

LEADERSHIP SERIES SECOND QUARTER 2017

# Quarterly Sector Update

## PRIMARY CONTRIBUTORS












Fidelity Management & Research Company, Equity Division

Fidelity SelectCo



# Scorecard: Tech, Financials, and Industrials All Positive

The Technology, Financials, and Industrials sectors each had two positive indicators in Q1, and Tech had the best return of any sector. Health Care rallied after a disappointing 2016, and both consumer sectors displayed strong fundamentals. Energy slipped in Q1, pressured by falling oil prices and higher-than-hoped-for production levels.

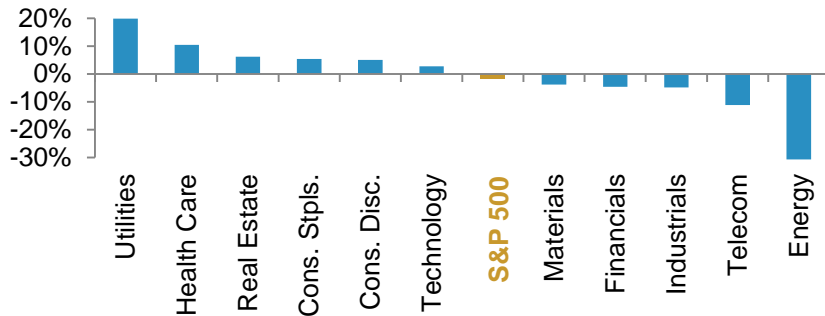
Sector	Longer	Time Horizon View			Weight in S&P 500® Index	Performance as of 3/31/17		
	Business Cycle	Fundamentals	Relative Valuations	Relative Strength		Shorter	Latest Quarter	Year to Date
 Consumer Discretionary		+			12.3%	8.4%	8.4%	1.4%
 Consumer Staples		+			9.3%	6.4%	6.4%	2.6%
 Energy		-	-	-	6.6%	-6.7%	-6.7%	2.7%
 Financials		-	+	+	14.4%	2.5%	2.5%	1.6%
 Health Care		+			13.9%	8.4%	8.4%	1.6%
 Industrials	+		-	+	10.1%	4.6%	4.6%	2.0%
 Information Technology	+		-	+	22.1%	12.6%	12.6%	1.3%
 Materials	-				2.8%	5.9%	5.9%	2.0%
 Real Estate		-	+	-	2.9%	3.5%	3.5%	3.3%
 Telecom			+	-	2.4%	-4.0%	-4.0%	4.6%
 Utilities	-				3.2%	6.4%	6.4%	3.4%
					<b>S&amp;P 500® Returns</b>	6.1%	6.1%	1.9%

Past performance is no guarantee of future results. Sectors as defined by the Global Industry Classification Standard (GICS®); see additional information in the appendix. Factors are based on historical analysis and are not a qualitative assessment by any individual investment professional. Green portions suggest outperformance; red portions suggest underperformance; unshaded portions indicate no clear pattern vs. the broader market as represented by the S&P 500. Quarterly and year-to-date returns reflect performance of S&P 500 Sector Indices. It is not possible to invest directly in an index. All indices are unmanaged. Percentages may not sum to 100% due to rounding. Source: FactSet, Fidelity Investments, as of March 31, 2017.

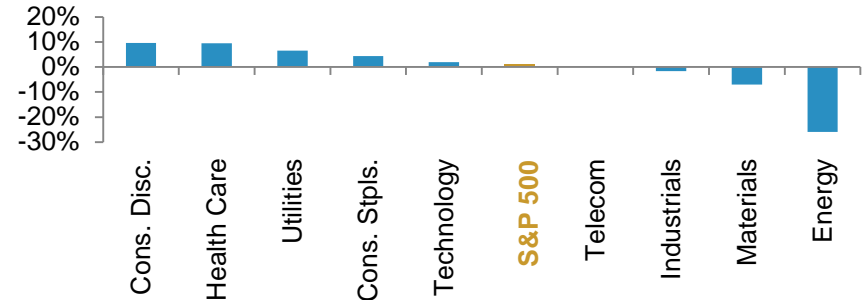
# Fundamentals: Health Care, Consumer Sectors Strong

Health Care had strong fundamentals in Q1, benefiting from healthy earnings per share and free cash flow. Consumer Discretionary and Consumer Staples also scored well, notably in return on equity. Energy fundamentals slipped in Q1 as oil prices trended downward and supply remained robust.

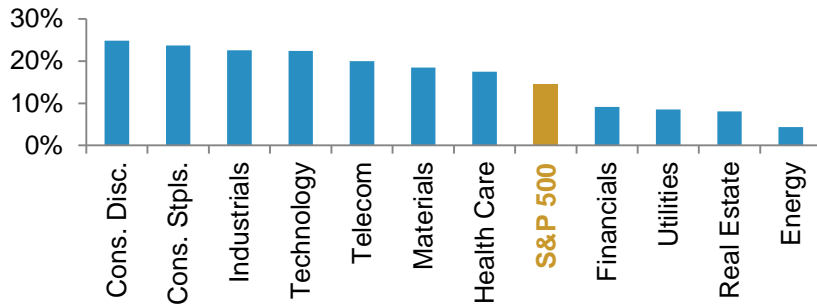
## EPS Growth (Last 12 Months)



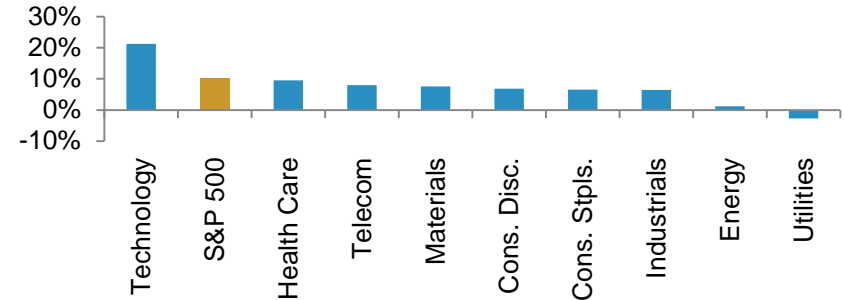
## EBITDA Growth (Last 12 Months)



## Return on Equity (Last 12 Months)



## Free-Cash-Flow Margin (Last 12 Months)



**Fundamentals:** Strong and improving fundamentals historically have been an intermediate-term indicator of sector performance. Fundamental analysis gives a view into how each sector is doing in terms of growth and profitability.

