

# Views expressed at the September 21–23 Face to Face with Fidelity in Palos Verdes

## Key themes and summary

Speakers struck a cautious tone with respect to their near-term market outlook. Andrew Marchese and David Wolf explained that we are in a late-cycle market environment highlighted by slowing global growth and heightened volatility. However, even in this environment, Fidelity's portfolio managers are finding opportunities to position their funds for positive market movements. Many portfolio managers found opportunities in the aftermath of the Brexit vote; however, they noted that the market pullback was not pronounced enough to capitalize on any sizable price dislocations. Meanwhile, David Wolf has, in recent months, modestly reduced overall risk exposures in the portfolios he co-manages.

Many portfolio managers discussed the importance of mitigating downside risk. Positioning portfolios to mitigate losses in the short term leaves more capital to compound over the long term. Portfolio managers Steve MacMillan and Dan Dupont highlighted their low portfolio turnover rates, consistent with their longer-term investment time horizons. All spoke of the importance of being aware of inherent emotional biases that can cloud investment judgment and cause poor investment decisions.

The U.S. election was also a widely discussed topic; Andrew Marchese and Steve MacMillan discussed how political considerations don't factor into portfolio construction, and both believe firmly in the check-and-balance system in the U.S., which places limits on presidential power.

The presenters argued that the global investment landscape offers a good stock-picking environment for those with access to the depth and breadth of global research that Fidelity offers. Ramona Persaud discussed how global investing provides a larger investment opportunity set and the potential for enhanced returns with lower volatility. Steve MacMillan emphasized in particular the importance of the U.S. market as a strategic long-term allocation in Canadians' investment portfolios. He believes that the U.S. offers the largest investment opportunity set in the world.

## Views expressed at the September 21–23 Face to Face with Fidelity in Palos Verdes

### Andrew Marchese

*Chief Investment Officer and Portfolio Manager, Fidelity Canadian Disciplined Equity<sup>®</sup> Fund, Fidelity Canadian Equity Private Pool and Fidelity Concentrated Canadian Equity Private Pool*

- **Focusing on the basics:** Andrew's goal is to maximize compounded returns over time for investors through a consistent and repeatable investment process. To achieve best-in-class risk-adjusted returns over the long term, he focuses on the factors that drive investment returns: specifically, business growth, dividends and valuation expansion (or contraction).
- **Late-cycle environment:** Andrew noted that the current market cycle has lasted nearly eight years since bottoming in March 2009. He explained that market cycles rarely last more than ten years. We are seeing signs of anaemic growth globally, particularly in the U.S., characterized by a profit recession that he believes has been in place since October 2014. Since October 2014, corporate profits have been driven primarily by cost-cutting initiatives, not revenue growth. These factors combine to give Andrew the view that we are in a later stage of the market cycle.
- **Late-cycle leaders and laggards:** Andrew also spoke of the factors that have led the market year-to-date as further evidence that we are in a late-cycle environment. He explained that stocks exhibiting low fundamental quality factors such as high beta, high volatility, high EPS variability and low earnings quality have generally outperformed stocks exhibiting better fundamental quality factors, such as high return on invested capital, low price-to-earnings and high asset turnover.

### Steve MacMillan

*Portfolio Manager, Fidelity Small Cap America Fund, Fidelity American Equity Fund, Fidelity American Balanced Fund*

- **Behavioural biases:** Steve noted the importance of avoiding emotional decision-making, and emphasized that detached objectivity is the cornerstone of his investment process. He looks for companies that are attractively valued, exhibit low economic sensitivity and have recurring business models. Steve also explained that his sell discipline is just as important as his buy discipline, because avoiding a loss can be as important as making a gain.
- **Long-term return potential for the U.S.:** Steve believes U.S. stocks should continue to outperform over the long term. He believes an investment in U.S. stocks is not a short-term trade, and that it has a place in any diversified portfolio as a long-term strategic allocation.
- **Positioning:** Steve has found attractive investment opportunities in service-oriented companies, focusing on names with strong fundamentals, attractive valuations and management teams that can allocate capital efficiently.

