INVESTMENT OUTLOOK

Fidelity Personal Investing's market and investment view

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- Japan is unfairly out of favour

January 2019

"Ten years since the crisis, there are still opportunities, but balance and diversification will be key this year"

By Tom Stevenson,
Investment Director, Personal Investing

Fidelity™ INTERNATIONAL

Outlook at a glance

Please note that this information is not a personal recommendation for any particular investment. 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	
Shares	☑	▶	Earnings growth remains positive, valuations are reasonable and the alternatives unattractive. Shares remain the asset class of choice.
Bonds	⊟	▶	Government bonds and emerging market debt look more interesting than corporate credit. Bonds remain a good diversifier.
Property	☒	▶	Prime property remains expensive. As yields rise on other assets, the risks of holding an overpriced asset for income are hard to justify.
Commodities	☑	▶	Oil, industrial metals and gold all have their attractions at the tail end of the economic cycle and after price weakness in 2018.
Cash	☑	▶	With a growing focus on capital preservation and volatility creating opportunities, cash is always welcome in a portfolio.
Regions	**Current View**	**3 Month Change**	
US	☑	▶	Still the most highly-valued stock market but, after a fourth quarter fall of nearly 20%, the US is oversold.
UK	☑	▲	The UK could be the contrarian call of 2019 as the Brexit fog lifts. Deeply unloved, the London market looks cheap. A great source of income.
Europe	⊟	▶	Another decent income play, with positive total returns expected. But politics casts a long shadow over the region.
Asia Pacific ex-Japan	☑	▶	Another contrarian call while the US/China trade tensions remain unresolved. But 2018 was such a poor year that valuations are compelling.
Japan	☑	▶	Out of favour, with some headwinds to come in 2019. But there's a good story too and the market has become increasingly cheap.

Current View: ☑ Positive ⊟ Neutral ☒ Negative

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

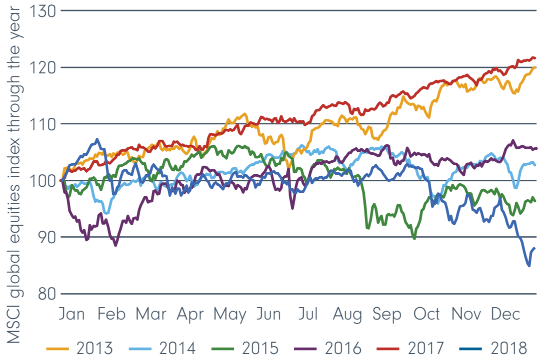
For more market data including full 5 year performance figures see page 15 ▶

Important information: Please be aware that past performance is not a reliable indicator of future returns. 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. The Select 50 is not a personal recommendation to buy funds. 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.

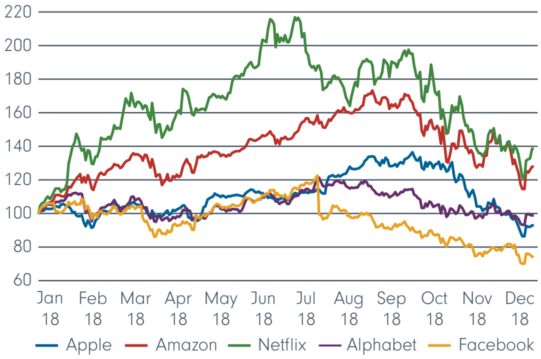
2018 in three charts

Investing through the cycle

The traditional cycle is seven years of feast and seven of famine. As this interesting chart shows, however, the stock market works on a shorter time-horizon. Each line shows the performance of shares over one year, rebased to the same starting point. Calendar years are arbitrary time periods over which to look at investment performance, of course, but the divergence of the lines here makes a useful point about the difficulty of predicting where markets will go in any 12-month period and the necessity of sticking with it through the challenging years to ensure you benefit from the better ones that usually follow. 2018 has been the worst year in the past six for investors in a broad spread of global shares. 2017 was the best. Obviously, this is a small selection from which to draw conclusions, but it is notable how the gains achieved in the good years are significantly larger than the losses incurred in the bad ones.



Source: Refinitiv as at 31.12.18, total returns in local currency, figures rebased at end of previous year to 100.



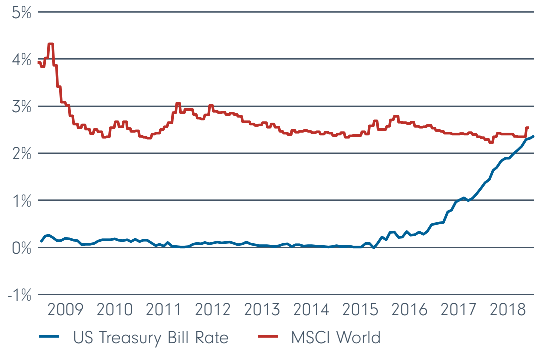
Source: Refinitiv as at 31.12.18 total returns in local currency, figures rebased to 100

The ups and downs of the technology rollercoaster

Technology stocks led the market higher and they have been the smoking gun for anyone trying to understand the volatility and overall weakness of the US stock market in the final three months of 2018. It really has been a year of two halves when it comes to the FAANGs. Investors' love affair with all things technology soured for a range of reasons. Netflix probably just overshot – like Amazon it has still ended 2018 significantly more valuable than it started. With Apple, investors have started to worry that the company is over-dependent on one remarkable product that is now ubiquitous and increasingly expensive. Google-owner Alphabet and Facebook are struggling to justify their valuations in a world that is less willing to give big-tech the benefit of the doubt. More intrusive regulation, privacy concerns and stricter tax enforcement mean these companies will not have it all their own way from now on.

Cash is back

For the ten years since central banks responded to the financial crisis by slashing interest rates, cash has been trash. As the chart shows, it was for a long time impossible to generate a decent income from a deposit. Since the Federal Reserve began normalising interest rates three years ago, however, cash has become progressively more competitive. Here, the 3-month Treasury bill's yield is seen catching up with the average dividend yield offered by shares around the world. They are now neck and neck and for many investors the same income with considerably less risk to their capital will be a compelling proposition. Sure, there's no prospect of a capital gain when you hold your money in cash or a near proxy but, after a ten-year bull market, that won't bother more cautious savers.



