Digital Insights

Jeff Moore, Portfolio Manager

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

We're joined again today by Jeff Moore, Fidelity fixed income portfolio manager who works out of Merrimack New Hampshire.

Jeff, who first joined Fidelity in 1995, is involved in several mutual funds and ETFs for Canadian investors as a portfolio manager, portfolio co-manager, and fixed income sub portfolio manager.

Jeff explains to host Pamela Ritchie what lessons have been learned both in the past year and investing through volatile markets throughout his career.

And Jeff also shares where he and his team are going for yield, with government bond yields around the world at near zero.

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Pamela Ritchie: Jeff, great to see you.

Jeff Moore: Well, thanks for having me back.

Pamela Ritchie: What a time in the markets it is, but let's begin with what you go through in order to make a move.

Jeff Moore: When clients buy our fixed income products, they're really buying our process. As good as the past results have been — and I'm really proud of the team, just like Hugo is, of how great they've been in the past — what you're buying now is the future. It's all about process. For us, we have a five-step process. Step one is always macro. Macro is we're deciding how big a risk are we going to take, how much risk do we want to put in the portfolio. In general, just stepping back, we want to be low risk, low volatility, a great diversifier versus stocks, but get as much yield as we can. Those are our kind of goals. Within macro what does the opportunity set look like globally? Who helps us with that? It's Khana, Dee Dee, Heather, Tom, Arina and others. So that's our macro.

Step two is sector. Once we decided how much risk to take, the second step is where are we going to take it. We can buy anything, anywhere on earth. As clients know we often will go buy bonds in other countries and hedge them back so that we don't have the currency risk, which is a big vol, and to go get exposure to great sectors around the world. So we use our global presence.

Third step is asset allocation. This is where we stress test everything all the time. The whole point of this is we have our view of what we think will happen. We know we're going to be wrong with 100% certainty, right? Then where do we go?

Step four is all about security selection. Every bond in the portfolio has a fundamental credit assessment done.

Step five is portfolio construction. We put it together and it's a gold-rated process — one of the very, very few in the U.S. — by Morningstar. That's the kind of thing that makes us proud, is that the process itself is awesome. Frankly, in March and April, it worked perfectly. People like to say, "what do you do when volatility hits?" Well, you hold on to your process even tighter.

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Pamela Ritchie: That's exactly what I was just going to say. The whole idea of liquidity going through those months was a question mark, although we also saw very quick action. Again, what were you doing with the process at that time? Take us through how you put it into action.

Jeff Moore: We entered that period with a ton of liquidity and a ton of risk-free debt — U.S. Treasuries — partly because we didn't like valuations and partly because our macro call, even at Christmas time of 2019 was eh, it's a low return world so just bet low. We didn't call for COVID, but when COVID hit all of a sudden volatility spiked and it became a high return world. So you had to immediately pivot from low return to high return. Look what Hugo did, great commentary — I was listening to the two of you. I have to say, that's exactly what our team did, they pivoted so well from low return to high return, and now guess what, we're pivoting back the low return like Hugo said.

[04:52]

Pamela Ritchie: Interesting. As you say, let's go to some of the products themselves and again, how they display the process. But also allow for different investors to take a look at the fixed income world. Let's go through those now if you don't mind.

Jeff Moore: The four products that we have right now, we have Multi-Sector Bond and our Global Core Plus ETF. Think of those two as a pair. One's ETF form, one's mutual fund, we're comfortable with whatever clients want to do. The Global Core Plus has a bit bigger presence globally, but long term I expect those two will have about the same risk and should, over a long period of time, if we do this right, around the same return. The other two products we have are a little bit newer. We have our Investment Grade Total Bond Fund and its little cousin, if you want to look at it like that at this stage, it's the same thing. Both of those portfolios have constraints on how much below investment grade we can take, so they're a little less risky, but they have a little less yield. But those two are really designed to be a little bit better diversifiers to stocks than the other two. All four are great diversifiers, but the first two, Multi-Sector and Global Core Plus ETF, offer more yield, a bit more correlation to the stock market.

