

INVESTMENT OUTLOOK

Fidelity Personal Investing's market and investment view

In this issue:

- UK upgraded to neutral
- Value harder to find in most assets
- Europe remains our top region
- Read our top themes and fund picks for 2018

January
2018



"We are in the home stretch of the nine-year bull market but in the absence of recession or inflation the gains can grind on"

By Tom Stevenson, Investment Director



Executive summary

Please note the views in this document should not be seen as investment advice. If you are unsure about the suitability of an investment, you should speak to an authorised financial adviser.

Asset classes	Current View	3 Month Change	
Equities			A slice of 2018's returns was brought forward into 2017. Some consolidation is to be expected. A good time to be a stock-picker.
Bonds			The reckoning was postponed again in 2017. The big story was the lack of inflation. High-yielding corporate debt looks most vulnerable.
Property			Real estate remains a source of high and sustainable income. But the end of the cycle is nearer. Parts of the market are frothy; selectivity is key.
Commodities			Oil has recovered and should trade in its current range. Slowing China limits the outlook for metals. Gold remains an insurance policy.
Cash			With so little volatility in 2017, expect more ups and downs in 2018. In that environment, cash will help investors take advantage of any dips.
Equity regions	Current View	3 Month Change	
US			There are reasons to be both positive and negative on the US but the valuation headwinds marginally outweigh the growth tailwinds.
UK			The UK market has suffered in relative terms as investors focused on Brexit. The bad news is now largely in the price of this defensive market.
Europe			Good growth, a supportive central bank, reasonable valuations. Europe remains our most favoured regional market at the moment.
Asia Pacific ex-Japan			The past year has been profitable for Asia and Emerging Market investors. The long-term growth story remains intact and valuations are reasonable.
Japan			No longer the equity market's big secret, Japan is back on investors' radar. But there is still plenty to go for in this cheap market.

Current View:  Positive  Neutral  Negative

3 Month Change (since the last Investment Outlook):  Upgrade  Unchanged  Downgrade

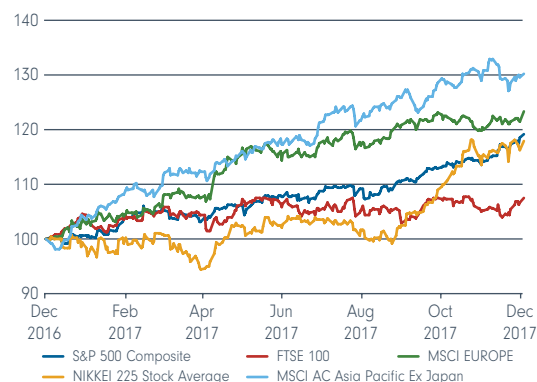
For more market data including full 5 year performance figures see page 15 

Important information: Please be aware that past performance is not a reliable indicator of what might happen in the future. The value of investments and the income from them can go down as well as up, so you may not get back what you invest. When investing in overseas markets, changes in currency exchange rates may affect the value of your investment. Investments in small and emerging markets can be more volatile than those in other overseas markets. Reference to specific securities or funds should not be construed as a recommendation to buy or sell these securities or funds and is included for the purposes of illustration only. This information does not constitute investment advice and should not be used as the basis for any investment decision nor should it be treated as a recommendation for any investment. Investors should also note that the views expressed may no longer be current and may have already been acted upon by Fidelity. Fidelity Personal Investing does not give personal recommendations. If you are unsure about the suitability of an investment, you should speak to an authorised financial adviser.

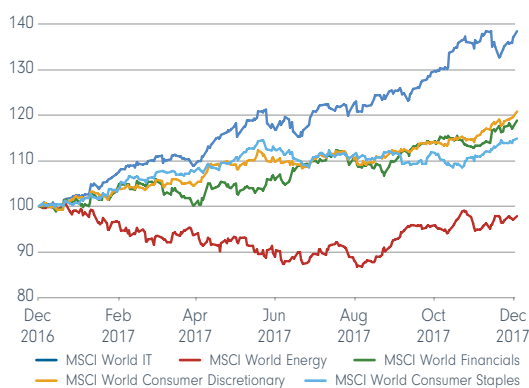
2017: the year in three charts

Regional winners and losers

2017 was a good year for equity investors. The UK was the laggard but even here, given the relatively high yield London-listed shares offer, total returns were acceptable. The other main regional markets got to similar positions to each other but via different routes. The US was the steadiest performer, as real growth picked up the baton after early Trump-related optimism was tempered by political realism. Europe picked up the pace after the relief of the elections in the first half of the year and was supported by good earnings growth thereafter. Japan was going nowhere until the autumn when an easing of North Korean tension and the re-election of Shinzo Abe boosted sentiment. Asia was the stand-out performer. This might raise alarm bells were it not for the low base the region was starting from. Looking back at the executive summary from a year ago, we were positive on the US, Europe and Japan and neutral on Asia and the UK. Not a bad hit rate.



Source: Thomson Reuters Datastream, as at 31.12.17, rebased to 100.



Source: Thomson Reuters Datastream, as at 31.12.17, rebased to 100.

Technology leading the pack: sector returns

At the risk of sounding like a cracked record, it is hard to overstate the importance of diversification in an investment portfolio. Even in a relatively calm year in the markets, with low volatility and supportive growth and policy, the gap between the best and worst performers has been significant. There's no doubt which sector led the pack in 2017. Technology was the stand-out performer but comparisons with the dot.com bubble are wide of the mark. Despite the fact that technology is finally delivering what it promised two decades ago, valuations are notably more realistic thanks to the sector's remarkable profitability and growth. Energy had a disappointing year despite the more recent rally in the oil price. Financials had a good second half, buoyed by the prospect of rising interest rates and deregulation. Consumer staples went sideways in the second half as the sector was less favoured as a safe haven in a recovering global economy.

Fund picks: beating a benign market

The past year certainly provided benign conditions for investors so it would have been disappointing if the year's fund picks had not done pretty well. The thinking a year ago was that growth would accelerate in the US, so two of the four recommended funds had a bias towards the world's largest stock market. Old Mutual North American explicitly so; Rathbone Global Opportunities thanks to its heavy US weighting (around 60%). Higher growth expectations also informed the choice of Fidelity Special Situations, although the market stuck with its preference for more defensive plays for much of the year. Schroder Tokyo came good later in the year, rewarding our support over two years among our fund picks. With some of this year's growth undoubtedly brought forward into 2017, it would be wrong to expect a repeat performance in 2018. Our picks for the next 12 months can be found on page 5.



Source: Thomson Reuters Datastream, as at 30.11.17, rebased to 100.

