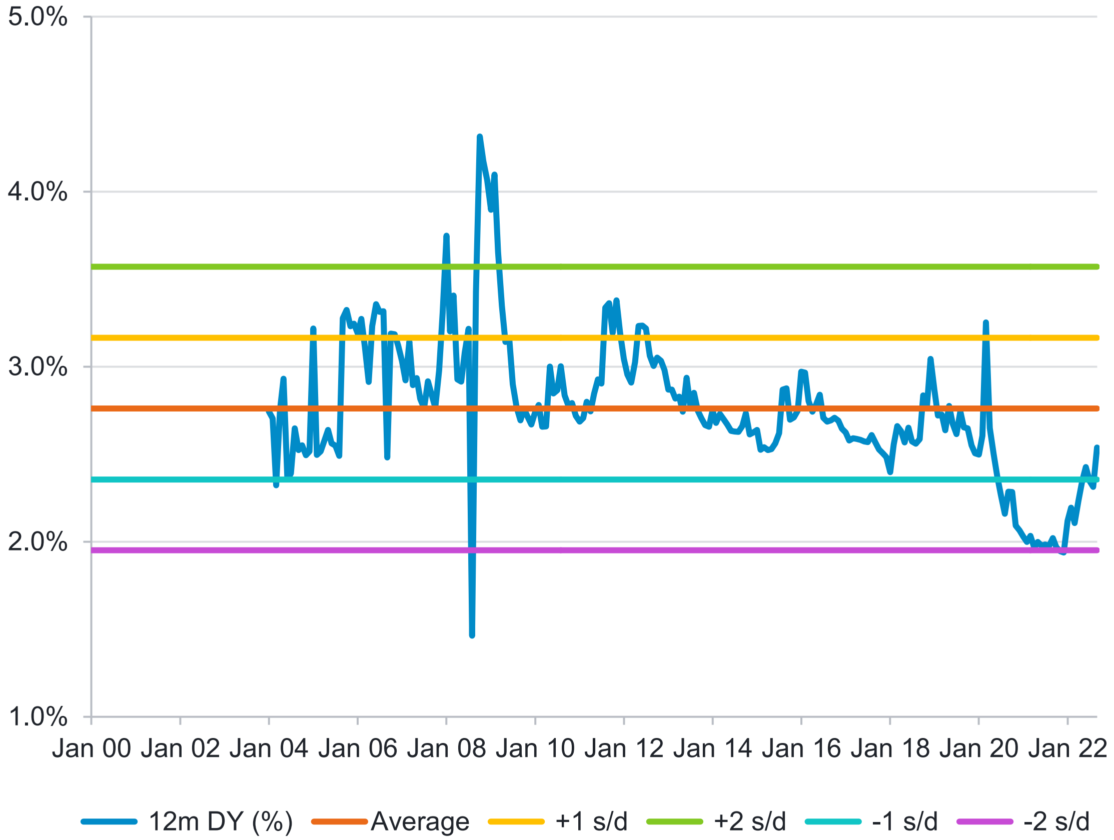
Meanwhile, investors still have faith in dividend strategies. Forward dividend yields are picking up.

12m Forward Price to Earnings, MSCI AC World



Source: Refinitiv, Fidelity International, September 2022.

12m Forward Dividend Yield, MSCI AC World



ICE BofA 1-10 Year US Inflation-Linked Treasury Index. Source: Refinitiv, Fidelity International, September 2022.

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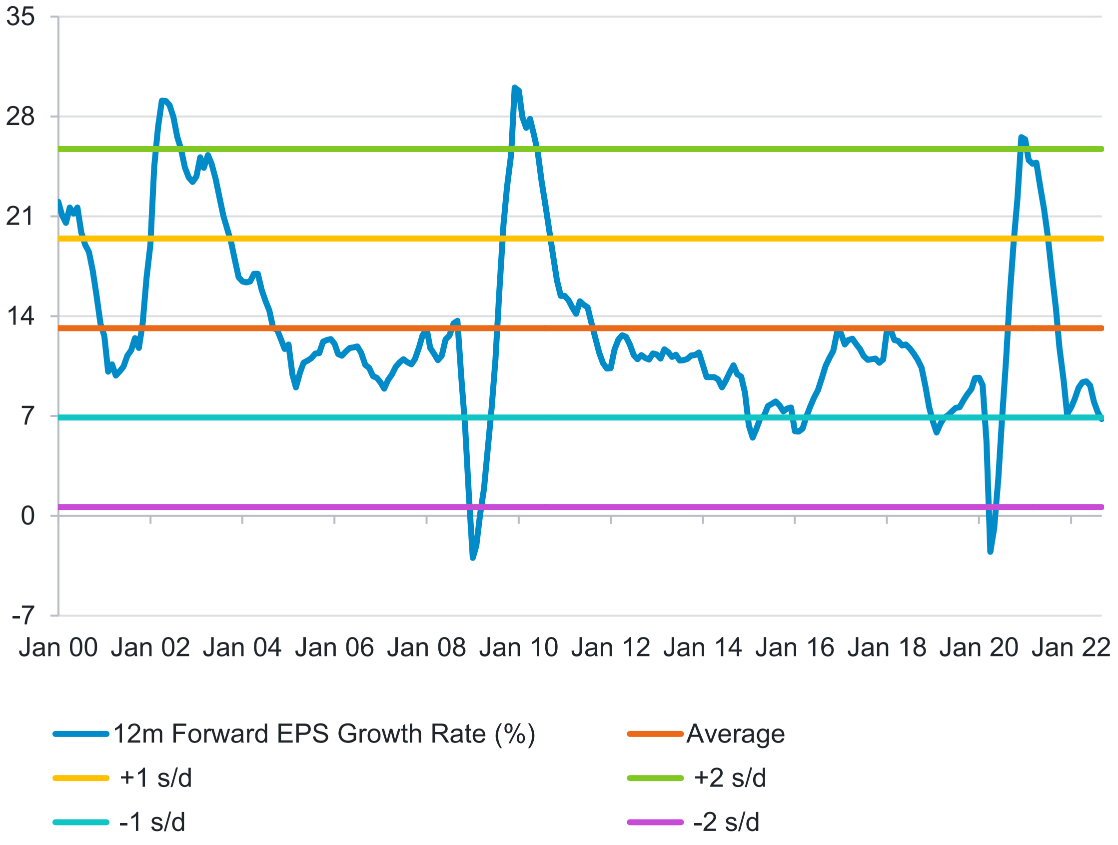
Earnings guidance could come under pressure

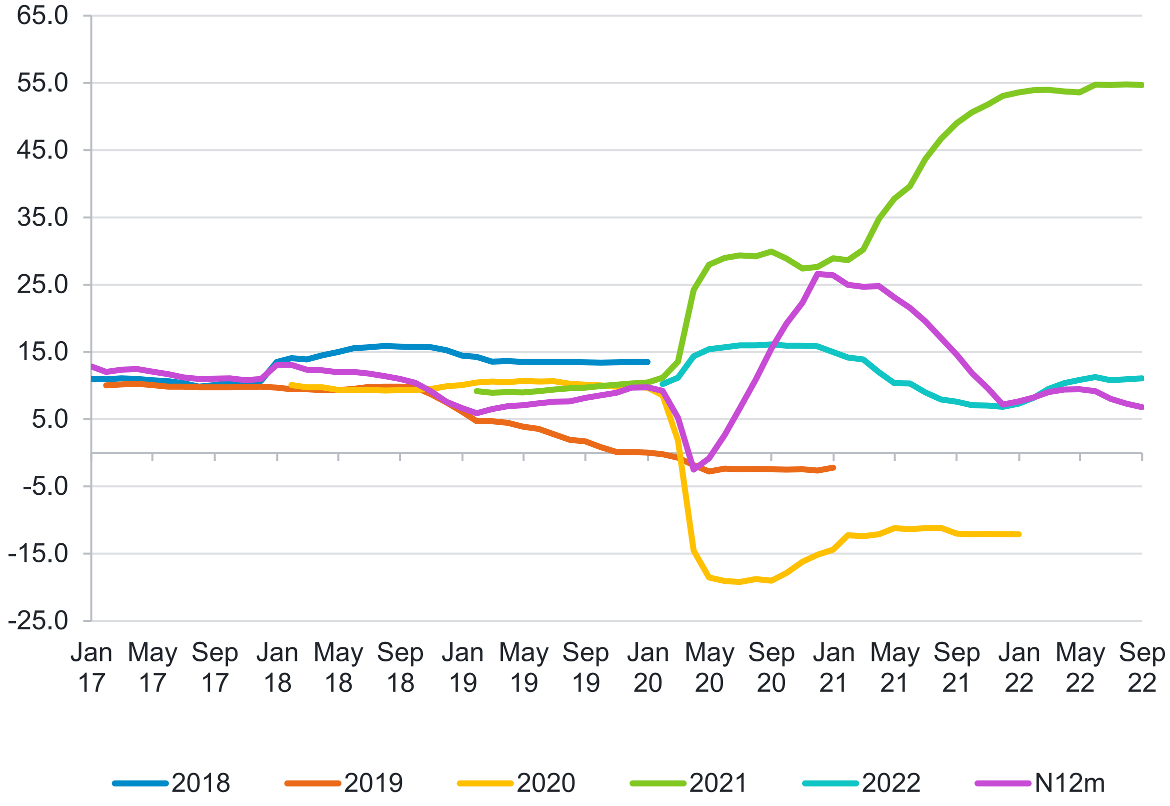
Global forward earnings estimates may prove optimistic

12m Forward EPS Growth (%)



Source: Refinitiv, Fidelity International, September 2022.