Source: Refinitiv, as at 17.12.18

Past performance is not a reliable indicator of future returns. When investing in overseas markets, changes in currency exchange rates may affect the value of an investment. Reference to specific securities should not be construed as a recommendation to buy or sell these securities 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 Gary Monaghan, Investment Director in Hong Kong, Jeremy Osborne, Investment Director in Tokyo, Leigh Himsworth, UK Portfolio Manager, Neil Cable, Head of Real Estate, Curtis Evans, Head of Investment Directing, European Fixed Income, Kasia Kiladis, Investment Director, US, Rebecca McVittie, Investment Director, Emerging Markets, Natalie Briggs, Investment Director, Europe, Bill McQuaker, Portfolio Manager, and Ayesha Akbar, Portfolio Manager.

Focus: Ten key questions for 2019

Success in investment is 100% measurable – but only after the event. At the end of 2019 we will know the answers. At the start of the year, the best we can hope to do is to ask the right questions. So here is my top ten.

1. Are you getting paid for the risk?

The most important determinant of your investment return (or at least the one you have some control over) is the price you pay at the outset. Over-paying is a short-cut to disappointment. Paying a reasonable price, or even better picking an asset up for less than its intrinsic value, stacks the odds in your favour. Sometimes, everything is either cheap or expensive. That's not the case today – being selective has never been so important. In my comments on the different regions elsewhere in this report, I've highlighted the increasing value in the UK and Japan. Picking up blue-chip stocks with a near-5% yield (see the chart below) will probably look obvious with the benefit of hindsight in a few years' time. Cash, for the first time in years, is beating inflation – with no risk to capital. Property on the other hand is not even compensating investors for the erosion of value from depreciation and obsolescence – let alone the risk of tenants going bust.

UK shares – rewarding investors

Source: Refinitiv, total returns in local currency as at 31.12.18.

Past performance is not a reliable indicator of future returns.

2. Trade wars – who blinks first?

The rising tension between the US and China is probably the most important theme for investors in 2019. The battle between the world's two largest economies is about much more than trade, of course. It is a fight for supremacy, which fortunately is still being played out only via the proxy of tariffs. The significance for investors is that trade has underpinned economic growth for the past 40 years since China rejoined the global economy in the 1970s. Rolling back the tide of globalisation may make geo-political sense to Donald Trump but it threatens the growth on which stock market valuations depend. 2018 saw tensions build steadily. If they can be resolved in 2019, markets will breathe a sigh of relief, especially those in emerging markets, Europe and Japan that are most at risk. If the mood darkens further, investors will most likely prefer defensive ports in the storm – like the US.

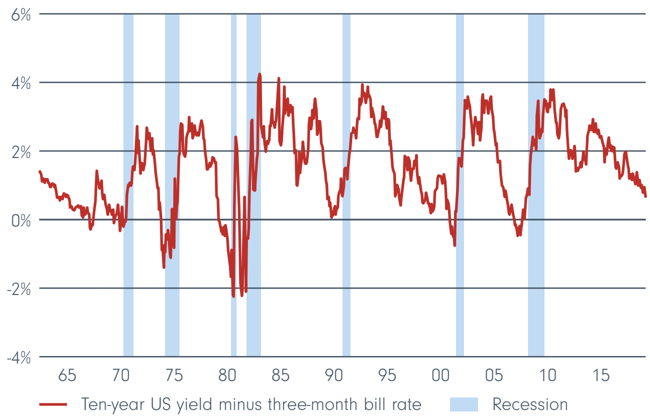
3. When does the Fed stop squeezing?

The second most important question for investors in 2019 is whether the Federal Reserve sticks to its expected interest rate tightening path. The Fed's forecasts are for two or three more quarter point hikes. This is clearly the central bank's preferred outcome, because it will ensure that when the next downturn arrives it will have some ammunition in the shape of potential interest rate cuts. The markets are less convinced, thinking that a slowing economy and volatile markets will prompt a more cautious approach. The trajectory of US interest rates matters for a few reasons: it drives the value of the dollar, which has been a headwind for overseas, especially emerging, markets; it has a direct impact on US consumer sentiment, via the mortgage market; and it determines the relative attraction of riskier income streams, like company dividends.

4. What is the yield curve telling us?

It is unusual for stock markets to fall far in the absence of a recession. So, the ability to predict when the next downturn will arrive is a useful tool for an investor. It's not that easy, but one warning sign of impending recession that has a good track record is called the 'yield curve'. This measures the difference in the yield paid by bonds due to mature many years hence with those that are due to pay out much sooner or cash equivalents like Treasury bills. Usually, longer-dated bonds pay a higher yield to compensate investors for the risks involved in locking up their money, such as inflation. At a time of rising interest rates, like today, however, this picture changes. Shorter yields rise in line with interest rates while longer yields fall in anticipation of lower growth and inflation. In extremis, rates on longer bonds can fall below those on shorter ones (below the 0% line in the chart below). In the jargon, it's called an 'inverted yield curve'. It doesn't happen often, but when it does a recession is usually on its way. Currently, long and short yields are almost the same so this reliable recession signal could be triggered soon. One to watch.

The yield curve – recession warning



Source: Refinitiv, as at 3.12.18.

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

5. Does OPEC matter anymore?

Donald Trump marched them up to the top of the hill and he marched them down again. Re-imposing oil sanctions on Iran at the end of 2018 threatened to push the oil price back towards the $100 a barrel mark at which energy costs have a significant negative impact on economic activity. Faced with rising fuel costs ahead of the mid-term elections, the US President twisted the arm of his Middle Eastern ally, Saudi Arabia, to keep the pumps open and so to cap the oil price. When he simultaneously gave big oil importers like Japan and India a waiver so they could keep buying Iranian oil, a glut ensued and the oil price fell in short order from $86 a barrel to below $60. Why does this matter? Because the cost of oil is a key driver of inflation and so interest rates. If OPEC has lost the power to hold the world to ransom, the oil price may be one thing we don't have to worry about in 2019.

6. Brexit: who cares?

The intuitive answer is that we should all care. Whether Britain stays in the EU, achieves a soft exit with continuing close economic ties to Europe or leaves without a deal will obviously have an economic impact. What its influence on the stock market turns out to be is harder to predict, however. Forecasting the twists and turns of the Brexit saga has become so hard that many investors, particularly overseas, have simply given up the unequal task. They are choosing instead to leave the UK market out of their portfolios. This is great news for investors who are prepared to look through the short-term noise and focus on the longer-term opportunity. On a medium to long-term time horizon, this looks like a good entry point to the UK, in particular the internationally-focused FTSE 100 which is less vulnerable to the ups and downs of the British economy.

