Fidelity Connects

Global Dividend Investing

Voiceover:

Hello and welcome to Fidelity Connects – by Fidelity Investments Canada - connecting you to the world of investing and helping you stay ahead.

Today's podcast features Portfolio Manager Ramona Persaud. Ramona will take us through what to look for when finding dividend-focused stocks, how to look at sector investing and her thoughts on ESG as a theme.

Ramona explains to host Pamela Ritchie the benefits of having dividends in a portfolio, which are that dividends offer stability and a source of real income growth with the current concerns about inflation.

Ramona also touches on her overall investing approach, how her portfolios are currently positioned, and the typical turnover in her mandates. For Canadian investors, Ramona manages, among others, Fidelity U.S. Dividend Fund, and the equities sub-portfolio of Fidelity Global Monthly Income Fund and Fidelity U.S. Monthly Income Fund.

This podcast was recorded on February 18, 2021

[01:42]

Pamela Ritchie: Hello and welcome to Fidelity Connects. I'm Pamela Ritchie. Dividends have the potential to be a reliable source of income for all types of investors. In today's near zero interest rate environment, which may endure even in the face of potential inflation, dividends could become even more attractive for those seeking income and stability in today's rather unstable times.

So what are the inherent qualities of dividend-paying companies that may be suitable for right now and into the future, and which sectors or even global regions represent fertile ground for picking strong, outperforming, dividend-paying companies? We're joined by global income investor Ramona Persaud today. Ramona runs portions of, or all of the U.S. Dividend Fund, Global Dividend Fund and the Global Monthly Income Fund. A warm welcome to you, Ramona, great to see you again.

Ramona Persaud: You too, Pamela. Thank you.

Pamela Ritchie: Ramona, I wonder if we can situate ourselves in the year that we're in and how it is set up, how it is looking for dividend investing.

Ramona Persaud: Maybe I can just take a step back and just say what the benefits are of having some dividends in your return stream. First, especially with the current concerns about inflation, dividends do offer a source of real income growth, so there's a measure of inflation protection and that's just by virtue of equities offering a measure of inflation protection. If you own high- quality stocks typically they have pricing power, which means that they can price above their costs and therefore get real pricing. Real pricing translates into real free cash flow growth, real earnings growth, and then dividends are paid out of that free cash flow, so you can get real income growth off of your dividend stream.

Next, dividends offer a measure of stability. To have enough dividends in your total return stream actually dampens the volatility of that total return because the volatility of dividends is lower than the volatility of price. It's more predictable, is why it drives that lower volatility. So as a result, you can really have a nice risk-adjusted total return by having enough dividends in your return stream. So those are two key factors in the market we're in today for considering dividends in one's return stream.

[04:07]

Pamela Ritchie: Is this a so-called … I mean, it's a recovery of sorts, we're seeing some interesting parts of recovery and reflation. Again, I guess just sort of situate us for the way or the style that you invest in. Do you set up to catch the recovery as well as that stability that's given by dividends? How does that work together in a year like this?

Ramona Persaud: I'll step back again and very briefly say what we're looking for in all of the strategies that I run. I'm looking for three things. One is investment return, like everyone else, sourced globally. Not necessarily like everyone else, so I just like to go all over the world and find ideas. Two, is downside protection because these are meant to be more conservative funds, and three is a reasonable level of income. If you actually put those three things together, what you get is risk-adjusted total return. The total return is your denominator of price plus dividend, and the risk adjustment is that volatility consideration in the denominator, so risk-adjusted total return. So what that means is these funds, given the focus on downside protection, should really protect downside in drawdowns as we saw last February into March. So you get really good downside capture, so less capture of the market, and then you get reasonable upside participation. So if you can compound those two outcomes, really strong down capture with good up capture over long periods of time, you get really strong risk-adjusted returns, which is what we've seen in the global strategies for the 10 years that I've run them.

What that means is that in recovery scenarios these strategies should do really well absolute, but not necessarily beat the market but again, if you're more than beating the market on the down, and you combine that with doing reasonably well on the up, you do really well. So the long-term down capture is like low 80s, and the long-term up capture is mid to high 90s. So in a recovery scenario, if I'm doing something like high 80s, low 90s, that's actually in my mind pretty good because I know that in a drawdown, if I'm positioning the fund well, that the downside capture will more than make up for not being over 100 on the up.

