Fidelity INTERNATIONAL

Year in review
2023-2024

There's a smarter way to access the world

Year in review 2023 - 2024

Lawrence Hanson
Managing Director
Fidelity International

Putting pen to paper to reflect on the year that was, I can safely say no one predicted the type of market that we've seen over the past 12 months. This time last year, investors were preparing for a much-anticipated US recession, a lowering of interest rates in major markets (economists were predicting 8 across the year in the US!), and a general slowdown in markets more broadly.

Happily, for both Australian and global investors, markets have performed strongly over the past 12 months, with the US market hitting record highs. Nvidia has become a household name, with its market capitalisation surpassing that of Apple's*. And this is all in the context of continued conflicts, heightened geopolitical tensions, and sticky inflation.

But with lofty market valuations across a concentrated number of stocks, investors are wondering how they can look to diversify their portfolio. At Fidelity, we know there are always interesting opportunities to be found across the financial markets, reflecting our global strengths and local insights.

This leads me to some exciting product news which we've been working on for some time. We are proud to have recently launched four new Active ETFs on the ASX. Investors can now access active strategies investing in India, Asia, global small-mid caps, and Australian shares as ETFs in one simple trade.

Earlier this year, we also launched the Fidelity Global Bond Fund. While we are well-known for our equities experience, we have been managing fixed income assets for more than 35 years. We know that many of our clients are looking to invest globally in fixed income with a proven active manager, so we are delighted to be able to offer this solution to Australian investors.

We continue to be committed to helping investors on their investment journey and are super proud of our award-winning investment podcast - SoundBites - our home-grown monthly bite size podcast where you'll hear from our investment experts around the world on all things investing. You can subscribe on our website, and it's available on all the leading podcast platforms. What's in store for the next 12 months for Fidelity? While markets are clearly harder to predict, I do know that we will continue to bring to new solutions to Australian investors to help meet their investment goals. Fundamentally, investing can make a real impact to people's financial futures, and we look forward to partnering with our clients on that journey.

*As at 6 June 2024

Our investment expert views

Australian equities

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

A stable economic backdrop
The consumer has been strong despite higher rates and there are two factors driving this: immigration has returned after Covid and those who arrive are spending on goods, and older people with no debt and are cash rich have been benefiting from higher deposit rates, so have been able to spend typically on experiences and services (travel, restaurants, etc).

However, younger people have more broadly been constrained due to higher rents and higher cost of living, while mortgage owners have faced higher rates, thus less disposable income. Interestingly, the unemployment rate is low, so those facing higher rents and mortgages still have work to help pay these costs.

A stable backdrop has been supportive for the financials sector, and higher rates has helped the net interest margins for banks. There has been some optimism around improving credit quality versus the impairments feared post-Covid. The consumer discretionary sector has done well as consumption has held up. However, the materials sector has felt the pain from problems in China. China is the world's largest consumer of metals, with the property sector being key to this demand. The slowdown in China property has seen a fall in demand, which impacts a number of Australia's miners.

Fund performance
The Fidelity Australian Equities Fund has seen strong returns from some of its holdings in financials. Commonwealth Bank has seen strong investor support and we remain invested, in part because it is well positioned to compete in an environment of greater tech disruption to the banking sector. We have also benefited from owning a large position in Suncorp. It was a financial conglomerate, which creates a lot of operational and regulatory complexity. They received approval to sell their banking division, which simplifies the business to focus on general insurance, and means they have a few billion dollars of excess capital, which will find its way to shareholders via buybacks.

Goodman Group was also a strong performer. It is a global leader in industrial property and has been a key beneficiary of growing e-commerce as e-commerce companies require significant industrial unit space to house inventory. However, some of our positions in miners faced a challenging 12 months, especially lithium and nickel miner/refiner IGO after we witnessed a large fall in lithium prices as supply growth outpaced global electric vehicle demand. Weaker nickel prices also saw write downs on recently acquired nickel assets. However, it owns high quality assets and is a low-cost producer who should benefit from demand driven by structural growth in electric vehicles. Although metal prices are down, general cost and wage pressures have been high.

