2017: Surprise!

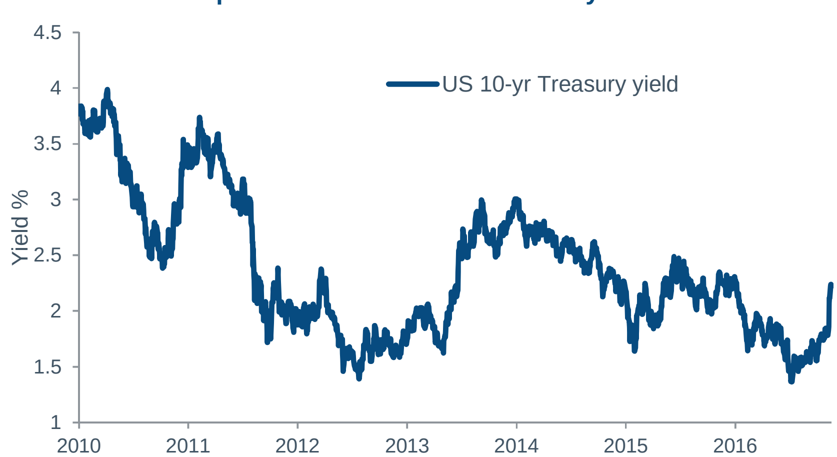
If 2016 taught us anything, it was to expect the unexpected – and for the unexpected to prove surprisingly popular for risk assets. Whilst 2017 may well be another year of surprises – which by definition I cannot predict – there are some themes to bear in mind.

A Keynesian renaissance

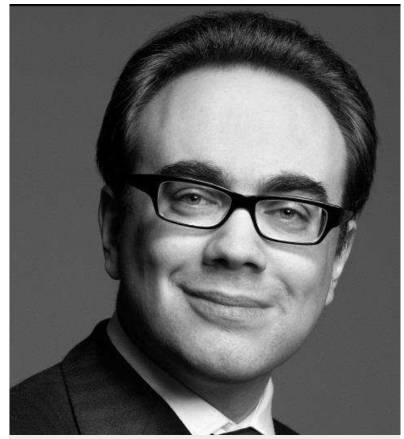
I would contend that the greatest short-term impact of a Trump victory will be the re-adoption of fiscal stimulus as a tool in managing the economy across developed markets. Both the UK's EU referendum vote and Trump's victory demonstrated the phenomenal – and perhaps unsurprising – level of dissatisfaction of the 'average worker' whose income has barely moved since 2008, and their frustration with the dogmatic adherence to austerity and 'you'll thank me later' policies of loose monetary and tight fiscal policy. Successful politicians in 2017 will be united by one mantra – we are all Keynesians now.

If this move to fiscal policy is borne out, we may have finally seen the end of the bond bubble. Fixed income has gone from already expensive to chronically over-valued in the past few years, driven by excessively loose monetary policy and interest rates hovering around zero. Just the shift in expectations from Trump's victory led to a sell-off within days (Chart 1), and that move may well look inconsequential compared with the full potential scale of the unwinding of the bond market. Expect, therefore, rising growth and inflation, although I would caution that interest rate rises may be slower than the market expects as governments exert pressure on 'independent' central banks to accept temporarily higher inflation as a price worth paying for reinvigorating stagnant economies. Whilst duration may be the enemy for some time, there will still be areas of value within fixed income. Most notably this includes local currency emerging market debt, which may offer much of the upside potential of emerging markets equity but with less downside risk and a substantial yield cushion to boot.

Chart 1: Post-Trump election sell-off in US treasury bonds



Source: Bloomberg, November 2016

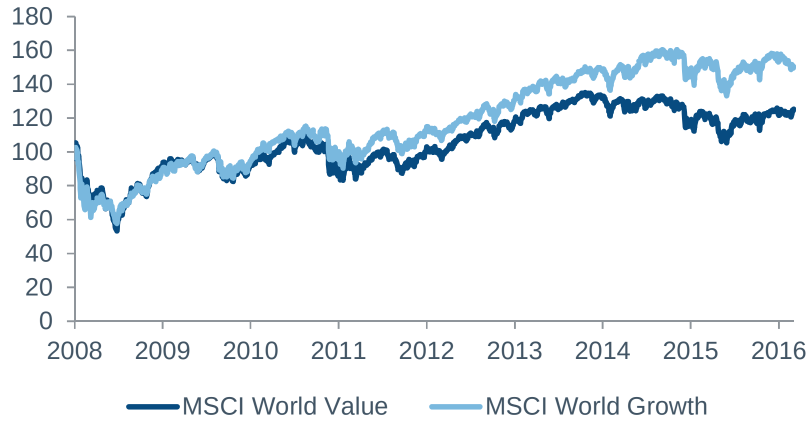


JAMES BATEMAN is Chief Investment Officer - Multi Asset.

James leads Fidelity Multi Asset's global team of investment professionals, which includes portfolio managers and a large research team. He has considerable experience in multi asset and multi manager investment, and joined Fidelity in 2012. James started his career as a management consultant at Mercer Management Consulting before moving into investment management; taking various research and portfolio management roles at IMS (now part of FundQuest), Northern Trust and Barclays Wealth. He has an MA in Economics from the University of Cambridge.

Turning to equities, the quality dividend-paying stocks that have driven much of the bull market since 2009 are likely to lose much of their lustre as interest rates move above zero – reversing the search for yield that has driven investors further and further up the risk spectrum. Value investing – which has suffered since the financial crisis – may now see a resurgence (Chart 2). Whether through active or smart beta strategies, equity exposure with a value approach is likely to deliver better returns than the broad index.

