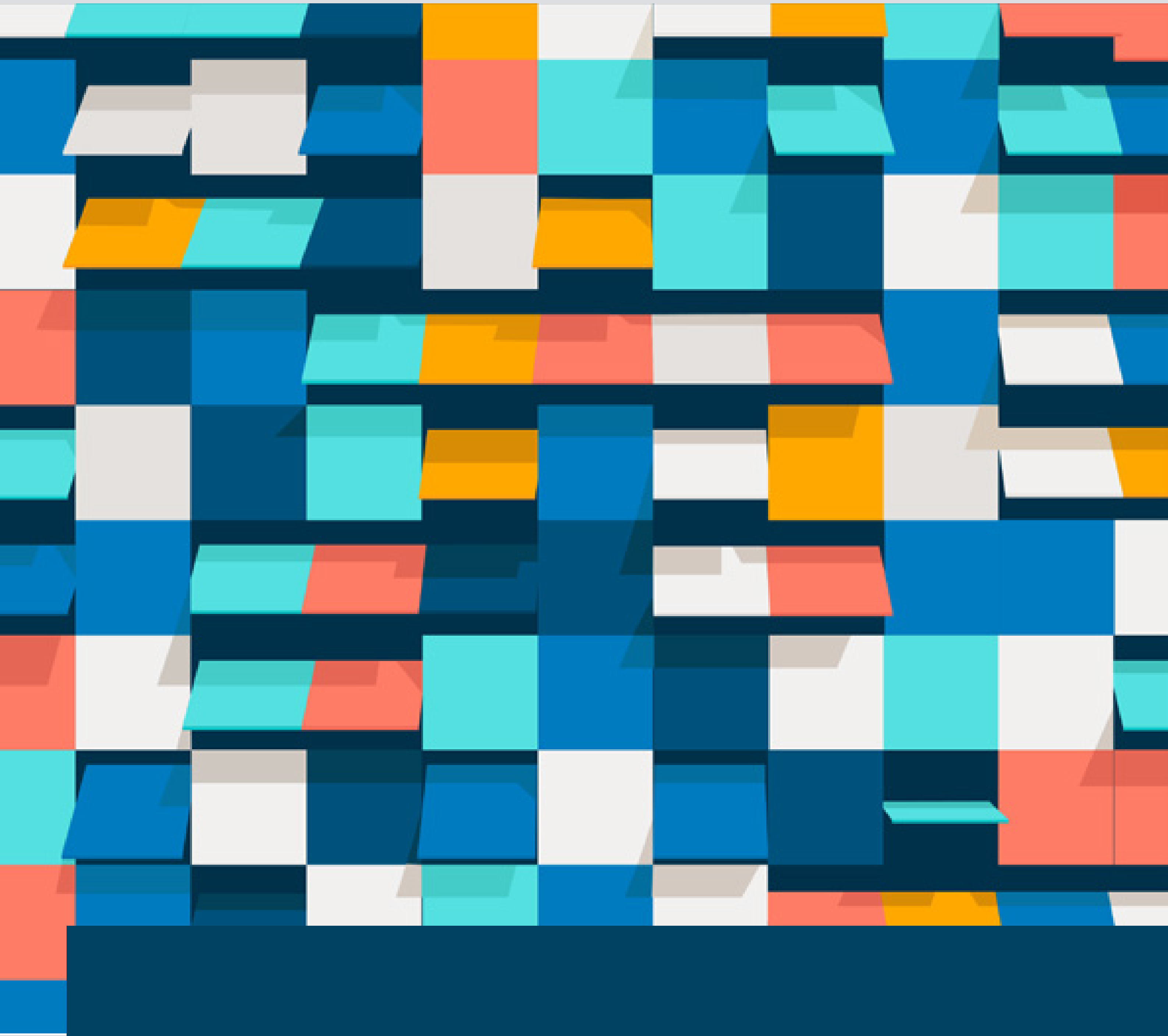
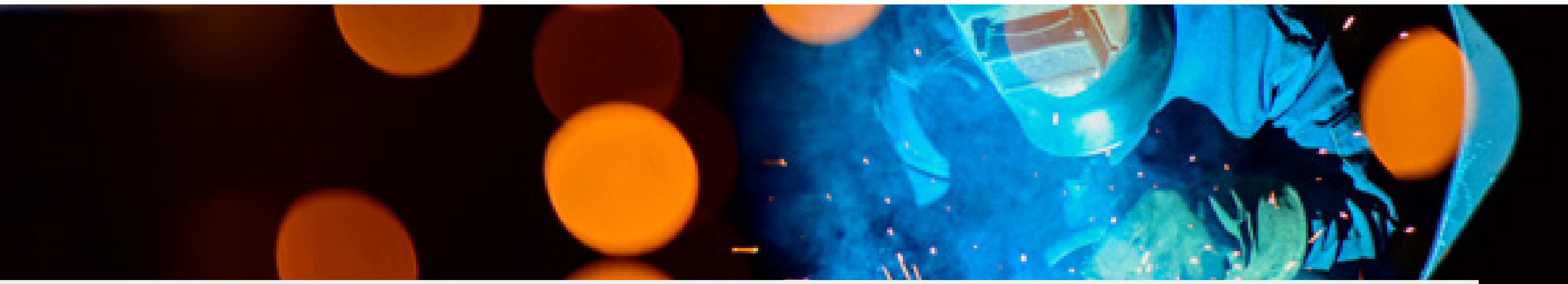


New regimes

Analyst Survey 2025

Our annual Analyst Survey gives you a taste of what Fidelity International's research is telling us right now. It gels the views of more than 100 analysts who cover sectors and companies across the world in detail and in depth.

Contents



Introduction: Model me this

I read the research our analysts do every day, and it delivers.

Niamh Brodie-Machura
Co-Chief Investment Officer, Equities

I've been an equities investor for most of my career but a story I heard recently from my fixed income colleague James Durance tells you a lot about the importance of research in our business.

It dates back to early 2024, when official interest rates were at their highest in years, prompting a flight to quality across fixed income markets as investors wondered how borrowers would handle higher funding costs.

James, who specialises in global income and European high-yield strategies, was looking over a batch of research from one of our analysts when he spotted something. The numbers from corporate real estate researcher Othman El Iraki showed that almost all of the European and UK investment grade issuers he had assessed would still be able to service their debt under a higher rate environment. Importantly though – and contrary to the market's instincts at the time – *the same was also true for the sector's junk-rated credits*. And these were being shunned by many investors.

The result was James's most profitable trade of 2024, and the lesson is an obvious one: in a business centred around the management of risk and the search for momentary opportunities, timely and strong analysis is indispensable. The detailed modelling Othman had done on tolerances for higher rates showed something most in the market had missed. James and his team started paying extra attention to real estate prices as a result. When they saw signs of stabilisation, they began to add to their holdings in the space.

Those holdings weren't just plain vanilla corporate credit. They bought some convertible debt and took restructured equity from a default in one business. Their conviction about the businesses, thanks to Othman's thorough research, led to the team's second-biggest allocation of 2024, and some of their best returns.

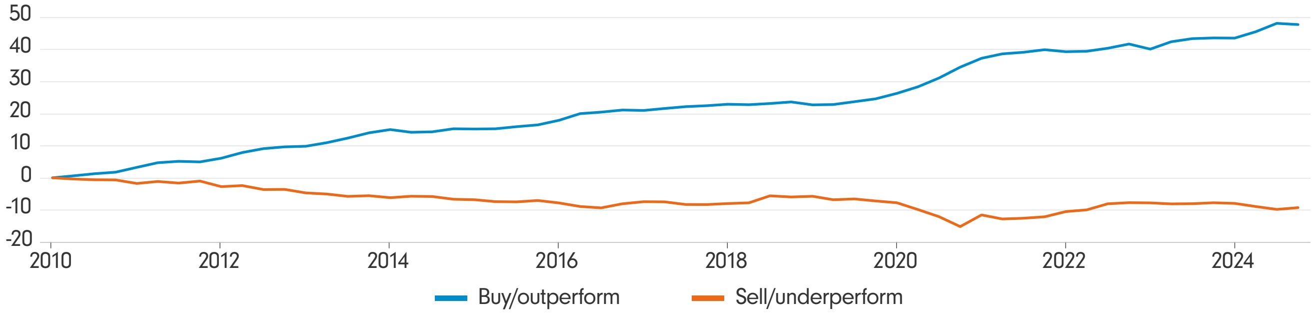
Our annual Analyst Survey gives you a taste of what Fidelity International's research is telling us right now. It gels the views of more than 100 analysts who cover sectors and companies across the world in detail and in depth.

