Commentary | Fourth Quarter 2022

Investment Research Update

From the desk of

Denise Chisholm
Director of Quantitative
Market Strategy

Performance Summary: A Shift Toward Cyclicals

Consumer discretionary and energy stocks came in first and second, respectively, during the third quarter. They were the only sectors to post positive returns, highlighting investors' preference for certain cyclicals following months of outperformance by defensive sectors. Financials came in third place. Communication services, real estate, and materials were the bottom performers for the quarter.

Sector	Performance as of 9/30/22				Weight in S&P 500®
	Latest Quarter	1-Year	3-Year Annualized	Dividend Yield	
Communication Services	-12.7%	-39.1%	-0.1%	1.2%	8.1%
Consumer Discretionary	4.4%	-20.9%	6.7%	0.8%	11.7%
Consumer Staples	-6.6%	-0.1%	6.2%	2.8%	6.9%
Energy	2.3%	45.7%	13.4%	3.6%	4.5%
Financials	-3.1%	-17.6%	4.9%	2.3%	11.0%
Health Care	-5.2%	-3.4%	12.5%	1.7%	15.1%
Industrials	-4.7%	-13.9%	4.0%	1.8%	7.9%
Information Technology	-6.2%	-20.0%	14.9%	1.1%	26.4%
Materials	-7.1%	-12.1%	7.6%	2.3%	2.5%
Real Estate	-11.0%	-16.4%	0.4%	3.3%	2.8%
Utilities	-6.0%	5.6%	3.7%	3.2%	3.1%
S&P 500®	-4.9%	-15.5%	8.2%	1.7%	

Past performance is no guarantee of future results. Sectors defined by the Global Industry Classification Standard (GICS®); see Index Definitions for details. Performance metrics reflect S&P 500 sector indexes. Changes were made to the GICS framework on 9/24/18; historical S&P 500 communication services sector data prior to 9/24/18 reflect the legacy telecommunication services sector. The top three performing sectors over each period are shaded green; the bottom three are shaded red. It is not possible to invest directly in an index. All indexes are unmanaged. Percentages may not total 100% due to rounding.
Source: Haver Analytics, Morningstar, FactSet, Fidelity Investments, as of 9/30/2022.

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Scorecard: Favoring Energy and Health Care

A combination of good fundamentals and low valuations have made the energy and health care sectors appealing, while recovering fundamentals may boost the outlook for financials. Defensive characteristics may drag on performance for communications services and utilities, while information technology may be fully valued.

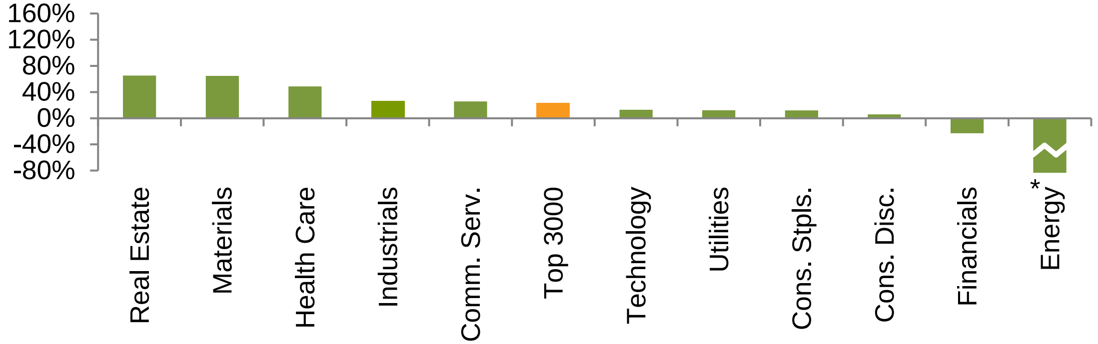
Sector	Strategist View	Longer — Time Horizon View — Shorter			Comments
	Overweight / Neutral / Underweight	Fundamentals	Valuations	Relative Strength	
Communication Services	Underweight	+		–	Defensive characteristics may hinder performance
Consumer Discretionary	Overweight	–	–		Increasingly constructive contrarian indicators, median valuation compelling
Consumer Staples	Underweight			+	Valuation has changed to a tailwind.
Energy	Neutral		+	+	Increasingly mixed signals from macro and fundamental
Financials	Overweight	–	+	–	Recovering fundamentals bolster the outlook
Health Care	Overweight				Good combination of fundamentals and valuation
Industrials	Overweight		–		Other predictive valuation indicators still compelling
Information Technology	Underweight	+		–	Strong fundamentals increasingly priced in
Materials	Underweight	+	+		Fundamental indicators and valuation not predictive
Real Estate	Underweight				Elevated valuation likely to be a headwind
Utilities	Underweight	–	–	+	Defensive characteristics may hinder performance

Past performance is no guarantee of future results. Strategist view, fundamentals, valuations, and relative strength are based on the top 3,000 U.S. stocks by market capitalization. Sectors defined by the GICS; see Index Definitions for details. Historical communication services data has been restated back to 1962 to account for changes to the GICS framework made on 9/24/18. **Strategist view** is as of the date indicated based on the information available at that time, and may change based on market or other conditions. This is not necessarily the opinion of Fidelity Investments or its affiliates. Fidelity does not assume any duty to update any of the information. Overweight and underweight views represent opportunistic tilts in a hypothetical portfolio relative to broad market sector weights. Sector weights may vary depending on an individual's risk tolerance and goals. Time horizon view factors are based on historical analysis and are not a qualitative assessment by any individual investment professional. The top three sectors based on each time horizon view metric are shaded green; the bottom three are shaded red. See Glossary and Methodology for details. It is not possible to invest directly in an index. All indexes are unmanaged. Source: Haver Analytics, FactSet, Fidelity Investments, as of 9/30/2022.

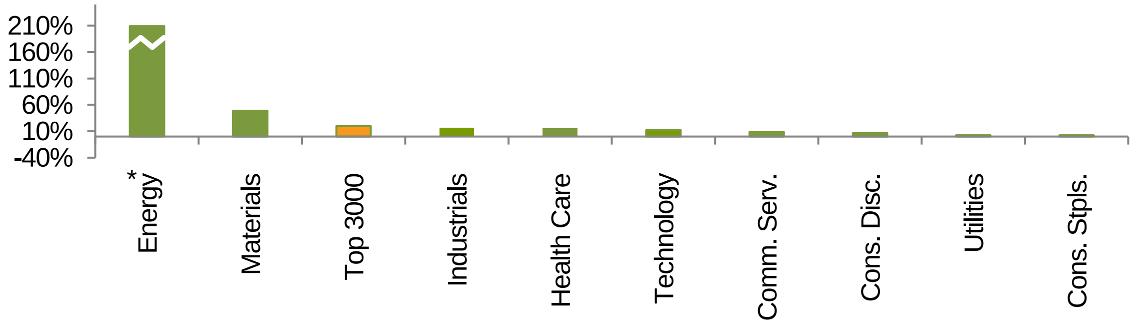
Fundamentals: Tech, Materials, and Communications Lead

Technology led the fundamentals rankings, coming in first in return on equity (ROE) and free-cash-flow margin. The materials and communication services sectors also scored well. Financials was the worst-performing sector, ranking tenth in earnings-per-share growth and ninth in ROE. Utilities and consumer discretionary also posted relatively poor fundamentals.

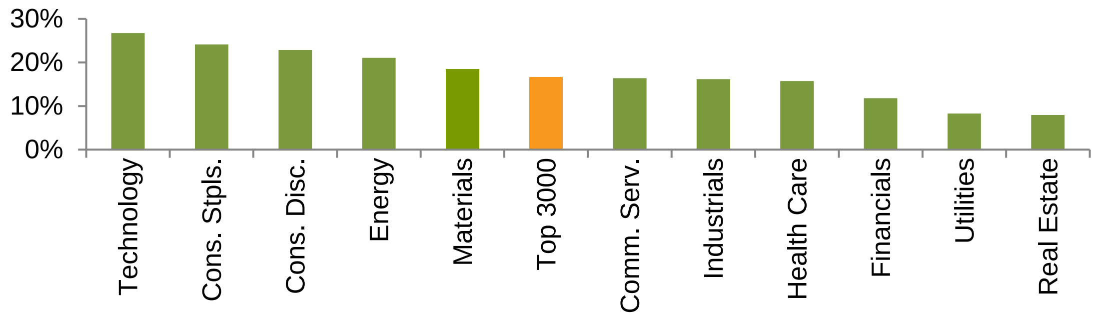
EPS Growth (Last 12 Months)



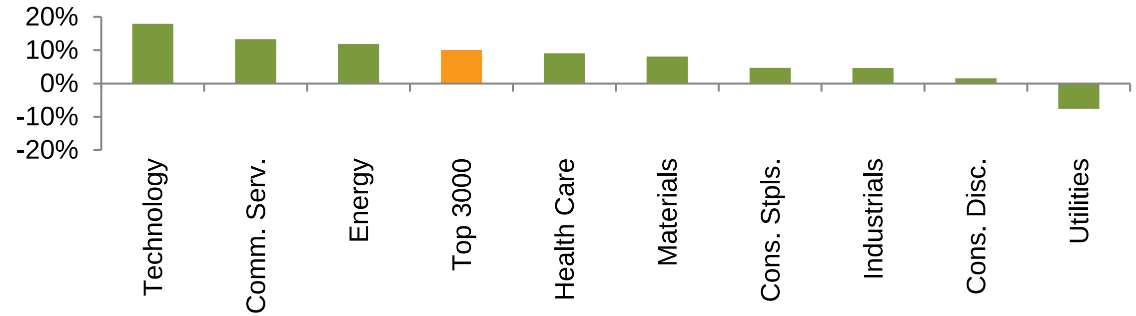
EBITDA Growth (Last 12 Months)



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. Our analysis gives a view of how each sector has done in terms of growth and profitability.

