Marketing communication

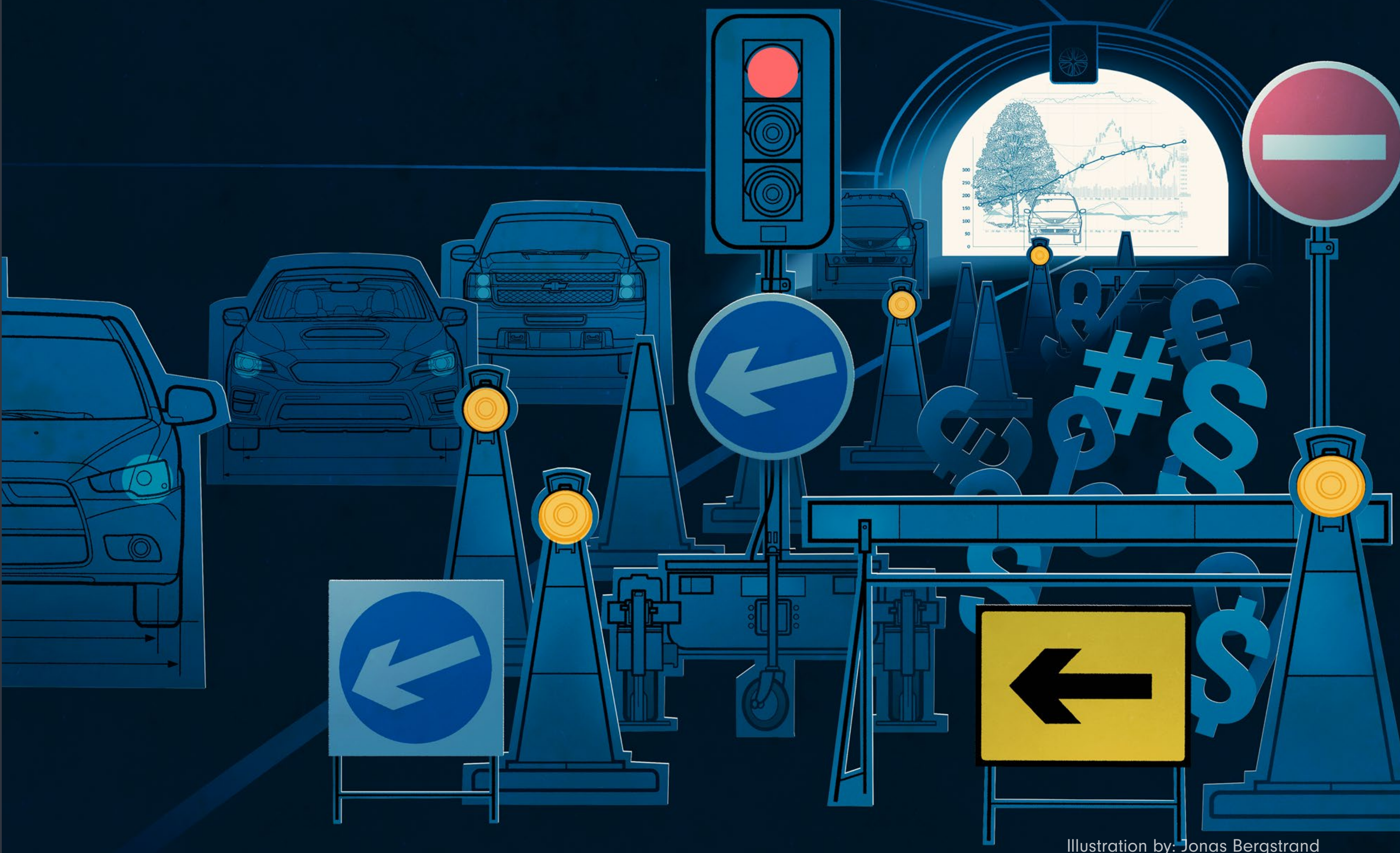

Illustration by: Jonas Bergstrand

Analyst Survey 2023

Light at the end of the tunnel

This material is for investment professionals only

Fidelity INTERNATIONAL

Foreword

The investing world is not short of views on the future. But there is only one Analyst Survey. In this report you will read how Fidelity International's 152 investment analysts assess the companies they cover. They build these views from an equity, fixed income, private credit and cross-asset perspective, and it adds up to a rounded picture of what lies ahead.

This year the analysts completed the survey in December 2022 and our team worked on the analysis in the weeks that followed. What has emerged is a nuanced and detailed picture not just of where the world is now but how the management teams of the 2,500 companies Fidelity covers expect the year to unfold. At a time when many are wrestling with the impact of war, inflation, and a challenging financial backdrop, I take comfort from the positive stories which are emerging. I hope you enjoy reading it too.

Richard Edgar, Editor in Chief, February 2023

Ben Traynor
Survey Editor

Gita Bal
Global Head of Fixed Income Research

Fiona O'Neill
Head of Strategic Initiatives, Global Investment Research

Lucas Klein
Global Head of Equity Research

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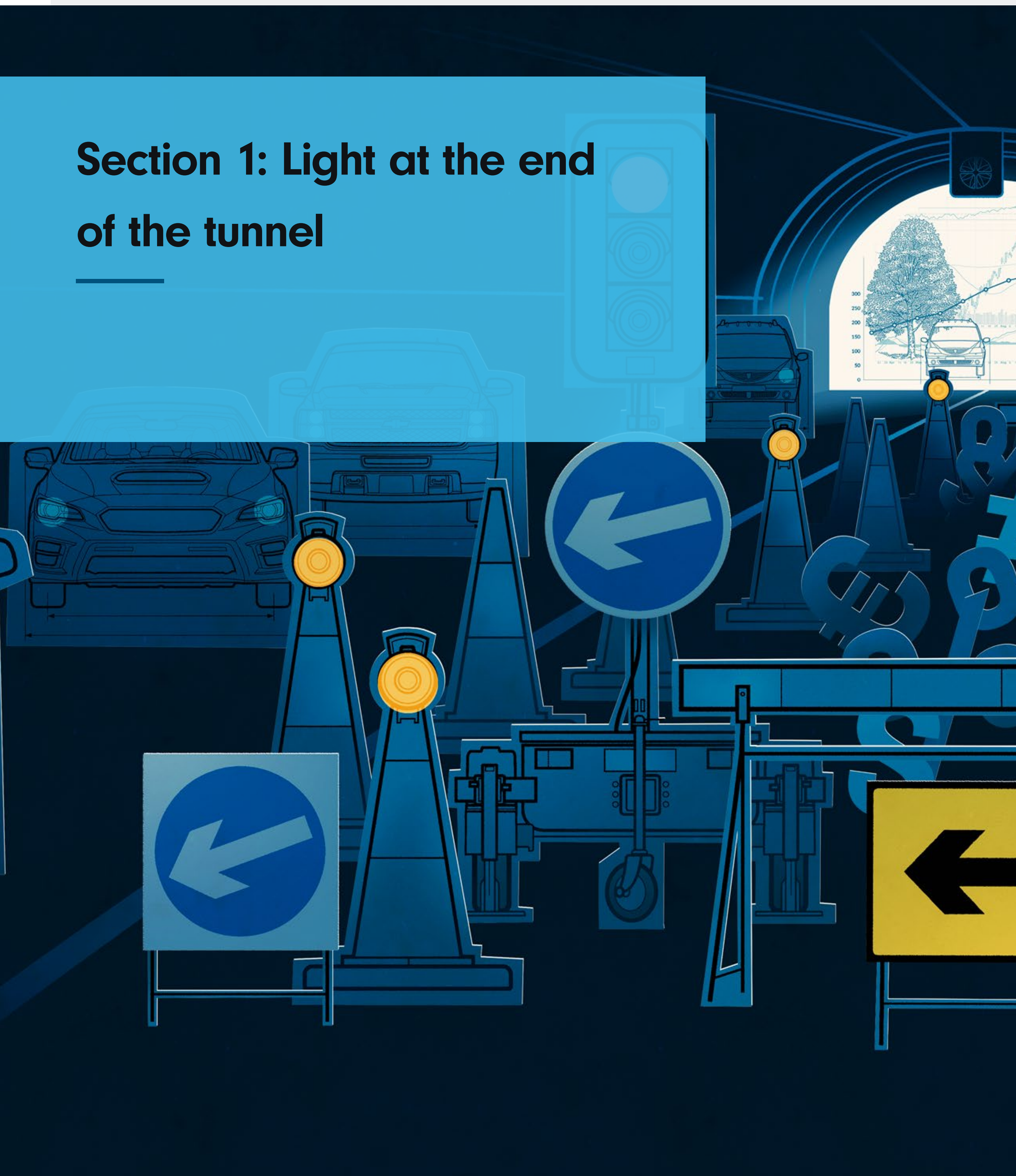
Section 1: Light at the end of the tunnel



Ned Salter
Global Head of Investment Research

Fiona O'Neill
Head of Strategic Initiatives, Global Investment Research

Patrick Graham
Senior Writer

Boards may be firmly in damage-control mode, yet the most striking finding from Fidelity International's 2023 Analyst Survey is that more than half of analysts expect the business cycle for their companies to turn more positive within the year.

