

Investing ideas for 2014

Unwrap some of the top themes that we believe are worth considering now.

What a whirlwind year this has been for investors! Stocks posted one of their best years ever, as the S&P 500® Index set new all-time highs by gaining roughly 30% on a total-return basis, as of mid-December 2013. When all is said and done, this year's gains could outpace those made in 1999—when the dot-com craze was in full swing.

While every sector of the market is on pace to finish well in the green, consumer discretionary stocks spearheaded the rally once again, along with financials and health care.

Will momentum continue for stocks in the new year? If it does, which industries might lead?

There may be a number of potential opportunities, including those created by the ongoing recovery in the U.S. housing and nonresidential construction markets. This dynamic could provide growth opportunities for home improvement, furnishings, media, engineering and construction, electrical equipment, and machinery companies. Elsewhere, the growth in electronic payment systems, energy efficiency, and mobile instant messaging represents other ideas to consider.

Of course, there are risks to take into account. Chief among them are potential market disruptions derived from U.S. fiscal and monetary policy, and adverse developments in important emerging markets, including China and Latin America.

Read on to see the opportunities our sector experts have identified for 2014.

1. Technology stocks: mobile instant messaging

2013 was a relatively up-and-down year for technology. Yet there's a lot to be excited about in this group going forward, according to Charlie Chai, manager of the **Fidelity® Select Technology Portfolio**

Mobile instant messaging, for example, is one area that has experienced a lot of growth, particularly in Asia, but that still could be a significant opportunity for tech companies that are in a position to capitalize on this trend, says Chai.

And while cloud computing may seem like a familiar investing theme, Chai believes we may still be in the early phase of this unfolding growth story. Companies that run public cloud resources may gain a lot of new revenue over the next few years, as the number of computing workloads running in the public cloud is expected to grow, and IT services companies that can help migrate functions to the cloud are likely to benefit.

2. Financial stocks: banks, insurers, electronic payment systems

The banking industry continues to undergo transformation, spurred by regulatory and technological changes. At the same time, historically low interest rates may begin to rise in 2014.

Christopher Lee, manager of the **Fidelity® Select Financial Services Portfolio**, thinks rising rates may have a positive impact on banks' net interest margins (the difference between the rate banks charge when they lend out capital and the interest rate they pay on deposits). Higher rates also tend to benefit life insurance companies.

Additionally, Lee thinks the general migration away from cash toward non-cash, electronic payment mechanisms could help the general flow of goods and, as a result, financial firms that process payments via electronic funds transfer (EFT).

3. Consumer discretionary stocks: housing, furnishings, media

Over the past several years, the U.S. housing market has recovered substantially from recession levels in terms of sales and median prices. As of the beginning of October, U.S. home prices had risen 12.1% from the previous year, continuing to fuel growth in household net worth—a positive dynamic for consumer discretionary spending.¹ This development, coupled with stabilizing economies in Europe and an expanding global middle class, could produce both short-term and long-term opportunities to invest in consumer discretionary stocks.

Gordon Scott, manager of the **Fidelity® Select Consumer Discretionary Portfolio**, thinks home improvement centers, home furnishing producers, and home media companies could all benefit.

4. Consumer staples stocks: multinationals

Growing middle-class populations and rising wealth in emerging market countries have resulted in millions (potentially billions) of people who are now able to purchase products made by consumer staples companies—such as toothpaste, toilet paper, and shampoo—on a more regular basis.

The capital costs of launching into a new foreign market can be significant. But during the past several years, many large companies have strategically built manufacturing and distribution operations in emerging markets. Robert Lee, manager of the **Fidelity® Select Consumer Staples Portfolio**, thinks that such multinationals might be optimally positioned to benefit from the rise of the global consumer.

5. Energy stocks: exploration and production

The oil and gas revolution taking place in North America has set the stage for a total remake of the global energy market. Much has been made of forecasts for the United States to become the largest supplier of energy in the world by 2015, supplanting Saudi Arabia.

Yet prices may not come down commensurately with the expected increase in U.S. production, according to John Dowd, manager of the **Fidelity® Select Energy Portfolio**. He thinks a rewarding strategy might be to own the stocks of oil producers with operations in strategic commodity-rich regions where production costs are expected to decline the fastest. Among these regions are the Bakken, which is located primarily in North Dakota, Marcellus in the Appalachians, and Eagle Ford and Permian in Texas.

6. Health care stocks: health care technology and services

Many of the same forces that drove health care stocks higher this year may continue in 2014 and beyond, according to Eddie Yoon, manager of the **Fidelity® Select Health Care Portfolio**

Yoon believes innovation in biotechnology, specialty pharmaceutical, medical devices, and life sciences industries could result in these segments remaining top performers in the health care group. Additionally, he thinks there might be tailwinds created by mergers and acquisitions (M&A) among health care providers.

However, he has grown more cautious on biotech. He says that although he will continue to invest in large-cap biotech stocks, he has reduced exposure to small-caps, where he believes valuations are generally more expensive on a risk-adjusted basis compared with where they were earlier in 2013.

7. Industrials stocks: engineering and construction, electrical equipment

Industrials stocks could continue to see more support from the healthy pace of building underway. Residential housing (a source of strength in the U.S. economy right now) tends to lead nonresidential construction, which is also beginning to heat up. One key leading indicator of nonresidential activity is the Architecture Billings Index², which reached a six-year high earlier in the year. And even though residential housing has decelerated moderately in recent months, it remains in the recovery phase.

