Fidelity Connects

The Path to Retirement with Fidelity ClearPath Portfolios

Ruthann Pritchard, Institutional Portfolio Manager

Bryan Borzykowski, Host

Voiceover: Hello and welcome to Fidelity Connects – a Fidelity Investments Canada podcast – connecting you to the world of investing and helping you stay ahead.

Today on the program, we welcome Institutional Portfolio Manager Ruthann Pritchard. She discusses why Fidelity ClearPath portfolio may be a right fit for investors and how it could provide a good investment mix.

She explains how ClearPath is a multi-asset portfolio that consists of 14 suites which help target investors' retirement, and their children's post-secondary education and future goals.

And in our current market environment, Ruthann notes ClearPath could provide a steady and value-based approach to your investments.

Ruthann also addresses other forces affecting the markets and what the ClearPath management team are looking at which includes inflation, labour issues including a slowdown in hiring and job cuts.

Today's podcast was recorded on February 2nd, 2023.

And please note, as this was originally presented as a webcast, you'll hear references to a few charts.

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Bryan Borzykowski: Ruthann, thank you for joining us.

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Ruthann Pritchard: Thanks for having me. With all of the market volatility and busy lives, we think ClearPath makes even more sense for advisors and their clients, so always happy to chat.

[00:02:05]

Bryan Borzykowski: Great. We'll get into how some of the volatility is impacting the work that you're doing but first, why don't we talk about ClearPath, just what is it? Make sure we all understand exactly what we're talking about.

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Ruthann Pritchard: No problem. At the highest level, it's a suite of 14 different funds managed by three portfolio managers and an investment team that collectively manage about a half a trillion dollars in target date assets. The portfolios themselves are professionally managed; they're fully diversified, and they gradually become more conservative as the investor ages. Within the portfolio itself, strategically, we hold ten different asset classes and actively we hold two more. So, globally diversified not only in equities, but also in fixed income.

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Bryan Borzykowski: You mentioned target date. Is ClearPath essentially … are they the same thing as target-date funds? Is there any difference or is it kind of in the same category?

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Ruthann Pritchard: It's the same category, but I think it's useful to kind of take a step back. Target-date funds have really been around since the mid-1990s and they were developed because plan sponsors, fiduciaries and consultants in the States were seeing that defined contribution investors really weren't giving themselves an asset allocation that was consistent with their retirement goals, shall we say. If you fast forward to today, about 90% of plan sponsors in the U.S. have adopted target-date funds for their plans in the U.S. The same trend is coming to Canada.

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On the advisor side, we really see them as a flexible tool for the practice. They can be used for retirement goals and other long-term goals like buying a cottage or even education saving. Between the fact that the asset allocation becomes more conservative over time, you can use them as a one-stop shop solution for all the assets of a client, or we've seen some advisors use it for some of the assets and then the advisor can put their own investment views around the core portfolio. Either way, the result is the same, you get more time back with your clients and you can spend it on fun things or things like financial planning or wealth management.

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Bryan Borzykowski: I think a lot of people think target date is simply for retirement, but you mentioned cottage, some other things. How do you use it? Retirement, is that still kind of the primary use, but are there other ways and other goals that you could save for with these kinds of funds?

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Ruthann Pritchard: Yeah, absolutely. They were designed for retirement and that's because that's probably the longest goal we have. If you think about saving for retirement, you might start when you start your career, so call it 25. You're going to save for 40 years, yes, we do work that long, and so at 65 when you retire you still have 25 to 30 years of spending. It's really important to start saving early because you have all that spending. But there are other long-term goals, like buying a cottage, like buying a car, like education saving for children. You can be really versatile with them and sort of put the client maybe where they are on their risk tolerance spectrum and then ClearPath does the rest. It rolls down and becomes more conservative and diversified as you get towards that goal, if that makes sense.

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Bryan Borzykowski: I wonder if you could talk a bit about kind of the trends in the advisor space a bit. It does seem these kinds of funds are becoming more popular. You mentioned it before, just freeing up some of the time for the advisors, but it's not just sort of freeing up time, the whole industry is shifting a little bit more to this holistic planning, not just investing. How does this kind of help advisors, maybe, and the industry, kind of move forward into something that's different based on current client needs?

