

Point of view – Bob Swanson

A recessionary tale: Surviving and thriving in recessionary times

How to succeed in a recession: Resources make the difference

Bob Swanson, Portfolio Manager, Fidelity Canadian Asset Allocation Fund

Bob Swanson has over 25 years of investment industry experience. He joined Fidelity's Team Canada ten years ago as an institutional portfolio manager and now leads the Canadian Asset Allocation Team, responsible for the tactical allocation of \$14.7 billion of balanced funds.* He also manages the equity portfolio of Fidelity Canadian Asset Allocation Fund and the Fidelity Canadian Equity Private Pool.

Q: Fidelity Canadian Asset Allocation Fund is celebrating its 15th anniversary with better returns than the TSX and only 61% of the volatility. Essentially, it's providing equity-like returns but with balanced fund-like risk. What would you say is the single biggest factor behind that long-term success?

A: Conditions have changed over the past 15 years, of course. But I'd say the real differentiator is the depth and breadth of the resources at Fidelity. They are really unparalleled. I'm constantly receiving insight from nearly 1,000 in-house experts that enables me to make better choices for our clients.

That expertise also means I can invest in many different asset classes globally, and I take full advantage of that, adding convertible bonds or high-yield bonds, or emerging market equities or U.S. large-cap growth when valuations are compelling.

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My clients tell me that this portfolio is a core holding for them. So having that information flow and these options allows me to create the risk/return profile they need, under any type of market conditions.

Q: How do these resources fit into your investment process?

A: When I assumed the responsibility for Fidelity's asset allocation funds, I wanted to cast as wide a web around the Fidelity network as I could, to make sure all that information and expertise could be part of our decision-making process. We meet monthly to look at all those inputs. That includes material from the 23 portfolio managers and analysts on Team Canada, of course, but it goes way beyond that. We've got managers around the world and global sector teams that provide insight. We've got teams that have travelled to China almost every month for the last couple of years. All of that information and insight is captured and goes into our own decision-making process. It's fundamental research and analysis, which is the basis of Fidelity's investment philosophy. But sometimes the market doesn't focus on fundamentals. So we also get quantitative and technical inputs, to give us the complete picture.

* Includes all series and classes of Fidelity Canada Asset Allocation Fund, Fidelity Dividend Fund, Fidelity Monthly Income Fund and Fidelity Monthly High Income Fund as at December 31, 2009.

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Q: We've just come through one of the worst crashes ever. Yet both of Fidelity's flagship balanced funds – Fidelity Canadian Asset Allocation Fund and Fidelity Canadian Balanced Fund – have outperformed the S&P/TSX Composite from the peak of the market in the summer of 2008 to the end of 2009.* Are you saying that it was better information that made the difference?

A: It's not just the information, it's the analysis that comes with it. The hardest thing we've had to do in the last two years is to make decisions: "Should we get out of stocks? Should we buy into corporate bonds? Or high-yield bonds? Oh my God, now the market's rallying. Do I need to be getting back into stocks?" There's so much information; I wouldn't know what to do with it all. If I had to sit and make these decisions by myself, I would have been a deer in the headlights. But there's so much help available – nearly 750 equity investment professionals, 175 fixed-income investment professionals and 45 high-income investment professionals around the world. So that makes decision-making a lot easier.**

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Q: With all this expertise available to you, did you have some sense that a major market crash was coming?

A: Absolutely. It allowed us to position ourselves much better.

In the summer of 2007, our credit teams were telling us there was a problem in the structured bond market. So much product was being created that investors were starting to reject it. Things were unravelling in the credit markets, and that was affecting the financial markets.

Our credit teams were doing their due diligence to make sure we weren't holding what could turn out to be bad credit. But meanwhile, for the asset allocation team, it was an indication that times were getting a little riskier. So we started to cut our equity exposure, and we went from about a 70% equity position to just over 52% at one point.