Othman is here. So are Alex Laing and Ketul Nathwani, who predicted the rise of power grid investment globally last year and the resulting outsized returns from the big utility companies. And Akshen Thakkar, whose detailed analysis convinced portfolio managers to buy an Indian air conditioner company when it issued new stock in late 2023 – up an astonishing 172 per cent in the months since.

Past performance is not a guarantee of future returns, but as the chart below shows, the long-term numbers suggest strong research helps. This year's survey reflects the knowledge generated by thousands of meetings and calls with the leadership teams of hundreds of global companies.

Chart 1: Research has delivered over the long term

Global equity research performance

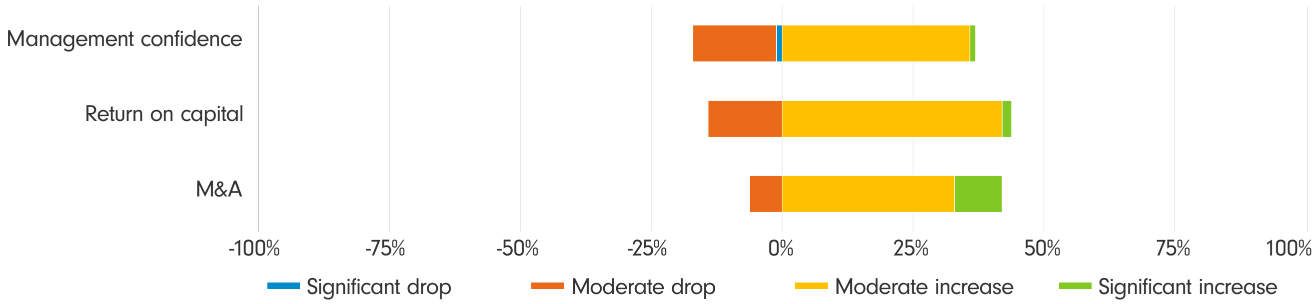


Regional returns weighted by market cap of companies rated either buy/outperform or sell/underperform. Value add calculated vs regional indices. Past performance is no guarantee of future returns. Source: Fidelity International. Data as at 30 September 2024.

In aggregate, our findings show company managers worldwide are far more optimistic than they have been in either of the past two years. Expectations for returns on capital are better than at any point since the pandemic, while several sectors expect the change of administration in the US to deliver a much-needed boom in M&A deals.

Chart 2: Optimism on top

Analysts positive on returns on capital, M&A, and management confidence



Over the next 12 months: "How would you describe the confidence level of your companies' management teams to invest in their businesses compared to the previous 12 months?"; "What is the outlook for overall returns on capital?"; "Do you think M&A will be any more or less prevalent among your companies?" Source: Fidelity International, January 2024.

One notable conclusion from the survey is that the AI revolution's big breakthrough as a generator of profitability and new revenues for companies beyond the tech sector is yet to arrive. And is unlikely to do so this year. The industrials sector meanwhile has the highest proportion of analysts that expect their companies to perform better this year compared to last. And while reflation trades may have dominated the end of 2024 for markets, outside of the US, analysts expect inflation to continue to retreat as a priority for companies.

As well as these broader themes, we lay out a handful of case studies here that show the direction of travel across several sectors and regions, giving more insight into the work our analysts do day after day.

As investment managers like James will tell you, it's worth reading.

The return of Donald Trump: Start of the deals

Could the president's second term be as much about dealmaking as inflation?

Terry Raven
Director of Research

Rebecca Motta
Director of Research

Eight years on from his first inauguration as president, the global companies that Fidelity International's analysts cover believe Donald Trump's arrival in the White House will have more impact than last time. Yet there are also expectations of a real improvement in the value of a number of sectors, driven chiefly by hopes for a surge in corporate mergers.

Chart 3: More impact than 2017

What impact are your companies expecting from Trump's presidency over the next two years?

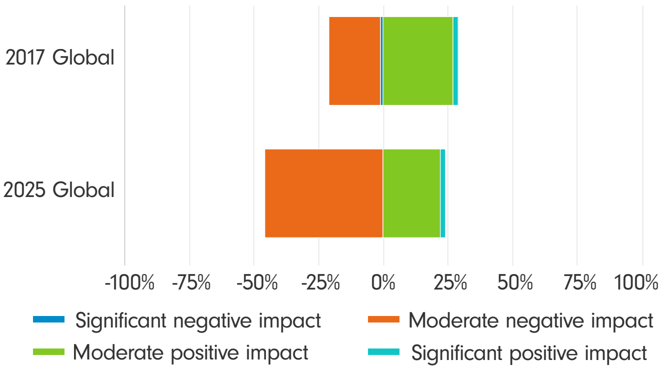


Chart shows percentage of analysts responding to the question "What impact are your companies expecting from Trump's presidency over the next two years?"; Analysts who responded "No impact" are not shown on the chart. Source: Fidelity International, January 2025.

Those are the headline conclusions about the new administration in the US from our annual survey of 112 Fidelity analysts who watch and meet regularly with the world's biggest companies with a view to investing in them. Geopolitics and the fallout from November's election feature heavily.

Chart 4: Not so alarmed

What impact are your companies expecting from Trump's presidency over the next two years?

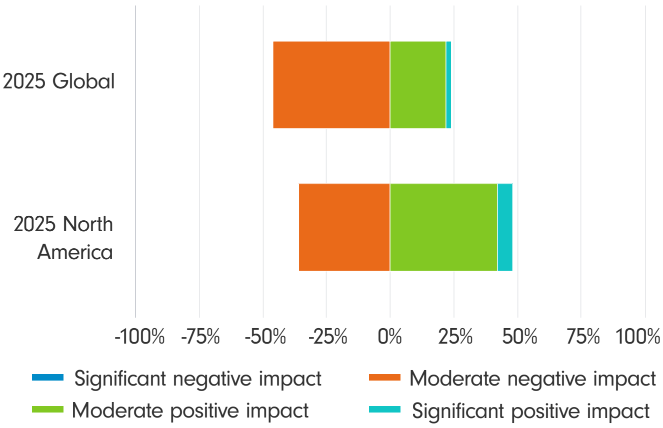


Chart shows percentage of analysts responding to the question. Analysts who responded "No impact" are not shown on the chart. Source: Fidelity International, January 2025.

As the charts also show, however, those who cover North America's enterprises have a more positive outlook than the global group concerning the impact of the new administration on their sectors. Central to that is an easier approach to domestic regulation - both of day-to-day business and acquisitions that previously might have been frowned upon.

"The Federal Trade Commission will be less likely to block potential takeovers under a Trump administration," says healthcare analyst Sahil Kapoor.

Expectations of a rise in dealmaking under the man who prides himself on his "art of the deal", have substantial implications for how businesses, and their stock prices, are viewed.

Chart 5: Hints of an M&A boom

Do you think M&A will be any more or less prevalent among your companies over the next 12 months?

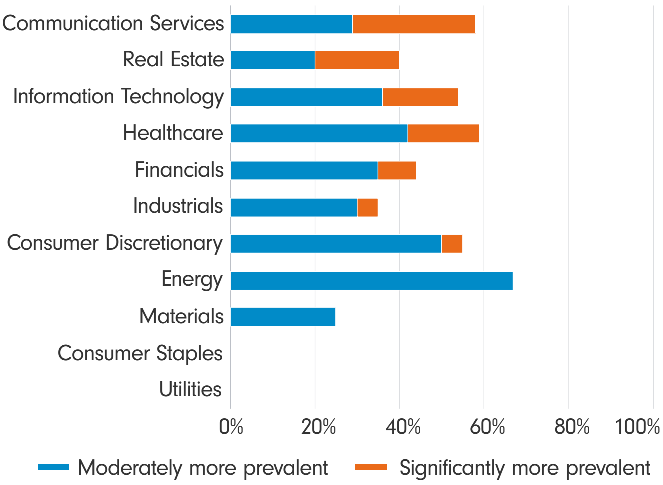


Chart shows percentage of analysts responding "Moderately more prevalent" or "Significantly more prevalent" to the question "Do you think M&A will be any more or less prevalent among your companies over the next 12 months?" Source: Fidelity International, January 2025.

