The Upside

Hugo Lavallée, Portfolio Manager

Emily Anonuevo, Host

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

Portfolio manager Hugo Lavallee joins us again for another FidelityConnects podcast. And, we are pleased to present podcasts with Hugo in both English and French to kick off 2021.

As you may know, Hugo is a contrarian investor, and manages Fidelity Greater Canada Fund and Fidelity Canadian Opportunities Fund, for Canadian investors.

In today's podcast we'll get to know Hugo a bit more: find out what being a contrarian investor means to him, and hear about how he first joined Fidelity, after his now colleague Max Lemieux spoke to Hugo and other students at McGill University in 2002.

Hugo also shares with host Emily Anonuevo how he is positioning his funds to add value for investors, the benefits of Fidelity's large research resources, and how he chooses which of the many companies he meets with to actually invest in. Hugo reflects on the impact of COVID-19 on the Canadian market in 2020 and looks ahead to his 2021 Canadian market outlook.

For context, today's podcast was recorded on December 10, 2020.

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[02:08]

Emily Anonuevo: Hugo, so great to see you and happy to have you on the show today.

Hugo Lavallée: Thank you, Emily. Thanks everybody for joining.

[02:15]

Emily Anonuevo: Looking forward to our conversation. Hugo, many investors know you but some may not be too familiar with your work, so let's begin with a bit about you. What led you to a career as a portfolio manager?

Hugo Lavallée: Well I was a student at McGill from '98 to '02 and I remember one weekday, pretty late in the evening, Max Lemieux came over to talk about his job and his industry. Max is one of my colleagues now, and at the time he had just made Portfolio Manager at Fidelity. He was very successful. He was living in Boston, and I just remember that meeting really clearly and saying, "That's the job I want and I'm going to focus towards that." Luckily it worked out. It was really interesting to go work abroad for a few years, focus on stock picking, really joining industry legends: Peter Lynch, Anthony Bolton, the Will Danoff, getting a chance to work with a few of those down in Boston. I was there for seven years, and in '09 we came back to Canada, so here we are. Here I am today at my home in Montreal and really happy. It's been over a decade now that we're back in Canada and just keep doing the same job. It's been 18 years now and it's been a really good journey.

[03:34]

Emily Anonuevo: Absolutely, so over a decade since you've been in Canada. Over 18 years you've been in the financial industry, so really looking forward to hearing your thoughts today on such a tremendous year to say the least. Hugo, one of the funds you manage, Canadian Opportunities, recently won the coveted 2020 Lipper Award. The performance of Greater Canada, as I mentioned off the top, very strong and all in a year with so much volatility. Before we get into how you got there, can you just describe what your investing philosophy is overall?

Hugo Lavallée: I'm a contrarian investor, so I invest a little bit how I live my life. I'm always trying to beat the crowd to the ski hill, or once a year to the waterpark, or for my lunch when we're in the office. I hate waiting in line and the older I become, the worse it gets. I kind of bring the same philosophy to investing. It's easier to be the smartest person in the room if you're the only person in the room. I just try to anticipate a little bit where the puck is going and try to skate towards there weeks and months ahead of the competition. The best way I can explain it is through some personal examples where you're trying to buy a great company but it's fallen on super hard times. You know that five, ten years from now they're going to be much bigger, but right now things are really difficult. They're in the news for the wrong reason. Personally this summer I brought my little family to Banff, saw Jasper, saw Lake Louise, but it was at a fraction of the cost the same family would've done the trip in 2019 right? Yes, there was some calculated risk, but the planes weren't full, the hotels were a third of the price, and we saw the same Lake Louise and Lake Moraine and the same mountains, but it was at a fraction of the price from the family who did it a year earlier.

That's kind of the same thing in the stock market. You're trying to buy companies that you think that will be much bigger five, ten years from now, but in the short-term things are really, really tough. It might be exogenous shocks like the pandemic. It might be self-imposed or self-inflicted wounds, something didn't work out, a new product wasn't very good. In the restaurant industry maybe there was some food safety issue. There's so many things that can happen that are self-inflicted or exogenous, and then you just focus on these companies. We talk to the companies. We try to understand A, their balance sheets. Are they going to make it and do they have time? Time is really important. Two, is the story broken? If the story is not secularly broken and you can see a path over the next two, three years, things will sound a lot better, and then it's just at a much cheaper price. I think that's my competitive advantage. A lot of people can't do that. A lot of people can't take the pain to focus on, "Okay, things are going to be really difficult for next six months, but over time things will get better." That's kind of my secret sauce and that's what I try to apply to the fund.

