Eric Granat on SmartHedge™

Eric Granat, Portfolio Manager

Eric Granat: We believe that market drawdowns actually have two distinct phases.

The first phase is one that we all know very well. That's the phase where we see an abrupt and sometimes painful decline in equity market prices. And usually that's accompanied with a spike in implied volatility and a retreat in investor confidence.

The second part of the phase is the period in time where we see a stabilization in equity prices and actually equities begin to rebound.

We believe that it is critical to have a hedging solution to focus not only on the first phase and to reduce the depth and duration of market drawdowns, but also continually remains focused on positioning for superior upside capture once volatility begins to decline.

This is a new offering that seeks to provide capital appreciation with reduced exposure to drawdown risk and unwanted market volatility.

The fund is a hedged equity strategy, where we're using an actively managed rules-based put option deployment to reduce exposure to unwanted market volatility.

Because it's a replication strategy for the equities, let's focus on the defensive side of the mutual fund and how we hedge downside risk.

There are several unique features in our hedging methodology that we should review. The first that I'd like to emphasize is that we deployed an always-on, rules-based mechanism for defensive hedging. And this rules-based implementation is very important for us because it allows us to effectively eliminate market timing risk.

It is critical that we diversify our put options not only by expiration date, but also by strike price. And this allows the strategy to hedge a broader spectrum of market risks, both in timing and also in severity.

Our derivatives portfolio is rebalanced on a monthly basis. And frankly, in periods of elevated market volatility, the derivatives in the portfolio are rebalanced intra month. And this allows us to adapt the portfolio risk exposures to suit the current risk regime in the market today. So we work very hard to maintain that uniform defensiveness across time and across market environments.

Fidelity SmartHedge™ U.S. Equity Fund uses derivatives to implement a disciplined options-based strategy designed to provide downside risk mitigation. The strategy used by the Fund, while designed to offset or mitigate a decrease in the value of the Fund's investments, does not completely eliminate downside risk. Using an options-based strategy carries no guarantees, and options can expire worthless, meaning that the Fund can lose the entire amount of the premiums that are paid to purchase those options.

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