Fidelity International 2010 Market Outlook

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ASIA

Maria Abbonozio
Investment Director, Asia ex Japan

Equity-friendly conditions are expected to remain and Asia Pacific economies will be the place to invest with robust economic conditions to continue throughout 2010.

Asian markets remain attractive for investors but the degree of confidence in the region in 2010 will depend largely on the pace of economic recovery in the West and the extent to which growing domestic demand in Asia can offset the region's reliance on exports. The structural story in Asia remains intact and the region is in a fortunate position whereby government, corporate and personal balance sheets are healthy which is a very different story to many Western economies.

There are four key differentiators which will drive future growth in the region: natural resources wealth, emerging industries, the low cost of manufacturing and the growing consumer class.

Asia's geography is heavily endowed with natural resources, including coal, oil and natural gas. We have seen a number of international companies embark on or look to form joint ventures in countries such as Australia and Indonesia and this foreign investment will continue.

Asia also has a number of emerging industries and deeper markets are starting to develop as more foreign capital flows in. China is a good example of this. For example, there are a number of local companies that are currently developing jet airlines which are set to compete with the existing duopoly of Airbus and Boeing.

Low cost manufacturing continues to be a competitive advantage for most Asian countries and developed market dollars have flowed into the region in search of cheaply manufactured goods and low cost production and in 2010, this trend will continue. And of course, Asia has a growing consumer class and demand for western-style consumer goods will grow exponentially as a result of growing prosperity across the region.

INDIA AND EMERGING ASIA

Teera Chanpongsang
Portfolio manager of Fidelity Funds - Emerging Asia Fund and Fidelity Funds - India Focus Fund

Emerging Asia presents a strong long term investment opportunity. Early signs of a recovery are visible in recent economic indicators and earnings upgrades. The region has one of the strongest GDP growth rate in the world, driven by favourable demographics and healthy population growth, which means more people are added to the region's work force. Low penetration of various consumer goods and services and rising income levels imply significant consumption growth potential. The key overweight positions in this portfolio are in the consumer discretionary, financials and technology sectors.

In India, a key theme that I am playing is a further recovery in the domestic economy. Consequently, the portfolio is overweight in the consumer discretionary, financials and industrials sectors. The overweight among software services exporters is because of the prospects for - and India's strong position in - the global outsourcing industry. Favourable demographics, less reliance on exports relative to regional peers and strong domestic consumption trends bode well. A stable government at the centre for the next five years should drive future reforms and fulfil infrastructure development needs.

CHINA

Martha Wang

Portfolio manager of Fidelity Funds - China Focus Fund

I remain positive about China given the economic growth momentum and government's inclination to ensure the rapid pace of expansion. The crisis management programmes deployed at the end of 2008 could be gradually scaled back as stimulus measures gain traction and market participants and policy makers feel more confident that recovery is sustainable. However, the government is focused on transforming the economy into one which is more reliant on domestic sources of demand and hence some of the measures are expected to continue.

The rollback undertaken so far has mainly focused on preventing risks associated with overheating of the economy, such as dropping incentives on second mortgage lending. In its latest report, the Asian Development Bank revised its forecast for China's economic growth this year to 8.2% from its 7% estimated earlier, and expects it to grow 8.9% next year, on likely maintenance of its fiscal stimulus while the global economy recovers moderately. At the same time, equity market sentiment will probably remain volatile until investors are convinced that there is indeed a meaningful gap between the end of easing and the beginning of tightening.

SOUTH EAST ASIA

Allan Liu

Portfolio manager of Fidelity Funds - South East Asia Fund

In 2010, I believe that Asian equity markets should continue to do well. Economic fundamentals remain strong, there continues to be a healthy population growth and the trend towards urbanisation and industrialisation will require infrastructure development in urban and rural areas.

The key opportunities to watch out for are in sectors benefiting from the healthy growth in domestic demand and a global economic recovery. Broadly, the fund is overweight in the consumer discretionary, financials and information technology stocks. I also have a marginal overweight in the industrials sector, given the increased infrastructure spending in the region.

JAPAN

Robert Rowland

Portfolio manager of Fidelity Funds - Japan Fund

My outlook for 2010 is mixed. The current economic cycle is improving from a very low base, with exports, industrial production and capacity utilisation in the driving seat. This has translated into a tentative recovery in corporate earnings and a number of companies have surprised the market with stronger-than-expected results and guidance at the interim stage.

While recent earnings upgrades are encouraging, there is a question mark over their sustainability because the absolute level of economic activity remains low and any further pick-up is likely to be focused on exporting sectors, with little prospect of an immediate recovery in domestic demand. Although corporate Japan has become less pessimistic, capex plans and earnings forecasts remain weak. Furthermore, employment and income conditions remain severe and deflationary trends are becoming more entrenched.

While a cyclical recovery in the global economy, the prospect of political change and structural reform and historically attractive valuations should support the Japanese equity market, the headwinds that Japan faces are not abating. These include potential political disappointments if the new government does not deliver the changes anticipated. Fundamental weakness in the domestic economy and the strength of the yen are other hurdles that need to be overcome.

US

Adrian Brass

Portfolio manager of Fidelity Funds - America Fund

Whilst the market has recovered significantly, there are still many reasons to remain positive. First, we remain a

long way off the 2007 peak, with the S&P 500 still at the same level it traded at back in 1998 following a 'lost decade' of performance. Second, valuations are still reasonable versus history on recovery earnings and cash flow-based measures. Third, earnings are likely to recover strongly from here and may continue to surprise versus expectations. This is due to corporate America having reduced costs more than at any time in the past fifty years. This has helped preserve cash flows in these difficult times, but will also produce new records in profitability for some companies as we move further into the recovery.