[06:14]

Pamela Ritchie: The next question is how do you get yield, which is a big question. I guess the question is sort of how much risk do you want to take? And things seem to be changing right now. We just watched rates go up over the course of the last 36 hours, there has been a change. What do you want now in terms of risk, in terms of finding yield?

Jeff Moore: Right now we have… risk-free rates are at zero, pretty much. Maybe you want to get really tight with it say U.S. Treasury is at 90 basis points or 0.9%, but around the world, whether it's European, the Brits, Canada, Bank of Japan, even China right now and U.S., global risk-free rates are extraordinarily low. They're probably going to stay low for a long time, that's my instinct, but we can just hold that for a second. So where do we go? You hit it on the head. I can go buy risk, but the question is how do I put together in a package where clients will say "I want that kind of vol", because I want the return, but I also want a certain type of vol. One of the things we do, we use our global reach. We're looking around the world for really good bonds and we think right now, based on our scenario work — and this is where our hotshot PhD Stacey comes into work on stage three or step three of our five-step process. Stacey's always stress testing our portfolio for everything we can think of: a COVID crisis, another 2008, Y2K if you want to worry about that, what happens in the Mexican peso crisis? What Stacey is doing is trying to give us what I call the envelope of returns. Our goal for clients is that no matter what happens or pretty much no matter what, we want to give you a positive return over a reasonable period of time.

What I mean by that… Stacey is taking a lot of the bonds we're looking for around the world and saying, "listen, even if everything goes haywire, how much price loss can our income offset?" In general, if you look at the portfolio right now, whether you think rates go up a per cent, down a per cent, stock market goes down 10%, down 20%, the portfolio is designed to get all of your money back, even if we're dead wrong, within six months just from coupon. So your client says, "hey, those are positive returns." Look at March, didn't expect COVID, but we built a portfolio that's designed to take stress into account. There's always somebody bad doing something to somebody, right? So we have to take that into account and so the portfolio's designed, all of them, good diversification and to put a portfolio of different bonds from around the world together including the low investment grade and above investment grade.

Here's the thing. We think, right now, we can reasonably buy clients things yielding between 3 and 4% — that's pretty reasonable, — and still keep that six month horizon for losses. If we try to push it to 6 or 7%, that's when losses look, could be potentially bad if we're wrong. So we don't want to do that. Right now we've pulled in our horns, we're pulling in our yield expectations that 3-4% area all to control risk. Long-winded way of saying we like the portfolio where it is, but you have you have the modest gain thoughts.

[09:37]

Pamela Ritchie: You mentioned investment grade and going a little bit below or staying above. A few months ago, triple-C was sort of an area that looked okay. I'm wondering how it looks now. Are we at a different time period? Are companies up against a different set of worries at this point? How does that space look right now: riskier or too risky perhaps?

Jeff Moore: Triple-C is a place where we rarely play even in the best of times. I leave that to the high yield team and the high yield group. Where we play mostly is double-Bs, single-Bs and triple-Bs. We love those pieces. We think they're relatively inefficient. We think double-Bs even now are one standard deviation cheap to triple-Bs. There's still capital gains coming from double-Bs in our mind. Triple-Cs are a little bit different cat. A triple-C

entity is an entity that has enormous amounts of default risk, so you'd better have a great credit team doing it. We do have our high yield team, that's their job. But that's not what our clients are looking for in my mind per se. Generally our triple-Cs will be less than 2% of the portfolio at almost any time you look at it. When we go below investment grade, it's generally in the double-Bs or… and think about a few things, we can buy hybrid securities from Canadian banks — talk to Hugo —, those hybrid securities are rated double-B. The Bank of Nova Scotia is still a double-A bank, it's just we can buy something deeply subordinated and our bank analysts take good care of that.

Those are the kind of things we're trying to do when we say we're going below investment grade. We're not going too far below and we're looking for entities where there's actually a pretty good story.

