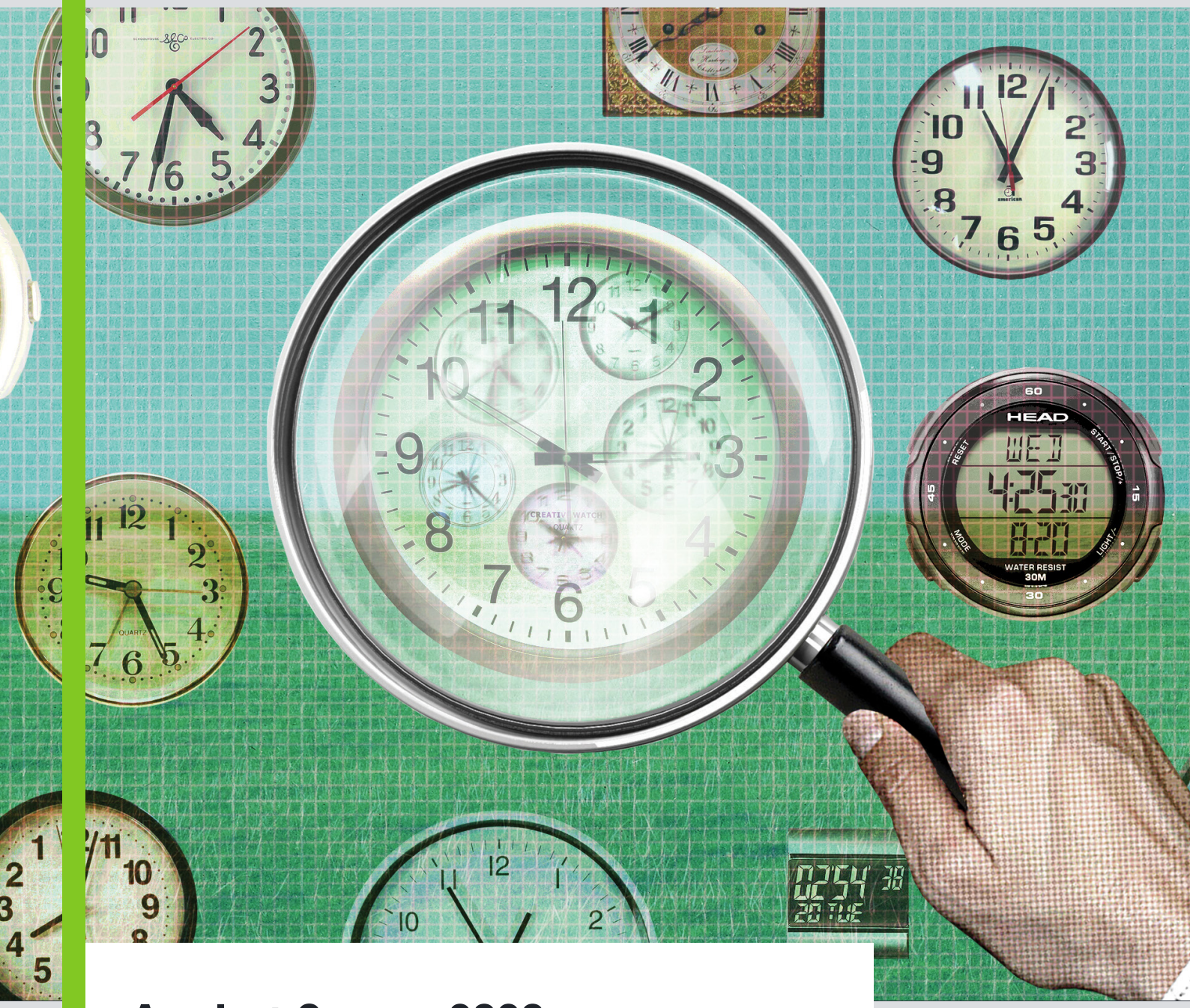


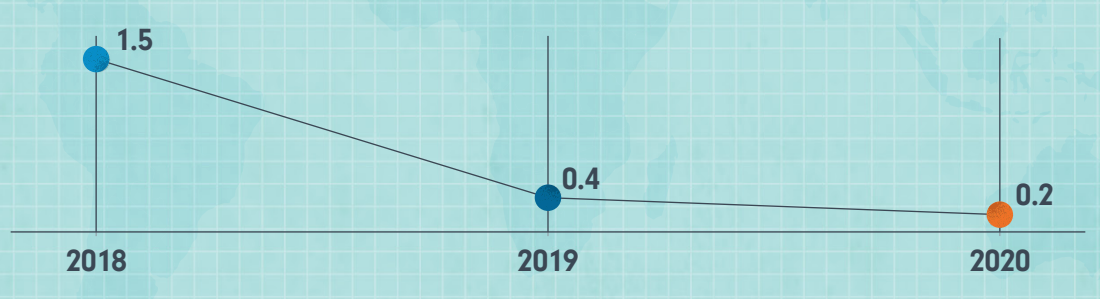
Analyst Survey 2020

Fidelity INTERNATIONAL

Fidelity Analyst Survey

A unique perspective on the trends that will shape the corporate landscape in 2020 from our analysts.

Fidelity Sentiment Indicator: positive...just



151 analysts participated in this year's survey

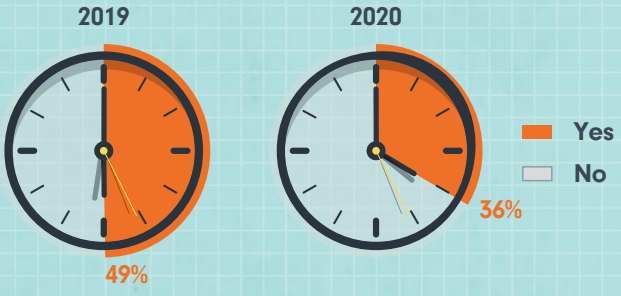
China	APac	US	Europe	Japan	EMEA/LatAm
21	28	40	41	11	10
-0.4	-0.3	0	0.2	0.5	0.8

Contraction ← Sentiment → Expansion

Cycle, what cycle?

Despite sentiment softening, companies are anticipating the cycle will keep going for the time being

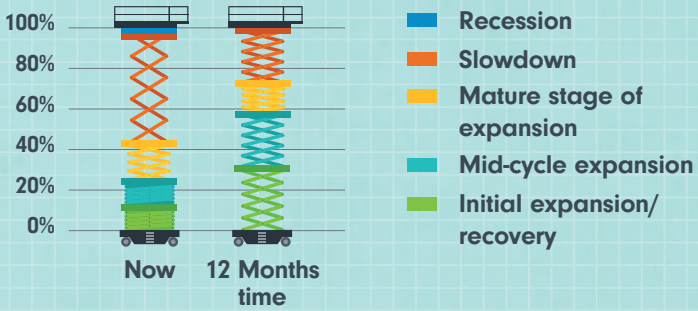
"Are your companies reacting to end of cycle indicators?"



Manufacturing green shoots

And while industrials have struggled over the past year, our analysts expect things to improve

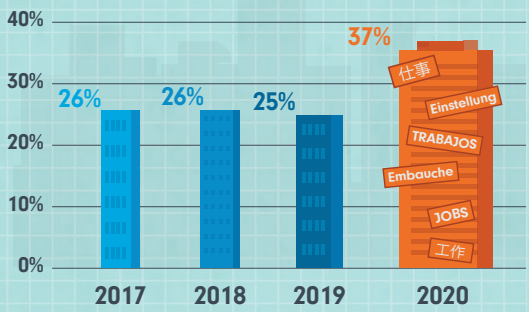
"What stage of the cycle is your sector in now (and in 12 months' time)?"



Widespread hiring

Companies are planning to increase headcount in almost all regions and sectors

"What percentage of your companies are planning to increase headcount this year?"

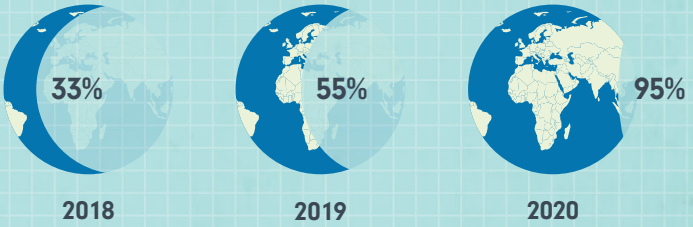


Source: Fidelity Analyst Survey 2020.

A watershed year for ESG

ESG will dominate corporate agendas all over the globe like never before in 2020

"Have you seen a growing emphasis among your companies to communicate and implement ESG policies in the past year?"



Analysts responding "Yes, in a minority" or "Yes, in a majority" of companies

Executive summary

Decisions need data. And the Analyst Survey, taken by our 151 analysts, provides mountains of it. Behind the charts, articles and infographics are more than 12,000 data points that describe the hopes and fears of corporate managers, their spending plans and even the impact of climate change on businesses. It's an annual, colourful snapshot of the data we use on a daily basis to inform investment decisions.