Consensus Global EPS Growth Estimates (%)



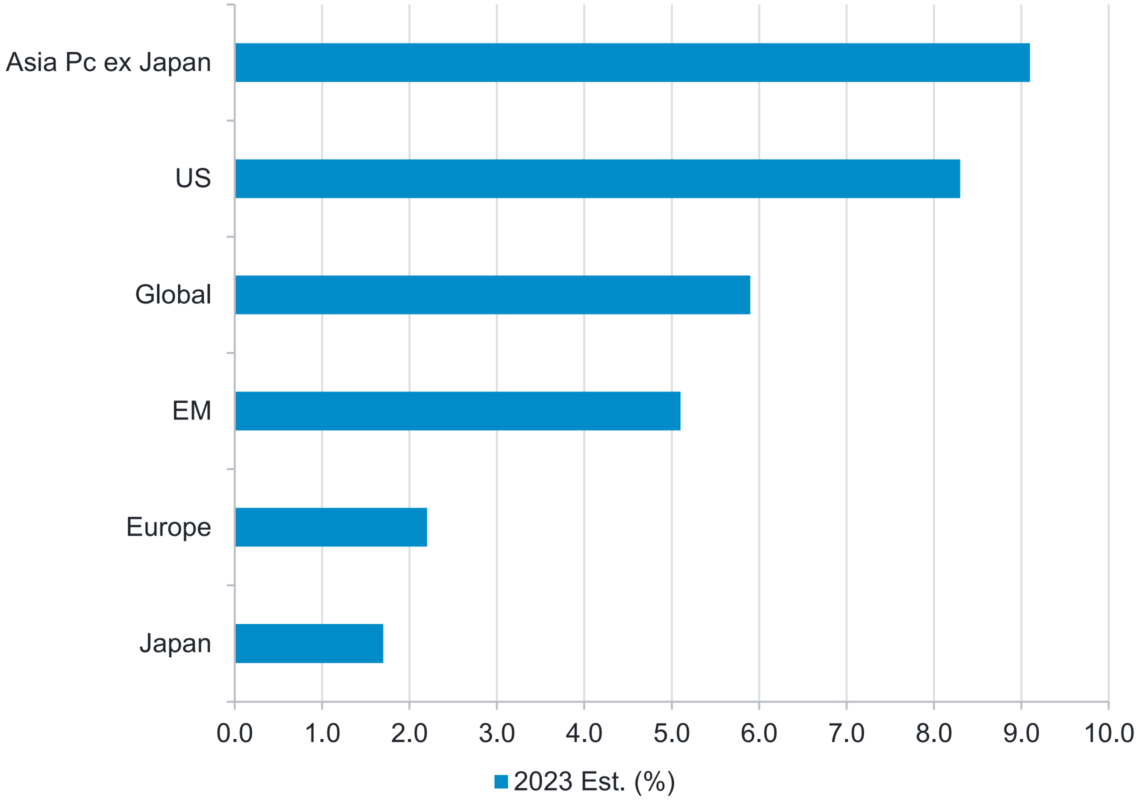
MSCI indices. Source: Refinitiv, Fidelity International, September 2022.

Most positive on Asia Pacific ex Japan (especially Asean)

Top sectors for earnings growth are consumer discretionary/utilities, bottom sectors are materials/energy

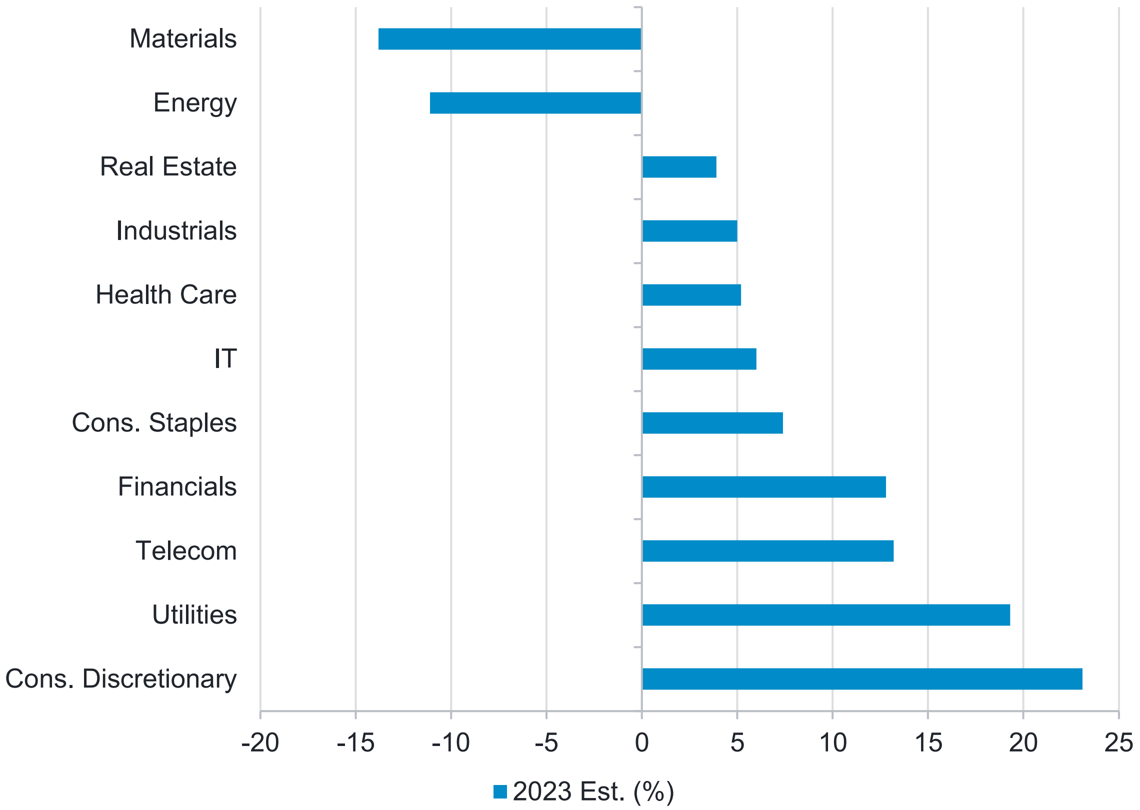
Consensus earnings forecasts, 2023

Region Level



Source: IBES, 30 September 2022.

Sector Level

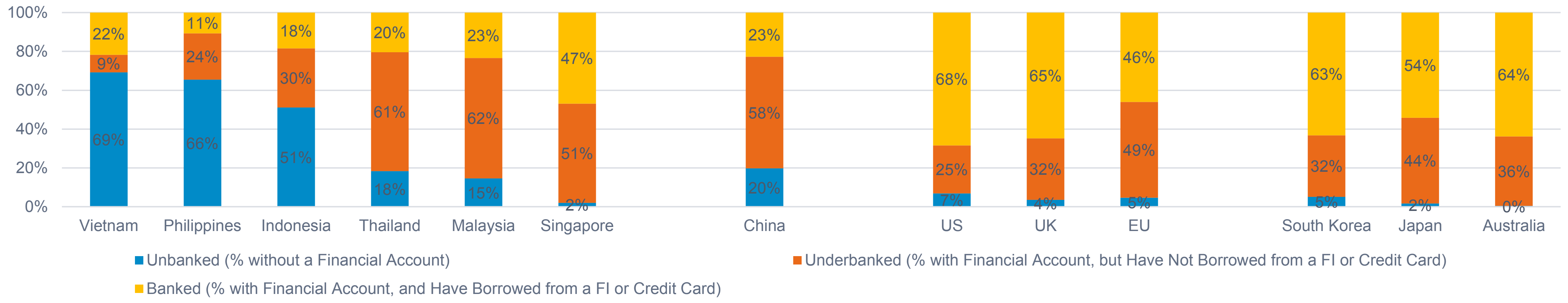


Source: IBES, 30 September 2022.

