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 Darren Lekkerkerker is back for another FidelityConnects podcast – joining host Pamela Ritchie to discuss his portfolio positioning for his fund Fidelity North American Equity Class entering into 2021. Also, Darren discusses where he is finding opportunities and how he is balancing U.S. and Canadian equity markets.

In addition to Fidelity North American Equity Class, Darren manages Fidelity Global Natural Resources Fund with Joe Overdevest, and is equities sub-portfolio manager on Fidelity Canadian Balanced Fund and Fidelity Canadian Asset Allocation Fund.

Darren is bullish on Canada and on commodities, and is optimistic on 2021 as we're presented with low rates, fiscal stimulus, and the COVID-19 vaccine.

Darren also shares what the recent U.S. election means for his investment thesis – and today's podcast was recorded on January 5th 2021 – the day of the Georgia run-off election in the United States.

[01:57]

Pamela Ritchie: Darren, welcome. Great to see you.

Darren Lekkerkerker: Hi Pamela. It's great to be here. Happy New Year.

Pamela Ritchie: Happy New Year to you as well. We can start actually with the election. It's a bit of an all-eyes on this situation. It has to do with the Senate. What does it mean for the markets one way or the other and really for your investment thesis?

Darren Lekkerkerker: Just so that everyone understands what it is, right now with the election in November, the Democrats will control the White House and the Congress but the Republicans currently have a slight edge in the Senate with two seats doing a runoff election today in the state of Georgia so it's very topical. If they were both to flip from Republican to Democrats then the Democrats would also control the Senate. So it's very important because it means that in terms of the Democrats and President-elect Biden's ability to control policy and legislation that would allow them to do so. I think if they were to win, I think that they would likely … you would see a bigger stimulus, from, passed which would, I think, certainly benefit the economy in terms of the impact on the markets. It's always hard to know in advance. The market doesn't always follow the script that Wall Street thinks it will. I think that the market liked the divided government of both the Democrats and Republicans following the last election. So you may see a little bit of pressure on the market. One policy that investors would be a little bit afraid of would be the government raising taxes on corporates and possibly capital gains. So that could be a little bit of pressure for the market. However I think that might be a little bit offset by a greater stimulus. I think what you could also see is you could see a lot of rotation in terms of sectors moving and I think it would be towards more value-oriented sectors. People may worry a little bit more about regulation on big-cap technology as well. So that's what I think could happen here.

[04:13]

Pamela Ritchie: It's interesting. Let's talk about sectors that have been beaten down a little bit. I'm going to pick on oil right now because an announcement's come out minutes ago that the OPEC discussions, OPEC Plus discussions … we see Saudi Arabia proposing cutting, doing its own cutting. Anyway the price of oil is jumping. I know this is an area that you follow closely. Let's talk about this rotation to value, whether oil fits into it or not for you. Give us your broad thoughts on that.

Darren Lekkerkerker: I'm going to stick with what I said last year when we had these discussions and that is in terms of commodities, I invest with geological scarcity and where I see that is more in the material sector as opposed to energy. I think if you look at commodities like copper it's much more geologically scarce than oil where you have a lot of spare capacity. But since oil is topical let's talk about it. The one thing I think is actually super interesting and broadly actually in commodities is you've actually had this really big … everyone's focused on the NASDAQ bull market, but you actually had a really big bull market run in commodities from the … they actually killed in March, April, but from the lows you had a really big run. In terms of energy I think it's interesting. But as you mentioned there's a lot of spare capacity and what's going on today is because of a headline that says that Saudi Arabia may reduce capacity.

What's going on is, you've got this OPEC Plus and the Plus refers to Russia. So you've got this agreement between OPEC and Russia. It restricts supply from the market because right now we've got limited mobility and demand is lower than the normalized amount pre-COVID when we were all driving. So the agreement called for an increase in capacity and they've been negotiating and it's been rumoured that the Russians actually want to stick to the agreement and increase capacity so they can pump more volume and get more revenue whereas the Saudis want to hold back because they don't want to collapse the price. It's unclear, is this just a negotiation, or what's exactly going to happen? The market is taking it favourably and looks like WTI is up 4% off this.