EPS = earnings per share. EBITDA = earnings before interest, taxes, depreciation, and amortization. The Financials and Real Estate sectors are not represented in the EBITDA Growth or Free-Cash-Flow Margin charts. See the Glossary and Methodology slide for further explanation. Source: FactSet, Fidelity Investments, as of March 31, 2017.

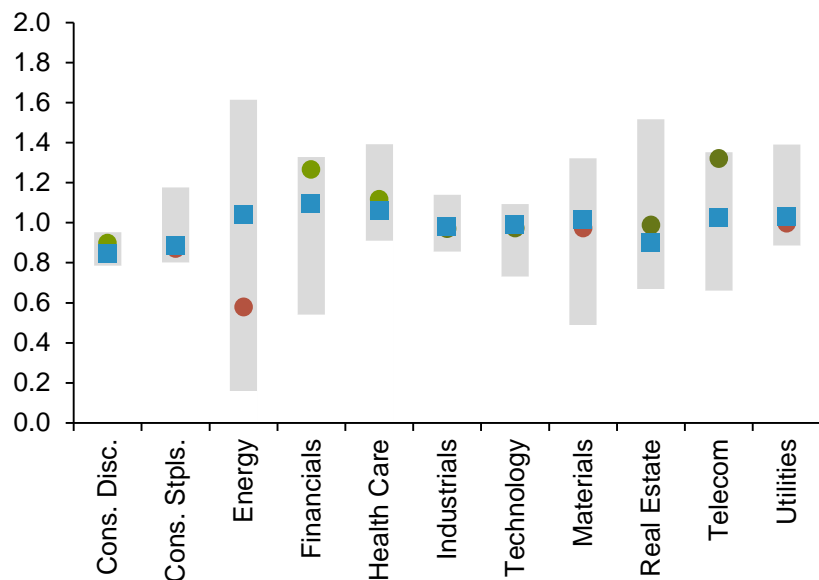
# Relative Valuations: Financials, Real Estate Tie for Top Spot

The Financials and Real Estate sectors had the lowest relative valuations of any sectors in Q1, based on their compellingly low price-to-book (P/B) ratios and above-average earnings yields. Conversely, the Energy sector continues to send mixed signals, with a high P/E ratio but weak earnings and free-cash-flow yields.

## Earnings Yield

■ 10-Year Range (excl. top & bottom 5%) ● Current ■ Historical Average

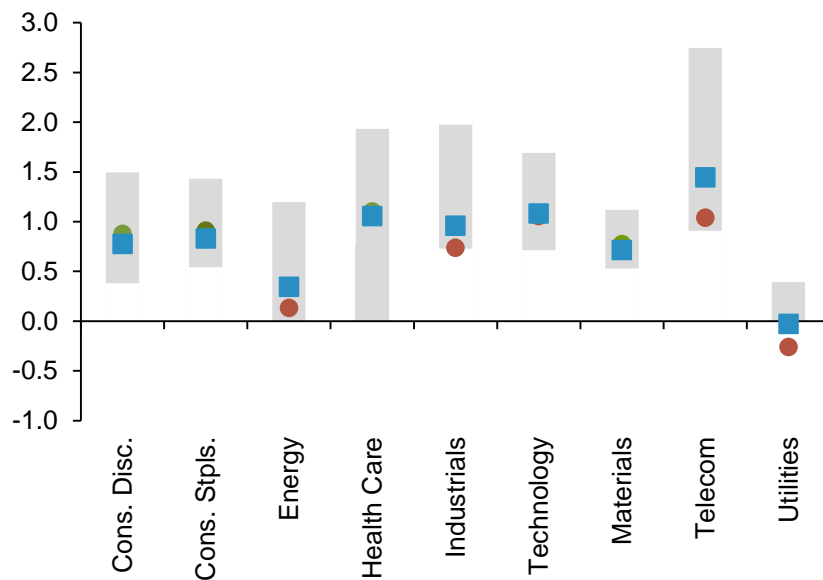
Relative Forward Earnings Yield to S&P 500 Index (%)



## Free-Cash-Flow Yield

■ 10-Year Range (excl. top & bottom 5%) ● Current ■ Historical Average

Relative Free-Cash-Flow Yield to S&P 500 Index (%)



**Relative Valuations:** On their own, valuations are not necessarily the best indicator of sector performance, but when combined with other factors, valuations can be a useful tool in determining the risk-and-reward profile.

Forward earnings yield reflects analysts' published earnings-per-share estimates for the next 12 months, divided by market price per share; it is the inverse of the price-to-earnings (P/E) ratio. Free-cash-flow yield reflects free cash flow divided by market price per share; it is the inverse of the price-to-free-cash-flow ratio. During periods of extreme earnings volatility, metrics like earnings yield may not be indicative of market consensus of valuations. Financials and Real Estate not represented in the Free-Cash-Flow Yield chart; see Glossary and Methodology slide for explanation. Source: FactSet, Fidelity Investments, as of March 31, 2017.

