The Upside

Don Newman – 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.

In today's podcast, host Emily Anonuevo catches up with Don Newman. Don is Director of Research at Fidelity Investments Canada, and portfolio manager of Fidelity Dividend Plus Fund. Don also is equities sub-portfolio manager on several funds, including Fidelity Dividend Fund and Fidelity Monthly Income Fund.

Don places high value on the quality of a company, its ability to generate free cash flow, and the strength of its balance sheet, and in today's podcast Don shares how he is positioning his funds to generate income with dividend investing and shares his outlook for markets and dividend investing in 2021. Don, who's been in the industry for over 20 years, also shares with Emily what initially got him into investing, discusses Fidelity's research resources, and touches on the benefits of individual investors having a financial plan.

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Emily Anonuevo: Imagine quadrupling your savings over time. Well, according to research this is the value that advisors can add to our lives by planning for the future, saving with discipline and by allocating to non-cash assets. In fact, in today's low interest rate and uncertain times, getting exposure to assets that offer stable returns is more important than ever. Dividend-paying stocks have historically been a smart way to protect and grow our purchasing power and work towards building our goals. So how have dividends held up in 2020, what is their outlook for 2021 and where are there opportunities for strong returns? To help pull these pieces together, we're joined by portfolio manager and director of research, Don Newman. Don manages the Fidelity Dividend Plus Fund and others, and oversees a team of research analysts who spend their time examining companies' future potential. Don, welcome to the show. So great to have you here.

Don Newman: Hi, Emily. Great to be here.

Emily Anonuevo: Let's begin by sharing a bit about you and what led you to a career as a portfolio manager?

Don Newman: It's actually sort of an interesting little story. I'll try to be brief here, but when I was about 12 years old, I started getting interested in financial markets and I decided I'd like to maybe try buying a stock. I went on one of our family vacations, and we flew down to where we were going, and my mother had remarked on how wonderful the service of the airline had been. So I, in my infinite wisdom, I decided that it would be great to buy a few shares with some money made mowing lawns in this particular airline. I did so and basically sheer luck a couple of months later, the airline got taken out for 100% premium and I ended up making a small amount of money, but to me at that time it was really good. As I say, it was totally lucky as I found out and look back at it. Basically the airline had to sell itself because it was running out of money. It was probably a terrible … in investment terms now it would have been a terrible decision but it really sort of piqued my interest. Fast forward 10 years later, I got the opportunity to move down to New York and work for an investment bank in the investment research department on Wall Street, spent a few years there, and then one of the biggest and most respected clients we had was Fidelity. A couple years into my role at the investment bank in New York, I got the opportunity to interview at Fidelity, managed to land a job in their research department, and 18 years later I'm still working at the firm and enjoying what I do.

[05:07]

Emily Anonuevo: Excellent overview. I knew that story about you when you were younger but I didn't know you started that young, 12 years old, so super neat. Fantastic. Don, I know that part of your investing strategy is to actively seek exposure in non-traditional dividend-paying companies. Can you just elaborate a bit on that?

Don Newman: I think we've talked about the buckets I look at in general in the fund. One is the secular growers. The base of the fund is always just good, solid, dividend-paying companies that are going to be around forever. You can count on the yield, and over time you're going to grow and pay people a great yield. The other part of the investment bucket is just looking at … sometimes I have a very small weighting in it and sometimes it gets bigger. After going through a downturn, that bucket specifically is the beaten-up cyclicals bucket so you might look at whether it's beaten-up real estate, you might look at some metals and mining companies, you might look at some energy companies. You might look at some beaten-up cyclicals that people haven't looked at, so there is a portion of the fund that depends on where we are in cycles, but right now that portion actually looks fairly interesting because they're stocks that are still down a fair bit and have recovery potential.

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Emily Anonuevo: Don, let's just talk about this year in general. Obviously it's been an unprecedented year in the markets. Dividend investors have gone through their fair share of changes. Historically dividends have proven to weather this storm and produce good returns. Can you talk a little bit about the distinct characteristics of dividend-paying companies and why, in your opinion, they may be a good fit in today's markets. I just wanted to hit that point home with the investors on the line today.

