

Fidelity Connects

Nicole Connolly, Portfolio Manager

Pamela Ritchie, Host

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Voiceover: Hello, and welcome to Fidelity Connects by Fidelity Investments Canada, connecting you to the world of investing and helping you stay ahead. Portfolio Manager for Fidelity's Women's Leadership fund, Nicole Connolly, is back on the program discussing the ESG trend post U.S. election, where she is finding opportunity in the ESG space.

Nicole says post U.S. -election has translated into a particularly exciting time for ESG. Nicole believes that investors are starting to become more educated on ESG, and they understand that they don't have to sacrifice performance to invest sustainably. Sustainable investing allows investors to align their capital with their value, while also providing downside protection, risk management, and opportunity through looking at various ESG factors.

Year to date in the equity space, there are \$180 billion inflow into the ESG funds globally - that's more than double the inflow compared to last year.

Commentary surrounding COVID-19 and financial markets is frequently changing.

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[02:00]

Nicole, let's begin with a huge event, which was the presidential election in the United States. We keep hearing that this is going to be a further catalyst for the sustainable investing movement. Is it? Have those who are not on the boat missed the boat? Bring us up to date.

Nicole Connolly: It remains such an exciting time to be focused on this type of investing, and so the tailwinds continue. We talked, I think, last time about just how COVID has really brought more attention to how companies are treating their employees and their customers, and the well-being of those employees and customers, the political backdrop in many countries and now in the U.S., which is really exciting and is very accommodating for renewable energy, as an example. I think investors are just starting to be more educated about what ESG is and this idea that you don't have to sacrifice performance to invest with an ESG lens. I mean, ESG funds have done very well through COVID, which I think has given people confidence about this type of investing, so a lot of momentum. Just to put some numbers around what I just said, year-to-date in the equity space we've see about 180 billion of inflows into ESG funds globally, and that's more than double what we saw last year. The train is moving, let's get onboard. It's not too late and still a lot of ESG products are being launched, there's a lot more excitement to come.

[03:43]

Pamela Ritchie: It is. It's fascinating because it does feel like it's something that's just moving, and you want to get a sense of where they are. It's always good to go back to the basics. I remember you talking about a business roundtable that really was one of the catalysts for some of this, so maybe you can just kind of put it together for us.

Nicole Connolly: Sustainable investing is, I think, this powerful combination of allowing investors to align their capital with their values while also providing downside protection, risk management and opportunity through [audio cuts out] the valuation of ESG factors. I say that last part because it's through that evaluation of the E, the S, the G – environmental, social and governance – that we sometimes [audio cuts out] the risks and opportunities that might not have been observable through traditional financial analysis. When we look at things through an ESG lens, we're looking for companies that are trying to limit their impact on the environment, they're trying to do right by their customers, their employees, their suppliers, they work with the communities as the essence of the S – the social – and then good governance, diverse and independent boards of directors, management teams that are navigating the business prudently.

You might ask what do E, S and G – those letters – have to do with each other but really it's a framework with which we can evaluate how a company is engaging with all of its stakeholders. They're not just the shareholder, but every single stakeholder. That idea is this concept of stakeholder capitalism which, to your point about the business roundtable, I think the stakeholder capitalism idea was somewhat catalyzed by the business roundtable, which is a group of about 200 CEOs of the largest companies across the world getting together and changing their mission statement last year from one that was primarily focused on the shareholder to one that is now focused on every stakeholder that the companies serve.

One example of that in the fund, the Women's Leadership Fund that I manage, is Williams Sonoma, which is one of the only companies in the market that has a female CEO and a female CFO. They're one of the few retailers, they sell appliances and home furnishings under the Williams Sonoma, Pottery Barn and West Elm brand, and they're one of the very few retailers that committed to pay employees through store closures. Many retailers were having to lay off employees, furlough employees, but they committed to paying employees through store closures. Then, very recently, they announced that they're increasing their dividend, they're resuming their share purchase program, they're paying down debt... That's an example of a company that's doing right by their employees, by the equity holders, by the debt holders. That's kind of what we mean when we say stakeholder capitalism.

[06:51]

Pamela Ritchie: The government's piece is not new to the way that you look for opportunities in the market.