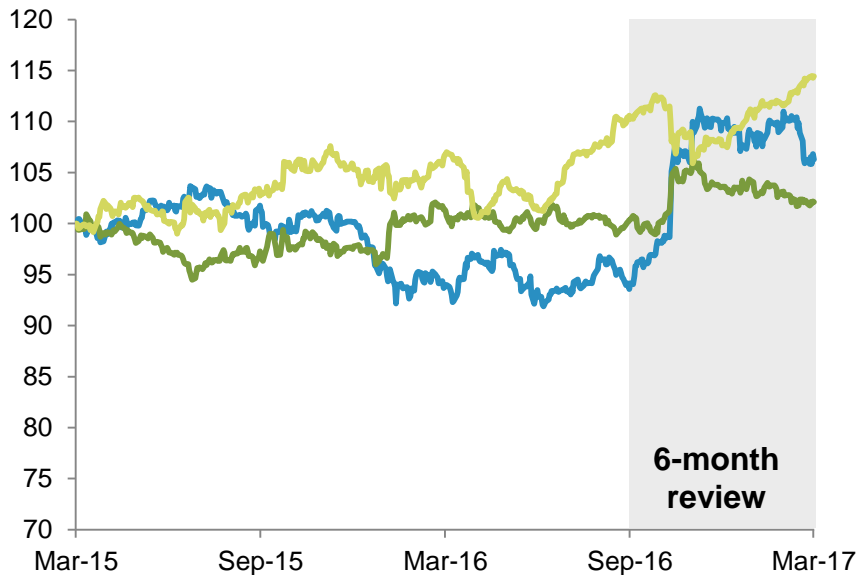
# Relative Strength: Cyclical Sectors Remain in Favor

The strong defensive rally during much of 2016 continued to fade from memory by Q1 2017. Cyclical sectors, such as Financials, Technology, and Industrials, posted the strongest performance relative to the broad market. Less economically sensitive sectors were generally not as competitive with the S&P 500 during the past six months.

## Sectors Exhibiting Relative Strength

— Financials — Industrials — Technology

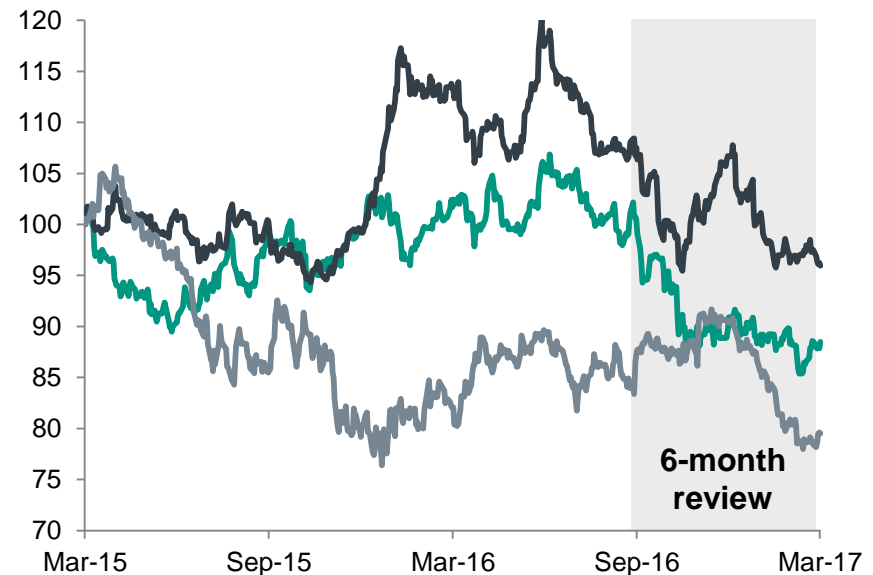
Price Relative to S&P 500 Index



## Sectors Exhibiting Relative Weakness

— Real Estate — Telecom — Energy

Price Relative to S&P 500 Index



**Relative Strength:** This indicator compares the performance of each sector with the performance of the broad market based on changes in the ratio of the securities' respective prices over time.

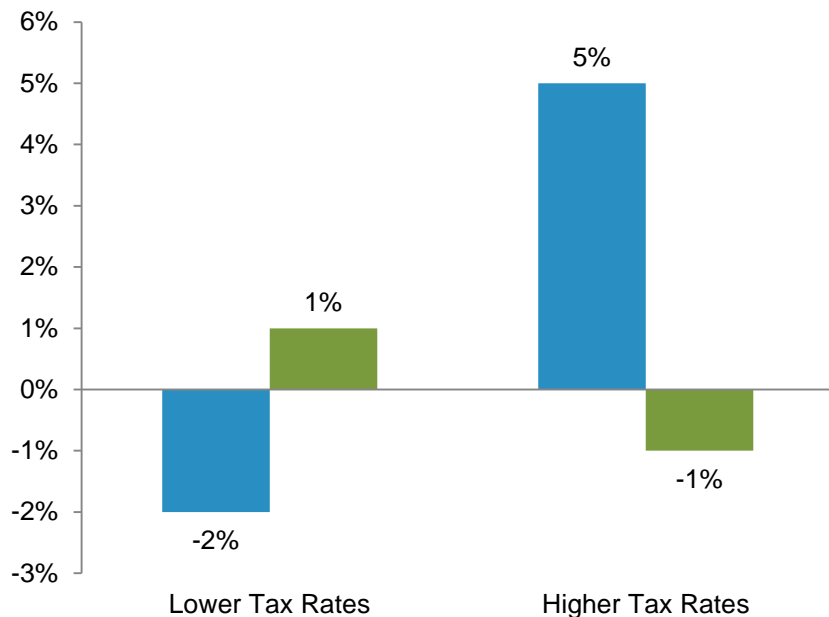
Past performance is no guarantee of future results. Charts represent performance of specified S&P 500 Sector Indices relative to the broader S&P 500 Index. It is not possible to invest directly in an index. All indices are unmanaged. Source: FactSet, Fidelity Investments, as of March 31, 2017.

# Tax Reform May Help Drive a Corporate Profit Recovery

Cyclical sectors have outperformed when corporate taxes have fallen. Lower taxes lift corporate confidence, a catalyst for investment spending and profit recoveries, which tend to begin prior to actual reform. Starting points matter: When corporate earnings were previously in decline, earnings growth recoveries tend to be more durable.