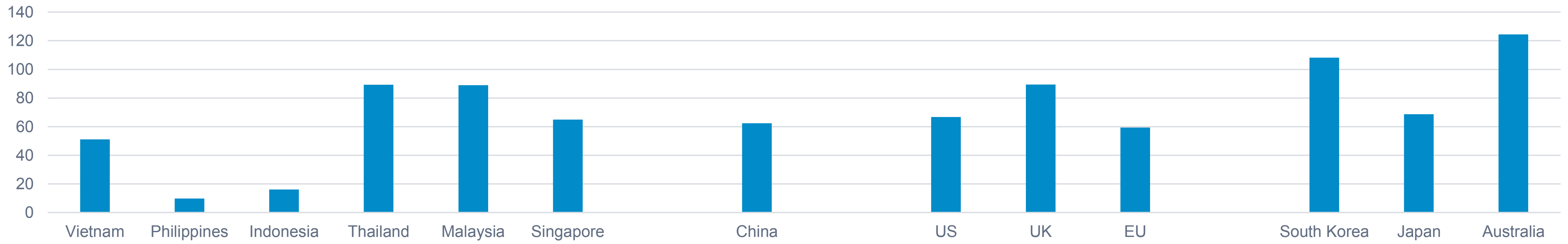
Financial inclusion an additional kicker to growth for Asean

Could provide investment opportunities for highest returning lenders in region

Financial Services Penetration amongst Adult Population (>15yo), 2017



House Debt to GDP Ratio



Source: World Bank Global Findex database, CEIC, Eurostat, Singstat, New York Fed, September 2022. Note: Indonesia and Philippines household debt estimated using outstanding consumer loans.

Fixed Income

Fixed Income: Key takeaways

Recessionary risks persist

- Inflation busts loom over several economies following central bank tightening stubbornness
- Interest rates continue to rise even if policymakers are forced to pivot

Remaining defensive

- We believe high yield credit is yet to price in 2023 recession risks. Prudent credit selection within high yield is therefore essential.
- Where current high yield spreads would leave investors more vulnerable in a rising default environment, investment grade is offering a positive "spread premium"
- We remain defensive, with continuing exposure to investment grade bonds

Central banks pivot

- US and core Europe duration seem relatively attractive, considering the risk of a hard landing.
- We expect policymakers will finally be forced into a long-speculated pivot towards easier policy. The difficulty over the past year has been predicting when that will occur.
- Consumer price growth in the US and Europe has remained stubbornly high, but the first falls may allow central banks to finally shift

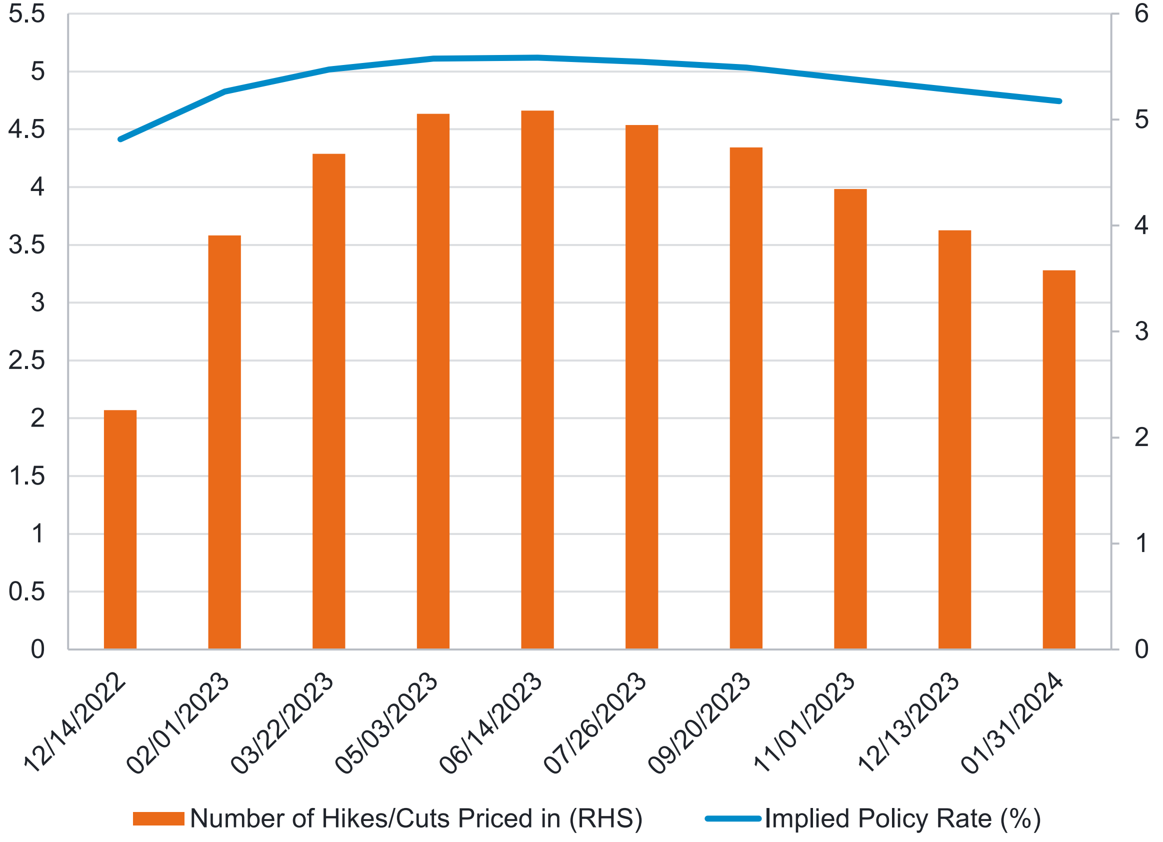
Bond yields finally starting to look attractive again

- We believe rates will settle far higher than they have been at any point over the past decade
- This should be good for bonds, which have struggled through a decade of zero yields

Recessionary risks persist

Market continues to project rate hikes into year-end and well into 2023 while credit spreads widened in euro, sterling and US, mainly driven by elevated macroeconomic concerns and a risk-off environment.

More rate hikes expected before the Fed pivots



Source: Bloomberg, October 2022.