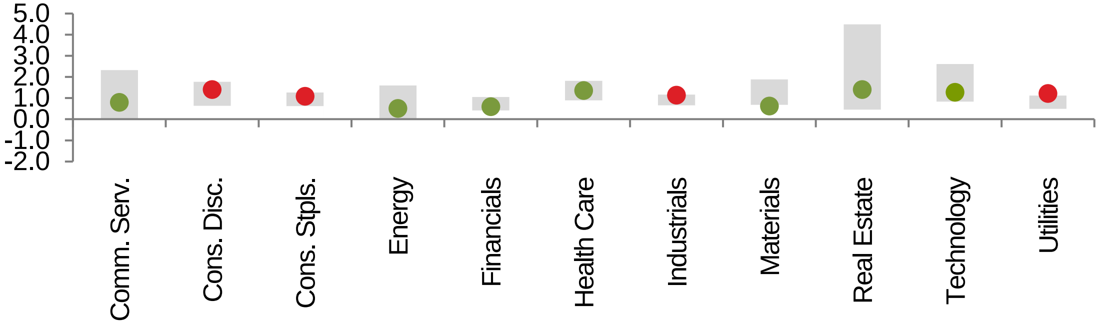
Past performance is no guarantee of future results. EPS = earnings per share. EBITDA = earnings before interest, taxes, depreciation, and amortization. * EPS growth values over the last 12 months for energy was -230%; EBITDA Growth for energy over the same period was 272%. The financials and real estate sectors are not represented in the EBITDA growth or free-cash-flow margin charts because of differences in their business models and accounting standards. See Glossary and Methodology for further explanation Sectors based on the top 3,000 U.S. stocks by market capitalization and defined by GICS. Communication services data restated back to 1962.
Source: Haver Analytics, Fidelity Investments, as of 9/30/22.

Valuations: Materials, Energy, and Financials Look Cheap

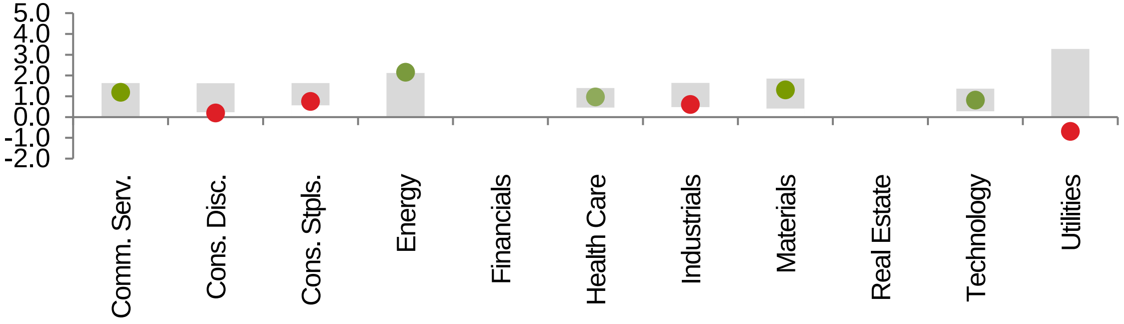
Materials had the cheapest quarter-end valuations based on price-to-earnings and second-cheapest based on free-cash-flow margin. Energy and financials also had relatively low valuations as of quarter-end. Consumer discretionary, utilities, and industrials were the the most expensive sectors.

Historical Range   Current: Green/Red = Cheap/Expensive Relative to Historical Average

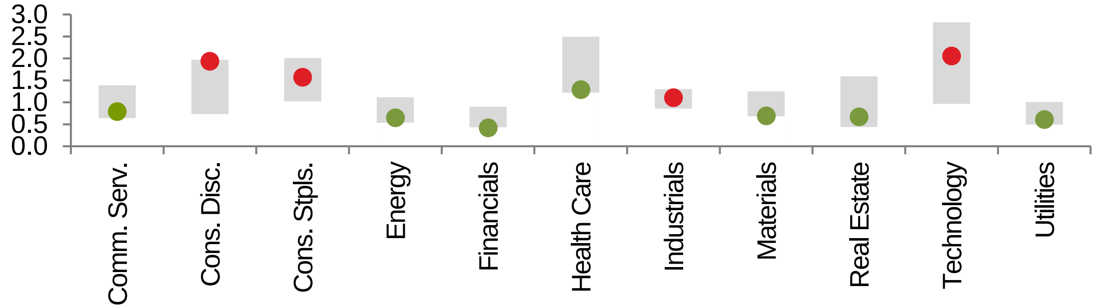
Price-to-Earnings Ratio; Forward Price/Earnings Ratio Relative to Top 3,000 Stocks



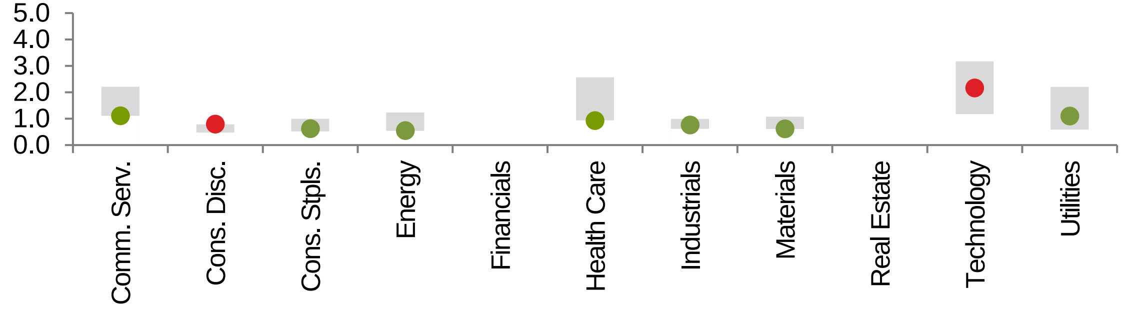
Free-Cash-Flow Yield; Free-Cash-Flow Yield Relative to Top 3,000 Stocks



Price-to-Book Ratio; Forward Price/Book Ratio Relative to Top 3,000 Stocks



Price-to-Sales Ratio; Forward Price/Sales Ratio Relative to Top 3,000 Stocks



Valuations: On their own, valuations are only a moderately effective indicator of future sector performance, but when combined with other factors, they can be a useful tool in determining the risk-and-reward profile.

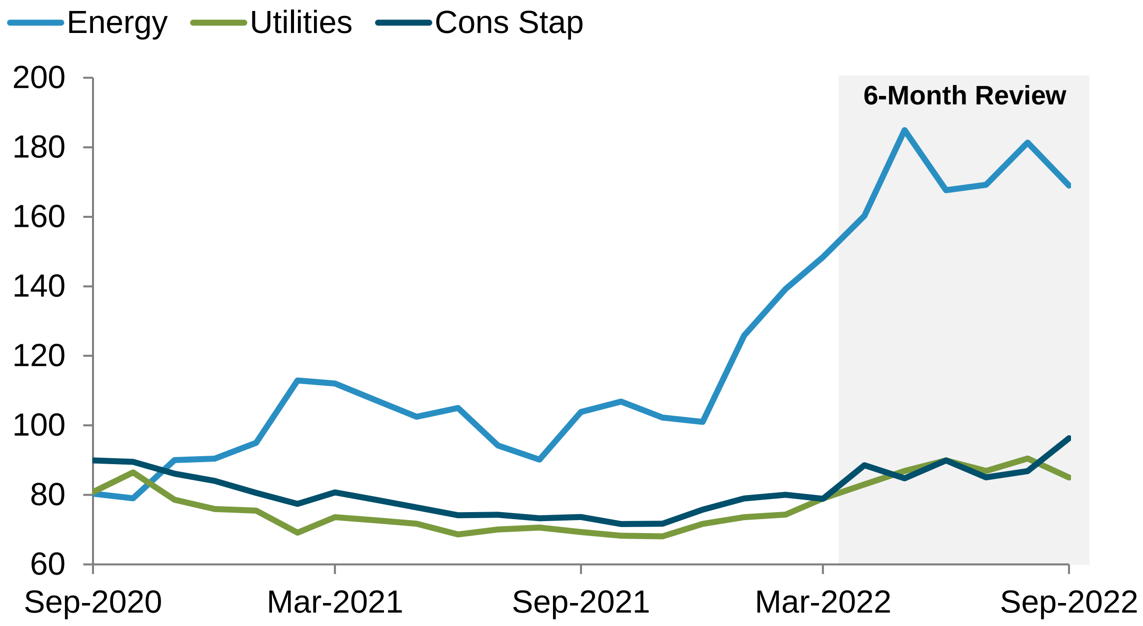
Past performance is no guarantee of future results. Free-cash-flow yield reflects free cash flow divided by market price per share; it is the inverse of the price-to-free-cash-flow ratio. Historical range excludes the top and bottom 5%. Green or red circles indicate if current levels are below or above the historical average, which excludes the top and bottom 5%. The financials and real estate sectors are not represented in the free-cash-flow yield or price-to-sales charts because of differences in their business models and accounting standards. See the Glossary and Methodology for further explanation. Historical range since January 1962. Sectors based on the top 3,000 U.S. stocks by market capitalization and defined by GICS. Communication services data restated back to 1962. Source: Haver Analytics, Fidelity Investments, as of 9/30/22.

Relative Strength: Energy, Utilities, and Staples Have Momentum

Energy, utilities, and consumer staples sectors demonstrated the greatest relative strength over the past six months. Information technology, financials, and communication services had the weakest relative strength as of the end of the period.

