Analyst Survey 2019: The end of optimism

The Fidelity Analyst Survey

A comprehensive perspective on the corporate landscape from our analysts

51 North America

50 Europe

27 China

14 Japan

12 EMEA/Latin America

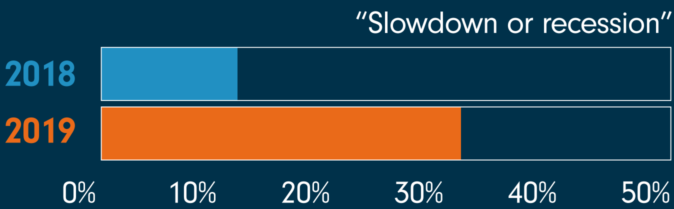
165 Fidelity analysts participated in this year's survey

37 Asia Pacific (ex. Japan ex. China)

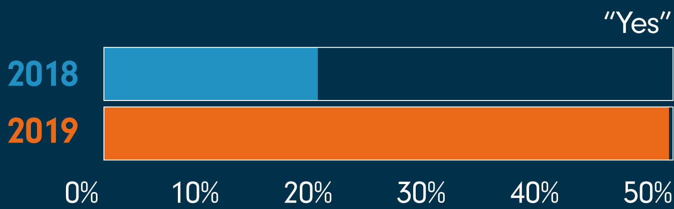
Key themes from this year's survey

Optimism wanes as the end of the economic cycle draws near

What stage of the cycle are your sectors in?

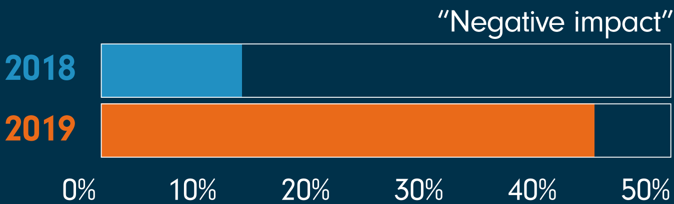


Are your companies responding to indicators associated with the end of the cycle?



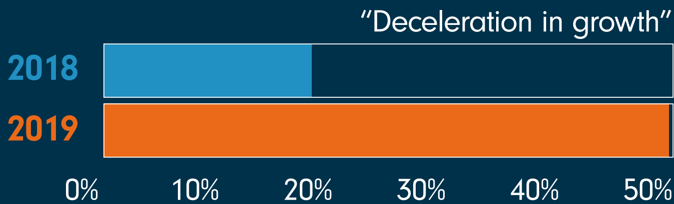
Opinion sours on Trump's policies

What impact are your companies expecting from Trump's policies over the next two years?



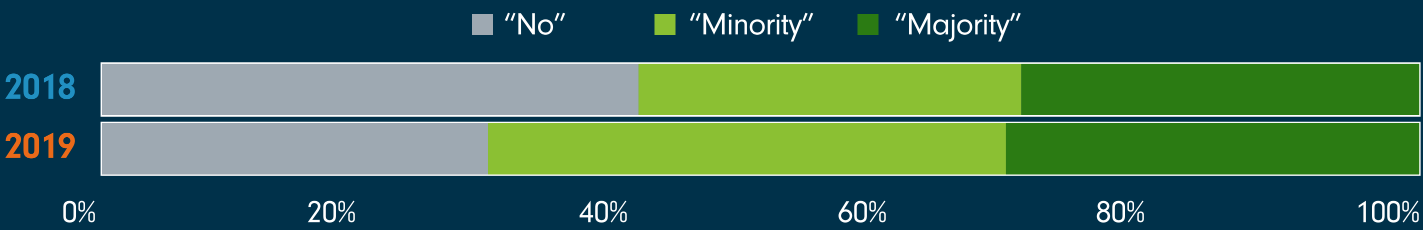
China slowdown becomes a central issue

What are your management teams expecting for economic growth in China?



Improvements in ESG but small steps

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



Country numbers indicate the number of responses per region rather than the number of analysts. Analysts who cover more than one sector complete the survey once for each sector.

Executive summary

A Fidelity analyst-in-training is presented with a bottle of beer. They are asked what they see. The correct answer is: "glass, water, barley, hops and yeast."

Later, a business is put in front of them and the same analysis is expected. Then entire sectors. The results of hundreds of these corporate dissections, which inform security selection and portfolio management, are collected in our Analyst Survey every year and used to build a broad picture of what the next 12 months hold for businesses.

Here's a breakdown of the key findings for 2019:

- Amid the negative headlines dominating newspapers around the world, the obvious first question to ask is whether the data shows an imminent recession. This year, our survey says no. But more analysts are reporting slowdowns in their industries, while political volatility, increasing input costs, and rising funding prices are denting managerial confidence.
- It is clear some companies will struggle. However those that make the right strategic decisions and continue to innovate are likely to excel even in challenging times. It is only through our analysts' frank assessment of business conditions that they are able to identify these opportunities.
- The survey results are covered sector-by-sector and region-by-region. Of the former, only healthcare shows an improvement in sentiment from last year. The indicators for the consumer discretionary and utilities sectors show that analysts expect the prospects for their companies to decline.
- Similarly, analysts in all regions are less positive than last year, but China analysts are the only ones to report a worsening outlook. They are also the most pessimistic about their companies' return on capital over the course of 2019, reporting slowing demand as the principal cause.
- Talk of China soon leads to talk about the US. And that leads inevitably to discussions about President Donald Trump. Concerns about the US administration's approach to trade and business are mounting. For the first time our analysts report that the net impact on companies is expected to be negative.
- Analysts are also reporting their companies' growing concerns over environmental, social and governance issues. More than two thirds of analysts globally said that the companies they cover are thinking about ESG, up 12 percentage points on last year. However, they paint an uneven picture and not all sectors register the same level of concern.

The bottle of water, barley, hops and yeast has gone from half full to half empty since last year's Analyst Survey. Read on for more of the genuine article.

Richard Edgar
Editor in Chief

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Analyst Survey 2019: The end of optimism

By Benjamin Moshinsky

Analyst Survey 2019: The end of optimism

While the responses to Fidelity's 2019 Analyst Survey point to a fall in management confidence and a slowdown in growth for many industries, they do not indicate an imminent recession.

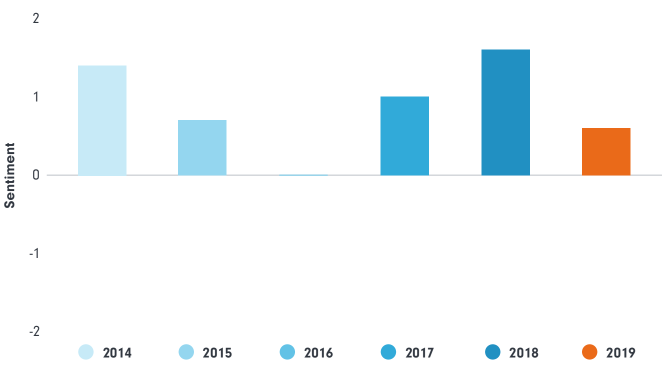
All analysis starts with a question. To investigate their companies' plans, prospects and threats, Fidelity's 165 analysts ask tens of thousands of them a year. We distil these down to around 60 questions for the annual survey, and here, the pot is simmered until just one remains: does the data suggest an imminent recession?

While a decline in overall economic activity may still be a way off, we can already discern its faint outline in the numbers. From the point of view of corporate sentiment, an exuberant start to 2018 has given way to a cautious 2019. Our analysts are reporting the first signs of a decline, aided and abetted by political volatility, rising input and funding costs and weaker consumption. But it would be a mistake to interpret this as a signal to retreat. Throughout the survey our analysts report pockets of optimism and success. As the business cycle turns, life is becoming more difficult for companies - the good ones have to work harder to win and our research team's job is to find them.

Globally, the Fidelity Sentiment Indicator, an aggregate measure of corporate confidence through the eyes of our analysts, suffered its sharpest drop ever, falling from 1.6 in 2018 to 0.6. Despite the alarming plunge, it remains in positive territory - this is not a retrenchment. More detailed analysis brings out the light and shade. China was the hardest hit region, with sentiment declining from 1.4 to -0.4 (a number below zero indicates worsening sentiment), although government stimulus has proven effective at restoring confidence in the past and may do again. Within the sectors, healthcare was the only bright spot, with sentiment increasing for the third year running from 1.1 to 1.4. Nominally, consumer discretionary analysts were the most downbeat, averaging -0.5 across the sector.

Chart 1: Global sentiment falls from its peak

Fidelity Sentiment Indicator



Source: Fidelity Analyst Survey 2019.

Sputtering engine

The already mature business cycle is slowing further, although the falls in sentiment should be taken in the context of a buoyant 2018 survey. A third of analysts globally reported their sectors were in a slowdown or recession versus 13 per cent last year. Only a fifth report an expansion, against 35 per cent in 2018. Analysts are now split 51 per cent to 49 per cent about whether we are at the end of the business cycle, compared with 68 per cent for "no" last year.

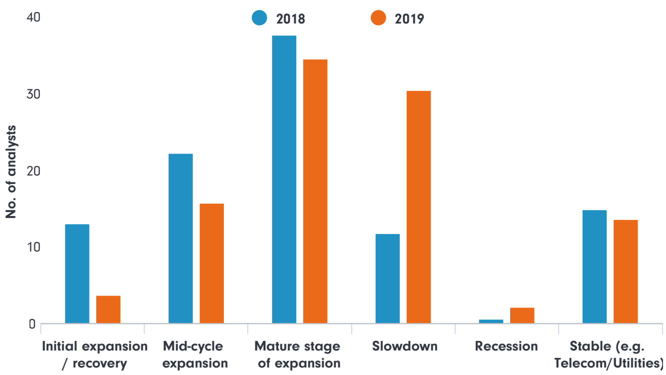
The pessimism has two core drivers, a weaker consumer and increasing costs of doing business. Both of these threaten to squeeze profit margins in 2019. This is borne out by the marked decrease in analysts expecting better returns on capital, from 48 per cent in 2018 to just 18 per cent now. China dropped from 43 per cent to just 7 per cent and North America from 50 per cent to 20 per cent. Globally, four out of 10 analysts foresee a negative return on capital over the next 12 months.

"A third of analysts globally reported their sectors were in a slowdown or recession versus 13 per cent last year."

Every sector has its own indicator of the late cycle. A US banking analyst is watching "the emergence of alternative sources of capital, such as hedge funds, insurance companies and loan funds prepared to lend at prices and with covenant structures that banks aren't comfortable with." Meanwhile homebuilders are cutting back on new land purchases, our analysts report, as valuations start to look expensive.

Chart 2: The business cycle rolls towards a slowdown

What stage of the cycle is your sector currently in?



Source: Fidelity Analyst Survey 2019.

Analyst Survey 2019: The end of optimism

Consumer scepticism

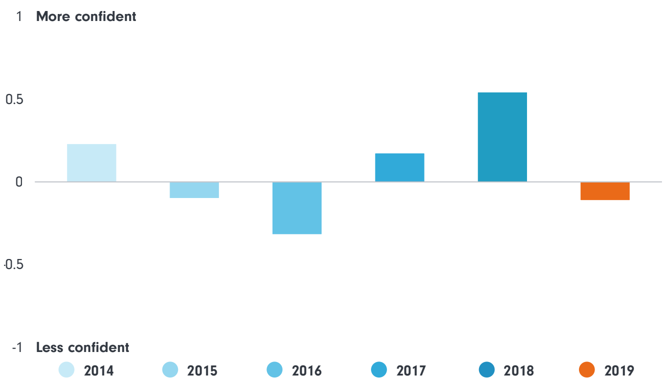
The anxiety is unevenly spread around the world and this year, China stands out. Around half of analysts covering the region report a drop in management confidence, versus just 10 per cent last year. One of the global economy's great engines, the Chinese consumer, is in a stall. And corporate managers are preparing to cut outflows as a result. Almost half of the China analysts expect a reduction in capex, against 18 per cent in North America and only 8 per cent in EMEA Latin America.