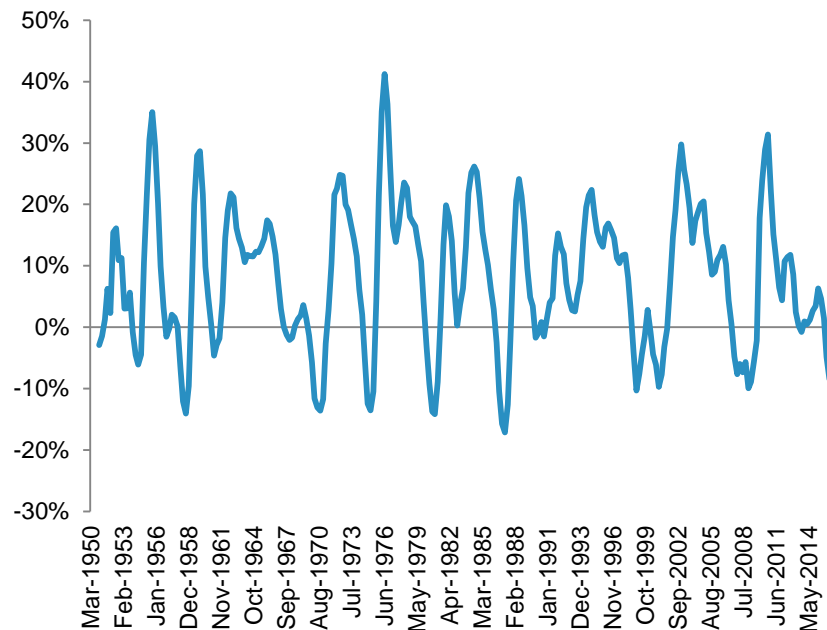
## Lower Corporate Taxes Can Mean Outperformance for Cyclical Sectors

- Average Defensive Sector Relative Performance
- Average Cyclical Sector Relative Outperformance



## Earnings Growth Recoveries Tend to be More Durable When Profits Were in Prior Decline

Corporate Profit Growth (%), Rolling 4Q Avg.



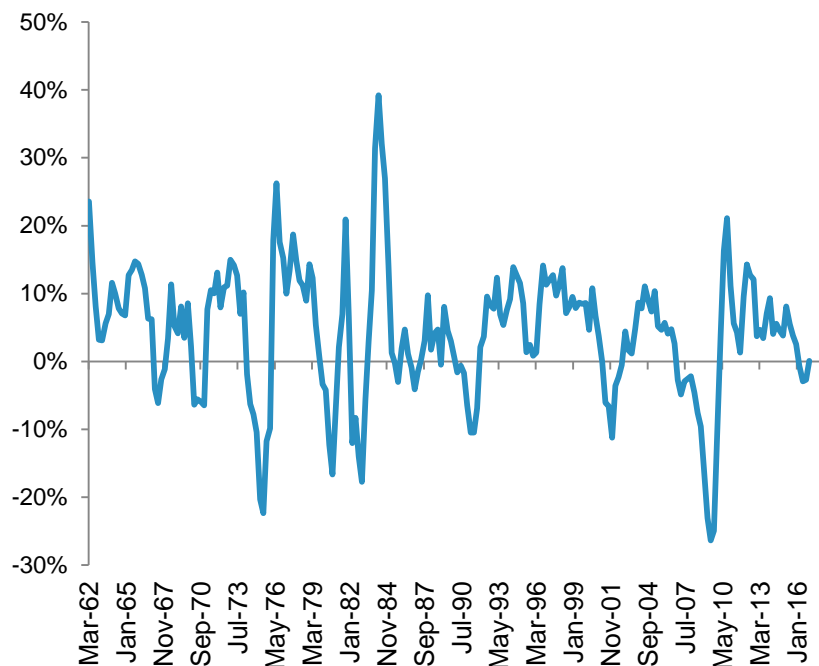
Past performance is no guarantee of future results. **Left chart:** Period shown is 1962 to 2016. Sectors defined as GICS sectors of the S&P 500. Defensive sectors: Consumer Staples, Health Care, Telecom, Utilities. Cyclical sectors: Consumer Discretionary, Energy, Financials, Industrials, Materials, Real Estate, Technology. Returns reflect defensive and cyclical sector performance when corporate taxes are falling or rising on an annual basis. Source: Haver Analytics, as of Dec. 31, 2016. **Right chart:** Annual corporate profits shown are after tax and seasonally adjusted. Source: U.S. Bureau of Economic Analysis, as of Dec. 31, 2016.

# Investment Spending Supports Financials, Discretionary

Investment spending—money used to produce capital, goods, or services—has been weak in recent years. But investment spending recoveries can be stimulated by profit recoveries. Financials and Consumer Discretionary have had the highest odds of outperforming the S&P 500 Index just before and during investment recoveries.

## Corporate Investment Spending Has Been Relatively Weak in Recent Years

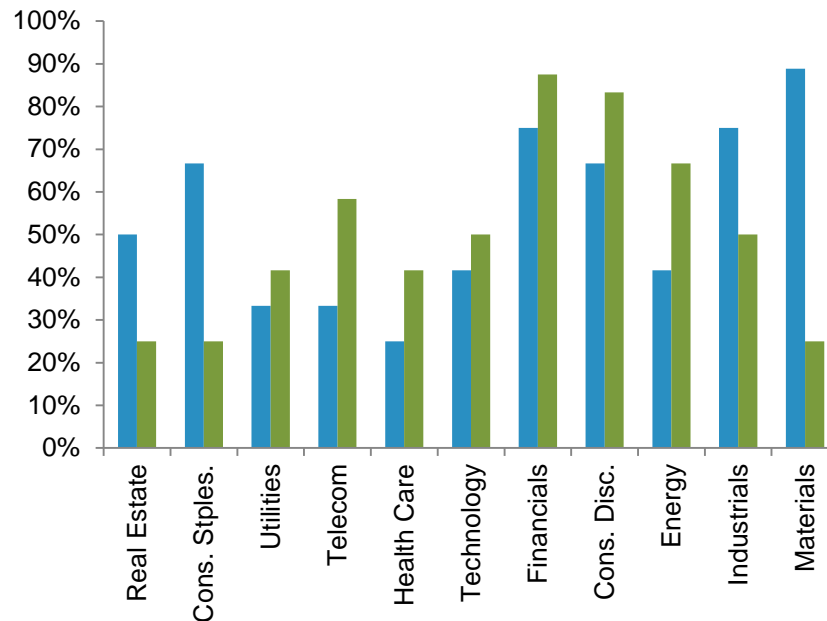
Investment Spending Growth (%)