[06:37]

Emily Anonuevo: Okay, excellent. You talked a little bit about your strategy there. Looking for companies where their story is it broken, is it not broken. Can you just expand on this and let the viewers know what worked so far this year? Talk about your ideas, trends, sectors that contributed to your fund's performance this year.

Hugo Lavallée: Well this year has been a really abnormal year to say the least. There's almost been three markets. There was the pre-pandemic market where both of my funds were a little bit more on the safety side. I had a little bit of cash. Things were going pretty well, and it was hard to find a lot of contrarian ideas. It was hard to find just a lot of names that were struggling. Things were pretty good. The funds were more into consumer staples, a little bit of grocery stock, a little bit of liquidity, waiting for something to happen and then the mother of all exogenous shock happened with the pandemic. Really quickly things went from really good to really bad.

What was interesting is just working with the team. Just to be clear, you talked about the Lipper and everything, and I got the recognition, but Fidelity is such a large organization. We got 24 analysts based in Toronto that just cover North American securities and then everybody in London and everybody in Tokyo. Just working with the team to find and get aggressive and find a lot of companies. I don't think I've ever worked that hard over that three-week period, mid-March to early April, just trying to find a lot of companies, or companies that we obviously already knew but we wanted to reconnect with them.

So you're working with the team, you're working with the analysts. I went down cap which means I bought a lot more small mid-cap companies. You sold your safer big companies to go and take more risk in the small mid-cap companies, companies that their stores were closed, forced shutdowns by the government or people were concerned about the balance sheet and you're exchanging with the companies. I mean some companies we're talking every two, three weeks, understanding the balance sheet. Are they going to make it? What does it look on the other side? What's our best guess at 2022? Obviously six, seven months ago you don't know what 2022 is going to look like but you can take an educated guess. Our analysts run financial models. You have an income statement, a balance sheet, a cash flow statement, so you're working away at all these things and you try to make an educated guess that, "This company, the revenues are down 95%, the stores are closed, but they have the balance sheet to make it. Our best guess this is ten times earnings two years from now and historically it's 30 times earnings because it's a great company with a ton of white space to open new stores, and it's a high return concept."

We bought these stocks for 2022 and it all happened really quick. In six, seven months a lot of the companies rebounded. We focused on trends. We focused on cycling, working from home, buying stuff, Sea-doos and water sports to people that were fortunate enough to keep their jobs. There's a leisure bucket that went to zero when people bought stuff. We focused on that, trying to anticipate where the puck is going, skate towards there. So we did really well there.

Around the U.S. election, when everybody was focusing on the U.S. election, one thing I was trying to focus was, "What about reopening plays, vaccine plays?" Not so much the healthcare stocks, but more the leisure bucket. I want to refocus on leisure buckets, air travel, hotels, casinos, cruise ships, cruise lines. "What are people going to do? People have been stuck at home for so long and what are people going to get excited about doing again?" We started focusing on that late October, early November, and then the Pfizer news hit on the vaccine which was huge obviously. It was such positive news and really pulled forward these expectations. That's what you've seen in the stock market over last five weeks. People really anticipating that a year from now life will be hopefully pretty normal. We've almost had three markets, and luckily working with the team it made such a big difference, focusing on, "What should we do next?"

[10:45]

Emily Anonuevo: So how do you approach certain sectors this year and do you see that changing now with the vaccine coming closer into sight?

Hugo Lavallée: In our industry what's important is to focus on your circle of competence. For example, I don't do a lot of healthcare. I do some, but I don't do a ton. I do a lot of tech. I do a ton of consumer. What I've been thinking about as we roll into '21 is I've been churning my consumer discretionary basket. Initially we were buying working from home beneficiary, companies that were benefitting, seems like everybody was buying bicycles and some of these stocks went from, "Oh my god, they're almost bankrupt" to they're having unbelievable sales. That played out pretty well. Some companies that their stores were shut and people were concerned, then they reopened, not only were they having good same-store sales, they were having same-store sales they've never had before plus 40%.