Nicole Connolly: That's right. I mean Fidelity has been doing this type of ESG research for many years, and especially on governance. I mean, every day when we look at our companies we're thinking about what's the board structure of this company, how is management incentivized, how is management allocating capital... That's just part of the day-to-day analysis of our companies. Governance is obviously super important for every company across every sector.

[07:33]

Pamela Ritchie: It's a fascinating area. You just mentioned Williams Sonoma being in the fund that you manage. Tell us a bit about the fund. It's been an example, I've always loved your term, of sort of the stickiness the ESG which has been an interesting observation for this year obviously.

Nicole Connolly: Yes. The fund, just for people that aren't familiar with it, is a women's leadership fund that's part of our ESG product suite that aims to deliver return with a purpose. The purpose, in this case, is paving the way for future female leaders and helping women and, hopefully, all under-represented populations thrive in their organizations.

To your point about stickiness, I was doing a marketing call with a financial advisor and they commented that "you have had positive flows every single month since launching the fund", and I had kind of noticed that but when he said it, it was like "yes". That is the power of this kind of investing. This is investing where I think the investor feels committed, feels passionate, and that will help the investor stay invested through ups and downs of the market. And that's what we want. We want investors not to throw in the towel at the worst possible time, but to remain invested, and so everybody wins. That's good for Fidelity, that's good for the investor. I think the stickiness point is an important one.

The fund has done well...

[09:15]

Pamela Ritchie: Fascinating. There's so many questions rolling in, not surprisingly. This area is absolutely fascinating. We did a poll not long ago asking which of the letters – the E, the S or the G – a couple of days ago, people were most interesting in. It was the environmental side of things.

Here's one of the questions that actually just rolled in, but keep that in the back of your mind. Can you expand on the environmental side beyond replacing fossil fuels? What does the entire environmental economy – they have it in quotes – look like? And what are some of the themes that you'd like to approach or take a look at?

Nicole Connolly: The E is such an interesting theme and I'm playing that in my fund. When I was last here with you Pamela, we talked about all the different drivers of the transition to a low carbon economy. We have the fact that the cost curve for technology is like wind and solar, has dropped dramatically over the past decade. We have the fact that countries all over the world, and now the U.S., are committed to clean energy. We have companies across the world now putting out goals around being carbon neutral and even carbon negative, which will drive the need for renewable energy.

Personally, with the fund, one way I'm playing that is through solar. I own Sunrun, which is a female-led and female-founded leader of residential solar in the U.S. Pamela, if you and I were to put solar panels on our roof, we would work with Sunrun and instead of paying an electricity bill every month we would pay a lease payment to Sunrun. Sunrun believes that that could save your average household about 10 to 40% on their electricity bill every month. Just to give you a sense of how early we are in this market opportunity, solar represents about 3% of the U.S. electricity landscape today, so still a long runway for growth.

As an ESG investor we like to think about the tangible impact that we're having. Sunrun talks about the fact that since 2007, they have offset about 5.2 million tonnes of carbon which is the equivalent of negating 13 billion of miles travelled by your average car, or the electricity consumed by 900,000 households a year. A really positive impact that we're having on the environment by making investments in Sunrun through this fund.

To the person's question on the line, solar is a theme, wind is a theme, both onshore and offshore. One area that we've been doing more work is hydrogen. Hydrogen is maybe where wind and solar was ten years ago in terms of it still really high on the cost curve, so we're just thinking about how fast could that come down, how fast could that be competitive with these other fuels.

[12:43]

Pamela Ritchie: Hydrogen is used already. I think of things like forklifts in a warehouse or something when you use hydrogen. I mean, it's not in our cars that we're driving around, but it has all other uses, it sounds like, that are already kind of in motion, is that right?

Nicole Connolly: Yes, but again the cost is still somewhat kind of prohibitive. There are ways that you could play hydrogen, but it's still early days. Personally, I just want the business models to be a little bit more established, so I haven't gone there yet, but still doing a lot of work to figure that out.

[13:29]

Pamela Ritchie: There's been great discussion, as you know, of a rotation, or are we in the midst of one. So I'm always people "what do you think about this rotation to value". Sometimes it's a so-called thing. Sometimes it's an actual thing for investors. But it includes small caps, certainly. Some of the companies that you're looking at are big, but there must also be a lot of feeling around in areas that are quite small companies. Is that right? How does that work?

