Fidelity Perspectives: What does the Ukraine crisis mean for markets?

Investors should focus on the long-term

Across the globe, the entire Fidelity family is watching closely the humanitarian impact unfolding in Ukraine. We stand with all individuals and families impacted and our hearts and thoughts are with them.

This situation is also creating concerns about the potential impact on financial markets and the global economy. History shows that while geopolitical crises such as the one between Russia and Ukraine can temporarily roil markets, they don't typically have long-term consequences for investors.

As Dirk Hofschire of Fidelity's Asset Allocation Research Team says, "In general, these types of crises tend to only have a significant and lasting impact on global financial markets if they have a sustained macroeconomic impact on major economies." While Russia's economy ranks as the world's 11th largest, according to the International Monetary Fund, at only 1/20th the size of the US and 1/15th the size of China, it is likely not big enough by itself to affect global markets or economic growth, even if it were to suffer significant economic damage as a result of sanctions or other measures taken against it by the US and Europe.

Still, because Russia is also the source of 10% of the world's energy—and nearly 50% of the energy consumed in Europe—the conflict does pose risks that could extend beyond the 2 countries' borders including higher energy prices and increased financial market volatility.

Economic impacts

The impacts of the conflict are likely to vary depending on geography. Europe—and particularly countries such as the Baltic states and Poland—would be likely to experience more negative impacts than would countries that depend less on Russia for energy. Western Europe, particularly Germany, also has no easy alternative source of energy to replace Russian natural gas.

Hofschire says that an escalated Russia-Ukraine conflict would add uncertainty about the strength of the economic expansion in Europe. While that would inject some uncertainty into the global outlook, he says, the North American economy would appear to be relatively insulated from the conflict. For individual investors and consumers in North America, the effects would most likely take the form of additional inflationary pressures due to higher energy prices.

Impact on markets

From an investment standpoint, the biggest impact will likely be negative market sentiment on Russian stocks, bonds, and currency. Hofschire says that a Russian military action against Ukraine also poses a relatively short-term risk to energy prices. "It could drive up prices of oil, natural gas, and other commodities at a time when inflation is already a problem." Higher oil and gas prices could further benefit North American energy companies, whose stocks have been among the best performers over the past year.

The following are the views from various Fidelity Portfolio Managers and subject matter experts who have weighed-in on the topic.

Andrew Marchese

Chief Investment Officer and Portfolio Manager

The escalation of the Russian and Ukraine conflict may contribute to increased short-term volatility. Andrew believes that the tension has more impact on investor sentiment and valuation multiples than on the global economy. Given the relative size of Russia's economy it is likely not big enough by itself to affect global economic growth. Disruption of Russian energy exports because of the conflict could temporarily contribute to rises in global energy prices.

Looking at the performance of the markets during other periods of global unrest, such as the Gulf wars, Vietnam war, Korean war and so on, the economic cycle mattered more from a mid-to-long term market performance standpoint. Against this backdrop, Andrew is opportunistically taking advantage of the indiscriminate selling of certain securities by the market.

Geoff Stein, David Wolf, David Tulk, Ilan Kolet

Fidelity Global Asset Allocation Team

The Russian invasion of Ukraine is causing fear in markets. While this is not an uncommon response, it is also not an investment strategy. One of the pillars of the team's deliberate research-based framework is sentiment, which in practice means taking advantage of market fears rather than indulging them. This is also something that the underlying building block managers do as well by looking for buying opportunities when sentiment is overly negative in an underlying security in their Funds.

The team's focus regarding geopolitical events is the impact these events have on asset prices and the economy. They consider policy, not politics in the decisions they take in the Funds they manage. Heightened geopolitical tension has pushed oil prices and inflation expectations higher, which is a broader theme that the Funds have been positioned for, and yet the Canadian dollar has pushed lower. The Canadian dollar underweight helps to build in downside protection into the Funds in the event of risk-off events like we are seeing today. As a broader point, the team emphasizes diversification in the structure of their Funds so that they are resilient to these kinds of shocks over the medium term, and the news this morning highlights how critical our research-based framework is in achieving these goals.

