Paul Baiocchi, Director of Sector Investment Strategy, Fidelity Investments

Paul Baiocchi: Hi, I'm Paul Baiocchi. The fourth quarter of 2016 was certainly an eventful one for investors. So let's take a look at how the presidential election and rising interest rates affected the broad stock market in Q4. I'll also discuss how the new administration's policy proposals could potentially affect specific equity sectors.

First, though, let's review how the overall sector universe performed during the fourth quarter. There are many ways to evaluate sectors. In our Quarterly Sector Scorecard, we focus on five metrics based on investment time horizon: business cycle, fundamentals, relative valuations, momentum, and relative strength.

Scorecard: Industrials, Tech, Financials Among the Positives

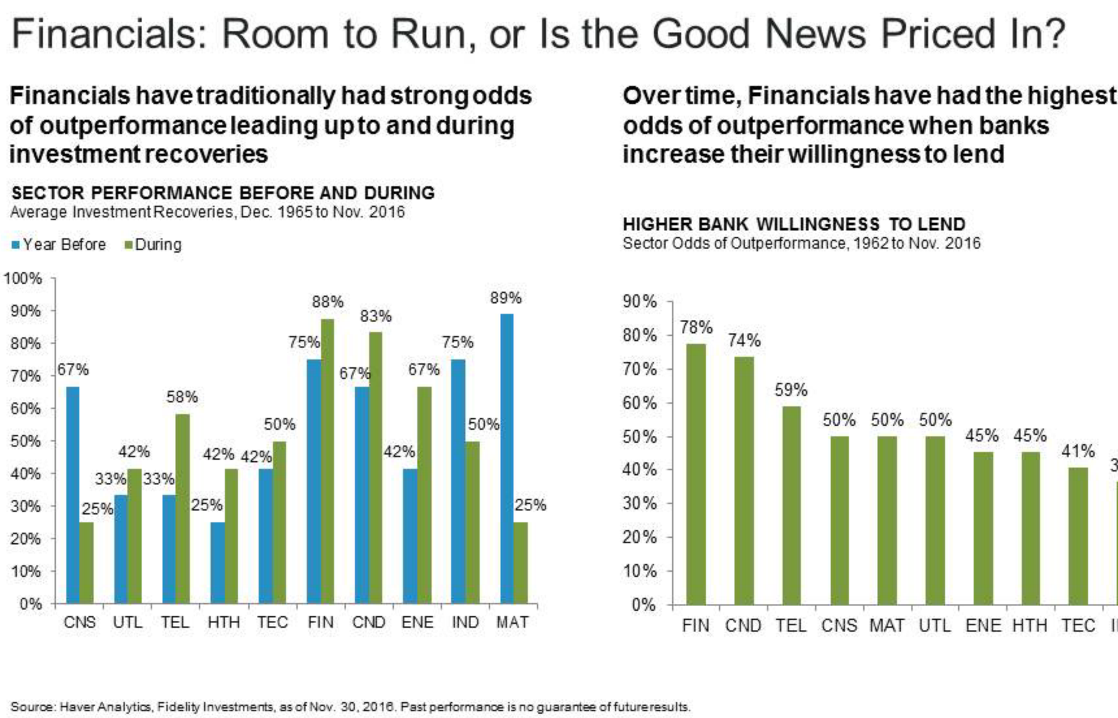
	Longer	Time Horizon View			Shorter		Performance as of 12/31/16		
Sector	Business Cycle	Fundamentals	Relative Valuations	Momentum	Relative Strength	Weight in S&P 500® Index	Latest Quarter	Year to Date	Dividend Yield
Consumer Discretionary		+				12.0%	2.3%	6.0%	1.5
Consumer Staples				–		9.4%	-2.0%	5.4%	2.7
Energy		–	–	+		7.6%	7.3%	27.4%	2.6
Financials		–		+	+	14.8%	21.1%	22.8%	1.6
Health Care		+	+	–		13.6%	-4.0%	-2.7%	1.7
Industrials	+		–	+	+	10.3%	7.2%	18.9%	2.1
Technology	+				+	20.8%	1.2%	13.8%	1.5
Materials	–		–			2.8%	4.7%	16.7%	2.1
Telecom		+	+		–	2.7%	-4.4%	3.4%	4.4
Real Estate			+	–	–	2.9%	4.8%	23.5%	3.3
Utilities	–	–			–	3.2%	0.1%	16.3%	3.5
						S&P 500® Returns	3.8%	12.0%	2.0

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 Dec. 31, 2016.