Past performance is not a reliable indicator of what might happen in the future. When investing in overseas markets, changes in currency exchange rates may affect the value of an investment. Reference to specific securities or funds should not be construed as a recommendation to buy or sell these securities or funds and is included for the purposes of illustration only. For full 5 year performance figures please see page 15.

Acknowledgements

I would like to thank the many knowledgeable and experienced people within the wider Fidelity organisation who have helped me develop the ideas in this *Investment Outlook*. Although the views expressed here do not represent the shared opinion, or house view, of Fidelity's investment team, the combined expertise of over 380 investment professionals in 13 countries is a very significant resource on which I have been able to lean. In particular, I would like to thank Adnan Siddique, Senior Investment Writer; Paras Anand, Head of European Equities; Richard Lewis, Head of Global Equities; Toby Gibb, Investment Director, European Equities; Jeremy Osborne, Investment Director in Tokyo; Tim Orchard, Head of Asian Equities in Hong Kong; Natalie Briggs, Investment Director, Emerging Market Equities; Matthew Jennings, UK Investment Director; Curtis Evans, Investment Director in our London-based Fixed Income team and Neil Cable, who heads Fidelity's Real Estate investment team.

Front of mind: four themes, three fund picks

Investing in an age of technological disruption

Is your portfolio Amazon-proof? Twenty years on from the stock market flotation of the online-bookseller-turned-disrupter-in-chief, this is a question that many investors will be asking in 2018.

Amazon is not the only corporate revolutionary, of course, but it is the poster child of the seismic changes that have every chief executive looking nervously over their shoulder.

Technological disruption is moving well beyond retail. It is up-ending sectors such as energy and automotive manufacturing, too, as technology companies grab an ever-bigger part of the value chain. For the laggards in this process, the risk is that disruption is terminal. Some companies will simply never bounce back.

This matters to investors because it changes the rules. Simply waiting for the right point in the cycle to pick up underperforming companies on the cheap – classic contrarian value investing – just doesn't work anymore. Successful investors now need to ask serious questions of the companies they invest in – like do they have a future at all? There are more value traps around today – companies that look cheap but will probably get cheaper still.

Then there is the challenge of valuing the winners. For a handful of the top companies, there really may be no price that is too high. For some, it really is 'different this time'. The promise of the dot.com bubble is finally being delivered nearly two decades on. But watch out; different this time was the thinking behind the Nifty 50 stocks in the 1970s and it was an approach that ended badly then. Valuation clearly matters still and companies that let their investors down will pay a heavy price – investors are shooting first and asking questions later if the share price falls after profits warnings in the past year are any guide.

So, investing is more exciting than ever but also riskier. The potential gains from this technological revolution are enormous. The need to protect your portfolio against failure has never been greater.

Amazon: the rewards of disruption



Source: Thomson Reuters Datastream, 31.12.17, total returns in local currency.

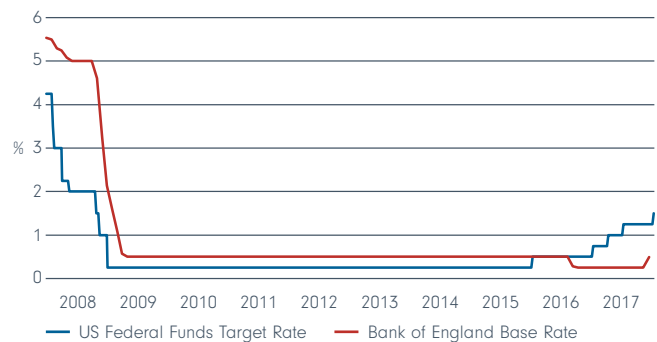
Past performance is not a reliable indicator of future returns.
When investing in overseas markets, changes in currency exchange rates may also affect the value of an investment.

Central banks: getting back to normal

The biggest driver of stock and bond markets since the credit crunch has been central bank policy. The emergency measures implemented in the aftermath of the crisis succeeded in

their principal objective – preventing a repeat of the Great Depression. Since then, however, the main achievement of rock-bottom interest rates and quantitative easing has been to boost the value of financial assets. For those of us lucky enough to have kept our jobs and owned bonds, shares and property, it has been a case of 'Crisis, What Crisis?'

Interest rates: starting to diverge



Source: Thomson Reuters Datastream, 31.12.17

Past performance is not a reliable indicator of future returns.

The era of abundant liquidity and cheap borrowing is slowly but surely coming to an end. Janet Yellen has been a safe pair of hands at the Federal Reserve and has preferred to fly with the doves, along with her counterparts in the UK, Europe and Japan. However, despite failing to restore inflation to the Fed's target (the unfinished business of her four-year term), Ms Yellen has clearly set the US central bank on a path to monetary normalisation.

She delivered the promised three quarter-point rate hikes in 2017 and it is likely that her successor, Jay Powell, will deliver another three this year and two in 2019.

This will see America diverging from the rest of the developed world. Mark Carney has undone last year's panicky post-Brexit cut but is under no pressure to deliver any more tightening at the Bank of England. The outlook is too uncertain in the UK to take the risk and inflation will fall back as the currency settles into its current band. In Frankfurt, Mario Draghi at the ECB is even more cautious and will not raise rates until this year's tapering of QE is done. Policy remains super easy in Japan.

So, interest rates will be less helpful in 2018 than they have been, but only marginally so. The new normal in America will see rates of only about 3% and for the rest of the world even that hurdle remains a long way off. Seeking an income will remain a priority for investors.

Tales of the unexpected: putting politics into perspective

It feels like politics should matter more than it does. The past couple of years has seen profound changes in the political landscape on either side of the Atlantic and an escalation of geo-political risks further afield. But the impact of all the dramatic headlines – from Trump to Brexit, North Korea to the Middle East – has been short-lived and largely inconsequential.

Politics does affect market sentiment, however, and so it cannot be ignored. Take the European stock markets, for example. At the beginning of last year, many were worried about a swing towards populism and protectionism. When mainstream candidates gained the upper hand across the region, investors were able to focus on improving fundamentals. Nothing really changed other than investors' perceptions.

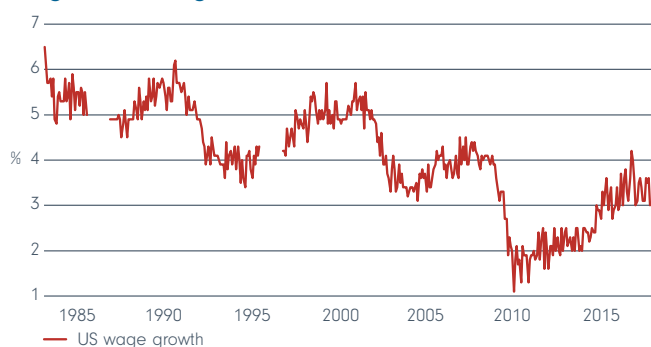
Something similar has happened in the UK, where anxiety about Brexit has had an impact on both the real economy and market sentiment. As with Europe at the beginning of last year, there is a danger that investors have overdone the gloom. Weak sentiment means that the UK is starting to look like an interesting contrarian play. It would not take much progress towards a trade deal (or even just the prospect of an extended transition period) for investors to start seeing the glass as half full again.