Don Newman: Just general the background for dividend companies, they tend to be companies that have been around a little bit longer, generate decent amounts of cash flow. Balance sheets are generally relatively stable. They can actually afford to pay dividends and that's nice. Cash flow generation is a key part of investing in any company. The difficult thing with some of the dividend stocks is we sort of started the year and a lot of them tended, because they may be a little bit older economy, been around for a while, tend to not do fairly well in a pandemic COVID environment. I think that's going to be the great opportunity going forward. I think what's really interesting about dividend-paying stocks, and what I'd say is a great pitch for them right now, is number one yield. The yields across the world have absolutely been compressed. The yield environment has really changed. But one place it hasn't changed, because you did have a tough period for dividend stocks earlier in the year, is the yield you get from the dividends.

If you're able to look out the next couple months, I think I mentioned before, there's going to be a real push and pull between COVID and vaccine, and stimulus and no stimulus. But if we assume that hopefully vaccines eventually are effective here and things eventually work their way back to normal in '21 and '22, and if there's real upside to a lot of the dividend-paying stocks that maybe haven't performed quite as well over the last little bit. So you get yield and the potential of a good upside over the last couple years. I think that's a pretty compelling opportunity.

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Emily Anonuevo: So I just wanted to get more insight on what has contributed to that and how you are actively positioning to capture as much upside, and as little downside, in the next year in 2021.

Don Newman: How I frame this is at the start of the year I was fairly conservatively positioned. We hit March and the market dropped 35% in three weeks. At that point it became the if not now, when are you going to invest? There is no better time. Canadian banks hit book value for the second time in 20 years. You priced in a full recession in the course of three weeks. That's the busiest period I've ever had as portfolio manager and there's a combination of one just buying things, and it was across the spectrum 'cause everything was on sale. It was the secular winners, it was the good dividend-paying stocks, it was really beaten-up cyclicals, and then there was some rotation in the fund. Out of some defensive stuff that I'd had in the fund and into a little more cyclical stuff I had in the fund. It was a combination of being a little bit defensive, putting some money to work, and then I'd also like to point out it's not just me. Fidelity is wonderful. The process that I use has been the same. I've been at the firm about 18 years now, and we have 36 analysts in Canada and the U.S. who are everyday putting out research, calling companies. I'm probably spending five plus hours a day on Zoom meetings with companies now and just finding the best ideas. A lot of it's just been decent stock picking. Our analyst team is picking out some great stocks, and it's been a real team effort. It's worked out for investors fairly well, and I'm optimistic about dividend-paying stocks into the next year or two.

[11:04]

Emily Anonuevo: That's great to hear. You're absolutely right about the depth of our team here and the research analysts. It is a truly incredible team effort. I want to go back to the role of advisors for a moment. I mentioned it off the top in my intro. Obviously advisors help investors foster discipline in challenging and confusing times like today, and just staying focused. If you can expand on this. As maybe a first-time investor, or even a veteran investor, the headlines that you see, especially this year, could be scary and confusing. How do investors stay the course and stay disciplined? Can you expand on your thoughts on that?

Don Newman: For me, it's interesting. You watch TV and the internet these days and there's so many commercials about how people should be doing it on their own. That may be fine for a number of people, but for the vast majority of people you have a real job. You spend your entire day, you're not involved in capital markets, you're not involved in finance. You spend your entire day working to provide for your family, and then you come home at night and you spend your time with your family. You don't have hours a day to be spending on your financials. One of the really great things is just having people out there that can help you stay the course, stay focused, focused on maintaining your purchasing power. When life changes for you, your investments maybe shouldn't be the same. There's a whole bunch of other stuff that goes into a financial plan for you. It's not just, you want to pick the right funds and obviously that's important to us. There's estate planning, there's insurance planning, there's a lot of other stuff that goes into making a financial plan and just having a steady hand there to help you through it is definitely worthwhile.