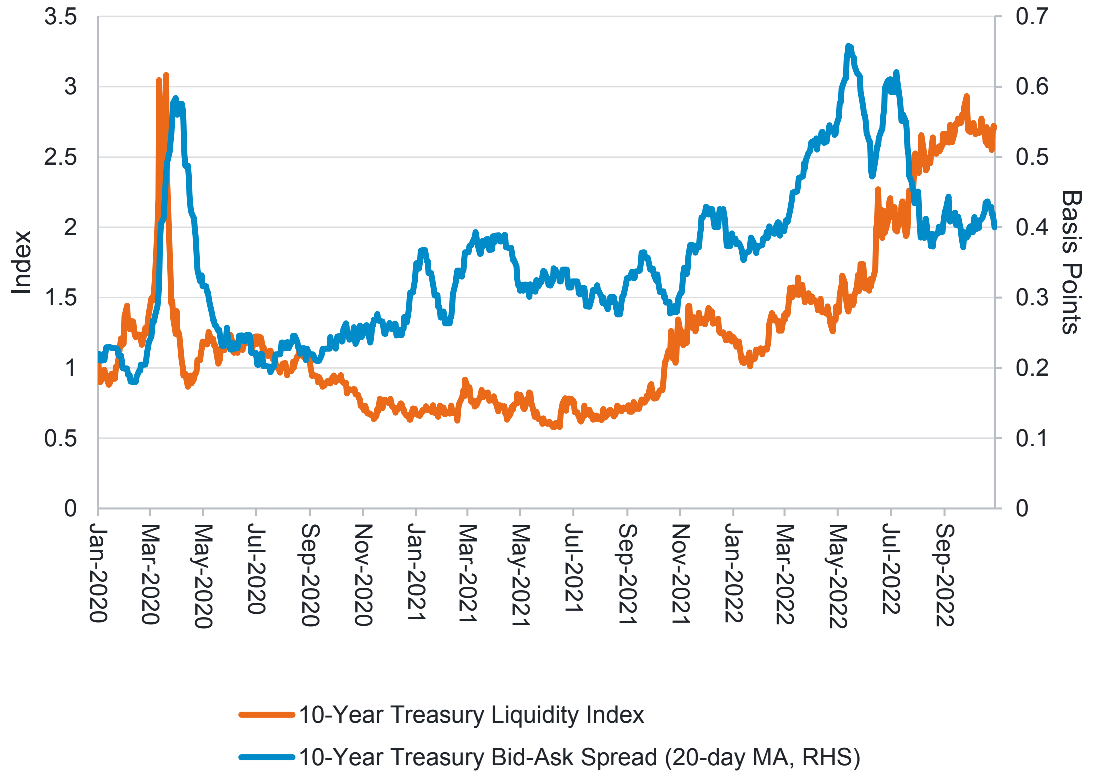
Global IG credit spreads

Source: Bloomberg, October 2022.

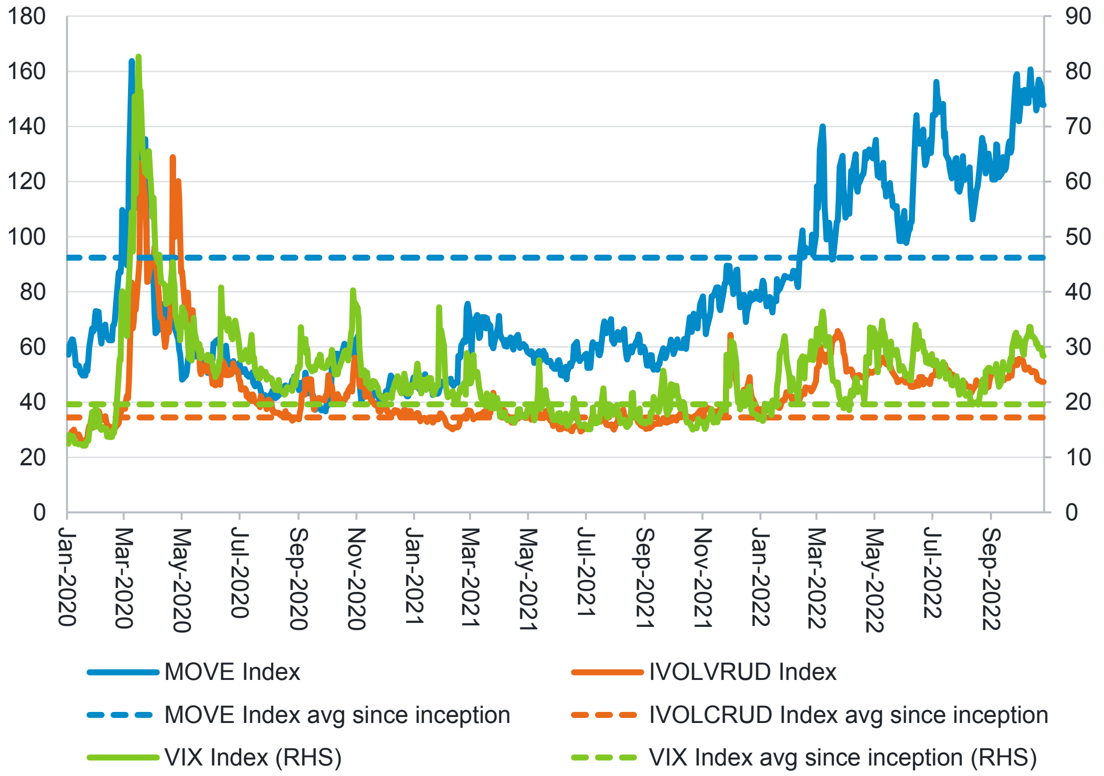
Financial (in)stability

Rapid rate hikes expose weaknesses in the financial sector, e.g. UK LDI

Treasury illiquidity is near Covid downturn levels



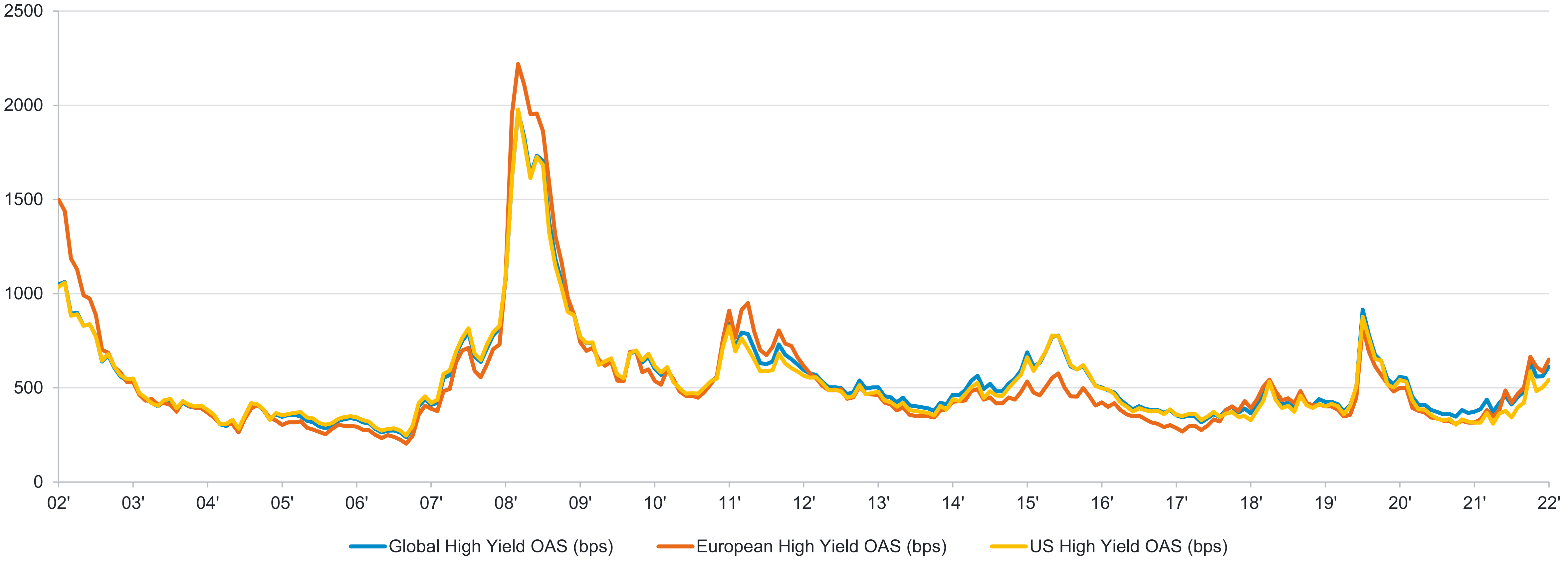
Market volatility in bonds, equities and oil



Source: Fidelity International, Bloomberg, IMF October 2022 Global Financial Stability Report, November 2022.