This year we saw a decline in the level of our sentiment indicator, which compresses the survey responses into a single number. While it's still positive, at 0.2, suggesting our analysts expect fundamentals to improve slightly in 2020 overall, it is at its lowest level since 2016. It reflects the concern over geopolitical impediments to trade and also the fact that we are late in an already lengthy cycle.

Some sectors are fairing better than others. Materials analysts expect a contraction this year, while healthcare and technology are the source of more optimism. Analysts covering companies in Emerging Europe, Africa and Latin America are the most optimistic, and while those covering China expect corporate fundamentals to be slightly worse than in 2019, they note that the rate of decline is softening.

The survey also shows that environmental, social and governance issues are influencing corporate decision-making as never before - the proportion of analysts seeing an increased emphasis on ESG has grown in every region and (almost) every sector. Europe leads the way here.

Of course, considered forecasts are always at the mercy of the unexpected. The coronavirus is one such shock with the potential to alter expectations materially. The extent to which it will derail a nascent recovery in the industrial sector, or even boost online shopping companies in the tech and consumer sectors, is not yet fully known. But the potential impacts are addressed below.

The survey provides a useful, at-a-glance view of the fundamental drivers behind corporate earnings, and how those factors are expected to evolve over the course of the year. What it presents is data, what it offers is improved decision-making. We hope it helps yours.

Richard Edgar
Editor in Chief

Contents

Analyst Survey 2020: Cycle, what cycle?

Economic cycles typically last several years, not entire decades. But this one is different. Not only is it already the longest on record - at 10 years and counting - but, according to the latest Fidelity Analyst Survey, it is set to continue, despite a decline in management confidence.

With little sign of the usual late-cycle imbalances in services, even as manufacturing has languished in recession, can we even call it a cycle at all?

After correctly predicting an end to synchronised growth in 2019 but no recession, our analysts believe the business environment will improve, but only slightly and at a slower pace. Recession again appears to have been postponed, at least until 2021, thanks to low interest rates, recovering global trade and a still-strong consumer. Only 36 per cent of analysts report that their companies are preparing for the end of the cycle, down from 49 per cent a year ago. Instead, Fidelity analysts anticipate a calmer 12 months for corporate fundamentals in aggregate, even as geopolitical risks remain and the full impact of the coronavirus is still unknown.

The analysts took the survey in December, and made their assessments based on some 15,000 meetings with corporate managers. But the impact of the coronavirus on Chinese economic growth, and the global economy, has since become impossible to ignore for investors. It is possible that the spread of the virus, and the efforts to contain it, may have a negative effect on global growth. Some sectors, such as travel, in-person retail, and casino gaming, have been first in line to take a hit to activity as quarantine measures took effect.

Beneath the surface of the Analyst Survey results, the picture is more mixed. Some sectors such as healthcare appear robust, while others like industrials continue to weaken, perhaps even bottom out, as their sharper, shorter mini-cycles play out within longer, late-cycle dynamics. While the survey reflects some broader market expectations, it reveals two big surprises: more companies plan to add headcount than last year, without triggering high inflation, and many more companies across all regions are embracing environmental, social and governance (ESG) factors, with utilities emerging as a climate-related investment opportunity.

Key takeaways:

- Sentiment Indicator is still positive...just
- Mixed picture for sectors and regions
- Companies (especially utilities) investing for growth, despite late cycle
- Ageing population impact balances out

Coronavirus: The grey swan

If not exactly a black swan for international companies and markets, the outbreak of the coronavirus is at least a grey one. Analysts took the 70-question survey in December, before the virus spread and quarantine measures were imposed.

The power of the survey comes from the exhaustive research that our analysts perform on the companies they cover. Their answers are informed by some 15,000 meetings a year with senior management, keeping them close to the issues that affect their businesses in real time. And, since the survey was taken, a lot of those conversations have mentioned the coronavirus.

Our analysts note that the hotel and travel industries in China took an immediate hit, as borders closed and tourism ground to a halt. Commodities too have been hurt and the virus is expected to delay any recovery. Similarly, transport analysts are predicting a short, sharp decline in revenues from cancelled flights and reduced airport spending. One made a comparison with the SARS outbreak in 2003, during which airline stocks fell between 20 to 40 percent, but recovered quickly once the virus was contained.

Online businesses are expected to fare better. As people remain in their homes, streaming services and online gaming are picking up, while bricks-and-mortar outfits are suffering. Visits to Macau dropped 80 per cent in the first five days of the Chinese New Year period and analysts believe the virus could weigh on the sector until mid-2020. More broadly, most analysts expect the Chinese government to increase its stimulus measures in response to the impact on first quarter GDP growth.

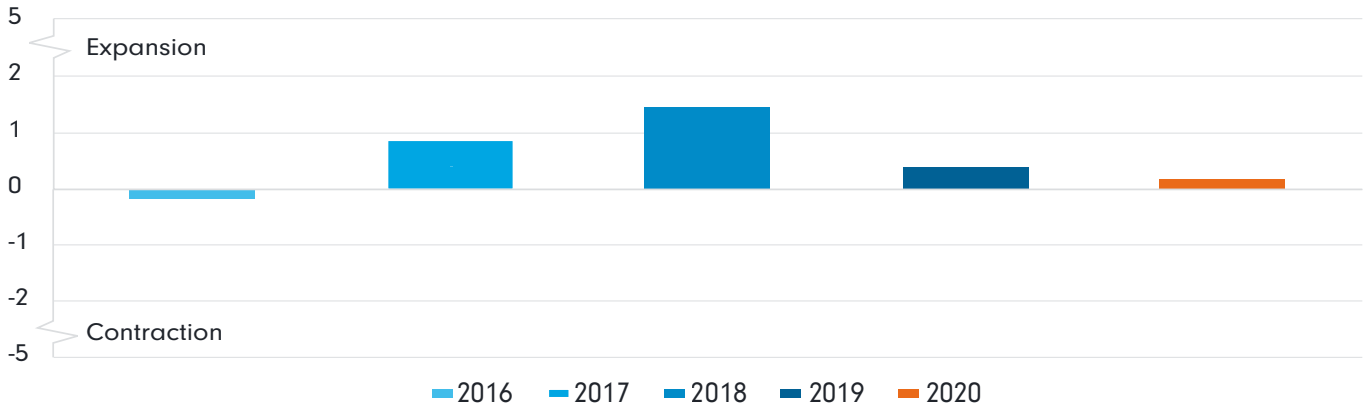
The spread of the coronavirus, and the extent to which it will affect the global economy, however, is almost impossible to predict. Instead, the survey works as a tool for forecasting patterns in corporate fundamentals, and for determining the cyclical and structural trends that will shape businesses over the following 12 months. And, in this regard, it has proven to be accurate in the past.

Last year, for example, we forecast that corporate profit growth would slow after the bumper years of 2017 and 2018. And indeed, 2019 turned out to be a year of fairly flat earnings growth for companies globally. However, the survey is concerned with corporate fundamentals, rather than valuations, and the equity market rallied strongly after the US Federal Reserve lowered interest rates at the start of the year. Our analysts also identified China's slowing economy and global political volatility as key risks to watch. Their concerns were valid. China's economic growth did slow to 6 per cent in 2019 amid trade tensions with the US, and businesses were affected by street protests from Chile to Hong Kong.

And China is once again in the spotlight. By staying plugged in and listening to management, our analysts can make forward-looking estimates and inform investment decisions, no matter how dark the swan turns out to be.

Chart 1: Sentiment is down on last year, but still in positive territory

Fidelity Sentiment Indicator



Proprietary forward-looking sentiment indicator calculated from analyst opinions on management confidence, capex, dividends, return on capital and balance sheets, on a scale of -5 (very significant deterioration) to 5 (very significant improvement). Source: Fidelity Analyst Survey 2020.

Global sentiment still positive...just

The Fidelity Sentiment Indicator - an aggregate measure of the outlook for corporate fundamentals among our analysts - demonstrates how the corporate environment has changed. It combines our analysts' views of management confidence, balance sheet, capital expenditure, return on capital and dividend trends over the next 12 months. This year, the survey received 179 responses from 151 analysts (some analysts cover multiple sectors). For 2020, they predict a small expansion in overall corporate activity, 0.2 on our index, albeit at a slower pace than 2019.

Healthcare looks set for another robust year, with more corporate merger and acquisition activity than elsewhere. Most M&A is expected to be bolt-on acquisitions, though more analysts are forecasting major strategic M&A in the sector than last year.

Despite this flat overview, we find considerable differences at sector and regional level. For example, corporate performance in China continues to moderate but at a much slower clip than last year, making a hard landing less likely than it was in 2019. Analysts report that company managements believe further policy direction by the Chinese authorities will help cushion a decline in economic activity. The outlook for US corporates is flat, having previously led the global expansion, while companies in Europe and Japan look set for a better year.

