AUGUST 2014

TECHNICAL ANALYSIS

Near-term correction should lead to a solid entry point to secular bull market

There could be some early signs of a correction in the US given the underperformance of domestically focused small caps relative to large caps. But if a second-half correction does materialise, it is not likely to be nearly as severe as the -20% of 2011. Overall the global Advance-Decline line remains supportive, especially for the longer-term appeal of large-cap stocks. A market pause would present investors with another good long-term buying opportunity, since the well-established secular bull market is expected to continue after this pullback. This rather optimistic outlook is supported by gradually improving economic recoveries and sustainable low volatility; Asia potentially leading a much-anticipated rerating of emerging market stocks; and technically speaking, the 2013 breakout to new highs of US equities.

Jeff Hochman is Director of Technical Analysis and a member of Fidelity's Asset Allocation Group.

Before he joined Fidelity in 1996, Jeff spent five years with Deutsche Bank as an equity analyst and strategist, and worked for Chase Manhattan Bank prior to that.

Jeff holds a Masters degree in International Management and a BA in Political Science and English Literature.

CURRENT MARKET OUTLOOK

Strong market breadth should offset any correction

After five strong years of the current secular bull market that commenced in 2009 – confirmed by US-led all-time highs in May 2013 – real returns of near 20% a year are nearing the historical peaks of previous secular bull markets that subsequently led to market corrections before resuming the long-term bull story. To this end, we have been expecting a pause in 2014 to digest all the gains and confirm the breakout. While this is still possible, it should not be terribly severe because market breadth, as measured by the global Advance-Decline line, is still too strong. The market remains ahead of the simple Cycle Composite model I follow, which still suggests a correction in the second half followed by a more significant buying opportunity leading into 2015. Although presently out of synch, the model has a very good hit rate and remains worth monitoring.

Financial sector stability is deemed a necessity for a new Europe and UK upleg

The UK and Europe have struggled lately, churning sideways as pressure on the banks and industrial sectors, as well as strong currencies and a raft of recent profit warnings act as brakes on the market after a 50% rerating from 2012. Eventually, we can expect the FTSE 100 to break through the 7000 level to new price highs (the total return is already 30% higher than the 2007 peak). However, at present, there are insufficiently strong chart patterns supporting overall price action to push through the barrier. Again, the bank sector in particular needs to break higher out of its trading range to prompt another concerted upleg in Europe.

Pick-up in Asian emerging markets supports global equity outlook

The prospects for Asia and some emerging markets are picking up; technically they are very promising for the second half of the year. The huge emerging market outflows in 2013 brought about a contrary buy signal. Very importantly, Chinese large caps and H-Shares are now performing much better, threatening to end a four-year dominant downtrend. Here too, financials remain key, with unquantified risks – NPLs and the debt story – possibly being trumped by the recent cyclical stimulus and the end of the recent derating momentum.

Fidelity WORLDWIDE INVESTMENT

Small and mid caps could remain under pressure

Small and mid caps have been hit hard and are highly correlated to high yield bond yields, which have also partly unwound lately. Although the valuation gap has narrowed versus large caps, it is still historically high and expected consensus EPS growth rates of greater than 20% in Europe for small and mid caps are likely to be wishful thinking. Near term at least, small caps could remain under pressure if the perception that HY yields have hit a floor persists into the fourth quarter.

Regional variations in valuations and earnings growth

Globally, earnings growth expectations remain a key risk this year and next. Developed markets have already rerated considerably with European, UK and US stocks largely trading on forward and trailing PEs that are generally considered to be fair value to expensive. A positive development for global equities could be the end of the derating process across emerging markets and particularly Asian stocks. Consensus analyst forecasts show double-digit global EPS growth in 2014 and 2015, but as is typical in earnings forecasting, 2014 EPS is being reduced, but 2015 EPS is 10%+ higher with small and mid caps even double. The regional pace of downgrades has moderated, but as current earnings season is showing, it remains very stock-specific in terms of hitting/missing targets. PE multiples could expand further if inflation remains low; this is something to watch.

The outlook for inflation remains relatively benign

UK and US long bond yields are subdued because inflation expectations are still relatively benign, but this could change suddenly if wage growth eventually creeps higher. UK and US short-term rates are rising in anticipation of another rate tightening cycle commencing, so yield curves have been flattening. In Europe, the opposite of course is happening with yields pushing even further lower to challenge the 2012 lows.

Sterling leads the major currencies

Sterling's strength is slowing slightly as we've already seen against the US dollar, and the euro finally seems to be weakening versus most major blocs as short-term rate differentials start to bite. Emerging market currencies are showing a modest rebound (with associated inflows to emerging market bonds). The recent RMB devaluation is likely coming to an end.

Healthcare maintains sector leadership

Despite a second quarter mini sell-off, sector leadership remains with healthcare in many regions. Energy is showing strength but is extended in the short term, and utilities to date are supported by relatively high dividend yields in a low yield environment. Technology is stronger in select mega and large caps than the many small- and mid-cap technology names. Importantly, select materials are benefiting from the recovery in the emerging markets, but this is far from leading to a new supercycle.

There are still no signs of a meaningful correction in the US market

Chart 1. Source: Bloomberg, ML, WSJ.