Chart 2: Value investing has suffered relative to growth since 2010



Source: Bloomberg, November 2016

Reappraising risk and volatility

Whatever the medium term impact of Trump's economic policies, we should expect increasing volatility as Trump (and geopolitics more generally) drive markets between fear and greed. A new and politically inexperienced leadership in the US, elected more on the basis of rhetoric than tangible policies, brings both inevitable uncertainty and likely missteps, even if calamity is avoided. This is before considering the potential for European political upheaval, as the UK attempts to renegotiate its European relationship amidst national elections in France and Germany. Such instances may lead to short-term reversals in trends both on an equity versus bonds basis and across industries and sectors. Some degree of tail risk hedging – perhaps through both gold and oil – may make sense in a portfolio, whilst active management and opportunistic buying of risk assets on weakness (and reducing at highs) would be prudent. 2017 is not the year to be static with your asset allocation.

Avoid the long term decline

Just as some markets seem to re-price almost immediately – think sterling against the US dollar following the UK's decision to leave the EU – others do so gradually and over protracted periods. One such example to my mind is UK small and mid-cap companies. It is hard to envisage anything but a negative trend for many of these names, with multi-year exit negotiations weighing on sentiment. Even if the outcome in a few years is benign, they will remain out of favour until hope moves to certainty. Whilst the FTSE 100 has been buoyed by the dramatic depreciation of sterling, inflating the index to new highs, in aggregate smaller companies will not see this benefit. This matters particularly for those with active equity exposure to the UK. The index concentration in mega cap names means the average manager runs a sizeable mid-cap bias, and those with a larger cap bias typically favour dividend-paying names which, as already discussed, are likely to lag on a global basis. Equity exposure in the UK – if taken at all – might therefore be better through a FTSE 100 tracker than an active manager, as even the best are likely to lag the index next year. The savvy investor will identify similar longer-term losers in US equity as Trump's policies become clearer.

Important Information

This document is for Investment Professionals only and should not be relied on by private investors.

This document is provided for information purposes only and is intended only for the person or entity to which it is sent. It must not be reproduced or circulated to any other party without prior permission of Fidelity.

This document does not constitute a distribution, an offer or solicitation to engage the investment management services of Fidelity, or an offer to buy or sell or the solicitation of any offer to buy or sell any securities in any jurisdiction or country where such distribution or offer is not authorised or would be contrary to local laws or regulations. Fidelity makes no representations that the contents are appropriate for use in all locations or that the transactions or services discussed are available or appropriate for sale or use in all jurisdictions or countries or by all investors or counterparties.

This communication is not directed at, and must not be acted on by persons inside the United States and is otherwise only directed at persons residing in jurisdictions where the relevant funds are authorised for distribution or where no such authorisation is required. Fidelity is not authorised to manage or distribute investment funds or products in, or to provide investment management or advisory services to persons resident in, mainland China. All persons and entities accessing the information do so on their own initiative and are responsible for compliance with applicable local laws and regulations and should consult their professional advisers.

Reference in this document to specific securities should not be interpreted as a recommendation to buy or sell these securities, but is included for the purposes of illustration only. Investors should also note that the views expressed may no longer be current and may have already been acted upon by Fidelity. The research and analysis used in this documentation is gathered by Fidelity for its use as an investment manager and may have already been acted upon for its own purposes. This material was created by Fidelity International.

Past performance is not a reliable indicator of future results.

This document may contain materials from third-parties which are supplied by companies that are not affiliated with any Fidelity entity (Third-Party Content). Fidelity has not been involved in the preparation, adoption or editing of such third-party materials and does not explicitly or implicitly endorse or approve such content.

Fidelity International refers to the group of companies which form the global investment management organization that provides products and services in designated jurisdictions outside of North America Fidelity, Fidelity International, the Fidelity International logo and F symbol are trademarks of FIL Limited. Fidelity only offers information on products and services and does not provide investment advice based on individual circumstances.

Issued in Europe: Issued by FIL Investments International (FCA registered number 122170) a firm authorised and regulated by the Financial Conduct Authority, FIL (Luxembourg) S.A., authorised and supervised by the CSSF (Commission de Surveillance du Secteur Financier) and FIL Investment Switzerland AG, authorised and supervised by the Swiss Financial Market Supervisory Authority FINMA. For German wholesale clients issued by FIL Investment Services GmbH, Kastanienhöhe 1, 61476 Kronberg im Taunus. For German institutional clients issued by FIL Investments International – Niederlassung Frankfurt on behalf of FIL Pension Management, Oakhill House, 130 Tonbridge Road, Hildenborough, Tonbridge, Kent TN11 9DZ.

In Hong Kong, this document is issued by FIL Investment Management (Hong Kong) Limited and it has not been reviewed by the Securities and Future Commission. FIL Investment Management (Singapore) Limited (Co. Reg. No: 199006300E) is the legal representative of Fidelity International in Singapore. FIL Asset Management (Korea) Limited is the legal representative of Fidelity International in Korea. In Taiwan, Independently operated by FIL Securities (Taiwan) Limited 15F, 207 Tun Hwa South Road, Section 2, Taipei 106, Taiwan, R.O.C. Customer Service Number: 0800-00-9911#2

IC16-123

Fidelity™
INTERNATIONAL