There are a range of sectors in particular where our analysts predict a surge in takeovers and mergers, including healthcare, communication services, IT, real estate, and energy.

"Valuation levels have recovered from cyclical lows, increasing asset coverage to creditors and equity value to shareholders," says Evan Delaney, a fixed income analyst who covers North American telecoms, media and tech-focused businesses.

"This in turn has improved each company's access to capital markets, leading to a renewed interest in growth and investment in a sector that not too long ago was left for dead," he says.

There are a range of sectors in particular where our analysts predict a surge in takeovers and mergers, including healthcare, communication services, IT, real estate, and energy.

"A different regulatory environment should get bankers talking," says another media and television-focused respondent to the survey, Samuel Thomas.

"Warner Brothers Discovery, Paramount, Fox, and the NBC unit of Comcast are all candidates for consolidation. Cable M&A may also pick up and video games is a fragmented industry where consolidation could be more likely. Strategic assets including Roku could also be targets."

American exceptionalism

European and Asian-focused analysts suspect their companies may face a shuttering of markets in the United States, underpinning concerns compared to 2017 about the impact on profits of a new trade war.

Chart 6: Geopolitical risk looms large

What impact do you expect geopolitical risk will have on your companies' profitability over the next 12 months?

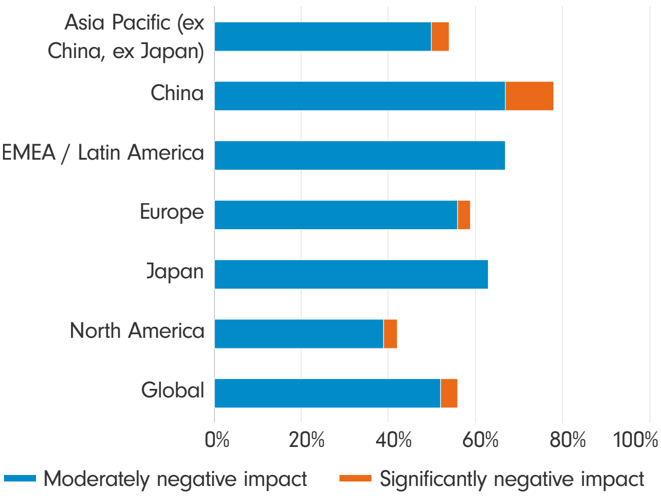


Chart shows percentage of analysts reposnding "Moderately negative impact" or "Siginificantly negative impact" to the question. Source: Fidelity International, January 2025.

"Companies think Trump will prove more reserved on tariffs because they use the same global supply chain as their US counterparts and it would hurt US autos companies along with everyone else," says Asian auto industry analyst Alan Zhou.

"In practice the government is likely to provide some forms of exemptions to US companies, and this will allow them to push ahead with a policy of higher tariffs."

Reflate to innovate

As the fluctuations in market expectations for inflation and rates in the month since analysts filled in the survey have shown, thinking on a 'reflation' scenario for the next year varies widely depending on the sector and the region.

"The positive of tax breaks could be offset by the negatives of inflation from trade wars," says consumer sector analyst Robert Glatt. "But that is more of a medium-term impact. Over the short term, we could benefit from improved consumer sentiment and the removal of uncertainty."

All of the analysts were answering the survey before the Fed's release of higher inflation projections in mid-December, but more immediate fears about the impact of tariffs on prices were already showing up for US-centric businesses.

"Tariffs are likely to lead to increases in prices for end customers, which negatively impacts volume demand," says Jonathan Tseng, who covers Nvidia and the world's other big chip producers. "The risk of US or China restrictions on certain tech products may disrupt normal business."

And as financial markets have already shown in 2025, loose fiscal policy – widely expected from the new administration – does also come at a price.

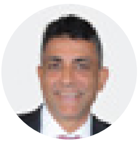
"With the 30-year mortgage rate nearly back to 7 per cent, challenged affordability at the entry level may weigh on demand in 2025," said Bobby Missar, who covers US homebuilders. He added that his companies were in a good position to offset that with incentives for buyers.

High hopes

Fidelity's analysts are paid for the detailed insights they generate on their sectors and companies, and it is no surprise that this year's survey contains competing messages on the impact of the new administration. But for US companies, the overall verdict leans positive: 47 per cent of our North American analysts said management at their companies were more confident about investing over the next 12 months. That number is three times what it was a year ago.

AI's big breakthrough won't happen this year

Artificial intelligence is expected to have a minimal impact on companies' profitability in 2025, with most of its potential still some years away. For now, though, the big names in technology are still going strong as they prepare the ground for this brave new world.



Viral Patel
Director of Research

Will 2025 be the year AI takes over the world? The word from our analysts is: don't get too excited. At least, not yet.

> "AI remains more of a buzz word than a profit driver at the moment."

Our annual survey shows a small drop in the proportion of Fidelity International analysts who expect AI will have a positive impact on their companies' profitability in the year ahead compared to this time 12 months ago. A large majority (72 per cent) expect AI to have no impact this year.

Chart 7: A stagnant buzz

What impact, if any, do you expect AI will have on your companies' profitability over the next 12 months?

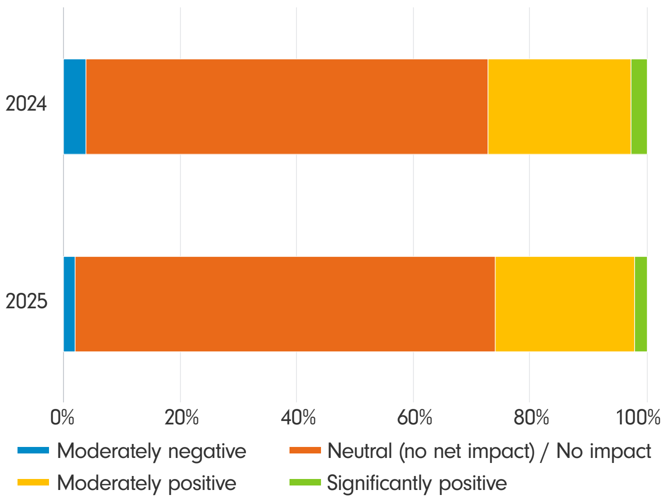


Chart shows percentage of analysts responding to the question. Source: Fidelity International, January 2025.

"AI remains more of a buzz word than a profit driver at the moment," says Evan Delaney, a telecoms, media, and technology fixed income analyst focusing on North America. Yet he does expect AI will have a moderately positive impact on his companies' profitability this year, thanks largely to an automation of call centres and other customer service activity using the technology.

Back-office activities and customer service functions dominate the examples Fidelity's analysts give of how the companies they talk to are currently using AI.

Chart 8: How are companies using AI?
Which parts of your companies are seeing material benefits from the use of AI?

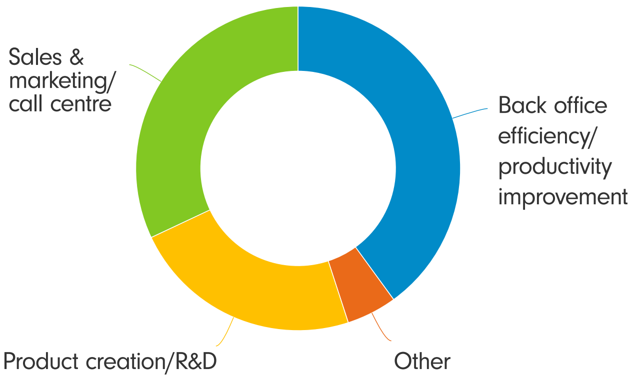


Chart shows percentage of responses to the question. NB Analysts could choose more than one option. Source: Fidelity International, January 2025.

"My payroll companies are all talking about adding AI chat bots and replacing HR employees with it," says Nathan Ha, a commercial and professional services equity analyst. "This won't be a gamechanger though as I think any edge will be competed away."

While most analysts say at least some of their companies are seeing productivity benefits from AI, by far the most common response is that this applies to only a minority of the companies they cover.

Chart 9: AI is beginning to make an impact, but it's small
What share of your companies are seeing productivity benefits from AI?