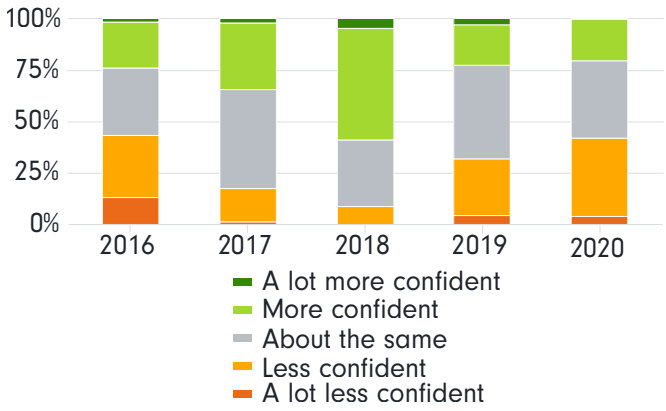
From a sector perspective, the consumer industry is mixed, with staples marching ahead while discretionary struggles, albeit less than last year. Energy and materials remain weak, while industrials continue to slide. However, our analysts expect to see signs of recovery in certain industrial subsectors over the next 12 months. Healthcare looks set for another robust year, with more corporate merger and acquisition activity than elsewhere. Most M&A is expected to be bolt-on acquisitions, though more analysts are forecasting major strategic M&A in the sector than last year.

Glum managements, solid dividends

Analysing the key components of the Sentiment Indicator gives us a more nuanced view. One element that contradicts the positive headline number is the year-on-year drop in management confidence, similar to that in 2016. This is perhaps due to late-cycle caution and continued geopolitical uncertainty. Offsetting managements' gloomier mood are year-on-year capex growth (up 1.8 per cent according to Fidelity estimates) - as companies continue to invest in their businesses - and expectations that balance sheets will be well-managed, given low interest rates and opportunities to restructure. Just as in previous years, however, the biggest upward kicker is dividends: our analysts are forecasting that current high levels are likely to be maintained.

Chart 2: Late-cycle blues for company executives

"What is the confidence level of the management teams in your sector to invest in their businesses versus 12 months ago?"



Source: Fidelity Analyst Survey 2020.

Investing for growth, as ESG moves up the agenda

A closer look at capex reveals that companies are planning to invest more in growing their businesses than in maintaining them, compared to last year, as they seek to capitalise on structural trends. Energy and utilities are seeing the biggest increase in the proportion of growth investment, amid a jump in ESG interest across all regions, driven in part by climate change and the need for low-carbon technologies.

A closer look at capex reveals that companies are planning to invest more in growing their businesses than in maintaining them, compared to last year, as they seek to capitalise on structural trends.

With more growth-driven investment, our analysts expect more companies to raise capital in the next 12 months - around 38 per cent of companies globally compared to around 30 per cent last year. However, while interest rates remain low, analysts do not see this as an indication of stress; default rates should rise only slightly. The expected wave of US bond maturities and associated refinancing, which could squeeze lending conditions, does not start until 2021. Indeed, balance sheet management scored highly within the overall Sentiment Indicator and analysts expect leverage will fall in 2020.

Riding the never-ending cycle

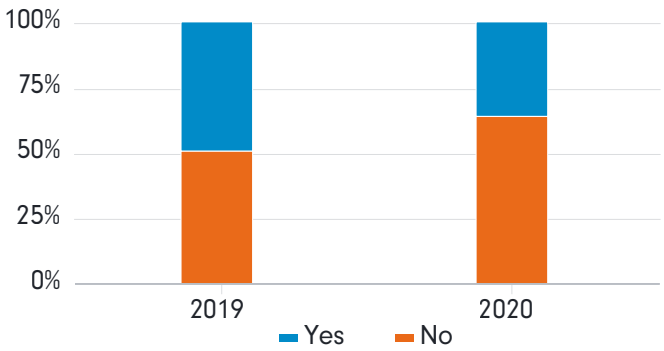
Fears of recession have certainly subsided since early 2019, especially in China where 73 per cent of analysts say companies are not preparing for the end of the cycle, up from 30 per cent last year. In some ways, companies are reacting to late-cycle dynamics, for example by borrowing less.

Of course, the grey swan of the coronavirus may upend this optimism. Chinese on-shore and off-shore markets fell sharply at the start of the year as concerns over the economic impact of the outbreak spread to investors. Markets, investors and companies alike are all averse to uncertainty. And the full extent to which the coronavirus outbreak has an effect on corporate activity won't be known until the disease is contained and controlled.

But the survey's capex readings and a surprise spike in planned headcount across all sectors and regions (despite already low unemployment) suggest that many companies feel the cycle can be prolonged.

Chart 3: No end in sight for this long cycle

"Are your companies reacting to indicators associated with the end of the economic or market cycle?"



Source: Fidelity Analyst Survey 2020.

Ageing well

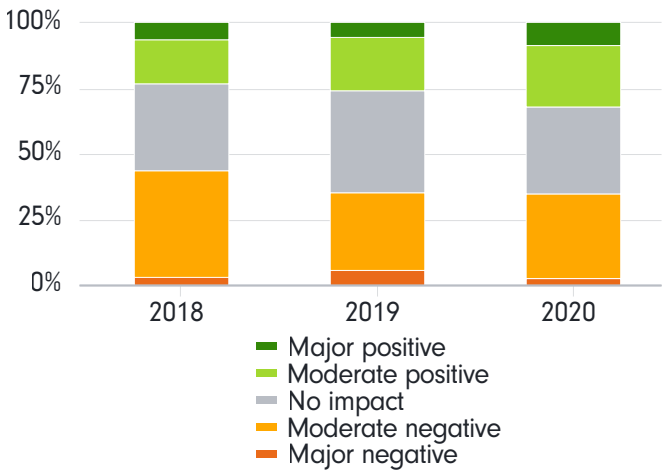
While much of the survey focuses on 2020, it also captures the progress of longer-term trends. Corporate regulation, for example, has been increasing in recent years, especially around data privacy, health and the environment. It looks set to jump again in 2020, with 55 per cent of the analysts expecting regulation to increase this year, compared to only 32 per cent last year.

This year, our analysts expect ageing populations to have a more balanced impact on companies than in the past, when it was predominantly viewed as negative.

Demographic changes also feature. This year, our analysts expect ageing populations to have a more balanced impact on companies than in the past, when it was predominantly viewed as negative. As we enter a new decade, companies are adapting to the needs of an older population, with IT and healthcare the greatest beneficiaries.

Chart 4: Older population has more balanced impact than before

"What impact will an ageing population have on your companies in the next 10 years?"



Source: Fidelity Analyst Survey 2020.

This ability to adapt, combined with favourable policy conditions and the increased emphasis on ESG, is making the global corporate outlook appear more balanced than might have been expected last January, even as this seemingly endless cycle creeps onwards.

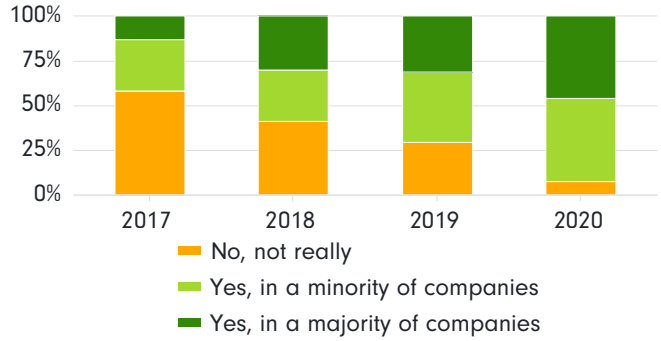
Analyst Survey 2020: ESG - a watershed year

Environmental, Social and Governance issues (ESG) have been increasing in importance for a while but are shooting up corporate agendas in 2020.

Over 90 per cent of Fidelity analysts report that some or all of the companies they cover are focussing more on ESG, following a pronounced increase in climate change awareness and corporate reforms. The change can be seen throughout most sectors and all regions, including areas where ESG interest had previously appeared to stall or be in decline.

Chart 1: ESG issues shoot up the corporate agenda

"Have you seen a growing emphasis among your companies to implement and communicate ESG policies in the last year?"



Source: Fidelity Analyst Survey 2020.

Key takeaways:

- ESG is shooting up corporate agenda
- Utilities is the stand-out sector due to climate change
- China could be hotspot for renewables ahead of subsidy withdrawal
- Board diversity lags behind other measures

ESG on the rise in China...and the US

While ESG has been increasing in importance for a while in Europe, it is now very much on the agenda in countries like China where 80 per cent of analysts report an increase in ESG emphasis at some or all of their companies in 2020. This marks a dramatic rise from 63 per cent in last year's survey and just 33 per cent in 2018.