7. Where next for the High Street?

No part of the UK economy was under more pressure in 2018 than the High Street. The retail sector faced a quadruple whammy of Brexit uncertainty, a weak pound, high property taxes and the relentless assault on bricks and mortar shopping from the internet. The UK stock market looks unfairly out of favour but the same cannot really be said of the High Street. The perfect storm of adverse influences on retail profits makes the sector look like a classic value trap. That describes a situation where investors are tempted by apparently cheap valuations only to realise that cheap can get cheaper still. An even bigger value trap may turn out not to be shop chains themselves but the property companies which house them. I suspect this part of the market is some way from hitting the bottom.

8. Does diversification still work?

Diversification is the most important word in investment. Putting your eggs in a variety of baskets is the surest route to sleep-filled nights during the market's periodic difficult years. We have looked at the returns from a range of different asset classes over the past two decades and there hasn't been a single year when every asset has fallen in value. In the jargon, they are uncorrelated – some rise when others fall and vice versa. This was even the case in 2018, a particularly challenging year in which returns were poor pretty much across the board. A key factor last year for UK-based investors was the fact that the pound's weakness boosted the returns from overseas assets. So, for example, the S&P 500 had an indifferent year in dollar terms but a respectable one after translation back into sterling.

9. Value or growth?

In the long run, the returns from cheap and unloved shares have outperformed those of high-growth companies because the latter tend to become over-priced. The tendency for things to revert to the mean ensures that investors live to regret paying up for apparent quality as valuations swing back to the average. Since the financial crisis, that has not been the case. In a low-growth environment, investors have been rewarded for sticking to the best. Will that continue in 2019? I suspect it might. If, as expected, growth starts to moderate in the face of rising interest rates then quality and growth potential will still attract a premium.

10. Where to invest in 2019?

The value versus growth question has informed the first of my fund picks for 2019. Although I see considerable opportunities in the UK market, the continuing Brexit uncertainty means I am hedging my bets by investing in it via a quality-focused fund. Nick Train's **Lindsell Train UK Equity Fund** will do well if the UK bounces back and should be defensive if it does not.

With the Fed likely to pause and other central banks yet to even begin to tighten monetary policy, investors will continue to chase income. Dan Roberts runs a very defensive global equity income fund, the **Fidelity Global Dividend Fund**. This is another way of tapping into what growth is available in 2019 while remaining focused on capital preservation.

As I explain more fully elsewhere, Japan is unfairly out of favour so this is where I'm making my third recommendation. The **Baillie Gifford Japanese Fund** is one of the highest-quality funds in this category.

Finally, I'm playing the diversification theme with the **Fidelity Select 50 Balanced Fund**. Ayesha Akbar's multi-manager fund invests across different asset classes and geographical regions to deliver a smoother voyage across choppy waters.

Nick Train
Lindsell Train

Dan Roberts
Fidelity International

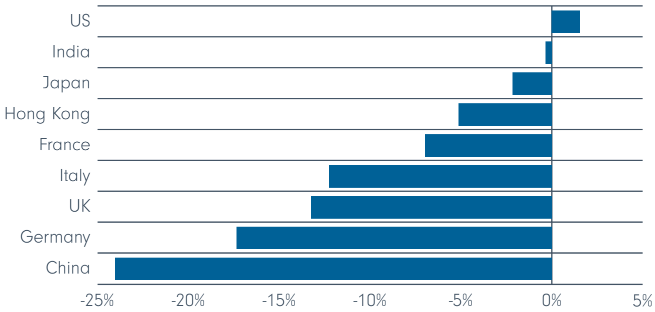
Matthew Brett
Baillie Gifford

Ayesha Akbar
Fidelity International

Asset classes

SHARES

Nowhere to hide



Source: Refinitiv, total returns in GBP as at 31.12.18.

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

Sometimes it is helpful to go back to basics. What determines share prices and how might these key drivers evolve in 2019? I think there are three worth considering: the outlook for corporate earnings, the price investors are prepared to pay for a share of those earnings and what alternatives are on offer.

Starting with earnings, 2018 was a one-off, driven by Donald Trump's tax reforms. It is clearly unrealistic to expect company profits to continue rising at more than 20%. Indeed, most analysts see the earnings growth rate in America falling to less than 10% as costs begin to rise. That will bring the US back into line with the rest of the developed world but crucially it remains a positive figure. We are not looking at an earnings recession.

Given that is the case, the only way that stock markets will fall materially in 2019 is if investors decide that they are no longer willing to pay as much for a slice of the action. In the jargon, the market derates. This is possible but the starting point, even in the most expensive market, the US, is not particularly high by historic standards after recent falls. In some markets, like the UK and Japan, the derating has already happened. Valuations are not currently a reason to worry.

Finally, what are the alternatives? Cash is increasingly competitive for the most cautious investors who are more concerned with capital preservation than growth. For the first time in years, cash on the side-lines is not dead money but a sensible precaution. Looking beyond cash, however, it's not easy to see where investors would prefer to put their money to work. With bond yields unlikely to rise much this year as the Fed pauses and other central banks resisting the urge to tighten, shares still offer the best combination of income and growth potential.

Select 50 recommendations: *In recent years, my fund picks have usually featured a global equity fund. For most investors, these are the best way to gain exposure to the stock market as they have built in diversification and, by definition, they benefit from the biggest hunting ground. Actively-managed funds cost more than passive funds but the best more than earn their higher fees.*

In my experience, global funds are run by some of the best managers in the industry and the Select 50 includes some excellent investors. Dan Roberts manages the ***Fidelity Global Dividend Fund****, a new entrant to my fund picks for 2019. He is a prudent manager who focuses on capital preservation as much as income and growth. I think he is a safe pair of hands for this stage in the market cycle.*

Others worth a mention are James Thomson, manager of the ***Rathbone Global Opportunities Fund****. This fund has a bias towards developed markets, especially the US, so will be a defensive play if investors look for safe havens this year. Another excellent manager, in charge of the best-performing of 2018's recommendations, is Jeremy Podger. The* ***Fidelity Global Special Situations Fund*** *is a good all-weather global fund.*

PROPERTY

The reasons to invest in commercial property are simple. It is a tangible, physical asset that provides some protection against inflation; it generally offers a high and predictable income stream; and it helps balance a portfolio, especially if the outlook is for heightened volatility in mainstream assets like bonds and shares. The diversification benefit of property holds true today and may be enough to persuade you to have some exposure to real estate. The other two cases are becoming harder to make.