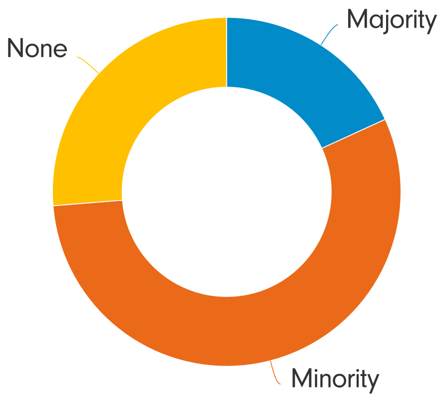


Chart shows percentage of analysts responding to the question. Source: Fidelity International, January 2025.

"Automation is already widely used on assembly lines but there's little application of AI," says Alan Zhou, a fixed income analyst covering the Asian automotive sector. "AI may be useful at the R&D stage to speed up product development but so far that does not seem to be the case."

This focus on automation hints at the pivot to robotics some tech companies are making as AI starts to mature. Reggie Pan, a China-focused analyst who covers the industrial sector, cites automation as the main use case for AI among his companies.

Andrew Hall, an equity analyst who covers North American grocers and convenience stores, says his companies are using AI mostly to optimise promotions and price setting. But, he adds, there's little evidence of a material change in effectiveness.

Another consumer staples analyst, Louis Lee, says that the Asean companies he covers have little use for AI because of the region's low labour costs. Sam Heithersay, who covers Australian metals and mining firms, says some of them are using AI to improve mine productivity and electricity grid use, but it's still in its infancy.

Interestingly, more analysts expect their companies will spend more on AI this year than expect them to materially increase their use of the technology. One interpretation is that software vendors are bundling unloved AI features into existing products and then using the extra features to justify a price hike. The cliché about picks and shovels comes to mind, when many gold rush prospectors came away empty handed no matter how impressive their newly bought tools might have been. Perhaps the most successful AI use case so far is channelling money into the coffers of tech companies.

Chart 10: AI costs expected to outpace usage

Do you expect your companies to materially increase their use of/spend on AI over the next 12 months?

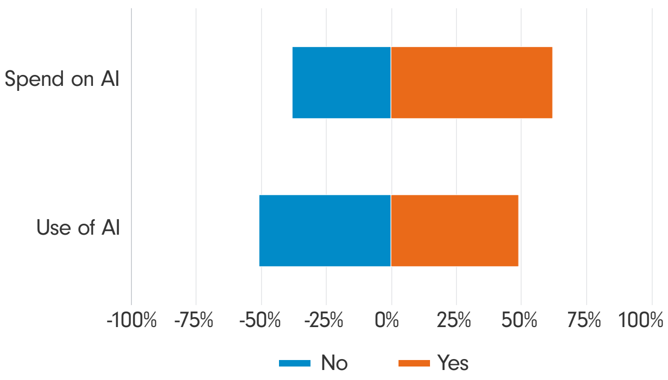


Chart shows percentage of analysts responding to the questions "Do you expect your companies to materially increase their use of AI over the next 12 months?" and "Do you expect your companies to increase their spend on AI over the next 12 months?" Source: Fidelity International, January 2025.

Another interpretation for expected spending outstripping use in 2025 is research and development. Unsurprisingly, it's IT, financials, and communication services companies that are making the biggest AI bets as things stand.

Indeed, we manage a team here at Fidelity that is working on several AI solutions to improve the speed and quality of insight generation, such as using the technology to build simpler models, to generate assessments of companies ahead of doing fundamental research, and to help analyse company results. The aim is both to complement our own work with ideas from the public arena, and more importantly to make the most of our time with companies, their customers, and their competitors.

Chart 11: Tech, financials, and others making big bets on AI

Do you expect your companies to materially increase their use of/spend on AI over the next 12 months?

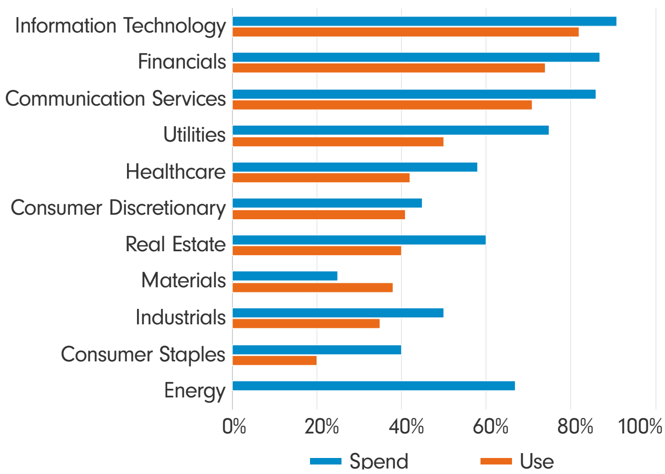


Chart shows percentage of analysts responding to the questions "Do you expect your companies to materially increase their use of AI over the next 12 months?" and "Do you expect your companies to increase their spend on AI over the next 12 months?" Source: Fidelity International, January 2025.

Investors will need to be patient for AI's impact

A lot more analysts expect AI will have a positive impact on companies' profitability over a five-year horizon compared to their more neutral expectations for the next 12 months.

As for how the technology will be used, the biggest potential over the next five years appears to be in the healthcare and financial sectors, via use cases like medical imaging, streamlining drug development and sales processes, originating loans, credit scoring, software improvements, and those ubiquitous back office and call centre applications.

Chart 12: Give it time

What impact, if any, do you expect AI will have on your companies' profitability over the next five years?

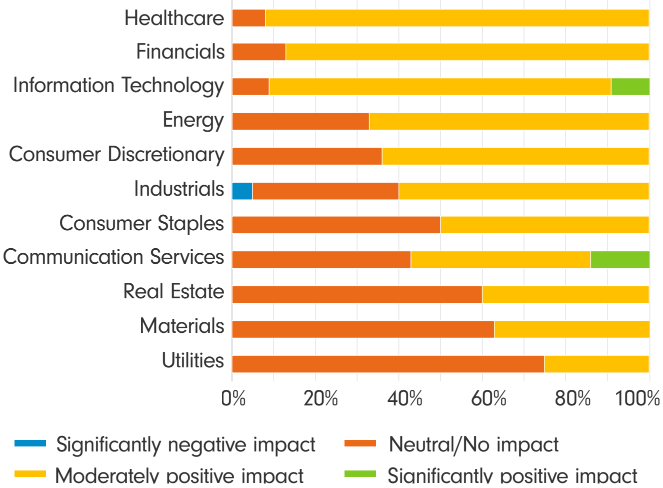


Chart shows percentage of analysts responding to the question. Source: Fidelity International, January 2025.

In the meantime, investors waiting to see big breakthroughs in AI adoption and killer use cases will need to wait. The question is, will they have the patience?

Tech tailwinds

The AI hype has been one of the big drivers of the surge in technology shares over the past 12 months and a failure of the sector's next big thing to live up to its vaunted promises would weaken the case for further gains. For now, however, there seems to be juice left in the tech orange.

"Tech has had a strong year and at this stage I don't see a strong valuation de-rating catalyst," says Clare Coleman, an equity analyst who covers software and internet companies across Asia Pacific outside of China and Japan. "However, maintaining current earnings momentum and delivering on consensus expectations will be pivotal. The sector is expensive as a whole but there are still companies with such strong structural growth that they will outpace more modest market growth and the risk-reward is still fair."

Investors will need to be especially selective when deploying money into those sectors showing most promise for AI longer term given the divergence in valuations.

Chart 13: Divergent valuations

Looking at valuations as we head into 2025, would you say the disparity in valuations among your companies is high, medium, or low?

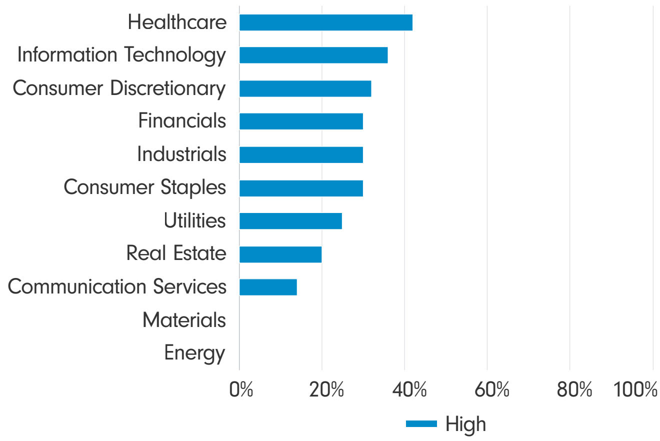


Chart shows percentage of analysts responding "High" to the question. Source: Fidelity International, January 2025.