But just broadly, just into thoughts on energy. I think energy could have a decent year this year as you have some recovery in mobility and demand and I think the stocks are cheap. I think longer term is a little more mixed. I worry about the sustainability of longer-term demand as you see a rise in the pervasiveness of electric vehicles, what that could have on demand. I also worry about the multiples on these energy companies as ESG investing becomes really important and they have capital restricted to them. I also think that they're getting capital restricted to them from the banks too. I know that the banks think about this in terms of their own ESG ratings. Where I am quite favourable is on the materials commodities. I've talked about copper in the past, I still like copper. I think copper is geologically scarce. Demand was really strong last year as China actually had a strong economy. They recovered very quickly from COVID. Supply is very restricted from copper. There's no large mines slated to come on in terms of copper and I think you could see a recovery in demand from the rest of the world. I think sentiment is positive as there is some demand coming from electric vehicles that do require a lot of copper, but also in terms of bolstering the grid. If we're all going to charge our electric vehicles at the same time when you come home from work, you will need some demand there. I think copper has looked good. We've seen a rally there and that's an area where I do have some holdings and it has benefitted my funds.

[08:04]

Pamela Ritchie: Very interesting. Let's just talk about some of the funds and the ideas that you've been playing out in your funds. I do want you to sum up what you've been doing over the course of 2020.

Darren Lekkerkerker: So, in terms of 2020, in terms of the markets and investing obviously it was a fascinating year in terms of what happened and certainly the way that it turned out. For me, I have an investment style where I focus on investing in high quality companies and I would define that as companies that have a competitive advantage and as a result generate superior returns on capital. I think that really showed its robustness last year. So my largest holding was Microsoft in the North American Equity Fund. One of my largest holdings in the Canadian Balanced Fund was CP Rail, which is also a large holding. These high quality companies are very different. One's a software company, but they really benefitted from work from home and it really showed the resiliency there and I think it held up really well. I continue to own it.

CP Rail actually had increased their profits. It's also a monopoly or oligopoly type of business. Something else that I would talk about last year that was more tactical was in March, April when the market was killed and people thought we were going to have a deep consumer recession, I was able to add a lot in consumer discretionary names to the funds. One area was restaurants and retail. They were left for dead and I was looking for restaurants and retailers that would have strong demand in a work-from-home environment and that would benefit from an omni-channel like a strong e-commerce, or in the case of restaurants take-out or delivery strategy, and benefit post-COVID with less competition, better access to key retail sites and so on and so forth.

I think one other area that I think is really interesting and super topical today, and we talked about it multiple times last year, was ESG investing but also a focus on environmental stocks. Last year I invested in a few areas in terms of renewable power, in terms of green hydrogen, in terms of solar energy. I still have investments in all these areas. I have taken some profits. It did much better than I would've thought last year. I think the stocks are a little expensive and so it's still an area I'm really looking at. I'm trying to find some better value there. What drove these stocks, and I think what can continue is society is focusing more on decarbonisation. Biden winning the presidential election and the Dems focusing more on green. I would say lastly ESG and a lot of capital coming into the space.

[11:03]

Pamela Ritchie: Do you think markets are looking fully priced, a little overvalued? You can attach to it any of these monikers, but do you think things are getting a little bit lofty here and what is your exit strategy? Just so investors understand, how do you approach this if you need to?

Darren Lekkerkerker: We certainly had a very nice and fun Santa Claus rally post the election into year end. Having said that I'm still optimistic on this year. I think that you've got really low rates, you've got fiscal stimulus coming, you've got a vaccine coming which I think could potentially release some animal spirits in terms of consumers that have been able to maintain or actually improve their balance sheets during this and probably some desire for pent-up spending. So I find consumer discretionary a very interesting area. People talk a lot about how expensive it is, the markets, but when you look at the large-caps … my largest holding is Microsoft, I think it's a little bit more than 30 times forward earnings. It was double that in the tech bubble. I think most areas of the market you can find reasonable valuations. I think there are some areas of the market which are certainly very expensive, but overall I would say I'm positive.

You mentioned exit strategy and from that I think you mean when do I sell a stock and certainly that's very important. For me, whenever I buy a stock I have a short and concise investment thesis. If I find that that thesis is no longer valid, or I find a company that I prefer, I would buy that. Or if I think it's just done so well that that thesis is played out, we've made some money, it's time to take some profits and move on and find better opportunities. But as I mentioned to you last year it's certainly an area that I'm trying to be a little more active. I think I used the word ruthless and that's focus for me on my investment process.

[13:09]

Pamela Ritchie: We've touched on oil, we've touched on materials broadly, different areas of materials, alternative energy. I think you mentioned financials more in sort of cost of capital for oil companies and so on, but these are all pretty Canadian stories. Are you bullish on Canada? How bullish are you on Canada? And how does that fit with your mandate for North American investing?