A good example is the country's car market, which, with 25 million vehicles sold annually, is the biggest in the world. In the last four months of 2018, car sales "cracked," according to an industrials analyst. They registered double-digit, year-on-year declines. This is a meaningful change in a market that hasn't known a down year in a decade and accounts for a good proportion of global spending on higher spec, higher margin car models.

Similarly, the luxury industry has become more dependent on the Chinese tourist for growing sales around the world, and the country is home to around 35 per cent of its consumer base. The high double-digit sales growth of the past few years is expected to moderate to around 6 per cent in 2019, but fears are growing it could sink to zero. Consumer confidence is in part driven by the wealth effect, which sees discretionary spending increase when the stock market rises. "Luxury managers are concerned the feel-good factor is leaving China" following the market declines in 2018, a luxury goods analyst says.

Chart 3: Managers are the least confident about investing in their businesses since 2016

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 2019.

Where demand falters, so does pricing power. For China, half of analysts expect price rises below consumer price inflation, versus a quarter for North America in 2019. A third of all analysts globally report this to be a problem as input costs will rise, although this is at levels similar to 2018.

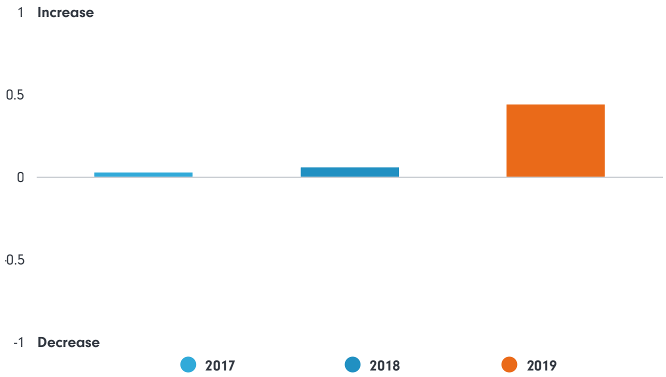
On the cost side, wages are rising across the board, with almost three-quarters of analysts globally expecting increases. Funding costs are also on the up, although it is worth noting that analysts completed the survey at the end of last year, when the market expected the US to continue on a path of monetary tightening. Globally 48 per cent of analysts foresee an increase in funding costs, up from 25 per cent last year.

In Europe, companies facing the prospect of increased funding burdens are breaking with regional tradition and finding lenders among investors rather than banks. Forty-six per cent of analysts expect higher funding costs in Europe, and of that 52 per cent report companies intend to meet their funding needs through increased use of bond issuance. Our financials analysts observe a trend away from bank-dominated corporate funding in Europe towards the capital markets. Corporate issuers have been attracted to issuance by low costs of borrowing in the region.

While only one in five analysts reports a rise in corporate leverage globally, the same as 2018, around two-thirds of those analysts observing this trend say rising debt ratios are driven by deteriorating cash flows, up from 31 per cent in 2018.

Chart 4: Money too tight to mention

How will funding costs likely change in the next 12 months for your companies based on credit quality?



Source: Fidelity Analyst Survey 2019.

Painful politics

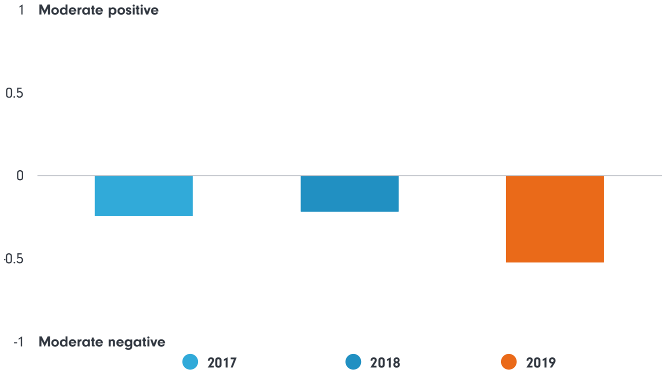
Meanwhile, political turmoil has added an element of chaos to the challenging business environment. Analysts across the range of sectors and geographies report that the unstable geopolitical backdrop is increasing costs of business and driving a pessimistic outlook. The worst affected include the IT, energy, consumer and industrials sectors, where analysts all report increased risks. The impact can be physical. For example, French luxury stores had to shut their doors as the Gilets Jaunes citizens' protests raged in Paris in the lucrative run-up to Christmas. The street battles also persuaded high-spending tourists to stay away.

Healthcare, ostensibly the most positive sector, is not invulnerable to political risk. In the US, politicians on both sides of the party divide have called on pharmaceutical companies to cut costs to consumers, elevating the risk of an enforced change to pricing models over the next few years. Meanwhile, the Food & Drug Administration was not able to accept new drug approval filings during the US government shutdown, slowing the rate at which new drugs could be released to the market.

Analyst Survey 2019: The end of optimism

Chart 5: Analysts are more negative than ever on geopolitics

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 2019.

Most participants in this cycle may be finishing their espressos and calculating the bill, but a few around the table are still deciding on dessert. Healthcare has been a beacon of sustained optimism, with analyst sentiment growing consistently more positive every year since 2016. As a less economically sensitive sector, its companies are not as exposed to slowdowns in demand. “People will keep spending on healthcare, even if that means forgoing the latest iPhone,” as a healthcare analyst said. There are also secular trends that are buoying the sector, including the increased demands for treatment from an aging population and expanding obesity rates.

"Healthcare has been a beacon of sustained optimism, with analyst sentiment growing consistently more positive every year since 2016."

Conclusion

Our analysts’ responses do not suggest a full-blown recession in the next six to 12 months, but the overall picture is less rosy than last year. We have taken another step towards the end of a cycle that started a decade ago amid the economic wreckage of the financial crisis.

The signs are there, report analysts. Managerial confidence is dented by increasing costs and decreasing ability to pass them on to the end consumer, coupled with political uncertainty and trade friction between China and the US. Of the thousands of questions to be posed by our analysts to their companies in 2019, no doubt a fair proportion of them will be focused on how they intend to navigate these risks.

Analyst Survey 2019: Sector by sector

By Neil Gough and Benjamin Moshinsky

Analyst Survey 2019: Sector by sector

Consumer staples

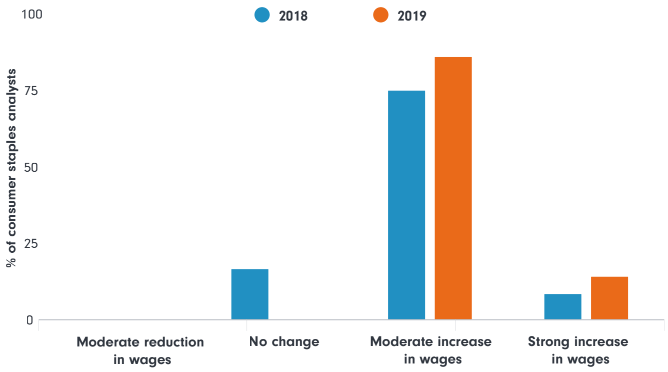
Rising costs are the focus of responses from analysts covering the consumer staples sector, with the Fidelity Sentiment Indicator falling sharply from 2.1 to 0.7. The indicator remains positive, just about, showing analysts expect little change in 2019. Almost a third of analysts observed a reduction in the optimism of management teams to invest in their businesses this year while only 14 per cent of analysts report an increase. The confidence of the consumer, particularly in the US, has been hit by trade wars and volatile politics and markets.

More than three-quarters of analysts covering the sector say they expect costs to rise, with a total of 64 per cent noting these will be passed on to consumers, against a global average across other sectors of just 30 per cent. Increasing freight costs have become a serious headwind for some US retailers, our analysts report, particularly for budget clothes resellers, which have a harder time passing those costs onto consumers. The thin margins and heavy reliance on domestic transport networks that characterise the business also increase their sensitivity to freight costs. Oil prices have come down, but wage costs for lorry drivers have risen, offsetting any potential benefit from cheaper petrol prices.

Indeed, the sector is particularly vulnerable to wage rises. All consumer staples analysts say wages are on the up in their companies, partly due to increasing political pressure on the issue of low pay. Regulation is also a source of concern, with 86 per cent of analysts expecting more in 2019. Internet companies are in the crosshairs of regulators and analysts report that this has the potential to limit monetisation of some parts of consumer staples firms' business models.

Chart 1: Wages push up costs for consumer staples companies

What is the sector outlook for wage cost inflation over the next 12 months versus last 12 months?



Source: Fidelity Analyst Survey 2019.

Consumer discretionary

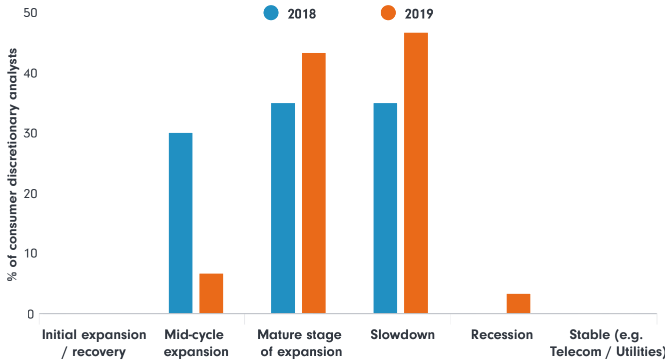
Our consumer discretionary analysts are the most pessimistic in this year's survey. The sector's Sentiment Indicator is at -0.5 with almost two-thirds of analysts reporting that management is less confident than last year. Almost half say the sector is in the slowdown phase of the cycle, a greater proportion than for any other industry, while more than half see declining returns on capital. Sluggish demand is weighing on companies' pricing power, analysts report. However, these conditions aren't necessarily all bad news for big firms in their fight against smaller companies.

The business environment has served to increase barriers to entry and make life hard for companies with fewer resources to draw on. Within the luxury industry, for example, the bigger brands have managed to increase the frequency of new product releases compared to their smaller competitors.

While costlier, this approach has helped established firms capture the imagination of younger consumers, who demand frequent product drops and a high degree of customisation. "Millennials make up 35 per cent of luxury consumers and they have high expectations for service," an analyst covering the sector said. Meanwhile the shift from bricks-and-mortar stores to online retailing is spurring more capital expenditure in the form of tech investment as shop foot-fall declines.

Chart 2: Consumer discretionary cycle moves to slowdown

What stage of the cycle is your sector currently in?



Source: Fidelity Analyst Survey 2019.

Healthcare

Healthcare is a rare ray of light this year - the only sector to show an improvement in sentiment, increasing from last year's reading of 1.1 to 1.4, making it the most optimistic of all. Healthcare also stands out for its overall location in the business cycle. Not a single analyst thinks the sector is in slowdown, against an overall average of 30 per cent, while one in five is witnessing a mid-cycle expansion.

Analysts report healthcare CEOs are the most confident on developing new markets and this optimism is also reflected in expected returns on capital, which half of our analysts view as increasing, driven by new technology and products. For example, the biotech industry is eyeing sales gains of around $3-5 billion from expanding the application of a new type of minimally invasive heart surgery, an analyst reports.

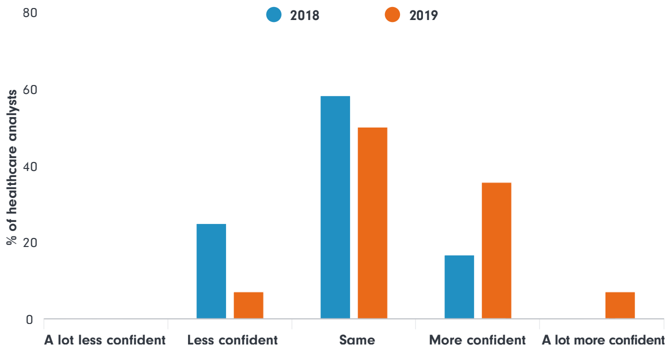
The positivity is spurring investment across the sector. M&A activity is expected to pick up, particularly in the pharmaceutical industry, and companies across healthcare industries are also becoming more ambitious on R&D spend, our analysts report. Management optimism has been buoyed by the US Food & Drug Administration's more relaxed approach to drug approvals under Commissioner Scott Gottlieb, which is helping to fast-track some new cancer treatments and spur innovation.

