# The four pillars for 2019

**David Wolf** | Portfolio Manager
**David Tulk, CFA** | Portfolio Manager

### Key Takeaways

- As in 2018, cross-currents suggest market volatility ahead, requiring disciplined asset allocation
- Macro pillar points to particular caution, especially in Canada
- But asset classes are all now cheaper, which is encouraging for longer-term returns

2018 was a difficult year for investors. No less so for those of us allocating assets on behalf of investors. As Fidelity's market strategist Jurrien Timmer has pointed out, despite a meagre 1.7% return, cash was actually the best-performing of any asset class for a USD-based investor for the first time since at least 1951. Absolute returns available to Canadian investors were a bit better, reflecting the tailwind to unhedged foreign asset returns from the broad 6% depreciation in the Canadian dollar through the year. Still, a 60/40 index portfolio made up of half unhedged foreign assets and half Canadian assets would have shown a loss in 2018 (even gross of fees).

Moreover, 2018 was a year particularly amenable to getting whipsawed. The strong performance of equities in January of last year gave way to sharp losses in February; the grind up through much of the remainder of the year was more than reversed in a disastrous Q4. As we write in early February, risk assets have begun the year by reversing some of the fourth quarter's losses, while bonds have generally held in.

It is through these volatile periods that the disciplined approach taken both by ourselves as asset allocators and by our underlying equity and bond managers is particularly rewarded. Not all of our multi asset class funds managed to eke out positive returns net of fees, but 24 of the 26 main funds for which our team is responsible finished in the top quartile relative to peers for the year as a whole (See Exhibit 1).

Does all of this herald a year ahead with greater opportunity for investors? As usual, we apply our four-pillar framework to answer this question and thus guide our active allocation decisions.

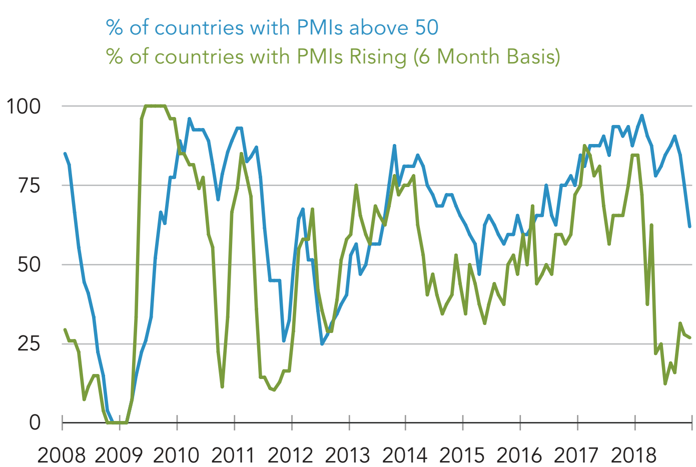
Our **macro** pillar, on which we rely most heavily, suggests caution. The previously-flagged slowdown in global growth is both intensifying and broadening (see Exhibit 2), although for now the data continue to point to only a small risk of recession. Markets appeared to be overly fearful of an imminent risk of recession late last year; the subsequent bounce suggests that investors may now have a more balanced view. A big part of that bounce, however, has also been prompted by the view that the US Federal Reserve tightening cycle is now done, and that the broader headwind of global policy tightening is not as threatening as previously judged.

That may be an overly sanguine view. The reduction in global central banks' balance sheets is proceeding unabated. And if the Fed is indeed done raising its policy rate, it likely means that the economy has slowed sharply, enough so to put at risk the earnings expectations that the market is now relying on. By contrast, if the economy stays fairly healthy, the Fed is likely to keep tightening, given the tightness of US labour markets and the risk of future inflation. Either way, the nexus of policy and the economy is unlikely to be particularly market-friendly as capacity constraints bind, which is typical of the late-cycle period we are now in.

Two other market challenges appear to us to be underestimated. First, the threat posed by the ongoing 'trade war' is very difficult to analyze, both because of the unpredictability of the politics involved and because the modern global economy has never experienced the sort of protectionism now being contemplated. The fact that this risk essentially can't be modeled means it probably is insufficiently discounted in investors' expectations. Second, closer to home, household spending growth in Canada is finally buckling as high debt levels meet tightening financial conditions. This is happening slowly but surely, as seems clear in data such as credit growth, retail sales and housing activity. We remain skeptical that exports and business investment can pick up the slack in this environment of weaker global growth and downside trade risks. The plunge in oil prices in recent months added further to downside pressure on the Canadian economy, which we continue to believe the consensus is underestimating; a Canadian recession in 2019 cannot be ruled out (see Exhibit 3).