Our holding in Dominos, a pizza delivery business, was negatively impacted by a normalisation in home deliveries post Covid restrictions as people started going out again, and some over-expansion in Japan. Ramsay Healthcare has also had to contend with costs, mainly via higher staff wages, and at the same time is seeing a slower recovery in post-Covid operations. As we see a stabilisation in inflation, we would expect to see these cost issues for companies like Ramsay Healthcare improve.

Global equities

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

Global mid-cap equities rose by 10% over the past 12 months. During this time, it became evident that an economic recession in the US was less likely to materialise than was being predicted. Once the market started to gain confidence, and a recession was no longer imminent, multiples expanded.

Over the year, markets were also factoring in the prospect of interest rate cuts by leading central banks, particularly the US Federal Reserve (Fed). Given all this attention surrounding outcomes related to the US economy, the US was the best performing region among its peers in the global developed, mid-cap equity market.

Meanwhile, oil prices maintained a steady upward trajectory, rising by almost 20% over the course of the year, amidst less favourable geopolitics as well as economic demand. As a result, energy was the best performing sector, with oil producers leading the rally. Financials followed, where the strength of the equity market rally underpinned returns from capital market-led businesses.

The impact of AI
Over the 12 months, we witnessed an unabated enthusiasm towards artificial intelligence (AI) as a theme, and its associated growth prospects gave markets a reason to cheer and lift overall investor confidence. While the AI thematic was more beneficial for mega-cap technology bellwethers, particularly the cohort of 'Magnificent 7' stocks (Apple, Alphabet, Microsoft, Amazon, Meta Platforms, Tesla and Nvidia), it had a favourable impact for mid-cap information technology stocks, particularly good quality technology hardware-related names.

Looking ahead
Going forward, equity markets will navigate the volatility associated with the US election cycle until the end of 2024, while looking out for the Fed to initiate its rate cut cycle.

During this time, we believe investors are wise to remain vigilant. Higher interest rates haven't been able to have much impact in the US yet, and these impacts could still come through at a later stage.

On that basis, it makes sense to ensure portfolios remain resilient, and simultaneously, also maintain a balanced exposure to the upside. We believe a portfolio of high-quality businesses with strong balance sheets and secular growth opportunities, purchased at attractive valuations, remains a compelling proposition.

When it comes to finding these opportunities, and from a broader portfolio construction perspective, looking down the market cap spectrum towards global small and mid-caps is an exciting avenue to explore. We are also enthused to see that valuations in the small and mid-cap segment appear to look attractive, relative to their larger and mega-cap peers.

Recommended
Lonsec Research

Rating upgraded May 2024

Our investment expert views

Asian equities

Anthony Srom
Portfolio Manager
Fidelity Asia Fund
ASX: FASI

The last 12 months has witnessed a wide divergence in sentiment across the Asia region. The artificial intelligence (AI) theme and pick up in AI infrastructure spending boosted technology heavy markets like Taiwan, and India rallied as investors bought into its economic development story. However, sentiment is quite exuberant, valuations in those markets are trading well above long-term averages and talk of risks to the investment opportunities are being somewhat ignored.

While Taiwan and India have led the region, China and Hong Kong continue to struggle, even after a strong but short-lived rebound in Q1 2024. Concerns over the health of the property market and weak domestic consumer sentiment remain and investors are not confident there will be enough policy support to drive a turnaround. Weak sentiment is reflected in low valuations, but this is partly justified as risks are elevated. However, this also creates some mis-priced opportunities and we have seen good companies with solid structural growth drivers being sold down.

Despite pockets of opportunity across the region, we expect the broader challenging macroeconomic environment to continue. We believe careful stock selection, underpinned by rigorous company research, can effectively mitigate areas of risk and successfully capitalise on the beneficiaries of the region's long-term growth.