At more than half way through the year there is little to suggest there are any meaningful signs of a correction in the US. The second half of the year may prove more tempestuous. The expected consolidation is likely to only mean a slower growth path from the 2013 secular breakout. The long-term upwards trend line in this chart looks like it won't be broken. I still expect that this year has the potential to be a slower-growth year with a second-half correction, but we haven't seen that in the US just yet, except in terms of small caps, which is a trend we should monitor closely.

At this five-year stage of the secular bull market, it could be time for a pause…

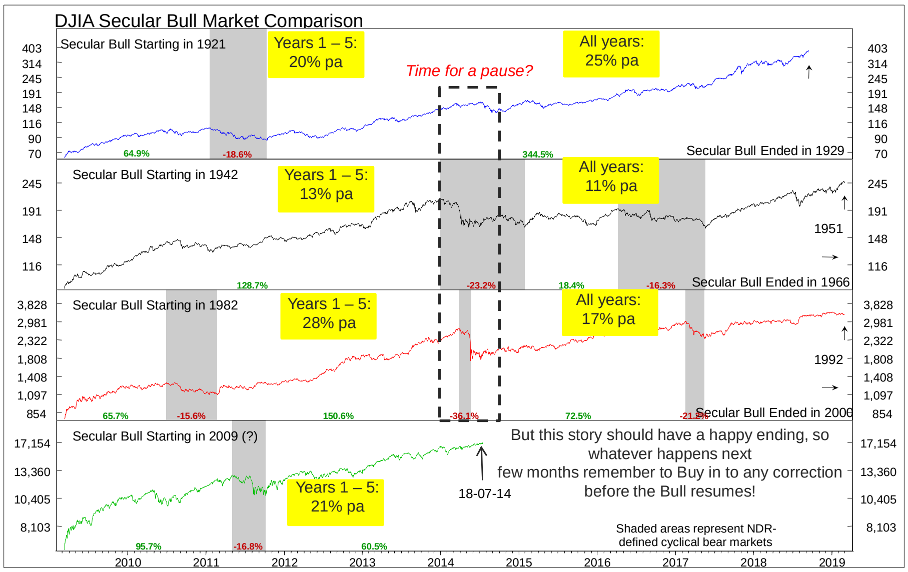


Chart 2. Source: Ned Davis Research.

This chart breaks down the Dow Jones 30 into three distinct secular bull trends, which started in 1921, 1942 and 1982. The grey shaded areas on the chart represent cyclical bear markets. The chart shows that these secular bull markets show similarities in returns over the first five years. Notably, it also shows that these bull markets experienced a pause in momentum around year five before they resumed their uptrends. Assuming that the 2009-vintage secular bull (see green line in the chart) follows the same pattern as these previous bulls, then investors should remember to buy during the correction before the bull resumes.

No sign of any real pick-up in volatility despite some market jitters

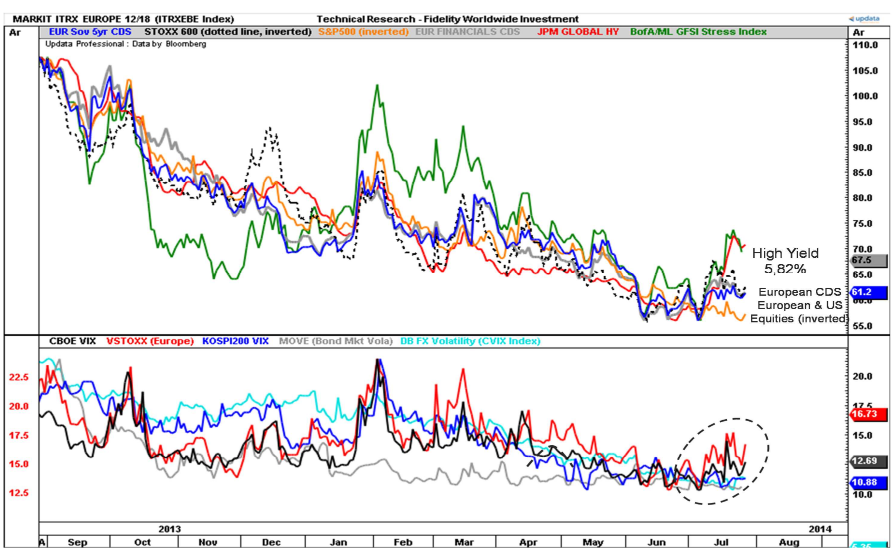


Chart 3. Source: Bloomberg.

As the US Federal Reserve ends its quantitative easing (QE) programme in October and the market is somewhat tense, recent comments made by its chairman Janet Yellen have caused some jitters in the market. Yellen said that valuations for high yield bonds appear stretched and she also made the same observation about smaller social media and biotech stocks. The yellow line (inverted) in the upper chart shows that to date there has been no broad impact on US equities and volatility levels remain cyclically low. This could change suddenly of course as the base is so low, but is unlikely to lead to a period of sustained higher volatility for now unless geopolitical tensions due indeed rise even further.