Overall, more than a quarter of analysts (28 per cent) say there is a high disparity in valuations among their companies right now. Healthcare and tech have the highest proportion of analysts who see a wide divergence in valuations.

"There's very high disparity between high and low-quality names," says Matthew Bowles, an information technology sector equity analyst with a focus on the EU. "It's still difficult for small caps, as most end markets are weak or still correcting after Covid."

Keep in mind too our analysts' view that there are many factors that will impact firms' profitability this year, and that AI does not look set to be the dominant one yet.

China: Where investors should look as policy shifts

China is facing a series of economic challenges - a troubled housing sector, persistent deflation risks, sluggish consumer demand, and possible tariff hikes from the US. But Fidelity International's analysts on the ground in the country see a number of areas of promise as the government pushes ahead with supporting growth in 2025.

Monica Li
Director of Research

Doubts about investing in China re-emerged last year as the country grappled with a series of economic difficulties. But our annual Analyst Survey shows that the government's stimulus measures are expected to mitigate downward economic pressure and improve the earnings outlook for a number of sectors.

Chart 14: China analysts have high hopes for both fiscal policy...
What are your expectations for how fiscal policy will impact your companies?

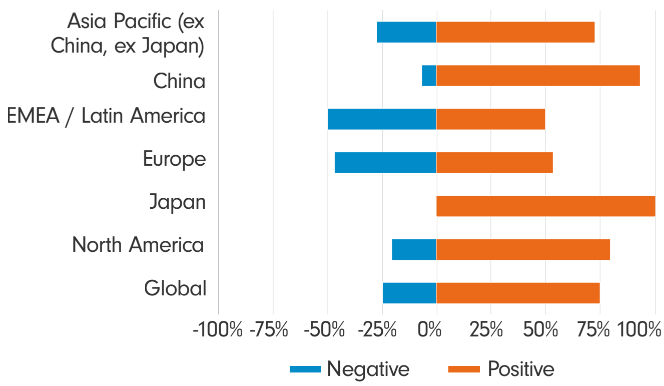


Chart shows percentage of analysts responding to the question. Analysts who responded "No impact" are not shown on the chart. Source: Fidelity International, January 2025.

Chart 15: ...and monetary policy
What are your expectations for how monetary policy will impact your companies?

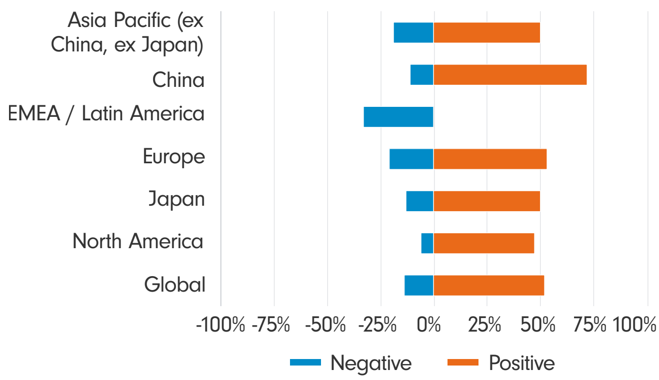


Chart shows percentage of analysts responding to the question. Analysts who responded "No impact" are not shown on the chart. Source: Fidelity International, January 2025.

Fidelity's China analysts have high expectations for fiscal and monetary policies in 2025: over 70 per cent of them say monetary policy will have a positive impact on companies' fundamentals, while more than 80 per cent say the same about fiscal plans. Both ratios are the highest in the world.

"The economy is slowing down," says Eric Tse, an equity analyst covering Chinese auto companies. "But the slowdown should be offset by stimulus policy to boost domestic consumption and reduce oversupply."

"It will encourage middle-class Chinese, who have excess savings and a demand for reasonable replacements and upgrades, to spend more on big discretionary items like appliances, furniture, and consumer electronics."

Pivot for growth

After months of piecemeal measures failed to revive the economy, China unveiled a broad package of stimulus late last year - including interest rate cuts, support for the property market, and offering citizens the option to trade in their old products for subsidised newer models in an effort to boost consumption. Leaders also pledged to expand fiscal spending and loosen monetary policy at December's Central Economic Work Conference, which sketches out economic targets for the year ahead.

Generating demand has become a high priority for China. At the start of 2025, the government expanded the consumer trade-in programme and increased funding for industrial equipment upgrades. Eric Zhu, an equity analyst covering consumer discretionary, says the stimulus will lead to a gradual recovery in that segment of the economy, which has so far struggled to bounce back.

"It will encourage middle-class Chinese, who have excess savings and a demand for reasonable replacements and upgrades, to spend more on big discretionary items like appliances, furniture, and consumer electronics," he says. "Additionally, China is relaxing visa requirements for foreigners, which will boost inbound tourism, helping the hotel, travel, and other related consumer sectors."

Earnings outlook

But there are uncertainties about whether stimulus measures like these will be sufficient to completely offset a combination of structural economic challenges and potential US tariffs. Domestic demand has struggled to pick up as the persistent real estate slump and the weak job market weigh on consumer and business confidence, which raises deflationary pressure even as the central bank has eased monetary policy.

On top of the domestic hurdles, pressure will come from abroad. US President Donald Trump, who took office earlier this month, has threatened to put tariffs of as much as 60 per cent on Chinese goods. According to our survey, 11 per cent of analysts say geopolitical risks will have a significantly negative impact on Chinese companies' fundamentals, the highest across the world. Two thirds see a moderately negative impact, the highest in Asia.

Chart 16: China analysts expect more downside from geopolitics

What impact do you expect geopolitical risk will have on your companies' profitability over the next 12 months?

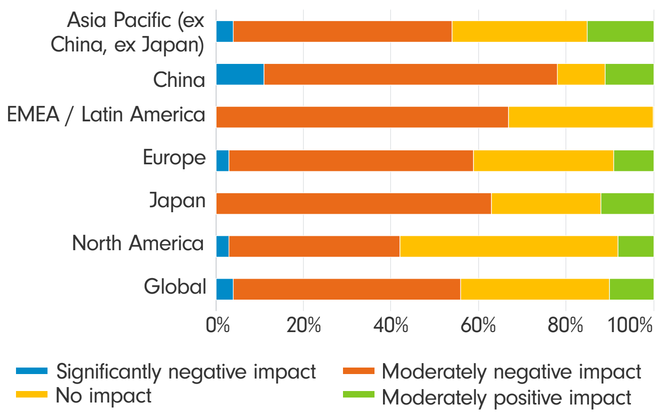


Chart shows percentage of analysts responding to the question "What impact do you expect geopolitical risk will have on your companies' profitability over the next 12 months?" No analyst selected "significantly positive impact." Source: Fidelity International, January 2025.

As the winner in the tug of war between policy stimulus and macro challenges isn't yet clear, less than half (44 percent) of analysts in China expect their companies' margins to moderately increase over the next 12 months, compared with 67 per cent in Japan and 56 per cent elsewhere in Asia. Of the China respondents, 44 per cent estimate margins will stay the same and 11 per cent estimate a moderate deterioration.[1]

"Management teams of domestic-facing companies will need business momentum to pick up before they are more confident to invest," says Teddy Gao, an equity analyst covering small-cap companies. "That being said, export-facing companies will step up on capex to relocate capacity out of China."

More than half (56 per cent) of analysts say the confidence levels of management teams is the same as last year. Only 28 per cent are more positive.

Notable exceptions

Nevertheless, there are plenty of stories Fidelity's analysts have unearthed across sectors in China that give them reasons for optimism.

Duanting Zhai, a healthcare equity analyst, sees incremental improvements in Chinese medical equipment companies' fundamentals in 2025 as they benefit from the government's trade-in programme.

Most importantly, she says, domestic players tend to be quick in upgrading their technology and narrowing the gap with global peers, which will help them gain market share over the long term.