## Views expressed at the September 21–23 Face to Face with Fidelity in Palos Verdes

### Dan Dupont

*Portfolio Manager, Fidelity Canadian Large Cap Fund, Fidelity NorthStar® Fund, Fidelity Monthly Income Fund, Fidelity Income Allocation Fund, Fidelity Concentrated Value Private Pool*

- **Investment approach:** Dan highlighted his bottom-up, fundamental approach to investing, which focuses on four key principles:
  - protecting capital
  - buying great companies
  - being infinitely patient on price
  - not predicting the unpredictable
- **Focus on downside risk mitigation:** Dan's core investment philosophy focuses on mitigating downside risk by investing in high-quality companies with stable business outlooks at low valuation multiples. This approach has historically led to material outperformance of his benchmark indexes over the long term. To achieve this, Dan buys companies with strong fundamentals, low economic sensitivity and predictable business models.
- **Valuations:** Dan believes current valuations remain elevated relative to historical levels, making it difficult to find good businesses trading at reasonable valuations. As a result, he has positioned his funds conservatively and stands ready to deploy cash if segments of the market pull back or opportunities arise that fit his investment criteria.

### Darren Lekkerkerker

*Portfolio Manager, Fidelity North American Equity Class, Fidelity Canadian Balanced Fund, Fidelity Global Natural Resources Fund*

- **Investment style and philosophy:** Darren aims to invest in great businesses with strong management teams and where valuations are reasonable. Some of the key qualities that he looks for in a company include a high return on invested capital, strong free cash-flow generation and a shareholder-oriented management that is able to allocate capital effectively.
- **Ownership mindset:** With a background in private equity, Darren aims to invest in great businesses with strong management teams, smart capital allocation policies and reasonable valuations. He views each investment as an ownership stake and aims to have a longer-term investment horizon.
- **Fidelity North American Equity Class:** The Fidelity North American Equity Class provides investors with access to Darren's expertise. This Fund offers the flexibility to explore the best ideas in North America while harnessing Darren's successful investment process. The Fund will generally invest between 40% to 90% in U.S. equities and up to 50% in Canadian equities. The fund also has the added flexibility to invest up to 20% outside of North America.

## Views expressed at the September 21–23 Face to Face with Fidelity in Palos Verdes

### Mark Schmehl

*Portfolio Manager, Fidelity Canadian Growth Company Fund and Fidelity Special Situations Fund*

- **Positive-change investing:** Mark's investment approach is aimed at identifying a positive change in company fundamentals. He looks to add value by focusing on uncovering investment opportunities where he believes that business conditions are improving.
- **Looking beyond the mainstream:** Mark tends to look for opportunities among stocks with high expectations and valuations, where outsized moves can often occur; examples include Shopify<sup>1</sup> and Kinaxis.<sup>1</sup> He also looks for stocks with low expectations and low valuations that have lagged, and that could outperform if something occurs to provide a positive catalyst, such as Blackberry<sup>1</sup> and Agnico Eagle Mines.<sup>1</sup> However, Mark tends to move quickly when fundamentals change or conviction weakens, noting that his sell discipline is a key component of risk management.
- **Machine intelligence:** Mark believes that new integrations of machine intelligence, or artificial intelligence, are creating interesting growth opportunities. He has invested in AcuityAds,<sup>1</sup> a company that provides digital marketing solutions powered by machine intelligence technology. In addition, he has leveraged the strength of Fidelity's research capabilities in the private equity space to make an investment in Waterloo, Ontario-based Thalmic Labs,<sup>2</sup> which has developed an armband that lets people control computers with gestures.

### Ramona Persaud

*Portfolio Manager, Fidelity Global Dividend Fund, Fidelity Global Monthly Income Fund*

- **The importance of dividend income:** Historically, reinvested dividends have enhanced total investment returns over time through compounding, and have materially outstripped returns without dividends.
- **Investment philosophy:** Value stocks generally outperform growth stocks over time, and investing in quality companies with good to improving fundamentals helps mitigate downside risk. Ramona believes that this combination of value and quality wins over time on a risk-adjusted basis.
- **Adding value by investing globally:** Ramona believes that there is a case to be made for investing globally, whereby one can achieve a good combination of yield and risk-adjusted returns. Since non-U.S. countries account for more than 75% of global gross domestic product (GDP), they provide a larger opportunity set for active portfolio management, particularly for those firms with a deep pool of research resources.

## Views expressed at the September 21–23 Face to Face with Fidelity in Palos Verdes

### David Wolf

*Portfolio Manager, Fidelity Canadian Asset Allocation Fund, Fidelity Canadian Balanced Fund, Fidelity Monthly Income Suite of Funds, Fidelity Income Allocation Fund, Fidelity Managed Portfolios, Fidelity Asset Allocation Private Pools, Fidelity American Balanced Fund, Fidelity Conservative Income Fund*