It follows Chinese authorities' drive to improve governance, a rush among companies to invest in renewables before government subsidies are cut, and calls from investors for greater transparency around supply chains. More Chinese companies are also considering increasing dividends to shareholders and engaging with investors as a way of attracting further capital. Despite these trends, the absolute

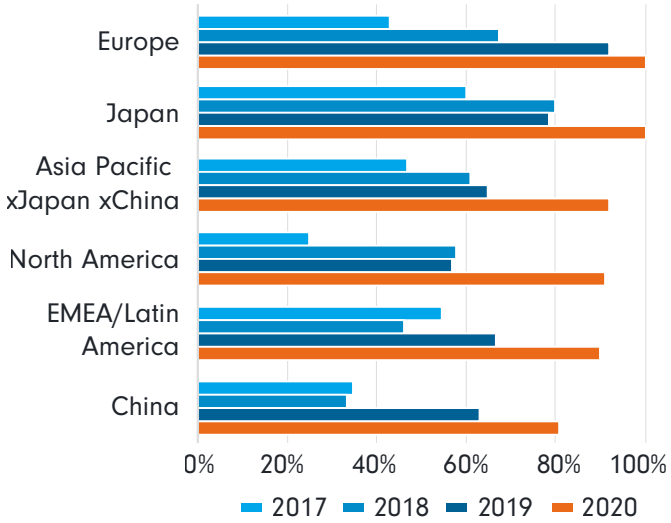
number of Chinese firms considering ESG issues remains lower than in other parts of the world.

Even in the US, where President Trump has weakened environmental regulations and the Securities and Exchange Commission has warned ESG investors not to ignore their fiduciary duty to maximise returns, interest is growing. Indeed, sustainability is bouncing back after appearing to be on the wane in 2019, spurred on by the very public re-definition of corporate purpose by the Business Roundtable, which commits large US corporations to deliver value to a wider range of stakeholders. Just over 90 per cent of our analysts covering the US and Canada cite a growing emphasis on ESG at some or all of their companies, compared with just 57 per cent in 2019. EMEA/Latam follows a similar pattern.

"ESG, mostly E, is definitely becoming more important for US companies," says one US energy analyst, "but from a relatively low base. These companies need more than incremental change to their business strategy; they need a big leap."

Chart 2: Europe leads the pack, but ESG is on the rise in China, and even the US

"Have you seen a growing emphasis among your companies to implement and communicate ESG policies in the last year?"



Analysts responding "Yes, in a minority" or "Yes, in a majority" of companies

Source: Fidelity Analyst Survey 2020.

Corporate reform tips the scales in Japan

Meanwhile, Europe and Japan are powering ahead. In Europe, every single one of our analysts observe that some or all of the firms they cover pay close attention to ESG issues, compared with 92 per cent last year. Japan too is at 100 per cent, up from 79 per cent in 2019 as the government pushes companies to simplify shareholdings and appoint more independent directors. Board structure and composition have suddenly attracted much more attention, with 73 per cent of our Japan analysts citing these factors as an important part of decision making at their companies, surging from only 18 per cent last year.

Just over 90 per cent of our analysts covering the US and Canada cite a growing emphasis on ESG at some or all of their companies, compared with just 57 per cent in 2019.

One Japan-based analyst notes: "Japan's big institutional investors have become much more demanding, particularly on governance, and many more companies now take these developments seriously. This is in response to the introduction and revision of Japan's stewardship code and the trend has been accelerating over the past year or two."

Energy and industrials' interest in ESG rebounds

When it comes to sectors, energy and industrials look set for an ESG resurgence after being distracted by poor financial performance in 2019. Three-quarters of energy analysts say that most companies they cover are stepping up their ESG efforts, compared to only one third last year, while the same figure for industrials has almost trebled to 45 per cent from 16 per cent. Healthcare has also seen a big rise. Among healthcare analysts, 45 per cent report that companies are increasing their ESG focus in 2020, up from 29 per cent in 2019.

Utilities offer opportunities amid greater climate awareness

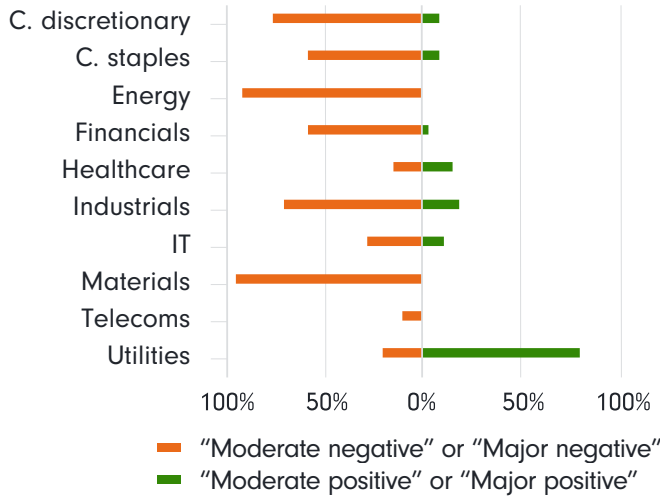
The real stand-out sector, however, is utilities, where the focus on ESG has been high and rising over the last three years.

One utilities analyst says: "ESG comes up in every single management meeting and analyst call without fail. A few years ago, it was only mentioned sporadically, with the odd offhand comment. Now it dominates the conversation."

The sector is also an outlier in terms of climate impact. Broadly, our analysts covering other sectors are more worried about climate change than last year, with 59 per cent expecting it to have a negative impact on their companies, up from 35 per cent last year. But among our utilities analysts, 80 per cent expect a positive impact compared to just 8 per cent of analysts from other sectors.

Chart 3: Utilities benefit from climate impact

"What impact will climate change have on your companies in the next 10 years?"



Source: Fidelity Analyst Survey 2020.

This difference between utilities and other sectors is being driven by greater climate change awareness - specifically, a growing appreciation of its impact on asset values and realisation that companies adopting climate mitigation and adaptation strategies stand to benefit from greater business resilience as well as new opportunities.

"Assets of companies that still rely on traditional generation (especially coal) will naturally attract a valuation discount versus renewables, as they will be phased out and therefore have a more limited life span," says one European analyst.

According to the survey, utilities are ploughing a greater proportion of their capex into growth as opposed to maintenance, despite the lateness of the cycle, funding investment in grid expansion, renewables and other types of power generation that will be needed in order to electrify heating and transport.

China could be hotspot for renewables and gas in 2020

Energy-hungry China could be a particular hotspot for renewables investment in 2020, according to one Hong Kong-based analyst. China is ending subsidies for new onshore wind power projects next year, incentivising companies to launch projects ahead of the deadline. Solar subsidies are also being cut as solar energy prices fall towards those of coal.

The analyst says: "A large number of companies will increase investment in China in the next 12 months, not only in renewables and the grid, but also in gas companies, as China encourages coal-to-gas conversion as another way to lower carbon emissions."

More to do as board diversity lags

While corporate governance is generally improving, with greater levels of investor engagement throughout the world, companies have made less progress on board diversity. Most analysts report that their companies' boards have low to middling diversity, with almost no change on the previous year.

However, in other areas and at the aggregate level the trend is clear: 2020 looks set to be a watershed year for ESG. The hot topics for boards will be: carbon and climate change, waste management, health and safety, data protection, reinvestment policies and executive pay. Across the globe, the most significant is likely to be climate change as US, Chinese, European and Japanese businesses, as well as governments, reach a tipping point on recognising and addressing the issue.

Analyst Survey 2020: Region by region

Below we summarise the key findings from the 10 different regions covered by the survey.

North America: How long can it go on?

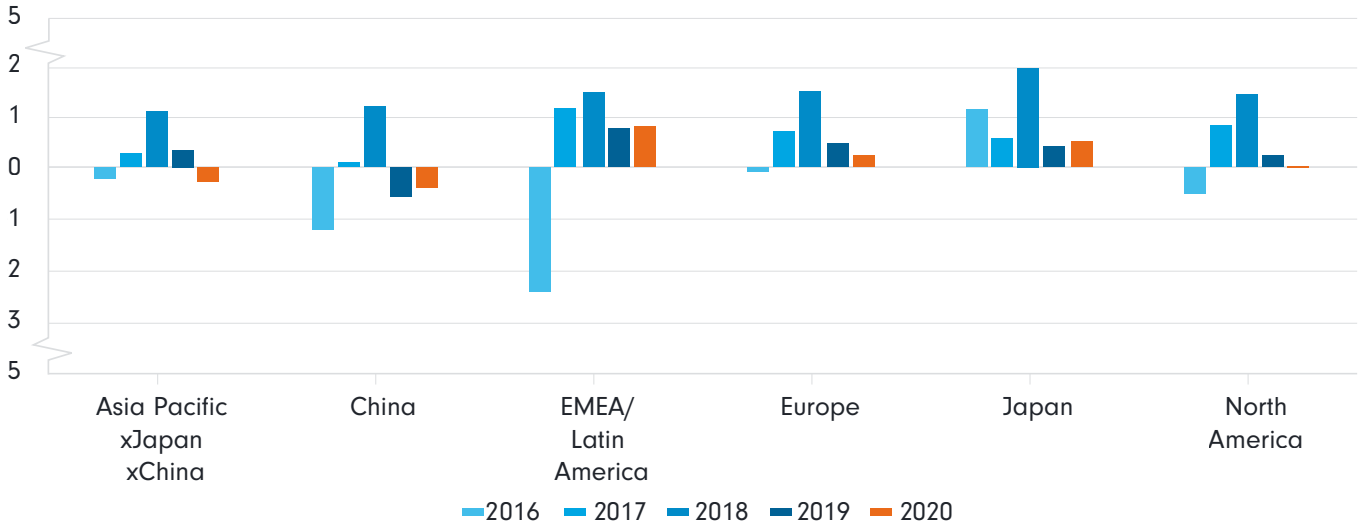
North America's sentiment indicator has fallen back to a neutral position - with analysts reporting that companies are neither bursting with optimism nor bracing for the worst. As the cycle extends beyond historical norms, it is becoming harder to determine exactly where things will go next.