Dividends and buybacks are moving up the corporate agenda. Alex Dong, an equity analyst covering consumer staples companies, says stocks with sustainable earnings streams and growing dividend payments will be more resilient amid the gradual recovery of consumer demand.

Around 60 per cent of Chinese analysts expect the companies they cover will moderately increase total dividend payouts this year. That's higher than the 38 per cent in Asia (ex China, ex Japan), although it still lags behind Japan, which stands at almost 90 per cent - the highest in the world.

In the face of US trade sanctions, China has stepped up support for the local semiconductor industry, seeking to become self-sufficient in chip production. Home-grown semiconductor tool makers are starting to make headway in developing more sophisticated machines to produce advanced chips.

[1]EBITDA margins

"Chinese equipment suppliers are still playing catch-up with the US and Japanese leaders," says Allen Yang, an equity analyst covering semiconductors. "But Chinese chip makers are actively replacing western suppliers with domestic options due to geopolitics. I see large potential for revenue growth for domestic equipment makers."

Another intriguing story is Chinese companies' overseas expansion. China's leading battery makers and auto part suppliers have built manufacturing facilities abroad to better capture the opportunities presented by the era of electrification and digitisation, says auto analyst Tse.

"Chinese companies' heavy investment in R&D and access to the world's largest electric vehicle market will help them maintain technology leadership and enhance their competitive edge over international peers," he says. "Chinese suppliers with dominant market shares will be able to pass cost increases from rising protectionist measures on to customers."

Although there is some way to go before China can welcome a full-scale economic recovery, it's the businesses that have built resilience that are likely to thrive as further stimulus is delivered – perhaps emerging even more vibrant than before.

Aircon: The new symbol of India's growth story

Akshen Thakkar
Investment Analyst

Improvement in everyday life is being signalled by something more practical in India's scorching climate - a green flag for leading white goods companies.

If you want evidence of increasing spending power in India, go to an Indian wedding. Whereas 10 or 15 years ago, parents might have brought along a bike or a scooter (essentials for any Indian with a commute), newlyweds can now also expect air conditioners and refrigerators. That shift is sweeping across both rural and urban areas. It's what I've heard repeatedly from the distributors of white goods while travelling the length and breadth of northern India - one of the great joys of my job covering India's consumers, who spend USD 1 trillion a year on merchandise.

But even before hitting the road, I had a hunch. One leading cooling and refrigeration company has been a top performer in my coverage. Revenue at the AC segment of this company grew at a compound annual growth rate of 14 per cent between the financial years of 2013 and 2023, and the stock has risen over 100 per cent since the start of 2024 and over 200 per cent since the start of 2023. Demand for its air-conditioning has remained strong despite an overall slowdown in consumption in India in recent years. We're expecting revenue in aircon sales across the industry to rise by 20 per cent in 2025.

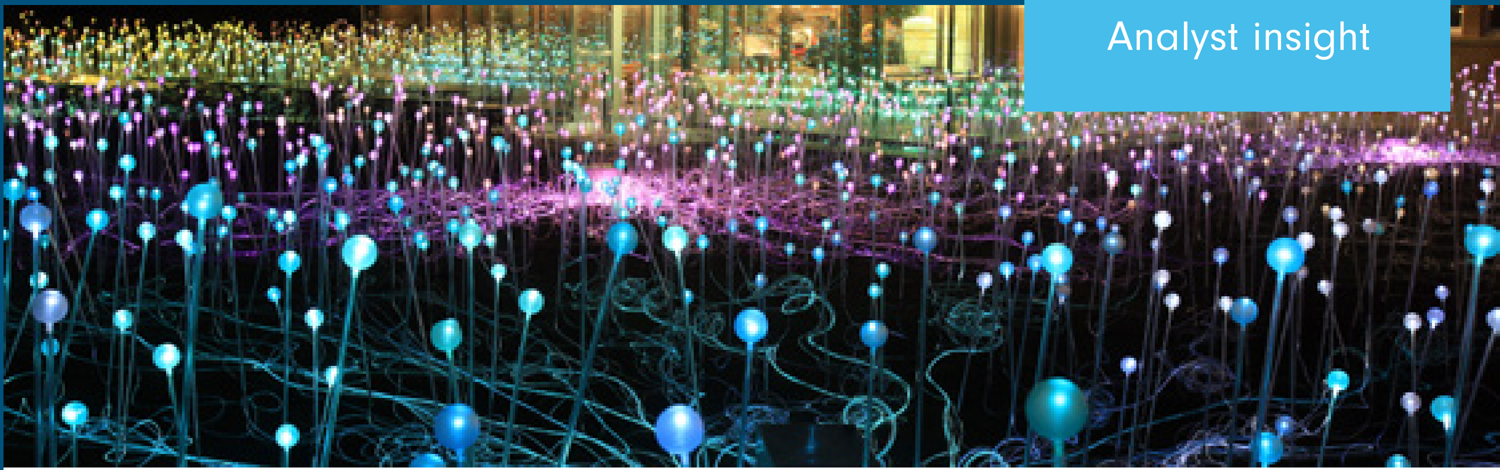
Behind this company's rise is a classic emerging market tale. A growing middle class means more people can afford air-conditioning and other 'aspirational' consumer goods (for context, India's middle class, more than 400 million-strong, could more than double to a billion before 2050). With domestic household penetration just above 10 per cent, India's AC market has a long growth runway when compared to other emerging Asian economies such as China, which stands at 80 per cent, or Indonesia, at 36 per cent. While India's GDP per capita (almost USD $2,700 in 2024) is far from $10,000 - the threshold at which AC penetration tends to jump - India has 60 million people with annual income greater than $10,000. These are key target customers for AC companies, and this group could grow to about 100 million by 2027.[2]

Climate change is expected to steepen that demand curve. A summer of record high temperatures in 2024 - north of 50 degrees Celsius in some cases - has underscored aircon as increasingly necessary across this vast nation that sits just above the equator. The International Energy Agency (IEA) estimates India could have 1 billion AC units by 2050 - about half of the current worldwide tally. Where household income falls short, white goods companies offer consumer finance, not unlike loans for cars in developed economies. Both of these factors skewer growth expectations to the upside.

Admittedly, the macro backdrop has been largely disappointing, despite a brief post-pandemic bump. High inflation, high interest rates, and a lack of real wage growth have all eaten into households' budgets. Severe weather disruptions over the past year added to the pain. The hope is that we're nearing a turning point as inflation shows signs of easing. External factors should help, too. Hiring could pick up pace, as the IT services sector, one of the largest employers in India, benefits from more spending by big US corporations. Expected monetary and fiscal stimulus will also provide support.

If the story of air-conditioning has taught us anything, however, it's that strong companies in India can grow regardless of the economic environment. That's why we remain undeterred by price-to-earnings ratios as high as 50 times in this sector. As white goods spread more widely as a symbol of affluence, more companies are likely to fall into this exciting bucket of stocks.

[2]Goldman Sachs



Opportunity rings in US telecoms

Evan Delaney
Senior Credit Research Analyst

A shift in sentiment around fibre optic technology in the US has brought about a recovery for many smaller companies and looks set to prompt a surge in M&A.

There was an extraordinary turnaround for many US telecoms companies in 2024. Firms that had been teetering on the edge of bankruptcy are now back on solid footing.

Historically, the industry has had a reputation for being a staid, slow-moving business. It's a highly capital-intensive sector, and because it takes a lot of money to upgrade networks - and because returns can be underwhelming - there's been a history of underinvestment across legacy firms.

But change is afoot, not least because of the growing demand for fibre optic cabling. Fibre is becoming increasingly important as more consumers expect it for their homes, but also as companies further integrate AI and machine learning into their business models, requiring enterprise grade long-haul fibre that can move vast volumes of data at speed. While these trends have not changed the underlying economics of the sector, and the hype around the future demand for AI may be a little frothy, it's not an understatement to say the shift in market sentiment that has come on the back of these two pillars of demand has saved the industry - at least for now.

In particular, we've seen a real turnaround in the perception of companies that specialise in fibre to the home. This has always been an expensive process - it can cost up to USD $1,500 to run fibre to a residential property, and then around $600 to connect each customer to the network. Many of these businesses have struggled as they wait to realise returns on their investments. Frontier Communications, for example, filed for Chapter 11 bankruptcy in 2020, while Lumen Technologies went through an aggressive restructuring and debt exchange as recently as November when it couldn't meet its repayments.