Right now I'm a little bit lighter on that team, a bit like what I said earlier on the consumer side. I'm more focused on, "Where is going to be the pent-up demand? What have people really, really missed?" I think that's what I've been focusing on, and there's always other stuff going on. The last two weeks we've worked so hard on all the IPOs, so all the names that everybody knows that are in the newspapers. We've been focusing on them and talking to the founders and deciding if we want to participate or not. There's all this other stuff going on as well, but what I'm trying to allocate time every day is focus on reopening plays.

For example, on Monday we were talking to a Spanish hotel company that own hotels in Southern Spain, they own hotels in the Caribbean. I've been pushing the analysts in London, "Hey, I really want to talk to this company. It looks like a great leisure reopening play." Every week we're trying to line up calls for next week, and then you try to go through your week and think about what you're going to do next. That's what I've been focused on.

[12:41]

Emily Anonuevo: Interesting. Interesting point about focusing on the reopening plays. You talked about speaking to so many people from different companies, and that has really increased this year right, Hugo? I mean working from home, you've mentioned before how that is just a great opportunity to be meeting up with companies and speaking to members there. A really great advantage, right?

Hugo Lavallée: Yeah. Look, in our industry, and that comes all the way back to Peter Lynch in the late 70s and the 80s, Fidelity's always been "connect with companies, talk to companies". It's almost like being at a poker table and every time you have a company meeting, you're shown more cards and you can make a better educated decision. That's like the first thing you learn at Fidelity when I joined in '02, is you start going to all these meetings. At that time it was in Boston, it's physical. So many companies come in and you're in school and you're seeing videos of John Chambers from Cisco, and then you're there at Fidelity your first week and John Chambers is in the office and Jeff Bezos. That's how we make educated guess and run the portfolios.

The one thing that's been incredible for our industry in the pandemic in Fidelity is now everybody is working from home, people are more available, you don't have to travel, there's a lot of wasted time that's not wasted anymore. You can attend literally multiple conferences the same day that before you couldn't because physically they'd be in different cities. To be able to see all these companies all the time is really helping. We've never been anywhere close to seeing so many companies in one year, and I think you've seen that in my process. Part of my process, it's important to talk to the companies, so it's been really good. Frankly I hope and I think some of this will stick. Yes, we will travel again at Fidelity but, hopefully we won't travel as much. We'll still have some of these virtual conferences. We used to do these bus tours where you fly to California and then you see all these companies, and you have to take the bus between headquarters, or you see one company every two hours. This year we did virtual. We're literally seeing companies every hour. Just to be able to see more companies and I think it's paid off for the fund investors this year.

[14:50]

Emily Anonuevo: Hugo, I want to go back to the role of advisors for a moment, just the value of advice and sticking to a plan. Advisors help Canadians by fostering discipline in challenging and confusing times like today, by staying focused and not trying to time the markets. Can you expand on this and add to this in terms of the importance of being disciplined?

Hugo Lavallée: Well if the clients are listening today, it means they got a good advisor that told them, "You should listen to Fidelity," right? That's part of it, is help them navigate. There's a lot of competition. There's a lot of products. How do you pick the right firm? How do you pick the right product for you with the right firm? One thing that's really helpful from advisors that Fidelity doesn't do, and I don't do, is we don't pick up the phone when the market is down because we're busy running the money, right? So the advisor is really there to help the client on their journey and keep them in the game. So much of our industry is just staying in the game. Fidelity has all this research, and even the amazing funds like Peter Lynch, where Peter Lynch compounding that some insane amount per year and the average investor to even get that because people have a tendency, it's human behaviour to come in and out at the wrong time. For me, a ton of the value from the advisor is just keeping the customer in the game, being there to bring them along this journey, answering the phone when the advisor has fears, they have questions, they have tax issues, all stuff that we don't do. My job is wake up every day, talk to a lot of companies, run the portfolios and that's 98% of my time. That's what I'm focused on, and that's why the advisors are there to help the customers.

[16:30]

Emily Anonuevo: Hugo, more questions rolling in here from viewers, one about oil and one about the Canadian dollar. What are some things that might impact the Canadian dollar? Is that a factor you consider when you think about how you invest?

Hugo Lavallée: Yeah, sometimes. I use the Canadian dollar as a tool to limit volatility in the funds. For example, in March/April when the market is selling off, Canadian dollar is selling off as well normally. So people that own the funds, they're seeing less volatility, because we're all Canadians, our money is invested in Canadian dollars. If you have a foreign position and the stock market is down 5%, but the Canadian dollar is down 1%, so your foreign exposure obviously is down 20% less. That really helps in terms of keeping clients in the game.