If we discount those sectors regarded as stable (i.e. non-cyclical), an overwhelming 34 of the remaining 40 North America analysts now view their sectors as past the initial or mid-cycle growth stage. Consequently, analysts are focusing on the endurance of the cycle, with one analyst citing a positive surprise as: "Anything extending the duration of the cycle". At this stage of the market, several analysts point to product innovation as being a key requirement for companies to outperform.

Nearly 40 per cent of analysts think return on capital will fall, mostly driven by higher costs and slower growth in

Chart 1: The cycle grinds on in North America

Fidelity Sentiment Indicator



Proprietary forward-looking sentiment indicator calculated from analyst opinions on management confidence, capex, dividends, return on capital and balance sheets, on a scale of -5 (very significant deterioration) to 5 (very significant improvement). Source: Fidelity Analyst Survey 2020.

domestic final demand. If consumers finally lose their remarkable resilience, it could signal that we are one step closer to the end of the cycle. Unemployment at record lows in the US may be driving consumer strength, but it is having a limited effect on wage growth. Wages may continue to rise, but most analysts believe the pace of growth is slowing.

A particularly intriguing result from this year's survey relates to the impact of the trade war. Compared with other regions, a higher percentage of analysts covering North American companies think that protectionist measures will be harmful to profits over the next year. This indicates that the US, which instigated the most recent trade war and juggles multiple fronts, could stand to lose the most from the ensuing protectionism. As one analyst succinctly put it: "Companies just do not want to invest while trade war uncertainty persists".

Europe: Leaning towards growth

Europe's sentiment score is just the right side of the expansion threshold at 0.2 (versus 0.5 for last year). Our analysts see growth coming from a couple of directions: capital expenditure and some gains in return on capital.

Nearly half the analysts expect capex to increase, with a slight tilt to growth over maintenance projects, as well as some M&A. The outlook for return on capital is also quite positive: two-thirds of our Europe analysts predict it will be the same or will rise over the next 12 months. Most of the improvement is expected to come from higher end demand.

Brexit remains an issue. Our analysts sense companies are still reticent about investing in the UK, possibly because a permanent relationship with the European Union is yet to be negotiated. The UK government's self-imposed deadline of the end of 2020 to reach a trade agreement means that a 'cliff-edge' for businesses could still occur. Considering the trade and regulatory uncertainty, the eventual effects of Brexit on the UK economy are still unclear, highlighted by an industrials analyst who said: "Uncertainty about the UK macroeconomic picture as a result of Brexit has resulted in a reluctance to invest in large UK projects and has seen some companies look to diversify revenues overseas".

Europe continues to lead on environmental, social and governance (ESG) issues. While all regions are showing increased focus on ESG, Europe has maintained its lead, with all 49 analysts finding that their companies are placing more importance on implementing and communicating their ESG policies. Climate change is the number one environmental issue.

This attention to ESG partly explains the greater restrictions the analysts expect on doing business in Europe. Most analysts expect more regulation, with rules around climate change, gambling, pharmaceutical drugs, data protection and digital advertising likely to be beefed up. The past year saw the changing of the guard at the European Commission, European Council, European Parliament and the European Central Bank, and the new cohort of leaders will be eager to make their mark.

China: Most improved, but still trailing

At negative 0.4, China's Sentiment Indicator is bottom of the league, despite improving more than any other region. China is closer than it was to the rest, but still behind. Even though the economy is slowing down, the rate of decline looks set to be modest. The number of analysts expecting their companies to react to indicators associated with the end of cycle has fallen from 70 per cent last year to just 27 per cent this year, while not one of our 26 analysts covering China expects a hard landing. This would seem to suggest cause for modest optimism, however these responses were given before the outbreak of the coronavirus, which has the potential to destabilise this outlook.

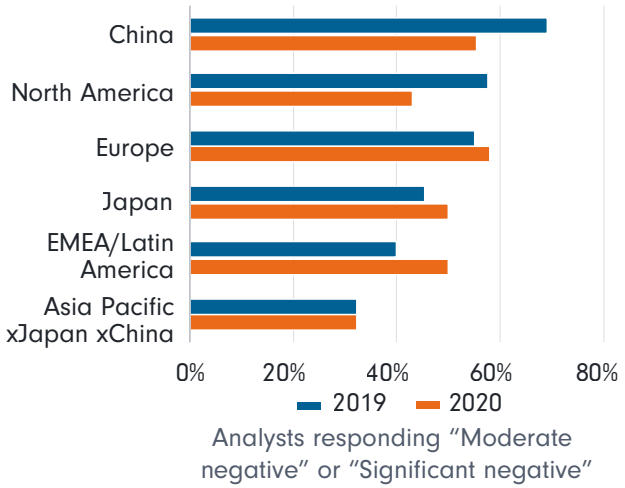
Indeed, even without the epidemic, the components of the Sentiment indicator for China are almost universally decelerating. Return on capital looks particularly bad, with over half of analysts expecting it to decline in 2020. A slightly lower proportion also think capital spending will fall. One ray of light comes from balance sheet strength, which has improved significantly from last year. The perfect balance sheet shouldn't be too cautious, which may indicate an inefficient use of capital, or too stretched, which suggests a company is taking too much risk. Our China analysts, on the whole, think balances sheets are positioned just about right. But they are keeping an eye on defaults.

A third of analysts expect the number of defaults to rise slightly, while 4 per cent predict a significant increase, up from zero in 2019. At this level, defaults are not especially worrying and funding costs are broadly expected to stay

the same or fall, but this could change quickly given the extent of leverage in the Chinese economy.

Chart 2: Geopolitics still damaging China investment despite partial trade deal

"To what extent is the geopolitical backdrop having an impact on the strategic investment plans (capex and M&A) of the companies that you cover?"



Source: Fidelity Analyst Survey 2020.

China's pressures are no great surprise. It's been dealing with two powerful headwinds for some time: an economic slowdown and a bruising trade war with its biggest trading partner, the US. Our China analysts are generally not convinced by the apparent rapprochement on trade between the US and China. Two thirds still believe that Trump's policies will be negative for their sectors, with one analyst commenting: "Companies are now fully aware that tense US-China relations will be the new norm and thus are not too fixated on short-term developments."

Asia Pacific ex Japan/China: Management confidence takes a knock

The old saying that when the US economy sneezes, the rest of the world catches a cold could equally apply to China and its neighbours in Asia. China's slowdown appears to be weighing on the rest of Asia.

Asia Pacific ex Japan/China saw the largest move in the sentiment indicator of any of the regions, but in the wrong direction. The indicator fell from a respectable 0.3 in 2019 to negative 0.3 in 2020. Confidence, or a lack of it, among business leaders is one of the main reasons why.

Over 80 per cent of analysts in the region report that management teams are no more confident than last year, with a considerable knock-on effect on corporate decision making. A third of analysts covering the region believe capital spending will fall in 2020. And while analysts expect an increasing amount to be allocated to growth opportunities in most other regions, in Asia ex Japan/China spending on growth is predicted to fall.

Dividend payouts also look less than promising. Asia Pacific ex Japan/China has the second lowest proportion of analysts who report dividends will rise this year behind China. In fact, the same number think dividends will fall or that there won't be a dividend payment at all. For a region largely defined by growth, that's a disappointment and suggests executives are particularly gloomy.

Perhaps most telling is that when analysts were asked about the scope for positive surprises in the region, the most common answer was some variation of "not much".

Japan: Caution prevails despite potential opportunity from ageing population

Recent economic data from Japan has been weak and this is matched by low confidence among management. Over half of analysts report confidence will be lower this year while just 9 per cent think it will improve. This is despite Japan having the second highest sentiment score, suggesting the actual business environment won't be too bad.

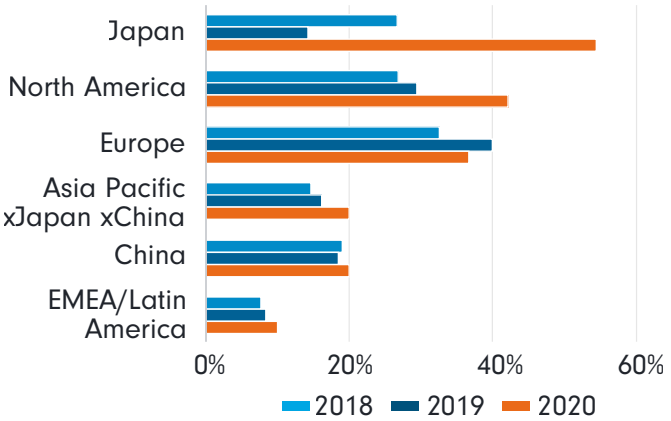
'Fortress balance sheets' have been something of a trend in Japan in recent years and this looks unlikely to change in 2020. Nearly three-quarters of analysts say balance sheets are too cautious, marked by large cash piles and under use of leverage. And this caution could deepen given that a third of analysts expect leverage to fall further.