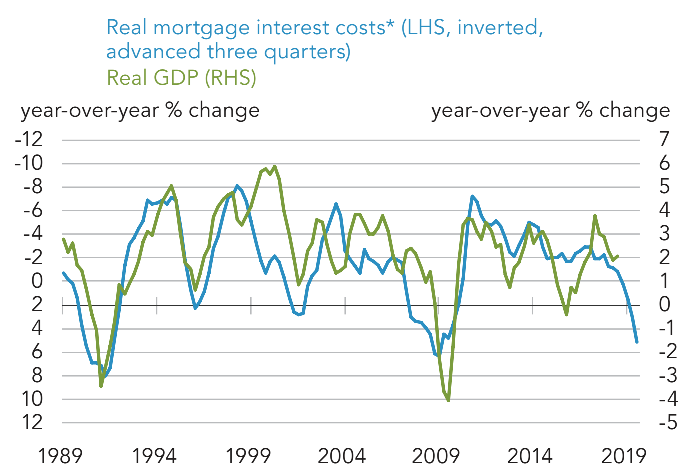
The **bottom-up** pillar – the collection of insights we gather from our underlying asset class portfolio managers and analysts – is somewhat more constructive. While earnings expectations are generally falling, our intelligence seems more consistent with a moderation in earnings growth rather than outright contraction, with

**EXHIBIT 2: Global economy decelerating**




Note: Data shown for 30 largest world economies
Sources: Haver Analytics, FMR Co.

**EXHIBIT 3: Higher rates biting in Canada**



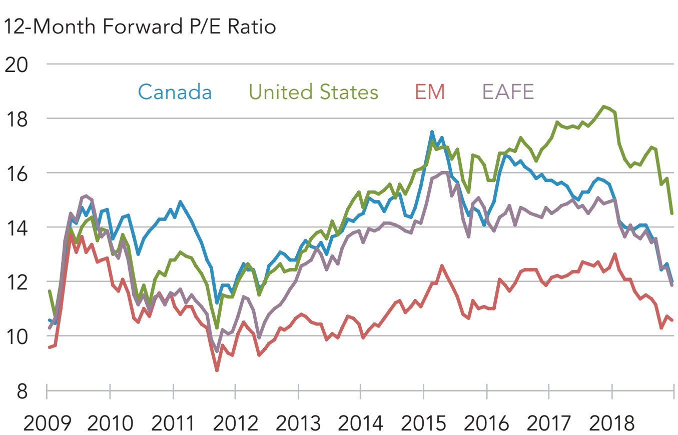

* CPI mortgage interest cost component deflated by total CPI
Sources: Statistics Canada, Haver Analytics, FMR Co.

very few stories of companies hitting the kind 'sudden stop' that markets had fretted about. However, our equity colleagues in Canada are generally less sanguine regarding the outlook for Canadian companies, as has been the case for some time.

The **valuation** pillar is also more constructive, at least relative to recent years. Through 2018, equity P/E's fell, government bond yields rose and credit spreads widened. This cheapening across asset classes is encouraging with respect to absolute returns ahead, but is somewhat ambiguous regarding our allocation decisions, given that as asset allocators we are most focused on relative valuations. On net, the valuation improvement in equities – exemplified by the four-multiple-point peak-to-trough decline in equity forward P/E's through 2018 – looks most compelling (see Exhibit 4).

The **sentiment** pillar – where we look to lean against the most popular and crowded trades – is commonly the hardest to get a handle on, and the current period is no exception. Investors were clearly gripped by fear in the fourth quarter, but have equally clearly breathed

**EXHIBIT 4: Equities cheaper around the world**




Note: Based on consensus forward earnings.
Sources: Factset, FMR Co.

a sigh of relief with the rally to start the year, leaving ambiguous the signal we are getting from the breadth of the sentiment and positioning indicators we look at.