As for geo-political risk, history shows that markets can take even the most dangerous situations in their stride. While conflict in Korea or an escalation of the rivalry between Saudi Arabia and Iran would be catastrophic, it would be wrong for investors to treat either as their base case. Investment is a game of probabilities and both remain relative long-shots. It feels like 2017 was the year when we started to put politics into perspective after the upheavals of 2016.

Risks: what keeps us up at night

So, if politics is not the major risk as we move into 2018 what is keeping us awake at night? The biggest concern is that the lower for longer interest rate thesis is wrong. Bull markets do not die of old age, they tend instead to be 'murdered' by central banks. So why might interest rates rise faster than investors currently expect?

Wages: bouncing back



Source: Thomson Reuters Datastream, 15.10.17, US Atlanta Wage Growth Tracker (3 month moving average)

The most likely cause is a pick-up in wage inflation. Wages are a major driver of the overall inflation rate and it would not take much of a rise in labour costs to put pressure on the Fed to raise rates faster than the currently-expected trajectory. Rising wages are, in fact a double negative for share prices because if workers regain some of the bargaining power they have lost over the past 40 or so years today's high profit margins will be unsustainable. The mismatch between historically low unemployment and a lack of wage inflation is a puzzle but history has shown that bull markets tend to peak as the jobs market approaches full employment.

A second reason why rates might rise more quickly than expected is if central banks decide they are stoking a bubble in

asset prices and worry about the impact of market excesses on financial stability.

The third reason to fear higher interest rates is if the Fed starts to worry about the impact of excessive fiscal easing thanks to President Trump's tax reforms. Tax cuts are a great way of stimulating a depressed economy (as Ronald Reagan knew) but they might be a reckless measure when the jobs market is already tight and debts are at record levels.

One knock-on impact of higher rates could be an increase in the default rate on corporate bonds (already rising). Problems in the high yield bond market tend to prefigure trouble in the equity market, so this is something to watch closely in 2018.

2018 Fund picks: bracing for a tougher market

Nearly nine years into the current bull market, more caution is warranted than last year. But there are still some good opportunities in those regions of the world which have lagged the mighty US market in recent years.

The region that we like most as we move into 2018 is Europe. Valuations have certainly risen but they remain undemanding compared to those in the US. The region's central bank remains supportive, so the Goldilocks backdrop of recovering economic activity but accommodative monetary policy should continue. The region is a treasure trove of excellent companies that will benefit from the ongoing global pick-up in activity.

The fund we have chosen to play the Europe theme is the **Invesco Perpetual European Equity Income Fund**, managed by Stephanie Butcher. This is a value-oriented fund, which means it has lagged somewhat in 2017 as growth has remained the style of choice for most investors. If economic recovery picks up then Butcher's style could have its moment. An income-focused fund looks attractive in an environment of persistently low interest rates (which I don't expect to change until the region's quantitative easing programme is unwound).

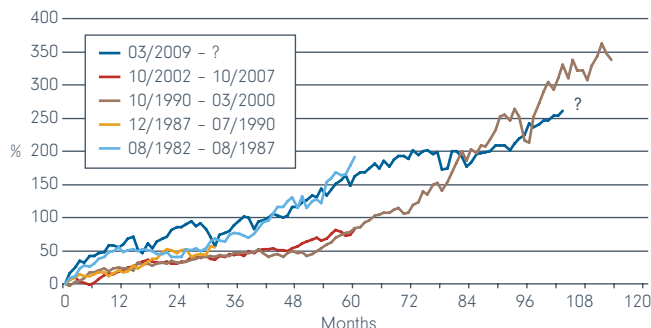
Sideways-moving markets are quite common and can persist for some time if there are offsetting positive and negative factors at play. In such an environment, a strong case can be made for active stock-picking as well-selected shares can outperform a crab-like market significantly. For this reason, we are recommending another out-and-out stock-picker from Fidelity's stable of strong active managers. Jeremy Podger's **Fidelity Global Special Situations Fund** has the additional merit of being an unconstrained global fund which can chase opportunities wherever in the world the manager finds them. With a decent exposure to Japan, this fund also fills the gap left by not having a Tokyo-focused fund this year.

The last of our three recommendations is another quantitative Old Mutual fund run by Ian Heslop. This time it's the **Old Mutual Asia Pacific Fund**, which has a broad spread of holdings across the region, including Australia. The fund has done well over the past couple of years, helped by holdings in both Tencent and Alibaba, China's equivalent of America's soaraway FANG stocks. With sentiment likely to be more volatile next year, we like Old Mutual's focus on this key driver and the manager's ability to move in an agile way between stocks and sectors as the market mood shifts.

Asset classes

EQUITIES

Bull markets compared: how much longer?



Source: Thomson Reuters Datastream, 31.12.17

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It's been a vintage year for equity investors. Outside the UK, which has had other things on its mind, stock markets have delivered fantastic returns. Buoyed by reasonable earnings growth as the world enjoyed a synchronised recovery, investors were happy to bring forward 2018's returns into last year.

The bull market since 2009 has been long and strong. In duration, it has only been exceeded by the 1990s in the post-war period. The drivers of the nine-year bull market – particularly higher valuation multiples – are, however, largely played out.

That is the bad news. Offsetting this is the fact that there is little reason to expect a bear market in 2018. To believe that will happen, you have to think we are on the brink of a recession or that inflation is poised to return with a vengeance, pushing interest rates up much faster than either investors or the Fed

currently forecast. Neither of these looks particularly likely although inflation, as I discuss elsewhere, is a genuine tail risk.

Putting money to work in the stock market makes sense only if you think the potential reward outweighs the possible risks. With the S&P 500 having reached the 2,700 mark that has looked like a sensible target for some time, the market as a whole may go up a little from here. But, having risen four-fold in ten years, there's a real chance that it retreats by rather more. The risk and reward is, therefore, asymmetrical.

If volatility remains low then another few percentage points of capital plus dividend income might look alright in a context where cash and bonds offer such paltry returns. If, as I expect, volatility comes back next year, as investors respond to central banks delivering on their promised tightening of policy, then the rewards may look a bit more marginal.