I went to school with a lot of people from a four-year commerce background and there's a ton of them have financial advisors simply because they're not in finance. They're doing marketing, they're doing accounting, they're working for tech companies and they're devoting their time to that, not spending hours a day on their financial plan. It makes sense to have the steady hand there that's guiding and can help you through the turbulent markets.

[13:36]

Emily Anonuevo: You're absolutely right about that. Just having that value of advice and that steady hand especially during this year. It's just been an incredible year. Let's go to some of the headlines. Vaccines making the waves in the news right now as many countries are receiving the vaccines right now. As they're being rolled out, there are many beneficiaries in the economy and in the market, so how can dividend-paying companies benefit from this?

Don Newman: I mentioned earlier that … and one of the reasons I was fairly conservatively positioned, at least into a pandemic, because you go around and for our research department there's not a lot of dividend stocks that I'd classify as huge COVID winners. To the flip side of that is there's a lot of stocks that actually will do well coming out with a vaccine. You think about financials, people end up going back to work, more people are employed, there's less provisions for credit losses. Telecom, you get your roaming fees back, you get your fees associated with all the sports are shut down right now, but that all comes back. Just in general, you look at whether rates start rising a little bit, that's good for insurance. People decide, hey listen, I've been stuck in the house for a year, year and a half, and maybe when this ends I'd actually like to go back and go and shop somewhere. It's crazy, everyone shops online now, but maybe I'd like to actually go and shop and head back to the office. There's good things for real estate. There's a lot of sectors that are very dividend specific that have been beaten up.

Energy, it's not really a big dividend sector, but it's a place where I have some exposure because if you go over and look at China, they're almost 100% back to consumption of oil at this point. Eventually North America will probably get there too. Yes, there is a secular of EVs and renewables. I have some of that in the portfolio, but some of these things have been left for dead, and I think there are interesting recovery stories over the next couple years.

[15:59]

Emily Anonuevo: Any other sectors, you mentioned energy there, that could be COVID winners in your opinion in the upcoming year in 2021?

Don Newman: It's across the board for dividend sectors. I mentioned financials. I mentioned telecom. Obviously there's a lot of money being printed and a lot of money chasing fewer goods. Metals could be okay, real estate. It's across the board on the dividend space where things hopefully should get better.

[16:41]

Emily Anonuevo: Let's talk about inflation for a moment. In the situation that it could go up, with so much monetary and fiscal support in the economy right now, are dividends a good way to hedge for this?

Don Newman: I think it's in a really, really good place. We talked about it earlier in the broadcast here. There's very few places that you can actually find a 4% yield where things are getting better at this point. The way I think about inflation, I'm not necessarily thinking that the CPI, which is the consumer price index, is going to go absolutely crazy. There's portions of that. I think they take it … if you go out and buy a computer, they take it, well the price may go up, but you're getting more power so actually you got that as a … it's cheaper. But that's not the case … and the example I like to use is the grocery store. You go to a grocery store, you have $100. The $100 basically this year will buy you a certain amount of groceries. If I put that $100 into the bank and I go back to the grocery store next year, what am I going to get for that? My answer is probably less groceries. What you're going to find is because there's so much money chasing [indecipherable] the same amount of goods, you'll find the commodities index chart is at about a 6 year high. The price of [indecipherable], the price of oil, the price of packaging that you're going to be using at the grocery store, the price of labour is all going to be going up. So it comes into the idea of preserving your purchasing power.

Next year when you go to that grocery store, if you put money in the bank, you're probably going to be able to buy less groceries. You might be able to buy less of a car, you might be able to buy less of a home. One of the things that advisors can really help you do, and one of the main functions for your financial goals, should be maintenance of that purchasing power. Next year instead of having $1.00, you have a $1.04, you have a $1.05, you can go back and you can offset that inflation. It's not big right now, but the money chasing goods is pushing prices up. You want to be able to protect that power, the value of your money so you can go to that grocery store next year, or go and buy the house you're looking to buy 'cause lumber's going crazy, the car you're looking to buy, aluminum is going up, steel's going up, and be able to take that money and still buy the same amount of goods. I think with yields compressed all over the place, having a 4% yield on dividends means, instead of $1.00, next year you have $1.04 and then you have some upside hopefully that can come through research and stock picking that we do here at Fidelity.

