Fidelity Multi Asset | December 2018

Asset allocation view

As we head into the closing stages of 2018, commentators are re-working their year-in-review pieces which were probably going to focus on continued low volatility, and tech-led US stock market divergence from the rest of the world. Instead, the fourth quarter has seen an upsurge in volatility, a crack in the infallibility of the FANG stocks, and equity markets in the US back to around zero return territory for the year. Oil has also sold off significantly, down around 30% from its four-year high in early October, and credit markets like US high yield are under pressure. While we aren't yet running to the exits, and have been positioned well for the significant change in conditions, we have taken a slightly more cautious stance by moving to a neutral position in fixed income, and maintain our relatively defensive exposure to equity markets.

For many of our team based in London, Brexit is clearly front-of-mind, and the tail risk of an acrimonious 'no-deal' divorce could be wide. But contagion from Brexit is far from Europe's only worry. Perhaps more concerning is the performance of Germany, with the region's economic powerhouse posting its worst period of quarterly output since 2013. With uncertainty in Italy continuing, and the ECB still signalling the path to normalising interest rates, the outlook is not positive in the near term, and has led us to an underweight position in the region.

As we move into 2019, the range of potential outcomes, both positive and negative, is phenomenally wide. Will the Fed slow the pace of its tightening path, as the market interpreted from Powell's most recent speech? Or will the G20 summit produce a détente in the US/China trade war? Both these potential outcomes could lead to a resurgence of risk-on sentiment, at least in the near-term. Investors looking to recoup their losses may also come into play to fuel a risk-on trade, and we will be closely watching technical indicators for this eventuality.

In this highly uncertain environment, we will continue leveraging the wide range of instruments and asset classes at our disposal to both protect capital, and find the sources of alpha that will undoubtedly come with increased volatility.

Yours faithfully,

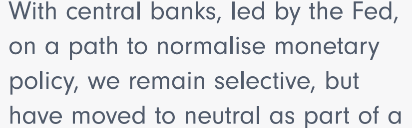
James Bateman
Chief Investment Officer - Multi Asset

In brief

Equity

Volatility has continued in equity markets, but there remains the possibility of a late-cycle rally. We maintain our bias towards downside protection within equities, however.

Fixed income



With central banks, led by the Fed, on a path to normalise monetary policy, we remain selective, but have moved to neutral as part of a continued tilt towards defensiveness.

Cash

We have moved back to neutral on cash given our desire to increase duration as a hedge position.

Macro

The Fidelity Leading Indicator (FLI) still indicates 'decelerating below-trend growth', but is moving towards 'improving'. However, we are cognisant of front-loading in Asian supply chains driven by the fear of further tariffs impacting this shift.

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Views from Fidelity Multi Asset