Consensus EPS growth forecasts revised higher even as revisions are flat

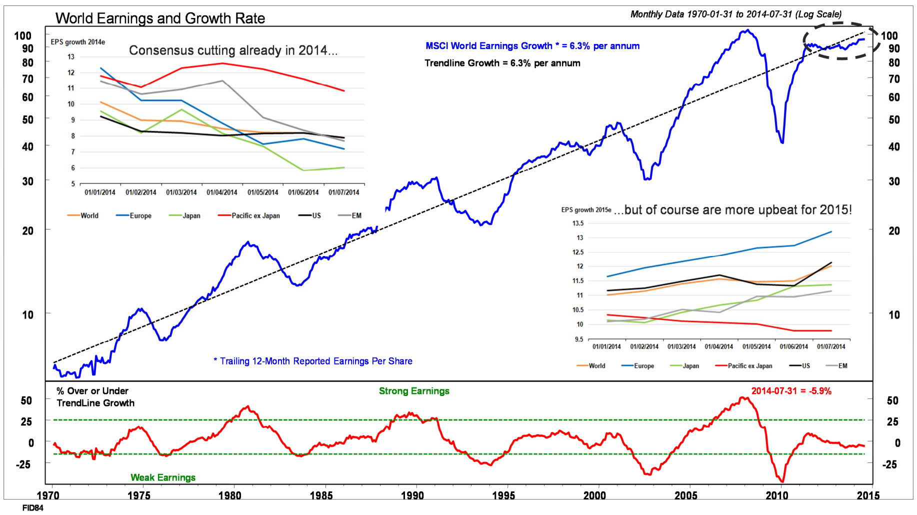


Chart 4. Source: Soc Gen, FactSet, Ned Davis Research, MSCI, May 12, 2014.

Global earnings growth expectations remain a key risk for 2014 and 2015, as the developed markets have already rerated a huge amount. The long-term global annual earnings trend for equities is 6.3%. The two inset detailed charts in this chart show that consensus analyst forecasts have been revised up for 2015 even though downward revisions are being made for 2014. There is a positive expectation that the derating phase is ending in emerging markets, led by Asia. The regional pace of downgrades has moderated, but the current earnings season shows stock-specific reactions commensurate with how well or not a company has met its earnings' target.

Will the rerating story finally shift from West to East in the second half of the year?

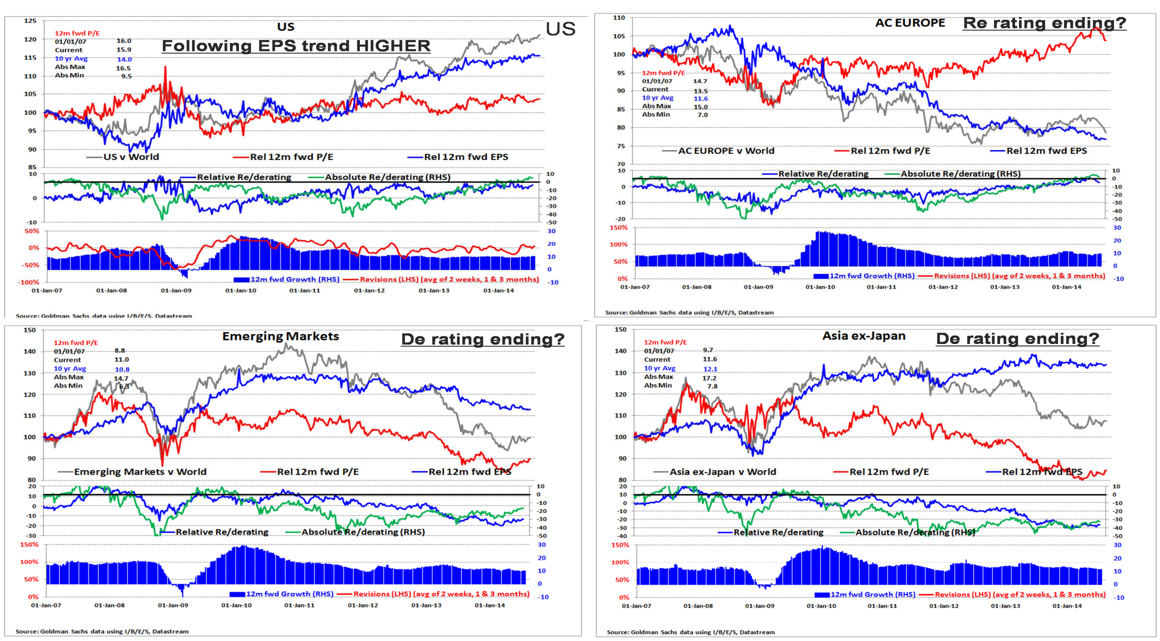


Chart 5. Source: Goldman Sachs, IBES, Datastream, FIL. Data is from 2007 to July 21, 2014.

These charts map the experiences of the US, Europe, emerging markets and Asia ex-Japan between 2007 and July 2014. The blue lines show the relative EPS (rebased to 100 in 2007), the grey lines are relative performance and the red lines are the relative PE. The key questions that these charts raise are whether the rerating in Europe has gone too far and if we are starting to see a nascent recovery in Asia and the emerging markets. While it is still too early to call this second scenario, if it does develop this will be a very welcome trend for equities generally.