Analyst Survey 2019: Sector by sector

The ageing cohort of baby boomers makes for a powerful demographic tailwind, and healthcare is the only sector where analysts see increasing life expectancies as a benefit. Ninety-three per cent of healthcare analysts report a major positive impact from the ageing of the population, against a global average of 25 per cent. The hearing aid market is due for a growth surge as more people pass 72 years old, the average age at which people first seek hearing help. These consumers are eager for innovation and are prepared to pay more for products equipped with the latest technology, such as "Bluetooth music streaming," according to a biotech analyst.

Chart 3: A wave of optimism in healthcare

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 2019.

Financials

Financials recorded its first fall in sentiment in three years, but the overall measure remains positive and the drop itself is, at half a point, the smallest among the sectors. This is due to a lack of pessimism rather than any buoyant optimism, according to our analysts.

"80 per cent of analysts note the end of expansion and the start of a slowdown."

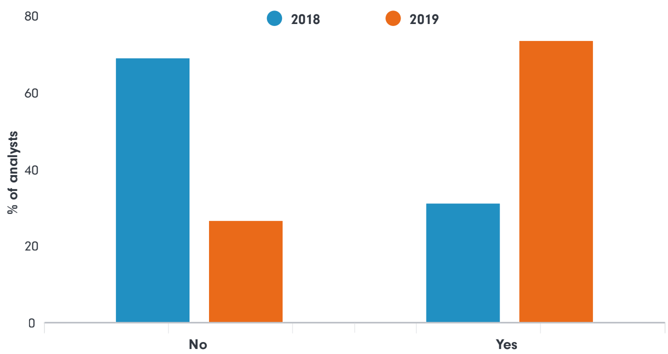
The financial sector was shaken by volatile markets in 2018. Analysts report a significant move into the latter stages of the business cycle, with more than 80 per cent of analysts noting the end of expansion and the start of a slowdown. Three quarters of analysts say their companies are reacting to the indicators associated with the end of the market cycle, compared with just 31 per cent last year. In Europe, macroeconomic factors such as the European Central Bank's hesitation around hiking interest rates has dampened confidence in the sector, according to analysts. The net margin on retail deposit taking and lending, which is heavily influenced by the base interest rate, contributes up to 80 per cent of revenue for some retail firms in the region.

Financial stability is chief among concerns of the sector's supervisors, and, as a result, analysts report balance sheets are conservative. Banks are continuing to refine their risk management systems, putting the days of over-stretched and under-capitalised business models behind them, with around a quarter expecting leverage to decrease further. Some of this is self-imposed rather than coming from supervisors, according to our analysts, and managers are still reacting to the trauma of almost going under in 2008.

However, analysts are also seeing the early signs of a trend towards deregulation, with 18 per cent expecting less regulation in 2019, the highest among all sectors. For example, the US is reassessing its Dodd-Frank legislation, enacted in the wake of the financial crisis, with a view to reducing the regulatory burden on banks. The pendulum is swinging back towards deregulation, just as the banks that survived the 2008 financial crisis get used to a more cautious approach to risk-taking.

Chart 4: Financials analysts see the end of the cycle fast approaching

Are your companies reacting to end of cycle indicators?



Source: Fidelity Analyst Survey 2019.

Industrials

The industrials sector is a broad one, covering everything from recruitment consultants to air freight companies. But that diversification does not save it from a precipitous drop in sentiment, from 1.6 in 2018 to a barely positive 0.1 in 2019. Companies have little room for further expansion this cycle, and almost half of analysts expect declining returns on capital while only 6 per cent report a more confident management at their companies.

More than half, or 55 per cent, of industrials analysts expect funding costs to increase. Most at risk from this trend are the "M&A-driven growth stories," according to one analyst, as well as companies that lease their products. This is because higher interest rates may have to be passed on to the consumer, dampening demand.

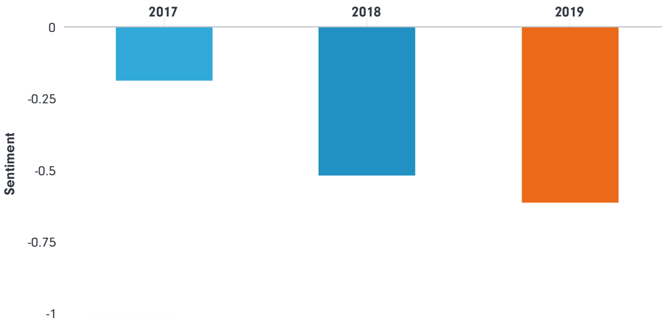
Analyst Survey 2019: Sector by sector

The sector, relying on delicate supply chains that are coming under pressure from tariffs and trade wars, is sensitive to geopolitical tensions. A full two thirds of analysts expect a negative impact on investment from geopolitics.

The sector is also second only to healthcare in the proportion of analysts expecting a negative outcome from Brexit. Analysts note that companies were awarded a limited number of service contracts while Brexit paralysed the political infrastructure. They cited this as a reason for industrial companies to scale back exposure to the UK.

Chart 5: Industrials analysts report an increasingly negative Brexit impact on UK investment

How has the Brexit referendum impacted the willingness of your companies to invest specifically in the UK?



Source: Fidelity Analyst Survey 2019.

Utilities

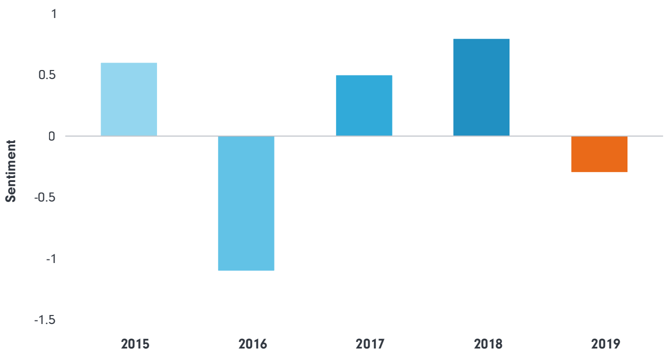
The outlook for utilities is under pressure again. After two consecutive years of gains, our gauge of overall sentiment towards the utilities sector has fallen to a reading of -0.3 index points this year, down from 0.8 points in the 2018 survey. It is one of only two sectors where sentiment is firmly in negative territory (the other is consumer discretionary).

One core reason is our analysts' expectations for declining returns on capital in the sector. A key factor weighing on return expectations is the regulatory environment, according to the survey, but the impact varies across subsectors. Utilities provides, which include grid operators or networks and power generators, and retailers that sell to households are divided into two main groups - those subject to regulated returns or pricing and those where the market has been liberalised.

In markets where returns to utility providers are regulated, as is commonly the case with grid operators, those returns are often benchmarked against bond yields. As bond yields have been declining for most of the past decade, this has hurt returns on capital across the sector. Among retailers in Europe, returns are under pressure from intense price competition, driven in part by the rise of online comparison websites and the emergence of smaller companies with leaner cost structures and better IT. The UK is unique in that retail tariffs have been capped by the regulator following pressure from the government.

By contrast, in markets where pricing has been fully liberalised, like Germany, it has tended to track the price of coal and gas as the key sources of fuel for power producers. Broadly declining coal prices through late 2016 put pressure on power prices, which led to lower earnings for utilities firms. But the picture now is mixed. As coal and gas prices have rebounded, returns are expected to rise for most traditional power generators - such as coal, nuclear or gas generators in Europe that don't rely on subsidies or contracted sales.

Chart 6: Utilities overall sentiment most negative since 2016



Source: Fidelity Analyst Survey 2019.

Energy

Sentiment within the energy sector is down in line with the oil price slump towards the end of 2018. According to our analysts, aggregate sentiment of the energy companies they cover dropped to 0.5 points heading into 2019, marking a steep step down from 2.1 points a year earlier. That's one of the biggest sentiment swings for any sector in the survey this year - a decrease matched only by the drop in sentiment toward technology.

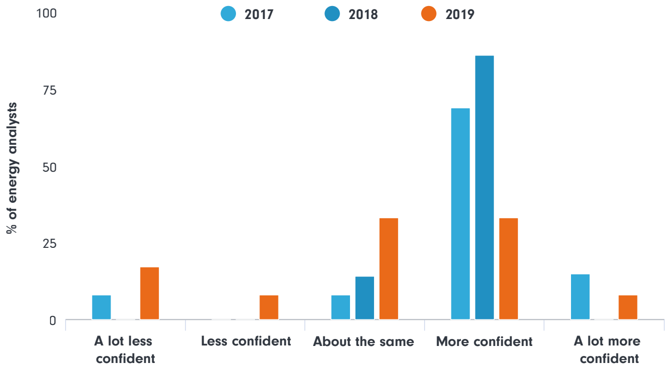
"Our analysts are forecasting oil prices to average $72 per barrel over the full year, according to follow up interviews conducted separately from the analyst survey questions."

Brent crude fell swiftly by more than 40 per cent, from a peak of more than $85 a barrel in October 2018 to a low in late December of just over $50 per barrel. Heading into 2019, our analysts are forecasting oil prices to average $72 per barrel over the full year, according to follow up interviews conducted separately from the analyst survey questions. That's slightly higher than consensus but it isn't driven by expectations of resurgent demand; instead, they view supply side dynamics as the biggest influence. A squeeze by OPEC is expected to be the main driver of supply tightness, which could potentially be weighed down further by nonvoluntary falls in production from other producer nations such as Venezuela and Iran.

Other factors to watch in the year ahead include currency volatility, which is expected to affect energy more than any other sector in the survey - even if the magnitude of that impact is expected to be generally moderate. Energy prices are dollar-denominated but big producers in emerging markets such as Russia, South Africa, Brazil, Canada and China face costs in their local currencies. If the Federal Reserve hikes interest rates this year, against current market expectations, it could strengthen the US dollar causing a headwind for global oil prices and demand.

Chart 7: Management confidence is waning in the energy sector

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 2019.

Materials

Which way China goes in 2019 will have an outsized impact on the materials sector. The world's most populous country and second largest economy is also the biggest consumer of a number of commodities and base materials, everything from copper (for electrical wiring in buildings) and iron ore (for steel) to coal (for power plants).

Analysts no doubt had management concerns over China's economic slowdown in mind when responding to this year's survey, as overall sentiment within the sector has declined to 0.5 points this year from 1.7 points in 2018. Almost half (45 per cent) said the sector is already in the slowdown phase of the industry cycle, up from 13 per cent a year ago. But materials is a broad-bucket sector that encompasses mining, building materials and chemicals - so there is divergence as you drill down into the findings. Seventy-three per cent of our analysts say the management teams of the companies they cover are expecting a deceleration in China growth this year, up from 40 per cent when we asked the question a year ago.

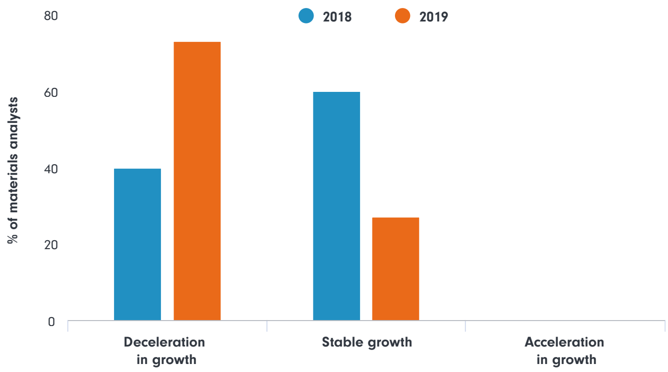
For many commodities companies, the biggest swing factor for the sector would be a potential stimulus package by Chinese authorities that prioritises infrastructure spending, but the timing and scope of such a move is uncertain. Policymakers in Beijing have a clear desire to avoid a hard landing for the economy but are limited in the scale and nature of stimulus they can provide by China's already massive debt load.