[11:19]

Pamela Ritchie: It's a good differentiator, looking within there. When you see interest rates come up a little bit, looking at 90 basis points or whatever, do you sort of go, "oh, big deal we're still in a low rate environment" or is that a big deal that we've seen some movement there?

Jeff Moore: I don't think it's a big deal. You should know, my expectation here is that we're going to have low rates for a super long time. Whether you think the 10-year should be 1½% or 1%, okay, great, but that's not that high.

Pamela Ritchie: It's still 1% give or take, yeah.

Jeff Moore: It's still 1%, it's not going to get you and your clients where you're going. In a way, we were stuck. We have rotten demographics… If you think about Canada and U.S., if you've been on my calls before you know we had the best demographics in the G10, and ours stink compared to where we used to be. Six of the G10 countries have population decline. Remember, from the first year macro class, the number of people that go to work times the output per person, that's the GDP. The number of people are going down, GDP is going to have a heck of a time doing great things. The amount of debt —Hugo said it — how long can you run $500 billion deficits in Canada or the U.S., trillions and trillions in the U.S.? You can't. Rogoff and Reinhart have said countries that add a lot of debt grow slower all else equal. We're probably here for a long time plus/minus.

One more little thing. This idea that somehow interest rates are going to go flying unhinged higher is nonsense in my mind. Why? In March, who took control of the yield curve? Who got control of risk asset markets? It's the Fed. All of a sudden do you think the Fed's going to take a stupid pill now and somehow the yield curve is going to be uncontrolled? No. Unfortunately, not. The Fed likes the power. You even had Tiff Macklem, who's the new Bank of Canada governor, what did Tiff just say? "Hey, I'm gonna use all my Canadian bullets on the long end of the yield curve." Well, Tiff wins because he's got more money than the rest of us in Canada, and the fact is he can control the yield curve to the extent he wants it. Will he want to have a little bit of play in the yield curve so he keeps people from doing crazy levered things? Yes. But is he going to let it go unhinged? No.

[13:39]

Pamela Ritchie: So why is there a camp that's so worried about inflation?

Jeff Moore: Inflation is tricky. It's been 45 years since we've had it. It's funny, I've spent the last couple of months rereading all my books from the 1960s, '70s and '80s, including Alan Greenspan's book Age of Turbulence. It's a great history of Volcker, President Reagan and the kind of things that were happening in the '80s to get inflation under control. But when you go back to it, and I tell people this, this is the anti-1960s and '70s. If you're worried

about the inflation in 1960s-70s, you have to realize that we are in a much different world. We're in a world that is massively deregulated, the 1970s and '80s, read Alan Greenspan's book again. He talks about all the silly regulations. It was regulated everywhere, like transportation regulation, taking planes anywhere, putting a cat on a plane required the FAA commissioner to sign off. Why would that happen? That was the '70s. We also had social security benefits and we had medicare benefits get indexed. We had a massive union economy in the '60s and '70s. We had an oil shock. We've had all these things. Inflation is hard to get. What I would argue is that in this next go-around, given the surplus capital which is surplus labour that's out there now and potentially later especially as technology keeps rearing its head and moving and actually leaving people behind, it's going to be even harder to get inflation.

[15:19]

Pamela Ritchie: What do you think about the overlay of ESG, it's spoken about a lot right now, it's an interesting way to look at the world and has a lot of pieces within it that seem to be useful. Is it useful to what you do, to look at things that way or maybe you already look at things from those perspectives?

Jeff Moore: Again, listening to you and Hugo, I love the fact that Hugo wants to push, and push, and push the E in ESG. I think that's a fabulous idea. That's where we all are mentally. We have to be there. One of the benefits I've always had at Fidelity is because of the way we're constructed every bond I buy, we know the company management team just like our equity colleagues and so a lot of times when it comes to governance we know who the management team is. We understand the governance strengths. When it comes to some of the social responsibility, again, we know deep into the company what's happening there. Those things have always been done by us and done very well.