This, of course, is at the aggregate market level. It is a good reason to be suspicious of the siren call of low-cost market trackers that guarantee to deliver you market returns minus fees. It is an equally good reason to roll up your sleeves and go to the effort of identifying that minority of fund managers who have the ability to deliver market-beating returns.

The 30-year collapse in real interest rates has provided a tailwind for equities. The rising tide has taken away the need to pick winners and avoid losers. Just turning up has been enough. This won't be the case next year and probably for many years to come. In more ways than one, the New Year is a good time to get active again.

Select 50 pick: In a sideways-moving market where active investment is rewarded, we prefer stock-picking funds like Jeremy Podger's **Fidelity Global Special Situations**.

COMMODITIES

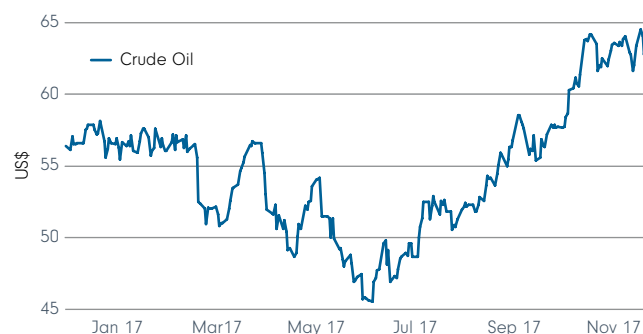
Oil continues to be the most widely-watched and important commodity. As we move into 2018, the outlook is balanced and the base case must be for crude to stay within its current trading band between \$60 and \$70 a barrel.

The reasons to expect further rises in the price this year include the continuing discipline of OPEC and its partners, notably Russia. They have extended production curbs until the end of 2018, albeit with a review in the middle of the year. This confirms Saudi Arabia's new-found desire to put a floor under the oil price while it pushes through far-reaching reforms at home and faces off against its regional rival Iran. The days when it thought it could quickly price US Shale out of the market are long gone. On the supply front, it's worth bearing in mind that disruptions due to war and weather are unusually low at the moment. There is a view that the rate at which output falls away in Shale wells in North America may have been underestimated too.

The other main driver of the oil price is end-user demand. Here, too, the pressure looks like being to the upside as the global synchronised recovery remains on track. Half of oil demand comes from the developed countries in the OECD and growth here is firm.

Offsetting these positive factors is the ever-present risk that a much higher price of oil will encourage more Shale production. This source of new potential supply will continue to put a ceiling on the oil price. The days of \$100 oil are long gone and the market looks in reasonable balance.

Oil in focus



Source: Thomson Reuters Datastream, 31.12.17

Past performance is not a reliable indicator of future returns.

BONDS

Returns for fixed income investors were good again as yields across the bond spectrum ended the year a bit lower than they started. While markets were braced for a year of tightening, the real story was the unexpected failure of inflation to respond to the synchronised pick up in global growth.

Economists are having to re-assess the models which have served them well in the past, rules of thumb like the Phillips Curve which illustrates the trade-off between inflation and employment. With unemployment at historically very low levels, inflation should really be picking up faster than it is. This is a real conundrum for policy-makers, but maybe it shouldn't be. It simply reflects the ongoing headwinds for growth and inflation of too much debt and an ageing population that's dropping out of the workforce and into retirement.

The danger posed by the inflation puzzle is that central banks keep policy looser for longer and tolerate above-target inflation, even at the risk of stoking up imbalances in the system. We are already seeing debt at historically high levels and risk-taking by companies is increasing.

Whether this is a problem further down the track or not, it probably means that 2018 will be another year of low interest rates. This is particularly likely in Europe, where inflation is notably absent, and the UK, where Brexit continues to cast a shadow.

Only in the US are we likely to see a sustained tightening.

The bigger worry for fixed-income investors is in corporate debt where valuations have become stretched as the difference between the yields on company and government bonds has narrowed. High-yield bonds look particularly vulnerable because the reward for rising default risks is uncomfortably low.

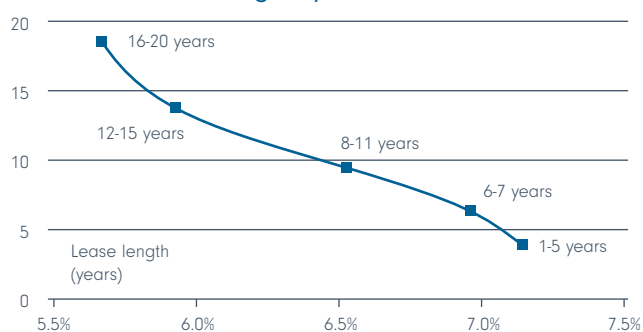
As in the equity market, the late stage of the economic cycle is a time to focus on picking the right securities. This is more important than trying to squeeze a little more income out of your bond portfolio.

Select 50 pick: *Ian Spreadbury is a very experienced and cautious bond manager. He has two funds on the Select 50, [Fidelity MoneyBuilder Income](#) and [Fidelity Strategic Bond](#).*

Important information: Please be aware that the price of bonds is influenced by movements in interest rates, changes in the credit rating of bond issuers, and other factors such as inflation and market dynamics. In general, as interest rates rise the price of a bond will fall. The risk of default is based on the issuer's ability to make interest payments and to repay the loan at maturity. Default risk may therefore vary between different government issuers as well as between corporate issuers.

PROPERTY

Shorter leases offer higher yields



Source: Fidelity. Real Estate data is based on Fidelity International's proprietary deals database, over the 12 months to 19.10.17

The commercial property cycle has, like its bond counterpart, gone on for longer than the sceptics feared. Real estate is still a source of attractive and high-quality yields and so property has a place in any well-diversified multi-asset portfolio. However, while 2018 will see many of the tailwinds for the asset class continue, we are, by definition, one year closer to the end of the cycle than we were a year ago. This is not a time to throw caution to the wind, as some real estate investors seem to be. This is rather a time to lock into sustainable income and to de-risk a portfolio.

There are a few ways to do this. First, it is worth noting a key difference between bonds and property. With bonds, an investor gets paid for taking the risk of holding bonds for longer. With real estate, it is the opposite. Short leases are considered riskier

(because of the potential for an empty building) and so investors pay less (and get a higher yield).