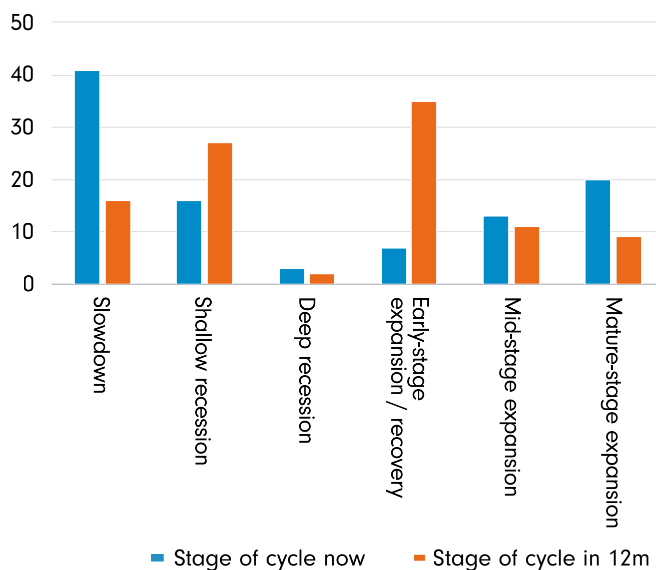
The economists' verdict is in: 2023 will be a tough year as higher prices and higher interest rates drive many economies into recession. But are they too gloomy? Fidelity's annual Analyst Survey, polling 152 experts who cover real businesses on the ground, paints a more hopeful picture.

The survey, which we have been running for over a decade, consults a range of fixed income, equity, private credit, and cross-asset experts who cover dozens of sub-sectors of the economy. It shows 60 per cent of analysts believe their sectors are already in a slowdown, a shallow recession or worse. Look slightly further out, however, and just over half of those analysts expect the business cycle will have turned positive again by the end of 2023. Only a handful expect to be deep in recession.

That may run contrary to the prevailing mood after a year in which the shocks delivered by Russia's invasion of Ukraine have run parallel to the end of a decade of booming stock markets and cheap money. But from a wider perspective, it is in line with economic logic: as companies reach the bottom of the business cycle, they begin to think about the opportunities to come.

"As long as there isn't a Black Swan event and this is a 'normal' recession, I expect we will start to recover out of it in the second half of the year," says one US consumer analyst.

Chart 1: This too shall pass



Questions: "What stage of the cycle is your sector currently in?" and "What stage of the cycle will your sector be in in 12 months' time?" Chart shows percentage of analysts. Source: Fidelity Analyst Survey 2023.

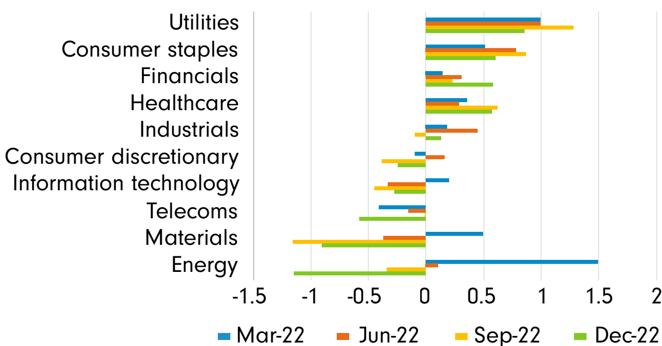
Hope in China's reopening

On the ground, how is this likely to unfold? For one thing, cost pressures, the results suggest, will peak for most sectors and regions in the first half of the year. China - assuming its reopening gamble works - will reboot, and materials, utilities and technology companies will shift back into investment mode, in part driven by the environmental transition.

Beyond the main annual survey, we also ask our analysts a smaller set of questions every month. The most recent monthly responses are a further source of optimism. The management sentiment reading, while still negative, appears to have broken a two-year downward trend, posting four straight months of improvement to January, with those analysts who cover China reporting positive sentiment among managers in both December and January.

Chart 2 below suggests that half of the 10 business sectors the survey covers will see revenue grow in the next 12 months, although much of that is forecast to stem from the easing of China's Covid controls - something that is still being closely watched.

Chart 2: Revenue growth heavily sector dependent



Question: "What are your expectations for revenue growth over the next 12 months?" Chart shows proportion of analysts expecting revenue will increase minus proportion expecting revenue will decrease. Strong positive and strong negative responses receive a double weighting. Higher values show analysts on balance expect revenue will rise. Source: Fidelity Analyst Survey 2023.

Be prepared

Although funding costs are a worry, balance sheets look less stretched than previously. Debt is expected to grow only in two sectors: utilities, where companies are investing heavily in renewable power, and in consumer sectors already struggling with the aftermath of two years of Covid restrictions. Analysts expect banks to see revenues boosted by the rise in interest rates, and others covering the financial sector expect 2023 to deliver - at a minimum - an improvement on the stock and bond market slides of last year.

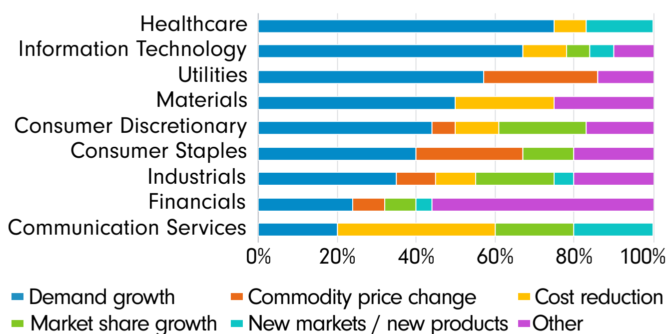
"While the near-term outlook is challenging, most companies in my coverage are in a much better balance sheet position than they've been historically," says another US consumer sector analyst.

74 per cent of analysts say their companies' CEOs expect earnings to grow over the next 12 months.

Turning to the bottom line, 74 per cent of analysts say their companies' CEOs expect earnings to grow over the next 12 months. Anecdotally, we know inflation is playing a role, as one consumer staples analyst explains: "Food retailers benefit from inflation as they pass on supplier price increases."

Analysts, however, also highlight other sources of expected earnings growth and the picture is illuminating: the dominant answer from those covering utilities, materials, information technology, and healthcare is that end-demand will improve.

Chart 3: Reasons to be cheerful: the biggest sources of earnings growth



Question: Chart shows percentage of analysts. Source: Fidelity Analyst Survey 2023.

The bottom-up view of the polycrisis

But in the near term, the pain to come is evident in the survey's wide range of data points (see p8). Analysts expect a rise in debt defaults over the next 12 months. Recent growth in shareholder pay-outs will fade, while M&A activity will slow, with 73 per cent of analysts saying the deals they do expect will be smaller, bolt-on acquisitions. Around three-quarters (74 per cent) say that, for now, the biggest focus for boards is holding down costs and shoring up revenues, rather than investing for growth or delivering shareholder returns.

"Companies feel very hesitant at the moment," says a communication services sector analyst. "Bold decision making has been replaced by more of a slow build. More focus on cost cutting. Not a lot of M&A rumours."