Overall, the signals with respect to risk assets coming from each of our four pillars have evolved over the past year, but the general notion of 'cross-currents' remains intact. This, coupled with the historical experience in late cycle of lower returns, higher volatility and a generally wider range of outcomes for markets, keeps us in a broadly neutral stance when it comes to equity exposure.

We continue to try to add value instead with active intra-asset class positions, notably a rotation away from North American (particularly Canadian) equities towards emerging markets and Japan, which look relatively inexpensive and still largely overlooked by most investors. On the fixed income side, we have generally reduced our exposures to lower credit-quality sectors such as high yield bonds, floating rate notes and convertible bonds. We also expect that the late-cycle volatility which tends to reduce the reliability of the opportunities for active asset allocators may actually increase the opportunities for our stock-pickers, which they indeed have tended to report over the past several weeks.

Regardless, our job as asset allocators will remain the same – to maximize return and manage risk for each of the funds under our care, with the goal of making the whole greater than the sum of its parts.

**David Wolf and David Tulk, February 4, 2019**

Follow Fidelity Canada on Twitter @fidelitycanada

**EXHIBIT 1**

| Fidelity multi-asset class fund | Morningstar category | Performance 1 yr | Peers beaten %, 1 Yr | Number of funds in the category, 1 Yr | Performance 3 Yr | Peers beaten %, 3 Yr | Number of funds in the category 3 Yr | Performance 5 Yr | Peers beaten %, 5 yr | Number of funds in the category 5 Yr | Performance 10 Yr | Peers beaten %, 10 Yr | Number of funds in the category 10 Yr | Performance since inception | Peers beaten since inception | Number of funds in the category since inception |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Fidelity American Balanced Fund F | Global Equity Balanced | 3.84 | 98 | 1,246 | 4.39 | 84 | 934 | – | – | – | – | – | – | 7.49 | 98 | 779 |
| Fidelity Asset Allocation Private Pool F | Canadian Neutral Balanced | (0.05) | 100 | 719 | 3.15 | 49 | 609 | 5.65 | 93 | 478 | – | – | – | 6.69 | 89 | 337 |
| Fidelity Balanced Income Private Pool F | Canadian Fixed Income Balanced | (0.24) | 88 | 568 | 2.92 | 78 | 469 | 5.05 | 98 | 384 | – | – | – | 5.62 | 93 | 202 |
| Fidelity Balanced Managed Risk Portfolio F | Global Neutral Balanced | (0.47) | 84 | 1,544 | – | – | – | – | – | – | – | – | – | 3.90 | 81 | 1,285 |
| Fidelity Balanced Portfolio Series F | Global Neutral Balanced | (1.38) | 76 | 1,544 | 3.45 | 66 | 1,135 | 5.82 | 82 | 835 | 8.58 | 87 | 365 | 5.04 | 81 | 199 |
| Fidelity Balanced Private Pool Series F | Global Neutral Balanced | (1.74) | 72 | 1,544 | 3.53 | 68 | 1,135 | 5.65 | 79 | 835 | – | – | – | 6.65 | 76 | 406 |
| Fidelity Canadian Asset Allocation F | Canadian Equity Balanced | (2.85) | 86 | 491 | 3.74 | 53 | 397 | 4.48 | 79 | 322 | 6.81 | 64 | 172 | 5.64 | 76 | 35 |