Strongly negative ○ ○ ○ ○ ○ Strongly positive

Asset Class	View	Rationale
Regional Equity		
US	○○●○○	Equity markets continue to struggle, but economic performance is still substantially outperforming the rest of the world. Most of all, the US remains a defensive market relative to its global peers, keeping us at neutral.
UK	○○●○○	While a draft Brexit deal has materialised, the cross-party support needed to get it through parliament does not appear forthcoming, and sentiment is broadly negative. However, valuations are attractive, leading us to close our underweight.
Europe ex. UK	○●○○○	Political uncertainty continues across the continent. Most worrying is Europe's EM- and China-dependency. We rotate our negative UK view into Europe.
Japan	○○○●○	Japan remains defensive and politically stable relative to other global equity regions. It is externally exposed like most countries, but the domestic picture is about as good as it has been for decades.
Asia Pacific ex. Japan	○○●○○	Trade war uncertainty continues as the G20 summit looms. We are waiting to see if China engages in more direct and impactful policy stimulus, but remain concerned that growth will slow further in 2019.
EM	○○●○○	We are not ready to go overweight EM, due to China concerns. However, sharp oil price falls have helped vulnerable importers like India and Turkey. A softer Fed and USD in 2019 could be the catalyst to turn positive.
EM - EMEA	○○●○○	Turkey has improved significantly, with the recent fall in oil prices an additional tailwind. Meanwhile, Russia as an oil exporter faces headwinds. South Africa looks challenged, but incrementally better.
EM - Americas	○○●○○	Mexico and Brazil have faced starkly diverging fortunes. The former has plunged on fears around the new administration's policies, while the latter has held up very well. Both look like overreactions.
Fixed income		
US Treasuries	○○●○○	US treasuries are becoming more attractive as a safe haven and we are drawn to US duration exposure. We are watching technicals closely as issuance is set to be strong given the US need to fund the fiscal deficit.
Euro core (Bund)	○●○○○	While Bunds remain a safe haven relative to the periphery, ECB policy has kept absolute yields depressed and we don't see meaningful upside.
Euro periphery	○●○○○	We remain underweight as short-term moves in Italian yields are being driven by newsflow. Other periphery countries are holding up better, but the Italian situation remains highly unpredictable.
Inflation linked bonds (US TIPS)	○○○●○	Inflation is still relatively muted, but wages and interest rates continue to rise. Oil has sold off significantly, but we still maintain a positive outlook on US TIPS as a defensive position.
Investment grade bonds	○○●○○	We maintain our selective bias towards short maturity, high quality issues given a deterioration in the asset class in recent weeks.
US high yield	○●○○○	The asset class faced a difficult month in November, driven by fears of increased refinancing costs and a sharp drop in oil prices. With these conditions unlikely to recede in the near term, our outlook has moved into negative.
European high yield	○●○○○	We maintain our negative view as political and trade policy uncertainty continue, and vulnerability to ECB policy is still an issue given low absolute yields.
Asian high yield	○○○●○	With resilient fundamentals and falling leverage despite trade war tensions, the asset class is attractive, especially relative to other high yield bond markets.
Hard currency emerging market debt	○○●○○	Remains vulnerable to tightening financial conditions, but the outlook continues to improve and valuations are attractive. We have moved to neutral.
Local currency emerging market debt	○○●○○	The asset class has been resilient in the face of volatile markets in recent months, and the outlook is improving after struggling earlier in the year.
Emerging market corporate debt	○●○○○	With global credit markets beginning to show signs of weakness, this area of the market remains vulnerable especially given continued USD strength.
Currency		
USD	○○●○○	Recent Fed rhetoric has softened, emphasising a return to 'data-dependency'. As the economy and the Fed slow down in 2019, and 'twin deficits' come back into focus, the best of USD performance looks to be behind it.
EUR	○●○○○	Disappointing core inflation compounded by poor PMI surveys, the ECB on hold until at least late 2019, rising political risks, and slowing external demand all add to downward pressure on the Euro.
JPY	○○○●○	JPY remains attractive as a relatively cheap defensive asset. Upside potential as BoJ moves to normalise policy.

Source: Fidelity International, as at December 2018.

These are the broad based views arrived at during our monthly Asset Allocation Group meeting, which includes portfolio managers and senior research personnel from Fidelity Multi Asset. The views reflect a time horizon of 12–18 months, and provide a broad starting point for asset allocation decisions. However, they will not necessarily be used as a direct input into portfolio construction for investment strategies where portfolio managers have greater discretion on asset allocation.

Fidelity Multi Asset

Fidelity has a significant history in multi asset investment, having managed multi asset portfolios since the 1980s. Today, Fidelity Multi Asset manages $41bn[1] of assets for institutional and retail clients, with a team of 32 investment professionals spread across global regions. These investment professionals are supported by dedicated implementation, operations and client servicing teams, working to deliver the optimal outcomes for clients through time.

	Client outcomes	Example funds and strategies
Outcome focused		
Income	Stable income distribution with capital stability	▪ Fidelity Global Multi Asset Income Fund ▪ Fidelity Multi Asset Income Fund ▪ Fidelity Multi Asset Income & Growth Fund ▪ Fidelity Multi Asset Balanced Income Fund
Risk Rated and Open Architecture	Range of strategies with a spectrum of risk/return profiles	▪ Fidelity Multi Asset Allocator range ▪ Fidelity Multi Asset Open range
Volatility Targeted	Capital growth with controlled volatility	▪ Fidelity Systematic Multi Asset Risk Targeted (SMART) Funds ▪ Fidelity Diversified Growth Fund ▪ Fidelity Diversified Markets Fund
Tactical Total Return	Capital growth with focus on downside protection	▪ Fidelity Global Multi Asset Tactical Funds ▪ Fidelity Patrimoine
Benchmark-aware		
Strategic Benchmarked	Adding value versus a given benchmark or strategic asset allocation	▪ Fidelity Euro Balanced ▪ Fidelity Select 50 Balanced Fund
Equity Multi Manager	Equity-benchmarked global and regional funds using Fidelity underlying managers	▪ Fidelity International
Target Date / Rolldown	Progressive decrease in volatility	▪ Regional target date strategies in Europe and Asia

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[1] Fidelity International. Assets and resources are shown as at 31 October 2018.

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