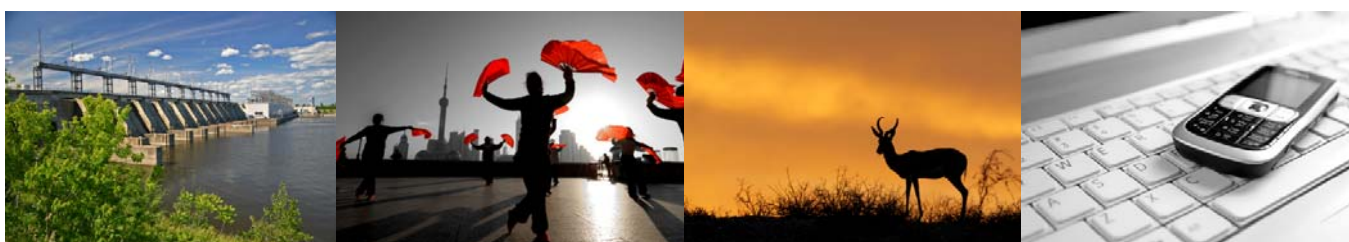




21st Century Investment Themes



Ten themes to move markets

THEMES FOR THE 21ST CENTURY:

- 1. The power-shift from West to East
- 2. Energy: how to power a growing world
- 3. The impact of demographics
- 4. The move to urbanised living
- 5. The potential for technical progress
- 6. The growing cult of consumption
- 7. The promise of emerging Africa
- 8. The economics of food & water
- 9. The move to a low-carbon economy
- 10. The power of the 'silver' wallet

The world has changed immeasurably in the last thirty years. The next thirty seem likely to yield even more dramatic changes as a number of significant themes exert their influence on what is now a more highly connected world.

Where once information was power, now it is everywhere, boosting the already frantic pace of entrepreneurialism in developing economies. Globalisation has brought enormous benefits, yet also introduced new vulnerabilities. The BRIC economies of Brazil, Russia, India and China are playing catch-up with the west and drawing other emerging market economies into their impressive wake.

Change is upon us. Investors must either embrace it or risk missing out on some of the biggest investment themes in a generation. The 10 themes we have identified seem sure to have a significant impact over the next few decades. But what are the investment implications? In this summary, we discuss how investors can position themselves.

THE FOLLY OF FORECASTING

Predicting the future is fraught with danger. It is a matter of a trend projection and virtual guesswork on the part of analysts to say what level the Dow Jones will be in five years time.

However, when it comes to the big, secular themes that are exerting a growing pull on economies and financial markets, there is more scope to be forthright and more reason for investors to take action. Most of the themes we have outlined are already highly visible and investible; the others will be too, in relatively short order.

CHANGE IS A GIVEN

As economic growth in emerging markets lifts people out of poverty (theme 1), consumption is expanding dramatically (theme 6). The global population is growing (theme 3), raising the challenge of how the world feeds itself (theme 8), and powers itself (theme 2). People are living longer (theme 10), and they are living, increasingly, in urban spaces (theme 4).

Climate change is a reality that must inevitably push us towards a lower-carbon world (theme 9). Hopefully, technology and technical progress will respond to these challenges (theme 5), as both developed and emerging markets see the value of investing in knowledge based industries. Change is a given; investors must now embrace the process of identifying its commercial beneficiaries.

GIVING WEIGHT TO THE THEMES

Attaching relative weights to a group of highly interconnected themes is tricky. Intuitively, in numbers, in broker forecasts, by anecdote, and by dint of a visit to Mumbai or Shanghai, the epochal power-shift from west to east, and the emergence of China and India, must surely be given most weight in this series. It is the underlying dominant theme which recurs, or acts as a catalyst, in many of the others.

Beyond this, it becomes more difficult to attach weightings. Is finding a solution to our energy needs more important than alleviating pressure over basic food and water resources? In truth, they are related, not least because bio-fuels are reducing the amount of arable land for food.