High yield spreads since 2022

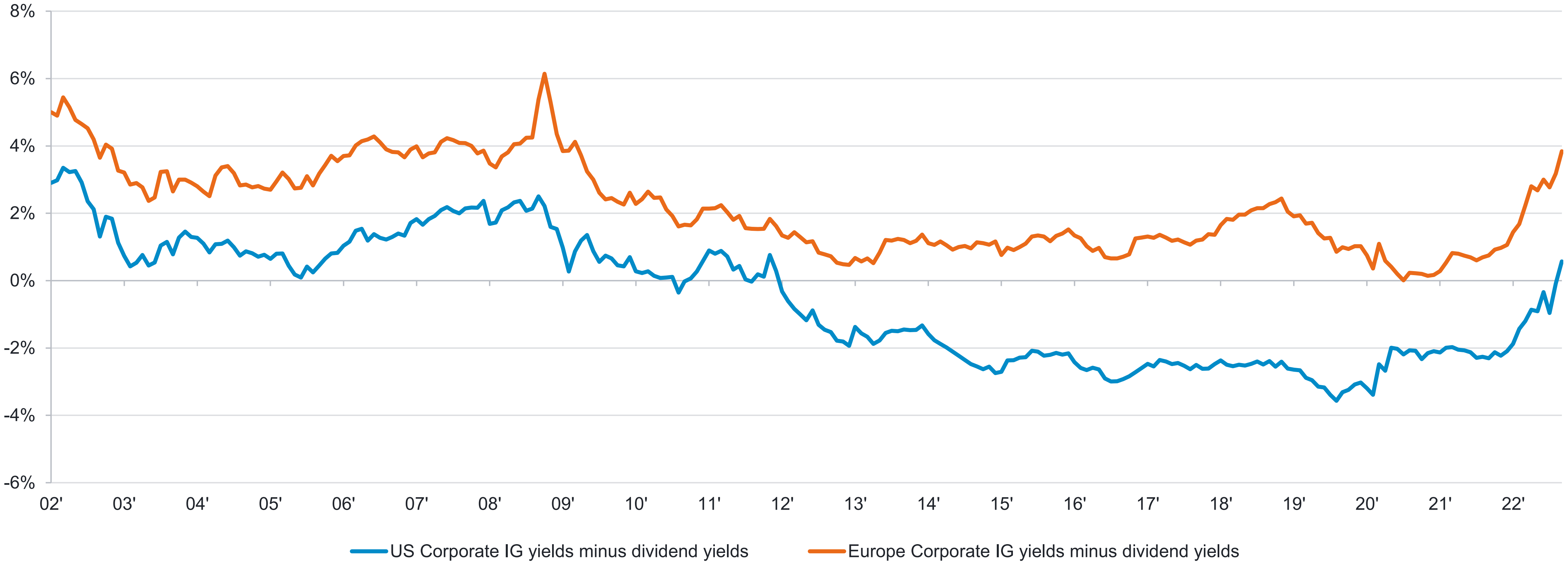
Current high yield spreads would leave investors more vulnerable in a rising default environment



Source: Fidelity International, Bloomberg. October 2022. Global High Yield Index: ICE BofA Global High Yield Constrained Index (HW0C), European High Yield Index: ICE BofA Global High Yield European Issuers Constrained Index (HQ0C) and US High Yield Index: ICE BofA US High Yield Index (H0A0).

Bonds are becoming attractive again

Difference between corporate IG and dividend yields are back to pre-GFC levels



Source: Fidelity International, Bloomberg, October 2022. Chart shows US and Euro Bloomberg Agg Corporate Index minus respectively S&P 500 and STOXX Europe 600 gross aggregate dividend yields

Private Credit

Private Credit: Key takeaways

Structurally sound

- While not immune to recessionary trends, private credit is likely to be more resistant than other asset classes
- Private credit's inherent strengths become key going into a period of volatility: floating-rate structures can hedge against rising rates, while leveraged loans are positioned at most senior point of capital structure
- Market exposure in loans and direct lending dominated by defensive sectors (healthcare, services, media/telecoms) with high EBITDA margins and strong cash generation

Spreads allow robust returns over the long term

- Analysis of soft and hard-landing scenarios illustrates high expected excess spreads currently priced into the market with potential for spreads to tighten in the longer term
- Even in most difficult scenario, leveraged loans expected to make positive net returns of around 8% including Euribor over the next three to five years

Resilience throughout the worsening environment

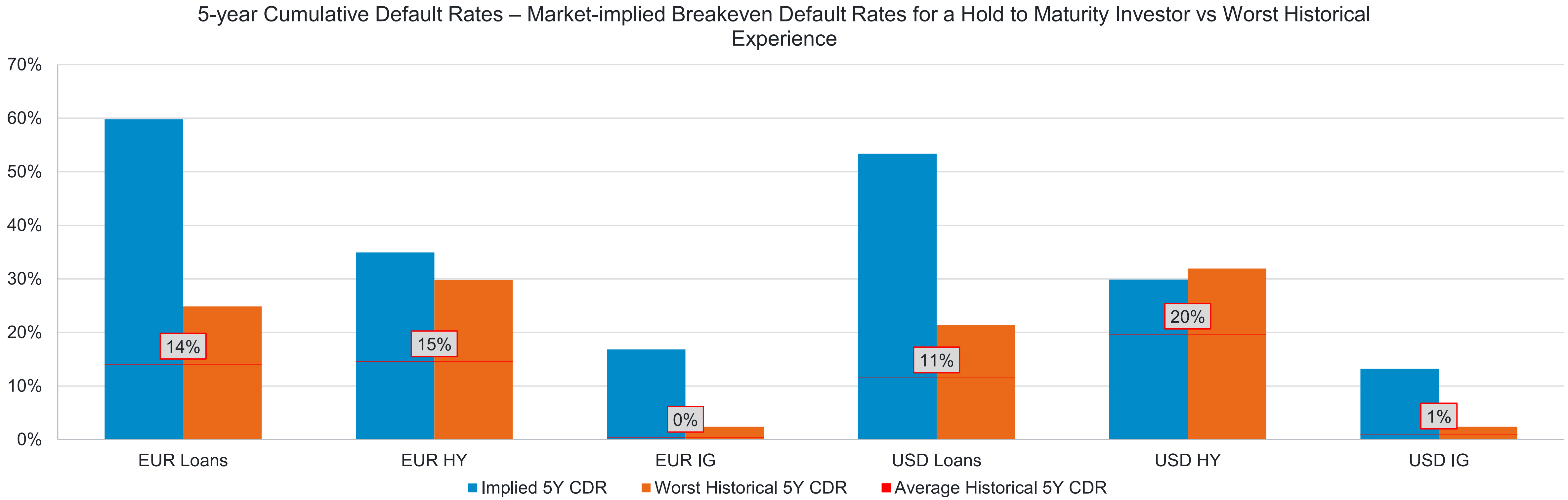
- Default rates will increase but we believe are less likely to reach the peaks of GFC due to added flexibility within leveraged loan structures
- Maturity wall manageable, although some forced amend & extends or defaults of 2024 maturities possible (this is less likely on cov-lite loans). The proportion of CCC rated names in the index remains manageable for time being
- During Covid, agencies took a lenient approach that helped contain CCC downgrades. We do not expect rating agencies to be as lenient in 2023

Security selection paramount

- The proportion of single-B rated loans is higher than going into previous recessions, highlighting the need for rigorous credit selection process
- Private credit lends to companies in the real world, and the worsening economic backdrop will equally have an impact across the private market

Valuations suggest lenders are covered for default levels never before experienced in the asset class

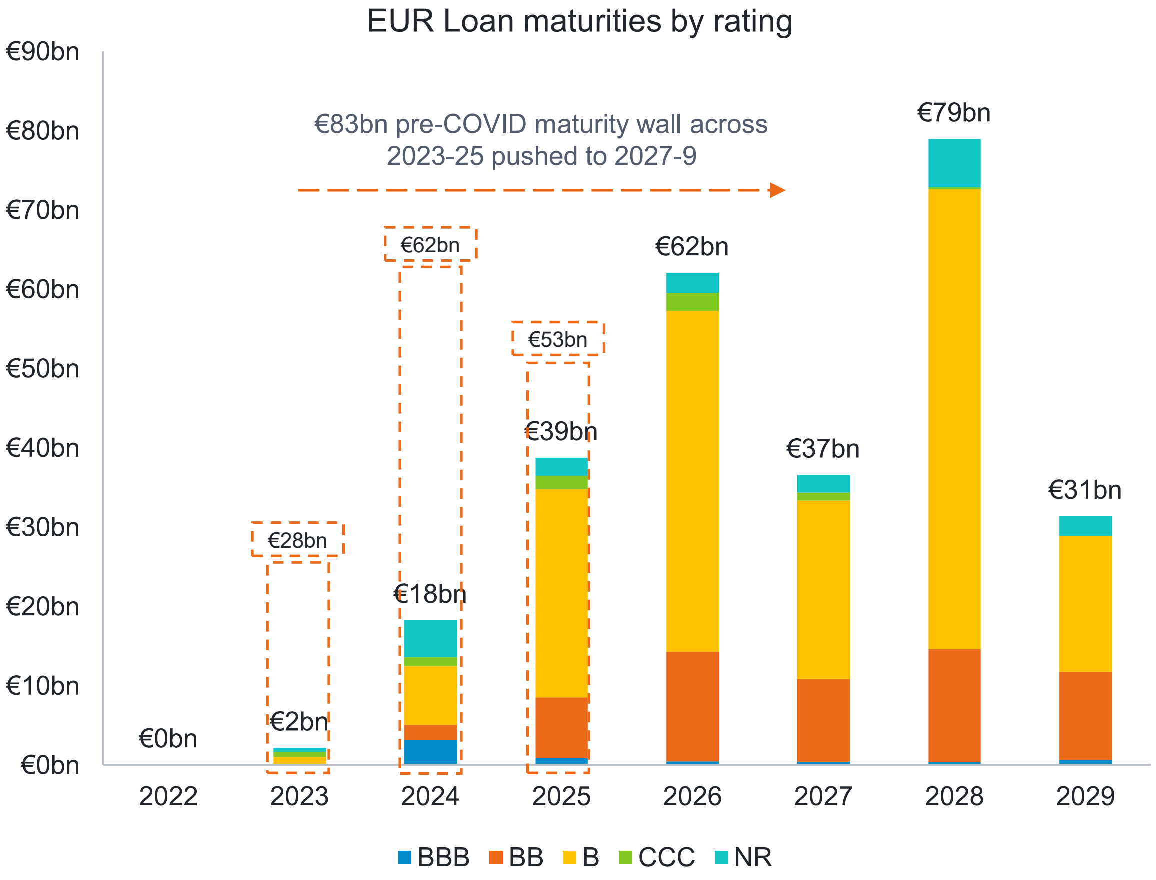
The market is pricing defaults materially higher than the worst period ever recorded. Even if we realised losses in line with the worst ever period, investors could still see returns of c. 8%, not accounting for any outperformance of the market due to active management