| Fidelity Canadian Balanced Series F | Canadian Neutral Balanced | (2.36) | 80 | 719 | 3.40 | 58 | 609 | 5.42 | 91 | 478 | 8.47 | 95 | 179 | 6.83 | 90 | 40 |
| Fidelity Conservative Income Fund F | Global Fixed Income Balanced | 1.17 | 95 | 664 | 2.32 | 60 | 412 | – | – | – | – | – | – | 3.01 | 83 | 340 |
| Fidelity Conservative Income Private Pool F | Global Fixed Income Balanced | 1.23 | 96 | 664 | 2.49 | 65 | 412 | – | – | – | – | – | – | 4.03 | 89 | 295 |
| Fidelity Conservative Managed Risk Portfolio F | Global Fixed Income Balanced | 0.57 | 92 | 664 | – | – | – | – | – | – | – | – | – | 3.07 | 90 | 541 |
| Fidelity Dividend Series F | Canadian Dividend & Income Equity | (1.93) | 87 | 637 | 4.39 | 36 | 519 | 5.31 | 86 | 388 | 9.58 | 81 | 195 | 8.05 | 90 | 83 |
| Fidelity Global Asset Allocation Private Pool F | Global Neutral Balanced | 1.37 | 93 | 1,544 | – | – | – | – | – | – | – | – | – | 0.69 | 91 | 1,529 |
| Fidelity Global Balanced Portfolio F | Global Neutral Balanced | (0.44) | 85 | 1,544 | 3.78 | 75 | 1,135 | 6.77 | 89 | 835 | 9.13 | 93 | 365 | 5.10 | 84 | 199 |
| Fidelity Global Dividend Series F | Global Equity | (2.55) | 71 | 1,923 | 2.88 | 37 | 1,338 | 8.67 | 74 | 986 | 10.20 | 74 | 491 | 4.25 | 63 | 323 |
| Fidelity Global Growth Portfolio Sr F | Global Equity Balanced | (1.27) | 87 | 1,246 | 4.93 | 91 | 934 | 7.71 | 94 | 639 | 10.98 | 98 | 322 | 5.74 | 94 | 207 |
| Fidelity Global Income Portfolio Sr F | Global Fixed Income Balanced | 0.57 | 91 | 664 | 2.91 | 82 | 412 | 5.96 | 100 | 238 | 7.99 | 95 | 124 | 5.13 | 93 | 68 |
| Fidelity Global Monthly Income Ser F | Global Neutral Balanced | 1.40 | 93 | 1,544 | 3.27 | 62 | 1,135 | 8.19 | 95 | 835 | 9.45 | 95 | 365 | 5.16 | 85 | 199 |
| Fidelity Growth Portfolio Series F | Global Equity Balanced | (2.70) | 77 | 1,246 | 4.36 | 83 | 934 | 6.54 | 87 | 639 | 10.00 | 92 | 322 | 5.50 | 92 | 207 |
| Fidelity Income Allocation Series F | Canadian Fixed Income Balanced | 1.36 | 98 | 568 | 2.79 | 72 | 469 | 4.81 | 96 | 384 | 9.70 | 100 | 166 | 8.07 | 100 | 85 |
| Fidelity Income Portfolio Series F | Global Fixed Income Balanced | (0.02) | 79 | 664 | 2.76 | 75 | 412 | 5.21 | 94 | 238 | 7.33 | 89 | 124 | 4.93 | 85 | 68 |
| Fidelity Monthly Income Series F | Canadian Neutral Balanced | (1.17) | 96 | 719 | 3.35 | 56 | 609 | 4.38 | 77 | 478 | 9.13 | 99 | 179 | 7.83 | 98 | 86 |
| Fidelity NorthStar Balanced Sr F | Global Fixed Income Balanced | 1.38 | 98 | 664 | 1.80 | 41 | 412 | – | – | – | – | – | – | 6.98 | 100 | 266 |
| Fidelity Tactical Strategies Series F | Tactical Balanced | (1.96) | 77 | 390 | 4.22 | 86 | 270 | 6.22 | 99 | 166 | – | – | – | 6.20 | 83 | 83 |
| Fidelity US Gr & Inc Private Pool F | Global Neutral Balanced | 6.07 | 100 | 1,544 | 5.23 | 96 | 1,135 | 9.53 | 99 | 835 | – | – | – | 10.52 | 99 | 795 |
| Fidelity US Monthly Income Ser F | Global Neutral Balanced | 3.59 | 98 | 1,544 | 4.07 | 81 | 1,135 | 9.27 | 98 | 835 | – | – | – | 10.69 | 99 | 671 |

Source: Morningstar, as at December 31, 2018.