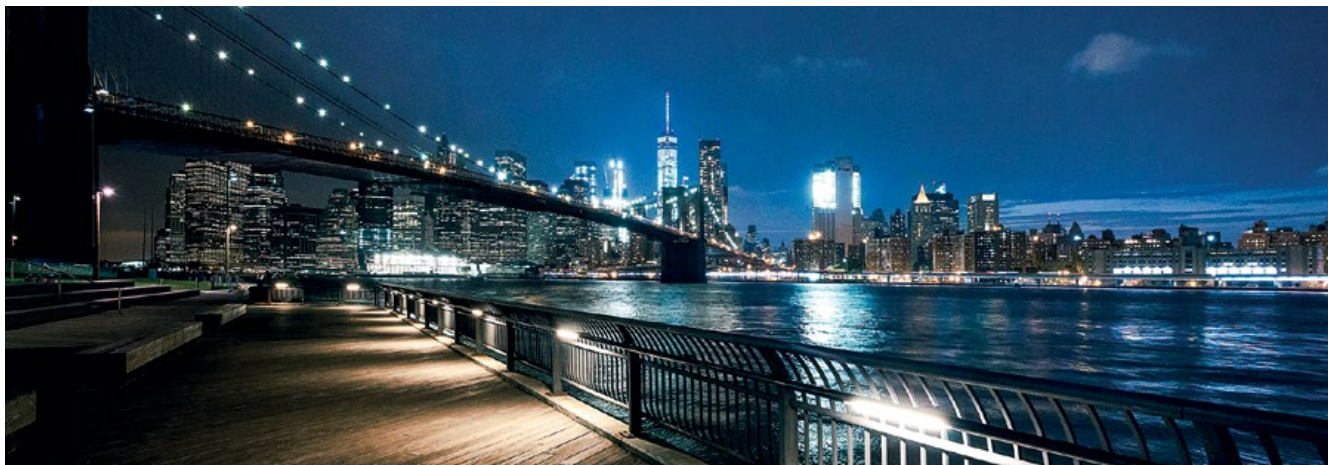
The frothiest part of the property market is high quality and long leases. Here yields are now as low as 3% or less. There is no room for error at this level, or even much income to pay for depreciation, obsolescence and other ongoing costs. So, counter-intuitive as it may sound, shorter leases with higher yields are worth focusing on today.

Another way to de-risk a portfolio is to shun leverage. Debts are cheap but late in the cycle is a good time to reduce not increase borrowings. Finally, look for contrarian ideas. The UK is out of favour with real estate investors because of Brexit fears. Arguably, this is now in the price.

Select 50 pick: *The illiquid nature of the property market can make it difficult to move in and out of a real estate investment. For that reason, the Select 50 suggests a property equity fund, the [BlackRock Global Property Securities Equity Tracker Fund](#). Invested in listed stocks, it is correlated to the equity market but provides access to property's income.*

Important information: Some funds in the property sector invest in property and land. These can be difficult to sell so you may not be able to cash in this investment when you want to. There may be long delays in acting on your instructions to sell your investment. The value of property is generally a matter of a valuer's opinion rather than fact.

Equities – a regional perspective



US

Valuations: rising steadily



Source: Thomson Reuters Datastream, 28.9.17

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There are reasons to be both positive and negative on the US market. On balance, the headwinds are likely to outweigh the tailwinds, however, and we think there are better opportunities elsewhere in the world.

The first reason to be positive about the US is its relative defensiveness. The high quality of American companies, their high margins and the speed with which they can protect profits by cutting costs, make America a safe haven if you think that the recovery might falter this year.

Secondly, the US dominates technology, which continues to look like a market leader in 2018 as the promise of the internet revolution is finally delivered. Partly thanks to technology, earnings revisions in the US are positive.

Thirdly, tax reforms have the potential to lift profits at US companies and to encourage those who have parked profits overseas to repatriate them and probably return them to shareholders via dividends and share buybacks.

That is the good news – and it is worth adding that betting against the US market would have been an expensive mistake throughout the nine-year bull market since 2009. The bad news is that there are also a number of reasons to be negative about US shares.

The first of these is valuation. As we have pointed out here many times in recent quarters, the US is the world's most expensive major market. Indeed compared to the rest of the world, it has exceeded the peak it reached in the late 1990s. Whether you look at valuations as a multiple of earnings or assets or relative to the dividend income paid by US companies, the alarm bells are beginning to ring.

Secondly, the US economy is in the late stages of the cycle. This is a time when risks increase because companies become more relaxed about raising borrowings and animal spirits re-emerge. We are seeing a deterioration in the health of US balance sheets. Expect this to show up first in the high yield debt market as defaults increase and then to spill over into the stock market.

The third reason to be nervous about US equities is the Federal Reserve. Bull markets tend to be killed off by central banks and there is no doubt that the Fed is further into its tightening cycle and more determined to restore monetary normalisation. With US workers likely to regain some of their lost pricing power as unemployment falls to historically low levels, we should expect rates to rise steadily through 2018.

The final reason to be cautious is that the US is starting 2018 from a higher base than other markets. More Americans already own shares than elsewhere so there is less money on the sidelines. And the US market is close to a share of global market capitalisation at which it has peaked in the past.

So, we have a balanced view of the US equity market, but definitely at the negative end of neutral.

Select 50 pick: if you still want some exposure to the US (which most portfolios will) then the **Rathbone Global Opportunities Fund**, with more than half of its assets in US shares, is a good way to achieve it.

UK

Inflation: well above target



Source: Thomson Reuters Datastream, 15.11.17

Past performance is not a reliable indicator of future returns.

I have been negative on the UK equity market for some quarters now since the post-referendum honeymoon ended and investors focused on slowing growth, declining real earnings and Brexit uncertainty. While none of those factors has really changed that much, the underperformance of the London market means the bad news is much more in the price. We're upgrading the UK to neutral.

To start with the negatives, the UK market's dependence on commodities now looks less appealing, with oil having settled in a new trading range and demand for base metals limited by slowing growth in China.

Secondly, economic growth is slowing for a number of reasons. Consumer confidence is weak as the sterling-fuelled inflation rate remains stubbornly higher than average household earnings growth. Business investment is weak. Perhaps most importantly productivity is poor.

Thirdly, the political backdrop remains unhelpful. The next year or so of Brexit negotiations will be tough and they will highlight the deep-seated divisions between and within political parties.

All this is known, however, and arguably factored into share prices in the UK, which anyway are less driven by domestic factors than most major stock markets.

The first of the positives is the valuation of the UK stock market, which on a number of measures looks compelling. First, measured against earnings, the UK equity market stands on a price-earnings ratio of just 14.4 compared with 14.8 in Japan, 15.5 in Europe and 18.3 in the US. Against companies' assets, the price to book value is less than half that in the US and as cheap or cheaper than in every other major market.

The area in which the UK looks most attractively-valued is income. The yield on the UK stock market is about 3.5%. That is twice the yield available in Japan and the US and significantly higher than in emerging markets and Europe. Only in emerging markets are valuations as attractive when compared with expected earnings growth.