The U.S. stock market, as measured by the S&P 500, gained nearly 4% in Q4. For 2016 overall, stocks rose 12%—their 8th straight year of positive calendar-year returns. Much of the market's advance was driven by optimism about the new administration's pro-growth policy initiatives—such as corporate tax reform and financial deregulation.

Against this backdrop, eight of the 11 sectors had positive returns in Q4, and all but one were up for the year overall. Cyclical sectors did much better than defensive stocks amid the growth-oriented environment. The Financials sector jumped 21% in the fourth quarter alone, roughly three times better than the next-highest sector return. Bank stocks were especially strong, driven by higher interest rates and the potential for a less-restrictive regulatory backdrop. Energy and Industrials stocks also did well, as oil prices rose and expectations for capital expenditures perked up. The defensive sectors—Telecom, Health Care, and Consumer Staples—had negative returns in Q4 as investors flocked to more economically sensitive segments of the market.

Turning to the Sector Scorecard, Industrials now has three positive metrics after gaining considerable momentum in Q4. Technology and Consumer Discretionary had no negative metrics, while relative strength and momentum accelerated for Financials. Meanwhile, recent market leadership for Utilities, Materials, and Consumer Staples ended the quarter with no positive metrics.

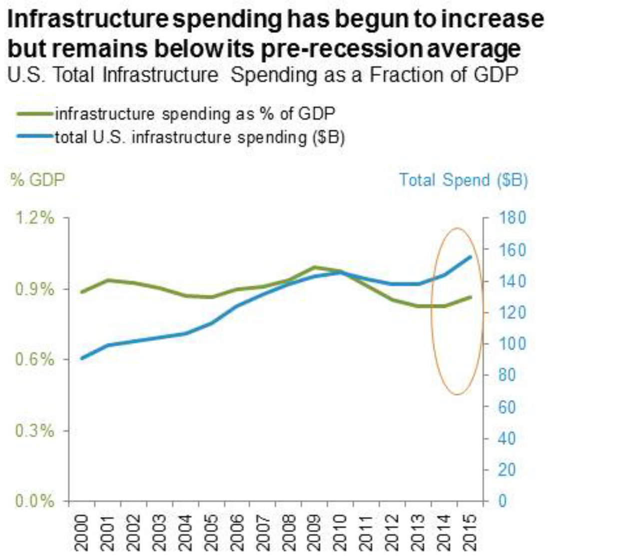


Let’s take a closer look at the rally in Financials. Through the first three quarters of 2016, the sector had gained roughly 1%. But by the end of the fourth quarter, Financials ended 2016 with a gain of almost 23%. Relative to other sectors, Financials received the largest boost from the results of the November election and December’s interest-rate hike. But can this rally continue?

Here are two reasons why it may. Historically, during investment recoveries, which we may be seeing now, Financials have had high odds of outperforming the broad stock market, both in the year prior to the recovery and in the year itself, as shown in this chart. So, if an investment recovery is truly under way, it's likely to be in the early stages with more room to run.

Second, if financial deregulation occurs, banks would likely be more willing to lend. Historically, that's led to higher loan growth and strong odds of outperformance for Financials over time. Remember, though, none of the new administration's policies have been enacted, and it's too soon to guarantee when, or if, they ever will. So keep that in mind in your investment decision-making process.