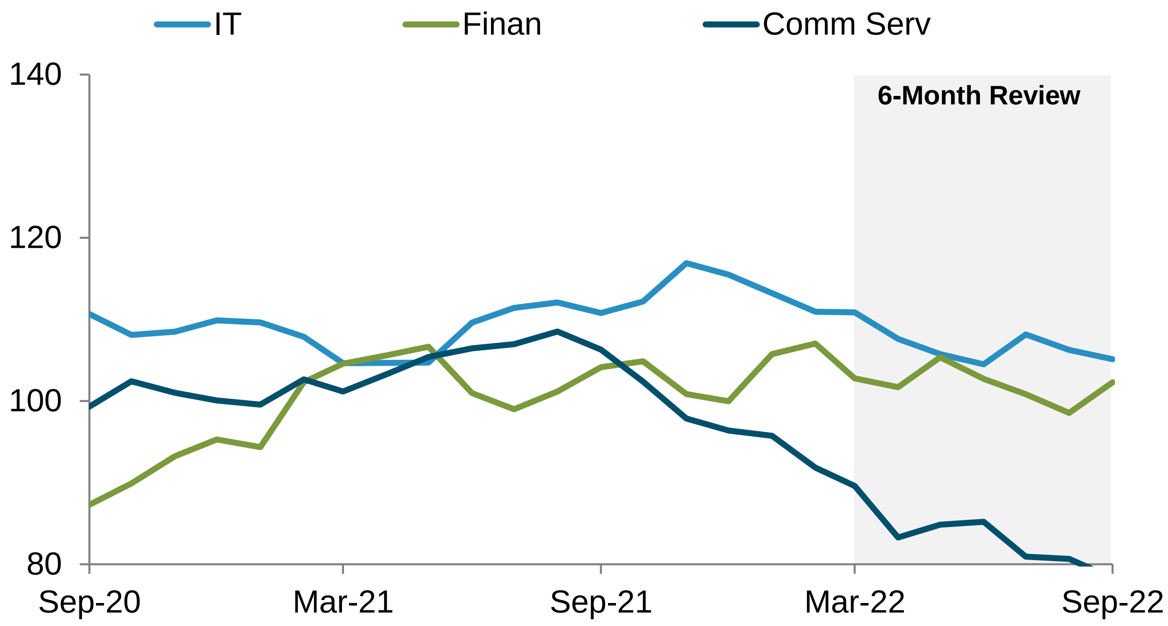
Sectors Exhibiting Relative Strength

Price Relative to the Russell 3000 Index



Sectors Exhibiting Relative Weakness

Price Relative to the Russell 3000 Index



Relative Strength: Stocks and sectors that have outperformed the broader market have tended to continue to do so.

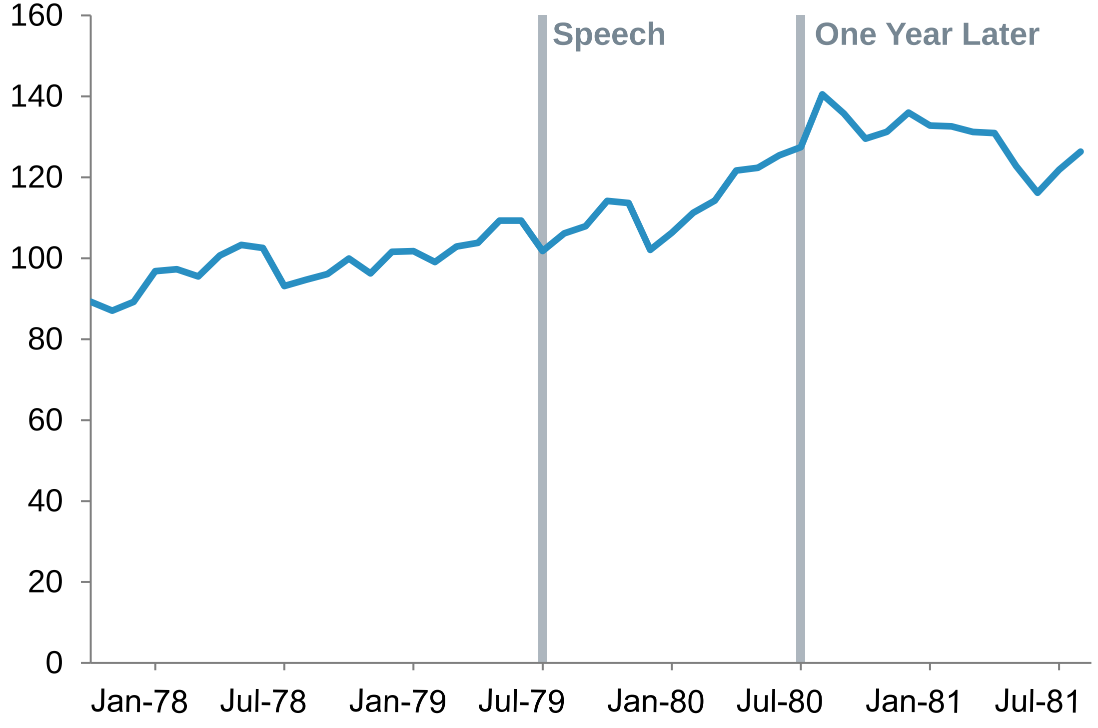
Past performance is no guarantee of future results. Relative strength compares the performance of each sector with the performance of the broad market, based on changes in the ratio of the securities' respective prices over time. See Glossary and Methodology for further explanation. Charts represent performance of sectors based on the top 3,000 stocks by market capitalization relative to the Russell 3000 Index. It is not possible to invest directly in an index. All indexes are unmanaged. Source: FactSet, Fidelity Investments, as of 9/30/22.

Higher Rates May Hurt the Economy More Than the Stock Market

I recently reviewed the last time the U.S. Federal Reserve went all-in against high inflation. On October 6, 1979, Fed Chair Paul Volcker gave a watershed speech detailing aggressive anti-inflation measures. Industrial production fell 6%, and unemployment jumped to 7.5% over the subsequent 12 months. But stocks gained 25%, helped by a plunge in crude prices—a good reminder that the economy is not the market.

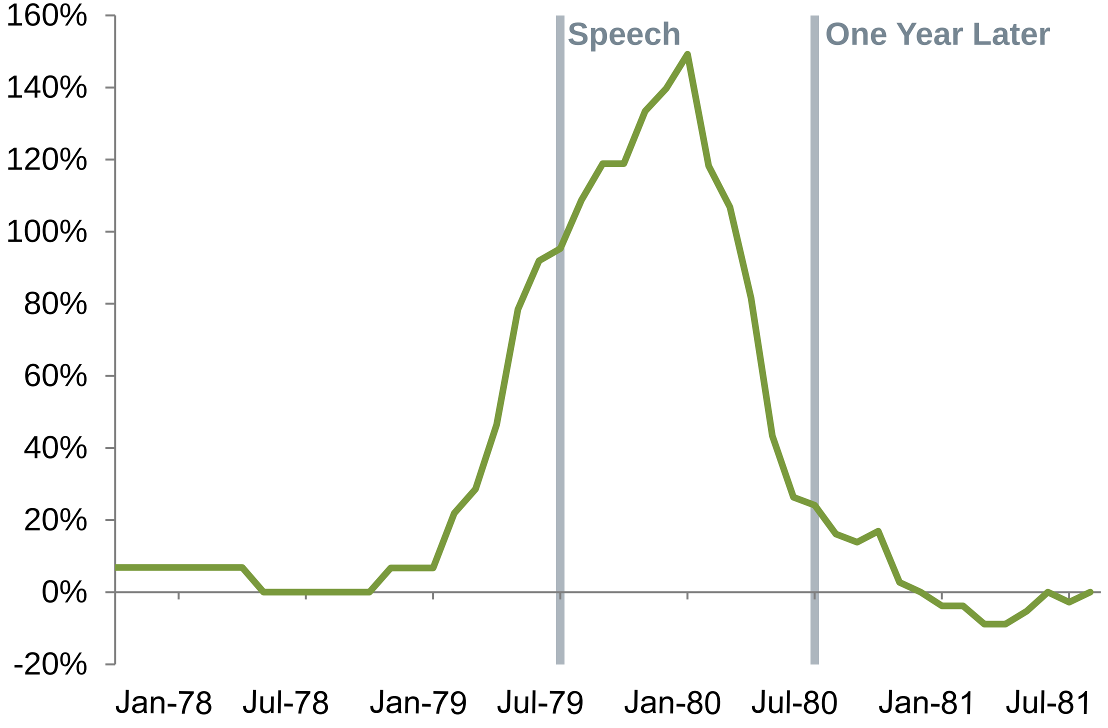
Stock Prices Rose After Volcker's 1979 Speech