On the E side of it, I agree with Hugo. We have to sort of up our game a little bit and say, "what does it mean to be E?" This is a pretty exciting time. There's new products that we're going to launch that are ESG-compliant. I think ESG is going to move a lot, what it means and is there a social licence that you have to get for your company? You can imagine, stuff like that. I feel like our team is always doing a lot of the ESG work, and I think by having external forces force it on other firms that probably didn't have the reach that we did or didn't have the analysts to know the companies, this just improves their process and I think that's a win for the whole marketplace.

[16:59]

Pamela Ritchie: Going back to co-relations generally, what do people need to be thinking about? One of the questions coming in for you right now Jeff is are you holding cash right now? How are you deploying things? Some people will point to a market that's been quite… there's been too much co-relation. How do you approach that when you explain to investors where things fit?

Jeff Moore: Co-integration and co-relations and correlation, those are all things that you should be mindful of. If you want something that's negatively correlated to the stock market, you're necessarily going to have to buy U.S. Treasuries or government of Canada bonds full stop. The problem is — we just talked about that — they don't have any yield. This is the challenge that we all have. Our portfolios are positively correlated to the stock market, and that's on purpose. By the way, does it make any sense to be negatively correlated to something that for 150 years has done nothing to go up? Who wants to be negatively correlated to that? What you kind of want, I think most people really are saying is they want something that has great diversification, and a little bit

more controlled. But to have a negatively correlated asset, it's extraordinarily costly in terms of yield. So we're low correlation, we spend again all our time thinking about these downside scenarios, modelling them, it's a very intensive modeling work with the notion we're trying to control your losses, but not get them to go to zero.

I say to people all the time, if you didn't lose money in 2008, shame on you. This was one of the great asset allocation opportunities in your history and your life, and if you didn't lose it, you had cash which sounded great — as long as your cash account didn't break the buck — you still didn't do anything on the flip side. When it comes to cash, I do not like cash. I never have. I have cash in the portfolios just to reduce friction when clients come in and out. We provide a service, every day you can come in and out, and we want to make sure that that's a costless thing to do. But in general, I'm always looking to move my money out into the curve and find good investments. Just like Hugo, I want to be fully invested at all times.

[19:18]

Pamela Ritchie: What does some of the modelling that you look at… I guess the macro, how do you get ready for, or have scenarios for the rollout of this vaccine, the hiccups inevitably will come in such a massive initiative and maybe time lags? There's been a lot of, some will say euphoria in stock markets or in other places, but how do you model this next X number of months going forward?

Jeff Moore: If you look at from here, what are the big events that my macro team has identified that every one of us should have in their calendar? The ECB in two weeks is going to roll out what we think will be an extension. They won't deepen or increase QE, they'll just extend the timeline. Which is to say the NPB of everything in the Eurozone should go up that day; not by a lot, just by extension. When the ECB, the Federal Reserve or the Bank of Canada provides liquidity to the marketplace and eases financial conditions, keeps financial conditions easy, in economies like ours that are so incredibly levered, that easing of financial conditions goes right to the net present value of things. The Fed knows this. There's a little lag here and there and it's not perfect one for one, but they know this works. You're going to have the ECB in a couple weeks. We have the Federal Reserve doing the second stress test. Keep that in mind. This is a supplementary stress test. The banks all passed in the summer, they're doing a supplementary one with just small, medium-sized businesses. We do know, all of us know that small businesses got clobbered in this whole COVID crisis. Most of the stuff that I invest in for clients — remember I'm a big-cap investor, so companies that have IPO'd, they generally have more staying power, things like that —, but when it comes to mom and pop small-caps, that's where the banks really do the lending. The banks are gummed up right now. So the stress test will find that out. Watch for that. The Fed will be looking at a dance between… because they're so gummed up they need extra capital, that means that probably banks can't do as much on dividends and can stock buybacks. Keep that in mind, that's coming up in the next two weeks. We'll watch that.