Other positives include sterling, which looks more likely to depreciate a bit from its current level than to appreciate by a great deal. The exposure of British companies to faster-growing emerging markets looks like a positive. Sentiment looks as negative as it is likely to get.

Finally, the prospect of a softer Brexit, with an extended transition period in which nothing much changes and businesses have the time to adapt to any new relationship with Europe, is looking more likely.

So, while things will remain tough in Britain for the foreseeable future, it feels that more of the bad news is now in the price.

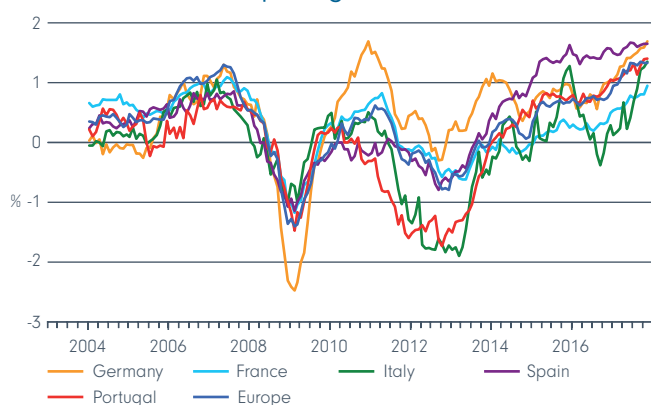
Select 50 picks: With income and the UK market's defensive qualities looking like the main positives at the moment, we like the look of the **Fidelity Enhanced Income Fund**, managed by Michael Clark, and Nick Train's **Lindsell Train UK Equity Fund**.





EUROPE

Economic sentiment improving



Source: Thomson Reuters Datastream, 15.11.17, quarterly percentage changes

Past performance is not a reliable indicator of what might happen in the future. When investing in overseas markets, changes in currency exchange rates may also affect the value of an investment.

Europe remains our preferred regional equity market for a long list of reasons. The first of these is the strength and sustainability of the economic recovery. The region still has a lot of catching up to do after losing significant ground during the sovereign debt crisis. Europe's economy is only just bigger than it was before the financial crisis, whereas the US and UK economies are 15% and 10% bigger respectively.

Markets have also lagged so there is a second string to the catch-up story. The failure of markets to keep pace has resulted in European valuations being significantly lower than those in the US. For stock-pickers there are a few sectors which look even more undervalued than the market as a whole – these include mining, industrials, insurance and car-makers.

Valuations look particularly low in Europe when you consider that company profit margins in the region are much more exposed to a pick-up in activity because the higher fixed-costs caused by Europe's less flexible labour markets mean profits rise more as sales improve.

A further positive factor for Europe is its exposure to the financial sector. This has been a serious headwind in the past as the balance sheets of banks have been under pressure. But in an environment of slowly rising interest rates and higher bond yields, the profitability of financials is likely to improve.

Next in the list of positives is the European Central Bank which has been very supportive under the leadership of Mario Draghi and will most likely continue to be so thanks to the ECB's single mandate to manage European inflation. With no sign of prices in the region rising there is little imperative for the Bank to do anything other than continue to stimulate the economy.

Finally, the political situation in Europe looks much less of a concern than it did this time last year. Having seen off the far-right threat in Holland and France, the chance of a populist upsurge in Europe is much diminished, albeit there is unfinished business in Austria and an election to come in Italy.

The one shadow that hangs over European equities is a further strengthening of the Euro which would make European exports less competitive. While the long-term outlook for the Euro is probably still positive, it has run a long way already so in the shorter term the currency looks less of a headwind than it has.

Select 50 pick: In a low interest rate environment, equity income will continue to look attractive. We like the **Invesco Perpetual European Equity Income Fund**, managed by Stephanie Butcher.

ASIA-PACIFIC EX-JAPAN/EMERGING MARKETS

Investors in emerging markets enjoyed 2017. Returns were spectacular and it would be too much to expect them to continue at that level in 2018 as well. The combination of reasonable global growth and a weaker dollar has been a positive one for emerging markets and may be worse on both fronts this year. That said, there are plenty of positives in this asset class with valuations undemanding and the long-term growth story still intact.

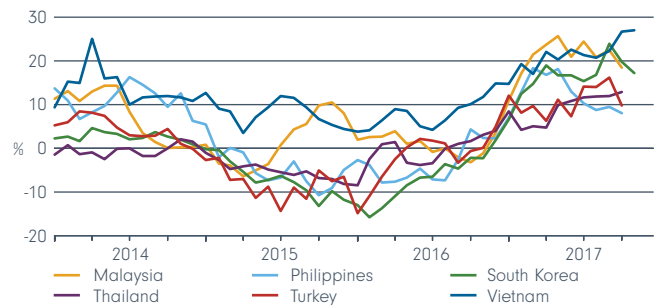
China is the big unknown, of course. It accounted for more than 40% of emerging market returns in 2017, largely thanks to the performance of its tech giants, Tencent and Alibaba. Valuations are no longer as cheap as they were. And the government is squeezing monetary policy.

Much more interesting is India, which still has a great deal going for it despite being one of the most popular destinations for emerging market investors. In particular, demographics continue to look compelling and India is way behind China in terms of urbanisation and the growth of its manufacturing base. India should benefit from technology, with internet penetration still a long way behind China's. Some of the headwinds affecting India are also weakening; it is little exposed to China at a time when that country's economy is slowing and the oil price should not rise much further from here, a big help to a major oil importer.

Outside Asia, it is, as usual, impossible to generalise. Russia remains dependent on the oil price. Brazil's economy is improving but politics remains uncertain. Mexico is a play on US growth. Because of these variations, we would always suggest a

well-diversified exposure to emerging markets that does not put too many eggs in one country or regional basket.

Emerging market exports: rising tide



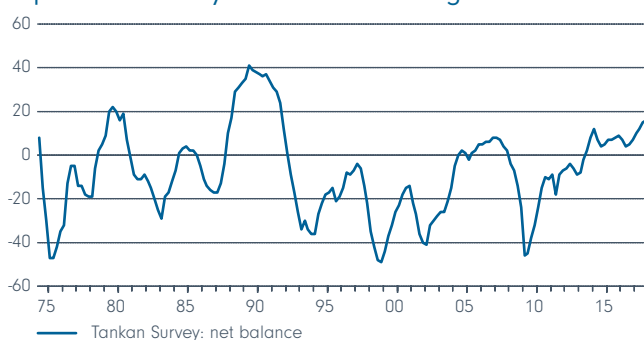
Source: Thomson Reuters Datastream, 15.10.17, 12 month percentage changes (3 months moving average)

Past performance is not a reliable indicator of future returns. When investing in overseas markets, changes in currency exchange rates may also affect the value of an investment. Investments in small and emerging markets can be more volatile than those in other overseas markets.