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Ruthann Pritchard: I think it goes back to the market environment we're seeing today. Yes, you can use it for a variety of different things, and it can help you in your practice a bunch of different ways, but the bottom line is that markets are really volatile and putting clients in a professionally managed portfolio I think gives them some comfort that they're getting all the resources that Fidelity has to offer globally. As I said before, you can kind of use it as a core and then express your own investment views around it.

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Bryan Borzykowski: Great. So, you do find that in the practice sense, when advisors use these funds, they do have more time to kind of focus on client communication and all those sorts of things.

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Ruthann Pritchard: Yeah. I mean, we all invest in them because we want to get that professionally managed advice and give ourselves a little bit more time to manage the assets for others.

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Bryan Borzykowski: Right. Let's talk about how this actually works. Maybe explain kind of what goes into ClearPath, how do you actually create these, what is sort of the fundamentals of this product?

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Ruthann Pritchard: I think the first slide might be a good one to actually pull up. This is a pyramid that we use to sort of talk about how we generate investment return. It's probably the most important slide to remember because it's got all these different facets to it. At the bottom, you see research; it's the foundation of absolutely every decision we make, and every decision is rooted in research. The big part in the middle, that's the glide path and that's driving the biggest part of the return, so call it, 80 to 90% of the investment return. When we're creating it, we're using a very long-term horizon. The goal here is to create the most diversified and resilient portfolio possible. And then the blue cap on top is the other 10 to 20% and that comes from active management.

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There are a couple different components to active management. The first would be active asset allocation decisions that we make where we can overweight or underweight the different asset classes that are in the glide path based on where we see value. For these types of decisions, we're no longer using that really long-term horizon; we're using up to five year or more intermediate term horizon. The other part of active management is active security selection decisions and those are being made by the portfolio managers of all the different underlying funds. So, managers you know like Maxwell Lemieux and Will Danoff and Ramona Persaud. We have a lot of Fidelity's great managers.

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Bryan Borzykowski: The asset allocation in these funds, how does that look? You mentioned before there's a variety of different kinds of assets in this. Talk us through that.

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Ruthann Pritchard: First, there are kind of three pillars that we live by when we're developing the glide path. So, what our Canadian investor needs; who is it that we're designing these for and what risk did they face along each part or each phase of their life? Second is diversification; what are the asset classes that we believe will bring independent sources of risk and return to the portfolios; which ones are going to zig when others can zag? Lastly, the capital market views... what do we think we can get out of the capital markets in terms of risk and reward? So, if you want to bring up the second slide, I can take you a walk down the glide path.

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If we start on the left-hand side of the slide, we start the investors off with really high allocation to risk assets, at 92% equity. So, they're young; it allows them to help start building wealth in their financial assets. They really have a long career ahead of them and their wage growth, largely, should keep pace with inflation and they have that really long-time horizon that I mentioned before, so they have lots of time to recover from just about anything the markets can bring. But even here, we don't have them in 100% equity, we have them in 92% equity because we also believe in diversification. I talked about wage growth and their career and inflation, but what about deflation? If you have a prolonged period where you have low or negative investment returns, that's not going to help them develop that initial wealth that can then compound down the glide path. We also include an allocation to long-term bonds right at the top of the glide path because, historically, they've really helped out in deflationary environments.

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As you move to the right and somebody's getting a little bit older –call it mid-career– life is a little bit more complicated, so we start to diversify; bring more resiliency into the portfolio and then as you near retirement, so getting closer to that vertical line, you can see retirement on the horizon. Human capital is declining, probably at peak earnings, so we not only increase diversification, but we also start to introduce inflation protection. That's going to help preserve purchasing power, which becomes really even more important in retirement. At the point of retirement, we have 49% equity, probably pretty similar to everybody here for someone that's just retired, and we believe that a portfolio has to work really hard well into retirement to get that 30 years of spending. So, after retirement we continue to de-risk and diversify and provide even more inflation protection globally. That provides more stability. We have short-term bonds and cash. Then the 65-year-old, the 75 and the 85-year-old all have different needs, so it just makes more sense to continue to diversify. That's kind of the whole lifecycle.

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Bryan Borzykowski: How do you incorporate current market conditions? Inflation wasn't an issue really for the last decade and now it is, and bonds last year had their worst year on record and this year you can get a lot more income from them, so how do you adjust based on kind of what's happening and how maybe of the things that we've seen happen now impacted the current ClearPath portfolios?