Fund performance

Over the last 12 months, the Fidelity Asia Fund has benefited from holding big positions in leading technology names like SK Hynix and Taiwan Semiconductor Manufacturing Company. Given the strong performance and high valuations, our position in technology has been brought down, as we are concerned that companies are spending on AI infrastructure, but will soon have to go through a period of implementing and integrating this into their businesses, and these risks are not priced in.

Conversely, our China exposure, especially in consumer-related areas, has lagged. Investor sentiment towards the consumer is weak, but any improvement in consumer sentiment could drive a material re-rating from low valuation levels. We are optimistic that a controlled stabilisation in the macro environment will eventually allow this thesis to play out. This could include more policy support for the country's ailing property market, which we are beginning to see. Large overweights in the China consumer space, like those in advertising company Focus Media, fast-food business Yum China, and beverages producer Kweichow Moutai, have been impacted.

Looking ahead

As we look ahead, there are a few things that we believe should be positive for relative returns for the Fidelity Asia Fund:

- Rate cuts in the US: we expect significantly lower US interest rates, which would benefit stocks likes Techtronic Industries and BOC Aviation.
- China consumer picks up: this may help the stocks mentioned above. We have also added positions in sportswear company Anta, which is structurally growing with changing lifestyles and benefiting from the rise of domestic brands, and Galaxy Entertainment, which should benefit from a steady improvement in Macau visitations and increasing spend per visitor.
- The AI cycle shifts from the hype phase towards realisation or disappointment.
- India de-rates or fails to meet high expectations.

Global emerging markets

Amit Goel
Portfolio Manager
Fidelity Global Emerging Markets Fund
ASX: FEMX

Global emerging markets (GEMs), despite trading higher, have been volatile over the past 12 months. Sentiment oscillated sharply, as several major GEM countries including India, Indonesia, South Africa, and Mexico went through elections. Markets grappled with elevated inflation in developed markets, and timelines for interest rate cuts, geopolitical tensions, and the pace of the economic recovery in China.

Country lens
Taiwan and Korea, which play a vital role in the global technology supply chain, have been in vogue the past 12 months due to strong demand for their technology hardware products, driven by artificial intelligence (AI).

Indian markets rallied as Prime Minister Narendra Modi's party came back to power with the help of its allies, which means more checks and balances, while the retention of key cabinet ministers signalled political continuity and stable policies.

Latin America's biggest markets, Mexico and Brazil, were out of favour, with slower than expected pace of interest rate cuts in the regions.

And finally, China's stock market, which experienced substantial declines in the last couple of years, amid a property downturn and weak consumer confidence, is now showing early signs of a recovery.

From a style perspective, GEM saw extreme momentum, both on the positive and negative sides. We continue to see an environment where stock prices are being driven by short-term sentiment despite valuation extremes, rather than medium-to long-term fundamentals. This creates headwinds for our quality-growth and longer duration-focused investment style.

China's impact on GEMs
In China, consumer sentiment remains subdued with weakness in property prices causing consumers to focus on de-leveraging, rather than spending. However, the savings rate has increased post COVID-19, suggesting that this is a problem of confidence to spend, rather than ability to spend.

China's global competitiveness and innovation of its people is not lost. China remains one of the leading consumers of mid- to high-end products and services in the world. Rising geopolitical tensions and disrupted supply chains are hastening the end of the era of globalisation and the process of decoupling.

Many developed market companies are redirecting production that was previously outsourced to China to other EM countries that are closer to home (nearshoring) or to friendly partners (friendshoring). For instance, Apple has moved its manufacturing to India and Tesla has moved its factories to Mexico.

On-the-ground views
We've remained close to our investee companies. The past 12 months, we've continued to focus on completing regular research trips to grasp market conditions first-hand and deepen our knowledge and understanding of businesses in which we invest.

In China, where consumer confidence remains subdued and consumer stocks continue to languish, we are mindful of negative momentum risks. While we are not increasing exposure, despite attractive valuations, we are making our exposure more diversified.