Darren Lekkerkerker: I am bullish on Canada. I think Canada hasn't done anything for several years and certainly underperformed the U.S. by quite a bit. I think in the short term, I think in a reopening of the economy, I think Canada does well in part because it's more cyclical. It has more exposure to some of these areas like materials, energy, financial. It also has a lot of exposure to consumer discretionary that could do really well. I also think that the currency, the Canadian dollar … I'm not going to get over my skis and try to predict currency returns going forward, but I think there's a lot of negative sentiment on the U.S. dollar. I think that the U.S. dollar tends to be less cyclical than the Canadian dollar in part because the economy is less cyclical. I think you could see the Canadian dollar and certain areas of the Canadian economy doing well. So yes, I think I'm bullish on Canada, certainly in the short term in a recovery trade.

[14:34]

Pamela Ritchie: I want to ask you about financial data. Big data is a huge topic but sort of zeroing in on financial data … includes big data as well … but there's been overused sayings like data is the new oil and so on. Tell us how you look at financial data companies and the theme generally.

Darren Lekkerkerker: Something we talked about last year, the information services group or the companies that benefit from selling data, I find it a really fascinating group because of the growing importance and value of data. I think this group did pretty good last year, but it didn't shoot the lights out and so I still like it. I think that for some of the companies I own clearly they're offerings to customers have grown in importance. We're seeing increased customer engagement. Some of these companies were able to improve their cost structure and profitability profile going forward as a result of COVID. I still think that there's good opportunities here and I continue to own these stocks.

[15:43]

Pamela Ritchie: There's a bunch of questions rolling in here. Let me get to a couple of them. This is very much a global macro story, but the geopolitical issues [audio cuts out] the globe, we see them in headlines certainly, Iran yesterday, this investor's writing in. How does that affect the way that you look at markets right now? Do you add in a layer of risk tolerance, or do you change that on some level? How do you look at the geopolitical if at all?

Darren Lekkerkerker: It's certainly really interesting. I actually think that when we have President-elect Biden in office you may actually have a little bit less political risk than the current administration. Clearly they have very different styles as presidents. I think you may get a little bit of an olive branch towards China which would be good for China and it would be good for those commodities which China is short and buys which include copper, oil and corn. It's something that I'm interested in and it actually makes me a little more bullish on commodities.

[16:50]

Pamela Ritchie: Let's pick up on corn, go to agriculture. This is an area that you like broadly speaking. Is corn one of the main stock commodities you're looking at? What is the agricultural outlook for the next little while?

Darren Lekkerkerker: I was actually the potash analyst in the big fertilizer and agriculture boom in the mid-2000s and so I have some fond memories here, but I've basically ignored it since 2012 after BHP unsuccessfully bid to buy potash. I basically ignored it and we've actually had a really soft agricultural economy. I actually have two cousins that are grain farmers, so I keep close tabs on this. But look, corn price is back and I think corn price is strong and other grain prices are strong, and I think that's resulting in a strong outlook for the agricultural economy. It is an area that I'm currently invested in and I'm finding attractive stocks. One thing I'll point out is stocks do really well when conditions go from bad to okay, so much better than when conditions go from good to great, or great to slightly better than great and I think we're seeing that in agriculture. I think the economy looks strong and I think there's opportunities in fertilizers, crop chemicals and some other areas as well.

[18:00]

Pamela Ritchie: That's absolutely fascinating. When you look at gold, which is one of the areas that we have not discussed, gold coins were used by the Romans, this is not a new trend. We'll just add our two cents to it. But where does it fit for you if it does at all? It's had some interesting moves through the last year. Some people will say Bitcoin needs to be the new gold. I don't know how you look at it. Where does gold fit?

Darren Lekkerkerker: I think Bitcoin and gold are similar in that they're currency alternatives. Obviously gold has a multi-thousand year history and Bitcoin was invented or came around in 2009, so it has a little shorter history. Bitcoin also has more of a secular growth whereas gold does not. Maybe Bitcoin is stealing a little from gold over time in that regard. But I think you can think of these things as a portfolio hedge that should do well when other financial assets are not, in which case inflation, if we were to have breakaway inflation, and that's not my base case in the near term, but clearly we're having a massive increase in the money supply and stimulus so that's a worry. I do own some gold. I think that if the U.S. dollar keeps going down, and if you see low rates in the U.S. as well as a bigger budget deficit, it's possible that the U.S. dollar gets debased. I think gold could do well. I prefer industrial commodities like copper just in terms of the reopening I think that you could see demand increase more there. So I do own some gold, but I would prefer natural commodities.

[19:43]

Pamela Ritchie: Another question rolling in here from one of the investors, are business owners broadly spending more or less money in the past year to improve their businesses given the uncertainty surrounding COVID-19?