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Ruthann Pritchard: If you go back to the pyramid, the big green part of that pyramid was the glide path or the strategic decisions. We don't update those very often; they do need to evolve, but they're not going to be updated very often. Then there's that little blue cap on top and that's where we can be a little bit more nimble and think about current market environment and express our views around an intermediate time horizon. To make those active decisions, we're following a value process. We're looking for asset classes that trade at a premium or a discount relative to our view of what fair value is. We call that inexpensive optionality, which means that in our view there's less downside risk to holding those asset classes relative to the potential reward of holding them. So, we believe that these kinds of dislocations or mispricing that can occur in the market are kind of for three different reasons.

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Number one, there are different regimes and cycles that exist in the markets over time. Number two, sometimes investors can overreact or underreact to different news that comes out in the market. Lastly, investors have different time horizons. Some are strategic, some are very tactical; some are day traders, and then there's us using an intermediate time horizon. So, that really gives us an opportunity to lean into those asset classes where we see value and lean away from asset classes where we don't think there is as much value.

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Bryan Borzykowski: Can you give us a real example of something that you have adjusted in terms of that active allocation over the last few months?

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Ruthann Pritchard: Absolutely. We want to bring up the third slide; it is our positioning today. At the highest level we are underweight U.S. equities, we are overweight emerging market equities and developed market international equities. We are underweight Canadian investment-grade bonds in global developed markets, sovereign bonds. And then we are overweight Canadian long-term government bonds. On this slide, anything pointing up is an overweight, anything underneath the axis is an underweight. We also have –I mentioned earlier– sometimes we use asset classes that we don't hold strategically, but we want to hold cyclically over that intermediate horizon. Commodities are a really good example of that. So, we do hold commodities and we did have an overweight in Canadian real return bond allocation earlier in the year.

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Bryan Borzykowski: Can I ask…? [indecipherable] emerging markets overweight, U.S. equity underweight, why do we see that?

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Ruthann Pritchard: When you're creating a multi-asset class portfolio there are really kind of four decisions or views that you have to express. One of them is equity beta; another is the U.S. dollar, then inflation and duration. All of those are very exciting topics these days, so let me take them one by one. The first would be equity beta. Right now, overall, for equity, we're fairly neutral equity beta. We believe that threading that needle for a soft landing is going to be pretty challenging. We see inventories rising; we see new orders dropping. Margins are hinting at sort of starting to decline, so we're in that camp that believes that later this year, early next year we may be heading into what, hopefully, is going to be a very mild recession. But then, if you look within the equity bucket... so we're neutral equities, but within equities, we are overweight non-U.S. equity assets, so both emerging markets and developed markets and underweight the U.S. That's because even with the drawdowns in the U.S., we still think that U.S. companies are expensive relative to history and relative to international markets.

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If you look at the CAPE, or the cyclically adjusted P/E, the U.S. is still above historical averages, whereas developed markets and emerging markets are catching up, but they are below historical averages. I think the market is warming to that same idea. So, if you look at the fourth quarter returns including January, international markets outperformed the U.S. handily. EAFE was up 22%; emerging markets were up 14. Canada did really well at almost 14, but the U.S. lagged. Still a healthy return of 10% but it did lag the rest of the world, which kind of leads you to the U.S. dollar.

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So, being underweight. U.S. equity means we're underweight U.S. companies and therefore underweight the U.S. dollar. Historically, in an inflationary environment the dollar goes down. Investors tend to go into places where there isn't inflation and they call that greener pastures. But in 2022, where there was huge global volatility and uncertainty, investors, I think, felt a little comforted by being in the U.S. and with the Fed hiking, in many cases they could get higher interest rates than they could find in their home markets. But now the market is entertaining that idea that growth really isn't going to be where they thought it might be and so the economy might be slowing and a recession ahead, so the dollar is coming down. That's why we're underweight the dollar.

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Bryan Borzykowski: On inflation, how do you view inflation today and kind of going to the future and how it impacts what you're doing in the portfolio?

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Ruthann Pritchard: In terms of positioning, I mentioned earlier that allocation to commodities, we don't hold it strategically. We're holding it over that active horizon. We put it on a couple of years ago because we felt the market was mispricing the potential for inflation coming and they've basically done really well for all of our investors. So, as that value has been realized, given the investment process that we use, that has led us to trim the position more recently. Early in the year I mentioned we had an overweight to Canadian real return bonds, but we've closed that. It's important to remember, though, that even though we closed that overweight, I mentioned earlier that strategically we hold an increasing allocation to Canadian real return bonds and global inflation-linked bonds. We feel like they offer a really important pay-off to help older investors retain their purchasing power.