Select 50 pick: Nick Price, manager of the **Fidelity Emerging Markets Fund**, is almost permanently on the road finding investment opportunities around the emerging world. This is the way to get an edge in this under-researched area.

JAPAN

Japanese economy: fundamentals strong



Source: Thomson Reuters Datastream, Q4, 2017

Past performance is not a reliable indicator of future returns. When investing in overseas markets, changes in currency exchange rates may also affect the value of an investment.

The combination of reasonable valuations and strong earnings growth continues to be the principal reason to stick with Japan. There are plenty of reasons to expect profits to keep rising in Japan. A key one is the diminishing drag of wages as better-paid older workers retire. The seniority system for determining salaries in Japan has lumbered companies with uncompetitive cost structures. Like many things in Japan's slow-moving corporate world, that is beginning to change.

Other positives for Japan include fund flows, with Japanese pension schemes very heavily weighted to bonds and households to cash. The potential for at least some of that to move into equities as the market starts to move higher augurs well for the stock market.

It's worth remembering, too, that the Japanese central bank will by the end of this year be the only one still expanding its balance sheet. Also, a positive for Japanese shares is the likely downward pressure on the yen from rising US bond yields. A falling currency is always good for the Tokyo market. Finally, Japan continues to have a lead in a number of industries of the future like manufacturing automation.

There are still negatives for Japanese investors. For one thing, Japan is no longer the great hidden secret of the global stock market. An overweight position in Tokyo is now more mainstream and so more priced-in than it was. Japan's demographics remain unfavourable; the country has high debts; and the shadow of China and North Korea hangs over the region. All of that said, though, there is enough going for Japan to keep it on our buy list.

Select 50 pick: All three Japanese funds on the Select 50 are good. We particularly like the **Baillie Gifford Japanese Fund** thanks to its attention to the automation story.

The new Select 50 – Our experts' favourite funds

The funds on the Select 50 are hand picked from the range available on our fund supermarket. Published on 9th January 2018, for the most up-to-date list and more information on how these funds are selected visit [fidelity.co.uk/select](https://www.fidelity.co.uk/select). The Select 50 is not advice or a recommendation to buy funds. Equally, if a fund you own is not on the Select 50 (or was on the previous Select List and isn't on the Select 50), we're not recommending you sell it. You must ensure that any fund you choose to invest in is suitable for your own personal circumstances. **Please be aware that past performance is not a reliable indicator of what might happen in the future.** The value of investments and the income from them can go down as well as up, so you may not get back what you invest. For funds that invest in overseas markets, the returns may increase or decrease as a result of currency fluctuations. Investments in small and emerging markets can be more volatile than other more developed markets. For funds launched less than five years ago full five-year performance figures are not available.


STANDARDISED PERFORMANCE DATA (%) OVER THE PAST FIVE YEARS

% (as at 30th November)	2012-2013	2013-2014	2014-2015	2015-2016	2016-2017	Morningstar Fund Rating
ASIA AND EMERGING MARKETS						
Fidelity Asian Smaller Companies	28.9	23.0	-2.2	37.7	11.7	★★★★★
Fidelity Emerging Markets	12.6	9.6	-5.1	19.1	28.4	★★★★★
Henderson Emerging Markets Opportunities	1.6	7.9	-9.4	29.2	15.7	★★★
Lazard Emerging Markets	4.6	7.6	-19.1	36.1	17.1	★★★
Old Mutual Asia Pacific	12.6	12.9	-6.0	36.0	34.0	★★★★★
Stewart Investors Asia Pacific Leaders	2.8	20.4	-2.8	23.0	10.6	★★★★
BONDS						
Fidelity MoneyBuilder Income	0.5	9.5	1.7	6.3	4.6	★★★★
Fidelity Strategic Bond [†]	2.3	8.9	0.7	3.9	4.6	★★★
Invesco Perpetual High Yield	-	-	0.1	4.3	12.2	★★★★
JPM Global High Yield Bond	7.9	2.9	-4.7	9.0	8.2	★★★
Jupiter Strategic Bond	6.8	5.8	1.6	6.0	5.1	★★★★
M&G Corporate Bond	1.3	8.9	1.5	6.3	6.1	★★★★
M&G European High Yield Bond	13.1	0.2	-9.0	23.2	11.2	★★★
M&G Optimal Income	8.2	5.6	-0.4	5.8	7.2	★★★★
Royal London UK Government Bond	-4.0	8.7	2.5	6.4	1.3	★★★
SLI Global Index Linked Bond	-4.1	7.2	0.6	6.5	1.9	★★★

[†]The investment policy of Fidelity Strategic Bond Fund means it can be more than 35% invested in government and public securities. These can be issued or guaranteed by other countries and governments. For a full list please refer to the fund's prospectus.

% (as at 30th November)	2012-2013	2013-2014	2014-2015	2015-2016	2016-2017	Morningstar Fund Rating
 EUROPE						
Baring German Growth	35.3	-0.3	10.3	14.3	33.4	★★★★★
Fidelity European Growth	-	-	-	16.7	17.3	-
FP CRUX European Special Situations	26.3	4.2	9.1	19.7	24.6	★★★★★
Invesco Perpetual European Equity Income	-	-	2.7	11.7	24.2	★★★
JOHCM European Select Values	31.4	4.8	4.4	16.5	20.2	★★★★
Jupiter European Special Situations	28.1	2.8	6.1	8.3	22.6	★★★★
Threadneedle European Select	20.9	8.6	7.5	8.8	24.3	★★★★
 GLOBAL						
BNY Mellon Long-Term Global Equity	18.1	9.3	5.4	23.8	15.1	★★★★
Fidelity Global Dividend	23.7	13.6	6.7	21.9	9.5	★★★★★
Fidelity Global Special Situations	29.0	14.6	11.0	23.7	19.0	★★★★
Invesco Perpetual Global Equity Income	-	-	5.2	18.1	15.6	★★★★
Rathbone Global Opportunities	23.6	12.4	14.8	16.3	21.0	★★★★★
 JAPAN						
Aberdeen Japan Equity	20.5	8.3	12.5	26.7	12.8	★★★★★
Baillie Gifford Japanese	44.3	3.0	11.1	31.5	26.3	★★★★★
Schroder Tokyo	27.1	3.9	15.3	27.5	13.0	★★★★★
Schroder Tokyo (hedged)	-	14.4	14.5	-5.4	20.4	-
 NORTH AMERICA						
JPM US Equity Income	26.6	19.2	4.7	31.0	8.9	★★★★
JPM US Select	30.5	21.2	7.3	28.2	10.9	★★★★
Lazard US Equity Concentrated	-	-	-	-	-	-
Old Mutual North American	38.7	21.9	9.5	31.3	15.9	★★★★★
Schroder US Mid Cap	31.6	18.1	11.1	35.2	7.9	★★★★★