"Fully 86 per cent of materials analysts said the sector will face declining returns on capital in 2019."

In the absence of a large stimulus campaign from China the survey results underscore how the materials sector will face the sharpest declines in returns on capital among all sectors. Margins have also been high in recent years, and so have further to fall if they regress to their longer-term norms. Fully 86 per cent of materials analysts said the sector will face declining returns on capital in 2019, up from only 20 per cent last year. The reasons cited for this are rising costs, slower end demand, and declining pricing power.

Chart 8: Analysts report China's growth slowdown is hitting materials companies

What are your management teams expecting for economic growth in China?



Source: Fidelity Analyst Survey 2019.

Analyst Survey 2019: Sector by sector

Information technology

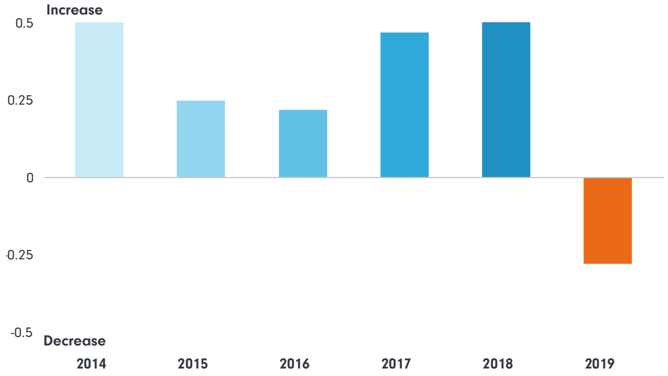
The technology sector has fallen a long way in 2019, declining to 0.5 points from 2.1 points a year earlier. Our analysts report that only 17 per cent of company managements are more confident to invest in their businesses than last year, compared with 84 per cent when we asked the same question in 2018.

What changed? One of the big challenges facing the sector is that of growth upon growth. The US is by far the biggest spender on IT across all geographies both in terms of penetration and absolute dollar amounts, and companies there benefited last year from major tax cuts and other incentives that greatly boosted the sector.

At the subsector level, there is quite a bit of nuance within the sector. For example, while hardware spending is expected to fall, it's a different picture for software and the cloud, where spending looks set to continue to rise, according to our analysts.

Chart 9: IT company capex expectations drop off a cliff in 2019

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



Source: Fidelity Analyst Survey 2019.

Telecoms

When asked whether their companies were reacting to indicators associated with the end of the economic or market cycle, all of our telecoms analysts said no - putting the sector in a class of its own.

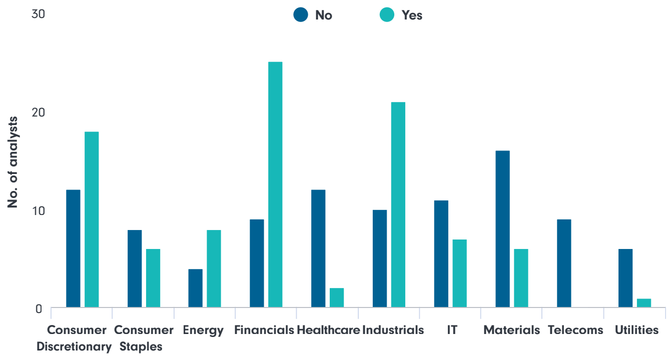
That's not to say the sector is without challenges. In the words of one telecoms analyst: "They're broadly stable if slightly declining businesses without pricing power thanks mainly to competition, but definitely in a recession or downturn they would be more attractive as they aren't subjected to as many downgrades as other sectors."

Overall sentiment within telecoms declined moderately, to a reading of 0.8 points in 2019 from 1.4 a year earlier. In addition to intense competition, telecoms firms face challenges including duplicate networks and a struggle to monetise the vast amounts of data they possess.

On the contrary, one area where there are expectations for further increases is capital expenditures. Capex is forecast to rise notably in 2019; in follow up interviews, one analyst cites rising spending on 5G spectrum options as a key factor here.

Chart 10: Not a single telecoms analyst reports their companies reacting to a slowdown

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



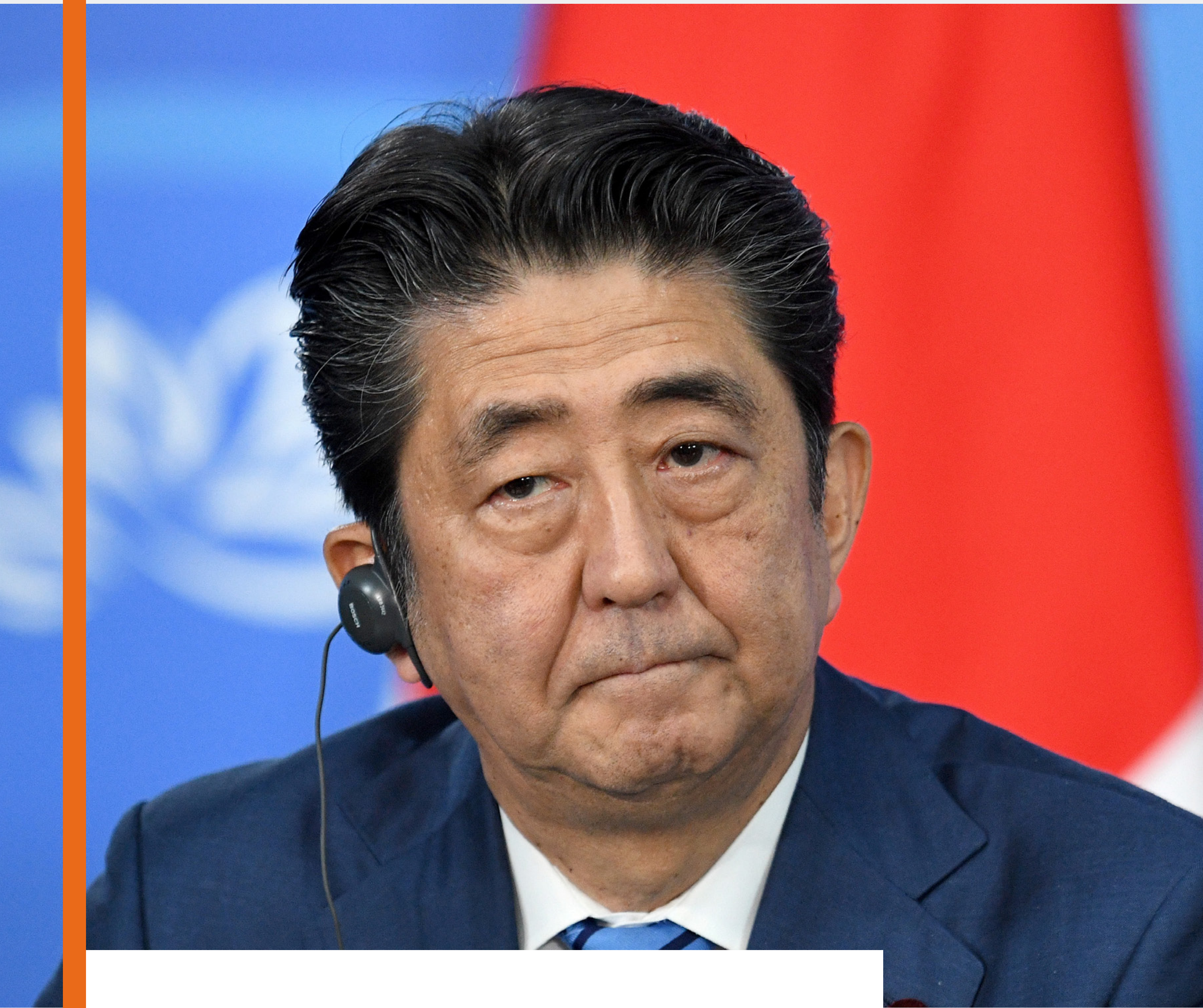
Source: Fidelity Analyst Survey 2019.

Currency volatility

According to our analysts, the impact of currency volatility will slightly increase this year. However, given the recent fluctuations in some emerging market currencies and dollar strength, and the continuing uncertainty around Brexit, it is surprising that the increase is so marginal. Only 15 per cent of analysts expect a 'high' impact this year, up a fraction from 13 per cent in 2018.

Technology analysts expect less of a currency impact this year, with 44 per cent viewing it as 'low', up from 17 per cent in last year's survey. Our analysts anticipate that the euro/dollar, which is the most important pair for North American software companies, is likely to be more stable this year, after a volatile period in the first eight months of 2018.

While the eventual outcome of Brexit continues to weigh on sterling, a good deal of negativity is already priced in to the currency. UK clothing retailers in particular were hurt by sterling volatility after the Brexit referendum in 2016. One analyst reports that at the time many retailers had hedges in place to reduce their currency exposure risk, but the majority of these hedges only ran until late 2017 and 2018. When they lapsed, the falling value of the pound inflated the cost of imported goods and put pressure on margins. The analyst adds that the year-on-year impact of this is expected to be smaller in 2019 compared with 2018, as the effects of the expiry of the hedges wash out of the data. As a whole, 40 per cent of analysts covering consumer discretionary, which includes retailers, expect a 'low' impact from currency volatility, up from 30 per cent in 2018.



Analyst Survey 2019: Region by region

By Raji Menon, Bob Chen, Lisa Twaronite and Adnan Siddique

Analyst Survey 2019: Region by region

Taking a tour of the survey by region shows some striking common themes emerge, particularly around declining confidence and ebbing bullishness.

Last year sentiment was at full-throttle, so 2019's results should be regarded in that context, but the mood has distinctly shifted down a gear. M&A, a strong indicator of corporate optimism, is down across the board, and, amid rising funding costs, company leverage is falling - perhaps less by design and more by compulsion as underlying cash flows deteriorate. But while the big picture looks similar, the granular details vary depending on the region, offering insight into the different conditions playing out across the globe.

North America: A tale of twin costs

Fidelity Sentiment Indicator 0.4 vs. 1.6 last year

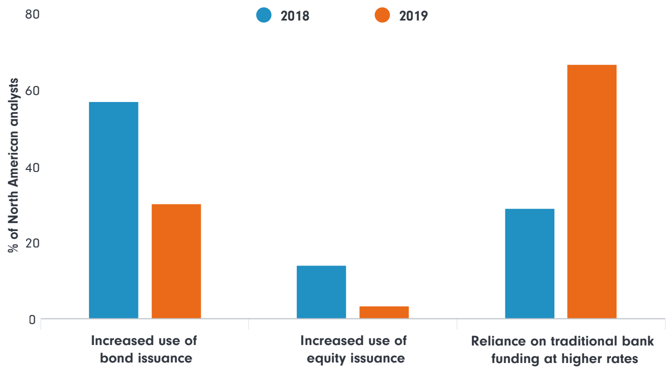
The story in North America can be boiled down into two words: costs and rates. As the US Federal Reserve and Bank of Canada were two of the few central banks to have been in a bona fide rate rising cycle in 2018, the North American corporate landscape has been shaped by costs - whether input costs or the cost of money. In fact, the primary cause of decreasing returns in North America is now increasing costs whereas last year it was disruptive technologies. The number of analysts citing input cost inflation as a problem has more than doubled to 37 per cent. A significant contributing factor is wage rises where 77 per cent say there is moderate or strong increase in pay, and this could be taking money away from the pot for investment - only 39 per cent indicate increasing capex, down from over half last year. An industrials analyst summed up the order of the effect of inflation, "first to cost structure and second to demand destruction".

"The number of analysts citing input cost inflation as a problem has more than doubled to 37 per cent."

Company funding shows similar pressures. A full 59 per cent of analysts mentioned funding cost increases, well over double last year's figure. This is contributing to pressure on servicing debt, with a third of analysts expecting an increase in default rates this year rising from 16 per cent of analysts last year. With more volatile equity markets and the potential of more defaults scaring bond investors, companies could be forced to change their capital sources. Indeed, our analysts say that most companies which are dealing with higher funding costs are relying on more expensive bank loans, whereas last year most opted for bond or equity issues.