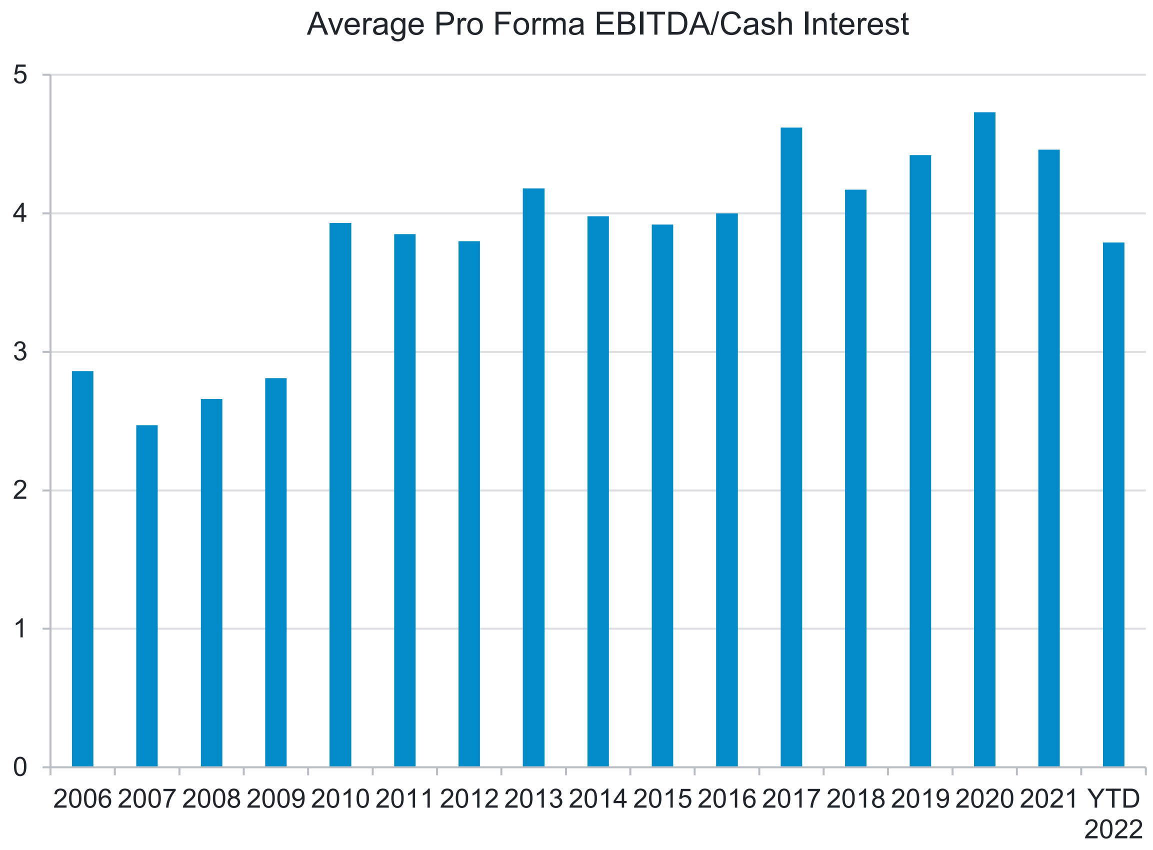
Source: Credit Suisse Western European Leveraged Loan Index - EUR Only DM to Maturity; CS US Leveraged Loan Index DM to Maturity; High Yield and IG ICE BAML OAS; Data as of 19-Oct-2022. Recovery Rates assumed at 60% for Leveraged Loans, 30% for High Yield and 40% for IG based on historical recovery rates and seniority. HY and IG historical default rates based on S&P 2021 Annual Global Corporate Default And Rating Transition Study (1982 to 2021). Leveraged Loan historical default rates from Morningstar US & European LL Indexes (2000 to 2022). EUR Leveraged Loans BDRs down to 41% with 30% Recovery Rates and 31% with 0% Recovery Rates.

Private credit well positioned heading into volatility

The leveraged loan market is in better shape heading into this expected recession than in previous crises, with few pressing maturities and strong asset coverage on collateral



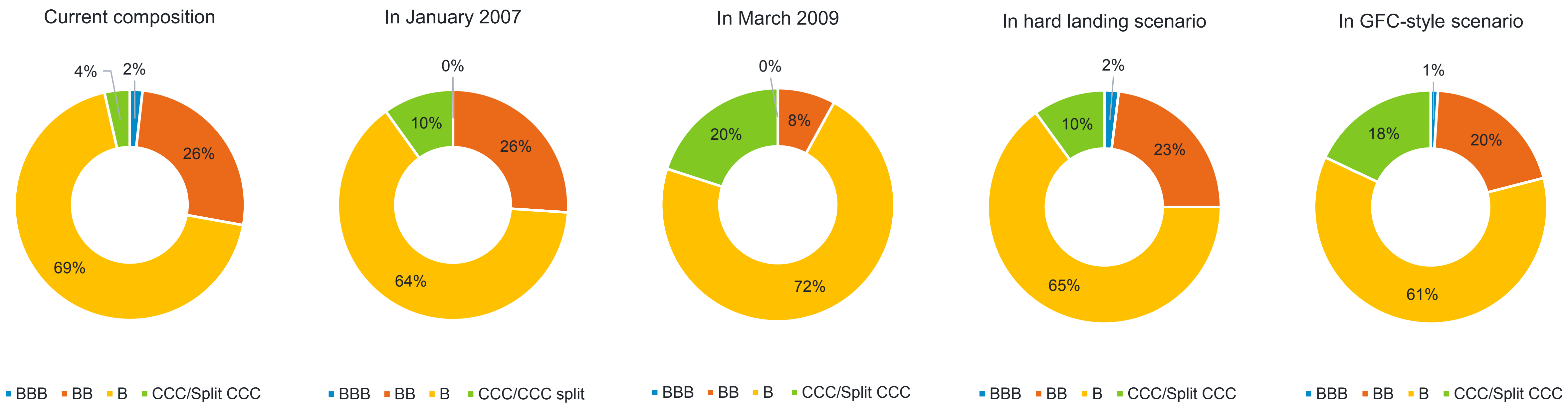
Euro-denominated deals only. Source: Credit Suisse Western European Leveraged Loan Index; Fidelity International, October 2022



Source: Pitchbook/LCD; Fidelity International, October 2022

Rating stress tests indicate market’s ability to weather worst downside scenarios

The composition of the European leveraged loan market showcases its resilience, with the proportion of CCC ratings (which lead to greater selling and spreads widening) smaller now than before the GFC.