- **Active asset allocation and the strength of Fidelity's bottom-up security selection:** David highlighted two sources of potential outperformance in the funds that he co-manages with Geoff Stein, the first being bottom-up security selection by the underlying portfolio managers, and the second, their own active asset allocation decisions. He notes that this division of labour allows for two complementary alpha streams in the funds that he co-manages.
- **Taking a prudent approach:** David agreed with Andrew Marchese, noting that the economic cycles around the world are showing late-cycle signs. He noted that market movements are at the mercy of central banks globally and that policy makers are running out of tools to spur the economy. He also mentioned that the global economy seems to be entering a new era of de-globalization and nationalism, citing Brexit and the popularity of presidential nominee Donald Trump as examples. He is positioning the portfolios he manages defensively by reducing equities to a lower-than-benchmark weighting. Fixed-income allocations have also been reduced in favour of cash, due to the fact that low interest rates have reduced the relative risk/return attractiveness of bonds. The fixed-income component has also been diversified by adding inflation-protected securities, which are trading at attractive valuations and provide insurance against any unexpected rise in inflation.

### Alan Wilkinson

*Market Strategist Emeritus*

- **Slow-growth world:** Alan believes that the global economy is moving at a slow pace, with economic projections for most major economies continuing to be revised lower. Although unemployment levels in the U.S. have declined significantly and wage growth has modestly improved, disposable income levels have dropped, as rent and other expenses have outpaced wage growth.
- **China continues to slow:** Alan believes that the Chinese economy is growing much more slowly than the government is suggesting as the nation shifts to a service-oriented economy. Lower lending rates have had a positive impact on housing prices in China, with investors flocking to invest in hard assets.
- **Canada and the U.S.:** Alan notes that while Canada's economy remains fragile, energy has finally contributed to GDP growth. Housing-related industries continue to be the fastest area of growth, as a share of GDP; however, household debt-to-income levels in Canada are among the highest globally, leaving the nation vulnerable to an economic shock. Meanwhile, in the U.S., companies are reluctant to invest their capital amid waning demand, as indicated by an increase in inventory stockpiles.

## Views expressed at the September 21–23 Face to Face with Fidelity in Palos Verdes

<sup>1</sup> Was held in Fidelity Canadian Growth Company Fund and Fidelity Special Situations Fund, as at June 30, 2016. At the time of this presentation, the security may not be held by the Fund. Please see the most recent full holdings or top ten investments for more information on specific holdings as of the date of issue.

<sup>2</sup> Was held in Fidelity Special Situations Fund, as at June 30, 2016. At the time of this presentation, the security may not be held by the Fund. Please see the most recent full holdings or top ten investments for more information on specific holdings as of the date of issue.

As at September 23, 2016.

For advisor use only. No recipient is authorized to pass this communication on to any other person whatsoever or reproduce it by any means without the prior written consent of Fidelity. Read a fund's prospectus before investing. Mutual funds are not guaranteed; their values change frequently and past performance may not be repeated. Investors will pay management fees and expenses, may pay commissions or trailing commissions and may experience a gain or loss. The indicated rates of return are the historical annual compounded total returns including changes in unit value and the reinvestment of all distributions and do not take into account sales, redemption, distribution, optional charges or income taxes payable by any security holder that would have reduced returns. Views expressed regarding a particular company, security, industry or market sector are the views only of that individual as of the time expressed and do not necessarily represent the views of Fidelity or any other person in the Fidelity organization. Such views are subject to change at any time based upon markets and other conditions, and Fidelity disclaims any responsibility to update such views. These views may not be relied on as investment advice and, because investment decisions for a Fidelity Fund are based on numerous factors, may not be relied on as an indication of trading intent on behalf of any Fidelity Fund.

Certain statements in this commentary may contain forward-looking statements ("FLS") that are predictive in nature and may include words such as "expects," "anticipates," "intends," "plans," "believes," "estimates" and similar forward-looking expressions or negative versions thereof. FLS are based on current expectations and projections about future general economic, political and relevant market factors, such as interest, and assuming no changes to applicable tax or other laws or government regulation. Expectations and projections about future events are inherently subject to, among other things, risks and uncertainties, some of which may be unforeseeable and, accordingly, may prove to be incorrect at a future date. FLS are not guarantees of future performance, and actual events could differ materially from those expressed or implied in any FLS. A number of important factors can contribute to these digressions, including, but not limited to, general economic, political and market factors in North America and internationally, interest and foreign exchange rates, global equity and capital markets, business competition and catastrophic events. You should avoid placing any undue reliance on FLS. Further, there is no specific intention of updating any FLS, whether as a result of new information, future events or otherwise.

© 2016 Fidelity Investments Canada. All rights reserved. Third-party trademarks are the property of their respective owners. All other trademarks are the property of Fidelity Investments Canada.