## Financials, Discretionary Tend to Do Best When Investment Spending Recovers

■ Year Prior to Trough ■ Year Post Trough

Odds of Outperformance During Investment Recoveries (%)



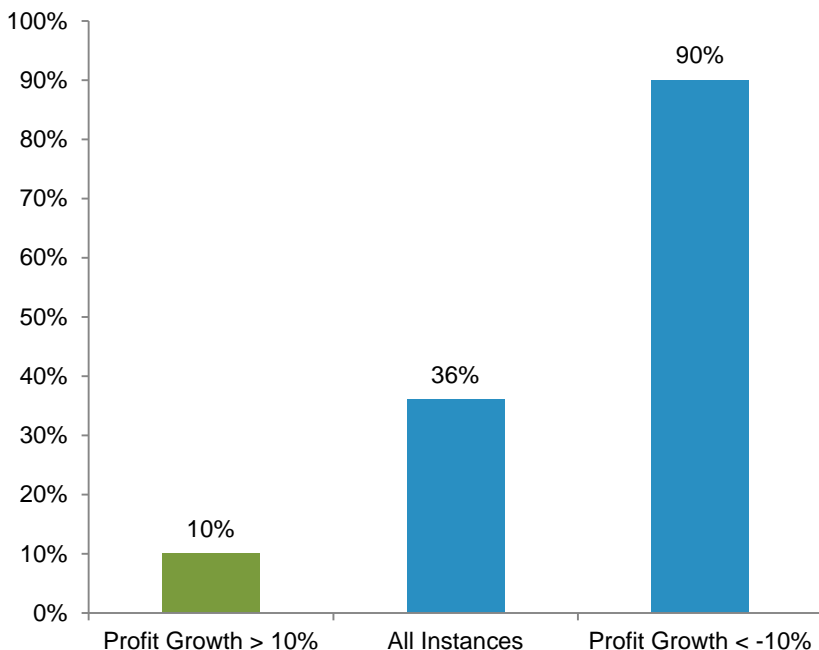
Past performance is no guarantee of future results. **Left chart:** Seasonally adjusted. Source: Haver Analytics, as of Mar. 31, 2017. **Right chart:** Period shown is 1962 to 2016. Sectors defined as GICS sectors of the S&P 500. Source: Haver Analytics, based on sector stocks among the largest 3,000 U.S. stocks, as of Mar. 31, 2017.

# Improved Credit, Steeper Yield Curve Drive Financials Sector

Profit recoveries have often coincided with improved credit and a steeper yield curve, meaning long-term rates are increasing relative to short-term rates. Improved credit typically causes the valuations of Financials stocks to expand, while a steeper yield curve tends to coincide with an acceleration in profits for the Financials sector.\*

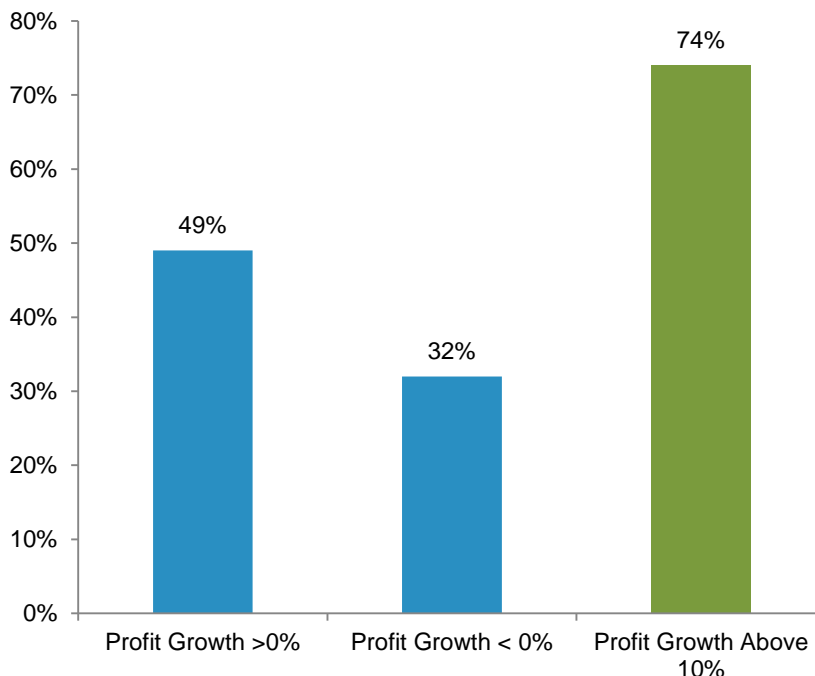
## When Profits Accelerate, Odds of Credit Deterioration Have Been Slim

Odds of Credit Deterioration (%)



## Profit Growth Above 10% Has Been Closely Correlated to a Steepening Yield Curve

Odds of Yield Curve Steepening (%)