Base scenario. We believe 80% chance of this

Assumes gas outages, extreme consumer stress, and limited fiscal or monetary support

Euro-denominated deals only. Source: Credit Suisse Western European Leveraged Loan Index; Fidelity International, October 2022

Real Estate

Real Estate: Key takeaways

Power has shifted to the buyer

- Achieved prices are now c.15% lower than sellers pricing expectations (a reversal from Q1)
- Sellers are now having to accept a discount for liquidity as there are fewer buyers on the side-lines - most investors with capital are playing the waiting game

Shallower, shorter cycle

- A much deeper, broader pool of investors post GFC as people have been investing more in private assets, should provide more liquidity and a greater range of risk appetite
- US capital already targeting distressed assets and taking advantage of currency

Sustainable opportunities will continue

- Acute shortage of supply and abundance of demand for truly sustainable buildings, notwithstanding market weakness
- There is increasing evidence of a green premium, for example, in London, there is now a 25% price differential for sustainable buildings (RCA, Oct 2022)

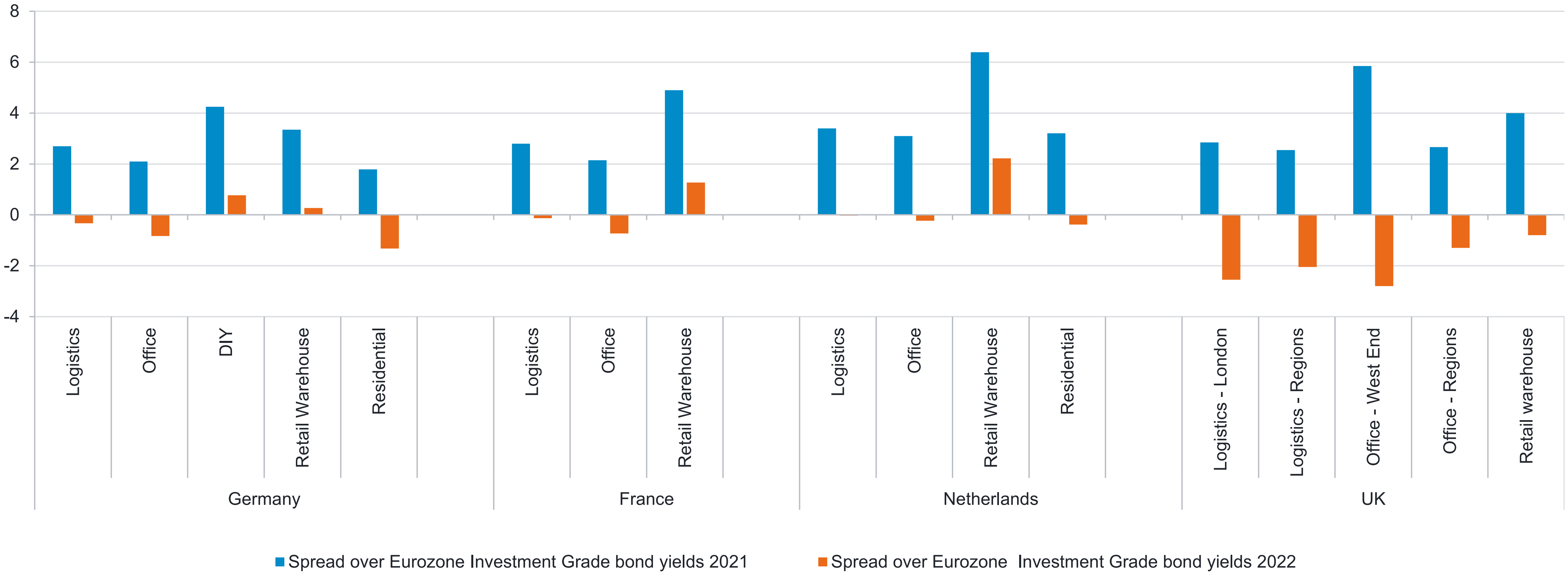
Occupiers (and some rents) surprisingly resilient so far

- Rents still rising across offices and industrials in most Western European markets (MSCI, 2022)
- Demand weakening but still surprisingly strong with some evidence of trading up to better quality space but reducing total quantum (mostly offices and industrials)
- Repricing of retail which already began pre-Covid should provide some resilience for rents and values

European real estate is repricing

Negligible spreads over investment grade bond yields suggest mis-pricing of income risk

Yield spreads have narrowed faster than expected

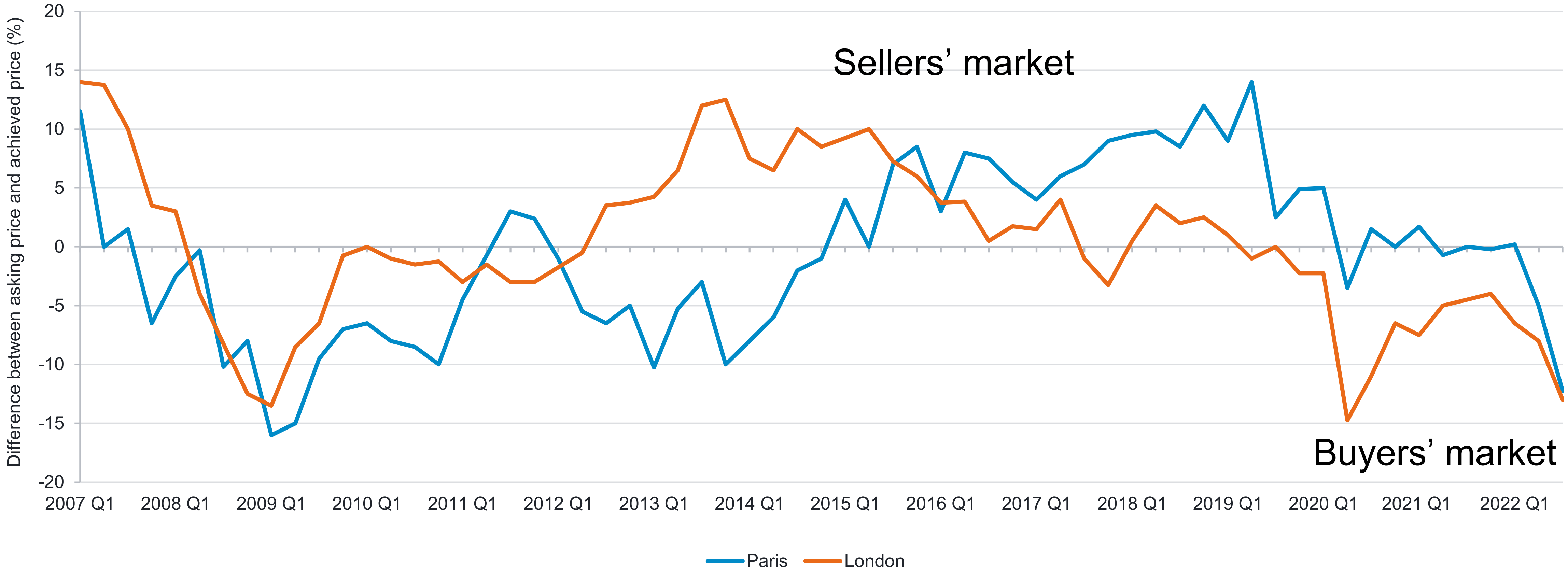


Source: Fidelity International, CBRE, September 2021 and September 2022; Bloomberg, as at 30/09/2021 and 26/09/2022.