S&P 500® Price Index Composite



Crude Oil Prices Peaked, Then Dropped

Spot Oil Price, West Text Intermediate Crude, Percent Change Year to Year



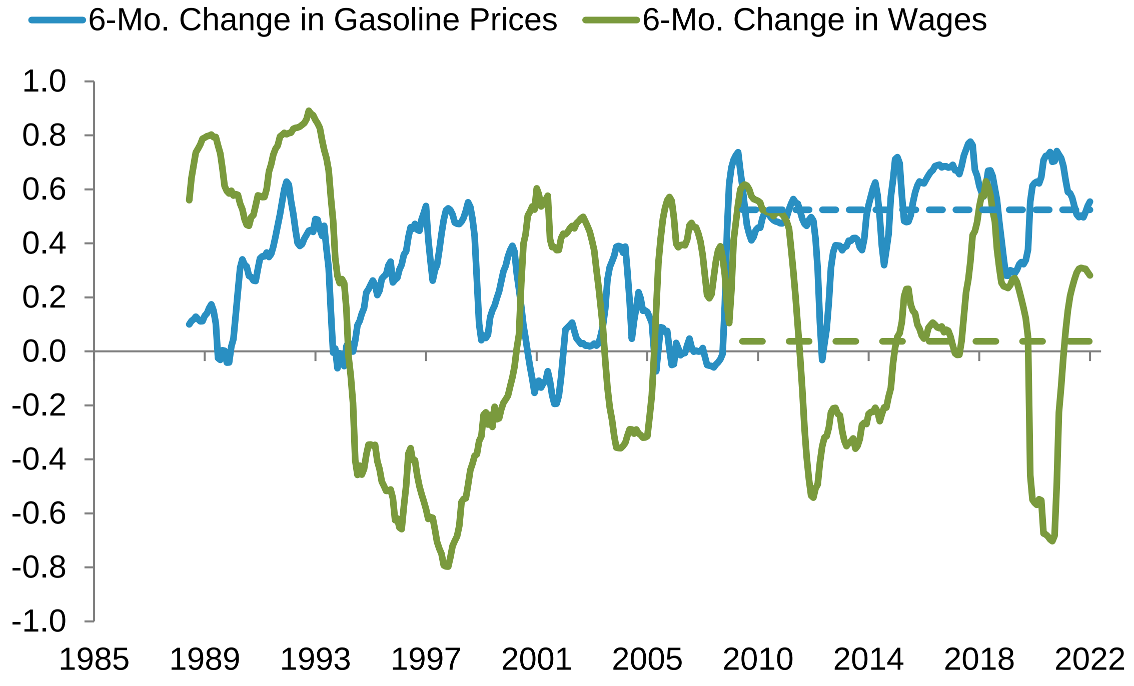
Past performance is no guarantee of future results. LEFT: The Industrial Production Index is compiled by the U.S. Federal Reserve Board and measures output in the manufacturing, mining, electric, and gas industries. The unemployment rate is measured by the U.S. Bureau of Labor Statistics. **RIGHT:** Haver Analytics, FactSet, and Fidelity Investments, as of 8/31/22.

Don’t Underestimate Energy Prices’ Impact on Inflation

Investors worry that fast-rising wages will keep core inflation high. On one hand, there has been little correlation between the two metrics over time. On the other hand, the price of energy, particularly gasoline, has had a very high correlation to core inflation, likely because energy is an input into nearly all goods. The recent 40% decline in gas prices could help core inflation ease.

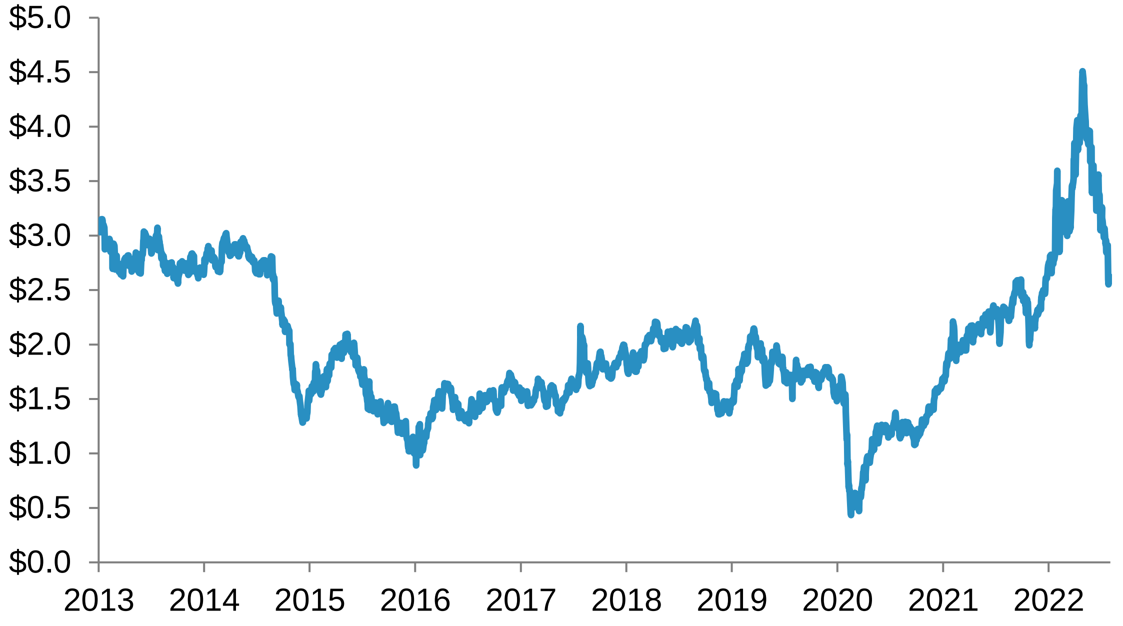
Energy Prices Are More Correlated to Core Inflation Than Wages

Rolling 3-Year Correlation to Core PCE Deflator for 6-Month Percent Change in Gasoline Prices and Wages



Gas Prices Have Tanked

Average U.S. Price Per Gallon of Gasoline



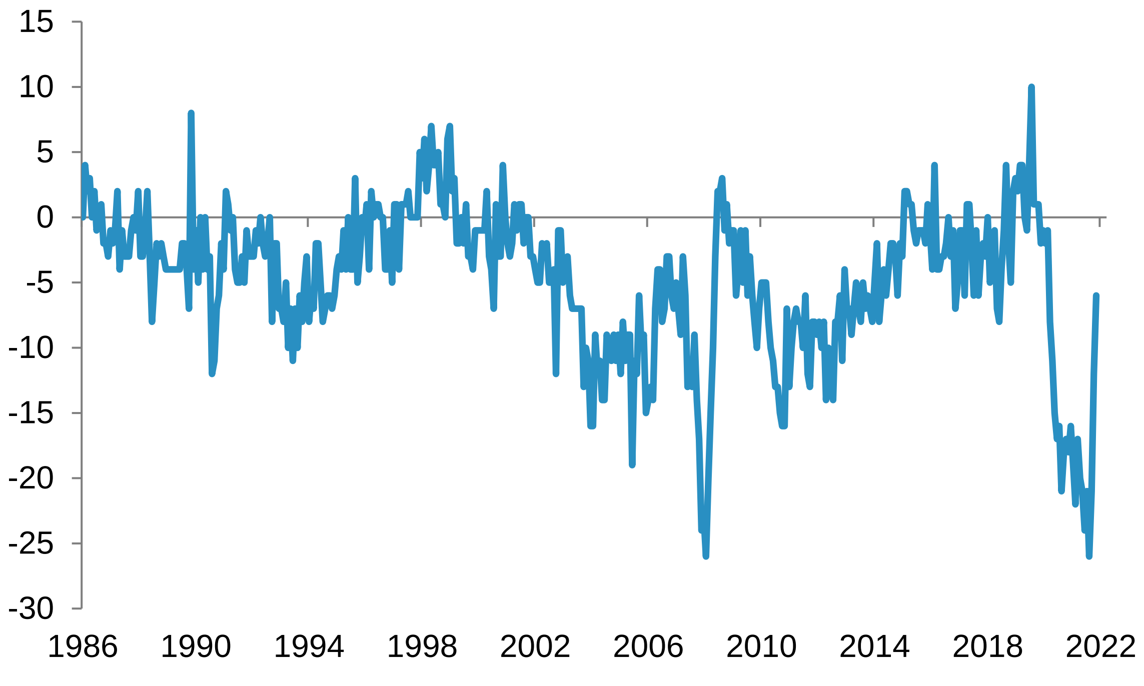
Past performance is no guarantee of future results. PCE deflator: Personal consumption expenditures deflator. Core PCE deflator excludes volatile food and energy categories. Wages reflect average hourly earnings. Source: Haver Analytics, FactSet, and Fidelity Investments, as of 9/7/22.

Stocks May Benefit from a Rise in Real Wages

The outlook for real, after-inflation wages has improved dramatically over the last six months. That's based on small business' planned wage increases minus planned price increases, using data from the National Federation of Independent Business (NFIB). The S&P 500® has tended to advance after big jumps in this indicator, likely because higher real incomes boost spending power.