US small caps lagging the market – inconclusive yet important to watch

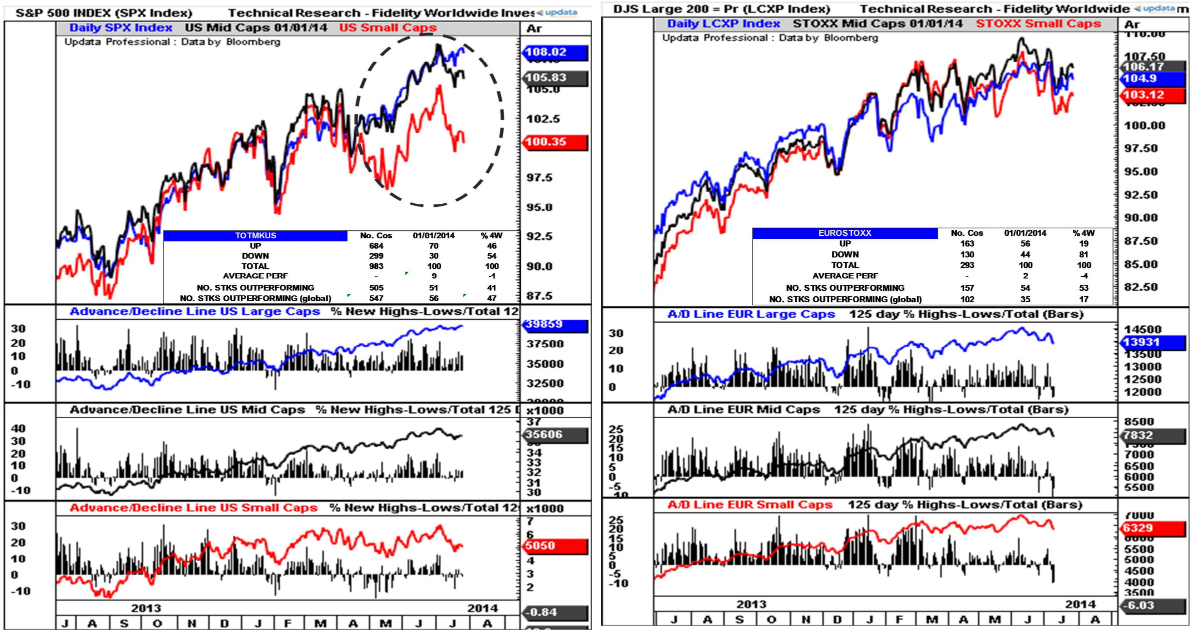


Chart 6. Source: Bloomberg.

There is a growing divergence between large caps and small and mid caps in the US particularly (left-hand chart) but also in Europe (right-hand chart). The breakdown in small-cap performance could be a warning sign for the broader market mainly because their perceived level of risk is higher than for large caps. However, we should remember that small caps have underperformed before and recovered quickly. Part of the current issue is simply that small-cap valuations have been very stretched, so large caps have bounced back in relative terms. Another issue is that the double-digit small-cap forecast valuations are about 2.5 times the large caps', and this level is likely far too optimistic.

FTSE 100 will eventually sail past the 7000 mark… but not just yet

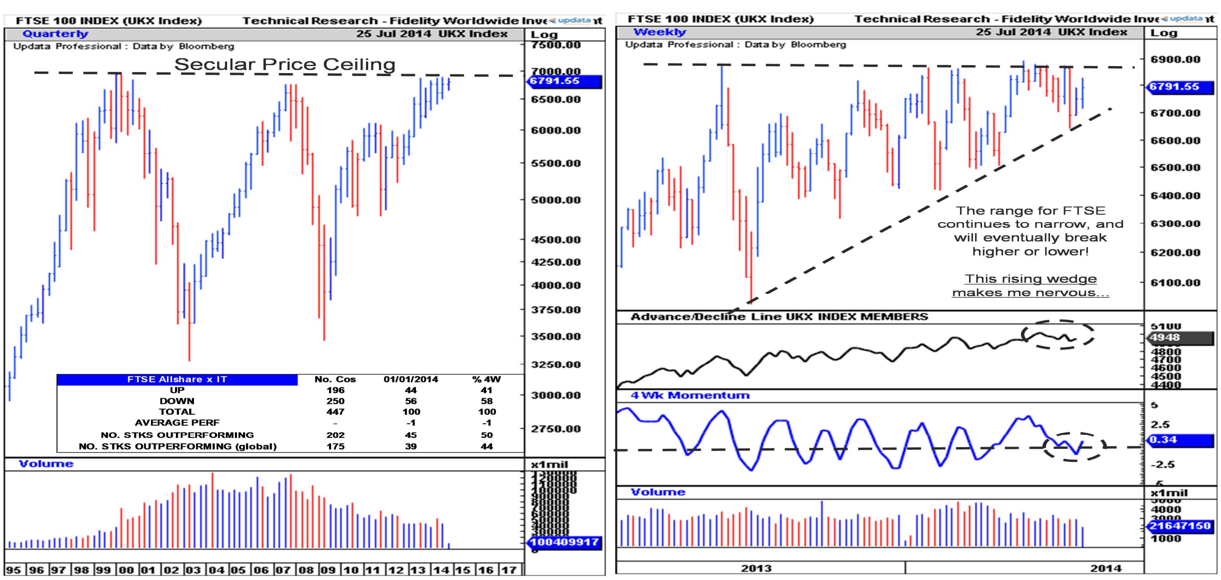


Chart 7. Source: Bloomberg.