Despite this, opportunities are starting to appear in Japan. There is a sharp increase in the number of analysts judging the country's ageing population as a business prospect. In the previous four years of the survey, it was viewed as a negative development, but this year more than half of analysts think it will be positive for their companies, as increased demand for healthcare and information technology solutions offsets a shrinking workforce.

Demographic pressures could also partly explain why 80 per cent of analysts expect IT spending to rise in 2020.

Chart 3: Japan prepares to make the most of demographics

"What impact will an ageing population have on your companies in the next 10 years?"



Analysts responding "Moderate positive" or "Significant positive"

Source: Fidelity Analyst Survey 2020.

Government spending is also increasing. Nearly half of our Japan analysts report their companies expect a positive impact from fiscal policies this year, up from only 14 per cent last year. Income tax cuts are expected to offset the consumption tax rises of last year, leaving households with greater capacity for discretionary spending. If the macro picture stays benign (companies in Japan have heightened sensitivity to global risks given the country's open economy), and fiscal spending materialises, then there could be a range of investment opportunities across different sectors.

EMEA/Latam: Leads the pack again

For the second year in a row, Emerging Europe, Africa and Latin America's combined sentiment score beats every other region. Despite protests in Chile, the collapse of the Venezuelan economy, debt default in Argentina and the turmoil in a number of Middle Eastern states, the region's positive corporate backdrop has held steady.

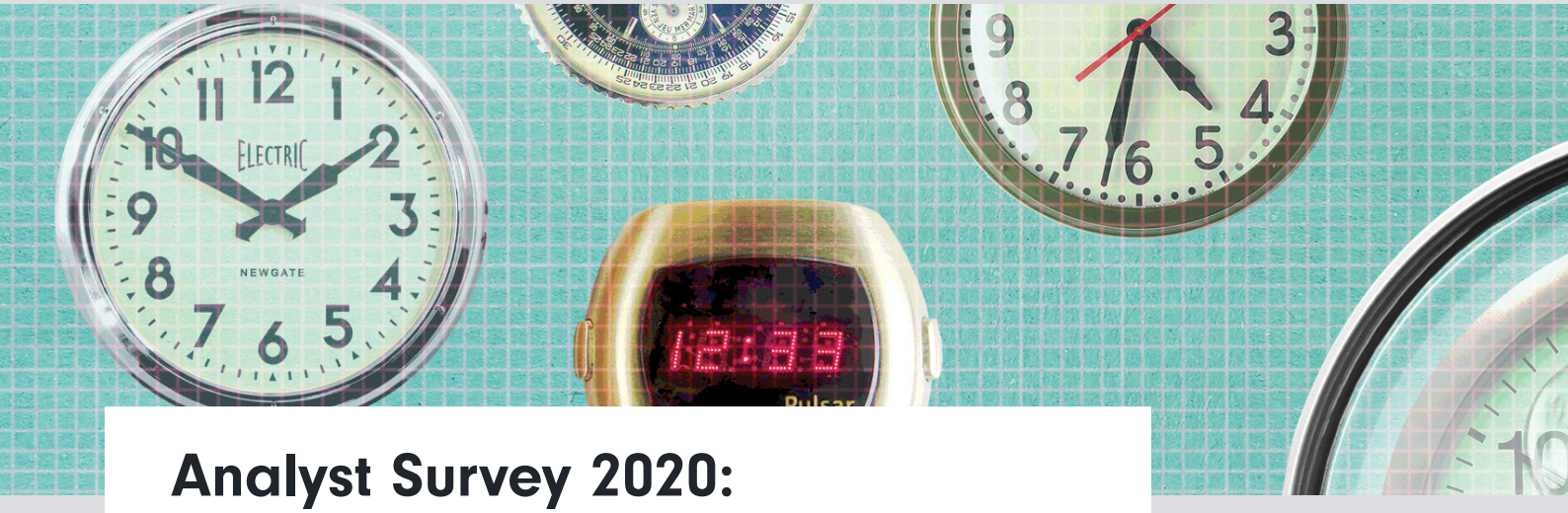
Market demand is the reason. Half of our analysts in these regions report that CEOs expect end demand growth to fuel earnings growth. Not one of those CEOs appears less confident than last year, which could explain why only 14 per cent of analysts think investment will be lower this year than in 2019. Overwhelmingly, analysts think this investment will be directed towards growth rather than maintenance projects.

Nearly a third of analysts think dividends will rise, while none predict a cut. Headcount is expected to rise, wage costs are not expected to be a problem, and balance sheets are positioned fairly cautiously and generally don't require refinancing.

For the second year in a row, Emerging Europe, Africa and Latin America's combined sentiment score beats every other region.

Currency volatility could pose a challenge, though. Many EMEA and Latam countries fit squarely into the emerging markets category where performance is traditionally sensitive to movements in the US dollar. A consumer analyst describes the effect as follows: "Revenues are mostly in emerging market currencies, but a lot of costs are linked to the US dollar. This affects gross margins, inflation and sentiment towards the broader economies". Interestingly, the proportion of analysts reporting high currency volatility has been falling for the last four years, perhaps indicating the gradual maturing of these economies.

When asked about risk factors, our analysts almost all point to macro and geopolitical events. But they also hint that the region has shrugged these off before and can do so again. Protectionist measures already appear to be having a less negative effect than last year, and with the USMCA (new NAFTA) deal now signed and sealed, businesses in Latin America at any rate should see less impact from trade wars.



Analyst Survey 2020: Sector by Sector

Below we summarise the key findings from the 10 different sectors covered by the survey.

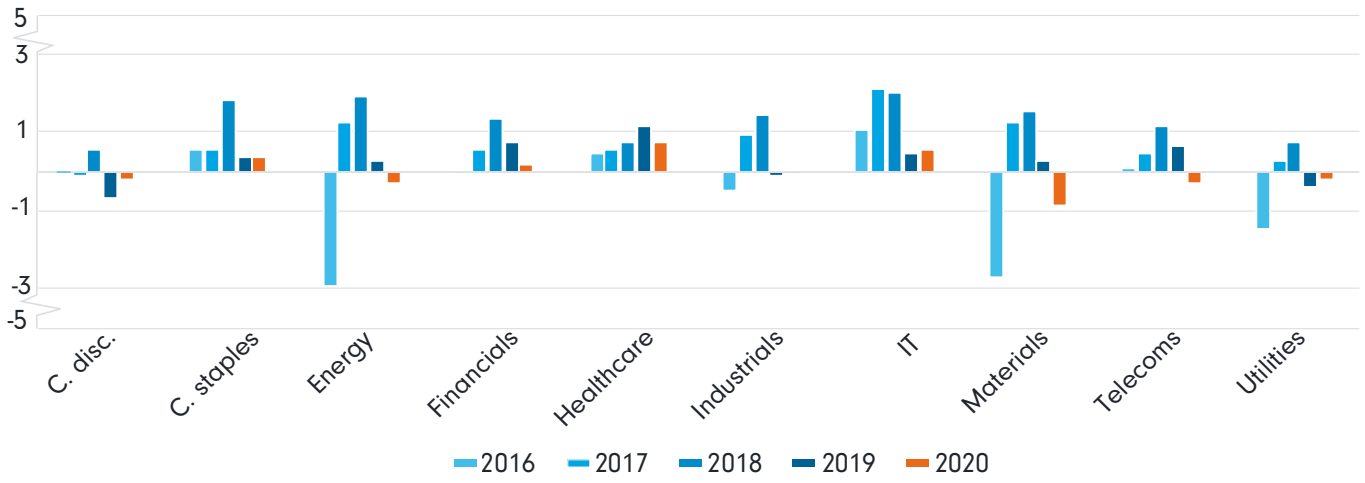
Consumer Discretionary

Consumer discretionary, which includes luxury goods, entertainment and leisure, has seen the biggest jump in sentiment of the 10 sectors our analysts cover. It has gone from -0.7 last year to -0.2 this year - still in negative territory, but much improved. This reflects consumer strength in the US and China and low levels of unemployment in most developed economies, supporting consumption even of higher-value goods. However, this outlook is conditional on the recent outbreak of coronavirus in China. If it is well contained, it should only prove a short-term disruptor to the Chinese economy. If not, it may well cause global forecasts to shift downwards.

A more dovish policy stance from the US Federal Reserve and targeted Chinese stimulus are helping to buoy the sector around the world. Only 32 per cent of sector analysts report their companies are reacting to indicators associated with the end of the economic cycle, down from 60 per cent last year. But while fears of recession have

Chart 1: The Fidelity Sentiment Indicator signals a high disparity between sector fundamentals in the year ahead

Fidelity Sentiment Indicator



Proprietary forward-looking sentiment indicator calculated from analyst opinions on management confidence, capex, dividends, return on capital and balance sheets, on a scale of -5 (very significant deterioration) to 5 (very significant improvement). Source: Fidelity Analyst Survey 2020.

faded, managements are feeling less confident than last year, highlighting the caution companies feel about the extension of the cycle.