Chart 1: North American companies falling back on expensive bank funding

How are your companies dealing with this higher expected cost of funding?



Source: Fidelity Analyst Survey 2019.

We further explore business conditions in the US elsewhere in the edition, The Trump bump is over, which focusses on the policies of the Trump administration.

Japan: Off the boil

Fidelity Sentiment Indicator 0.6 vs. 2.0 last year

Japan has gone from zero to hero and back again in the space of a few years. Last year, we hailed 'Abenomics' and the shareholder-friendly initiatives underway, but this year the region posts one of the sharpest reversals in sentiment. While Prime Minister Shinzo Abe has instituted a comprehensive set of reforms, there continues to be a lingering drag from deflationary forces around labour market flexibility, regulation and demographics.

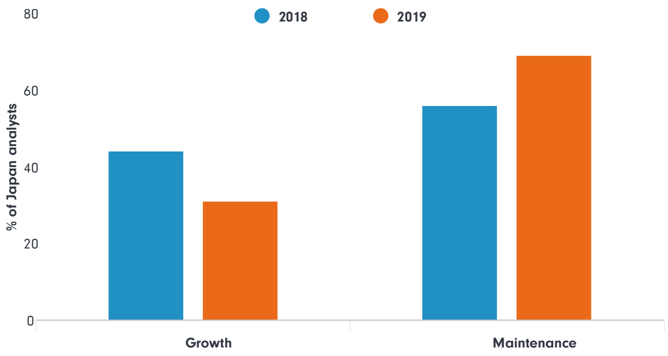
Dividend expectations are particularly interesting, reflecting some optimism. Half of all analysts expect companies in Japan to increase dividend payouts in 2019, more than any other country.

But the cold, hard facts of the economic data are difficult to resist. Japan's GDP growth figures have slowed over the past year and that's showing up in our analysts' observations. A hefty 29 per cent of analysts think returns on capital are dropping, up from 7 per cent in 2018, driven entirely by slower end demand growth. It follows that less than a third of corporate investment is directed towards growth spending, while that figure was nearly half last year, indicating "increasing reluctance for big capex decisions," according to one consumer analyst.

Analyst Survey 2019: Region by region

Chart 2: Japanese companies pare back growth investment

How does this split of capex compare to the previous 12 months?



Source: Fidelity Analyst Survey 2019.

Asia Pacific xJapan xChina: Caught between a rock and a hard place

Fidelity Sentiment Indicator 0.5 vs. 1.2 last year

Asia (ex China and ex Japan) spent 2018 largely trying to navigate being caught in the middle of a burgeoning trade war between two superpowers and facing headwinds from a strong US dollar. Both challenges remain with China's slowing economy adding more trouble. The region's economy is gradually moving into maturity and slowdown but there's still life left, with six out of ten analysts believing we are not yet at the end of the cycle.

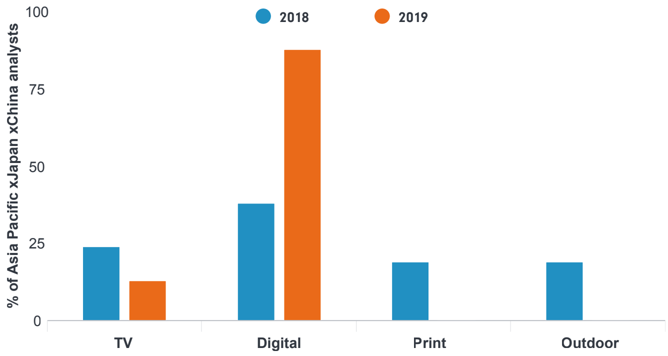
"88 per cent of marketing spending increases are allocated to digital and none of the increase directed towards print or outdoor."

Delving deeper into the region unearths how the corporate dynamics are changing. Asia ex China and Japan is well and truly going digital: 88 per cent of marketing spending increases are allocated to digital and none of the increase directed towards print or outdoor. There's growing attention on more complex forms of IT with a bigger proportion of spending on cloud technology and security systems rather than mobile. As we report elsewhere in the edition, ESG issues also appear more prominently, particularly around supply chains, health and safety and executive compensation.

Disruption is a bigger feature of corporate life with 95 per cent of analysts focussing on the region believing it could have an impact. An industrials analyst commented that disruption is most likely to come from "automation from the greater use of robotics in place of human labour", challenging the assumption of cheap labour in developing countries.

Chart 3: Marketing spending in digital soars

What is the increase in marketing spend mostly going towards?



Source: Fidelity Analyst Survey 2019.

Eastern Europe, Middle East, Africa and Latin America: Still basking in the sun

Fidelity Sentiment Indicator 0.9 vs 1.5 last year

Despite the sentiment indicator falling back, EMEA/Latin America still has a high reading - the most positive of any region. It's easy to see why. A year ago, EMEA/Latin America faced a busy schedule of corruption cases and elections, but it has largely come through this and is still benefitting from strong commodity prices which drive the economies in many parts of the region. What stands out most is its industry cycle: a full 92 per cent of analysts covering the region say it is still in some form of expansion stage - well above any other region.

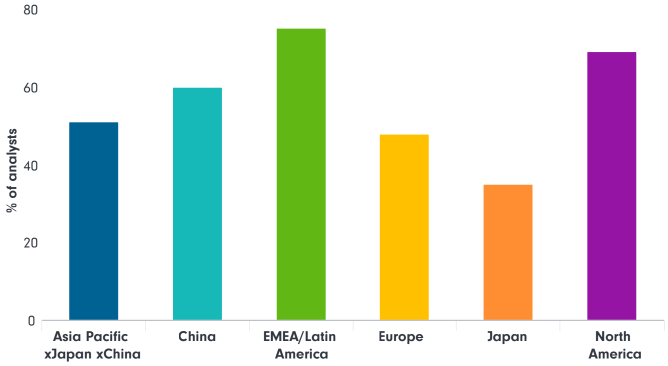
This positive outlook is further supported by a third of analysts who say management teams are 'more confident', which is the highest anywhere. Another 42 per cent expect capital investment to rise, a significant bump on last year's 31 per cent. No other region shows an increase here. "Some Russian oil and steel companies have had windfall gains from a strong dollar, and higher oil and commodity prices that have seen their free cash flow yields improve by double digit figures, allowing them to invest in capex and pay out dividends," said one analyst covering the region.

But EMEA/Latin America is not free from geopolitical threats. Three-quarters of analysts point to protectionist measures having a negative effect on the region. That figure is higher than any other region, perhaps mostly due to the export dependence of Mexico and Central America on the US. This is also showing up in the effect of investment in the region. Half the analysts think investment will hurt, up from 39 per cent last year.

Analyst Survey 2019: Region by region

Chart 4: EMEA/Latam bearing the brunt of protectionism

What impact do you expect protectionist measures to have on your companies' profitability over the next 12 months?*



Source: Fidelity Analyst Survey 2019.
*Analysts answering significant or moderate negative impact of protectionist measures.

Europe: More gloom than doom

Fidelity Sentiment Indicator 0.6 vs 1.6 last year

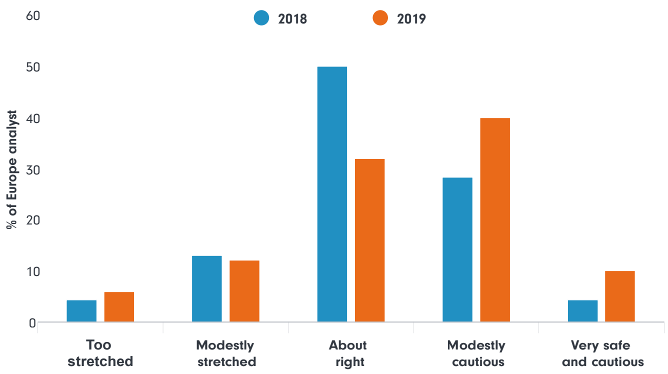
The growing optimism seen this time last year has given away to gloom. Other than China, no other region sees such a big jump in the number of less confident managers who are weighed down by the slowing economy, Brexit and populism. "European macro, interest rates and the effect of Brexit on consumer confidence are the biggest risk factors, affecting the fundamentals of European financials. Our worst-case scenario is inflation going up and growth down," said an analyst covering European financials.

A third of analysts mention falling returns, up from 13 per cent last year, but unlike Japan the drivers of this are widespread including slower end demand growth, rising costs, regulatory headwinds and competitive pressures. Corporates are responding however. More analysts are seeing their companies reduce leverage and half have companies positioning balance sheets cautiously versus a third in 2018.

Despite managers shifting to a more cautious stance, policymakers should still be mindful. Over three-quarters of our analysts believe fiscal stimulus will have a neutral impact compared to just 17 per cent last year. Given a quarter of our analysts point to a slowing industry cycle in Europe, fiscal policy may not offer the boost it once did.

Chart 5: European balance shifting towards cautiousness

How would you characterise the efficiency of the overall balance sheet in your sector?



Source: Fidelity Analyst Survey 2019.

UK: Increasing Brexit concerns

Britain's divorce terms from the European Union seem no clearer than they did a year ago, and as we approach the deadline of Article 50, the uncertainty is increasingly weighing on investment decision-making. The proportion of analysts covering Europe who say Brexit will have a negative impact on strategic investment of the companies they follow over the next two years, has marched upward from 63 per cent to 70 per cent this year. The negative impact on UK investment specifically has similarly climbed higher.

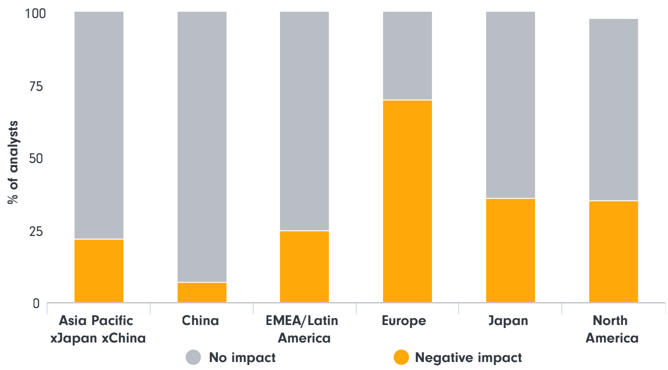
As concerns mount over the possibility of a no-deal Brexit having a knock-on effect on medicine supply chains, analysts covering the healthcare sector are particularly despondent with the percentage expecting a negative investment impact jumping from 25 per cent to 64 per cent.

"Brexit has created a lot of uncertainty and has reduced the willingness of companies to take risks in the UK, while the British government appears to be in limbo, with only a limited number of new service contracts awarded in the past two years," said one analyst.

However, the further away analysts' companies are from the UK, the less of an impact Brexit seems to have. Only 7 per cent of analyst covering Chinese companies expect a negative impact, versus 35 per cent in North America and 70 per cent in Europe. The impact of Brexit on UK inflation intriguingly hasn't shifted much from last year, with the bulk of analysts continuing to say it is stable.

Chart 6: Europe analysts most concerned about Brexit

To what extent will uncertainty around Brexit have an impact on your companies' strategic investment plans over the next two years?



Source: Fidelity Analyst Survey 2019.

Analyst Survey 2019: Measuring China's slowdown

By Neil Gough

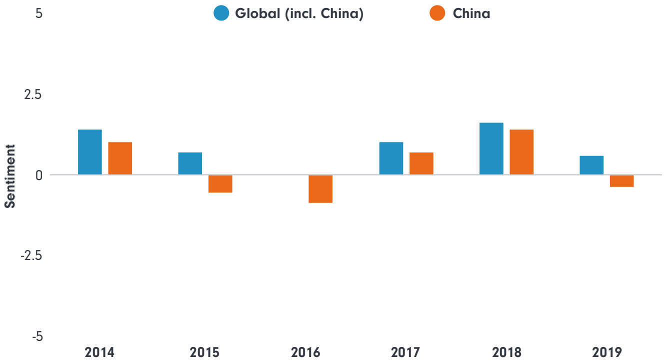
Analyst Survey 2019: Measuring China's slowdown

One of the biggest questions hanging over the global economy in 2019 is this: just how deep is China's economic slowdown, and what are policymakers in Beijing prepared to do to soften the blow?