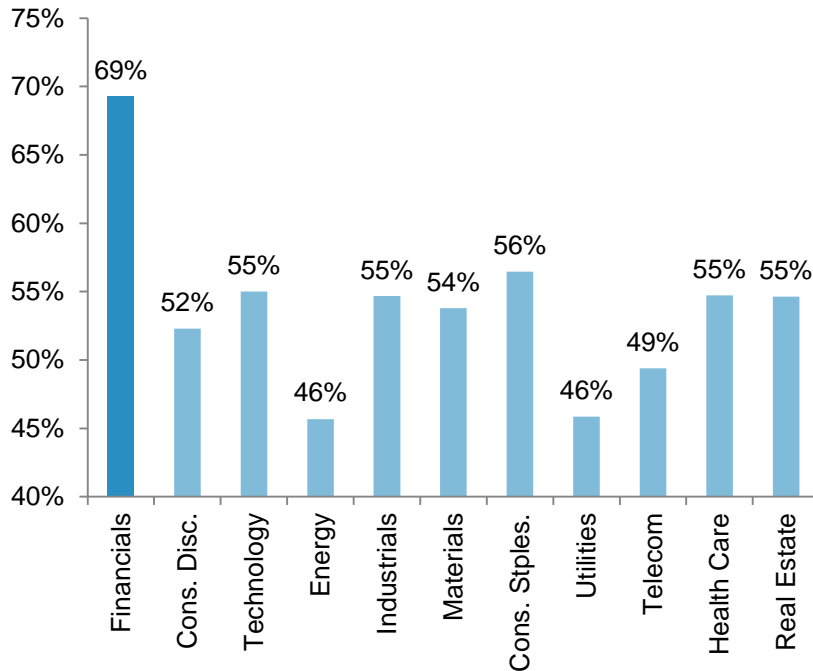
Period shown is 1962 to 2016. \*Banks in particular benefit from higher differentials between long-term interest rates they receive from commercial loans and mortgages vs. the short-term rates they pay on deposits. Past performance is no guarantee of future results. **Left chart:** Source: Haver Analytics, Federal Reserve Board Charge-Off and Delinquency Rates on Loans and Leases at Commercial Banks, as of Mar. 31, 2017. **Right chart:** Source: Haver Analytics, as of Mar. 31, 2017.

# Financials: Outperformance...and Then Some

The Financials sector is unique in two ways: When it has beaten the S&P 500 over a six-month period\*, it's beaten it again over the next six months almost 70% of the time. No other sector has shown this same tendency. And when Financials outperform the S&P 500, the sector typically beats the returns of other cyclical sectors as well.

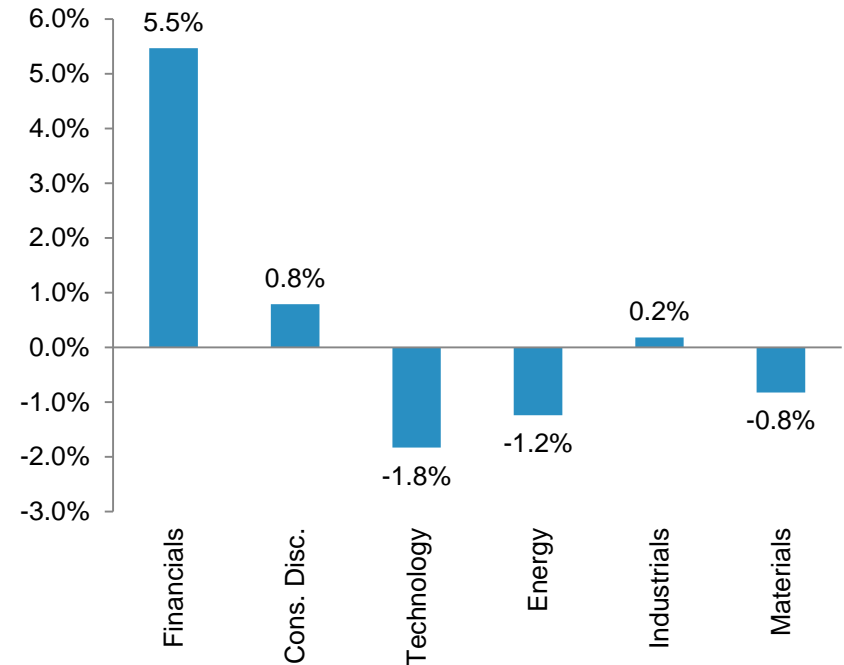
## Financials Sector Outperformance Tends to Be More Durable Than Other Sectors

Odds of Outperformance (%)



## When Financials Does Well, it Tends to Soundly Beat Other Cyclical Sectors

Excess Return Relative to S&P 500 (%)



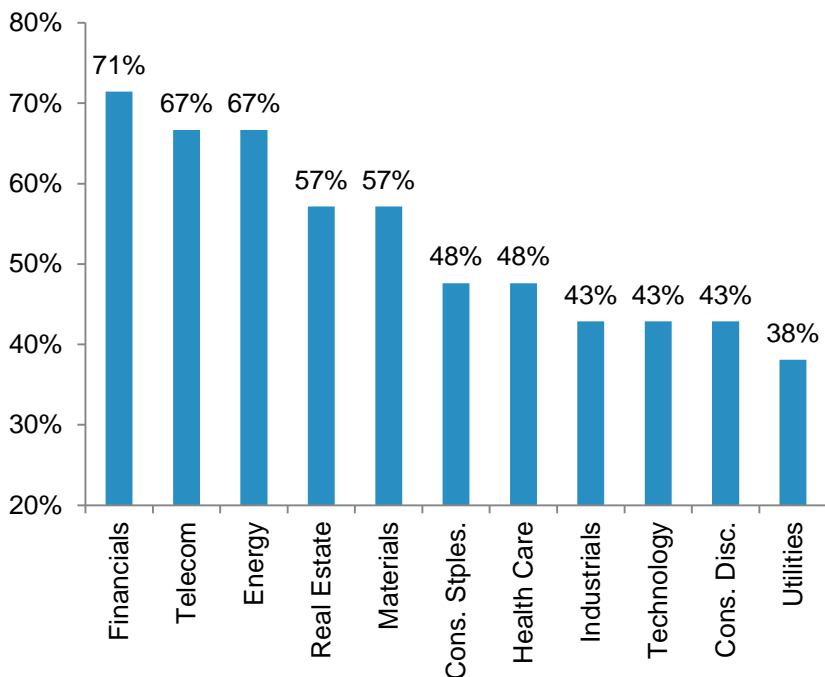
Period shown is 1962 to 2016. \*Outside of recessions. Broad stock market defined as S&P 500 Index. Sectors defined as GICS sectors of the S&P 500. Past performance is no guarantee of future results. Source: Haver Analytics, based on sector stocks among the largest 3,000 U.S. stocks, as of Mar. 31, 2017.