## Authors

**David Wolf** | Portfolio Manager

David Wolf is a portfolio manager for Fidelity Investments. He is the co-manager of Fidelity Managed Portfolios, Fidelity Canadian Asset Allocation Fund, Fidelity Canadian Balanced Fund, Fidelity Monthly Income Fund, Fidelity U.S. Monthly Income Fund, Fidelity U.S. Monthly Income Currency Neutral Fund, Fidelity Global Monthly Income Fund, Fidelity Dividend Fund, Fidelity Global Dividend Fund, Fidelity Income Allocation Fund, Fidelity Balanced Managed Risk Portfolio and Fidelity Conservative Managed Risk Portfolio. He is also portfolio co-manager of Fidelity Conservative Income Private Pool, Fidelity Asset Allocation Private Pool, Fidelity Asset Allocation Currency Neutral Private Pool, Fidelity Balanced Private Pool, Fidelity Balanced Currency Neutral Private Pool, Fidelity Balanced Income Private Pool, Fidelity Balanced Income Currency Neutral Private Pool and Fidelity U.S. Growth and Income Private Pool.

**David Tulk, CFA** | Portfolio Manager

David Tulk is a portfolio manager for Fidelity Investments. He is the co-manager of Fidelity Balanced Managed Risk Portfolio, Fidelity Conservative Managed Risk Portfolio, Fidelity Conservative Income Fund and Fidelity Conservative Income Private Pool.

### Endnotes

The quartiles divide the returns of all funds in a category into four equal regions. Expressed in terms of rank (1, 2, 3 or 4), the quartile measure shows how well a fund has performed compared to all other funds in the same category as defined by Morningstar, and are updated monthly. For multi-series funds (Series A, Series B etc.), each series is rated separately and counted as a fraction of an investment within this scale, which may cause slight variations in the distribution percentages. This accounting prevents a single portfolio in a smaller category from dominating any portion of the rating scale. The top 25% of funds (or quarter) are at the first quartile, the next 25% of funds are at the second, and the next group is at the third quartile. The bottom 25% of funds with the poorest performance are at the fourth quartile.



Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus, which contains detailed investment information, before investing. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.

Views expressed regarding a particular company, security, industry or market sector are the views of that individual at the time expressed and do not necessarily represent the views of Fidelity or any other person in the Fidelity organization. These views may not be relied upon as investment advice, nor are they an indication of trading intent on any Fidelity Fund. These views are subject to change at any time based upon markets and other conditions, and Fidelity disclaims any responsibility to update such views.

Certain statements in this commentary may contain forward-looking statements (“FLS”) that are predictive in nature and may include words such as “expects,” “anticipates,” “intends,” “plans,” “believes,” “estimates” and similar forward-looking expressions or negative versions thereof. FLS are based on current expectations and projections about future general economic, political and relevant market factors, such as interest and foreign exchange rates, equity and capital markets, and the general business environment, in each case assuming no changes to applicable tax or other laws or government regulation. Expectations and projections about future events are inherently subject to, among other things, risks and uncertainties, some of which may be unforeseeable and, accordingly, may prove to be incorrect at a future date. FLS are not guarantees of future performance, and actual events could differ materially from those expressed or implied in any FLS. A number of important factors can contribute to these digressions, including, but not limited to, general economic, political and market factors in North America and internationally, interest and foreign exchange rates, global equity and capital markets, business competition and catastrophic events. You should avoid placing any undue reliance on FLS. Further, there is no specific intention of updating any FLS, whether as a result of new information, future events or otherwise.

“Fidelity Investments” and/or “Fidelity” refers collectively to: i) FMR LLC, a US company, and certain subsidiaries, including Fidelity Management & Research Company (FMR Co.) and Fidelity Management & Research (Canada) ULC (“FMR-Canada”); and ii) Fidelity Investments Canada ULC (“FIC”) and its affiliates. FMR-Canada commenced business in Ontario on February 1, 2018. FMR-Canada is registered as a portfolio manager with the Ontario Securities Commission (“OSC”) and as a portfolio manager with the other Canadian securities commissions. The scope of FMR-Canada’s business is currently limited to offering the Global Asset Allocation (“GAA”) strategies through a discrete portfolio management team at FMR-Canada. The GAA strategies are offered by FMR-Canada on a sub-advised basis to accounts advised by Fidelity Investments Canada ULC (“FIC”), with FMR-Canada acting as either direct sub-adviser to FIC or as sub-adviser through non-Canadian Fidelity advisers, including (and principally) US SEC-registered investment advisers, such as FMR Co Inc. (“FMRCo”). FMR-Canada does not offer these strategies directly to investors in Canada. FMR-Canada has also registered “Fidelity Investments” as a trade name in Canada.



121191-v2019124 INM 120058