Geopolitical concerns, brought sharply into focus by the Russian invasion, are also growing, with the survey's negative net reading for this topic almost doubling. Companies remain focussed on the ESG challenges ahead, but there is little improvement in our indicators on net zero, biodiversity and other ecological issues (see p17).

Fear for the consumer

By sector, the hardest-pressed businesses over the next year will be those dependent on consumer spending. Many companies may have partially insulated themselves from the immediate effects of rising US and European interest rates but households are already suffering. The survey shows both that businesses targeting the consumer will have the least power to raise prices over the next year and that their balance sheets are the most stretched.

Yet, as so often in the past two decades, some salvation may lie in the pace of growth in China. Answering the survey as Beijing abandoned its zero-Covid policy in December, only 8 per cent of our analysts predicted even a shallow recession in the world's second largest economy, judging that the reopening, together with the room authorities have to support growth with policy, will succeed in rebooting growth.

It will, of course, not be a smooth ride, and those who expect a challenging year in 2023 will find plenty in our survey to support that view. Overall, however, the picture emerging is not one of perpetual gloom but also of brighter times to come.

Section 2: Companies prepare for a world after cheap financing

Gita Bal
Global Head of Fixed Income Research

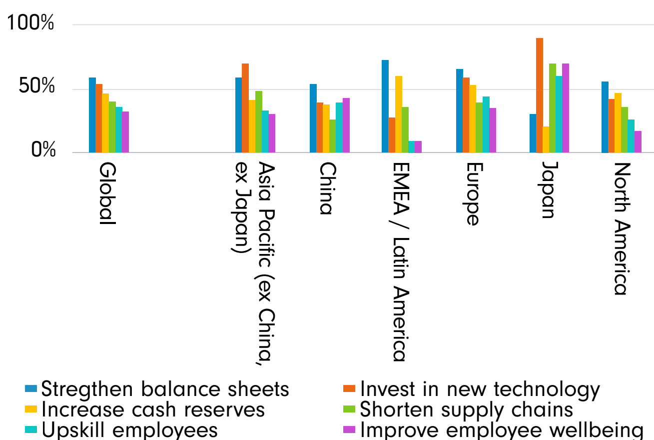
Stephen Whyman
Director Debt Capital Markets

Nina Flitman
Senior Writer

After almost a decade and a half of record low interest rates, the era of artificially cheap capital appears to be coming to an end. Fidelity International's 2023 Analyst Survey reveals how companies are adapting to what promises to be a challenging - but ultimately more sustainable - funding market.

Corporate treasurers are shoring up their businesses in preparation for a tougher funding environment. Six out of every ten analysts report that the companies they cover will have a high focus on strengthening their balance sheets in 2023, while 46 per cent also cite increasing cash reserves as a resilience measure they expect companies to take.

Chart 1: Strengthening balance sheets is companies' top focus



Question: "To what extent do you expect the following resilience measures to be a focus for your companies over the next 12 months?" Chart shows the proportion answering 5-7, where 1 means not a focus at all and 7 means very high focus. Source: Fidelity International Analyst Survey 2023.

Prioritising balance sheets emerges as the number one focus across almost every region and almost every sector too, with the exceptions of consumer staples and information technology, where analysts report a higher focus on investment in new technology.

> Companies are adapting to a challenging but ultimately more sustainable funding environment.

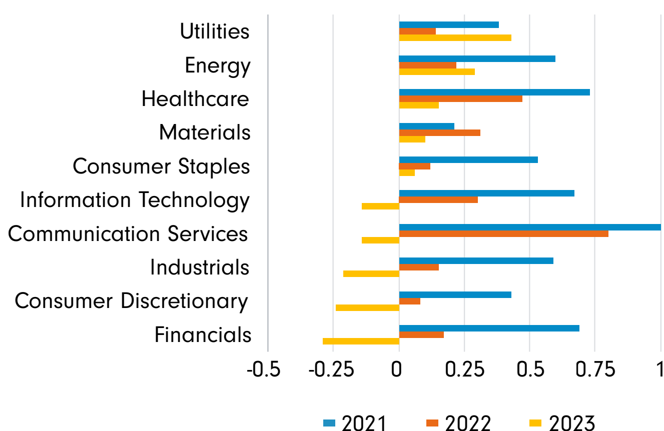
"Companies are fairly disciplined now," says one pharmaceuticals analyst covering Asia Pacific, "and are trying to be conservative with their balance sheets."

Analysts expect less M&A in 2023

This disciplined approach appears to be influencing companies' expansion plans. For the first time in recent years a majority of analysts believe that M&A will become less prevalent in the next 12 months. There is now no region where the average analyst response suggests an increase in M&A.

Look at individual sectors, however, and it is clear that some appetite for deals remains:

Chart 2: Utilities and energy firms among those still hunting for acquisitions



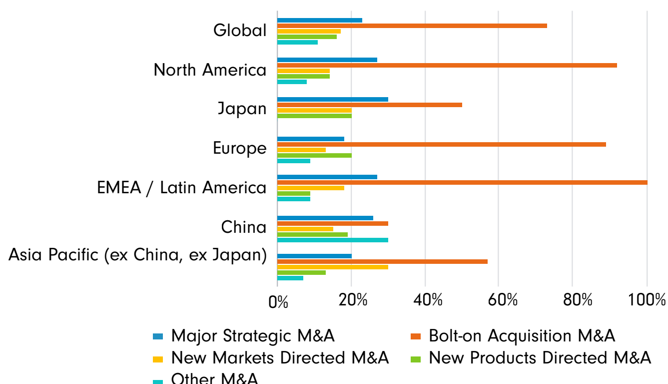
Question: "Do you think M&A will be any more or less prevalent amongst your companies over the next 12 months?" Chart shows proportion of responses expecting M&A will be more prevalent minus those expecting it will be less so. Strong positive and strong negative responses receive a double weighting. Higher values show analysts on balance expect M&A will be more prevalent. Source: Fidelity International Analyst Survey 2023.

"Utilities have abundant investment opportunities and capex related to renewables, resilience, and maintaining the infrastructure," says one North America-focussed analyst covering that sector.

Some analysts also note that the weakness in global equity markets could mean there are opportunities for take-private acquisitions. Overall, though, as one equity analyst covering healthcare firms in North America puts it: "Any M&A is likely to come from bolt-on deals rather than huge, transformative acquisitions."

"Debt has become more expensive, and there's still a valuation disconnect between buyers and sellers," he adds.

Chart 3: Most M&A deals will be bolt-on acquisitions

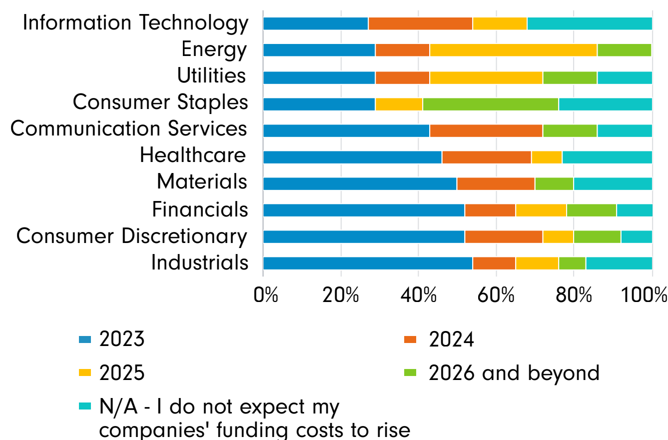


Question: "Where you are seeing M&A, what type is it?" Chart shows percentage of analysts covering region who expect a given type of M&A. Source: Fidelity International Analyst Survey 2023.

Many companies will face higher funding costs this year

The increased cost of debt, while anticipated for some time, is now a tangible or imminent reality for most companies. Of the analysts responding to this year's survey, 72 per cent anticipate that the funding costs of the companies they cover will rise materially before the end of 2025. Across every sector, at least a fifth of our analysts believe that funding costs will step up materially in the next year.