Jeff Moore and Michael Plage

Portfolio Managers: Fidelity Multi-Sector Bond Fund, Fidelity Investment Grade Total Bond Fund, Fidelity Global Bond Fund, Fidelity Tactical Fixed Income Fund, Fidelity Global Core Plus Bond ETF, Fidelity Global Investment Grade Total Bond ETF, Fidelity Tactical Credit Fund

Portfolio Managers Jeff Moore and Michael Plage note that while the humanitarian crisis occurring in Ukraine is deeply unsettling, the impact to financial markets is expected to be relatively contained at this juncture. As of December 31st, their multi-sector fixed income portfolios did not own any exposure to Russia or Ukraine.

Jeff and Michael further stress that although the escalating tensions are certainly contributing to market volatility, we have been in a period of elevated volatility for some time now, primarily attributable to mounting inflationary concerns and anticipated central bank action as it pertains to the looming commencement of an interest rate hiking cycle and the move from quantitative easing to quantitative tightening. The managers expect for these themes to be the primary drivers of market volatility in the short to intermediate term.

Jeff and Michael note that the market is pricing in six interest rate hikes by the end of 2022 in the United States at the time of this writing, well above their personal expectations. If these elevated levels of volatility continue, the potential for the market to price *out* one or more rate hikes is heightened, which can be a positive tailwind. Credit spreads across the fixed income sectors they invest in are modestly wider on today's news but have been widening out in general on a year-to-date basis. Since the beginning of the year, spreads are about 35 basis points wider on investment grade credit and about 100 basis points wider in the high yield market, placing them in the 40th-50th percentiles, historically speaking. Given that spreads in these sectors are starting to look fair again, and in line with their gradual contrarian approach, the managers have begun looking to potentially add credit risk back to their portfolios at these more attractive levels.

Will Danoff
Portfolio Manager: *Fidelity Insights Class, Fidelity Global Growth and Value Class*

Portfolio Manager Will Danoff tends not to overly focus on macroeconomic concerns as his investment strategy revolves around bottom-up fundamental analysis. There has been a lot of volatility in the markets over the past few months, the S&P 500 Index is down 10.5% year-to-date (CAD, as at Feb. 23, 2022) and the Nasdaq is down 16.0% over the same period, but there is a lot of damage below the surface. When the market makes a ~10-20% correction like this, what does it look like going forward? Historically if you look out 12-24 months past these moments in time, recoveries have often been incredibly strong.

This is not to say that the market can't go lower from here over the next few months, but Will has time horizon arbitrage, he is looking out 2-5 years from now whereas the market is focused primarily on what is happening today. As such, this is a period of time where Will is focusing on adding to companies that he likes where he has been waiting for valuations to come in, many of these companies are already in the portfolio. These are challenging times volatility wise, but there are a lot of positives to focus on going forward, historical data would suggest this as well.

Matt Siddle
Portfolio Manager: *Fidelity Europe Fund*

Russia's invasion of Ukraine is not a complete surprise given the recent troop positioning but is a significant and terrible escalation that creates a lot of uncertainty.

The exposure of European stock markets to revenues and profits generated in Russia and the Ukraine is very limited (very low single digit in total), and the Fund equally has very limited direct exposure, but it clearly has significant knock-on implications for commodity markets including oil, gas and wheat where Russia and Ukraine are key exporters, and a further spike in inflation for these will have some impact on European economies more broadly.

The most significant issue for Europe would be a stop to Russian gas imports, which make up about one third of European gas supply (heating the main use, then electricity and industry) and up to half for some countries like Germany and Italy (with France, Spain and the UK less exposed). It is getting closer to the end of the heating season, and

774008-v2022224

stockpiles have risen from their lows of a couple of months ago, but a prolonged stop would undoubtedly lead to issues in next winter's season as renewable or alternative capacity or more LNG terminals just couldn't be built quick enough for next winter, though it may be possible to delay the expected early decommissioning of nuclear plants in some countries.