Darren Lekkerkerker: That's a great question. I think that depends by a market and that depends by function. I think in terms of spending on a digital strategy or an omni-channel strategy in order, for example, a retailer to be able to serve us while stores are closed, or people just don't want to go in stores. They're spending a ton of money there, right? I think it's all about thinking where are they spending and who's got the best product or service, and that's where we're trying to invest. I mentioned Microsoft's my biggest position and so I think

Microsoft has been really well positioned there. It's really benefited. I think early on Satya Nadella, the CEO of Microsoft, said we've seen a pull forward in two years of digital transformation by businesses in the past two months. Maybe that's even expanded to beyond two years since then.

[20:52]

Pamela Ritchie: You mentioned a bit about regulation, technology off the top, what else do we need to know about that? Some will say the lid is taken off Pandora's Box, other say that's overdone, how much do you watch that?

Darren Lekkerkerker: I watch it. I think it matters most for Facebook and Google which I don't own in my funds, but I think it does matter for some of the other companies like Amazon and Apple. I think we're talking about it all the time, so I think to a certain degree it's priced into the stocks. I also think that this is not something that impacts consumers in a negative way, at least in terms of price. It's not something where through a monopoly they're able to raise prices. It's actually somewhat benefitting consumers. It's more maybe hurting the business competition ecosystem. That's hard to know. Is the U.S. going to want to pull back or slow down their global champions? I doubt it. I doubt it. But will the EU? Probably yes. So that's probably going to be some issue between the U.S. and the EU. So it's a pretty interesting discussion in terms of the stocks that I own. It is something I worry about, but I do think to a fair degree it's priced in.

[22:18]

Pamela Ritchie: You own your own fund. You're one of the biggest shareholders, is that right? I think you told us that last time. Is that right?

Darren Lekkerkerker: I am. I'm the largest shareholder of the Fidelity North American Equity Fund and for me it's just a good way for me to save money and compound my money over time. I typically add to it as I did last year every year. I like to say that because one of the things when people ask me how do I invest, one of the key points is management and I say, look at where a CEO has your money. Are they invested in their company? How do they earn their bonus? If you were to ask me all those questions … I own the fund, a lot of it, it's my most meaningful financial investment that I have in life. In terms of how I'm paid, my compensation is by outperforming the benchmark or outperforming the other funds. So it's something that I think that aligns the unitholders of the fund with me personally, or me with the unitholders, actually the other way.

[23:20]

Pamela Ritchie: Let's talk a little bit about the fun side of perhaps travel. We've talked a bit about snapback trades and so on, but I do want to get into actual travel, entertainment, leisure, how it might be different or how it might be exactly the same where we can't wait to get back to it. What do you do with those thoughts? How do you invest?

Darren Lekkerkerker: I think it's a super interesting area. I mentioned to you just before the show started that my family has booked a vacation to a beach resort in very early … we've got young kids, so we're definitely looking forward to that … in early 2022. I think a lot of people are thinking about that. Here's how I'm thinking about it, here's the framework. What's priced in? A lot of these stocks had a big run post the vaccine announcement in mid-November, so what's priced in and where's the opportunity? Differentiation between leisure travel, which I think will come back really strongly. I think everyone's going to want a vacation when this is over. I know I do. What kind of pricing? Maybe they can actually … they're probably going to increase the prices and frankly I would still pay it because I just want to go so bad. Versus business travel, where I think that will come back, but I think it will come back a little slower.

[24:36]

Pamela Ritchie: When you just said that that you would pay it and probably a lot of people who want to go on vacation would pay it, what does that mean for actual prices that an airline can charge?

Darren Lekkerkerker: I think with resorts and hotels and alternative accommodations, things like Airbnb or [indecipherable/VRBO], I think you'll definitely see it. That skews more towards leisure travel. I think on the airlines and some of the more business-oriented hotels you have to think about what happens with business travel and would airlines … there's a lot of capacity offline. I think it will come back online over time. The other thing you need to think about with airlines in particular is how much cash did they burn, how much shares did they issue, how much is their debt higher? You can't just look at the share price because there's more shares and more debt. I would look at the enterprise value which is the total value of the company now versus then. Clearly, I think that from a currently very depressed state business will get a lot better.

[25:38]

Pamela Ritchie: Darren Lekkerkerker, it's a pleasure to speak with you. Happy New Year and thank you for spending time here.

Darren Lekkerkerker: I'm really excited. It's a new year. I just want to thank everyone that listened to it, and really thank you everyone sincerely, everyone that's invested in my funds, I really appreciate it and I'm certainly really engaged and focused. Pamela, thank you. Let's hope 2021 is a great year and let's hope that at the end of the year things are normalized and maybe we'll do one of these in person or something.

[26:13]

Pamela Ritchie: More to come in 2021. Darren Lekkerkerker, thanks for joining us.

Ending: [26:18]

Voiceover:

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