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If you look at inflation data, yes, it seems to be slowing. Canada is now on pause. The U.S., apparently, has a little bit of a ways to go, but we think it's going to be really hard for either country to get to 2% quickly. So, looking at some of the individual components, housing is front and centre for everybody. Prices are falling; mortgage rates are up. A statistic I heard the other day, which is not going to be a surprise to anyone here, is that since the first quarter of 2022, mortgage payments on an $800,000 loan have risen 600 to $700 per month for a 5-year and $1,900 dollars a month for a 1- year. That's huge.

When you look at residential investment overall in Canada, it's off about 20% from a cyclical peak. All told, that's about 7% of the economy and a whole lot of jobs. But I will say with respect to housing, it is the middle of winter, so you expect all sorts of slowdown, and the spring housing market is going to be really important for both Canada and the U.S.

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Looking at labour, we think that's where the stickiness is really going to come. It's the bulk of CPI and there are a lot of competing forces that could really impact how we think about labour. The consumer is still pretty healthy. We may be seeing positive real wages for the first time in over a year. The stock market, at least for the moment, is rebounding, so everybody's still confident and they're still spending. I actually heard a funny data point not too long ago; there was a survey that concluded that, at least for millennials, the bloom may be off the travel rose because "they went to so many weddings in 2022 that they can't afford, and they don't want to get on an airplane in 2023." I thought that was telling.

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But labour... now you have their employers. Companies are signalling that there might be a hiring slowdown. There's some layoffs coming, and we've got some other soft forces that may keep labour tight. So, ageing demographics –which we all know about– that healthy consumer may not want to work as much and if you've got higher wages maybe you don't need that second job. Then there's the great resignation. Different lifestyle choices that people are making post-COVID and those with long COVID, and then all the offshoring, reshoring, all the different clean energy initiatives... all of those things can really change how we think about the labour market. So, overall, it's going to be sticky, in our view, but it is going to come down.

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Bryan Borzykowski: You said there were 14 funds. Are these all just sort of the target dates, so when I want to retire... they're different kinds? Maybe explain kind of the options that people have.

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Ruthann Pritchard: If you were going to save for retirement, you would pick the fund based on the year in which you think you're going to retire because that will give you the age-appropriate asset allocation on the glide path. Now, if you were going to use it for something else like education savings, the advisor might want to talk to the client about where they stand from a risk position and then place them on the glide path there, knowing that the whole portfolio is going to become more diversified and more conservative as time goes on towards funding that education goal.

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Bryan Borzykowski: Why would someone choose a ClearPath 2010 or 2015 now that those dates have passed? Can you pick ones that have passed, and why would you do that?

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Ruthann Pritchard: Absolutely. If you think about retirement, somebody may have chosen this fund years ago because they were going to retire in 2015. And because, we hope, life doesn't end in 2015 they still have to keep on a glide path that's consistent with their time horizon and their planning horizon. So, being in the 2015 fund simply means you're probably retired, and you still need to have that asset allocation continue working hard for you, but appropriately for you while you're in retirement.

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Bryan Borzykowski: Generally, you would talk to your advisor; you'd have your plan. You'd say "this is kind of when I want to retire"; you pick that fund and you just leave it.

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Ruthann Pritchard: Exactly. That's the beauty of it, right? You can set it and forget it. We don't set it and forget it. We have to work hard to make sure we've got the right portfolio at all ages. But those investors that are in the portfolios can walk away because 90% of the time investors in the funds don't have the will, skill or time to do all this investment management. They just don't want to do it and they don't know anything about it, and they'd rather go and do something else than spend the time to learn. From an advisor standpoint, you've got the skill, you've got the will, but you'd rather spend your time doing something else with your clients and helping them in other ways and let ClearPath do the work.

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Bryan Borzykowski: There's also something about… in times of volatility when people get nervous and sell, which is… lots of research show that investors do that. But I'm sure, you know, advisors also … they're and we're human and it's emotional that feel like they want to get their hands in a portfolio when there's volatility. How does this maybe help keep things on track where it takes that emotions out of the investing?