We head on to January, we're going to actually see President Biden, we're going to get to whether the Senate and Georgia flips, what kind of play, and we're going to get more and more information on how president-elect Biden, how he wants to govern. Those will be really important things. Keep all those in mind with the backdrop that interest rates are going to stay extraordinarily low because they can, and the Fed is bigger and more powerful than anyone else and the Bank of Canada is the same. By the way, no bank in Canada is going to try to take on Tiff when the superintendent of financial institutions is just down the road in Ottawa and will have words for the bank. That's just not how things work in this world.

[22:09]

Pamela Ritchie: Just walk right down the street. When you saw that Janet Yellen was going to be the next Treasury Secretary, what did you think?

Jeff Moore: I met Janet. You should know I'm a huge fan of hers. I think she's fantastic. She's low key, she's very, very forthright, but low key, but she's an incredible, incredible strength and expert. She's going to be awesome. She is going to be awesome. The markets will really like her. The combination of her and Chair Powell is frankly as good a combination as Chair Powell and Secretary Mnuchin. This has been a nice pick I think by president-elect Biden and I think that Chair Yellen… One of the big things about Chair Yellen, if you don't know her, she's a labour economist by training, and she's going to spend a lot of time trying to figure out how come we leave so many people behind? We know this. We call it income inequality. This is going to be one of the big stories in the next 2 to 5 or 10 years. Secretary of the Treasury Yellen will be perfectly positioned to have a bigger role than even she did as the Fed chair.

[23:22]

Pamela Ritchie: Isn't that amazing? The discussion that's so fascinating is the stimulus discussion/question in the United States. As we know Canada is planning to do some major spending, further major spending. There seems to be a little bit of a question mark of whether it will be a smaller package and will go on to a bigger package with President Biden being ushered in in the inauguration. What are your thoughts and how important is that to the investment thesis?

Jeff Moore: The fiscal piece matters. If you look at someone like Chair Powell, he was very clear that there's almost no amount of stimulus that would not be welcomed. So keep that in mind. Even though so many parts of our economy are doing well, there's again this massive group of people we've left behind. So from that perspective there's not inflationary at this stage and certainly not for a couple more rounds. My sense is that president-elect Biden will be more successful getting things done than you might otherwise feel. Remember, this is a person who's been in government for 40+ years, he's the ultimate insider. If you think about President Trump being the ultimate outsider, we just went 180 degrees to the ultimate insider. But within that, my sense is that he's got great personal relationships with Republicans as well as any Democrat senators, and he can probably get some stuff done. It depends on degree and scope. The reason I'm saying all this is when I think about what we're going to see in terms of fiscal stimulus, I think as time goes on it gets more targeted. If you think about what we did in March and April, we were just throwing whatever we could to the wall. I think that that was a great policy. It was gutsy. I don't know if I would've done it, but it was gutsy both in Canada and the U.S. But from here the sizes fall because we've used a lot of our bullets already, but I also think the targeting gets a little bit more clear. And watch for more of that in the second and third quarters of next year.

And then the question is really how fast do the vaccines get rolled out. I think one of the nice things for the marketplace is, again, the market does MPBs on everything. If vaccine doesn't get rolled out for three months, the market doesn't really discount that much further than if it's four months. An individual might be full of anxiety around that, but the market itself will feel pretty calm about that. I think what the market's saying right now is there was a question six months ago that maybe the vaccine would be two years away. I think most people, all of us, have tightened up our window so to say it's some time in 2021. And the market's kind of discounting that.

[26:06]

Pamela Ritchie: Jeff Moore, it's a pleasure to speak with you always. I always feel like you have all the answers to everything. It's great to get your views on where should the products belong for each type of portfolio for investors today. We'll see you again soon I hope.

Jeff Moore: Bye, Pamela.

Voiceover: Thank you for listening to the Fidelity Connects podcast. For more information on future live webcasts, please visit fidelity.ca. Don't forget to follow Fidelity Canada on Twitter and subscribe to Fidelity Connects on your podcast platform of choice.

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