This is where technical progress is crucial. Encouragement can be taken from the fact that every time the world has pushed up against resource limits in the past, mankind has found a way to overcome the situation. This time is different – this time we have even more brains from around the world, tackling the problems in energy, food and water, providing incremental advances and occasional step-changes that sum over time to extraordinary technical progress. It is technical progress that allows us to continue growing the global economy in the very long run, when the low-hanging fruit of simple industrialisation is complete.

CONSEQUENCES FOR INVESTORS – SEVEN THINGS TO CONSIDER

We have considered a number of interesting themes in this series. But what exactly are the implications for investors and what practical steps can be taken to exploit their potential?

We outline seven key things that investors should consider:

1. Invest more in emerging markets, beware home bias – As we witness an epochal shift from west to east, every investor needs to make sure they have enough exposure to emerging markets in their portfolio. Many investors remain structurally under-invested for two reasons. First, although allocations have picked up from negligible levels in the last decade or so, they still do not reflect the significant and growing share of global GDP attributable to these economies. Second, pension funds and other investors tend to be over-exposed to their 'home' market.

2. Take a long-term view - Investors must take a step back from the occasional hyperbole that crops up from time to time in the press about 'emerging market bubbles', and remember that the long-term outlook is compelling. Yes, there will be blips, on an upward sloping curve, but they should not stop investors getting their money on the table. Remember that industrialising economies like China can sustain much faster year-on-year growth as they grow strongly from a low-base.

3. Include frontier markets such as those in Africa. Incredible as the growth of China is, don't put all your eggs in one emerging basket. An allocation to emerging markets should include a range of economies at various stages of development. If you have China 'covered', then consider some genuinely frontier markets in sub-Saharan Africa, for example, which have vast mineral wealth and huge consumption potential. Globally, Indonesia, Nigeria, Mexico, and Turkey all have large populations and fast-growing economies and have been mooted as 'next big things'.

4. Invest in real assets – Some economists argue that we are entering an inflationary age. Moderate inflation is not a bad thing for equity markets. But, some doom-mongers are predicting a worse outcome, as the alleged inflationary effects of quantitative easing combine with higher commodity prices (particularly food and energy). It seems sensible for investors to include inflation-protection in their overall portfolio, such as inflation-linked bonds.

However, other economists are more sanguine, given spare capacity in western economies. Meanwhile, emerging economies are in the midst of an 'urbanising age'; one that requires infrastructure build and raw materials. An optimal strategy, therefore, may be to remain in equities but tilt the bias of investments towards real assets whose prices go up with inflation. By investing in companies that have pricing power in their part of the value chain, such as miners of industrial and precious metals, investors can participate in corporate growth *and* beat inflation. Given constraints on supply, these companies tend to benefit disproportionately from higher global growth. Platinum is preferred to gold since it has a significant industrial use. An essential component of catalytic converters, it is a key part of the move towards a low-carbon world.

5. Remember to add food and water – its not just metals and minerals in the spotlight. Fertiliser and agricultural companies stand to benefit from the combination of growing demand for food and changing diets in developing countries. Similarly, companies that build desalination and water management infrastructure and who can provide access to clean water should continue to have full order books as demand for water intensifies across various parts of the world.

6. Consider consumption – consumption is the end point of economic growth. As emerging economies grow, and become wealthier, the global middle class is expanding rapidly and consumption is set to soar, particularly in the discretionary segment where branding is key. Notably, beneficiaries will be based in both western and emerging markets.

7. Do not ignore pharmaceuticals – Pharmaceuticals have been an overlooked sector. The stocks performed well in the early 1990s, prior to the ascent of generics and the expiry of numerous blockbuster drug patents. However, the macro outlook looks bright. A massive expansion in middle class consumer populations in emerging markets, combined with people generally living longer, particularly in developed economies, paints a very rosy picture for global healthcare spending. There is scope for the best generic and branded names to benefit. Investors should write off pharmaceutical companies as boring, defensive stocks at their peril!

A FINAL WORD

Information may be everywhere, but genuine insight remains rare. The research effort required to understand constantly evolving themes, at the local level, within industries, and within companies is vast; in short, it is something that few investors and indeed investment managers can muster. In order to take the fullest advantage of these themes, investors are advised to seek out an experienced investment manager with a genuinely global research capability.



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