Our analysts have some answers. Their on-the-ground insights highlight clear reasons to be concerned about China's economy, but we also identify some pockets of brightness and a heated debate over how large and how effective expected fiscal stimulus measures will prove to be.

The Overview

Chart 1: Fidelity Sentiment Indicator for China lags the rest of the world and turns negative



Source: Fidelity Analyst Survey 2019.

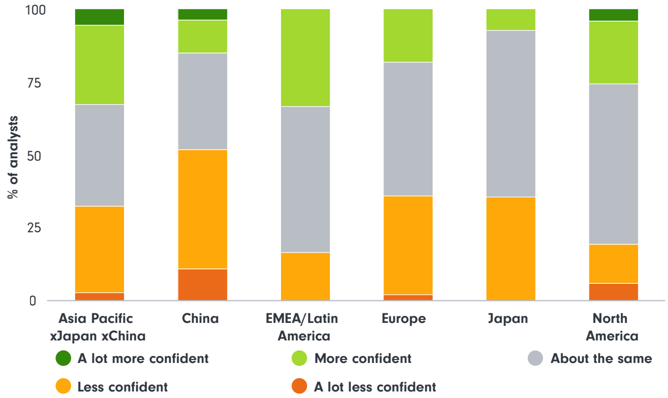
In aggregate, our analysts report that sentiment towards China for the year ahead is both more downbeat than for other geographies and reflects a steeper falloff from 2018 than elsewhere. In the words of one Shanghai-based analyst: "Usually offshore investors have a more negative view on China but last year we saw onshore investors join the bearish group too. It was an across-the-board downturn in sentiment."

> "In previous easing rounds we saw that China did very significant credit stimulus, but they may not do that this time."

Consider some of the surveys' standout findings: for 2019 our analysts report that management teams of the companies they cover in China are the least confident to invest among any region globally; they are also widely expected to show the most significant reductions in capex spending, the smallest number of companies expanding headcount, and the highest proportion of companies planning increases to leverage.

Chart 2: Management confidence in China is the weakest globally

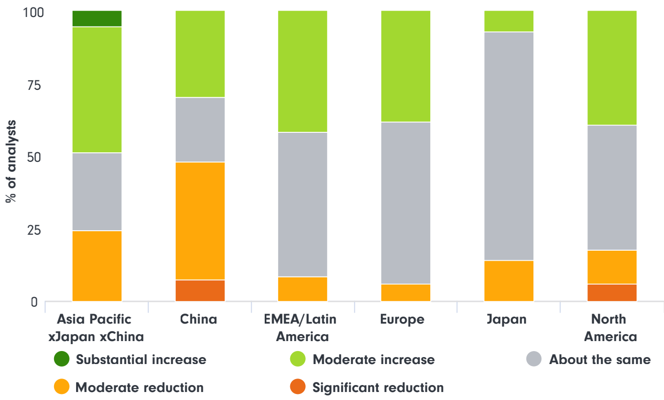
What is the confidence level of the management teams in your sector to invest in their businesses versus 12 months ago?



Source: Fidelity Analyst Survey 2019.

Chart 3: Cutting capital expenditure in China is a sign of the times

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



Source: Fidelity Analyst Survey 2019.

Slowing demand

One consistent refrain from the 2019 survey is that a broad-based slowdown in demand is rippling across many sectors of the economy. "The macro slowdown will weigh on the asset quality of banks, that's for sure. In previous easing rounds we saw that China did very significant credit stimulus, but they may not do that this time," one Fidelity analyst covering financials said.

Analyst Survey 2019: Measuring China's slowdown

After some modest financial easing in the past year, including several cuts to the reserve requirement ratio for banks, liquidity is generally ample in the financial system - but it isn't making its way to end users, such as privately-owned companies.

"Interbank liquidity is fine but the issue is money is not transmitting to the broader economy. I imagine some of the heads of corporate treasury departments may be losing sleep at night," the analyst said.

Financial stress is rising. Some 33 per cent of China analysts expect leverage to increase at the companies they cover, while the bias in most of the rest of the world is toward deleveraging. Two thirds of the analysts who expect leverage to rise at China firms say that deteriorating cash flows are the main reason for this.

According to one fixed-income analyst based in Shanghai: "a lot of companies are already highly leveraged and facing greater refinancing risk, so now many care more about survival than growth."

Trade war wary

Others see trade wars as a factor: "the number one issue," says one technology hardware analyst. The timing of the tariff phase-in and potential escalation meant a lot of China's exports were front loaded to the final months of 2018, and there have been concerns that the initial months of 2019 would show a slump. "It has brought a lot of uncertainty into the system, and I see a big slowdown in discretionary consumption and a cut off in capex intentions as well," the analyst adds.

Manufacturers remain a key driver of growth for the Chinese economy as a whole, regardless of whether they are exporting overseas or selling into the domestic market. And the uncertainties triggered by the trade wars mean that some will be mulling a 'Plan B', such as relocating supply chains from China to Southeast Asia.

> "It has brought a lot of uncertainty into the system, and I see a big slowdown in discretionary consumption and a cutoff in capex intentions as well."

For consumers, the uncertainties extend to their prospects for wage growth, and that has a second order effect on consumption. This can be seen in declining sales of bigger-ticket discretionary purchases like cars, or even smartphones.

Stimulus to the rescue?

Across nearly all sectors, the biggest swing factor cited by our analysts who cover Chinese companies - and potential for upside surprise - is fiscal stimulus. However, the survey results and in-depth follow-up interviews revealed diverging opinions over what shape this fiscal stimulus might take, how big the impact would be, and how much capacity the government has to boost such spending.

One analyst who covers utilities and energy says: "I think everybody is looking to China to provide a lot of fiscal stimulus, but with the background of recent tax cuts I really doubt how much room they have left for this. Already we're at a stage where much of the high returning infrastructure has already been built; the incremental value from new infrastructure will be limited from now on."

However, as suggested by the divergent opinions over its effectiveness, the impact of stimulus spending is expected to vary greatly by sector. "I don't think individual tax cuts will have much of a stimulatory effect on consumer spending because Chinese tax to GDP is already very low compared to many economies, and there isn't as much room to cut as there is in, say, the US," says one Asia equity analyst based in Hong Kong. "It would have a one-off sugar hit impact, and then fade quickly."

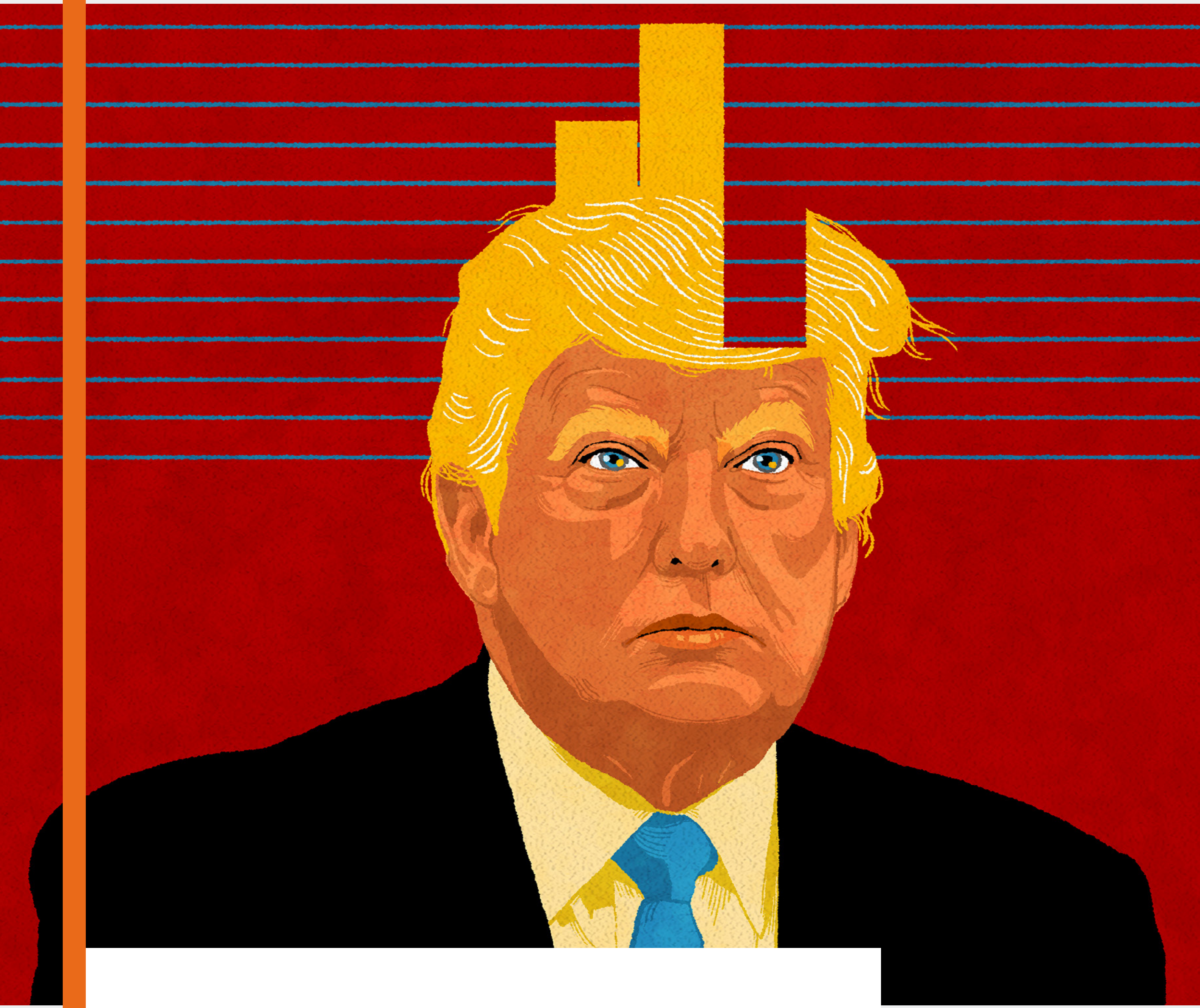
Contrast that view with the outlook for carmakers. Unlike previous rounds of across-the-board tax breaks, stimulus measures this time around are likely to be more targeted in scope, perhaps benefitting manufacturers with exposure to electric or other 'new energy' vehicles, or those with a stronger footprint in rural areas.

That same preference for using selective stimulus to support favoured industries or sector segments is a recurring theme in China. For example, beneficiaries of favourable policies might include new energy projects, such as distributed energy projects focused on solar power.

But the biggest direct beneficiaries of traditional infrastructure stimulus spending would still be the materials, metals and mining industries.

In recent months there was a notable increase in the number of approvals for local government infrastructure projects, as well as in the number of successful debt financing deals for local-government-linked entities. The combination of the two - financing and an official greenlight - could signal an increase in infrastructure spending as 2019 unfolds.

If that feeds through into an increase in fixed asset investment, it would be a boost to demand for industries like steel production, which tends to be a lagging indicator. Setting the tone for the year, the verdict from one analyst is that "the outlook for the Chinese metal and mining sectors into 2019 is similar to other sectors in that it is marginally deteriorating from here."