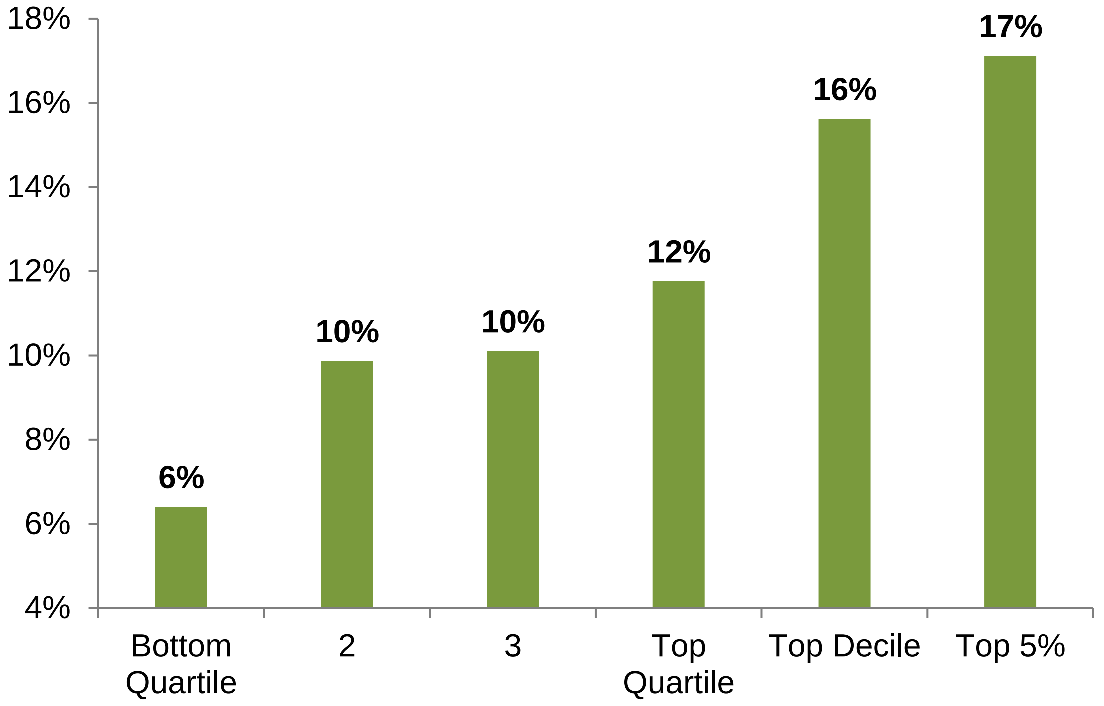
The Outlook for Real Wages Has Improved

NFIB Proxy, Net Plans to Raise Wages Minus Plans to Raise Prices



Stocks Have Historically Gained After Jumps in the Real Wage Proxy

NTM S&P 500® Returns in Tranches of Prior 6-Month Change in NFIB Real Wage Proxy



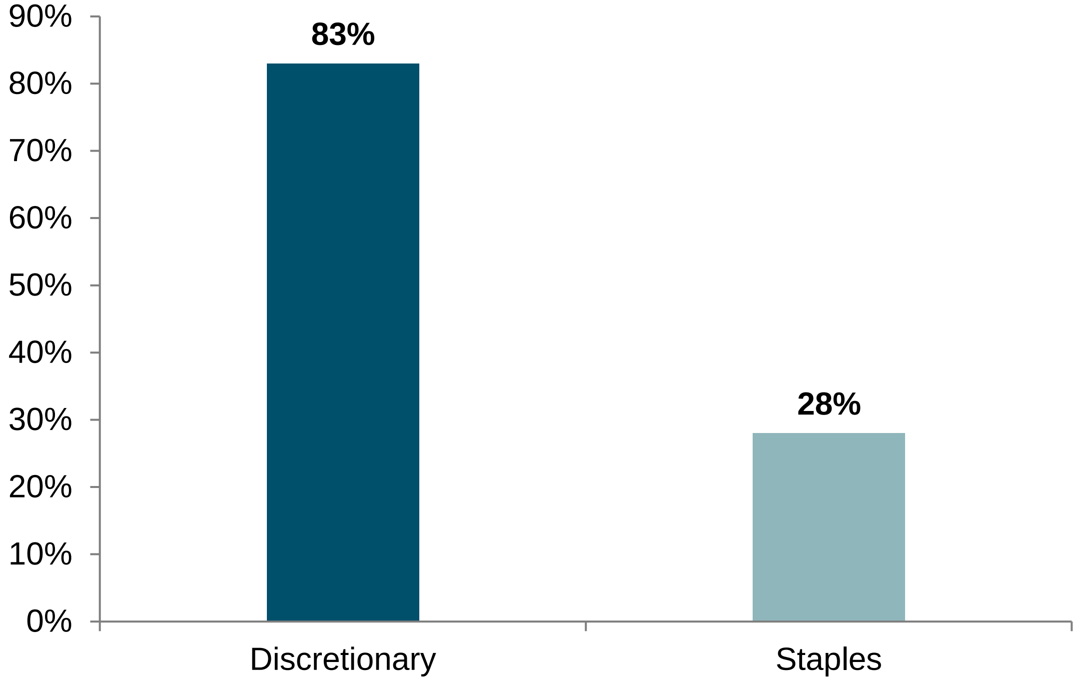
Past performance is no guarantee of future results. Historical data from 1986. NTM: Next twelve months. Source: Haver Analytics, FactSet, and Fidelity Investments, as of 8/31/22.

When Spending Power Increases, Consumer Discretionary Wins

Jumps in the NFIB Real Wage Proxy also have had clear implications for sector performance. After top-decile increases in the Proxy, consumer discretionary stocks have outperformed the market over the next 12 months 83% of the time, compared with just 28% for consumer staples. More broadly, cyclical sectors have tended to outperform and defensives have tended to lag.

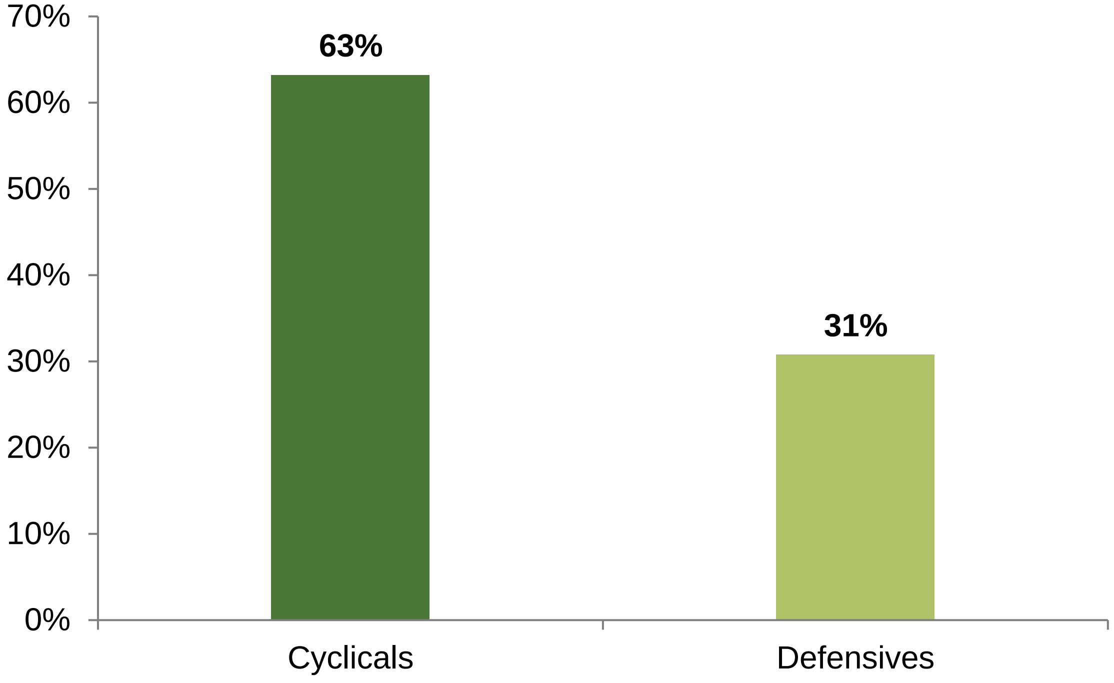
Jumps in the Real Wage Proxy Favor Consumer Discretionary…

Historical Odds of Outperformance (NTM) after Top-Decile NFIB Real Wage Proxy Increases, 1986–Present



…And Cyclical Sectors Overall

Historical Odds of Outperformance as NFIB Real Wage Proxy Rises, 1986–Present



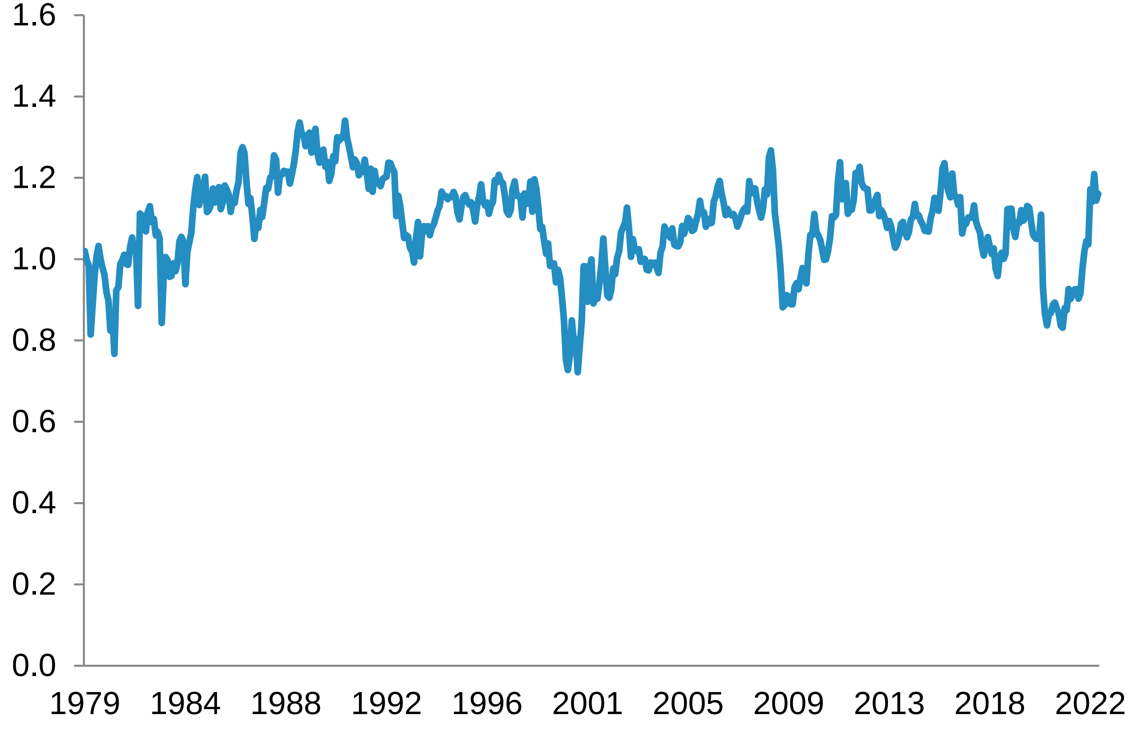
Past performance is no guarantee of future results. NFIB: National Federal of Independent Businesses. NTM: Next twelve months. Analysis based on the top 3,000 U.S. stocks by market capitalization. Cyclical sectors include communication services, consumer discretionary, energy, financials, industrials, materials, real estate, and technology. Defensive sectors include consumer staples, health care, and utilities. Source: Haver Analytics, FactSet, and Fidelity Investments, as of 8/31/22.