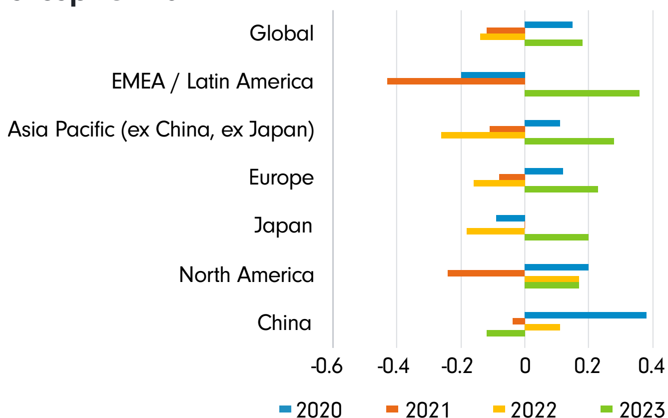
Chart 4: Coming soon: higher funding costs



Question: "When do you expect the funding costs of the majority of your companies to rise materially?" Chart shows percentage of analysts. Source: Fidelity International Analyst Survey 2023.

There are likely to be some firms that struggle in this environment of higher financing costs. Our analysts expect the default rate to increase across every region except China, which has already undergone a spate of defaults led by the property sector.

Chart 5: Defaults expected to rise everywhere except China

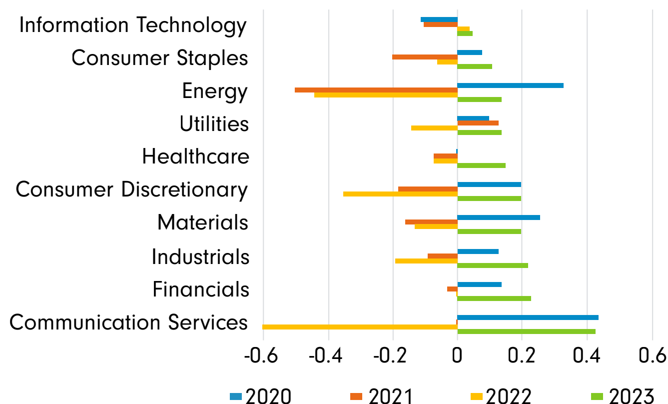


Question: "What do you expect to happen to the level of default rates in your sector over the next 12 months?" Chart shows proportion of analysts who expect default rates to rise minus those who expect them to fall. Strong positive and strong negative responses receive a double weighting. Higher values show analysts on balance expect default rates will rise. Source: Fidelity International Analyst Survey 2023.

> Our analysts expect the default rate to increase across every region except China.

Analysts also expect the rate of defaults to increase across every sector. Though we believe this default risk is priced in across certain products in some regions (for example in the European leveraged loan market), elsewhere fixed income markets may not have taken such a pick-up in default rates fully into consideration yet.

Chart 6: Rising default rates expected across all sectors



Question: "What do you expect to happen to the level of default rates in your sector over the next 12 months?" Chart shows proportion of analysts who expect default rates to rise minus those who expect them to fall. Strong positive and strong negative responses receive a double weighting. Higher values show analysts on balance expect default rates will rise. Source: Fidelity International Analyst Survey 2023.

Of course, companies face not just higher funding costs but also a challenging economic environment. As one European financial sector analyst observes: "Supply shortages would result in corporate clients of my banks having margins come under further pressure and hence possibly an increase in corporate defaults (or expected defaults) which would increase risk provisioning," although he adds that for banks themselves, buffers still in place from the Covid pandemic could be used to absorb some of this increase in expected defaults.

While these findings initially look concerning, they suggest markets are returning to normal. For over a decade, companies have been able to enjoy historically easy access to capital, with prices – and default rates - kept artificially low by rock bottom interest rates and a strong technical bid for paper.

How companies plan to adapt

While this high tide of liquidity lifted all boats in the past, now conditions are on the wane, companies with weaker credit structures will feel the most pressure. As one fixed income analyst who covers discretionary retail notes: "I expect the companies I cover to put an increased focus on liquidity and potentially also debt reduction given the increase in funding costs."

Elsewhere, many analysts report that their firms will try to reduce their reliance on debt markets.

"Most companies will try to refinance less if possible, using cash on the balance sheet to repay some debt and [raising funds through] selected disposals," says a fixed income analyst focussing on European communication firms.

"Some will try to reduce the size of their debt, although that's difficult for those that need to keep cash," adds one analyst who covers consumer staples in EMEA and LatAm. "Costs are elevated in both the bond and bank markets, and most private equity firms are not interested in putting in additional equity unless it's absolutely necessary from a liquidity perspective."

As well as relying more on available cash, some managers are also firmly in cost-reduction mode. Some 17 per cent of our analysts expect their companies will reduce capex to deal with rising funding costs.

Down but not out

Although the cost of financing across capital markets is expected to rise, a quarter of our analysts say their companies are still likely to raise capital from equity or bond markets this year.

"I expect the increased cost of funding will ultimately be passed through to consumers or absorbed by the companies to maintain their market position," says one fixed income analyst covering consumer discretionary companies in Europe.

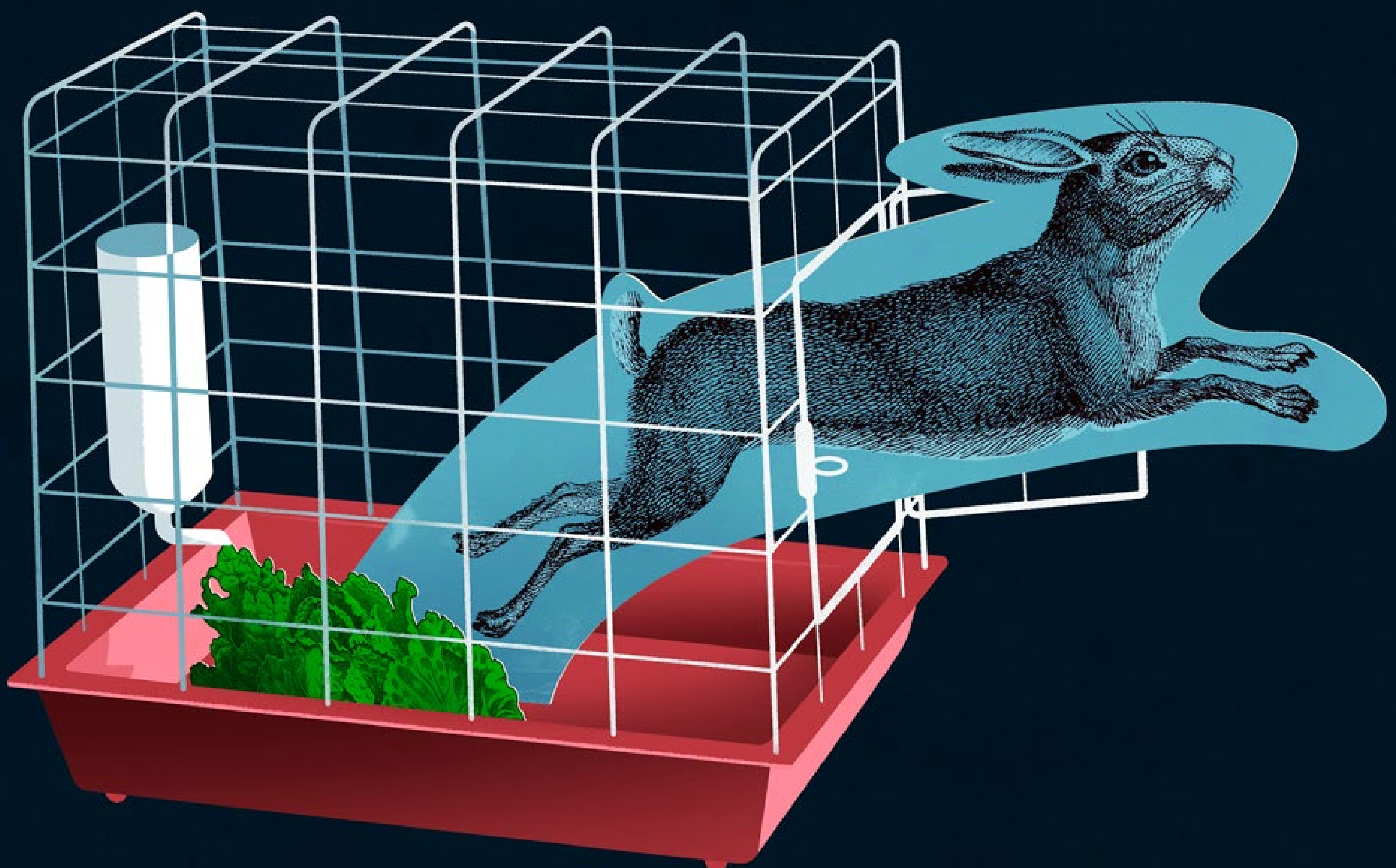
Of those analysts expecting their companies to tap capital markets, a third say it will be for routine liability management to refinance upcoming maturities. However, 30 per cent of these analysts state the reason for their companies raising capital will be to grow their business, while another 8 per cent say new funding will help companies expand into new markets.