The FTSE 100 will eventually break through the 7000 barrier, but there needs to be a significant event for this to happen and for this level to be maintained. Over the next three to five years we could see the index ascend to new highs of 9500 or up by 25%.

If emerging markets have turned a corner, Asia is ahead of EMEA and LatAm

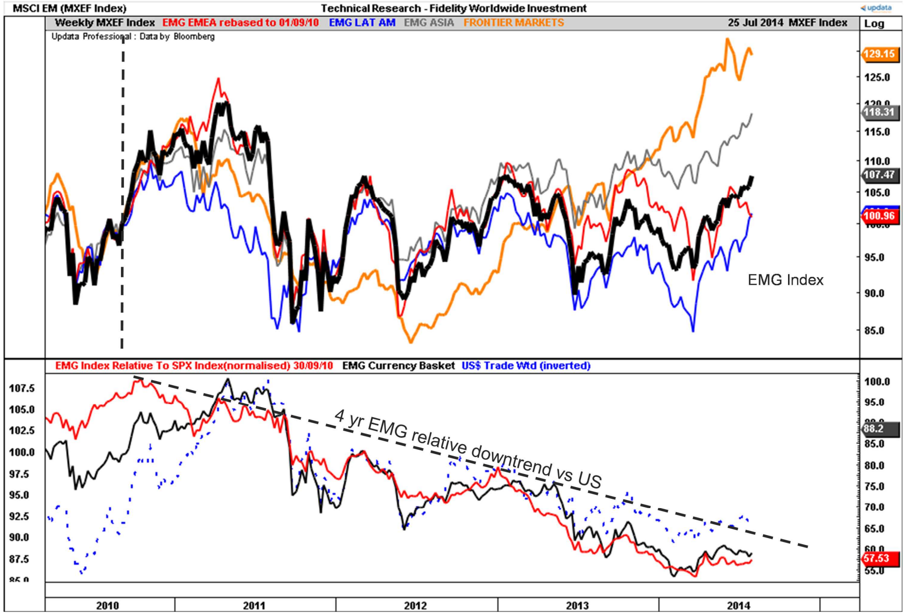


Chart 8. Source: Bloomberg.

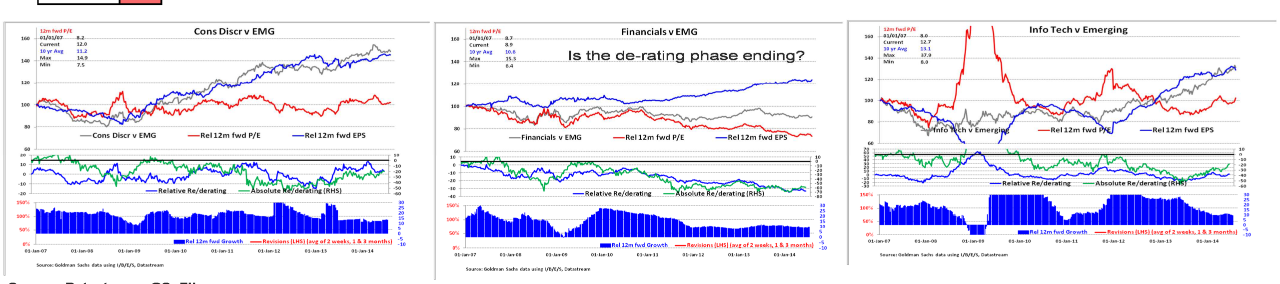
In absolute terms, emerging markets have only fallen about 6% in US dollar terms since the asset class hit its relative peak versus the US in September 2010. But in relative terms, emerging markets continue on a steady downward path. This is dominated by the large caps while many smaller companies are performing well. Encouragingly, HK and China are starting to look interesting once again. From a relative point of the view, the market has been poor but is now starting to recover a little. China H shares could target a further +25% if they break out of the four-year triangle trading pattern that has constrained such a move higher. Many emerging market countries are rebounding near term from deeply oversold positions in 2013.

Financials and IT could lead an emerging markets recovery

Sector Weights in MSCI Emerging Markets (horizonatally ranked largest to smallest)

Country Weights per Sector

Financials		I.T.		Energy		Materials		Cons Staples		Cons Discretionary		Telcos		Industrials		Utilities		Health Care	
26.7		13.6		12.2		11.4		7.8		7.7		7.7		6.3		3.4		1.2	
China	7.4	Taiwan	5.8	Russia	3.4	Brazil	2.4	Other	2.2	Korea	2.3	Other	2.2	Other	2.7	Other	1.5	Other	0.4
Brazil	3.5	Korea	5.2	China	3.1	Other	2.3	Mexico	1.5	Other	1.5	China	2.1	Korea	1.8	Brazil	0.7	India	0.4
South Africa	2.0	China	1.2	Brazil	1.9	Korea	1.5	Brazil	1.1	South Africa	1.3	Mexico	1.2	China	1.2	China	0.6	South Africa	0.3
Korea	1.9	India	1.1	Other	1.8	Taiwan	1.4	China	1.0	China	1.0	Taiwan	0.6	Brazil	0.7	Chile	0.5	China	0.2
India	1.8	Other	0.3	India	0.9	South Africa	1.3	Korea	0.7	Brazil	0.6	Russia	0.5						
Taiwan	1.7			South Africa	0.7	Mexico	1.1	India	0.7	Indonesia	0.5								
Other	1.3			Thailand	0.6	China	0.8	South Africa	0.5	Taiwan	0.5								
Russia	1.2					Russia	0.6												
Turkey	1.1																		
Malaysia	1.0																		
Thailand	1.0																		
Indonesia	0.9																		
Poland	0.6																		
Mexico	0.6																		
Colombia	0.5																		



Source: Datastream, GS, FIL

Chart 9. Source: Datastream, GS, FIL.