Stories like these are what have led to the hesitancy of big telecoms companies to step into fibre. But the growth in demand and cheap valuations has already led to some large M&A deals in 2024, with the potential for more to follow. Although the cash flow of the fibre firms may be challenged, they operate long-term, future-proofed technology that's cheap to operate and easy to upgrade. These strengths, combined with a fall in values during the market trough in 2022 and 2023, made fibre companies an attractive buy for larger players.[3]

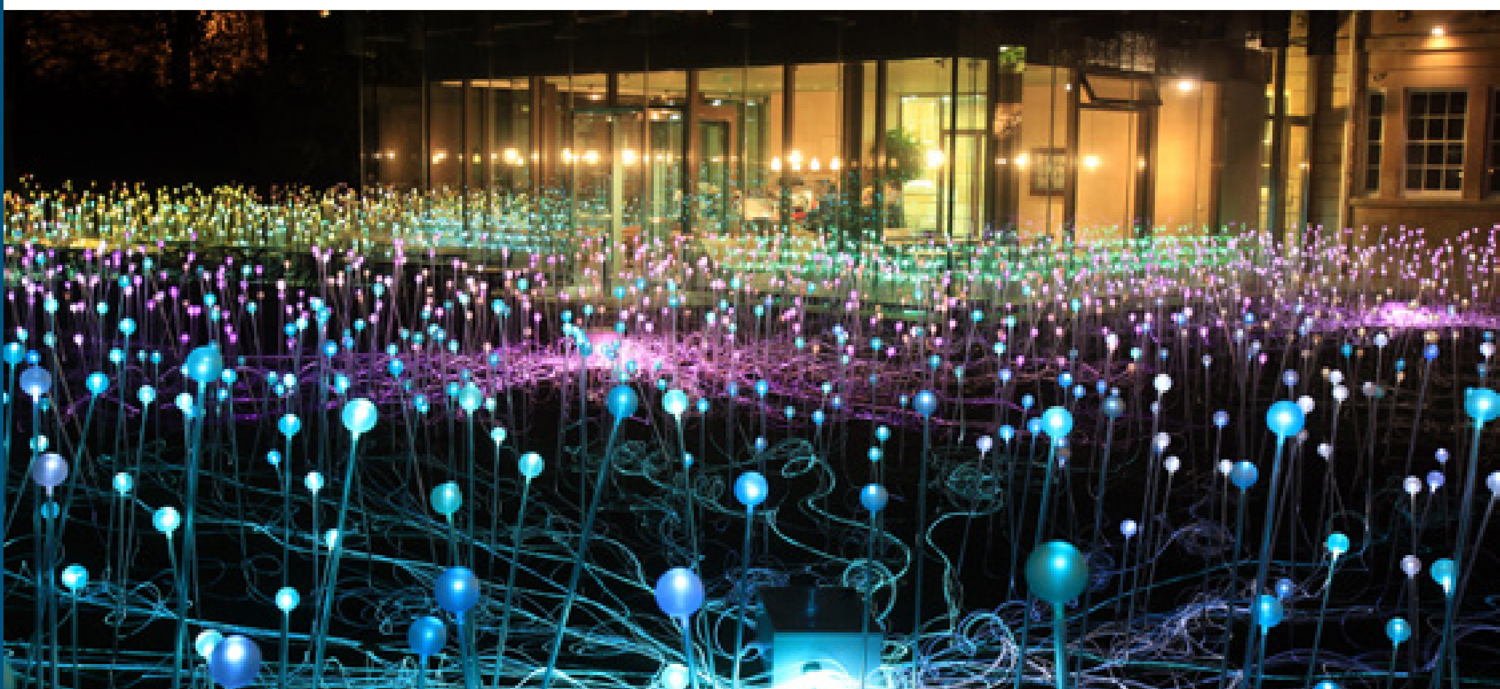
In the fourth quarter of 2024, Bell Canada announced that it was buying Ziply Fiber, while Verizon has launched its intention to acquire Frontier for $20 billion. These transactions have opened the floodgates, and now any fibre company that's not already part of a larger TMT conglomerate is a potential candidate for a takeover.

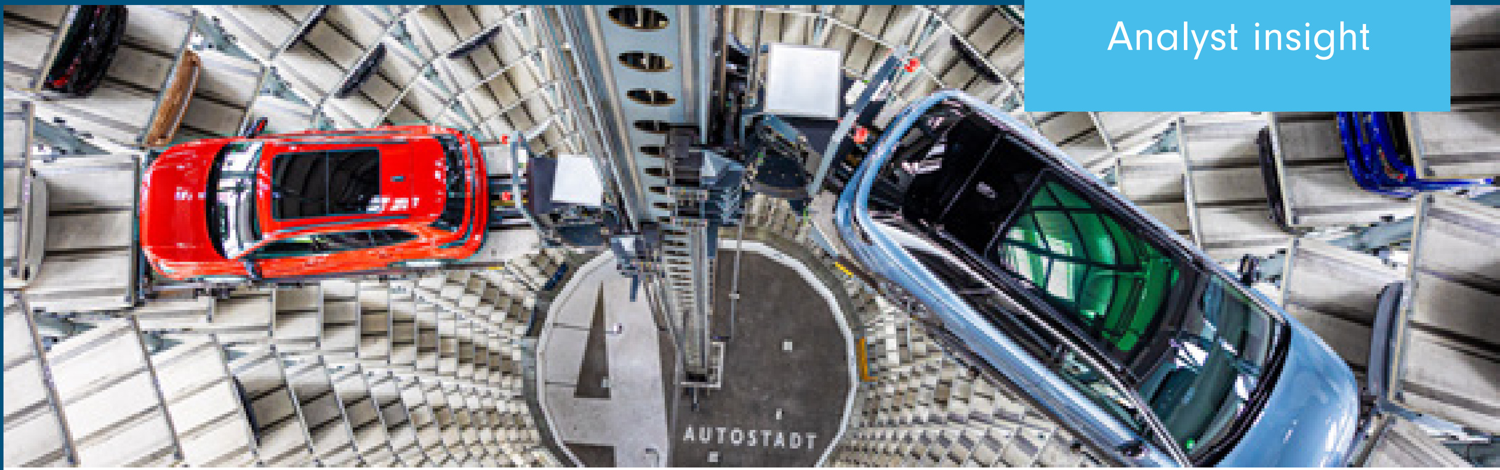
The availability of capital, the relative political stability in the US, and the prospect of the appointment of a third Republican commissioner to the Federal Communications Commission in 2025 all suggest that the backdrop for getting new deals done is going to be much stronger.

We had always believed that the wider market was overly pessimistic about the valuations on these fibre names. Uniti's unsecured bonds, for example, rose significantly in value from around $60 to nearly $90 last year. While these names have experienced a high degree of price volatility, the underlying trend has vindicated our view.

In general, there was a huge rally in distressed assets in the last half of 2024. Investors, fearful of missing out on any returns, have been piling into the more risky end of the ratings scale. This hype itself may now be a little overdone, and I believe as the dust settles in 2025 we'll see a return to a focus on fundamentals and where the real strength of these companies lie.

[3]The ratio of these companies' earnings versus their value fell as low as five to six times during this period





Don’t write off legacy carmakers

Tanay Dixit
Equity Research Analyst

Investors are turning their backs on traditional carmakers as they appear to fall further behind dedicated electric manufacturers. Their thinking is misguided - and that leaves carmakers undervalued.

The market is overemphasising the existential risk for legacy carmakers from the electric vehicle (EV) transition.

Instead of crowding the former out, I see market share being split between those legacy auto names and the sole-EV producers, like Tesla and BYD. The market does not share my view, and is fairly consistently pricing the legacy companies to zero over the long term. If I’m right, then investors are overplaying the comparative advantage of the new EV companies and undervaluing their traditional counterparts. It will take some time for the market to adjust, but it could reward those who are willing to endure the ride.

The trouble for legacy names lies in transitioning an entire production line and supply chain network from an internal combustion engine (ICE) model to an EV one. These firms didn’t help themselves by being slow off the mark when EVs first appeared on the scene, ceding an early advantage to companies which channelled all their resources into EVs from the start. EV companies have capitalised on that head start and are now building more advanced software into their cars, much of which is designed in-house.