That's getting into maybe a little bit too much technical stuff, but in this current recovery what has really helped me to position for it is valuation, as I always say. I really like looking at valuation differences, the difference in valuations between different types of stocks relative to their historical difference. If versus their historical difference that you're far off of the historical difference it's very, very telling, and it's telling in the sense that your future alpha odds are very high. There's still a lot of parts of the market that are economically sensitive and quite dislocated. In the UK I still have all kinds of economically sensitive stocks that would benefit from the pandemic resolving that I can still buy for great free cash flow yields. So that to me is quite exciting in the sort of recovery phase that we're in.

[07:13]

Pamela Ritchie: What sort of thing is still a good recovery stock that hasn't already seen the acceleration?

Ramona Persaud: If you just aggregate it all up, valuation spreads certainly, so this is those valuation differences I was talking about, got to about 70 to 80% of the global financial crisis level, which is pretty high, two-thirds-ish per cent at least, and that was so telling. Today we are at a much lower level of valuation difference, but still well over average. So it's about one standard deviation across the world, which is well over average, and that's enough for value-oriented names to continue working. And if that's the aggregated number, what I'm looking for is stocks that are higher than that in terms of their dislocation.

An example, I'll give you some funny examples. We always talk about this karaoke company in Japan called Daiichikosho and karaoke in nursing homes. If you think about it that was--

Pamela Ritchie: Fun!

Ramona Persaud: –fun but also … yes, totally before pandemic. So the pandemic hit, and the demand for that just went away, and the stock got really dislocated. They cut the dividend. I owned a lot of it, it's been a very dislocated stock, but it's giving me a chance to buy more at great valuations. It's an exceptionally run company. They get pretty good returns on capital in the context of it being a Japanese company. They will start to pay a dividend again, so I'll get really nice dividend recovery growth. Another one is called Informa in the UK, so they are an event company. Think of big conferences, nobody is going to conferences anymore, but at some point that business will come back. Super dislocated, also cut dividends, still very cheap.

Another one also in the UK is a caterer. There's a big catering company, think of workplace dining. Nobody's going to work anymore, so no one's eating in cafeterias anymore, so that business has gotten obliterated, but it's a very strong core business run extremely well, strong balance sheet, good management, very capital-allocation oriented. So when that recovers, I will get dividends again, and I'll get my recovery earnings, still pretty good valuation.

I could keep going obviously, but another one is a travel retailer in the UK called WHSmith which, if you think of the airports and you go to your convenience store in the airport where you buy your magazines and your snacks and all that stuff, that's their business. Electronics. It's actually a very good business. It grows reasonably well. They have excellent capital allocation … obliterated and still very dislocated in terms of valuation, and dividend recovery and all that stuff, so these things are all over. In the UK it's especially target rich 'cause the UK has this extra layer of Brexit confusion. So that's actually provided us pretty good valuation opportunity.

[10:10]

Pamela Ritchie: Fascinating. I fail to see how all of us couldn't be better off with more karaoke in our lives.

Ramona Persaud: As long as you believe Japanese people will not stop loving karaoke the business should be fine, and you increase your odds of alpha by buying it cheap.

[10:29]

Pamela Ritchie: Oh, I think that's something to look forward to. There's actually hope [audio cuts out]. I have to ask you, looking at the headlines of the weather right now, there's no question that in Texas there have been disruptions to certain areas of the economy in addition to a truly horrific story, people freezing in their homes in a lot of cases. But it has dislocated pieces of the economy in terms of growth, the oil price has been reacting. Is there anything within your investment universe … I know you look at the energy sector, are there things that have been affected by that one way or the other?

Ramona Persaud: Absolutely. It's a really tragic situation because that part of the world is not set up for this kind of weather. I have a lot of close friends from school who live down there and really Fidelity, we have a big operation down there, and so we have our colleagues and friends. The situation is quite real if you know people. That's kind of the personal side.