It is still possible to find a reasonable income from real estate but it generally involves some kind of compromise and higher risk. Prime properties in the best locations stopped offering a decent yield quite some time ago. With the best buildings generating just 2.5% or so on their cost, there is barely enough income to offset depreciation, let alone compensate investors for the lack of liquidity in the asset class. At this level, a rise in yield of just 0.25% could equate to a 10% fall in value. That's a bad trade-off.

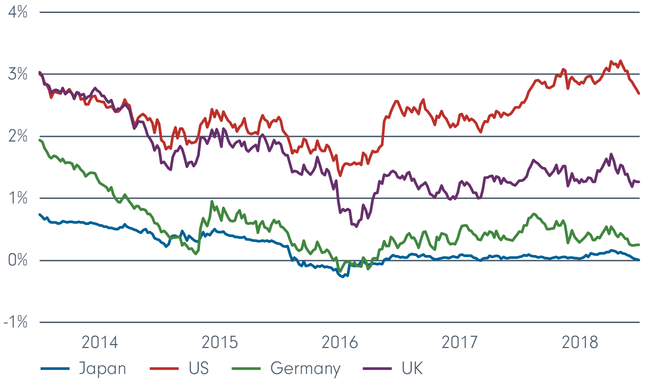
As for the security of an asset you can see and touch, that is less and less meaningful as the online world disrupts the High Street. The big discounts to book value at which stock-market-listed property investment companies trade tell you all you need to know about where valuations are heading for retail properties. Many retailers are being crippled by rent and rates; something has to give and it is the property owner who will likely pick up the tab.

So, the optimistic view for 2019 is that capital growth is marginally positive, with the total return from real estate attributable to rent. If you are looking for portfolio balance and a little bit of income, cash looks a better bet.

Important information: 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 the investment when you want to. There may be a delay 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.

BONDS

Government bonds: firm foundations



Source: Refinitiv, as at 31.12.18.

Past performance is not a reliable indicator of future returns.

Investors have been waiting for the end of the long bond bull market for many years. In 2018 it may finally have arrived. The tide that has lifted all boats – falling interest rates and other types of monetary stimulus – is now ebbing away. Making money out of fixed income is going to be much harder work and the features of the bond market that we have got used to – low volatility, low yields and positive returns may not be so obvious.

The safest part of the market is likely to be Government bonds where a pause by the Federal Reserve in its tightening cycle may mean that yields don't move much higher from here. If there are only a couple of further rate rises in March and June 2019, Treasury yields should remain about 3%. That's a reasonable return if the capital value of bonds is stable. The biggest risk to that scenario is rising inflation but there is no sign of that currently.

The bonds issued by companies, especially those with less secure balance sheets and higher levels of borrowing, look expensive, especially in the US where businesses look vulnerable to a slowing in the economy. Company bonds (known as credit) can be something of a canary in the coal-mine, with investors demanding higher income to compensate them for rising risks at the tail-end of the economic cycle. Higher yields equate to lower prices. Often this happens in the bond market before spilling over into shares.

One area that does look better value is emerging market debt where worries about growth and inflation are already priced in. The yield offered by emerging market bonds is higher than at any point since the financial crisis and some emerging market currencies are due a rebound versus the dollar.

Select 50 recommendations: *Bond funds should give a portfolio diversification, income and low volatility. Given the complexity of achieving that combination from such a wide range of different types of bonds, we prefer to leave the asset allocation and investment choice to seasoned experts with as broad a remit as possible. Within the Select 50, two funds offer that level of flexibility.*

The ***Fidelity Strategic Bond Fund*** *was managed for many years by Ian Spreadbury, now starting a well-earned retirement. The fund is now in the hands of Tim Foster and Claudio Ferrarese who have worked with Ian during an extended handover to ensure a smooth transition. The* ***Jupiter Strategic Bond Fund*** *is managed by Ariel Bezalel, a very experienced manager with a strong track record.*

Important information: There is a risk that the issuers of bonds may not be able to repay the money they have borrowed or make interest payments. When interest rates rise, bonds may fall in value. Rising interest rates may cause the value of your investment to fall..

COMMODITIES

The past year has been difficult for all the main commodities, albeit for different reasons. First, oil has retreated thanks to an unfavourable balance between supply and demand. There is just too much oil being produced. The US is now the world's biggest producer and Shale producers can make money at relatively low oil prices so there's no reason for them not to keep pumping. Donald Trump wants to keep fuel prices low for obvious reasons and he has been clever in playing other producers off against each other to ensure supply exceeds demand.

Precious metals have gone sideways for a long time now and that largely reflects the strength of the dollar. If the Federal Reserve pulls back from its planned interest rate rises, the dollar may weaken. That could allow gold to rise a bit, especially if investors start to focus on the inflationary potential of the Trump tax cuts. As for industrial metals, it's all about China. Even before trade tensions mounted, China was trying to reduce borrowings in the country. That has fed through to a weaker manufacturing sector which hits demand for metals, of which China is generally the biggest consumer.

So, the main reason to be interested in commodities is that bad news is already priced in. Any reduction in trade tensions, a fall in the dollar, output cuts by OPEC and Russia or stimulus in China could see better returns in 2019.

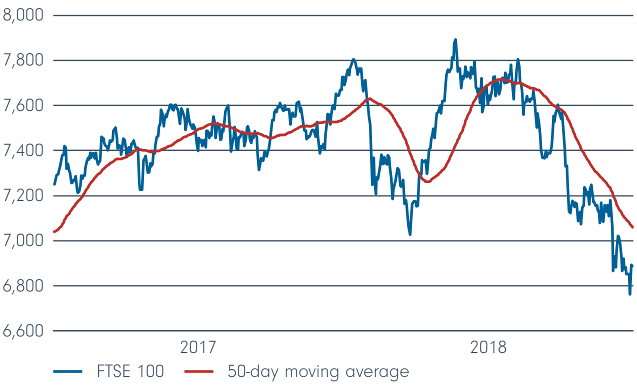
Select 50 recommendations: *Given the weakness in the oil price in 2018, probably the best way of playing a recovery in commodity prices is via funds with a big exposure to the oil majors. The share prices of stocks like BP and Shell have been weak since the spring on the back of the fall in the cost of crude. Bank of America Merrill Lynch forecasts a return to $75 a barrel. That would give the oil majors a boost.*

The ***JOHCM UK Equity Income Fund*** *has 17% of its assets invested in BP and Shell. They are the fund's two largest holdings. The* ***Franklin UK Equity Income Fund*** *has a smaller exposure to these two stocks but they still represent 10% of the fund and are its two biggest investments.*

Stock markets around the world

UK

UK: cheap versus history



Source: Refinitiv, price index as at 17.12.18.