STANDARDISED PERFORMANCE DATA (%) OVER THE PAST FIVE YEARS

% (as at 30th November)	2012-2013	2013-2014	2014-2015	2015-2016	2016-2017	Morningstar Fund Rating
 UK						
CF Lindsell Train UK Equity	31.0	10.9	10.6	8.9	20.7	★★★★★
Fidelity Enhanced Income	15.4	7.1	5.7	1.3	5.2	★
Fidelity Special Situations	33.6	0.5	11.7	11.1	16.2	★★★★
Franklin UK Smaller Companies	49.7	1.8	25.7	-4.1	32.1	★★
JOHCM UK Equity Income	-	3.6	2.2	9.2	20.5	★★★★★
Liontrust UK Growth	16.3	4.0	9.8	14.1	14.6	★★★★
Majedie UK Equity	31.5	5.8	-0.3	14.2	8.6	★★★★★
Old Mutual UK Smaller Companies	38.5	0.6	19.8	10.9	38.1	★★★★
Threadneedle UK Mid 250	28.1	5.8	19.8	-4.1	27.8	★★★★

ALTERNATIVES

Aviva Investors Multi-Strategy Target Return	-	-	5.5	-1.5	0.1	-
Invesco Perpetual Global Targeted Returns	-	-	2.1	2.2	3.9	-
Investec Global Gold	-45.6	-4.8	-25.3	89.6	-2.7	★★★★
iShares Global Property Securities Equity Tracker	-	-	4.2	23.7	2.9	★★★★

Before you invest, please ensure you have read Doing Business with Fidelity and the Key Investor Information Document (KIID) or Fund Specific Information Document (FSI), relevant to your chosen fund(s). These documents give you all the information you need to know about Fidelity, including details of the objective, investment policy, risks, charges and past performance associated with the fund(s). Instructions on how to access these documents can be found at fidelity.co.uk/importantinformation. If you do not have a computer or access to the internet please call Fidelity on **0800 41 41 61** to request a printed copy of the documents. The Full Prospectus is also available on request from Fidelity.

Source: Morningstar as from 30.11.12 to 30.11.17. Basis: bid to bid with income reinvested in GBP. Excludes initial charge. The fund's primary share class according to the IA is shown. For the latest yields please call 0800 41 41 61 or visit fidelity.co.uk

Please note, the performance figures shown here are based on 'clean' share classes. For more information about 'clean' pricing, please visit fidelity.co.uk/pricing.

Market data

Please be aware that past performance is not a reliable indicator of what might happen in the future. When investing in overseas markets, changes in currency exchange rates may affect the value of your investment. Investments in small and emerging markets can be more volatile than those in other overseas markets.

INVESTMENT VALUATION AT A GLANCE

	Price-earnings ratio 2018E	Dividend yield 2017		Redemption Yield
Equities		%	Bonds	%
US	18.8	1.8	ML Global High Yield	5.6
Europe	14.8	3.4	German 10-Year Bunds	0.4
UK	14.3	4.1	ML Global Corporates	2.6
Japan	14.7	1.9	UK 10-Year Gilts	1.6
Asia Pac ex Japan	13.2	2.7	US 10-Year Treasuries	2.4
Emerging Market Asia	12.4	2.2		
Latin America	13.7	2.8		
Central East Europe, Middle East & Africa	10.5	3.6		

INVESTMENT PERFORMANCE AT A GLANCE

% (as at 31st December)	3 m	2012-2013	2013-2014	2014-2015	2015-2016	2016-2017
Equities						
S&P 500	7.9	27.6	14.7	-0.1	15.3	22.4
FTSE All Share	3.9	16.9	1.1	-1.0	20.2	12.6
FTSE 100	3.8	14.6	0.7	-3.4	22.8	11.3
FTSE 250	4.5	29.5	2.9	9.4	9.0	17.9
MSCI Europe	3.9	21.9	-5.2	-4.4	3.7	27.9
Shanghai SE	1.1	-8.6	55.5	1.8	-4.1	7.2
Shenzhen	-0.7	16.6	19.6	20.4	-8.2	4.5
MSCI Emerging Markets	8.6	-6.5	0.2	-17.2	16.7	40.3
MSCI Asia Pacific	9.7	9.2	1.1	-4.1	9.3	33.4
Nikkei 225	14.2	55.0	9.0	7.6	8.3	22.2
MSCI World	7.0	23.3	6.2	-1.9	11.7	23.8
MSCI World IT	11.4	25.2	18.0	3.6	15.3	41.3
MSCI World Energy	10.8	13.8	-9.6	-22.7	29.6	8.5
MSCI World Financials	7.3	23.6	4.1	-5.0	18.4	22.8
MSCI World Consumer Discretionary	9.0	35.4	4.3	4.4	7.6	25.0
MSCI World Consumer Staples	5.2	18.5	8.4	6.0	4.2	17.6
Amazon	25.3	53.0	-22.2	106.5	18.9	59.7
Bonds						
US 10-Year Treasuries	-0.5	-6.1	11.3	0.7	0.5	1.9
UK 10-Year Gilts	1.4	-3.5	15.8	1.2	7.6	3.1
German 10-Year Bunds	0.3	-0.6	17.1	0.5	3.9	0.7
JPM Emerging Markets Bond Index	0.6	-6.9	5.4	1.2	10.8	9.0
ML Global High Yield	1.5	7.3	-0.2	-4.3	15.7	10.5
ML Global Corporates	1.5	0.8	3.3	-3.7	4.1	9.4
Commodities						
CRB Commodities Index	8.1	-5.9	-17.4	-23.6	11.0	2.2
Crude Oil (Brent)	22.7	-5.3	-48.6	-32.3	47.1	25.9
Gold Spot	3.8	-25.4	-3.8	-9.6	8.3	13.7
LME Copper	10.4	-9.0	-13.8	-27.0	22.1	26.9
GSCI Soft Commodities	7.5	-10.9	-15.7	-7.3	16.8	-16.2

Source: DataStream, 31.12.17 in local currency terms. Valuations: Source Citigroup Global Equity Strategist - Citi Research, MSCI, Worldscope, FactSet Consensus estimates as at 31.12.17. Bond Yields: Source DataStream as at 31.12.17.

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Source: Fidelity as at 30.9.17

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