

Key themes and their investment implications for Q4 2022

Asset Allocation

Equities

Fixed income

Private markets

Real estate

Soft, hard or crash landing?

- Defensively positioned, underweight in equities and credit; maximum allocation to cash.
- Despite appreciation, dollar remains key safe haven. Higher terminal rates, stubborn inflation and weak sentiment still support the dollar strength.
- Within credit, we prefer IG for its higher quality, defensive characteristics.

- Equity volatility likely to remain high due given policy volatility, geopolitics, inflation, central bank hawkishness and high chances of a recession.
- Earnings were relatively robust in Q2. However, inflation and dollar strength may be masking the real earnings picture. Some parts of the economy appear to be running hot and others cracking. Very careful selection is key.

- A time to be defensive - US HY is not yet pricing in recession risks. We prefer IG, which offers better quality and valuations.
- Risk of a hard landing makes US duration relatively attractive, although the Fed pivot has been pushed well into 2023.
- The extreme hawkishness of central banks makes breakevens unattractive for now, although we do see long-term value in US breakevens.

- Underlying credit metrics remain robust as we head into a downturn. Exposure to CCC-rated credits as a percentage of the index remains moderate.
- Floating rate instruments offer a form of protection against rising rates and widening spreads. They provide consistent income generation, while leveraged loans provide structural protection given their senior position in the capital structure.

- High inflation and falling growth has not been good for real estate historically.
- Asset selection and adding value through asset management will be much more critical drivers of performance this cycle compared to the last.
- We have already seen pricing shift by 40-50bps at a market level, and we expect to see a similar yield shift by the end of Q4, as more investment activity provides evidence for where valuations truly lie.

China – all eyes on the Party Congress

- Remaining cautious on China assets given the uncertain growth outlook. Neutral on EM equities overall.
- However, we are more positive on other parts of EM equities, especially Latin America.
- China's weak growth is putting pressure on EMD, which along with the strong dollar leads us to be underweight.

- We remain cautious on Chinese equities, given the zero-Covid policy impact, policy uncertainty and property sector instability. However, indiscriminate selling is creating significant opportunities.
- With the exception of the advertising and renewable energy sectors, our analysts are lowering earnings expectations.
- The mortgage boycott situation and the new lockdowns are delaying recovery. However, we still expect recovery over the next 12 months.

- Our short term view on China rates is neutral - PBOC easing is limited from diverging too far from DM central banks. We have a long-term underweight to China rates on expectation of economic recovery.
- Cautious on credit given policy uncertainty, the stilted recovery and continued woes of the property sector. The market is betting on improvement in policy implementation after the Party Congress, but our analyst is less optimistic.

- The zero-Covid policies continue to have an impact on global supply chains, therefore we are looking for signals of supply chain challenges easing as China starts to open up.

From monetisation to fiscalisation

- Neutral on UK equities - while the outlook looks grim, the FTSE 100 is cheap and is positively correlated with commodity prices. Recent volatility in the wake of UK fiscal policy will be important to monitor over the coming months.
- Underweight European equities, as earnings will deteriorate further even with fiscal support for consumers.
- We prefer the safety of US equities where data has been more resilient.

- EU and UK households will struggle this winter, but worst-case scenarios should be avoided thanks to excess savings and fiscal support.
- How fiscal support is articulated is critical, however, with UK episode leading to a flight out of equities on macroeconomic concerns.
- Volatility in DM equities is likely to remain high unless and until confidence in policymaking is regained.

- EU duration is attractive – given the challenging outlook for Europe, we believe the market is pricing in an excessive level of ECB hikes. This means core ECB debt should find support and offer some protection.
- However, we would urge caution on periphery debt at this stage given diminishing central bank support and greater political uncertainty.
- Disruption to UK fixed income markets from the "mini-budget" offers potential value in sterling credit. Cautious on volatility in sterling rates.

