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Global Market Outlook 2023

Fidelity Future Leaders Fund

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November 2022

Future Leaders – Valuation discipline is vital

We see renewed valuation discipline as investors recognise that inflation will persist, the era of free money is ending, and speculative, loss-making businesses are undergoing a reality check.

Key points

- Higher inflation, rising interest rates and geopolitical uncertainty are here to stay and will impact economic growth in 2023.
- There is a conspicuous scarcity of growth and certainty. This is favourable for high-quality investment opportunities and justifies in-depth evaluation.
- We will focus on companies with solid market structures where pricing power and competitive edge support margins and cushions against falling profits.

Against the backdrop of inflation, geopolitical tensions and slowing growth, what is the investment outlook for Australian mid-small caps in 2023?

The market continues to debate topics such as recession, hyperinflation and stagflation scenarios for 2023, and investors remain cautious. In Australia, rising mortgage payments will exert pressure on disposable incomes and, combined with a weaker housing market and tapering asset values may curtail consumption. While business sentiment is still positive, the pace of change needs to be monitored.

As the macroeconomic backdrop rapidly changes, fundamentals will be scrutinised. The market will assign a certainty premium for equities that offer viable growth, free cash flows and a reliable growth trajectory. It will be essential to steer clear of loss-making concept stocks, highly leveraged industries, low-quality momentum-driven names and high-risk microcaps.

What do you think could surprise the market in 2023, either positively or negatively?

A definitive timeline for the US Federal Reserve's monetary policy tightening should be well received by the market, while any further deterioration in geopolitics would heighten investors' risk aversion further.

What themes, sectors or regions would offer opportunities and potential risks?

We continue to look for opportunities in the Australian mid-cap segment, and the Fund is positioned to include high-quality and growth companies with strong market structures, visible outlooks and unique services, which will enable them to sustain margins and deliver earnings despite increasing economic pressures. The Fund remains balanced with a blend of strong positions in technology, electric vehicle resources, consumer names with global growth or defensive properties, and exposure to insurers, energy equipment and real estate. Some critical considerations over the near term include pricing power (given rising input costs, inflation and tight labour markets), sustainability of returns (as credit costs rise and competitive pressures intensify), and valuation discipline and duration (what is driving company growth - is it cyclical or structural?).

Within your portfolio, what has worked well in 2022, and what will you do differently in 2023?

We have actively focused on resource companies in areas underpinned by long-duration assets that service the growing demand for clean energy, especially in the electric vehicle domain. We have also maintained exposure to select property names that benefit from the strong retail demand we have seen in Australia over the year to date. The Fund also avoided momentum areas such as online gaming and building services providers. We will continue to focus on portfolio construction across the quality-momentum-transition-value paradigm.

How do you expect sustainability factors to influence returns in 2023, and how is this reflected in your portfolios?

We think about environmental, social and governance (ESG) issues holistically within the portfolio's context and at an individual stock level. The Fund's carbon footprint at a total portfolio level is a fraction of that of the benchmark, and the Fund has a better quality ESG rating than the investment universe.

Throughout 2022, we steered the portfolio away from tactical opportunities in areas such as coal, where there was a definite benefit from solid pricing, which would have imposed a significant carbon burden on the Fund and promoted less favourable environmental outcomes. Fidelity's proprietary sustainability ratings offer dynamic, analyst-driven insights blended with our fundamental research to create substantial financial and non-financial outcomes for our clients.

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