Consumer Staples No Longer Look Appealing

Investors have favored defensive stocks for much of 2022, pushing the relative valuation of consumer staples stocks to the high end of their historical range. Staples have tended to lag the market from similar valuations. Meanwhile, long-term headwinds, such as declining relative earnings growth, also could put a damper on the sector.

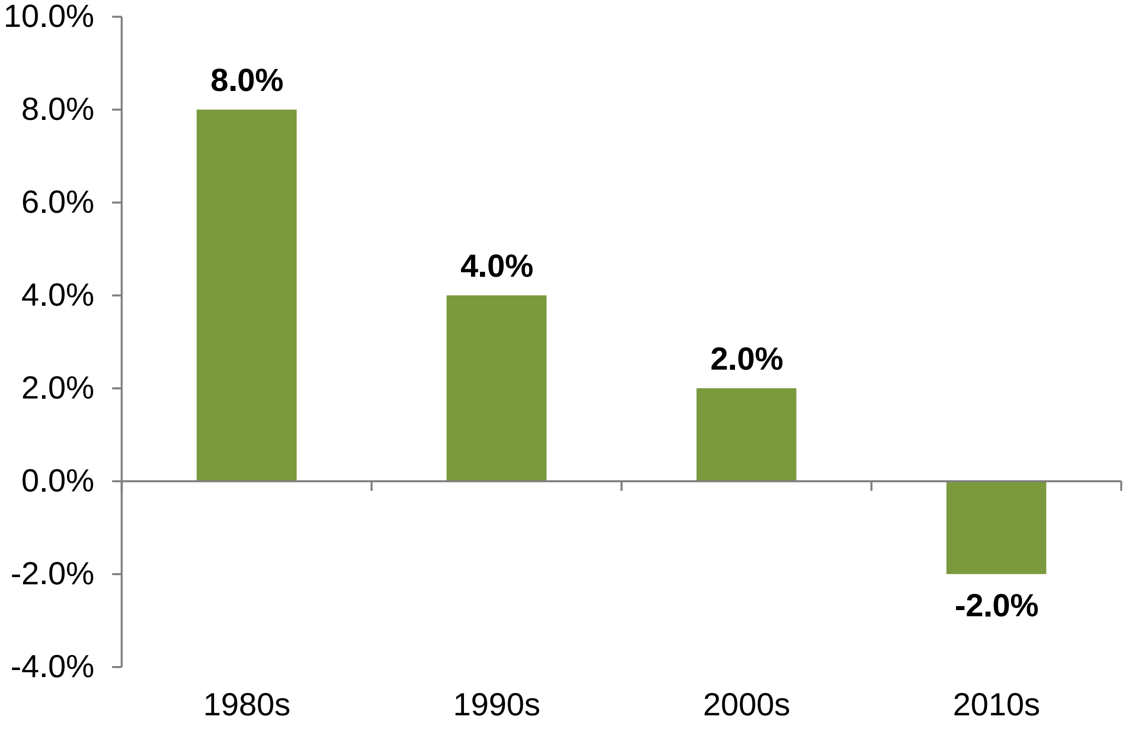
Consumer Staples Were Cheap, but Now They're Expensive

Consumer Staples Relative Forward P/E



Secular Headwinds Persist for Staples

Consumer Staples Average Annual Relative Expected Earnings Growth by Decade



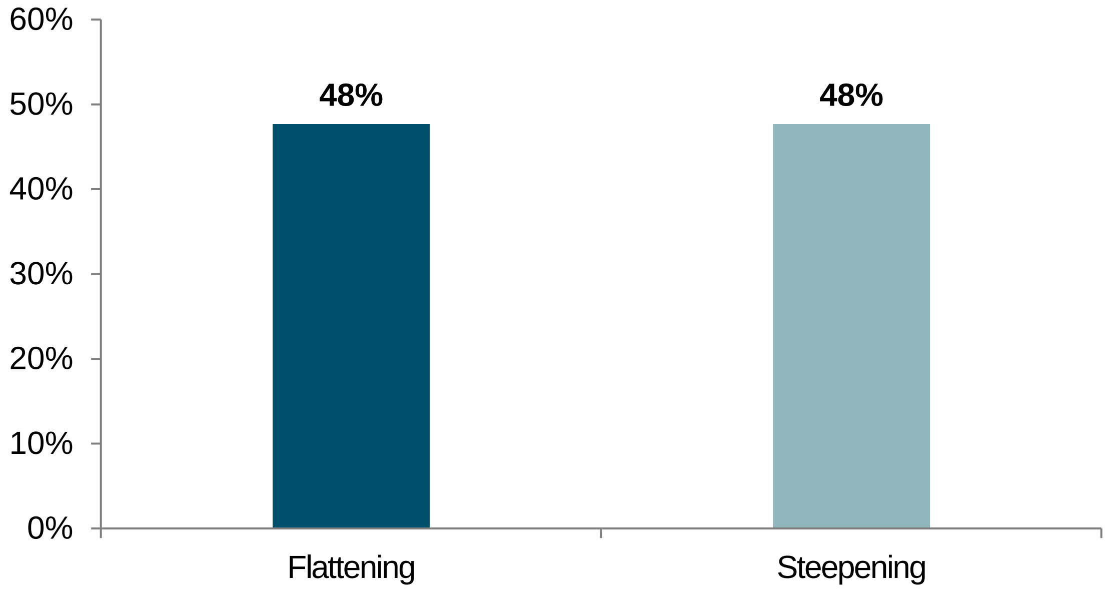
Past performance is no guarantee of future results. Fwd P/E: Forward price-to-earnings ratio. A forward P/E ratio typically uses an average of analysts' published earnings estimates for the next 12 months. Analysis based on the top 3,000 U.S. stocks by market capitalization. Source: Haver Analytics, FactSet, and Fidelity Investments, as of 8/31/22.

Discretionary May Lead Despite the Inverted Yield Curve

An inverted yield curve signals economic weakness, so some investors worry it could be a bad sign for consumer discretionary. History suggests otherwise. Since 1976, the sector has had equal odds of outperformance whether the curve was flattening or steepening. What's more, discretionary has tended to beat the market in the 12-month periods after inversions between 2- and 10-year Treasuries.

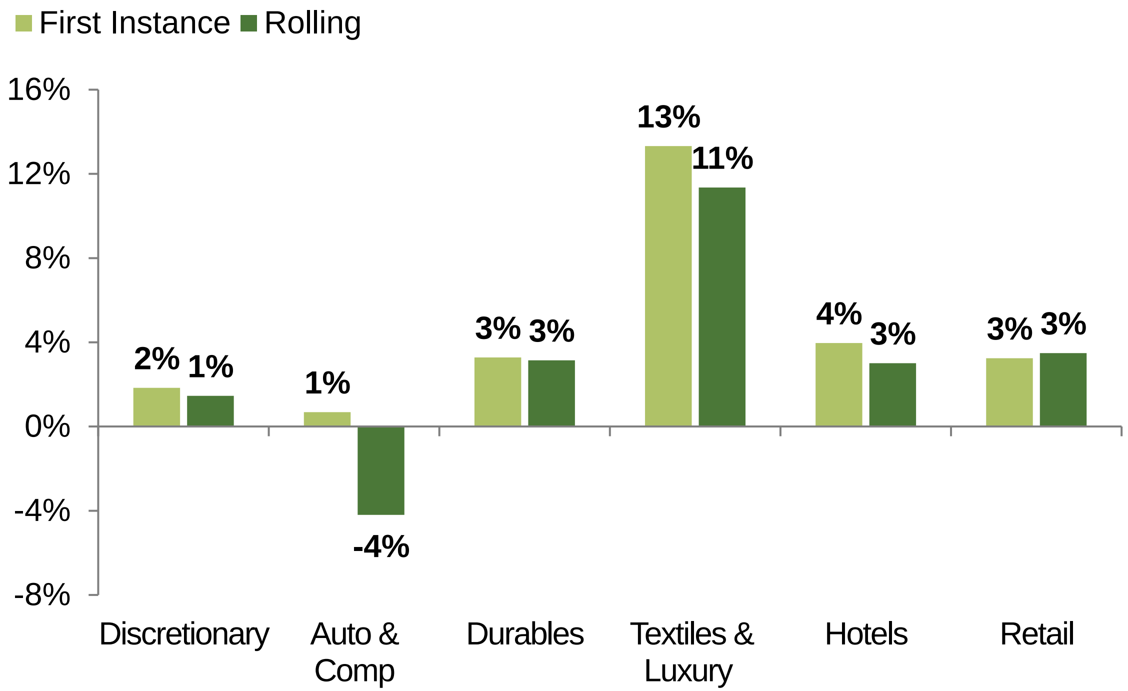
Discretionary Has Had Equal Odds of Outperformance with a Flattening or Steepening Curve