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Ruthann Pritchard: I think you get comfort knowing that it's professionally managed, backed by a firm like Fidelity. Really importantly, we have 22 million participants on our recordkeeping platform in the U.S., so we have real time data into what they're doing. Even in the high volatility that we've seen over the last year, 0.3% of people that held the target date fund as their only allocation in their defined contribution plan, actually moved their money. That gives us confidence that we're doing the right thing; investors are staying the course and when you look at data in Canada, it's the exact same thing.

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Bryan Borzykowski: Can you elaborate more about ClearPath income?

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Ruthann Pritchard: The ClearPath income fund is designed for somebody who's really old, so probably 20 years past retirement, in their mid-80s. That's a little bit different from some other target date funds that you see in Canada where the income fund is what people go into when they retire. But that's kind of the whole point of ClearPath is that age-appropriate asset allocation and recognizing the time horizon of somebody that has just retired means you need to continue to de-risk and diversify because the 65-year-old, 75 and 85-year-old are not the same in terms of what they need and the stability in the portfolio that you want to provide for them.

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Bryan Borzykowski: We've got another question. How has the rebalancing of the ClearPath funds been impacted by the current high inflation and interest rate environment?

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Ruthann Pritchard: That goes back to kind of where we are in terms of how we generate return, that pyramid. The big green part is strategic and we're building that so that we can have a resilient portfolio against any of these different types of market's environment. And then, where we express those kind of views that... I won't call it rebalancing, but I'll call it actively managed, are in that blue cap. So, you've got the underlying securities selectors that are picking securities and credits that they believe in the market environment they're investing in are going to help them beat their benchmark. Then we're trying to select those asset classes that we believe in the current inflationary environment or the environment that we see coming up over –call it, a 5-year horizon– are going to help us beat our benchmark and do the best we can for investors.

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Bryan Borzykowski: Just on maybe the active part of this... a quick question that I have is, how often do you meet and discuss? Is this a daily thing? If you want to keep it generally on this path, you're not making big changes like maybe other portfolio managers might in different funds. How often are you making those asset allocation decisions?

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Ruthann Pritchard: I won't say we move it tactically; that's not what we believe the investors in ClearPath want us to do, and it's also not where our strength lies. So, we use that intermediate horizon. But that doesn't mean that we're not talking every day. One fun thing that we do is set up challenge and debate. We'll have a group of us as investors take one side of the coin, like why should we be overweight emerging markets equity, and then we have the other side saying, why should we be underweight emerging market equities? That sets us up for having a great discussion where we can really affirm our views and make sure that we're heading in the right direction.

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Bryan Borzykowski: One more question from an advisor before we wrap up. They have an example; a client is looking to retire in 35 years and is investing with a growth strategy. If they choose the ClearPath 2060, at what point would it tip towards a conservative style versus growth?

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Ruthann Pritchard: Well, it's going to do it gradually. If you're in the 2060 fund, you've probably got 10-15 more years before we're going to start to de-risk the portfolio. What you want to do is ¬¬–about mid-career for this individual– recognize how things are changing; getting a little bit more complicated. You want to diversify for them and start bringing in different risk exposures for them to create that resiliency, if that helps.

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Bryan Borzykowski: There's also just maybe the difference between ClearPath and there's lots now of these all-in-one options that you/do have equities and fixed income all within ETFs, funds, and that's becoming more popular too. So, what is the difference between the two and maybe how they are they similar and how are they different?

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Ruthann Pritchard: I think the roll down is what makes it very different. That glide path is going to become more conservative and more diversified as someone ages. If you go into a 60/40 portfolio or a 70/30 portfolio, yes, you know exactly what your asset allocation is at any given time – or your allocation to equities is at any given time– but you also need to know when to get out and move to something else because you're ageing or you're getting closer to that goal that you actually invested in for in the first place. ClearPath allows you to just stay where you are and let us do the hard work.

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Bryan Borzykowski: We have 30 seconds left, maybe any last comments. Where do you see the interest in these kinds of portfolios going as the industry moves forward?

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Ruthann Pritchard: Just up. I mean, everywhere we go the interest in a fully diversified solution like this is just increasing. If you look specifically at defined contribution plans, it's exploding in Canada and within the advisor market, same thing. Everybody needs help in these markets and we're happy to help.

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Bryan Borzykowski: Great. We will leave it there. Looking forward to chatting again in the future but thank you so much for doing this today.

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Ruthann Pritchard: Thank you.

Ending [00:30:12]

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