Looking ahead
Overall, if we consider fundamentals, the quality of underlying assets or valuations, we believe that GEMs are in better shape, more resilient, and more attractively valued than in the past.

Medium-to long-term fundamentals are reasonable today compared to the past and we feel GEMs' strong fiscal position stands the asset class in good stead.

Our investment expert views

Sustainable investing

Daniela Jaramillo
Head of Sustainable Investing

Over the past 12 months, the Australian government has intensified its efforts to decarbonise our economy to not only meet commitments made under the Paris Agreement, but importantly to help safeguard our future export market.

Last year, more than 45%[1] of Australia's exports were high carbon products - iron ore, coal and natural gas. Notably, these exports were to countries stepping up their efforts to decarbonise their economies, including China, Japan and Korea.

To this end, the Government has introduced a myriad of initiatives which form a comprehensive framework for positioning Australia to strengthen its economy:

- **Critical Minerals Strategy 2023 - 2030** - highlights the importance of securing and developing minerals vital for clean energy technologies, with an aim to position Australia as a key supplier in the global market.
- **Sector Pathways Review** - which aims to provide tailored decarbonisation roadmaps for various industries, ensuring a cohesive transition across the economy.
- **The Sustainable Finance Strategy** - focuses on aligning financial systems with sustainable development and promoting investments that support environmental and social goals. This includes financing the development of the Australian Sustainable Finance Taxonomy.
- **Australian Safeguard Mechanism:** Aims to reduce emissions in the largest industrial facilities.
- **Future Made in Australia** - recently announced, this policy emphasises local manufacturing and innovation in clean energy technologies, aiming to build a resilient and sustainable domestic industry while reducing carbon emissions.

These initiatives also have implications for investors at Fidelity in a few ways.

Firstly, we are analysing how these policies are likely to impact the companies in which we invest, which companies will be winners or losers of these policies, and how they will adopt or interact with these policies. This analysis helps inform how we invest.

Secondly, as long-term investors, we engage with companies in high emitting sectors particularly iron ore, coal and natural gas, to understand how Boards and management are positioning their businesses to remain resilient over the medium and long-term, while meeting short term regulatory obligations such as the Safeguard Mechanism.

An example of this is our discussions with large Australian iron ore miners. We seek to understand how they are future proofing their business models as customers look for green steel alternatives. Similarly, we engage with oil and gas companies, focusing on ensuring that they have the appropriate board skills to navigate the complexities of the sector's future and robust governance structures to guide their climate transition plans.

Finally, as sovereign bond investors, we contribute to PRI's Collaborative Sovereign Engagement on Climate Change with the Australian government. Here, we seek to understand the government's management of climate change risk and encourage federal and state-level governments to prepare for the impacts of physical and transition risks on the Australian economy.

Focus on 'culture-based financial risks'

Last year we completed research to understand the multiple levels in which workplace misconduct can represent financial risks for investors. Harmful behaviours in the workplace such as abuse, bullying, sexual harassment, discrimination, and victimisation are well understood to translate into company-level financial impacts.

What is less understood is the financial implication of these behaviours to a broader portfolio, as they extend past the individual company. This research explored how harmful behaviours can lead to 'culture-based financial risks' that are interrelated and can lead to vicious cycles across sectors and the economy.

Our paper, which summarised this research, 'Workplace misconduct | The underestimated systemic implication for investors', included recommendations for actions and disclosures companies should undertake to help with the assessment of these risks.

We've applied our learnings to impact how we engage with companies to understand their management of these risks, and to assess any appropriate remediation in practice.

In conclusion

Overall, our approach to sustainable investing and culture-based financial risks seeks to develop decision-useful research to understand how societal trends and government policies interact with our investments and use those insights to engage with companies to ensure they remain resilient over the long-term.

Source: DFAT, Australia's Top 25 Exports, Goods and Services (a) Australia's top 25 exports, goods and services 2023 (dfat.gov.au)

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ASX: FASI	Fidelity Asia Active ETF
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