

Point of view

Fidelity Canada's 2009 market outlook – highlights

Key Investment themes for 2009

Bob Haber, Chief Investment Officer and Portfolio Manager, Fidelity Investments Canada

- The key investment themes for 2009 will be a return to risk assets – high quality corporate bonds, high-yield bonds, and equities – and taking advantage of continued market volatility to buy quality assets.
- The Canadian equity market, relative to its long-term historical growth trend, is as oversold as it has ever been. It is also among the most oversold of all major equity markets. Over the coming months, investors with the fortitude to move out of cash and government bonds face the buying opportunity of a generation. One has to go back to the depths of the 1973–1974 bear market to find a time when Canadian equities were this oversold.

Brian Miron, Portfolio Manager for Canadian Fixed-Income Products, Fidelity Investments Canada

- The year 2008 was one for the history books. U.S. ten-year treasury notes hit a multi-generational low of 2.00%. Three-month T-bills continue to yield virtually nil and at one point offered negative yields. The Federal Reserve has taken its target rate to an unprecedented level of zero and has acted aggressively to replace the massive amounts of liquidity that have been withdrawn from the financial system by rapid corporate and consumer deleveraging.
- Since the collapse of Lehman Brothers, we have seen counterparty, investor and consumer confidence plumb new lows, while at the same time, the policy response globally has been rapid and aggressive.
- We believe that while there will continue to be some awful economic data during the next six to twelve months, the markets have largely priced in the bad news. And for the stock and bond markets, we believe we are getting close to the point at which we can say that the worst is behind us.

- The massive amount of fiscal and monetary stimulus will work by reflating the economy; however, the time at which this development will gain traction is unknown. As we continue to navigate uncharted waters, the challenge for the policy makers will be to withdraw the monetary stimulus appropriately.

Financials

- U.S. financial institutions will in future operate much more like Canadian banks, supported by strong and broad-based deposit banking services.
- Canadian banks remain in extremely solid condition despite recent writeoffs and the slowing in business that comes with any recession. They have doubled their loan-loss provisions and have taken steps to recapitalize. They remain extremely solvent and well-capitalized and continue to generate double-digit returns on equity.

Earnings & business outlook

- We are hearing from management teams that business is challenging; however, we are encouraged by upticks we are seeing in insider buying. This shows that management teams believe that the markets may be undervaluing their businesses.
- We believe that the street's expectations for 2009 earnings – while down drastically in recent months – still remain high. As such, we will continue to use volatility to our advantage, adding to holdings in the strongest companies on short-term weakness.

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The U.S. and Canadian dollars

- The U.S. dollar has remained remarkably strong through the crisis, largely supported by the technical aspects of global de-leveraging and the traditional flight to safe-haven asset classes. We do not believe that the strength of the U.S. dollar is supported by fundamentals, and we expect to see it weaken over the coming years.
- We remain very bullish on the Canadian dollar. Even as Canada begins to run budget deficits, they are not anywhere near the order of magnitude that we are seeing in the U.S. In addition, the fundamental soundness of the Canadian financial system, coupled with our resource-rich economy, will support a strong Canadian currency.

Go Canada: The case for Canadian equities

- During 2008, the deterioration in fundamentals for commodities occurred much more dramatically and rapidly than we anticipated.
- However, we have no doubt that the fundamental pillars of the "Go Canada" thesis remain in place over the longer term. Long-term growth, urbanization and the industrialization policies and objectives of China, India and other emerging economies have not been altered by the recent market events. In fact, China and India have enacted massive fiscal stimulus policies of their own.
- While commodity prices have seen a massive correction, the drivers of a fundamental supply-demand imbalance have not shifted significantly. No additional capacity has been added, and capital spending on infrastructure remained largely constrained. In addition, energy and commodities producers cut back significantly on capital expenditures and reinvestment during the later part of 2008 in order to operate within their free cash flow means. As demand picks up, we will likely see prices driven higher by both these long-term and short-term supply constraint dynamics.

- We believe that emerging economies, and particularly China, will begin to use their enormous surpluses and foreign reserves to acquire more commodity assets and producers, providing additional technical support for commodity stocks.

Asset allocation themes

- In Fidelity Canadian Asset Allocation Fund, we have started to take advantage of weakness in risk assets to reposition the portfolio.
- We have added modestly to equities. In addition, we have allocated a portion of the Fund to U.S. high-yield debt and convertible securities (currency hedged), as well as overweighting our equity allocation to our natural resources portfolio.
- We have started to reduce exposure to investment-grade fixed income. In the fixed-income component, we are running a highly liquid portfolio, in order that we may add to Canadian mortgage-backed securities (CMBs) and high-grade corporates on weakness. The high liquidity in the portfolio will also allow rapid redeployment of capital within the Fund overall, to take advantage of weakness in other risk asset classes in the near term.

Overall outlook for 2009

Brian Miron

- In the very near term, we remain cautious, and are keeping fixed-income portfolios liquid, so as to take advantage of buying opportunities presented by compelling dislocations among credit investments. We continue to look for attractive entry opportunities among corporates (especially Canadian banks), provincials and CMBs.
- We are optimistic about the second half of 2009. There is a tremendous amount of stimulus in the system, and at some point it will start to work.

Point of view

Bob Haber

- We are of the view that current market conditions represent the buying opportunity of a generation for investors in Canadian equities.
- Capital markets are beginning to function normally; we are seeing credit markets beginning to “thaw” and function as they should.
- This is not a year to buy on strength, but to take advantage of volatility and buy on weakness.
- We believe that 2009 is a time to reinvest in risk. While we acknowledge that this may be extremely hard for investors to do at this point, “the hard thing to do is the right thing to do.”

These highlights are taken from Fidelity Canada’s 2009 Market Outlook webcast. To view the complete webcast, please visit www.fidelity.ca/straighttalk

Source: Fidelity Management and Research Company.

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