Financials and IT account for 40% of the market cap of the MSCI Emerging Markets index, so a rerating of these sectors could have a very large beneficial effect. Technically speaking, Chinese large caps, especially financials, are showing signs of improvement, which is a key support factor. Chinese internet stocks, small caps, mid caps and state-owned enterprises are starting to improve, driving the market higher.

Led by the US and select Asia, the technology sector is vying for a leadership position

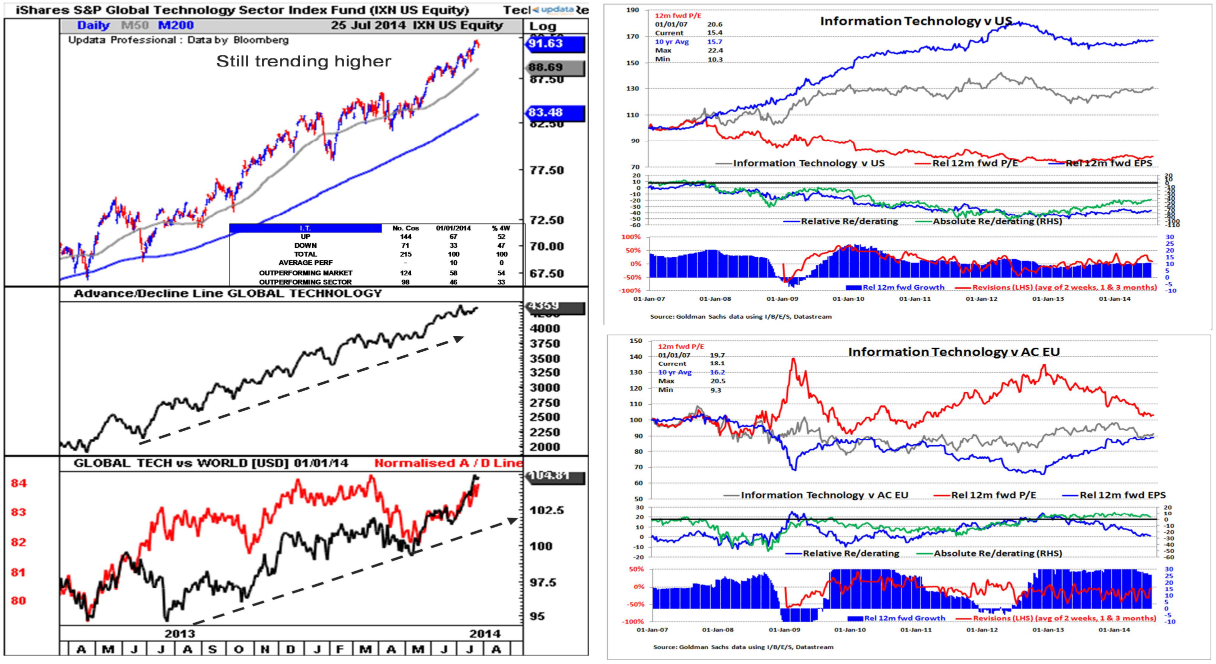


Chart 10. Source: Datastream, GS, FIL.

Technology is stronger in select mega and large caps but there is less consensus around the many small and mid-cap technology names. Sector leadership remains with healthcare despite a second quarter mini sell-off, energy is showing strength but is extended in the short term, and utilities are supported by very low long bond yields. Importantly, selected materials are benefiting from the recovery in the emerging markets, but this is far from a new supercycle. Consumer stocks are likely to remain under pressure given concerns about interest rate rises. Financials are likely to continue to tread water but will not enter into another secular bull market just yet.

Rising inflation worries will remain, but have yet to translate into higher B/E spreads