Historical Odds of Consumer Discretionary 12-Month Outperformance by Yield Curve Scenario, 1976–Present



Consumer Discretionary Has Outperformed After Inversions

Consumer Discretionary NTM Average Relative Performance After All Inversions and After First Inversion, 1976–Present



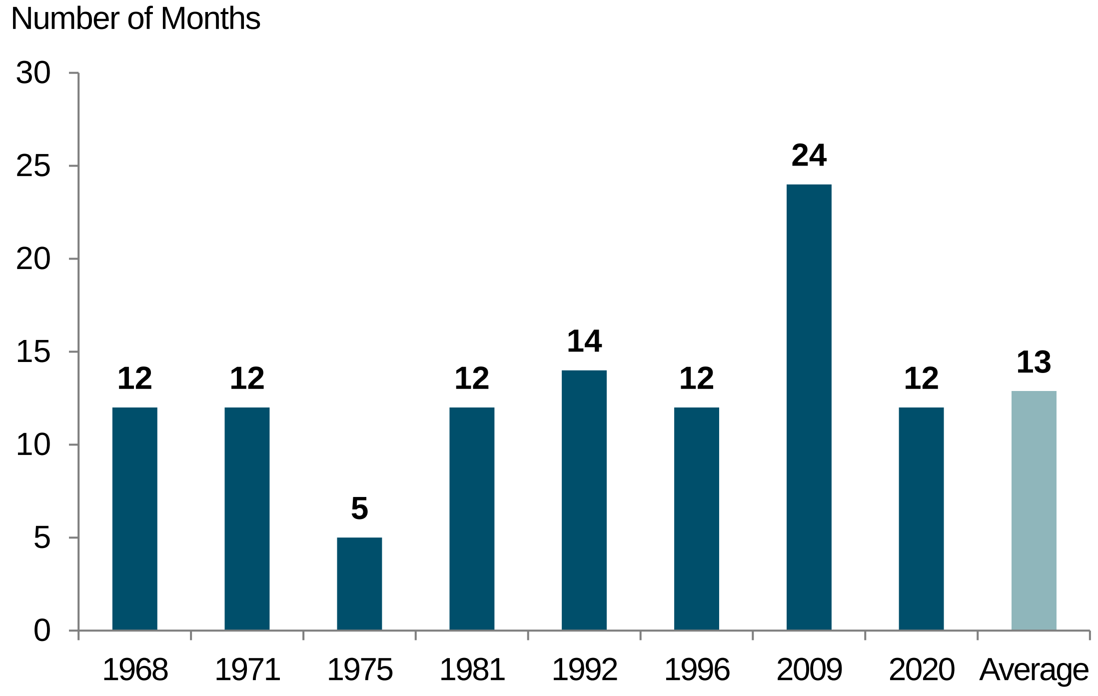
Past performance is no guarantee of future results. NTM: Next twelve months. Yield curve inversions defined as instances in which the yield on the 2-year Treasury exceeds the yield on the 10-year Treasury. Analysis based on the top 3,000 stocks by market capitalization. Source: Haver Analytics, FactSet, and Fidelity Investments, as of 8/31/22.

Discretionary Stocks Could Rebound Well Before Earnings Do

Consumer discretionary companies' earnings have suffered since February. Historically, the sector's earnings slumps have tended to last about a year, and its stocks have started recovering an average of nine months before then. Based on these precedents, discretionary may already have bottomed.

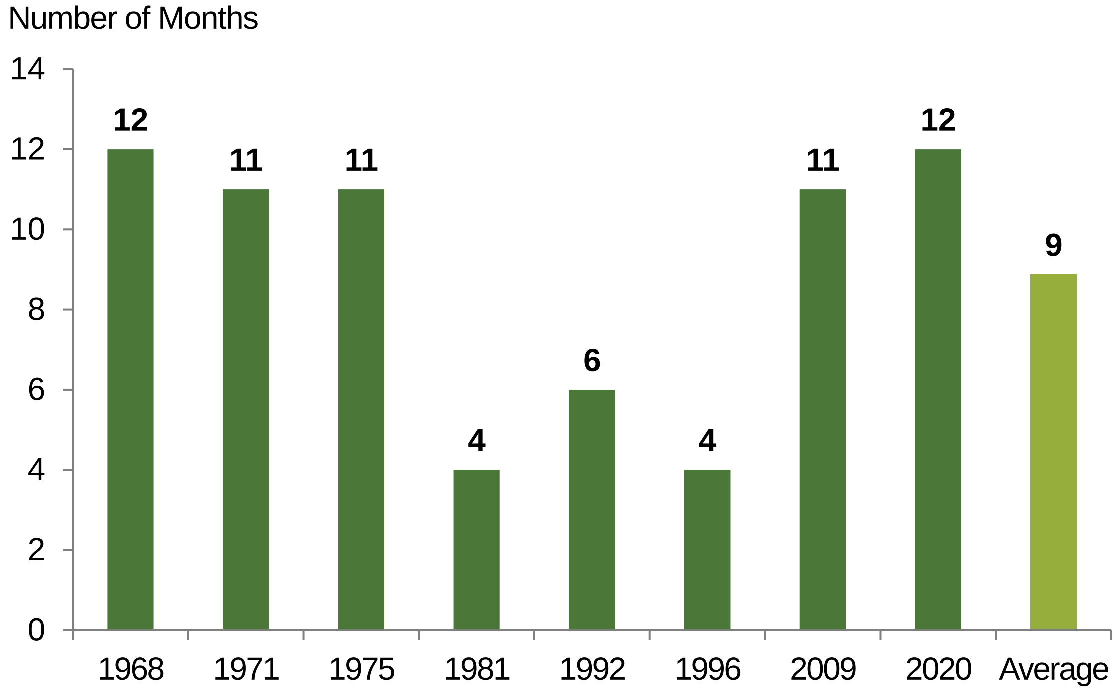
Consumer Discretionary Earnings Contractions Tend to Last About One Year

Duration of Consumer Discretionary Earnings Contractions in Months



Discretionary Stocks Have Rebounded Nine Months Before Earnings, on Average

Months Before EPS Troughs That Consumer Discretionary Stocks Started to Recover



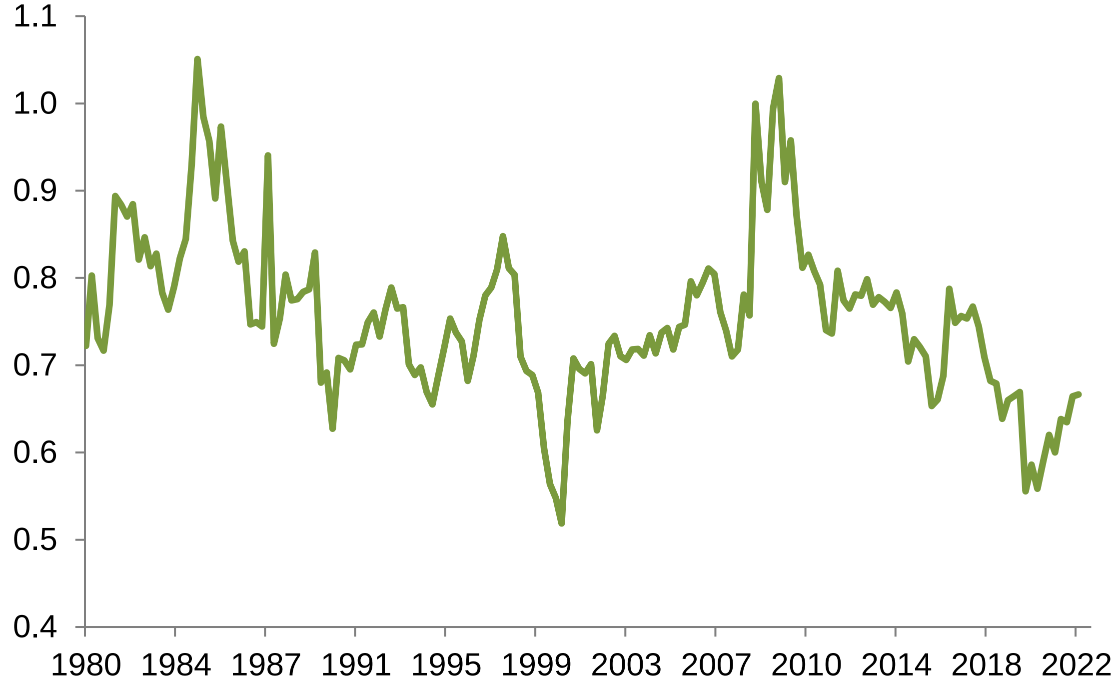
Past performance is no guarantee of future results. EPS: Earnings per share. Analysis based on the top 3,000 stocks by market capitalization. Source: Haver Analytics, FactSet, and Fidelity Investments, as of 8/31/22.

Cheap Financials Valuations May Present an Opportunity

Financials' relative valuations are extremely low versus their history. In the past, the cheaper the sector's valuation compared with the rest of the market, the better its average relative performance the following year. When financials have been in their cheapest quartile, they've outperformed the market by 5% over the next 12 months, on average.