Analyst Survey 2019: The Trump bump is over

By George Watson

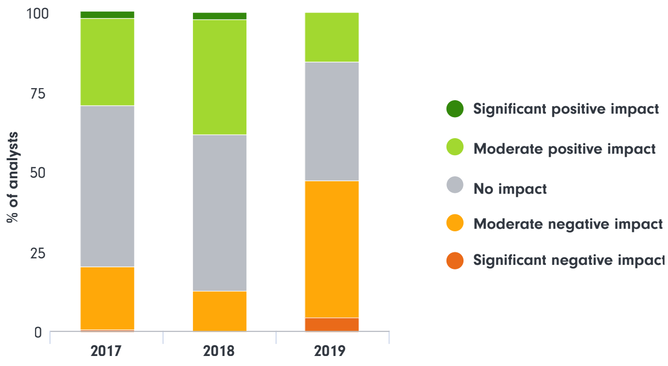
Analyst Survey 2019: The Trump bump is over

For two years in a row, the Analyst Survey showed a modestly positive impact of Trump's policies on companies globally, fuelled by optimism among US corporates. That has changed. Concerns about the US administration's approach are mounting, and the net impact on companies is now expected to be negative.

For the first time in the three years we have asked this question, the Trump administration's policies are expected to weigh on corporate performance over the next two years. Almost half of all analysts globally say Trump's policies will be a drag on their sector, up from only 13 per cent last year, and fewer than one in five thinks they will be positive, down from 38 per cent.

Chart 1: The end of the Trump boost as analyst sentiment swings

What impact are your companies expecting from President Trump's policies over the next two years?



Source: Fidelity Analyst Survey 2019.

But most significant is the shift among analysts covering North American companies, whose watchful optimism has entirely evaporated. It mirrors their views on protectionism, which more than two thirds say is a risk to business. In fact, only analysts covering emerging markets ex-Asia are more worried about protectionism.

Chart 2: Even US companies think US policies will no longer benefit them

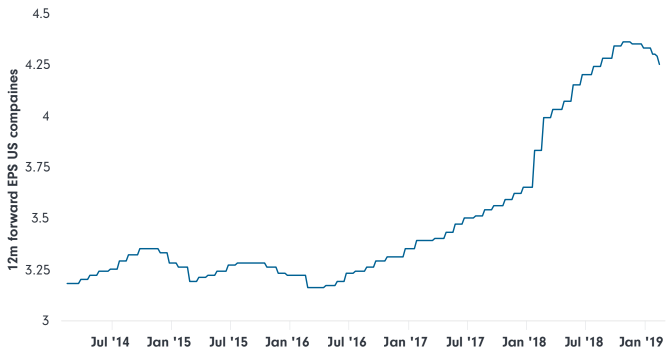
What impact are your companies expecting from President Trump's policies over the next two years?

*Pre-2019 data shows only US companies. Source: Fidelity Analyst Survey 2019.

Opinion sours

Two years ago, Donald Trump had just been elected President and media coverage was bursting with scare stories about his economic plans. Yet it seemed that managers, especially in the US, shrugged off the concerns and focussed on the potential benefits to their companies' bottom lines. The promise of lower corporate taxes, less regulation, more public spending and reduced international competition left them feeling more, not less, confident about their outlook.

Chart 3: Trump's tax cuts have boosted US fundamentals but the effect is beginning to wane



Datastream US Total Market Index, Datastream I/B/E/S EPS estimates. Source: Refinitiv, Fidelity International, February 2019.

Corporate earnings have indeed seen bumper years in the US, boosted by lower taxation in particular. As that impetus has faded infrastructure spending has disappointed, while Trump's combative stance on international trade has started to raise costs for importers and has complicated sales for exporters.

> "Almost half of all analysts globally say Trump's policies will be a drag on their sector."

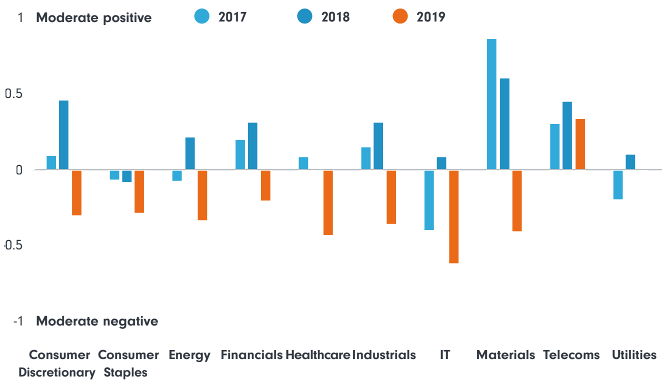
This is why only a quarter of analysts covering North America predict fiscal policy will be supportive this year, still driven by tax cuts.

Analyst Survey 2019: The Trump bump is over

Infrastructure spending is not predicted to be a significant factor and only one in six analysts predicts a further boost from deregulation. Nor do they think the war of words between Trump and his adversaries will pay off: the share of North America analysts who foresee a drag from geopolitics on investment plans has almost doubled to just under half of our sample.

Chart 4: Concerns about US policies are now shared by almost all sectors

What impact are your companies expecting from President Trump's policies over the next two years?



Source: Fidelity Analyst Survey 2019.

Tariffs weigh on almost all sectors

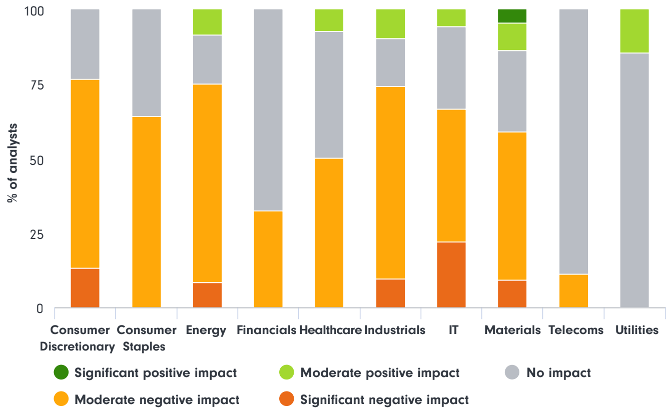
The telecoms sector, with its domestically focussed businesses, is the only sector where our analysts report management teams are unconcerned. In utilities the aggregate effect is expected to be neutral, but some analysts report Trump's decision to leave the Paris Agreement will increase uncertainty around other countries' climate change policies, including Australia's, which is hurting confidence in investment decisions.

Consumer sector analysts report tariffs are the main reason for the negative swing. "Many consumer products from textiles to toasters to toys are sourced from China. Increased supply costs will mean decreasing margins or passing the extra costs on to consumers, which decrease aggregate demand as well as add to inflationary pressures. In the long term, retailers can reconfigure their supply chains, but in the short term, even switching to Southeast Asian suppliers outside China might not mitigate price rises completely due to competition from other North American firms attempting the same," a consumer credit analyst notes.

In addition, technology, energy, industrials and materials analysts all say companies are expecting a negative impact from protectionism this year. Energy analysts agree Trump is keen to keep oil prices low but warn that his trade war could curb global energy demand.

Chart 5: Protectionism is expected to harm almost all sectors

What impact do you expect protectionist measures to have on your companies' profitability over the next year?



Source: Fidelity Analyst Survey 2019.

Auto tariffs and other trade restrictions are listed as key risks, with companies already blaming the trade war for falling consumer confidence. However, some of the effects may already have played out - some analysts suggest that sectors like autos were badly hit in 2018 and could bounce back if resolutions to the various trade conflicts, most importantly those with China, are found.

The chilling effect of Trump's policies is felt in far-flung places: our analysts say even Macau casino operators fear Trump's policies will weaken demand in China and depress their customers' spending, with little predictability for planning purposes.

More protection can also have indirect effects. While US consumers are expected to remain strong, and Trump's protectionism could indeed support sales for companies operating in the US - such as healthcare companies - analysts note there is a risk of the US closing to exporters and of higher costs due to lower labour availability if immigration falls.

Sectors with complex international supply and sales chains, especially technology but also materials, generally suffer the most from increasing trade friction, which explains some of the growing concern about the President's policies. Our analysts report tariffs are a headwind to revenues, and additional political uncertainty around technology transfers are a threat to IT business models.

Further stimulus before 2020 election is an outside chance

Still, some of this pain may be eased by the longer-lasting effects of tax reforms that have already been enacted, even if their impact will fade. It is also a relatively safe bet that President Trump will attempt some form of electoral sweetener in the next two years to bolster his chances of re-election in 2020. Giving the economy a boost of the same magnitude in the near future will be harder for Mr Trump to achieve after the Democrats took control of the House in the midterms. But even if he could, there are declining marginal gains to be made from further stoking the American economy.

Analyst Survey 2019: ESG now pervasive in Europe and growing in China

By Vanessa Glennie

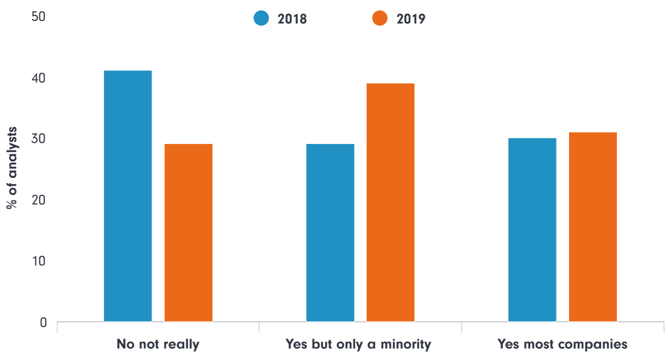
Analyst Survey 2019: ESG now pervasive in Europe and growing in China

Environmental, Social and Governance (ESG) issues continue to grow in importance at the companies our analysts cover.

Just over 70 per cent report that firms are increasing their emphasis on ESG policies, up 12 percentage points on last year. This should come as little surprise, given the increasing prominence of sustainable investing. Still, a sizeable share of our analysts (39 per cent) say this is only the case for a minority of their companies, suggesting it's not yet a concept that's caught on everywhere.

Chart 1: Companies step up their ESG efforts

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



Source: Fidelity Analyst Survey 2019.

Pervasive in Europe and leaping up the agenda in China

European companies take ESG the most seriously, with 92 per cent of our analysts observing some or all of their companies paying closer attention to ESG-related issues, up from 67 per cent last year. Sentiment appears to have tilted in favour in EMEA/Latin America, with a majority for the first time - 67 per cent of analysts - reporting a greater ESG emphasis among the companies they cover, compared to 46 per cent last year.

But the most notable attitude shift is in China - the number of our analysts reporting a growing ESG focus among some or most of their Chinese companies has nearly doubled to 63 per cent, from just 33 per cent last year. Even quite recently, environmental, social and governance considerations were not high on boardroom agendas across much of corporate China, if they existed at all. However, the growing stream of foreign capital into mainland markets has been accompanied by ever greater scrutiny of companies' ESG credentials.

"We're having far more ESG-related conversations with managements as clients, particularly in Europe, demand greater insight into how these businesses are run. It's clear that for many companies, particularly those founded by first-generation entrepreneurs, the topic had never crossed their mind before," notes one China consumer analyst.

This has prompted firms to take a closer look at where they can improve - as well as better communicate - the relevant policies and procedures they might already have in place. "In some cases, companies had low ESG ratings despite adhering to sustainable business practices, simply because managements hadn't declared them, most importantly to the vendors that collate ESG-related checklists," adds the analyst.

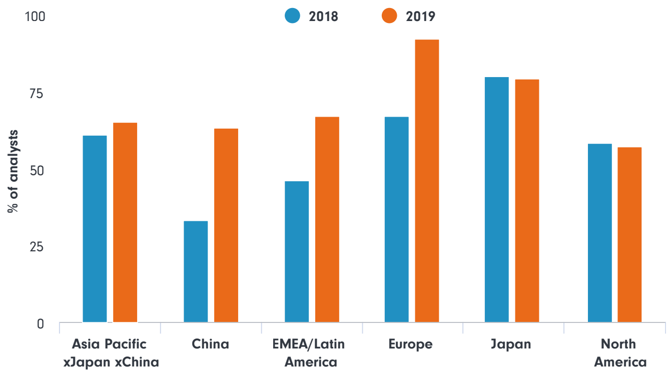
Policy directives have also helped. In a nationwide 'war on pollution' China's government has encouraged more use of renewables and natural gas in place of coal-fired energy generation, imposed restrictions on vehicle use in major cities, cut excess industrial capacity and even shut-down thousands of heavy polluting factories completely.