Nicole Connolly: I am finding a lot of opportunities in small caps. I think we talked about that last time as well. There's always a question of, well can small cap or value companies be good ESG investments. I think sometimes there is this perception that ESG is highly correlated with quality. We've done those correlations and we haven't seen that that is true.

One example of a small cap company we talked to recently that is committed to ESG and diversity specifically is Taylor Morrison, which is a small cap homebuilder. It's led by Sheryl Palmer. We just did a call with that company specifically on ESG. Sheryl got on the phone to talk about why ESG is so important to Taylor Morrison, and she has made it her personal mission to increase the diversity at Taylor Morrison and is trying to increase diversity broadly in the homebuilding sector. You see that with Taylor Morrison in that almost half their board is women, 40% of their management team is female, they're part of the Bloomberg Gender Equality Index.

On the E, they are trying to outfit all of their houses with best-in-class appliances from an energy efficiency perspective; they're trying to provide solar energy in all of their markets beyond just California where it's mandated; and they have a partnership with the Wildlife Federation to make sure that when they enter a community they are preserving the wildlife habitat in that community. Here's a small cap company that probably doesn't have as much resources on ESG as your larger cap companies, but they are really committed and showing why these issues are important.

[15:53]

Pamela Ritchie: When you see some of the people who are interesting in investing in this fund, in the ESG themes that you've mentioned, where does it fit going forward? Is it most interesting to younger investors who will be carrying forth some of these themes into their lives in the many, many decades ahead of them. Where does it have uptake and where does it fit?

Nicole Connolly: It's interesting. The Women's Fund is a diversified fund. I have exposure to every sector in the fund. I actually don't like to take big sector bets because I really want my alpha to come from stock picking, but because it's a diversified fund it can play a central role in somebody's equity allocation. It's also a thematic fund.

One of the more fun and rewarding parts of running this fund is having 40% of the investors in the Fund being actually male. The number of fathers with daughters that have reached out to me and said "I bought this fund for my daughter so that she can see the power of investing, so that she can see these female role models". Those stories have been abundant and so inspirational. I think you've got men who are interested in this trend, and you have younger investors, you also have high net worth investors who really want to pay it forward and really do right by future generations. We know that women, 75% of women, are interested in investing with impact, so I think it's broader now than just that younger generation that we first started talking about when we were talking about ESG.

[17:45]

Pamela Ritchie: A really interesting question has just come in and I think it goes to wanting to get deeper into the research and understanding the components, because you've mentioned some of this, but there's obviously more interest. Why is the S not as dominant? I'm not sure you agree with that.

Nicole Connolly: Yes.

[18:06]

Pamela Ritchie: *[audio cuts out]* says the investor, I understand that the E is important. I'd like to hear more about the S.

Nicole Connolly: That's funny, because when we were talking about this webcast right before we started here, we were talking about how you did a survey with Jurrien yesterday and I think 76% of the respondents said that E is the topic they hear most about from their advisors. I heard that, I was like "what?" Because the fund obviously does have more of an S angle to it.

I truly believe in this idea that organizations have embraced diversity, and diversity going beyond just gender. I know that our fund is focused on gender, but increasingly I'm looking to bring companies into the fund that are focused on all under-represented populations, because I believe that diversity of thought is really important. I believe that having companies with diverse and inclusive cultures that have more diversity of thought to bring more innovation to the company, to better serve your customers. I mean, I truly believe all of that translates into superior performance longer term.

I think we've talked on this webcast before about the study we did empirically trying to prove that. We looked at ten years of data for companies that had above average diversity profiles by looking at the board, by looking at the management teams, by looking at the diversity initiatives in place, and we found that those companies outperformed the market by about one and a half per cent a year over that ten year period. I'm a strong believer in the connection between diversity, inclusion and long term performance. I have four kids and the idea of creating a world where everybody has access to the same opportunities is a powerful motivator for me with this fund as well. We're doing good both for the world and, hopefully, financially over time as well.

[20:29]

Pamela Ritchie: I won't ask you to speak to geo-politics, but just to get at the fact that the fund itself can be international. We hear about ESG in the context of looking at companies in different countries, different regions, that are global... Just bring us up-to-date on where you can take the fund.