Past performance is not a reliable indicator of future returns.

For investors in the UK stock market there is light at the end of the tunnel. One way or another the Brexit uncertainty that has hung like a millstone around investors' necks will be resolved in 2019. This will be a welcome relief to all.

For many businesses, it really doesn't matter whether Britain is in or out of the EU. For others they will have to adapt to new circumstances but they will do so. What will benefit all listed companies in the UK is the end of the Brexit discount which has seen shares sold down indiscriminately.

The valuation of the UK market has reached a level that must surely be attractive to anyone investing over the medium to long term. Of course, no-one has any idea what the next six months holds, and it is entirely possible that UK shares and the pound could fall further. But on a three-to-five-year view this looks like a good entry point.

The FTSE 100 currently yields nearly 5%. This compares with 10-year government bonds offering a yield of less than 1.3% and interest rates at just 0.75%. The average FTSE 100 share costs just 11 times expected earnings. Both measures are attractive.

For stock-pickers, the opportunities are plentiful. Within the FTSE 100, 18 companies currently yield more than 6%, a further 11 offer an income of 5% or better. Another 13 yield more than 4%. Of course, not all of these dividends will be paid but some simple caveats like checking whether the payouts are adequately covered by expected earnings will highlight the obvious problems.

The price you pay at the time you invest is the most important driver of your eventual return and it is a fact of investment life that the opportunity to secure really attractive prices only ever comes when the outlook is bleak, or very uncertain anyway.

Back in 1992 when the pound crashed out of Europe's exchange rate mechanism and Britain was emerging from the recent recession, investing in the UK market did not seem like a great idea. But look back on the past 25 years and you can see that the FTSE 250 index of mainly domestically-focused shares has risen eight-fold.

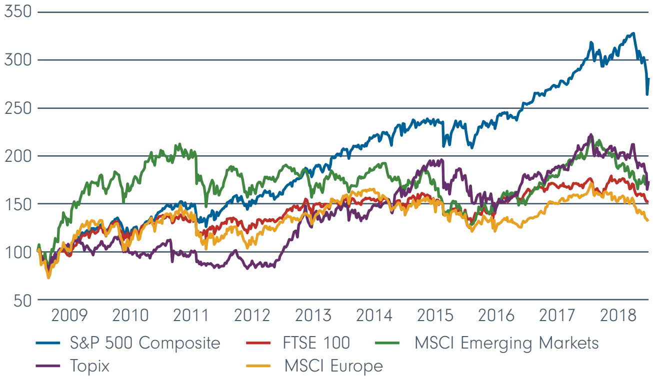
So, the UK is my biggest contrarian recommendation as we move into 2019. There's lots could still go wrong this year but I can't help feel that it's in the price.

Select 50 recommendations: *A year or so ago, I interviewed Alex Wright and Nick Train, two excellent fund managers with funds on the Select 50. They have very different approaches, one focused on out-of-favour stocks selling at a cheap price and one looking for high quality businesses that can ride out the ups and downs of the economic cycle but which are often more expensive as a result.*

Both the ***Fidelity Special Situations Fund*** *and the* ***Lindsell Train UK Equity Fund*** *could do well in 2019 if valuations recover as the Brexit fog lifts. Having to choose one of these for my annual fund picks, I went for the quality-focused Lindsell Train fund. It is probably better placed if things don't work out as I hope. But both are good funds and can sit happily alongside each other in a balanced portfolio.*

US

US: still leading the pack



Source: Refinitiv, total returns in local currency, figures rebased to 100.

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

Putting your money to work in the US stock market has been the sensible thing to do ever since the financial crisis. Wall Street has been the stand-out performer as the chart shows. Even in 2018, when volatility returned and the US market hit the buffers in the fourth quarter, American shares did better than most other stock markets around the world.

Nothing lasts forever, however. And the big question for investors in 2019 is whether the US can hang onto its crown. If GDP growth continues until July, this will be the longest US economic expansion since before the American civil war. But stock markets look forward and, while the S&P500 has very narrowly avoided a bear market (it fell 19.6% between October and Christmas), it has felt like a kind of reckoning.

The key determinant of whether the bull market resumes in 2019 is the timing of the next recession. Stock markets tend not to fall significantly in the absence of a recession. If a downturn can be avoided then the odds are stacked in favour of further market gains. In roughly 60% of years when recession is more than a year away, the S&P 500 has risen by more than 10%. In the years prior to a recession that gain was achieved only a quarter of the time and in nearly half these years the market fell by more than 10%.