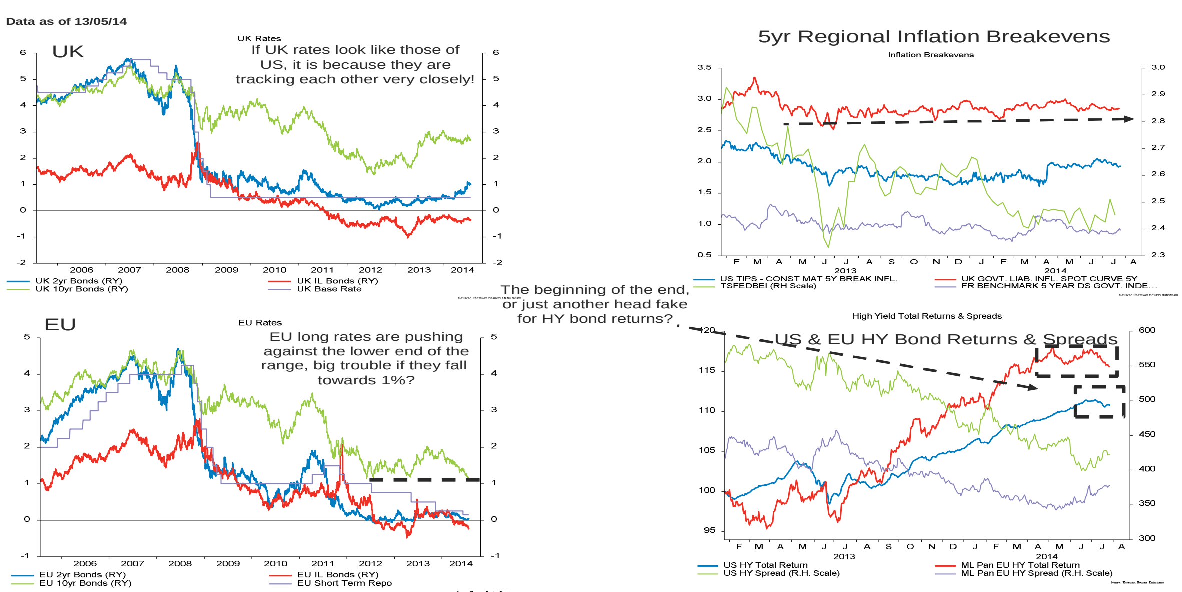
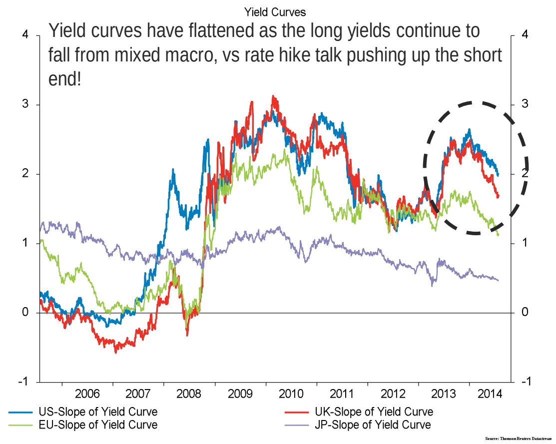
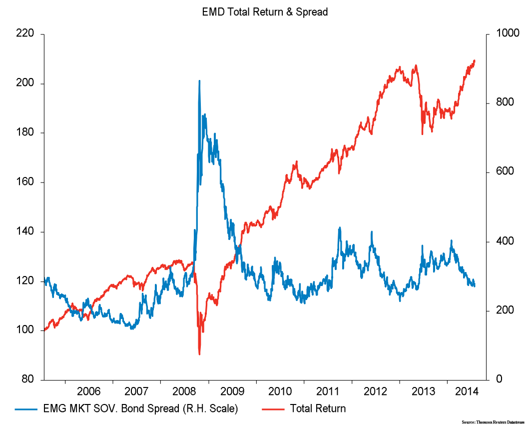


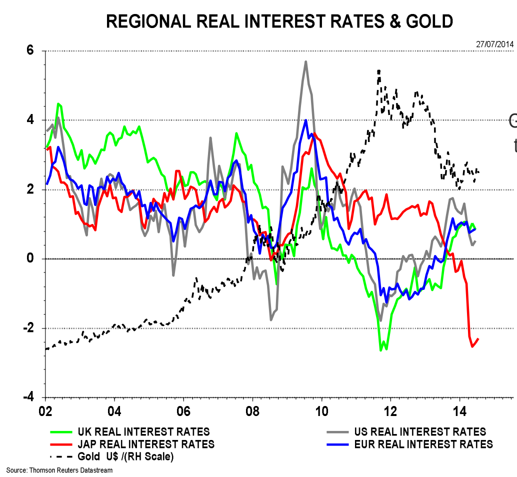
Chart 11. Source: Datastream, FIL. Data as of July 25, 2014,

In the top left-hand chart on the previous page UK rates look like those of US because they are tracking each other very closely. In the bottom left-hand chart, EU long rates are pushing against the lower end of the range – this could be very troublesome if they fall towards 1%. The arrow in the bottom right-had chart highlights concerns about whether high bond returns are facing a testing time on a temporary basis or are set for more or long-term correction.

As inflation expectations remain stable, recent fall in yields is in real terms







Gold prices have stabilized as Real Yields stopped rising in Q1. As soon as they commence rising again, Gold is likely to start again to fall to bottom of range

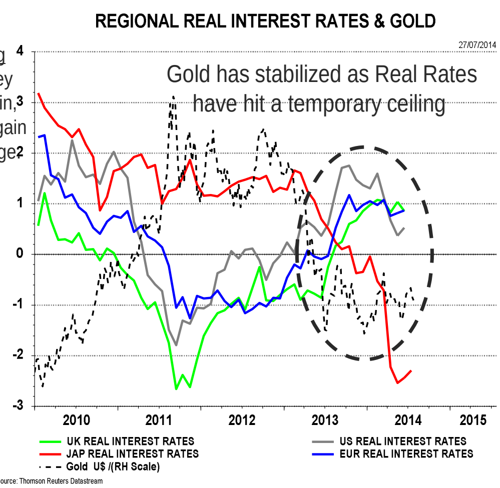


Chart 12. Source: Datastream, FIL. Data as of July 25, 2014,

In the top left-hand chart, EU, UK and US yield curves have flattened as the long yields continue to fall from mixed macro versus rate hike talk pushing up the short end. The bottom right-hand chart shows that gold prices have stabilised as real yields stopped rising in the first quarter of this year. As soon as they start to rise again, gold is likely to fall again to the bottom of range.