Tobias Welo, manager of the **Fidelity® Select Industrials Portfolio**, believes the U.S. construction industry will benefit from a strengthening residential and nonresidential market. In particular, he thinks engineering and construction companies, along with electrical equipment and machinery companies, are key areas to consider as beneficiaries of growth in nonresidential construction in particular. Machinery companies might power up off the demand by energy and chemical companies that are building up to capitalize on the wave of domestic natural gas and shale oil production.

8. Materials stocks: construction materials, containerboard

Big projects can be strong tailwinds for materials stocks. And the 2012 legislation known as MAP-21 was a really big one, with up to \$10 billion in loans for transportation infrastructure projects through 2014.³ Tobias Welo, manager of the **Fidelity® Select Materials Portfolio**, believes this program will greatly stimulate new construction.

In addition to public projects, stronger private construction is another key to the materials sector. Welo thinks a first-wave beneficiary of the housing recovery will be materials companies. In particular, gravel and concrete producers may be well-positioned to benefit from an increase in both residential and nonresidential construction.

Welo also thinks the containerboard business (a part of the paper and packaging industry) may continue to benefit from consolidation and pricing discipline.

9. Telecom stocks: cell phone tower operators, wireless and cable data providers

U.S. wireless carriers are now in a race to build out their 4G networks in an effort to handle the growing demand for wireless data and to compete on network quality. Consequently, capital expenditures rose significantly in 2013, and are likely to remain elevated or even rise further in 2014, says Matthew Drukker, manager of the **Fidelity® Select Telecommunications Portfolio**

Drukker believes U.S. companies operating cell phone towers stand to gain as wireless competition heads up. The national carriers need wider coverage and denser networks to upgrade their networks. Consequently, they need to lease additional space on more towers.

Meanwhile, he says European wireless providers may be entering a phase of industry consolidation and an improving regulatory environment, which could lead to higher profits. Certain companies may also be well positioned to expand into international regions, including Latin America, Africa, and Asia, where wireless growth opportunities exist.

10. Utilities stocks: natural gas infrastructure

Natural gas utilities are at the center of an ongoing natural gas infrastructure build-out, fueled by growing demand for clean energy and the abundant supply of natural gas. Douglas Simmons, manager of the **Fidelity® Select Utilities Portfolio** believes that capital investment by these utilities is a positive long-term growth trend for investors that will continue to play out in 2014 and beyond.

By building out new infrastructure to connect consumers to natural gas, utilities may be able to quickly recover their capital investment, which can lead to faster earnings and dividend growth. In fact, Simmons thinks the stocks of utilities that are involved in the build-out of natural gas infrastructure are a long-term trend that could play out in 2014 and beyond. These companies could generate the fastest earnings and dividend growth, and appear to be under appreciated by the broader investment community.

Before investing, consider the funds' investment objectives, risks, charges, and expenses. Contact Fidelity for a prospectus or, if available, a summary prospectus containing this information. Read it carefully.

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Indexes are unmanaged and you cannot invest directly in an index.

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Sectors and industries are defined by Global Industry Classification Standards (GICS®).

The consumer discretionary industries can be significantly affected by the performance of the overall economy, interest rates, competition, consumer confidence and spending, and changes in demographics and consumer tastes.

The consumer staples industries can be significantly affected by demographic and product trends, competitive pricing, food fads, marketing campaigns, environmental factors, government regulation, the performance of the overall economy, interest rates, and consumer confidence.

The financials industries are subject to extensive government regulation, can be subject to relatively rapid change due to increasingly blurred distinctions between service segments, and can be significantly affected by availability and cost of capital funds, changes in interest rates, the rate of corporate and consumer debt defaults, and price competition.

The health care industries are subject to government regulation and reimbursement rates, as well as government approval of products and services, which could have a significant effect on price and availability, and can be significantly affected by rapid obsolescence and patent expirations.

Industrials industries can be significantly affected by general economic trends, changes in consumer sentiment and spending, commodity prices, legislation, government regulation and spending, import controls, and worldwide competition, and can be subject to liability for environmental damage, depletion of resources, and mandated expenditures for safety and pollution control.

The technology industries can be significantly affected by obsolescence of existing technology, short product cycles, falling prices and profits, competition from new market entrants, and general economic condition.

The materials industries can be significantly affected by the level and volatility of commodity prices, the exchange value of the dollar, import controls, worldwide competition, liability for environmental damage, depletion of resources, and mandated expenditures for safety and pollution control.

The telecom services industries are subject to government regulation of rates of return and services that may be offered and can be significantly affected by intense competition.

The utilities industries can be significantly affected by government regulation, financing difficulties, supply and demand of services or fuel, and natural resource conservation.

Because of their narrow focus, investments in a single sector tend to be more volatile than investments that diversify across many sectors and companies.

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

Investment decisions should be based on an individual's own goals, time horizon, and tolerance for risk.

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

1. Source: Standard & Poor's Case-Shiller Home Price Index, as of September 30, 2013.

2. The Architecture Billings Index measures the demand for commercial and industrial buildings such as hotels, schools, hospitals, and shopping centers.

3. Source: U.S. Department of Transportation Website, "TIFIA Defined."

<http://www.fhwa.dot.gov/ipd/tifia/defined/index.htm>. Accessed October 28, 2013.

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