# Utilities Tend to Lag in a Profit Recovery & When Rates Rise

Over time, the sector least likely to outperform during a profit acceleration is Utilities. Because it has historically been a slow, steady grower, the sector's relative earnings have trailed those of its higher-growth peers when profits improve. Utilities also is one sector where rising interest rates have clearly coincided with its underperformance.

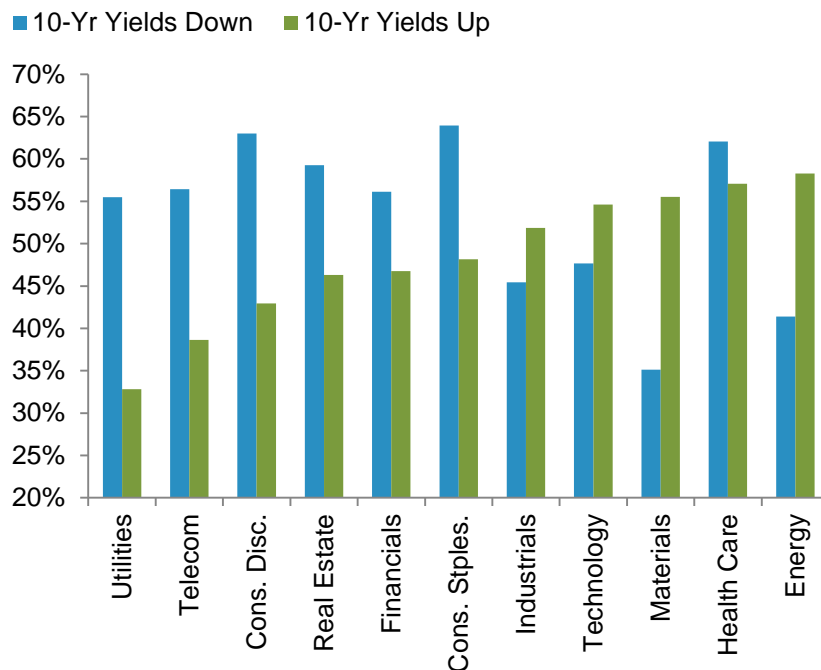
## Utilities Has the Weakest Odds of Beating Other Sectors When Profits Accelerate

Odds of Outperformance When Profits Increase (%)



## Utilities Tends to Underperform When Interest Rates Rise

Odds of Outperformance When Interest Rates Rise (%)



Period shown is 1962 to 2016. Broad stock market defined as S&P 500 Index. Sectors defined as GICS sectors of the S&P 500. Past performance is no guarantee of future results. Source: Haver Analytics, as of Dec. 31, 2017.

# Glossary and Methodology

## Glossary

### Bear Market

At least a 20% correction in the stock market.

### Cycle Hit Rate

Calculates the frequency of a sector outperforming the broader equity market over each business cycle phase since 1962.

### Dividend Yield

Annual dividends per share divided by share price.

### Earnings before Interest, Taxes, Depreciation, and Amortization (EBITDA)

A non-GAAP measure often used to compare profitability between companies and industries, because it eliminates the effects of financing and accounting decisions.

### Earnings per Share Growth

Measures the growth in reported earnings per share over the specified past time period.

### Earnings Yield

Earnings per share divided by share price. It is the inverse of the price-to-earnings (P/E) ratio.

### Free Cash Flow (FCF)

The amount of cash a company has remaining after expenses, debt service, capital expenditures, and dividends. High free cash flow typically suggests stronger company value.

### Free-Cash-Flow Yield

Free cash flow per share divided by share price. A high FCF yield often represents a good investment opportunity, because investors would be paying a reasonable price for healthy cash earnings.

### Full-Phase Average Performance

Calculates the (geometric) average performance of a sector in a particular phase of the business cycle and subtracts the performance of the broader equity market.

### Median Monthly Difference

Calculates the difference in the monthly performance of a sector compared with the broader equity market, and then takes the midpoint of those observations.

### Price-to-Book (P/B) Ratio

The ratio of a company's share price to reported accumulated profits and capital.

### Price-to-Earnings (P/E) Ratio

The ratio of a company's current share price to its reported earnings. A forward P/E ratio typically uses an average of analysts' published earnings estimates for the next 12 mos.

### Price-to-Sales (P/S) Ratio

The ratio of a company's current share price to reported sales.

### Relative Strength

The comparison of a security's performance relative to a benchmark, typically a market index.

### Return on Equity (ROE)

The amount, expressed as a percentage, earned on a company's common stock investment for a given period.

### Risk Decomposition

A mathematical analysis that estimates the relative contribution of various sources of volatility.

## Methodology

### Business Cycle

The business cycle as used herein reflects fluctuation of activity in the U.S. economy and is based on Fidelity's analysis of historical trends.

### Fundamentals

Sector rankings are based on equally weighting the following four fundamental factors: EBITDA growth, earnings growth, ROE, and FCF margin. However, we evaluate the Financials and Real Estate sectors only on earnings growth and ROE because of differences in their business model and accounting standards.