As well as relying more on available cash, some managers are firmly in cost-reduction mode.

Many treasurers will also be rethinking how they access the capital needed for growth, with 30 per cent of analysts saying that their companies will primarily turn to traditional bank loans rather than issuing bonds or equity to deal with the higher cost of funding.

Our analysts' insights illustrate how companies are readying for the change in the financing backdrop. Rather than a panicked response to an unprecedented crisis, the picture emerging is one of companies making a sober and uncomfortable - but necessary - return to what used to be classed as normal.

Section 3: China poised to lead expansion in Asia



Victoria Mio
Head of Equity Research,
Asia Pacific

Yi Hu
Investment Writer

China is entering the Year of the Rabbit poised to bound free from Covid lockdowns, and most Fidelity analysts expect the country will be in expansion mode by the end of 2023.

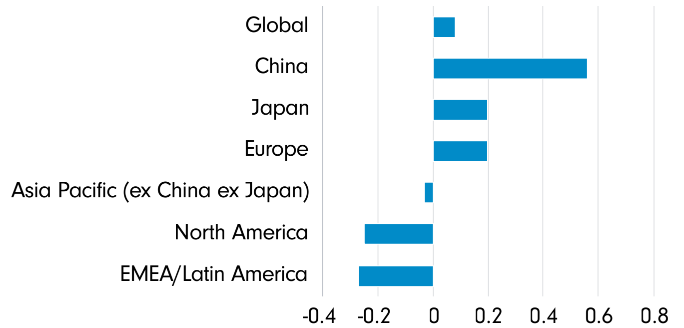
China entered 2023 with all the ingredients for recovery in place: inflation showing signs of peaking, management sentiment on the rebound, and policymakers putting an end to tough Covid lockdowns while also rolling out economic stimulus measures.

"As China emerges from its zero-Covid policy, economic activity is likely to ramp up starting from the first quarter of 2023," says a Fidelity fixed income analyst covering industrials. "Projects that local government financing vehicles had delayed due to Covid are likely to restart," the analyst added.

Once again, China's economy looks to be at a different point in the business cycle. Encouraged by a faster-than-expected reopening and strong policy stimulus, the majority (a lucky 88 per cent) of our China analysts expect their sectors to be in early- or mid-stage expansion in 12 months' time, compared with 35 per cent of analysts covering North American companies or 37 per cent covering European ones.

Most of our analysts covering the country expect to see revenue growth over the next 12 months.

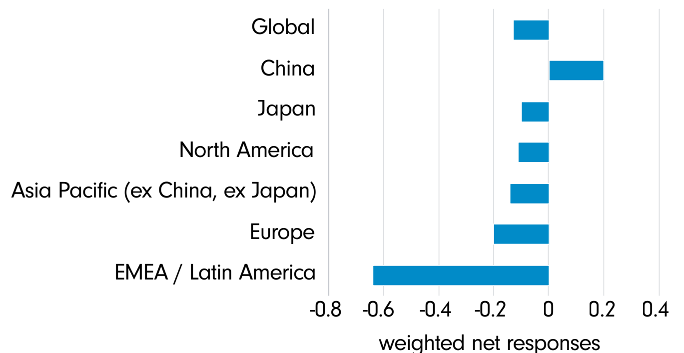
Chart 1: China leads in expectations for revenue growth



Question: "What are your expectations for revenue growth over the next 12 months?" Chart shows proportion of responses reporting expected increase in revenue minus those expecting a decrease. Strong positive or negative responses receive a double weighting. Higher values show analysts on balance expect revenues to increase. Source: Fidelity International Analyst Survey 2023.

China is also the only place where analysts forecast an overall increase in earnings margins, and the only place where the average return on capital (ROC) is expected to rise in 2023.

Chart 2: Bucking the trend for returns on capital



Question: "What is the outlook for overall returns on capital for your companies for the next 12 months?" Chart shows the proportion of analysts expecting returns on capital will increase minus the proportion expecting they will decrease. Strong positive and strong negative responses receive a double weighting. Higher values show analysts on balance expect returns on capital will increase. Source: Fidelity International Analyst Survey 2023.

Asked about the principal source of higher ROC this year, some 36 per cent of our China analysts cite cost reduction, while another 36 per cent point to strong growth in end demand.

Cost deflation starting to hit Asia

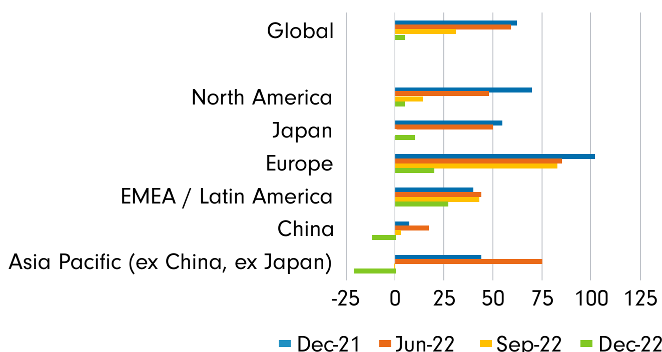
China and the rest of Asia (excluding Japan) also stand out as the only regions where Fidelity analysts expect companies' input costs will fall in 2023.

"Labour and supply shortages are unlikely to impact my companies," says an equity analyst covering Chinese financial firms. "There is also government pressure for financial institutions to cut compensation for their workers in the name of 'common prosperity'," the analyst added.

Cost inflation has also eased for technology hardware companies in China and other parts of Asia, says an equity analyst covering information technology.

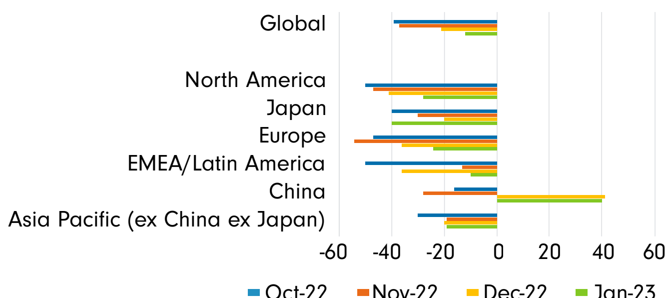
"Supply shortages are easing for foundries, which is good for downstream semiconductor firms," says the IT analyst, adding: "With easing supply of semis and related components, cost pressures for downstream tech hardware will also ease."

Chart 3. Input cost pressures expected to fall in China and Asia this year



Question: "How, if at all, do you expect inflationary pressures within your companies' cost bases to change over the next 12 months?" Chart shows proportion of responses reporting cost pressures are expected to increase minus those reporting cost pressures are expected to decrease. Significant increases and significant decreases receive a double weighting. Higher values show analysts are, on balance, reporting greater cost pressures at the companies they cover. Source: Fidelity International Analyst Survey 2023.

Chart 4. China's reopening promise has boosted management sentiment



Question: "Based on your interactions with companies over the past month, to what extent, if at all, has your perception of management sentiment over the next six months changed?" Chart shows proportion of responses reporting positive management sentiment minus those reporting negative management sentiment. Strong negative and strong positive responses receive a double weighting. Higher values show analysts are, on balance, reporting more positive sentiment among the companies they cover, lower values more negative sentiment. Source: Fidelity International Analyst Survey 2023.