For me also what's been happening now, it's more just trying to focus on – I'm thinking frankly less about the currency now. I'm thinking about where in the world can I find my best ideas? In the Greater Canada Fund, I can go up to 49% foreign content and I'm trying to maximize that foreign content, so working with the team. I own a lot of U.S. securities. I own some European securities. Sometimes I own Asian securities. I participate in Chinese IPOs. Sometimes I own Japanese stocks. Right now frankly I'm less focused on the Canadian dollar. I'm more focused on just maximizing the returns using the global research where I think the best stocks are. If I have a stock that I think is going to double over the next three years, I'm not really that worried about what the Canadian dollar is going to do. Sorry, what was the other question again?

Emily Anonuevo: The other question is just your overall thoughts on oil.

Hugo Lavallée: Historically I have been heavy in oil and gas. In 2016 my funds were over 20%, one fund was over 30% in oil and gas. That was really beneficial four, five years ago. Frankly I've just been mostly avoiding the sector this year. I think the world has changed. I know we're going to talk about ESG and the environment in a moment, and I can pre-empt that by saying I think unfortunately for oil and gas sector in Canada, the world is changing, especially for oil sands. I think we're a lot more sensitive to climate change, to emissions, and if you think about ESG, environment, sustainability and governance, Alberta and Canada we do a really good job on governance versus OPEC. But on the environmental side, one problem with oil sands is they have more emissions per barrel produced than basically any other oil extraction companies in the world. Unfortunately this is not on trend anymore and things are changing. I got a 12-year-old son. I try to be inspired by the conversation that we have, and I've been really trying to focus more on renewable companies, renewable utilities, renewable diesel.

For example in the Greater Canada Fund, one of my top three position basically all year has been Darling Renewable which is a renewable diesel company. They make diesel with literally old grease traps from McDonald's, but the key is: that diesel has 70% less carbon content than regular diesel. When you sell it to a state like California that has a $200 a ton carbon tax, they're trying to reduce their emissions, it's really, really beneficiary and really profitable for a company like Darling. As Canadians we're all wondering what to do with our oil and gas portfolio, it's a number one export, but there's better names out there that are more on trend and they're selling a solution.

I think that's what Fidelity is really, really good at frankly. That was not even my idea. It came from one of my portfolio manager colleague who sits in Toronto. He said, "You got to look into this. I know you're focused on climate change." It's been an amazing story, and the stock is basically at all-time highs where unfortunately oil and gas industry is still struggling in Canada. The point I'm trying to make is there's really good stories out there, you just got to go find them. Fidelity has really always been good at that. Peter Lynch, Will Danoff, Joel Tillinghast in Canada, the Alan Radlo, the Max Lemieux, the Mark Schmehls. We've always been really good at trying to find those stories. That's what we're focused on every day, and we come up with these ideas that very few people have heard of. They're not household names and that's the point. That's what we're pretty good at. That's what we're focused on doing every day.

[20:57]

Emily Anonuevo: Okay so you talk a little bit there about ESG and sustainable investing. Will that be a big part of your funds in your portfolios in 2021? I know you have mentioned in other shows about green initiatives and whatnot. You're very interested in that area.

Hugo Lavallée: Yes. I think it's coming like a tidal wave, and I think it's going to continue to come. I think it's multifaceted. A, there's changing consumer behaviour. We've hit reset on the economy. We're going to build it a little bit differently. I don't think in the Throne Speech Trudeau ever spoke about oil and gas. Biden has a $2 trillion plan on decarbonizing the grid in the U.S. but there's also changing consumer behaviours. People are going to say, "Maybe I don't want to do this. This doesn't feel right." In Sweden there's flight shaming.