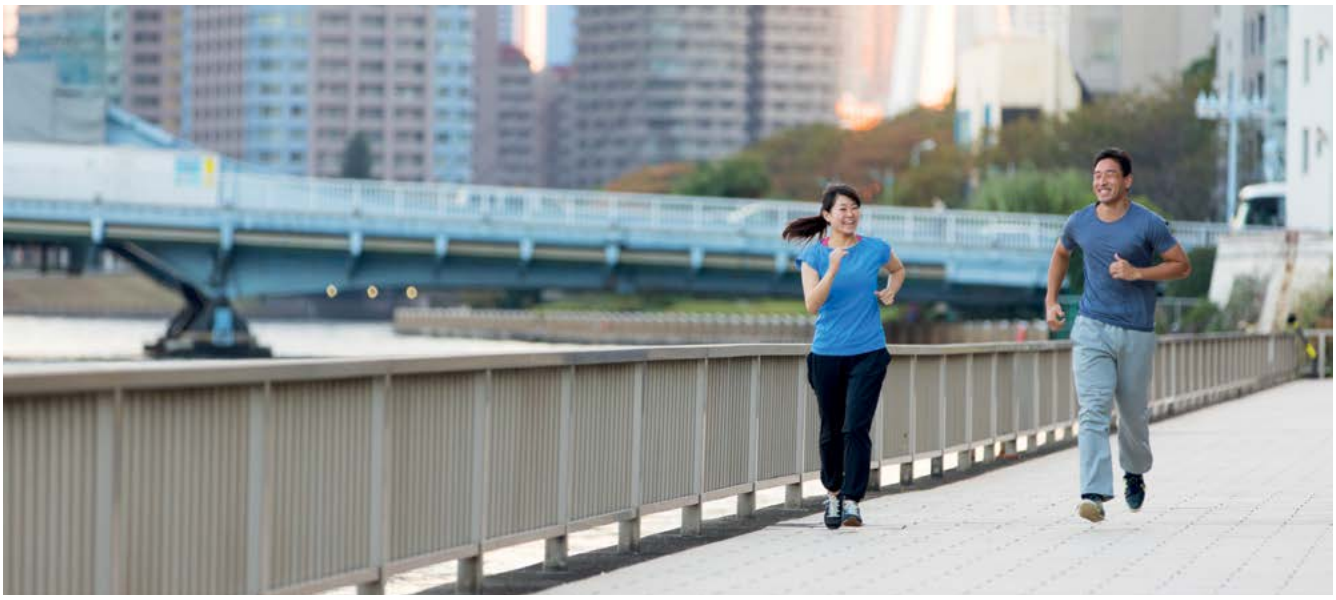
So, if you think that a recession is likely, even as far out as 2020, then 2019 could be the year in which investors start to really price in the downturn. As it stands, earnings are forecast to continue rising over the next 12 months but the probability that this will be offset by lower average valuations is increasing.

The good news is that much of the market froth has already been blown off. Before Christmas, Goldman Sachs looked at three different scenarios for 2019. The most pessimistic of these saw the S&P500 falling below 2,500. At the time the bank made the forecast it seemed far-fetched but the US benchmark hit 2,351 on Christmas Eve. Shares, which are currently priced at 14 times expected earnings have de-rated significantly.

From today's levels, Goldman Sachs's base case and bullish case (3,000 and 3,300) would represent an excellent outcome. Even if the S&P500 only ends 2019 where it started 2018, that will be a gain of 7%. When you start from a low base, the odds are stacked in favour of an acceptable return.

Of course, there is plenty to worry about in the US. The Fed continues to tighten policy, the President remains a wild card and who knows how the trade war with China will pan out. But after a savage fourth quarter correction, the risk/reward balance looks much more favourable.

Select 50 recommendations: *The US funds on the Select 50 have a range of approaches. At one extreme, the* ***JPM US Select Fund*** *has a focus on the technology stocks that did so well but which have disappointed more recently. Its portfolio tends to have higher valuations on average than the more cautious options. These include Angel Agudo's* ***Fidelity American Special Situations Fund****, which struggled to keep up when tech was flying high but has performed much better recently. Agudo has stuck to his guns, avoiding the FAANGs and building a more defensive portfolio that could do relatively well in a slower market. Also cheaper on average than its stable-mate is the* ***JPM US Equity Income Fund****. As you might expect, given its income focus, the fund is weighted towards banks, pharmaceuticals and oil & gas*



JAPAN

Japanese shares: unloved

Source: Refinitiv, as at 31.12.18.

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

Investors in Japan have had a year to forget. Having peaked in January 2018 at around 1,900, the Topix index ended the year at less than 1,500. That still means it has doubled since the election of reforming Prime Minister Shinzo Abe in late 2012 but it was starting from a very low base. Japan remains, in my opinion, one of the most unfairly out-of-favour markets in the world.

So what caused the big sell-off in 2018? The bearish case hinges on a handful of key arguments. The first is the belief that the world is looking down the barrel of a recession. If that were to happen, Japan would suffer more than most because it is highly dependent on global trade. Its stock market is more cyclical than other developed world markets.

The second negative argument is that the country is getting ready to hike its VAT rate in October 2019. Investors remember an earlier tax hike which triggered a big economic slowdown in 2014. A third concern is profit growth, which has been strong but which is bound to suffer if there is a general economic slowdown. Finally, overseas investors – who are a big factor in Tokyo – have been lured away by higher returns in America.

That explains why Japan has underperformed. So why might this be an overreaction? The first reason to be positive is the health of the Japanese consumer. The labour market is extremely tight in Japan and wages are rising as a result. The spectre of deflation no longer hangs over the Japanese economy. Even if the Japanese were not spending, inbound tourists certainly are. The number of Chinese visitors has risen more than four-fold in the past five years.

As for that VAT hike, it really is different this time. For one thing the scale of the hike is lower than five years ago – from 8% to 10% rather than 5% to 8%. In addition, key areas of the economy like food are exempt and there are tax breaks planned for big ticket items like cars and home renovations.

The most important argument in favour of Japanese shares, however, is valuation. Uniquely among major markets, Japanese shares are available at a cheaper multiple of earnings than they were in 2013. Profits have risen faster than share prices for six years. Importantly, shareholders are enjoying a bigger slice of those profits as big positive changes in corporate governance have made Japanese companies more shareholder-friendly. Dividends and share buybacks have grown strongly in the Abe era.

Select 50 recommendations: *We are spoilt for choice, with three good Japanese equity funds on the Select 50. The* ***Baillie Gifford Japanese Fund*** *regularly appears among our most popular funds but we also like Andrew Rose's approach and long experience in Japan, which you can access via the* ***Schroder Tokyo Fund****.*

EUROPE

Like the UK, Europe benefits from a high average dividend yield. That means an expected 4% price return from European shares next year could be twice as much once the income yield is added in. This means 2019 should be better than 2018, although that would not be difficult after a disappointing year.

Sentiment turned sharply lower last year as investors focused on the twin headwinds of trade tensions and unpredictable politics. Europe is particularly exposed to global trade, with many of the world's biggest and best exporters. A resolution of the US/China trade spat would provide some much-needed relief in the region.

As for the politics, Italy continues to cast a shadow while the ongoing Brexit uncertainty is unhelpful. Germany is looking to life after Merkel and France's President Macron has fallen out of favour. It was interesting that the cancellation of the parliamentary vote on Britain's withdrawal treaty triggered much bigger falls in European shares than in UK ones, which tend to be supported at times of crisis by a fall in the value of sterling.