Another issue is the general hit to sentiment, in terms of both consumer and investor risk appetite. Obviously, the longer there remains great uncertainty and significant military activity, the greater and more lasting the impact. At this stage, it is still too early to tell. The fund remains relatively defensively positioned, with a bias to those companies that generate more stable and less cyclically exposed cashflows, while trading on attractive valuations

Don Newman
Portfolio Manager: Fidelity Dividend Fund, Fidelity Dividend Plus Fund, Fidelity Monthly Income Fund, Fidelity Canadian Asset Allocation Fund, Fidelity Income Allocation Fund

Dividend Portfolio Manager Don Newman continues to monitor the evolving geopolitical situation closely to anticipate how it could potentially affect his investment universe, which outside of market volatility, isn't currently viewed as a direct significant risk. Prior to current events, Don has already been mindful of potential market volatility, given the U.S. Federal Reserve (Fed) is likely to starting increasing interest rates this year.

As such, Don has been positioned with what he believes to be higher quality, stable dividend-paying companies that are trading at low valuations in comparison to the broad equity markets. In light of recent events, Don views a potential near-term market consequence would be that the Fed would potentially take the rate hikes a bit slower, which may impact the near-term performance of banks and financials in general. Don continues to monitor the situation closely and aims to mitigate potential downside risk to provide investors with a lower risk level than the broad equity markets.

To close…

Despite geopolitical risks such as these, investors should not lose sight of the long-term investment goals. Diversification and professional management can help manage short-term risks while pursuing long-term investment goals. For more information, please visit Fidelity.ca or reach out to your Fidelity team.

As at February 24 2022.

Commissions, trailing commissions, management fees, brokerage fees and expenses may be associated with investments in mutual funds and ETFs. Please read the mutual fund's or ETF's prospectus, which contains detailed investment information, before investing. The indicated rates of return are historical annual compounded total returns for the period indicated, including changes in unit value and reinvestment of distributions. The indicated rates of return do not take into account sales, redemption, distribution or option charges or income taxes payable by any unitholder that would have reduced returns. Mutual funds and ETFs are not guaranteed. Their values change frequently, and investors may experience a gain or a loss. Past performance may not be repeated.

The statements contained herein are based on information believed to be reliable and are provided for information purposes only. Where such information is based in whole or in part on information provided by third parties, we cannot guarantee that it is accurate, complete or current at all times. It does not provide investment, tax or legal advice, and is not an offer or solicitation to buy. Graphs and charts are used for illustrative purposes only and do not reflect future values or returns on investment of any fund or portfolio. Particular investment strategies should be evaluated according to an investor's investment objectives and tolerance for risk. Fidelity Investments Canada ULC and its affiliates and related entities are not liable for any errors or omissions in the information or for any loss or damage suffered.

From time to time a manager, analyst or other Fidelity employee may express views regarding a particular company, security, and industry or market sector. The views expressed by any such person are the views of only that individual as of the time expressed and do not necessarily represent the views of Fidelity or any other person in the Fidelity organization. Any such views are subject to change at any time, based upon markets and other conditions, and Fidelity disclaims any responsibility to update such views. These views may not be relied on as investment advice and, because investment decisions for a Fidelity Fund are based on numerous factors, may not be relied on as an indication of trading intent on behalf of any Fidelity Fund.

Certain statements in this commentary may contain forward-looking statements ("FLS") that are predictive in nature and may include words such as "expects," "anticipates," "intends," "plans," "believes," "estimates" and similar forward-looking expressions or negative versions thereof. FLS are based on current expectations and projections about future general economic, political and relevant market factors, such as interest, and assuming no changes to applicable tax or other laws or government regulation. Expectations and projections about future events are inherently subject to, among other things, risks and uncertainties, some of which may be unforeseeable and, accordingly, may prove to be incorrect at a future date. FLS are not guarantees of future performance, and actual events could differ materially from those expressed or implied in any FLS. A number of important factors can contribute to these digressions, including, but not limited to, general economic, political and market factors in North America and internationally, interest and foreign exchange rates, global equity and capital markets, business competition and catastrophic events. You should avoid placing any undue reliance on FLS. Further, there is no specific intention of updating any FLS, whether as a result of new information, future events or otherwise.