It was tough. You want to buy on the dips, but we had to recognize that something was wrong, because our counterparts around the world were telling us, "You know what? This time it's different. This looks much worse than previous experiences." So by the time the market started really selling off, we'd already taken shelter from the storm, with our cash up to 19% and our equity position much smaller.

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In 2008, our financial teams and our counterparty risk teams told us that financial institutions were probably going to get hit pretty hard. That was another indicator that we acted on, shifting out of banks and other major lenders.

Q: But avoiding the worst of the crash was only half the game.

A: Right. So now we're into the year-end. Markets are down 50%, peak to trough. And all of a sudden, asset classes around the world are beginning to look pretty interesting. And we're asking ourselves, "How can we profit from this? Which asset classes are most likely to bounce back?"

Speaking to our bond teams, it became clear that convertible bonds had been hardest hit. So they might also offer the greatest opportunity. We started to add to convertibles in December, and continued in January and February of 2009.

* The S&P TSX Composite Index hit its all-time high on June 18, 2009. From that date to December 31, 2009, the S&P TSX Composite Index returned -17.9%, Fidelity Canadian Asset Allocation Fund, Series B, returned -6.4% and Fidelity Canadian Balanced Fund, Series B, returned -5.8%.

** Source: Fidelity Management and Research Company, Pyramis Global Advisors and FIC as at December 31, 2009. Data are unaudited. The investment professional figures reflect the resources of FMR Co. LLC, a U.S. company, and its subsidiaries, and the resources of Fidelity International Limited, a non-U.S. company and affiliate, and its subsidiaries.

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It turns out that of all the investments we made, it has been the best, outperforming stocks in the U.S. and Canada and high yield.

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At the same time, we also started to put money into high yield. At 20% spreads, everybody was assuming that bankruptcy rates were going to go to 12%, 15% or 20%, because the Great Depression was upon us, right? However, we've got a team of 28 high-income research analysts and associates managing \$60 billion of high-income assets, and they came to me and said, "Bob, these fears are overblown. You've got to start putting money in." If I'd had to make that decision on my own, forget it: it was too dangerous, too much risk. But having the fundamental background, expertise and knowledge of these teams urging me to move into action gave me the confidence I needed. We allocated to high yield, and it made 35% by mid-November. But without those resources backing me, I would never have made that decision.

Twenty-eight high-income analysts and associates were telling me, "Bob, these fears are overblown. You've got to start putting money in."

Once those decisions had been implemented, we started to get back into equities. Around the world, things were improving. At the companies we were interested in, business was getting a little better. The cost-cutting measures they'd implemented had had a dramatic effect on margins, and therefore profits. The mood among the CEOs we were meeting was beginning to improve. So we started to allocate money to equities.

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Then the markets ran up 40%, and the economic signs were starting to point to recovery. At that point, we had to start taking a little risk and have a fresh look at the balance of risk and return.

Q: What are some of the signposts you're looking for to indicate the recovery is really here to stay?

A: Housing got us into this mess: too much credit, too much leverage, higher prices, no equity in the deals, and that ultimately led to a messy collapse. So we have to keep an eye on that. Housing is improving, but it's not great. So it's still a cautionary flag.

Unemployment is another signpost, and the unemployment claims we see week to week are improving in the U.S. But with a U.S. unemployment rate at 10.2%, the highest since the early eighties, there are still some warning signs out there.

Consumer spending drives about 60% of the U.S. economy. Corporate profits have been tremendous, but this is a result of cost cutting and downsizing. And people don't like to spend money when they don't have a job. So they're cutting back, repaying debt, increasing the savings ratio – and all of this has a profound effect. So what we need to see is top-line growth, so that companies can start reinvesting and hiring again.

So until that happens, until the market is more balanced, we're going to continue to focus on the risk/return profile of the portfolio. That's what got us through the recession, and that's what will keep us going until the market stabilizes.

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