Little change in North America

Meanwhile, ESG is failing to gain much momentum among North American companies, according to our analysts. Only 57 per cent of analysts report a growing ESG focus among some or all of their companies, essentially the same as last year. The current administration has not pushed the ESG agenda. In some instances, it's doing quite the opposite, rolling back emissions standards across the energy and vehicle industries and withdrawing from the Paris Agreement on climate change.

Chart 2: ESG gains traction in Europe, EMEA/Latin America and China

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



Source: Fidelity Analyst Survey 2019.
*All responses indicating either a minority or most companies are increasing their ESG focus.

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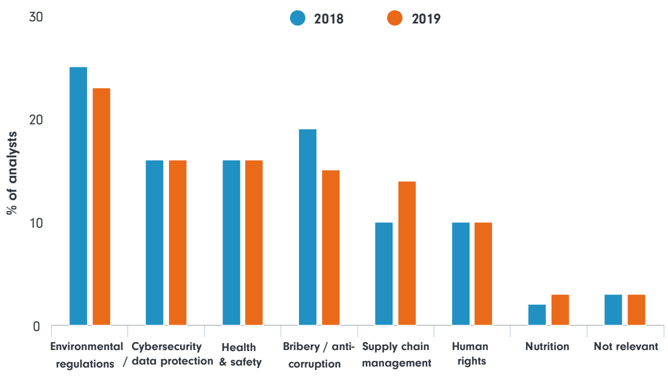
Minding your own business is not enough

Chart 3: Growing focus on supply chain management

Which environmental/social issues are most relevant to your companies?



Source: Fidelity Analyst Survey 2019.

Our survey results show that when it comes to the E and the S, environmental regulations continue to dominate management thinking, and particularly so for the utilities, energy, materials and industrials sectors. However, supply chain management is becoming an increasingly important consideration for companies and is now the most relevant issue for consumer staples firms, according to our analysts.

Consumers, particularly in the developed world, are more aware than ever about the provenance of the products and services they buy; whether workers involved have clean and safe facilities and are paid a living wage, for example. And these consumers are demanding that companies become more responsible, one of Fidelity's ESG specialists notes.

"The UK passed the Modern Slavery Act in 2015, partly to ensure transparency of supply chains, while Australia passed a similar law at the end of last year. But asset managers also have an important role here, to actively engage with their companies and promote change where required," he adds.

Companies and brands that do not have adequate insight or control over the quality and business practices of their suppliers, and even their suppliers' suppliers, can face a very public backlash. Just ask the Spice Girls. The girl band found itself on newspaper front pages for all the wrong reasons recently after it was revealed that the white t-shirts they had been pictured wearing were made in a Bangladeshi factory that paid its staff around 45 US cents an hour.[1]

High-end goods are not immune either. "Younger generations particularly expect a product to be 'squeaky clean' when they pay top dollar for it. This has prompted some high-profile brands to change the way they source crocodile leather, for instance, or stop using it altogether. Burberry has removed all real fur from its products and stopped burning unwanted stock, something it did to protect its brand and ensure such goods weren't sold at below market prices. It's promised to reuse, repair, donate or recycle the stock instead," notes one luxury goods analyst.

As global brands apply more stringent screening criteria and step up plant inspections, suppliers must adapt or lose business. China has long been a pivotal link in the world's supply chain. "Companies from industries as diverse as electronics, textiles, apparel and toys, have upped their game in recent years in response to pressure from end-retailers and tighter regulations from the Chinese government," one China consumer analyst notes.

Supply-chain management is a prominent issue across the industrial, technology and materials sectors, too. Gold and diamond mining have been cleaned up a lot in the last decade or so, but more recently attention has shifted to mining cobalt, an element of the batteries that power smartphones, tablets, laptops and electric vehicles.

One materials analyst notes that a shortage of cobalt and rising demand have caused prices to soar, incentivising 'artisanal miners' - independent operators not officially employed by a mining company. "These miners often operate outside safety regulations and can include children, posing a challenge for high-profile end-users, such as Apple and Microsoft, which want to maintain the integrity and security of their supply chains."

Utilities well-positioned to benefit from climate change

Almost three quarters of our utilities analysts expect climate change to have a positive impact on their companies over the next 10 years. Firms in the renewables space are obviously well positioned for the energy transition that's already underway. "Currently, less than 10 per cent of global power generation is through wind and solar sources, which leaves a lot of room for growth," notes one utilities analyst.

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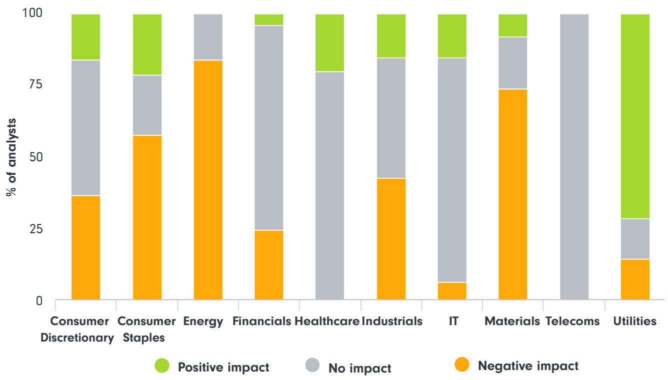
More indirectly, renewables generation requires additional network investment. Instead of one large power plant connected to the grid,

[1]https://www.theguardian.com/world/2019/jan/20/spice-girls-comic-relief-tshirts-made-bangladesh-factory-paying-staff-35p-an-hour

multiple points are required to connect typically smaller, more scattered renewable sources. Power generation from renewables can also be more volatile and networks must be equipped to manage bi-directional flows. Meanwhile, as energy transition encourages the electrification of other industries, most notably private transportation, electricity demand will naturally rise, benefiting utilities across the board.

Chart 4: Climate change brings opportunities for utilities
What impact will climate change have on your companies in the next 10 years?



Source: Fidelity Analyst Survey 2019.

Room for improvement

Overall, our analysts note that pressure from investors, consumers and governments has helped heighten ESG awareness across regions and industries. However, there is still a sizeable minority of laggards; 30 percent of analysts see no discernable shift in their companies' ESG efforts. It seems a glowing ESG scorecard is not yet a priority, or even possible, for everyone.

The power of the Analyst Survey

By George Watson

Each year, we ask our analysts what the companies they cover are expecting in the coming 12 months and how managements are positioning their businesses as a result. This year we gathered 191 responses from 165 analysts (some analysts cover more than one sector) from our equity and fixed income teams. The opinions of our analysts are formed from over 16,000 company meetings throughout the year and offer a unique, forward-looking perspective into how CEOs, CFOs and COOs are thinking and acting.

The survey avoids broad macroeconomic overviews and ruminations on valuations in favour of granular insight into the corporate fundamentals that drive business performance, built from the bottom up. Our analysts cover over 80 per cent of global market capitalisation and the results provide a country- and region-specific barometer of company managements' hopes and fears for the coming year. Are they excited about growth prospects? What are their spending plans? What do they expect from input costs and inflation? Are they more worried about the impact of geopolitical events this year than last?

Our analysts have one focus - to determine the best companies to own in a portfolio. To do that they develop a deep understanding of the companies and sectors they cover. What makes the survey so powerful is the patterns that emerge from the aggregation of these expert opinions. The trends that emerge in the data are used by our analysts to inform their future decision making to recommend companies that benefit from the tailwinds or are less exposed to the headwinds.

This year the survey features the highest ever number of responses as for the first time we include our analysts based in Canada, giving us a view of North America from closer to the action.

Recent track record

When we conducted our survey at the beginning of 2016, we noted a precarious outlook. Markets were jittery and threats and opportunities appeared finely balanced. Based on the survey responses, we were reasonably confident the world economy would avoid sliding into recession, but it seemed a close call. In the year that followed, concerns about the health of the Chinese economy and US rate hikes abated and fears of a recession gradually faded. Even though the global economy only returned to a firmer growth track in the second half of the year, when the oil price had recovered convincingly and the pressure on energy and materials firms started to ease, hindsight would probably say our survey overestimated the risks in play at the time.

By the beginning of 2017, our analysts signalled a much more optimistic outlook for the year ahead. We expected modest demand growth and continued innovation would drive investment and corporate activity. We noted executives appeared unfazed by recent political upsets and were expecting market dynamics to be favourable. So it proved to be, as capex, sales and earnings all improved markedly around the world during the year.

The survey responses that year also suggested a bottoming out of the capex cycle might be near after two years of declining investment. Company data from that period shows that capex did indeed start to pick up in 2017. But, if anything our analysts were too cautious as capital spending continued to increase throughout the year. Fiscal stimulus in China and expectations of pro-business policies from the Trump administration provided further support for corporates as equity markets repeatedly made new highs and credit spreads contracted globally as investors scrambled to adjust their outlook.

At the start of last year, the survey responses pointed to stronger fundamentals across all regions and sectors in the coming 12 months. Corporate sentiment was at a five-year high and the subsequent data for 2018 has largely backed this up. Earnings, sales, capex and free cash flow were all higher in 2018 than 2017. However, while the direction of travel was most definitely called correctly, the full-year results have not quite lived up to the high expectations of our analysts, and as the year progressed corporate fundamentals softened from the peaks seen in early 2018.

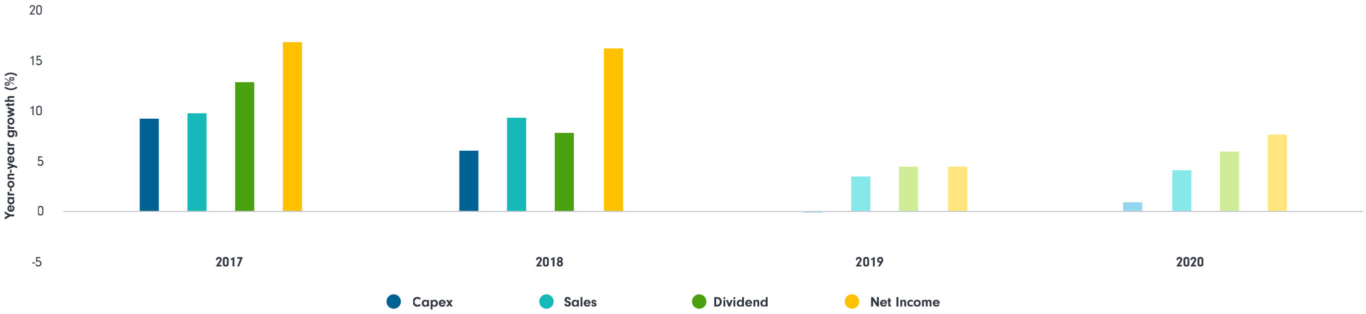
Despite the lofty sentiment indicator, our analysts noted that the market cycle was in its latter stages, summed up by our choice of title, 'As good as it gets'. In the end this proved remarkably accurate - the first quarter of 2018 turned out to be as good as it got for corporate fundamentals.

The survey data last year also pointed to upward pressure on wages and costs but not prices, contrary to consensus at a time when many were worrying about upside inflation risks. Again, events in the past year have proven our analysts' expectations largely correct - rising employment levels and wages have not fed into inflationary pressure and, with the global economy cooling as we begin 2019, the US Federal Reserve looks set to pause from its hiking cycle with fears now turning to the possibility of deflationary risks.

Unique value

The survey identifies broad market trends but from the opposite direction to most macro analysis - from the bottom up. The sheer number of our dedicated analysts and the scope of our market coverage make the findings unique and the conclusions robust. Looking at the world from many different angles can only be a good thing.

Chart 1: Our analysts expect business conditions to be tougher in the next few years



Global aggregate of companies that Fidelity International analysts cover. All figures converted to USD. 2019 and 2020 data is Fidelity analysts' forecasts. Source: Fidelity Analyst Survey 2019.

Important information