- Loan markets continue to exhibit lower volatility than other risk assets due to floating rate nature and seniority in capital structure.
- Security selection remains of paramount importance. Prefer higher quality, strong balance sheets in defensive sectors.
- Focus on refinancing risk as the 2024 maturity wall approaches.
- Attractive new deployment opportunities at lower leverage levels, stronger security and better pricing.

- Even though "green" offices may command higher rents, such are the savings to be made on energy bills compared to older buildings, occupiers may still find them to be the cheaper option.
- 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.

Important Information

This document is for Investment Professionals only and should not be relied on by private investors.

This document is provided for information purposes only and is intended only for the person or entity to which it is sent. It must not be reproduced or circulated to any other party without prior permission of Fidelity.

This document does not constitute a distribution, an offer or solicitation to engage the investment management services of Fidelity, or an offer to buy or sell or the solicitation of any offer to buy or sell any securities in any jurisdiction or country where such distribution or offer is not authorised or would be contrary to local laws or regulations. Fidelity makes no representations that the contents are appropriate for use in all locations or that the transactions or services discussed are available or appropriate for sale or use in all jurisdictions or countries or by all investors or counterparties.

This communication is not directed at, and must not be acted on by persons inside the United States and is otherwise only directed at persons residing in jurisdictions where the relevant funds are authorised for distribution or where no such authorisation is required. Fidelity is not authorised to manage or distribute investment funds or products in, or to provide investment management or advisory services to persons resident in, mainland China. All persons and entities accessing the information do so on their own initiative and are responsible for compliance with applicable local laws and regulations and should consult their professional advisers.

Reference in this document to specific securities should not be interpreted as a recommendation to buy or sell these securities, but is included for the purposes of illustration only. Investors should also note that the views expressed may no longer be current and may have already been acted upon by Fidelity. The research and analysis used in this documentation is gathered by Fidelity for its use as an investment manager and may have already been acted upon for its own purposes. This material was created by Fidelity International.

Past performance is not a reliable indicator of future results.

This document may contain materials from third-parties which are supplied by companies that are not affiliated with any Fidelity entity (Third-Party Content). Fidelity has not been involved in the preparation, adoption or editing of such third-party materials and does not explicitly or implicitly endorse or approve such content.

Fidelity International refers to the group of companies which form the global investment management organization that provides products and services in designated jurisdictions outside of North America. Fidelity, Fidelity International, the Fidelity International logo and F symbol are trademarks of FIL Limited. Fidelity only offers information on products and services and does not provide investment advice based on individual circumstances.

Issued in Europe: Issued by FIL Investments International (FCA registered number 122170) a firm authorised and regulated by the Financial Conduct Authority, FIL (Luxembourg) S.A., authorised and supervised by the CSSF (Commission de Surveillance du Secteur Financier) and FIL Investment Switzerland AG. For German wholesale clients issued by FIL Investment Services GmbH, Kastanienhöhe 1, 61476 Kronberg im Taunus. For German Institutional clients issued by FIL (Luxembourg) S.A., 2a, rue Albert Borschette BP 2174 L-1021 Luxembourg.

In Hong Kong, this document is issued by FIL Investment Management (Hong Kong) Limited and it has not been reviewed by the Securities and Future Commission. FIL Investment Management (Singapore) Limited (Co. Reg. No: 199006300E) is the legal representative of Fidelity International in Singapore. FIL Asset Management (Korea) Limited is the legal representative of Fidelity International in Korea. In Taiwan, Independently operated by FIL Securities (Taiwan) Limited, 11F, 68 Zhongxiao East Road., Section 5, Xinyi Dist., Taipei City, Taiwan 11065, R.O.C Customer Service Number: 0800-00-9911#2 .

Issued in Australia by Fidelity Responsible Entity (Australia) Limited ABN 33 148 059 009, AFSL No. 409340 ("Fidelity Australia"). This material has not been prepared specifically for Australian investors and may contain information which is not prepared in accordance with Australian law.

ED22-158