Indeed, nearly two-thirds of China analysts say cost pressures had already peaked by the end of 2022 for the companies they cover, the highest among all regions. Similarly, about 60 per cent of Asia Pacific analysts believe they have seen the worst of cost inflation.

Sentiment spikes

Adding to the bullish tone our most recent monthly surveys, which pick up shorter-term shifts in mood, China emerged as the only region with analysts reporting positive sentiment among company managers for both December and January. It was in December that China started easing lockdowns and preparing for reopening.

However, this optimism is tempered by concerns over a possible Covid resurgence, as China has swung from zero tolerance for infections to a fast reopening.

Covid exit will be "a bumpy ride"

"We have yet to see the impact of this very rapid opening up," says an equity analyst covering financials. "Some companies might see a weaker near-term performance given employee absence." He added that China's recovery will be "a bumpy ride before Covid cases normalise".

Real estate is one sector particularly vulnerable to a Covid resurgence, which may discourage homebuyers or cause delays in their purchases. The Chinese government has rolled out stimuli such as the reduction in mortgage rates following a sharp decline in home sales last year.

"On the one hand, it's clear that policymakers are now very keen to stabilise the housing market," says a fixed income analyst covering real estate, "But on the other hand, surging cases are likely to continue to drag on property sales in the near term."

Despite these risks, China's outlook is indeed brightening. There will be some tentative hops along the way, but overall we expect China to bounce back decisively in the Year of the Rabbit.

Section 4: Can't see deforest for the trees

Jenn-Hui Tan
Global Head of Stewardship and Sustainable Investing

Toby Sims
Investment Writer

Summary: Companies are sticking with sustainability despite the economic turbulence, Fidelity International's 2023 Analyst Survey finds. But there is still much room for improvement - especially when it comes to reversing the loss of biodiversity.

War, inflation, impending recession - 2022 was a test of companies' commitment to sustainability while fighting other fires.

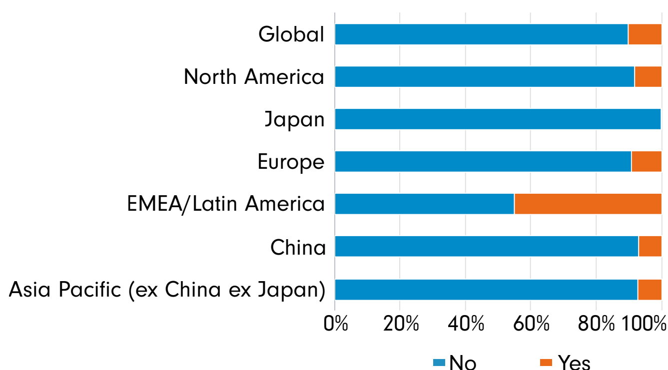
Encouragingly, the vast majority (90 per cent) of Fidelity analysts report their companies are placing the same or greater emphasis on environmental, social, and governance issues (ESG) as they were a year ago. But elsewhere in the survey we find that on urgent issues, like protecting oceans and ending deforestation. companies have a lot of room to improve. And without action we will lose the battle against climate change.

ESG still on the radar

"Russia-Ukraine might have changed the conversation a bit," says one Europe-focussed materials sector analyst, "but it has probably just slowed [progress on ESG] down as opposed to reversing it."

"Pretty much every company now has ESG on their radar and is setting it as a priority," confirms an analyst who covers Asia Pacific energy companies, a sector that has traditionally lagged in this area.

Chart 1: Companies have maintained their ESG focus



Question: "Has the emphasis on ESG among your companies fallen over the last 12 months?" Chart shows percentage of analysts. Source: Fidelity International Analyst Survey 2023.

There are a few exceptions. Nearly half of EMEA/ Latin America analysts report a reduced emphasis on ESG among their companies compared with a year ago. One industrials analyst explains that the companies she covers "are just trying to stay afloat" and therefore "ESG has taken a back seat".

"There are more pressing issues to talk about," adds another EMEA/Latam analyst, referring to conversations with the financial firms he speaks to in the region.

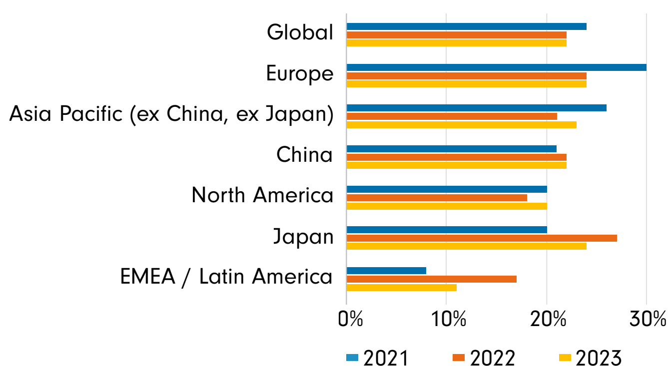
This sentiment is repeated sporadically even in regions where ESG is more established. One analyst who covers European industrials says: "Companies are more focused on supply chains, inflation and other matters."

Overall, though, to quote one IT analyst: "Companies are clearly improving their ESG communication, probably in response to increased investor attention."

Carbon neutrality still a distant goal for most, but companies are acting

Talking about ESG is one thing. Translating it into real-world progress is another. As Chart 2 shows, at a global level, our analysts expect only 22 per cent of the companies they cover will be carbon neutral by 2030 - a percentage that hasn't moved from last year.

Chart 2: Less than a quarter of companies are expected to be carbon neutral by 2030



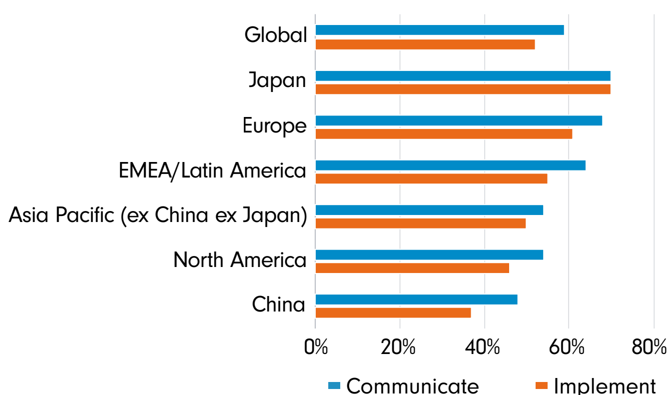
Question: "What percentage of your companies do you estimate will be carbon neutral (scope 1, 2 and 3 emissions) by 20130?" Source: Fidelity International Analyst Survey 2023.

As we noted in last year's survey, companies are getting better at assessing what is required to reach net zero, and the lack of movement in this headline number masks a lot of progress below the surface.

Responding to the 2023 survey, one analyst covering North America's consumer discretionary sector tells us: "Each year companies are gradually learning more and communicating more about ESG. While this is still not a core focus for most companies in my coverage, it is something they've gotten better at thinking about and talking about."

Companies are also taking active steps to improve their ESG credentials. As Chart 3 shows, more than half our analysts say the majority of their companies are better at both communicating and implementing ESG policies than they were a year ago, and most of the rest detect improvement in at least some of their coverage. Interestingly, our survey also finds a strong overlap between companies that communicate their ESG policies and those that follow through and implement them.

Chart 3: More companies are both saying they'll do more and following up with action



Questions: "Have you seen a growing emphasis among your companies to communicate ESG policies in the last year?" and "Have you seen a growing emphasis among your companies to implement ESG policies in the last year?". Chart shows the percentage of analysts who report a growing emphasis at a majority of their companies in the last year. Source: Fidelity International Analyst Survey 2023.

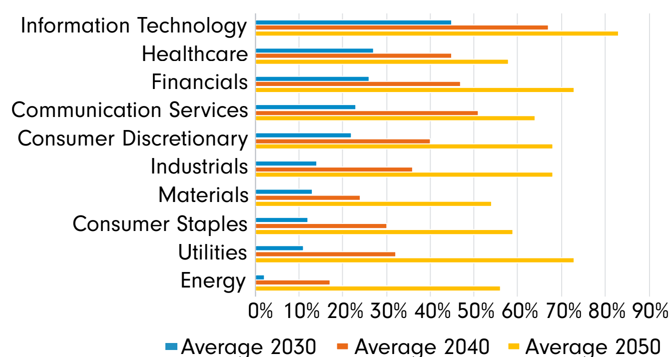
Commenting on the improvements he's seen, one North American consumer staples analyst says: "Many companies have made new commitments, including net zero targets, and a few have added ESG metrics to executive compensation."