So there's that I'm really sensitive to. There's also changing cost of capital. What you've seen in Europe as ESGs gain steam is that cost of capital for good ESG and bad ESG is really widening. One thing that I've been doing in my funds, like buying renewable utilities 15 months ago, is you're seeing their cost of capital drop, which means the stock is going higher and higher. Not only are they doing the right thing, we're doing the right thing. It feels better to invest with purpose, but also we're getting really good results out of this. I think frankly there's also regulation. If you see in the EU there's more and more regulation coming out of the EU, and I think it's going to come to Canada as well. I have a lot of sympathy for fellow Canadians in Alberta. That's frankly part of the reason why I went and spent some money there this summer. It's a beautiful place with really nice people, but we need to find some different ways there. I'm trying in my portfolio too. I think it's on trend. I think it's going to become more on trend. At Fidelity we've identified 600 companies in the world that have at least a third of their revenues from green products or greening the planet, so that's a lot of stocks to pick from. That's what I'm focused on. That's what I'm going to do more and more. As we roll into 2021, I don't expect that changing.

[23:07]

Emily Anonuevo: An incredible number, 600 companies, so definitely something to watch out for in the New Year. Hugo, what else is on your watch list for 2021 in terms of investable trends?

Hugo Lavallée: Well I've talked about vaccine beneficiaries, thinking a little bit more about financials with a steepening yield curve potentially. As Canadians we were staring into the abyss in March/April. Unfortunately we don't have good personal balance sheets a lot of us as a whole, and the federal government came in and really kind of bailed out the economy. What's positive with the vaccine is you can do these big deficits. You can't do them forever right? What's positive is the vaccine brings hopefully some finality to this. You can do this for a year or two. You can help people out in need, but you can't keep doing it forever because it creates a bunch of other problems. The vaccine was really positive news that fiscally maybe things will get better eventually. It also helps obviously people's personal balance sheets. It helps our financial industry. I don't spend a ton of time normally in financials. I've been thinking a little bit more about financials right now, and then the whole team up of climate change, the "E" in ESG, focus on lower carbon solution. That's one thing that I'll keep pushing forward, and we're always talking to companies.

Last week we spoke to a company that does electric drive trains, a public company based in Vancouver. On Monday we spoke to a California company who's going public through a SPAC. They make smart windows, so windows that automatically get a little darker with the sunlight or not. It helps for efficiency in the building, helps productivity of the employees, you don't need blinds anymore. It's just a lot of these companies out there frankly and you just got to tackle them one by one. We don't buy all of them obviously. Some of them, it's we don't like the story. Some of them, it's not their fault, the valuation we think is too high, but just to hit a lot of these companies and trying to get the earlier on those trends than the competition can't be overstated, and that's what I'm trying to do.

[25:15]

Emily Anonuevo: I'd just like to squeeze in a few more questions before we wrap up here. One viewer asking about inflation, so can you comment on your thoughts about inflation? Does this impact the way you invest?

Hugo Lavallée: A little bit. For me it's not a stock market, it's a market of stocks and I can't overstate that enough. If you're finding a really good story, I'm not going to worry a lot about inflation. The way I build a whole portfolio, I might think about, "Well I own a lot of utilities. Maybe I'm overexposed if inflation goes up because interest rates are going to go up eventually. So maybe I'll sell some utilities. I'm going to keep my renewable utilities, but I'm going to sell my other utilities." You kind of think about it in your background, and the back of your mind, but it's not my driving factor. You're trying to think about these amazing companies that will be a lot bigger ten years from now. It's in the back of your mind, but it's not the thing that's driving the most how I do my day to day.

[26:13]

Emily Anonuevo: Hugo, we're almost out of time. The half an hour flew by. Before we go, just wanted to switch gears. If you weren't a portfolio manager, what would you be doing? What career do you think you would be in?

Hugo Lavallée: Well I used to have more hair and when I was 13-years-old I would start playing the drums. I was in three separate bands in high school and all the way to university. I had aspiration to make it in a heavy metal band, and I remember doing a show when I was 21 or something in Montreal and met some 30-year-olds that hadn't made it, and still trying to make it, and I'm like, "I don't want to be that guy so I need to double down on the finance career." Here we are. It's turned out okay. I still play some drums. My son is 12. He's taking bass lessons now, so we can jam to some Red Hot Chili Peppers together. Trying to getting him into the heavier stuff, but he doesn't like it. I think it turned out okay, and I'm pretty happy about it.

[27:17]

Emily Anonuevo: Okay. That fact I did not know about you so maybe next time we speak you might have to play the drums for everybody on the line. We'll see but Hugo thank you so much. It was great to hear from you and get your insights for the year ahead. Thank you.

Hugo Lavallée: Thank you very much. Thanks everybody. Thanks for your time.

Ending: [27:34]

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