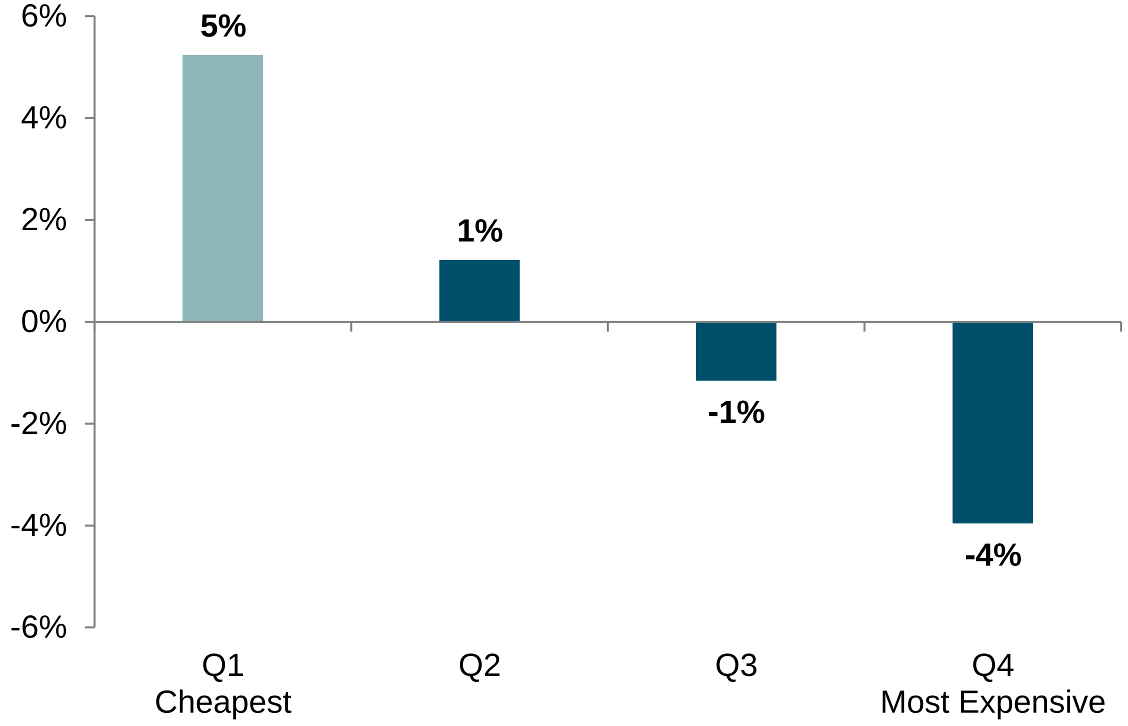
Financials Are Cheap Relative to the Market

Financials Relative Forward P/E



Outperformance Has Followed Low Valuations, Historically

Average NTM Relative Performance in by Relative Fwd P/E Quartile



Past performance is no guarantee of future results. Historical data from 1986. Fwd P/E: Forward price-to-earnings. A forward P/E ratio typically uses an average of analysts' published earnings estimates for the next 12 months. Analysis based on top 3,000 stocks by market capitalization. Source: Haver Analytics, FactSet, and Fidelity Investments, as of 8/31/22.

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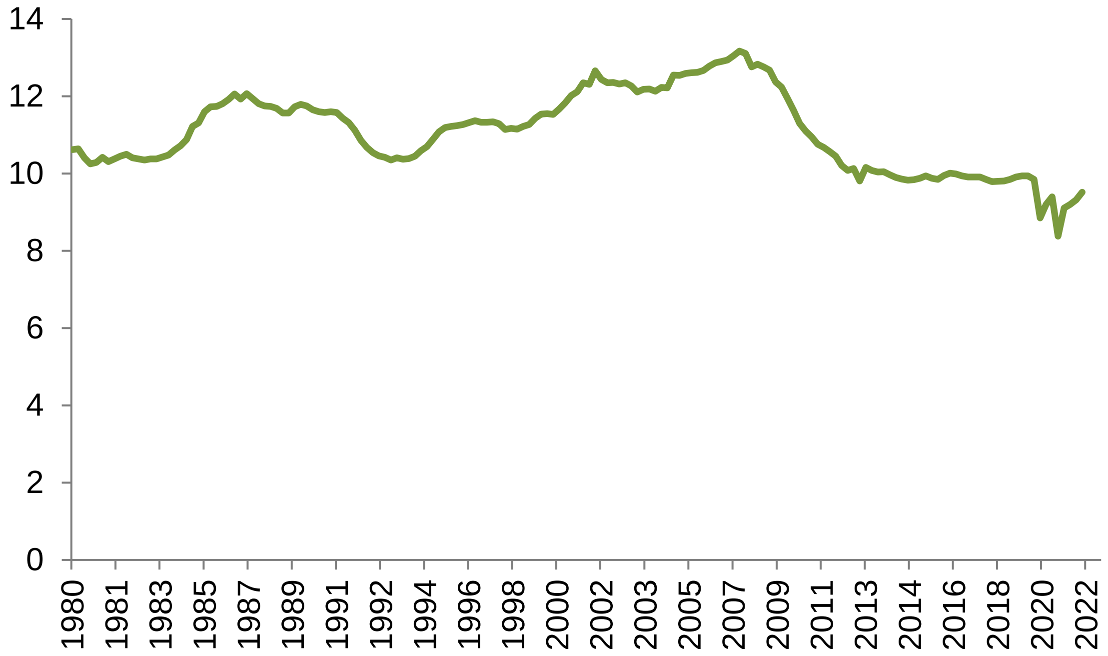
Financials Could Benefit from Low Debt Costs, Too

Household debt-service costs remain low; and during 12-month periods when this metric has been in the bottom half of its historical range, financials have outperformed about two-thirds of the time. Rising rates shouldn't balloon debt-service costs, which mainly consist of payments on fixed-rate mortgages.

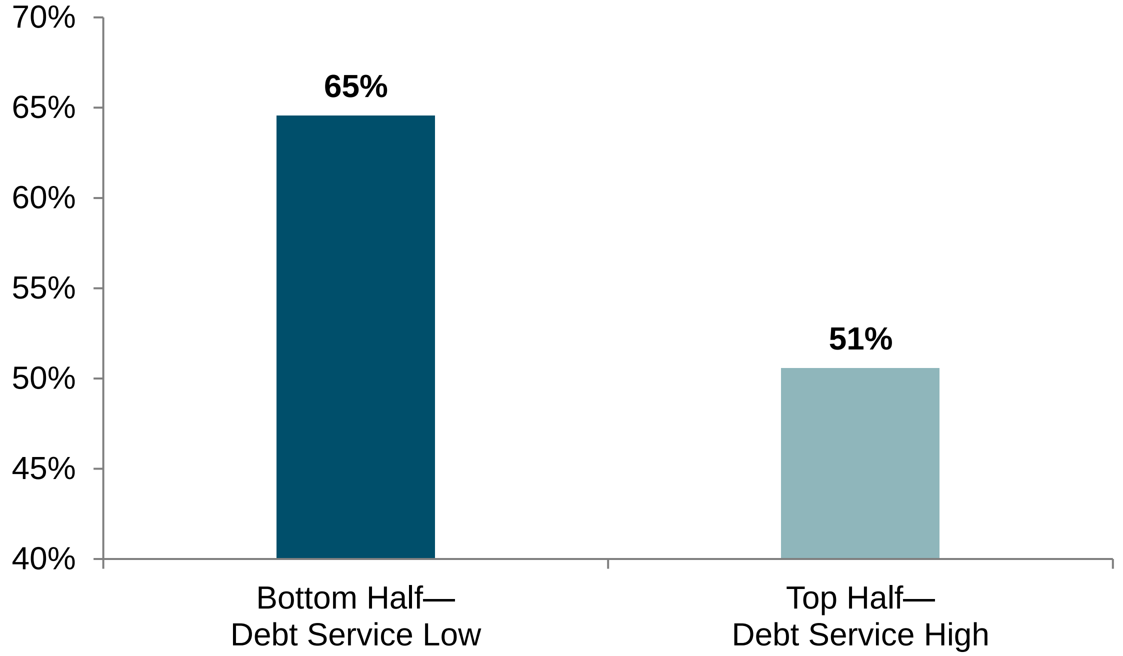
Households Have Low Debt Costs

Household Debt-Service Ratio as a % of Disposable Income



Financials Usually Outperform When Debt Service Is Low

Historical Odds of Financials Outperformance in Top- and Bottom-Half of Debt Service Historical Range, Rolling 12-Month Periods



Past performance is no guarantee of future results. Sector analysis based on the top 3,000 U.S. stocks by market capitalization. Source: Haver Analytics, FactSet, and Fidelity Investments, as of 8/31/22.

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Glossary and Methodology

Glossary

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.

Enterprise Value: A measure of a company's total value that includes its market capitalization as well as short- and long-term debt and cash on its balance sheet.

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 Margin: The amount of free cash flow as a percentage of revenue. High FCF margin often denotes strong profitability.

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 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 months.

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

Strategist View: Our sector strategist, Denise Chisholm, tracks key indicators that have influenced the historical likelihood of outperformance of each sector. This historical probability analysis informs the Strategist Views.

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 models 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 of 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: 37%; P/B: 21%; P/S: 21%; and FCF yield: 21%. However, the financials and real estate sectors are weighted as follows: P/E: 65% and P/B: 35%.

Appendix

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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.

Index Definitions: The Russell 3000® Index is a market capitalization-weighted index designed to measure the performance of the 3,000 largest companies in the U.S. equity market.

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 indexes include the standard GICS sectors that make up the S&P 500 index. The market capitalization of all S&P 500 sector indexes together comprises 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.

The S&P CoreLogic Case-Shiller U.S. National Home Price Index is a composite of single-family home price indices for the nine U.S. Census divisions and is calculated monthly. It is included in the S&P CoreLogic Case-Shiller Home Price Index Series, which seeks to measure changes in the total value of all existing single-family housing stock.

Appendix

Sectors are defined as follows: **Communication Services:** companies that facilitate communication or provide access to entertainment content and other information through various types of media. **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 and development companies. **Technology:** companies in technology software and services and technology hardware and equipment. **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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