One financial sector analyst meanwhile notes that "more banks are issuing Task Force on Climate-related Financial Disclosures (TCFD) reports", which help investors and others better see how a company is exposed to climate risks and opportunities.

Over time, a lot more companies should move towards net zero, even if most will take until beyond 2030 to get there. Our analysts expect 42 per cent of companies globally will be carbon neutral by 2040 and 68 per cent by 2050. This is taking into account all emissions associated with a company's activities, not just those the company creates directly but those up and down its value chain too. Consider, too, that some of those not expected to be carbon neutral in 17 or 27 years' time may no longer exist and we are looking at a profound shift.

Perhaps not surprisingly, it is in sectors with harder-to-abate emissions, such as materials and energy, where analysts expect more muted progress.

Chart 4: Hares and tortoises in the race to net zero



Question: "What percentage of your companies do you estimate will be carbon neutral (scope 1, 2 and 3 emissions) by: 2030, 2040 and 2050?" Source: Fidelity International Analyst Survey 2023.

Despite the challenges (or indeed because of them) our analysts are engaging fruitfully with company managers.

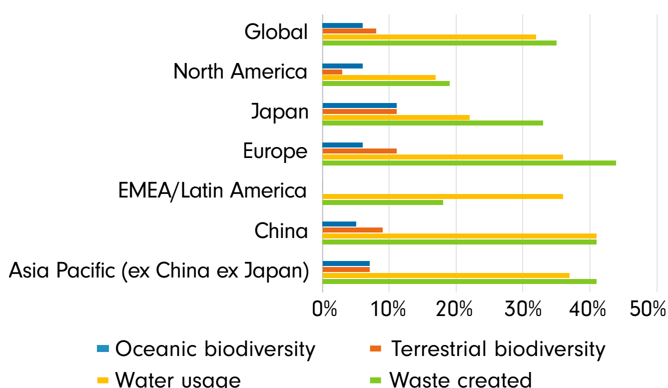
"Oil and gas companies understand that ESG is a requirement for listed fossil fuel companies and almost all have plans for net zero scope 1 and 2 emissions by 2050," says an Asia Pacific energy analyst, referring to companies' direct emissions (scope 1) and the indirect emissions from purchased electricity used by companies in their operations (scope 2).

However, "treatment of scope 3 emissions differs a lot", the same analyst observes. In other words, some companies are doing a better job than others of working to address the emissions caused by those using their product, which in the case of fossil fuels is where most emissions happen.

Nature calls

Despite ongoing progress towards net zero, there is one area that appears to have had too little attention. Reducing emissions is just one side of the climate change equation. On the other is the urgency of reversing nature loss and protecting forests and other carbon sinks. Only 8 per cent of analysts expect companies to reduce their negative impact on terrestrial biodiversity within the next 12 months. For oceanic biodiversity the figure is 6 per cent.

Chart 5: Biodiversity has been on the back burner up to now



Question: "To what extent do you expect your companies to reduce their negative impact on the following areas over the next 12 months?" Chart shows percentage answering 5-7 where 1 means will not reduce their impact and 7 means will significantly reduce their impact. Source: Fidelity International Analyst Survey 2023.

"Initiatives related to biodiversity are still in early stages for most companies", says one analyst. "Water and waste management has more direct benefit to the business from a cost savings perspective and companies tend to be more motivated to address those areas."

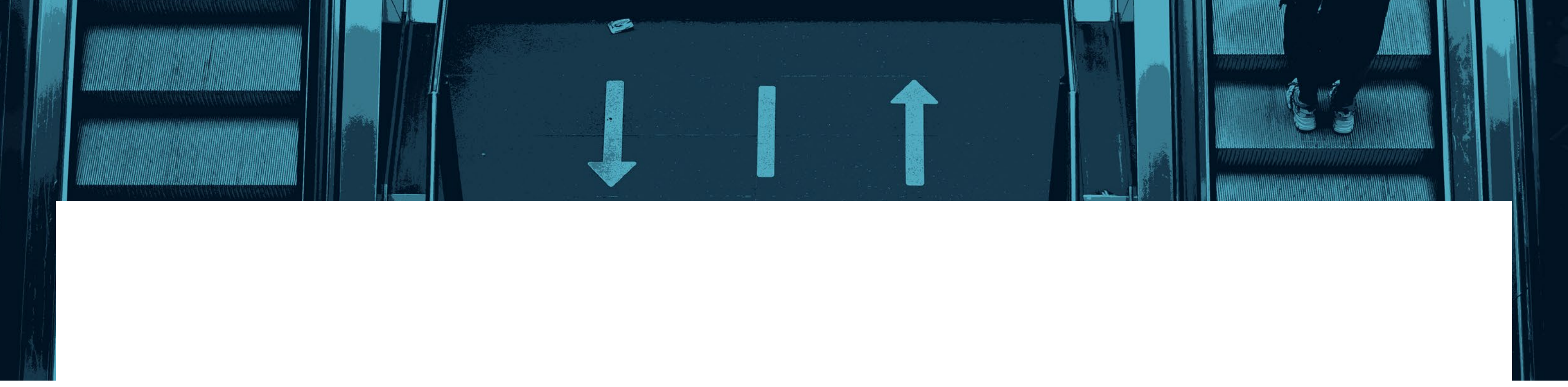
We are encouraging managers we meet with to recognise the incentives to their business of addressing nature-related risks as well, be they physical risks to which their supply chains are exposed, or legal and reputational risks arising from new regulations and the changing expectations of customers, investors, and the wider community.

Moreover, preserving and restoring natural capital is a necessary condition for tackling climate change.

December 2022's UN Biodiversity Conference in Montreal, also referred to as COP15, has raised the profile of biodiversity and its significance to achieving net zero, adding fresh impetus to our conversations with companies on this topic.

As our survey shows, businesses have not lost their stomach for the fight and have maintained their ESG emphasis during a tough 12 months. In 2023, we will continue to encourage managers to apply more of that energy to nature-related challenges like deforestation. There is much work to do but companies are listening – and acting.

Section 5: Inflation relief in sight



Gita Bal
Global Head of Fixed Income Research

Toby Sims
Investment Writer

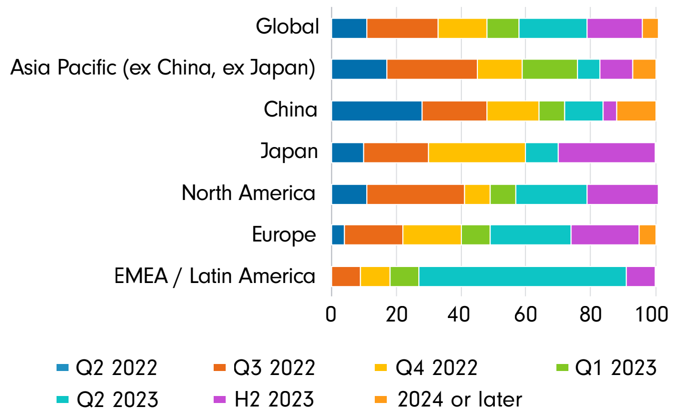
Fidelity International's 2023 annual Analyst Survey shows that most of our analysts tracking companies on the ground believe cost pressures have already topped out, or will do so early in 2023.

Consumer inflation has peaked, but debate will rage long into 2023 about the longer-term impact of the past year's rises in prices - the biggest in three decades. US Federal Reserve chief Jerome Powell was unconvinced at the end of 2022, saying it would take "substantially more evidence" to prove that price growth was on a sustained downward path. Fidelity's annual Analyst Survey suggests that evidence is already here.

Our poll of more than 150 equity and credit analysts who track US, European, and Asian companies on the ground suggests that price pressures on businesses will peak by the end of the first quarter.