Increasing regulations may also be a headwind for returns in the year ahead, for example those concerning gaming in Macau, where tighter regulations "would depress VIP gaming demand", according to one analyst. Protectionist measures could also be a headwind for the sector - three-quarters of analysts report this will have a negative impact in the coming 12 months. The US and China may have signed an initial trade deal, but tensions between the two superpowers are likely to affect supply chain locations and long-term investment.

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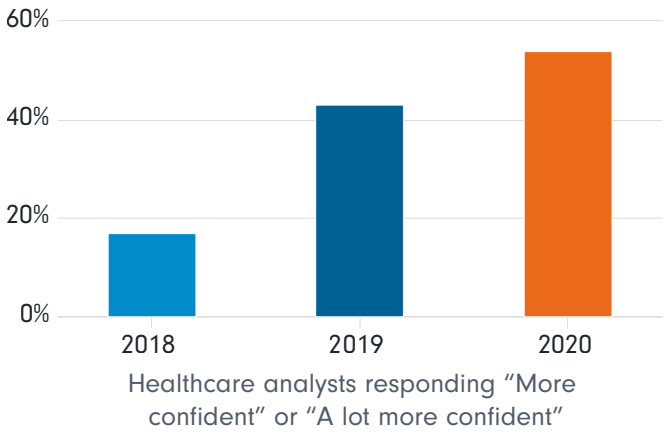
Disruption is also a big theme. More than 60 per cent of analysts expect at least a moderate impact from disruptive trends like autonomous driving, the sharing economy, changes in consumption patterns such as food delivery, e-commerce and payments, and robotic supply lines. But these trends bring tremendous opportunities for those which can capitalise on them, at home and abroad. One analyst noted: "Around 50 per cent of my sector are disruptors, in many consumer markets." And when asked which companies would outperform in the sector, many analysts cited product innovation as the key differentiator.

Healthcare

Our analysts' optimism about the healthcare sector is almost as strong as last year. The Sentiment Indicator is the highest of any sector for the second year in a row. Management teams are more confident about the year ahead, capex is expected to increase, while not a single analyst expects dividends to be cut. Just 7 per cent of analysts believe their companies are preparing for the end of the cycle - the lowest proportion of any sector.

Chart 2: Confidence is growing among healthcare sector managers

"What is the confidence level of the management teams in your sector to invest in their businesses versus 12 months ago?"



Source: Fidelity Analyst Survey 2020.

The sector will also become a renewed focus for M&A activity this year, with over half of analysts citing it as a 'big focus' or 'huge strategic priority' at their companies. Companies are well-positioned to open their wallets, as balance sheets don't look stretched, while our analysts report that funding costs and leverage will fall significantly from last year. Companies' ability to push through price increases has jumped year-on-year, while cost inflation should not be a problem.

In terms of risks, our healthcare analysts are most concerned about regulations on drug pricing, a reason why 62 per cent expect a negative impact from President Donald Trump's policies as he has repeatedly called for action in this area. The US election cycle is also hurting confidence, given the risk of even more stringent regulations should Elizabeth Warren or Bernie Sanders win in 2020.

However, regulations are moving in the other direction elsewhere, along with accelerated drug approval policies, which could be positive for the sector. This was seen recently with a spate of innovations and streamlining of regulators in China. It's therefore no surprise that 62 per cent of analysts expect companies to increase their investments into emerging markets, more than any other sector.

But healthcare is a fast-moving and highly competitive industry, which is highly susceptible to disruption from

medical technology firms. Our analysts expect product innovation and strong balance sheets to decide the winners and losers in the sector this year.

Industrials

Sentiment in the industrials sector lies at zero, marginally higher than last year. Over half of our analysts report the sector is in slowdown, having advanced from the mature stage of the cycle last year. But the nuance within this large and diverse sector is revealing. Global manufacturing has struggled over the past year, but the survey reveals signs of green shoots. Nearly three times as many industrials analysts expect their coverage universes to be to the 'initial expansion or recovery' stage in 12 months compared with today.

The sector is facing multiple challenges that were apparent to our analysts even before the recent outbreak of coronavirus, including coping with weaker growth that could be exacerbated by the virus. "A handful of industrials are increasing restructuring or reducing discretionary expense items, like lower priority investments and travel budgets," one analyst states. "Many are also turning to M&A as organic growth slows."

While capex for the sector overall is set to be lower than last year, some subsectors are compelled to keep spending. One sector analyst says: "Many automotive manufacturers are being 'forced' to increase capex to meet increasingly stringent emissions standards, keep up with the trend towards electrification, and develop autonomous technologies."

Geopolitics could also be a headwind. According to the same analyst, despite the phase one agreement between the US and China, the US and Europe may enter a period of tariff escalation, which could be particularly damaging for the auto industry given its dependence on cross-border flows. That said, previous concerns about the negative impact from the policies of President Trump have given way to a more positive view. He is expected to support the economy in an election year, with greater spending on defence and infrastructure that should support industrials.

Financials

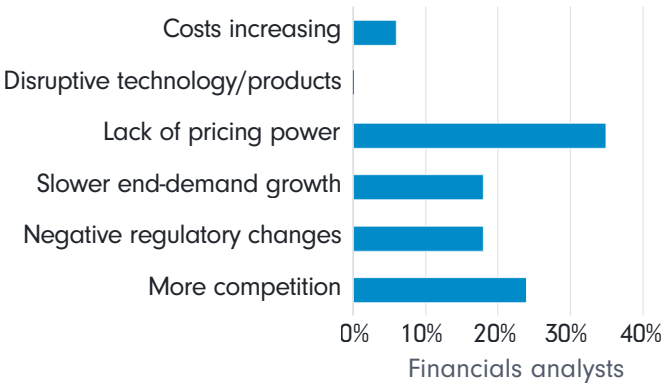
Sentiment in the financials sector indicates a modest improvement in fundamentals during the coming year, but there is a wide variation in the underlying components.

Analysts expect return on capital to be lower than last year, driven by lack of pricing power and greater competition, while managements are also less confident to invest in their businesses. Providing support are strong balance sheets and increasing dividends - 45 per cent of analysts expect payouts to shareholder to be higher in 2020 than last year.

When asked what stage of the cycle the sector is in, the most common answer is 'mature stage of expansion', narrowly beating 'slowdown'. However, our analysts expect these positions to be reversed within 12 months - 45 per cent expect the sector to be in a slowdown phase, while only 31 per cent expect the sector to still be in the mature expansion stage. While loose monetary policy has been a boost for some sectors, the current low rate environment has reduced margins and returns on equity for many financial firms. With the outlook for rates remaining little changed this year, it's no wonder that many management teams are feeling gloomy.

Chart 3: Low rates are hurting financials

"What is the principal cause of declining returns on capital?"



Source: Fidelity Analyst Survey 2020.

More positively, the sector is expected to have a big increase in IT spending, particularly in the areas of security, software and cloud computing, as it tries to respond to disruption trends. Mid-office and back-office jobs are being automated, but it's a race against time as fintech firms and robo-advisors are taking market share from legacy players and compressing fees.

Consumer Staples

The outlook for consumer staples looks relatively bright. The Sentiment Indicator for the sector is 0.4, the third highest behind healthcare and technology, indicating an expansionary environment and improving fundamentals compared with last year.

Fears of the end of the cycle have been put on hold thanks to central bank action. Only 17 per cent of analysts in this sector say their companies are reacting to indicators associated with the end of the cycle, down from 43 per cent last year. Capex is also improving - a third of consumer staples analysts expecting capex to rise, balanced between growth and maintenance. Compare this to consumer discretionary where only a fifth of analysts expect year-on-year capex to increase.

The outlook for consumer staples looks relatively bright. The Sentiment Indicator for the sector is 0.4, the third highest behind healthcare and technology, indicating an expansionary environment and improving fundamentals compared with last year.

The sector stands out in its ability to pass on cost increases to customers. Only 8 per cent of analysts expect cost increases to be a problem due to lack of pricing power, while half are confident their companies would be able to raise prices if inflation were to rise. This year's emphasis on ESG is also notable, with over 90 per cent of analysts report they are witnessing a greater desire to communicate and implement ESG policies at their companies, pointing to efforts in areas such as supply chains, health and safety, climate change and resource management.

Information Technology

Sentiment towards technology companies has increased to 0.6 from 0.5 last year, the second highest reading this year behind healthcare. None of our tech analysts believes the sector is in slowdown or recession compared to 28 per cent last year. "Everything went back to mid-cycle as soon as deterioration stabilised," remarks one analyst.

Our analysts report the sector looks set to benefit from a demographic tailwind - 65 per cent of technology analysts report ageing populations will have a positive impact on their companies, up from just 28 per cent when we asked the question a year ago. Management teams feel optimistic they can take advantage of opportunities in automation as the workforce gets smaller and healthcare technology as the population gets older.

Analysts do not expect many firms will need to raise capital over the next year - the sector once again ranks amongst the lowest - due to the strength of balance sheets bolstered by large cash piles. Analysts also report their companies have the highest pricing power of any sector - 39 per cent state IT companies have the ability to increase prices by more than CPI.