Nicole Connolly: 15% of the fund is international and 85% is invested in U.S. companies. I have found opportunities in Canada. I think we've talked about Aritzia on this webcast before, which I continue to own. They are a strong retailer of apparel in Canada and are now rolling out stores in the U.S. I'm finding opportunities in Europe. We talked about the environmental theme. A lot of those environmental themed companies are international or in Europe. Asia, there's a little bit less of opportunity from a diversity perspective, but I imagine just like everywhere else that will change over time. My international exposure is more developed versus Asia at this point.

[21:50]

Pamela Ritchie: Another question related on the environmental side – actually it's from the same advisor who asked one of the first questions –, are there environmental gains to be made in agriculture? I was going to ask you if you see, on the horizon, water being investable. Is there some of those themes that go to disclosures and the way we look at things? Do you see that on the horizon?

Nicole Connolly: It's a good question. Fidelity just launched a clean water fund to get to the fact that there are still billions of people across the world that don't have access to clean water. I think there are definitely opportunities there. This is not quite in the same area, but I do own a company, America Waterworks, that is a utility, that is a play on improving the water infrastructure in the U.S. where pipes break every two minutes. We lose a lot of water. That's a little bit on the water theme. But if this is an area that you're passionate about, that your clients are passionate about, I would check out the Fidelity Water Fund that's run by Janet Glaser, who is a long-time Fidelity fund manager and who is excellent.

[23:22]

Pamela Ritchie: What other types of themes are there, when you look at this gathering steam? It does seem like it's sort of grinding higher, this theme, this interest. It seems to be working so well. What's next for it? Where does it go from here? Is it more of the same? Is there any other things we should be on the lookout for?

Nicole Connolly: One thing that Fidelity is doing that we're really excited about is we're rolling out ESG ratings across all of our companies. Just like we put out a buy or sell recommendation on a company, we're going to have an ESG industry leader and industry laggard rating on these companies that we own. That's something we're really excited about. We're learning a lot more about our companies through that work and we think it'll be a real differentiator for us in the market.

One thing to mention that's interesting is that NASDAQ just came out with a proposal to the SEC to require two diverse directors on boards of companies listed on NASDAQ. That, I think, is a bold, awesome move. Adena Friedman, who is the CEO of NASDAQ, is a big supporter of diversity and inclusion. I think that kind of momentum, especially in the Biden/Harris administration, will continue.

[24:54]

Pamela Ritchie: It's so important on so many levels and it obviously is something that is a bit of an evolution. I'm sure that you see around you, I see it around me, women who have had to not continue with their jobs because the pandemic has led them to a place where it's really difficult to juggle everything in an even more difficult way. It's just so important to see the investable money coming in to recognize women in their roles.

Nicole Connolly: Yes, that's such a good point. There was this 'women in the workplace' study by McKinsey that just came out, maybe a couple of months ago, that said one in four women were either going to step back in their career or just leave their job entirely because of the challenges from COVID around homeschooling. I mean, we're homeschooling the kids for the first week this fall and it's a game changer. It's hard. Those kinds of challenges are really hard for women, and so with the fund, when we get on the phone with a company we're like "what are you doing to help women make it through this challenging time?" We've had companies tell us about flexible work environments, paid leave. We want to be doing something to help the fact that women are stepping out, and we've made so much progress on women in the workforce that to lose it now would be a tragedy. We're asking those questions to our companies and making sure we're invested in companies that are trying to help women through this time.

[26:36]

Pamela Ritchie: So much of it also comes down to the consumer level, Nicole; consumers making choices and maybe staying away from things that they don't see fitting into a framework of sustainability. Do you watch that? Is there anything that's changed through this rather radical period? Is there anything to take note of or is it just on a continuation?

Nicole Connolly: There was this study from NYU Stern a couple of years ago that showed that the products that were marketed as sustainable grew five times as fast as products that were marketed conventionally. More and more we see that this sustainability trend is one that companies are leaning into. Apparel companies are leaning into sustainability. We just talked to a company yesterday, an apparel and accessory company, that's really leaning into women's empowerment as a brand messaging point. They're working with women like Serena Williams, Jennifer Lopez to really showcase diverse women, bold women, and I think that is going to really resonate with their customer base. I think you're completely onto something. We're still in early innings of it, but it's exciting.

[28:08]

Pamela Ritchie: But the train is moving. It's fascinating. I can't wait to catch up with you again. I'm sure we will. All the best for the holidays. A safe and happy time.

Nicole Connolly: You too Pamela.

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