Falls in gas, oil, and other commodity prices which have led consumer inflation lower in the past two months are already quickly reducing pressure on companies, analysts say, with around half predicting pressures faced by their companies have either already reached their limit or will do so during the first quarter of 2023. Only 22 per cent expect the peak to come later than the middle of 2023.

Chart 1: Most analysts expect cost pressures will peak by the end of Q1 2023

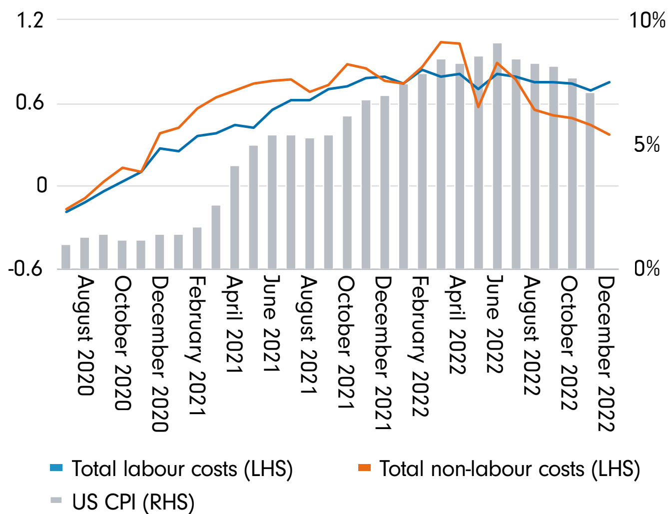


Question: "When do you expect input cost pressure will peak (or has peaked) for companies?" Chart shows percentage of analysts. Source: Fidelity International Analyst Survey 2023.

Cost breakdown

Separately, our regular monthly gauge of analysts' expectations suggests the decline is being led by a fall in non-labour costs. The balance of expectations among analysts is still for those costs to rise over the next six months, but the strength of that expectation has waned significantly in recent months and is now at its lowest levels in two years.

Chart 2: Non-labour costs are driving cost moderation



Question: "For total non-labour costs, what are your expectations for your companies over the next six months compared with current levels?" Chart shows US Consumer Price Index (CPI) mapped against proportion of analyst responses reporting costs are expected to increase minus those reporting costs are expected to decrease. Significant increases and significant decreases receive a double weighting. Higher values show analysts are, on balance, reporting greater cost pressures at the companies they cover. Source: Fidelity International Analyst Survey 2023.

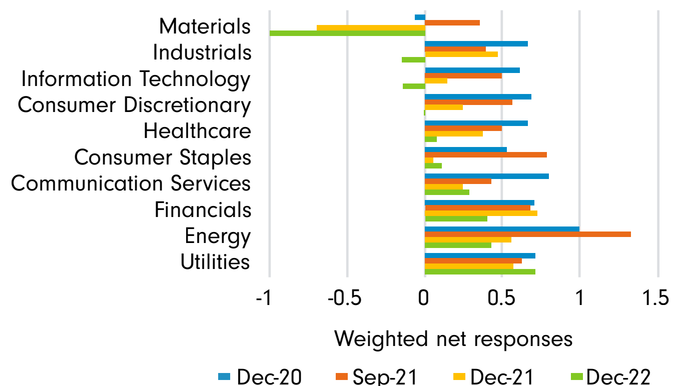
As the effect of last year's big rises in fuel and other costs rolls out of annual indices, one equities analyst who focusses on North American industrial companies explained that the "most significant change [in outlook since a month ago] has been with companies where commodities make up a big proportion of sales."

Inflation is starting to moderate and can come down even further in 2023.

Another equities analyst who focuses on Asian Pacific IT companies noted that supply shortages were no longer posing problems: "The key shortage is only around the end demand - not in the supply chain anymore."

Analysts covering the materials sector now expect their companies' input cost pressures to ease, as do those covering technology companies and industrial producers:

Chart 3: Some analysts now expect inflationary pressures on companies' input costs to ease



Question: "How, if at all, do you expect inflationary pressures within your companies' cost bases to change over the next 12 months?" Chart shows proportion of responses reporting cost pressures are expected to increase minus those reporting an expected decrease. Significant increases and significant decreases receive a double weighting. Higher values show analysts are, on balance, reporting greater inflationary pressures within their companies' cost bases. Source: Fidelity International Analyst Survey 2023.

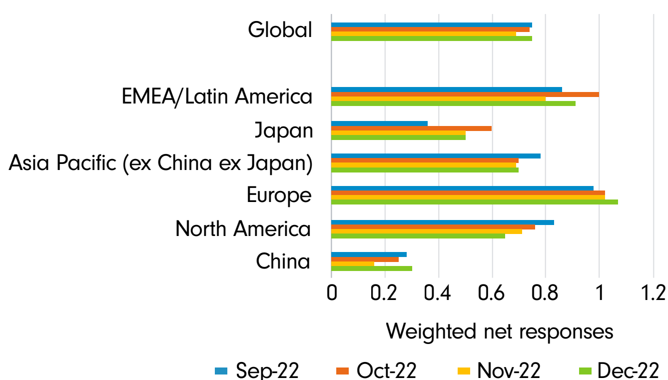
The big question, however, is how the past year's surge in prices will affect wages, potentially delivering a second round of cost rises for companies and creating further price pressures. Here, our analysts covering sectors across the US and European economies remain alert.

Globally, analysts' conviction that labour costs would rise over the next six months actually grew in December. The highest reading came from analysts focusing on European companies, which face a barrage of demands for higher wages as families struggle to deal with increasing costs of food, fuel, and other essentials. One fixed income analyst focusing on European consumer discretionary companies said: "Recent tariff negotiations for the strongest German industrial union have shown a relatively moderate level of increases.

Thus, arguably, 'wage inflation' is not sticky yet in Europe." Ongoing strikes in the UK and elsewhere also reflect these cost-of-living pressures, which could feed into higher wage demands.

With the US labour market still tight, North American analysts also still firmly expect rises in labour costs in the months ahead, although that expectation has declined consistently from last year's highs:

Chart 4: Labour markets remain tight

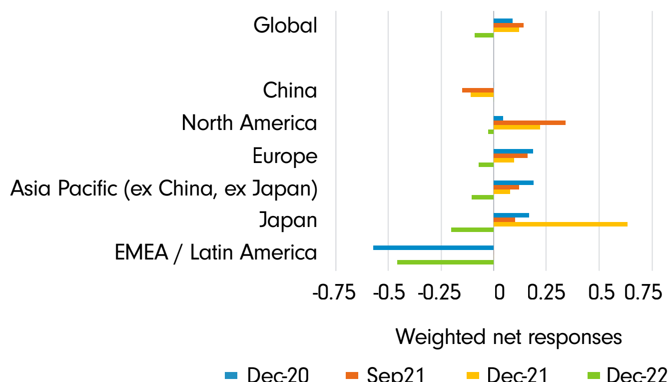


Question: "For total labour costs, what are your expectations for your companies over the next six months compared with current levels?" Chart shows proportion of responses reporting costs are expected to increase minus those reporting costs are expected to decrease. Significant increases and significant decreases receive a double weighting. Values above zero show analysts are, on balance, reporting cost pressures increasing at the companies. Source: Fidelity International Analyst Survey 2023.

Allied to the broader results of the survey, analysts' answers on prices show the impact of higher inflation and the changing macro backdrop on their companies' plans. One equities analyst looking at North American materials companies explained that "cost inflation and increasing concerns about a recession in Western economies have decreased management confidence in large-scale capital projects."

Whatever the outlook for costs, for the first time in years analysts expect companies will struggle to raise prices in the year ahead without sacrificing sales.

Chart 5: Companies' pricing power has weakened



Question: What are your expectations for pricing power at your companies over the next 12 months?" Chart shows proportion of responses expecting pricing power will increase minus those expecting it will decrease. Strong positive and strong negative values receive a double weighting. Higher values show analysts on balance expect pricing power will increase. Source: Fidelity International Analyst Survey 2023.

"The biggest threat to the fundamentals of my companies over the next 12 months is a demand recession", said one fixed income analyst who focuses on airlines, while another equities analyst had similar concerns: "The worry is demand will roll over at the same time that inflation hurts more than expected."

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