That said, things aren’t as bad for the legacy companies as they may seem. The conversation around Volkswagen, for example, and the cuts it’s been making recently, arguably is overblown. Every company has had to slash its cost base to keep up with Chinese producers. I expect to see a realignment of legacy business models, with greater emphasis on software development, electronic architecture, battery production, and vertical integration across the supply chain. It is of course likely that some companies will fall by the wayside. But it won't be the bloodbath the market currently predicts.

It's not as if sole-EV companies have had it all their way either. The rollout has taken longer than expected, with adoption rates in the US and Europe hovering around 10 and 20 per cent, respectively. There remain concerns over the driving range of current EV models, and it's proven challenging to build out the required charging infrastructure. They are also still much more expensive than ICE cars because battery costs remain high.

And while there's plenty of emphasis on high Chinese production rates, these companies have also faced challenges in penetrating the West. Here their upstart status counts against them - consumers remain anxious about the availability of spare parts and long servicing times, for instance. Brand recognition is also an issue.

I think we will see a lot of these competing dynamics come to a head in 2025. There will be plenty of churn. Volkswagen will attract more attention as it continues to cut costs. If it's successful in doing so, other smaller companies will follow suit. Meanwhile the market will continue to devalue these companies, many of which are already trading on a 40 to 50 per cent discount to their long-term valuation multiples.

At the same time, you're also seeing Chinese companies become more active in Europe. BYD, for instance, plans to open a factory in Hungary this year, with an intended building capacity of 200,000 cars a year that could ramp up as high as 1 million over the next few years - for context, there were around 13 million cars bought in Europe in 2024.

The car industry could exit 2025 looking a fair bit different from how it entered. But I don't think investors should be writing off their old holdings just yet - they still have plenty more miles left to run.

The upside of Japan's digital cliff

Noriyuki Takizawa
Research Analyst

2025 could be the year the Japanese economy begins losing tens of billions of dollars through data losses and system failures due to outdated technology. But a successful leap over this so-called 'digital cliff' would supercharge overdue upgrades - and growth at the most resilient IT service companies.

It is an often-cited paradox that as the leader in robotics, Japan is also one of the few countries that still embraces the fax machine. Home to the world's largest technology-focused venture capital fund, corporate Japan scarcely invests in its own tech talent. Cloud penetration lags far behind the US and Europe. The country's digital infrastructure has been in such a state that the government fears the economy could lose 12 trillion yen (USD $77 billion) a year if it fails to catch up in digitisation by 2025. But I believe it'll be IT services companies, which have long been the speedbumps to digital upgrades, that will benefit the most from this catch-up trade.

The problem can be traced back to a complex web of contractors. Unlike in most other developed markets, Japanese businesses prefer to outsource IT tasks to so-called 'system integrators' - vendors that delegate everything from hardware manufacturing to software development to sub-contractors. While this model relieves big corporates of troublesome tech projects, it has also driven up costs in the long run, hollowed out in-house tech talent, and created a sticking plaster approach to IT systems.

The irony is that Japan needs these IT services vendors now more than ever, as it races to catch up in digitisation. Heeding the government's call, businesses rushing to digitise are turning to the vendors for big-ticket transformations, such as cloud transition. In response, IT services vendors are starting to act more like consultants with wholesale solutions, rather than fixing one bug at a time - a change that gives them greater access to management teams, and, ultimately, more commercial opportunities. The impact is immediate and apparent. Nomura Research Institute (NRI), a leader in digital transformation with a strong consulting unit, has expanded return on equity from 11 per cent in 2017 to 20 per cent in 2024.[4] Fujitsu, which is even more well-known, is also improving operating margins - from 4 per cent in 2024, to an estimated 12 per cent in 2026 - after implementing a strategy akin to NRI's.

There is, however, no quick fix to the shortage in tech talent. The government warned in 2019 that Japan could face IT staff shortages of up to 800,000 by 2030. Some projects could get pushed back due to a lack of engineers. More likely is an incremental rise in wages in 2025 as the country approaches its digital cliff, which would favour bigger players that are able to pass on additional labour cost to clients. The fact that big companies and the government – at both central and provincial levels – are bearing the brunt of this digital upgrade will benefit larger contractors that have the scale and resources to take up such projects. The money's already trickling through. The Bank of Japan's Tankan survey shows software investment by companies has grown by double digits in 2022 and 2023, and are estimated to have expanded another 14 per cent in 2024.

But it's also worth watching smaller players, some of which are likely to start looking attractive for acquisitions. Value stands to be unlocked where there are clear advantages - for example, in the recent purchase of Net One, a cloud network integration specialist, by system integrator SCSK.

Smaller companies with strong management also have the potential to grow faster than more established competitors. The rapid growth of a new digital consulting unit at Simplx, which specialises in financial markets trading systems, has helped the company deliver a 32 per cent compound annual growth rate over the past five years - a pace that larger players can only dream of. Engaging with companies will be critical to capturing these event-driven opportunities in the sector, which could be some of the most rewarding in Japan's 2025 transformation.

[4]Financial years, which end in March in Japan

Insurance mid-market risks flying under investors' radar

Charles Jordan
Equity Research Associate

European mid-cap insurance names remain an overlooked sector, and exposure to this area of the market may add to the nuanced benefits of their large-cap counterparts.

From an equity market perspective, insurance is clearly a popular pick for investors. In Europe, this is a sector where large-cap names have consistently outperformed the index over the past decade, and there are still plenty of opportunities to complement this with names in the mid-cap portion of the industry that remain underappreciated.

In Europe, all non-life insurance markets are well differentiated. The UK is a hyper-competitive market because customers rely so much on price comparison websites. Although car insurance prices rose around 30 to 50 per cent in 2023, this momentum fell sharply over 2024 as companies competed for new customers.

Conversely, in markets such as Norway the industry is far more consolidated. There, customers are likely to have multiple policies with one firm and will remain loyal for several years. Scandinavian insurers can therefore take a slower but steadier approach to pricing, consistently applying increases over several years to maintain profitability.

One theme that binds these very different markets together is continued consolidation through M&A. The insurers we speak to increasingly talk of the advantages of scale given the growing cost of regulation and the investment required to stay at the cutting edge of data analysis and technology. In recent years in the UK, we've seen Esure taken private by Bain Capital in a deal that offered a 37 per cent premium to the undisturbed share price, Hastings acquired by Sampo Group at a 35 per cent premium, and most recently Aviva agreeing to buy Direct Line for a 73 per cent premium.

Similarly in Scandinavia, Tryg acquired Alka, Alm Brand acquired Codan, and Sampo acquired the remainder of Topdanmark for a 27 per cent premium.

It's long been known that European insurers are attractive on a standalone basis. They offer high returns on capital, low-risk investment portfolios, and profits that are generally less correlated with the broader macroeconomic environment than companies in other industries. For example, buying car insurance is often a legal requirement, while people are less likely to cut back on their home or health insurance during a recession than more discretionary purchases. That sort of visibility of returns is attractive in any environment.

Insurers in the space typically offer starting dividend yields of 4 to 6 per cent, often supplemented by some form of extraordinary capital returns such as share buybacks that can add a further 1 to 2 per cent. There are opportunities for growth alongside this too as companies branch into new products or win more market share.

But the nuanced nature of the different European markets and where they're positioned in the pricing cycle, the perceived complexity of insurance, and the smaller size of some of these mid-cap companies means this remains an area of the sector worthy of investors' attention.

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Page 6: U.S. President-elect Donald Trump at his inauguration, Washington, DC, USA.
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Page 13 and 16: Sale stickers entice a customer at a supermarket in Lianyungang, China.
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Page 17 and 18: A factory employee wheels statcks of air conditioners in Ahmedabad, India.
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Page 19 and 20: 5,000 bulbs of light, threaded with fibre optic cables and planted in the ground.
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Page 21 and 22: Volkswagen cars are lifted out of boxes at Volkswagen Autostadt, Germany
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Page 23 and 24: Megaliths of light shine birghtly at Mifuneyama Rakuen, Takeo Hot Springs, Japan.
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Page 25 and 26: Radials of blue reflect in various panes of glass in Berlin, Germany.
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