Sectors Poised to Benefit from an Infrastructure Boom



Source: Bloomberg Finance L.P., U.S. Bureau of Economic Analysis, Fidelity Investments, as of Nov. 1, 2016.

The Industrials and Materials sectors may also benefit from the Trump administration's proposals. One of the president elect's campaign promises was to rebuild America's infrastructure. Increased investment in infrastructure, in both the U.S. and China, may benefit companies exposed to non-residential construction—machinery companies in particular, but also a wide range of other industries.

A broad range of companies in the Industrials and Materials sectors may see a boost in revenue, with machinery companies among those at the top of the list. Road and rail, large conglomerates, electrical equipment, and construction and engineering companies may also benefit. Additionally, the Chinese government may continue to increase stimulus for infrastructure growth as a way to bolster its overall economy. Infrastructure spending in China has been growing steadily over the past few years, and accelerating growth there could benefit companies with global exposure to new construction, such as large machinery makers and international conglomerates.

For more information about our views and current themes in sector investing, please see our complete Quarterly Sector Update. Thank you.

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Generally, among asset classes, stocks are more volatile than bonds or short-term instruments and can decline significantly in response to adverse issuer, political, regulatory, market, or economic developments.

Foreign investments involve greater risks than U.S. investments, and can decline significantly in response to adverse issuer, political, regulatory, market, and economic risks. Any fixed income security sold or redeemed prior to maturity may be subject to loss.

In general, the bond market is volatile, and fixed income securities carry interest rate risk. (As interest rates rise, bond prices usually fall, and vice versa. This effect is usually more pronounced for longer-term securities). Fixed income securities also carry inflation risk, liquidity risk, call risk, and credit and default risks for both issuers and counterparties. Lower-quality fixed income securities involve greater risk of default or price changes due to potential changes in the credit quality of the issuer.

It is not possible to invest directly in an index. All indices are unmanaged.

Index Definitions

BofA ML High Yield Bond Index is an unmanaged index that tracks the performance of below-investment-grade, U.S. dollar-denominated corporate bonds publicly issued in the U.S. domestic market.

Barclays Long U.S. Government Credit Index includes all publicly issued U.S. government and corporate securities that have a remaining maturity of 10 or more years, are rated investment grade, and have $250 million or more of outstanding face value.

Barclays U.S. Aggregate Bond Index is a broad-based, market-value-weighted benchmark that measures the performance of the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market.

Barclays U.S. Credit Bond Index is a market value-weighted index of investment-grade corporate fixed-rate debt issues with maturities of one year or more.

Bloomberg Commodity Index measures the performance of the commodities market. It consists of exchange-traded futures contracts on physical commodities that are weighted to account for the economic significance and market liquidity of each commodity.

FTSE National Association of Real Estate Investment Trusts (NAREIT) All REITs Index is a market capitalization-weighted index that is designed to measure the performance of all tax-qualified REITs listed on the NYSE, the American Stock Exchange, or the NASDAQ National Market List.

JPM EMBI Global Index, and its country sub-indices, tracks total returns for traded external debt instruments issued by emerging-market sovereign and quasi-sovereign entities.

MSCI Emerging Markets (EM) Index is a market capitalization-weighted index that is designed to measure the investable equity market performance for global investors in emerging markets.

MSCI Europe, Australasia, Far East Index (EAFE) is a market capitalization-weighted index that is designed to measure the investable equity market performance for global investors in developed markets, excluding the U.S. and Canada.

MSCI EAFE Small Cap Index is a market capitalization-weighted index that is designed to measure the investable equity market performance of small cap stocks for global investors in developed markets, excluding the U.S. and Canada.

Russell 2000 Index is a market capitalization-weighted index designed to measure the performance of the small-cap segment of the U.S. equity market. It includes approximately 2,000 of the smallest securities in the Russell 3000 Index.

Russell Midcap Index is a market capitalization-weighted index designed to measure the performance of the mid-cap segment of the U.S. equity market. It contains approximately 800 of the smallest securities in the Russell 1000 Index.

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.

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