Risks to a sustained recovery remain focused on the government exit strategy from its quantitative easing and stimulus programmes and the impact of potentially higher taxes on a deleveraging consumer. My highest conviction ideas are in areas where the recovery is not yet priced in, such as the housing-related or semiconductor equipment sectors or, increasingly, in great quality, steady-growth businesses which have been left behind in the rally.

EUROPE

Alexander Scurlock

Portfolio manager of Fidelity Funds - European Growth Fund

When I look towards 2010, there is still a certain amount of nervousness in investors and I am often asked whether there will be a double dip and what shape the recovery is likely to take. At this stage, I do not see any reason why there should be a double dip. The government initiatives have been unprecedented and have led to an upturn in economic conditions. Furthermore, double dips are rare. As for the shape of the recovery, that is very much country-dependent. Within Europe, some countries will come out of the recession faster and be in a stronger position than others.

Even though I don't like to make top-down calls, I believe inflation will be more of a risk than is currently anticipated and, as a result, I believe that monetary policy will tighten next year. I think this will happen at both ends of the yield curve and I also believe that central banks will use more than just interest rates to control inflation. If inflation returns, it will most likely be asset price inflation and not core inflation. This should be supportive of equities as investors move out of (short-dated) government bonds and into assets which can provide a higher real return.

At the sector level, while financials have seen a large upheaval and posted good returns, I believe there is still plenty of upside in selective stocks. The industries which have been most affected by the crisis have been airlines, cement, autos and banks. However, it has only been the banks that have seen structural improvements. There has been very little capacity taken out of airlines or autos, which have both benefited from government initiatives, while the cement industry has been helped by fresh finance. The banking sector is the only industry which has seen capacity taken out and, as a result, margins improve. Many stronger banks have bought good assets at cheap prices and I believe this will lead to strong long-term outperformance.

EMERGING MARKETS

Nick Price

Portfolio manager of Fidelity Funds - Emerging Markets and Emerging Europe, Middle East and Africa Fund (EMEA)

It is my belief that emerging markets offer the prospect of growth which is patently not available in the developed world and, over time, the market will pay more of a premium for this growth. Near term, any significant stall in the US recovery would pose a considerable risk but it is an outcome which looks increasingly less likely. Indeed, housing has stabilised in the US, the worst of the increase in unemployment appears behind us and we are seeing the inventory cycle turning at last.

Over the long term, the secular trends across the region remain positive: a young population backdrop with some of the lowest retirement percentages per capita in the world; a diverse region with an unrivalled commodity exposure which can provide an important inflation hedge; rising productivity growth from the lowest-cost labour force; an undeveloped consumer base in Africa; a high propensity to save, underpinning domestic consumption across Asia; and, in aggregate, the opportunity to invest in stocks at reasonable prices.

GLOBAL SECTORS

Amit Lodha

Portfolio manager of Fidelity Funds - Global Real Asset Securities Fund

There are two key issues that investors should consider. Firstly, near term, is the prospect of inflation. It is clear that the scale of the global financial stimulus is unprecedented. Knowing by how much to increase the money supply and when to stop is difficult to get right; it is not a question of 'if' but 'when' governments will overshoot. An inevitable consequence of fiscal programmes on this scale will be a rapid return of inflation. I believe the rate cycle and onset of inflation will benefit real asset prices, be they commodities, real estate or industrials, like rail roads.

Secondly, we are at an interesting juncture in markets, where the developing world - countries like China, India and Brazil - continue to grow while, at the same time, to fight the recession, developed world countries have set in motion massive stimulus programmes. Again, this phase will create interesting opportunities both in the short and medium terms.

Combining both these mega-trends, I think investors should continue to focus on stocks that will do well in inflationary conditions and yet gain from the long themes of clean energy, food shortages or stimulus spends, provided those stocks can be found at reasonable valuations.

ASSET ALLOCATION

Trevor Greetham

Director of Asset Allocation and portfolio manager of Fidelity Funds - Multi Asset Navigator Fund

After being on the defensive since third quarter 2007, my fund has shifted gears and adopted a much more aggressive asset allocation approach. I raised commodities so that this now represents the same overweight percentage as equities. The rebuilding of developed world inventories will be a positive. At the sector level, I have taken industrials to overweight and I remain significantly overweight Asian and Emerging market stocks versus the US and Europe.

The path of inflation will be critical to the durability of this bull market. If inflation stays low, central banks will want to keep rates low, and we could see a period of prolonged expansion. This seems the most likely outcome in view of the massive spare capacity in the world economy.

On the other hand, headline inflation, including food and energy, is likely to be volatile. Between now and early next year we will see a rapid swing from deflation to inflation as the year ago base comparison for crude oil drops from $145 to $35. If this trend continues, interest rates will rise sooner than expected.

Either way, we appear to be in the early stages of a strong economic recovery and one that could prove very profitable for investors.

FIXED INCOME

Ian Spreadbury

Portfolio manager of Fidelity Funds - European High Yield Fund

I believe corporate bonds continue to offer good value despite their strong performance since March. Corporate bond yields remain high relative to expectations of nominal growth in the economy and credit spreads are wide versus history. The default experience of investment grade bonds has historically been exceptionally low, even in crisis periods, and I believe investors are currently being handsomely compensated for the added risks. Instead, the key risks for the asset class stem from economic factors such as the possibility of a double dip in the economy or a drastic rise in inflation. I see only a small chance of either of these occurring and, instead, expect slow growth and low inflation, which should prove to be a favourable environment for high quality credit.

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