Sterling strength will likely slow, but should remain the strongest of the currency blocs

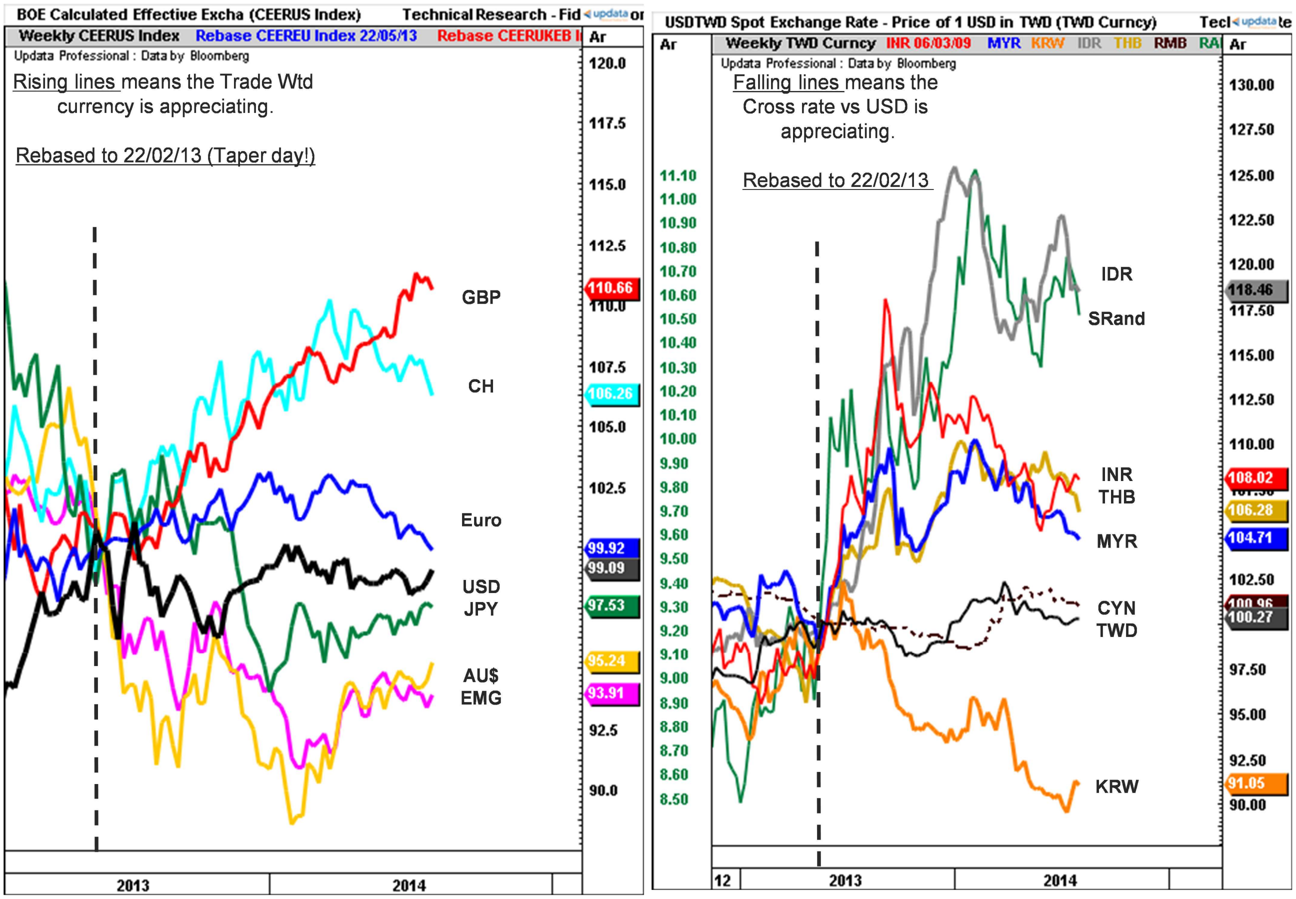


Chart 13. Source: Bloomberg.

These charts are rebased to February 23, 2013, otherwise known as taper day. In the left-hand chart the rising lines show that a trade-weighted currency is appreciating. In the right-hand chart, the falling lines mean the cross rate versus the US dollar is appreciating.

TECHNICAL ANALYSIS AT FIDELITY

At Fidelity, technical analysis provides a complementary tactical framework that is used to support our fundamental research and trading. Technical insights provide additional information to the investment teams that can be used to corroborate and support their investment decisions.

- **A value-added tactical tool that complements our fundamental research.**
- **The primary goal is to increase the level of conviction in the decision-making process.**
- **It can provide a 'reality check' to the assumptions made by fund managers and analysts. It provides an element of risk control for our retail and institutional funds.**

IC14-58

Fidelity™ WORLDWIDE INVESTMENT