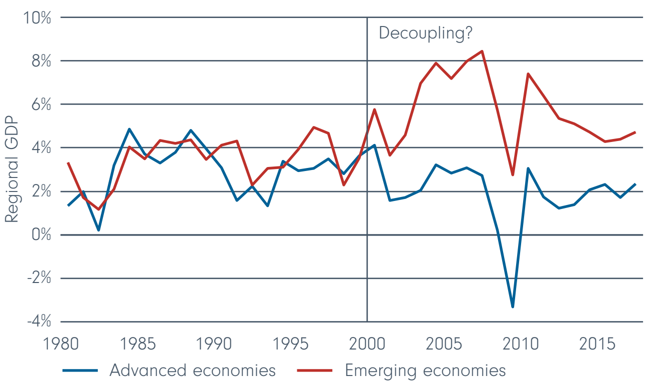
The good news in Europe is that the de-rating of markets appears to have already taken place, as it has in the UK and Japan. The fall in share prices has been more severe than the expected growth slowdown would imply. Also supportive is the ECB, which will not raise interest rates before the summer at the earliest and quite possibly not then either.

One bright spot in 2019 could be the oil & gas sector, which has a heavy weighting in European markets and could do well if, as forecast, the oil price bounces from its recent lows.

Select 50 recommendation: *Given the likelihood that interest rates will remain very low in Europe throughout 2019, keeping a lid on the yields of government bonds such as Bunds, dividend-paying shares in the region are likely to remain in favour. The* ***Invesco European Equity Income Fund****, run by Stephanie Butcher, was a disappointing fund pick in 2018 but it could do better this year.*

ASIA AND EMERGING MARKETS

Emerging markets: still growing



Source: Refinitiv, as at 17.12.18.

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 emerging markets can be more volatile than other more developed markets.

After a stellar 2017, last year was very disappointing in the Asia Pacific region, China in particular. Sentiment was hit hard by mounting trade tensions but the real story was the attempt by the Chinese authorities to rein in the country's huge debts. Cutting off the supply of finance to companies has taken some time to feed through into consumer demand but now the effects are becoming evident in sharply lower sales of big ticket items like cars.

There are two bits of good news for investors looking at the region now. First, the Chinese government is likely to swing back to modest stimulus as it becomes obvious that it may have overplayed its hand in clamping down on credit. Second, the collapse in share prices in 2018 has been so indiscriminate that great opportunities are emerging for stock-pickers in the country. Retail sales are still growing at around 8.5% and GDP growth is above 6%. Against that backdrop, falls of 40% or more in some consumption-related stocks look excessive.

The 2018 emerging market sell-off has taken valuations back to levels that compare with those during the financial crisis. Chinese A shares are an obvious example, but there is good value in other commodity-related businesses, too, such as miners, paper, fertilisers and oil & gas. Many of these shares offer high dividends too.

Although, emerging markets are vulnerable to trade fears and have suffered from a strong dollar, the underlying growth story is firmly intact. The rising purchasing power of emerging market consumers creates great opportunities for stock-pickers who can spot new growth areas.

Select 50 recommendations: *The past 12 months have delivered highly divergent performances from the Select 50 funds in the Asia and Emerging Markets category. Pick of the list has been the* ***Stewart Investors Asia Pacific Leaders Fund****, which invests in mainly large companies which can demonstrate a positive contribution to the sustainable growth of the region. This focus on quality has paid off in a difficult year.*

Much harder hit, and perhaps due a rebound, is the ***Fidelity Emerging Markets Fund****. Nick Price, its manager, promises a consistent focus on high quality companies which he expects to deliver good returns over the medium to long term as fundamentals reassert themselves.*

The Select 50 – Our experts' favourite funds

The funds on the Select 50 are hand picked from the range available on our fund supermarket. For more information on how these funds are selected visit 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 31st December)	2013-2014	2014-2015	2015-2016	2016-2017	2017-2018	Morningstar Fund Rating
ASIA AND EMERGING MARKETS						
Fidelity Emerging Markets	5.9	-1.1	19.7	30.1	-15.1	★★★
Fidelity Funds - Asian Special Situations	-	-	28.7	30.2	-8.7	★★★★★
Janus Henderson Emerging Markets Opportunities	4.8	-6.3	31.9	19.4	-11.6	★★★
Maple-Brown Abbott Asia Pacific ex Japan	-	-4.3	28.2	20.7	-10.3	★★★
Merian Asia Pacific	-	-3.1	32.1	38.5	-12.7	★★★★★
Stewart Investors Asia Pacific Leaders	19.9	1.9	19.6	13.5	5.4	★★★★★
BONDS						
Fidelity MoneyBuilder Income	12.1	-0.5	8.8	4.9	-2.4	–
Fidelity Strategic Bond†	9.1	-1.0	5.7	4.7	-3.5	–
Invesco High Yield	-	-1.2	7.9	9.4	-4.5	★★★
JPM Global High Yield Bond	1.1	-5.5	13.7	6.5	-3.7	★★★★
Jupiter Strategic Bond	4.3	1.2	7.4	4.4	-1.0	★★★★★
M&G Corporate Bond	10.8	0.1	8.6	5.3	-2.5	★★★★
M&G European High Yield Bond	-4.2	-2.9	21.9	9.8	-2.8	★★★
M&G Optimal Income	5.2	-0.9	8.1	5.8	-3.3	★★★★
Royal London UK Government Bond	11.4	0.1	9.0	1.7	-0.1	★★★
SLI Global Index Linked Bond	8.4	-1.1	9.7	1.8	-1.7	★★★★