Pricing has shifted rapidly in favour of buyers

Sellers are having to pay a premium for liquidity

Price expectations gap for London and Paris offices

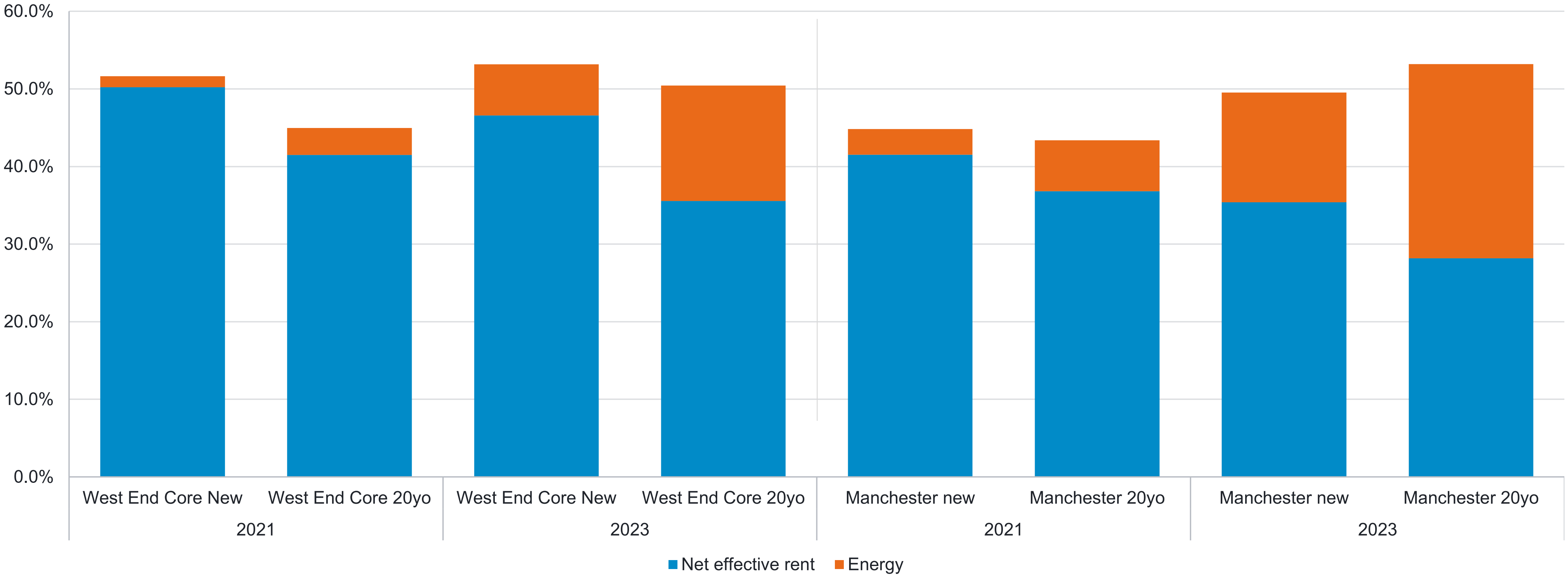


Source: Fidelity International, Real Capital Analytics, October 2022.

Rising energy prices increase occupancy costs in energy inefficient buildings

Demand for energy efficient buildings expected to grow, supporting rental values

Rents and energy costs as a % of total occupancy costs

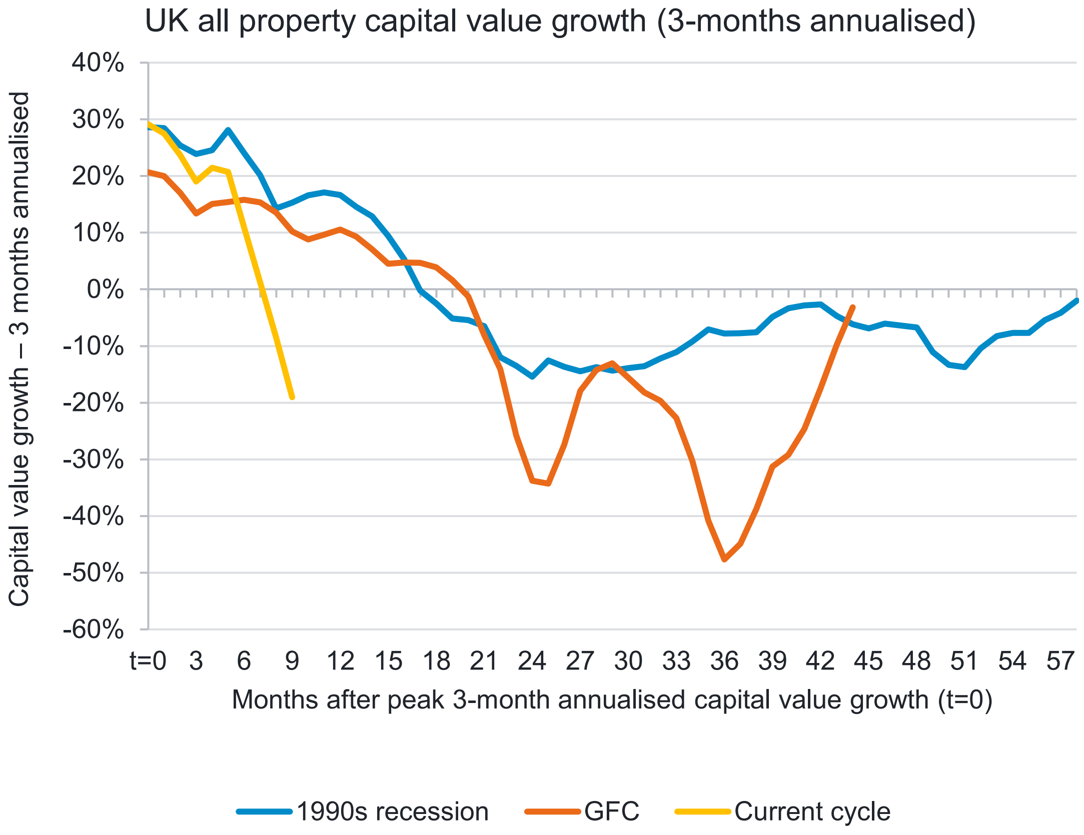


Source: Fidelity International, October 2022; Lambert Smith Hampton Total Office Costs Survey 2021. Analysis assumes a 4-fold increase in energy costs, a 10% increase in other costs and stable rental values from 2021 levels.

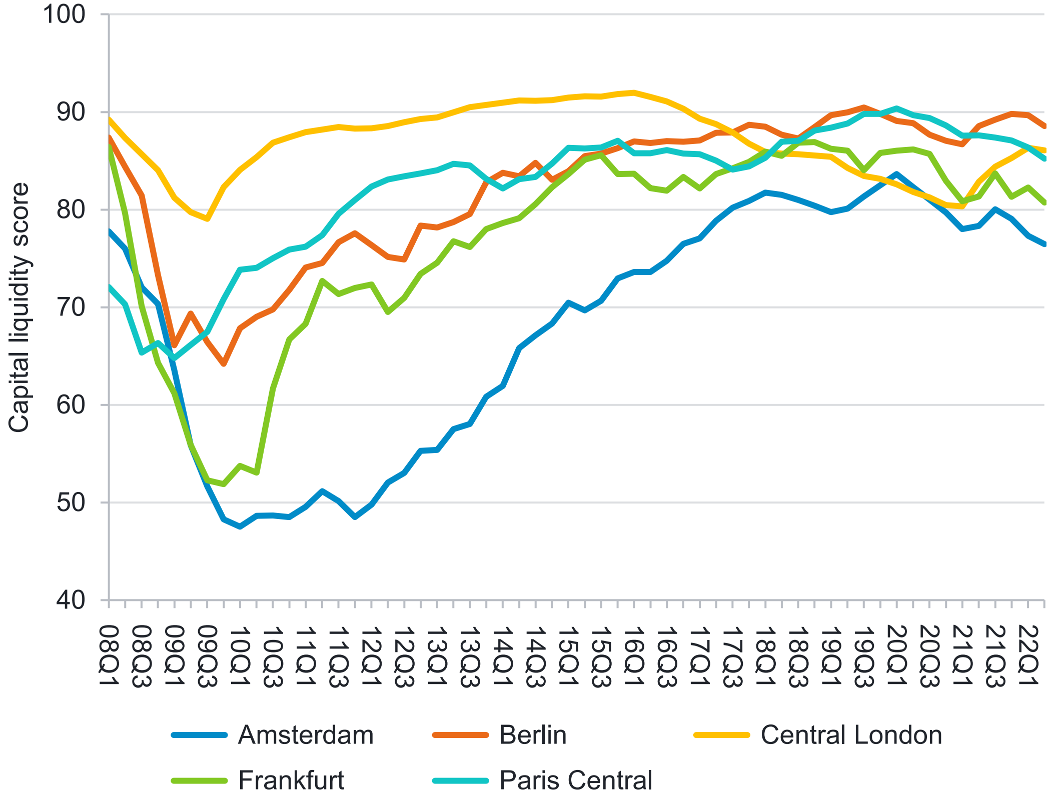
Data indicates that a sharp repricing of real estate is underway

We expect the cycle to be shorter and shallower, supported by greater market liquidity

Slowing from peak growth in current cycle has been rapid



Liquidity in European markets appears to be holding up



Source: Fidelity International, MSCI UK Monthly Property Index, October 2022; Real Capital Analytics, Q2 2022.

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