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Emily Anonuevo: It all makes sense and a great example there with the grocery store. I know you've said many times before that dividend investing just makes sense. Really solid numbers there.

Don Newman: When you think about returns on an index, or just returns that you're generating, I think everyone just looks at the return of the market, the market going up, the market going down, but I think what's lost over time is just that you're actually getting a lot of your total return from companies paying out dividends to you and that's the most stable part of your return, and the part you really want to kind of be able to count on. Markets are going to go up and down. Over time they'll go up 'cause companies become more profitable, but that dividend portion is the stable portion you can count on. This kind of almost understates its importance a little bit because it's looking at your total returns by decade. This is for the S&P/TSX and it's similar for the S&P 500, but in a lot of years it's 30, 40% of your total return can come from dividends.

If you think about it in terms of, that's just the index and there's a lot of companies in the index that don't pay a dividend. If you're in a good dividend-paying fund you can actually get a higher return, that nice stable return from dividends, and also get the upside from the market. I think the idea of, take a 4% yield, 10 years later if the market has done absolutely nothing you've got 40% more money, and on top of that hopefully you can get some good upside over the time, and it's a conservative way to compound your money, preserve your purchasing power and hopefully do fairly well in the upside.

[21:23]

Emily Anonuevo: Great strategy and excellent points there. Just a few more questions before we go. Let's look into 2021 and just describe your playbook and your strategy for the upcoming year. What are you keeping your eyes on? Are you looking two, three months down the road, or are you looking even longer term?

Don Newman: The market is a discounting mechanism. The market's going to look further than three months. As I mentioned, in the very near term you have a push/pull between COVID and vaccines, and stimulus and non-stimulus in the U.S., but the way I want to look at things is what are companies going to be earning in 2000, end of '21 and in 2022, and form a lot of my stock picks and what goes on the fund on that. I mentioned the three buckets I'm in - the good paying dividends, the secular winners and a little more of the beaten-up stuff. What I'm interested in at this point is hunting around in the beaten-up bucket and see how much … talk to our analyst, what's the recovery earnings power on something if we do actually get closer to normal in '21 and '22, and if that's the case, can we find a bunch of things that are really underpricing return to normal and things getting better, and look at stocks that are still down somewhere between 20, 30, 40%, that over the next couple years I think there's really good upside, and then if things still aren't that great, they probably don't go down that much. What I like to frame as risk reward potential. So your risk is much lower than your reward. If things go right, you make a lot of money and if things go wrong you don't lose very much. So that's sort of the bucket I'm looking in, sort of more … being able to recover and then still having the nice stable part of the portfolio that pays good dividends, good companies, you don't really have to worry about them and some secular growth on the other side. Hopefully that combination can produce good returns for fund holders.

[23:42]

Emily Anonuevo: Excellent way to frame it out for us and still lots of unanswered questions for the next year, but just a great way to round it out for investors on looking at dividend-paying companies. Don, before we go, you've been with the firm for 18 years, you've been in the industry for over 20 years, I'm just curious to know if you weren't doing what you're doing now, if you weren't a portfolio manager, what career do you think you would be in?

Don Newman: It's an interesting one. If you go by family history, I should be a teacher because my entire family basically has been teachers throughout time. I would tell you, I probably wouldn't have gone that route. I really do love what I'm doing. It would be something related to this, so I'd probably be at a big corporation doing corporate finance or corporate development or something like that, trying to build a company. It would be something related, but not the same thing.

[24:43]

Emily Anonuevo: And I absolutely believe you because of your story you told off the top of the show, paying into your first stock at 12 years old. Don, I want to thank you so much for being on the show today. Sharing your insights about the year that was 2020 and what to expect in 2021. Thank you so much for being on the show and speaking to our investors today.

Don Newman: Great. Thanks for having me, Emily.

Ending: [25:06]

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