### Relative Strength

Compares the strength of a sector versus the S&P 500 Index over a six-month period, with a one-month reversal on the latest month; identifying relative strength patterns can be a useful indicator for short-term sector performance.

### Relative Valuations

Valuation metrics for each sector are relative to the S&P 500. Ratios compute the current relative valuation divided by the 10-year historical average relative valuation, eliminating the top 5% and bottom 5% values to reduce the effect of potential outliers. Sectors are then ranked by their weighted average ratios, weighted as follows: P/E: 35%; P/B: 20%; P/S: 20%; FCF yield: 20%; dividend yield: 5%. However, the Financials and Real Estate sectors are weighted as follows: P/E: 59%; P/B: 33%; dividend yield: 8%.

## Primary Contributors

### Fidelity Management & Research Company Equity Division

The Equity Division within Fidelity Asset Management consists of 11 portfolio groups, as well as Select and Advisor Focus sector portfolios. Each group is responsible for portfolio management supported by in-depth fundamental research.

### Fidelity SelectCo

SelectCo is a division within Fidelity's Asset Management organization and is focused exclusively on expanding the company's 30-year heritage of sector investing to help meet the evolving needs of investors and advisers for innovative sector-specific tools, resources, and products.

# Appendix

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References to specific investment themes are for illustrative purposes only and should not be construed as recommendations or investment advice. Investment decisions should be based on an individual's own goals, time horizon, and tolerance for risk.

This piece may contain assumptions that are "forward-looking statements," which are based on certain assumptions of future events. Actual events are difficult to predict and may differ from those assumed. There can be no assurance that forward-looking statements will materialize or that actual returns or results will not be materially different from those described here.

## **Past performance is no guarantee of future results.**

### **Investing involves risk, including risk of loss.**

All indices are unmanaged. You cannot invest directly in an index. Index or benchmark performance presented in this document does not reflect the deduction of advisory fees, transaction charges, and other expenses, which would reduce performance.

Stock markets are volatile and can decline significantly in response to adverse issuer, political, regulatory, market, or economic developments.

Because of its narrow focus, sector investing tends to be more volatile than investments that diversify across many sectors and companies. Sector investing is also subject to the additional risks associated with its particular industry.

### **Business Cycle Definition**

The typical Business Cycle depicts the general pattern of economic cycles throughout history, though each cycle is different. In general, the typical business cycle demonstrates the following:

**Early-cycle:** economy bottoms and picks up steam until it exits recession, then begins the recovery as activity accelerates. Inflationary pressures are typically low, monetary policy is accommodative, and the yield curve is steep.

**Mid-cycle:** economy exits recovery and enters into expansion, characterized by broader and more self-sustaining economic momentum but a more moderate pace of growth. Inflationary pressures typically begin to rise, monetary policy becomes tighter, and the yield curve experiences some flattening.

**Late-cycle:** economic expansion matures, inflationary pressures continue to rise, and the yield curve may eventually become flat or inverted. Eventually, the economy contracts and enters recession, with monetary policy shifting from tightening to easing. Please note that there is no uniformity of time among phases, nor is the chronological progression always in this order. For example, business cycles have varied between one and 10 years in the U.S., and there have been examples when the economy has skipped a phase or retraced an earlier one.

### **Market Indices**

The FTSE NAREIT All Equity REITs Index is a market capitalization-weighted index that is designed to measure the performance of tax-qualified Real Estate Investment Trusts (REITs) that are listed on the New York Stock Exchange, the NYSE MKT LLC, or the NASDAQ National Market List with more than fifty percent of total assets in qualifying real estate assets secured by real property. Mortgage REITs are excluded.

The S&P 500® Index is a market capitalization-weighted index of 500 common stocks chosen for market size, liquidity, and industry group representation to represent U.S. equity performance. S&P 500 is a registered service mark of Standard & Poor's Financial Services LLC. Sectors and industries are defined by the Global Industry Classification Standard (GICS).

The S&P 500 sector indices include the standard GICS sectors that make up the S&P 500 Index. The market capitalization of all S&P 500 sector indices together composes the market capitalization of the parent S&P 500 Index; each member of the S&P 500 Index is assigned to one (and only one) sector.

MSCI USA Investable Market Index (IMI) is designed to measure the performance of the large-, mid-, and small-cap segments of the U.S. market. With 2,505 constituents, the index covers approximately 99% of the free-float-adjusted market cap in the U.S.

# Appendix

Sectors are defined as follows: **Consumer Discretionary:** companies that provide goods and services that people want but don't necessarily need, such as televisions, cars, and sporting goods; these businesses tend to be the most sensitive to economic cycles. **Consumer Staples:** companies that provide goods and services that people use on a daily basis, like food, household products, and personal-care products; these businesses tend to be less sensitive to economic cycles. **Energy:** companies whose businesses are dominated by either of the following activities: the construction or provision of oil rigs, drilling equipment, or other energy-related services and equipment, including seismic data collection; or the exploration, production, marketing, refining, and/or transportation of oil and gas products, coal, and consumable fuels. **Financials:** companies involved in activities such as banking, consumer finance, investment banking and brokerage, asset management, and insurance and investments. **Health Care:** companies in two main industry groups: health care equipment suppliers and manufacturers, and providers of health care services; and companies involved in the research, development, production, and marketing of pharmaceuticals and biotechnology products. **Industrials:** companies whose businesses manufacture and distribute capital goods, provide commercial services and supplies, or provide transportation services. **Materials:** companies that are engaged in a wide range of commodity-related manufacturing. **Real Estate:** companies in two main industry groups—real estate investment trusts (REITs), and real estate management & development companies. **Technology:** companies in technology software and services and technology hardware and equipment. **Telecommunication Services:** companies that provide communications services primarily through fixed-line, cellular, wireless, high bandwidth, and/or fiber-optic cable networks. **Utilities:** companies considered to be electric, gas, or water utilities, or companies that operate as independent producers

and/or distributors of power.

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