Politics, however, casts a shadow over the sector. More analysts report that management confidence to invest this year is falling than those that report confidence is growing. Some of this is due to the uncertainty of geopolitics in the year ahead. "Uncertainty means that many companies have less visibility on the operating environment and whether they can sell to certain customers," one analyst noted.

The policies of President Trump are a particular worry - 65 per cent of analysts expect a negative impact, the worst across the sectors and up marginally from 61 per cent last year. The ongoing trade war could fragment the global supply chain. Western companies are shifting production out of China, and investment decisions now require careful consideration due to lower visibility. Meanwhile Chinese companies are trying to diversify away from US suppliers by localising their supply chains, although this trend could be hampered by the coronavirus outbreak. However, while still a large issue for management teams, trade uncertainty is now accepted as the new norm and the recent phase one trade deal could provide some clarity. In fact, the most commonly cited risk factor for the year ahead was a synchronised global slowdown. But barring that, the sector looks set to continue its strong performance.

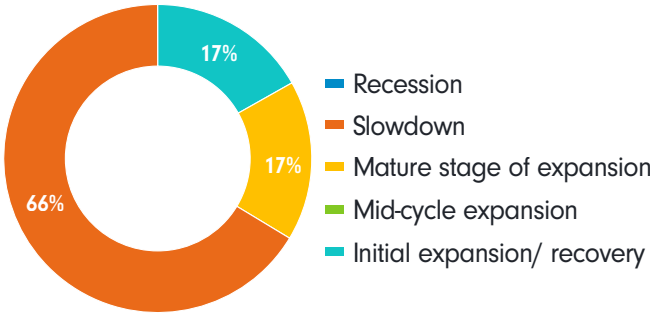
Energy

The Sentiment Indicator for the energy sector is at a four-year low of -0.3, after a difficult 2019 marked by slowing global demand and some oversupply. Half of our energy analysts report management teams are less confident about investing in their businesses this year, and more than 60 per cent state their sector is in the slowdown phase of the cycle. Slower end demand growth is flagged by three-quarters of analysts as the key reason for declining

returns. One analyst said: "A positive surprise would just be performing well, meeting expectations, as the general tone is bearish."

Chart 4: The global economic slowdown is weighing on the energy sector

"What stage of the cycle is your sector currently in?"



Energy analysts

Source: Fidelity Analyst Survey 2020.

The sector has plenty of issues to tackle, with 42 per cent of analysts expecting more regulation, many of them to enforce stricter environmental standards such as carbon reduction targets, limits on sulphur in shipping fuels, or bans on fracking. But by far the biggest risk our analysts mention is that of softer global macroeconomic activity, which looks set to be norm for the time being, despite the cycle extension, especially in light of the recent outbreak of coronavirus.

President Trump's policies represent a mixed bag for the energy sector. While his administration supports industry deregulation in the US, the trade war puts pressure on Asian demand.

In what might be a challenging year for the sector, our analysts expect those companies that take a sensible approach to capital allocation, including returning cash to shareholders where appropriate, to outperform their peers.

Materials

Materials is the most downbeat sector this year with a plunge in the Sentiment Indicator to negative 0.9 from positive 0.3. Global economic activity slowed in 2019, trade declined sharply, and commodity prices spent the year treading water, causing management teams to reset expectations. And given we asked our analysts before the coronavirus outbreak, which looks set to impact all of the above, it is likely the outlook has deteriorated since then.

Companies are moderating capex, adjusting production levels, lowering pricing to fight for market share, and focusing more on operational efficiencies. "Capacity is being mothballed to align supply with demand," one analyst notes. This year analysts report a jump in the number of CEOs who see cost reductions as their main opportunity to grow earnings. All this is summed up by the sector having the biggest year-on-year drop in management confidence of any sector since 2016.

A growing emphasis on government spending may offer some respite. The number of analysts expecting a positive impact from fiscal policies rose to 74 per cent from 36 per cent last year. As fiscal policy moves back up the agenda of governments around the world, materials is a sector that would certainly benefit from infrastructure spending in particular.

The recent surge of interest in ESG issues weighs heavily on these companies - 68 per cent of analysts foresee more regulation, many of which will involve environmental targets. Unsurprisingly climate change – and the responses by government and society - is expected by 95 per cent of analysts to have a negative impact on their companies, a similar figure to the energy sector.

Geopolitics is still at the forefront of out analysts minds, since commodity prices are sensitive to macro uncertainty and domestic flare-ups. Nearly 80 per cent of analysts expect a negative impact on profitability from protectionist measures, higher than any other sector. Although the US-China trade war seems to have cooled down recently, tempering the risk of a Chinese downturn which would be catastrophic for commodity demand, other regions have their own issues.

One analyst reports: "Latin American countries seeing widespread unrest like Chile and Argentina are causing management teams to rethink long-term investment plans. Africa has seen a wave of royalty/tax increases which is also causing a rethink."

Investors should keep in mind the cyclicality of the sector. While 79 per cent of analysts believe the sector is in the slowdown or recession phase of the cycle at the moment, that number falls to 42 per cent when looking a year out, with a corresponding jump in those expecting the sector to be in the initial expansion stage. But just as manufacturing data was starting to show signs of life, the

coronavirus impact may have extinguished the brighter outlook for materials.

Telecoms

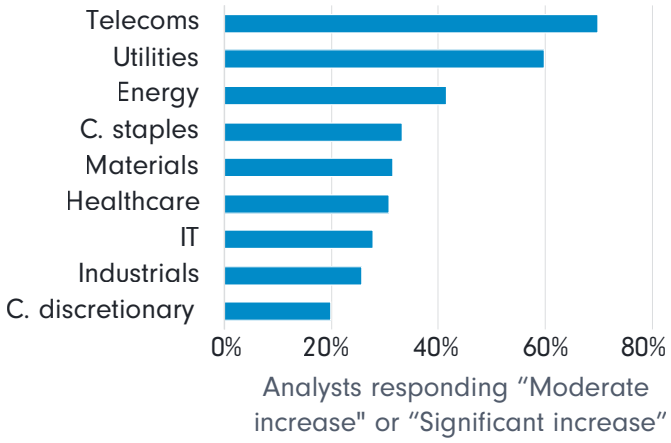
When asked what the scope for positive surprises this year was, one telecoms analyst quipped, "very little." The Sentiment Indicator for the sector slipped into marginally negative territory, primarily due to deteriorating balance sheets - two-thirds of our analysts report balance sheets are stretched compared to only half last year.

Other indicators, however, look brighter. Capital expenditure this year is forecast to increase at the fastest pace of any sector, spurred on by investment in 5G networks. Dividends are set to be similar to last year and while management enthusiasm has cooled in the last few years, it too is set to be broadly similar to last year.

Geopolitics and regulation are occupying managers' minds this year. Our analysts now expect President Trump's policies to weigh on the sector. His actions against Huawei bring uncertainty for companies' supply chains and 5G plans worldwide. And in what is already a highly regulated industry, 56 per cent of analysts expect more stringent rules this year versus only 11 per cent last year.

Chart 5: Telecoms splurge on 5G roll out boosts capex

"How do organic capex plans for your companies over next 12 months vary vs. last 12 months?"



Note: This question was not applicable to the financial sector. Source: Fidelity Analyst Survey 2020.

One of the largest risks is the potential of increased competition, which would lower prices and force companies to spend more to attract and retain customers.

Our analysts note that telecoms companies with established brands will be among the best performers this year, as well as those with strong balance sheets and lower leverage.

Utilities

A broadly flat Sentiment Indicator for the utilities sector overall disguises a more disparate picture under the surface. Returns on capital will take a significant dive this year due to negative regulatory changes and slower end demand growth. Balance sheets are looking more stretched than last year and this is feeding into weaker management confidence. Despite this, dividends in the sector remain compelling, illustrated by the fact that 40 per cent of our analysts expect companies to raise dividends, the second most of any sector after financials.

However, the overarching narrative of the sector this year is the pivotal position utilities are planning at the forefront of the transition away from carbon-intensive energy. Ambitious renewable energy targets at companies will bring capital spending back to life this year - 70 per cent of analysts expect an increase this year.

Analysts also expect fiscal policy to provide a notable tailwind this year. A great deal of the boost is expected to come from 'green' projects considering the ongoing groundswell in support of action to mitigate climate change, whether making necessary upgrades to power networks or building wind and solar farms. Additional announcements of any 'green new deal' spending plans would be a major boon to the sector.

To finance investment to meet government renewables targets, utilities companies are taking the opportunity to issue and refinance debt at current low interest rates, often by issuing green bonds.

Utilities tend to be one of the most highly regulated sectors because of their provision of essential services. While regulatory changes are therefore always the biggest risk for the sector, it is striking to note that, this year, our analysts expect only a slight increase in regulation overall, and moreover the lowest expected increase of any sector (20 per cent of utilities analysts even expect less regulation). In this more benign environment, companies with strong balance sheets and good cash flows will be hard to beat this year.

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