† 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 31st December)	2013-2014	2014-2015	2015-2016	2016-2017	2017-2018	Morningstar Fund Rating
EUROPE						
Baring German Growth	-5.2	14.0	20.8	26.7	-22.7	★★★★★
Fidelity Funds - European Growth	-	-	24.5	11.9	-7.9	★★★★★
FP CRUX European Special Situations	1.7	13.2	21.4	20.9	-15.2	★★★★★
Invesco European Equity Income	-	6.3	21.4	14.2	-11.9	★★★
JOHCM European Select Values	2.2	6.3	23.1	14.6	-13.3	★★★★
Jupiter European Special Situations	-0.9	10.2	12.9	16.2	-15.0	★★★
Threadneedle European Select	4.5	11.1	12.5	19.6	-10.6	★★★★
GLOBAL						
BNY Mellon Long-Term Global Equity	9.6	5.8	26.1	13.8	2.7	★★★★
Fidelity Global Dividend	12.8	9.0	22.6	6.6	2.2	★★★★★
Fidelity Global Special Situations	14.7	10.8	27.9	16.9	-6.5	★★★★★
Invesco Global Equity Income	-	5.8	22.8	12.7	-9.2	★★
Rathbone Global Opportunities	9.6	15.6	16.8	20.1	-0.5	★★★★★
JAPAN						
Aberdeen Japan Equity	8.1	16.3	23.6	12.7	-15.6	★★★★
Baillie Gifford Japanese	0.1	11.9	33.9	26.6	-12.6	★★★★★
Schroder Tokyo	4.1	16.5	27.3	13.7	-10.4	★★★★
NORTH AMERICA						
Fidelity American Special Situations	27.6	8.7	34.2	-0.1	0.3	★★★★
JPM US Equity Income	21.3	2.3	36.8	7.0	-0.4	★★★★
JPM US Select	22.0	5.2	32.6	9.7	-1.7	★★★★
Merian North American	-	7.7	36.8	12.4	-3.8	★★★★★
Schroder US Mid Cap	18.9	6.8	42.1	5.8	-6.7	★★★★

STANDARDISED PERFORMANCE DATA (%) OVER THE PAST FIVE YEARS

% (as at 31st December)	2013-2014	2014-2015	2015-2016	2016-2017	2017-2018	Morningstar Fund Rating
UK						
Fidelity Enhanced Income	5.0	5.6	4.0	5.0	-9.0	★★
Fidelity Special Situations	-0.9	12.3	14.4	15.4	-13.5	★★★★
Franklin UK Equity Income	6.9	5.5	15.3	12.0	-8.9	★★★★
JOHCM UK Dynamic	2.8	0.1	21.2	16.1	-10.2	★★★★
JOHCM UK Equity Income	3.6	2.2	9.2	20.5	-5.9	★★★★
LF Lindsell Train UK Equity	7.3	11.5	11.3	20.7	-1.1	★★★★★
Liontrust UK Growth	1.8	9.6	18.1	14.2	-6.1	★★★★★
Majedie UK Equity	2.6	-0.3	21.3	6.2	-9.6	★★★★
Threadneedle UK Mid 250	3.8	20.0	-2.9	27.6	-19.2	★★
ALTERNATIVES						
Aviva Investors Multi-Strategy Target Return	-	4.5	1.1	-2.1	-6.2	-
Invesco Global Targeted Returns	-	1.6	3.6	1.3	-3.8	-
Investec Global Gold	-2.7	-18.7	84.1	0.0	-0.6	★★★★
iShares Global Property Securities Equity Index	-	4.4	23.8	1.6	0.1	★★★★
Jupiter Absolute Return	-0.2	5.9	10.2	-2.6	-0.1	-

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 31.12.13 to 31.12.18. 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

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 2019E	Dividend yield 2019E
Shares		%
US	15.1	2.2
Europe	12.1	4.3
UK	11.4	5.1
Japan	11.8	2.6
Asia Pac ex Japan	11.7	3.5
Emerging Market Asia	11.0	3.0
Latin America	11.6	3.9
Central East Europe, Middle East & Africa	8.5	4.9

	Redemption Yield
Bonds	%
ML Global High Yield	7.1
German 10-Year Bunds	0.3
ML Global Corporates	3.5
UK 10-Year Gilts	1.9
US 10-Year Treasuries	3.0

INVESTMENT PERFORMANCE AT A GLANCE

% (as at 31st December)	3 m	2013-2014	2014-2015	2015-2016	2016-2017	2017-2018
Shares						
Alphabet	-13.4	-5.4	46.6	1.8	32.9	-0.8
Amazon	-25.0	-22.1	117.7	10.9	34.5	28.4
Apple	-29.9	40.6	-3.0	12.5	48.5	-5.4
Euro STOXX	-6.2	9.1	11.5	-9.5	20.9	-8.0
Facebook	-20.2	42.8	34.1	9.9	53.4	25.7
FTSE 100	-5.3	4.7	-1.9	11.1	12.3	-0.7
FTSE 250	-10.1	5.3	12.8	3.5	16.9	-4.9
FTSE All Share	-6.1	4.7	0.6	9.8	13.4	-1.5
FTSE Small Cap	-7.0	3.3	7.6	10.8	20.5	-3.7
MSCI China	-6.8	-0.1	-7.8	1.5	43.0	-13.5
MSCI Emerging Markets	-5.4	1.4	-16.7	8.9	33.3	-8.8
MSCI India	-8.6	32.9	-8.7	2.3	22.8	3.6
MSCI Latin America	5.5	-8.6	-36.2	21.4	16.7	-4.4
Netflix	-28.5	7.2	134.4	8.2	55.1	39.4
Nikkei 225	-1.5	13.4	15.1	-5.5	26.4	0.3
S&P 500	-4.4	16.9	2.7	8.1	22.9	6.3
Shanghai SE	-5.0	20.9	28.4	-5.7	2.1	-22.0
Shenzhen	-13.6	12.3	21.3	-3.1	-3.8	-23.2
TOPIX	-3.9	12.1	12.0	0.0	22.0	-7.0
Bonds						
US 10-Year Treasuries	-0.7	8.2	1.9	0.9	1.5	-3.2
UK 10-Year Gilts	1.1	11.5	3.4	6.3	3.1	2.4
German 10-Year Bunds	0.3	12.6	3.2	3.1	0.8	2.1
JPM Emerging Markets Bond Index	-0.9	9.3	-0.2	7.0	10.2	-5.4
ML Global High Yield	-1.9	3.1	-4.3	10.4	11.7	-1.9
ML Global Corporates	-2.4	3.9	-4.2	3.5	8.8	-3.9
Commodities						
CRB Commodities Index	-5.3	-7.4	-28.2	4.0	0.8	-2.1
Crude Oil (Brent)	-25.0	-35.5	-38.6	11.4	29.5	-9.5
Gold Spot	1.7	-6.9	-8.8	10.2	8.7	-4.1
Silver	-2.6	-23.3	-10.7	15.1	-1.5	-14.6

Source: Refinitiv, 31.12.18. in local currency terms. Valuations: Source Citigroup Global Equity Strategist – Citi Research, MSCI, Worldscope, FactSet Consensus estimates as at 14.12.18. Bond Yields: Source Refinitiv, as at 30.11.18.

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