The investing side I actually own some power retailers. They are both power producers and retailers of power. Before all of this happened, I owned them because they were really cheap, double-digit, 13, 14% free cash flow yields, which is unheard of. You only get that kind of yield when the market believes the business is going away. We have an excellent analyst on the sector who was basically saying the business is not going away and here's why. So all of a sudden Texas is having power supply issues, and this one company that provides a lot of the power down there has been able to meet demand and provide excess power, so the stock is doing really well. That's just an example of owning a really cheap dislocated stock. This is a deregulated utility that you can use strong fundamental research to get an investment edge and then buy it almost for the cheapness without much of a catalyst, and then sometimes you get a really incredible catalyst that propels the stock. So that's where we are today on that. It's still a really controversial situation. There's a lot of finger pointing about who's to blame about the situation, but in the meantime these guys are able to provide the power that people need, and they're getting rewarded in the marketplace for doing so.

[12:55]

Pamela Ritchie: And as you say, catalysts attend to certain things, obviously react to various catalysts within the marketplace as they come through. A big one that is well telegraphed is another round of fiscal stimulus in the United States. I wonder how you look at that for your investment world, and maybe for the world globally, does that push or pull for U.S. investments versus global? How do you look at that for your style of investing?

Ramona Persaud: That's a good question in terms of which one does it benefit more, U.S. or global. It's a really good way of thinking of it. Most of the marketplace is sort of obsessed with the impact on the U.S., but you're right, it could actually, at the margin, drive non-U.S. stocks more than U.S. stocks because it's not just the fiscal looseness, if you will, it's the combination of fiscal and monetary. If you've got fiscal generosity on the horizon, but in the past, certainly coming out of the global financial crisis, they offset each other, so austerity was used. Especially all across Europe when monetary was super loose, Europe implemented a lot of austerity, and so you didn't really get economic recovery. You got a lot of pain actually.

So what seems to be the government and central banks are doing differently today is telegraphing that they're going to be loose on both fiscal and monetary. So if you have that for a certain amount of time, not forever, that tends to be very bullish for economically sensitive stocks when you have both fiscal and monetary. If you believe that to be the case, then ex-U.S. should do better than U.S. just by virtue of the sector compositions. U.S. has more defensive sector composition than the rest of the world. If you think about Canada being so energy and financials heavy, or Europe or Asia, it's more cyclical than the U.S., and so those areas should do better. When you look at expectation of relative earnings growth and valuations, there's a decent case to be made for non-U.S. stocks. There's still also a pretty good case to be made for U.S. stocks. It's a bit unclear which way to really lean. So I own a lot of both.

[15:18]

Pamela Ritchie: I want to pick up on a couple of different sectors particularly, and one that I know has been on your top 10 published for some time is the semiconductor space, but again, the global sector, it's a global story, so it's not just U.S.-based, but can you talk a bit about that sector that clearly is seeing scarcity?

Ramona Persaud: And impacted by some of the weather stuff. Semis, I own some of them. I own the ones levered to economically sensitive end-markets like autos. There's some semi companies that most of their supply goes into automobiles, and so they're more the cyclical part of tech. Tech has been an interesting place to invest the last 10 years because there's the hyper-growth part of tech that loses money, needs constant capital infusions to keep going, but that the market has rewarded because you've an amazing top-line growth at a time when interest rates have been very, very, very low, which is super supportive for that kind of business. So I don't go there because I can't get an income stream off of that. Where I have gone in tech is in the cyclical parts of which semis is one, memory is one. There are times that the valuations get really rich, and times when the valuations get dislocated. Today I would argue that semis are reasonably valued enough to still own a lot of them.

So I own the one levered to auto end-markets. I also own, one I should talk about is Taiwan Semi, which is just a really dominant, high-quality company that is getting stronger and stronger as lots of other competitors lose share, lose technological advantage. I've known TSMC for a really long time, almost my entire investing career. When we could travel, I used to go to Asia and always meet with them. It's an incredible company. They are just so thoughtful about every single thing they do. The technical side of things, what I should really mention is they're really thoughtful about ESG, even before it had a name. They think about the water usage. This for me is an extra part of the investment thesis. They think about water usage. Semis are very water intensive. They think about chemicals, and they're part of the Responsible Mineral Initiative, which is about supply chains and supply chains being responsible in terms of where they source materials. They're part of the Responsible Business Alliance, which is about labour practices. They're definitely all over the carbon neutrality topic, so when you talk to them what's really impressive is how deeply they think about every aspect of their business including being responsible to all stakeholders. There are times it gets really expensive, and I'll sell a little, but I wait for that one to get cheap because it's a long-term holding based on the quality of the business.

[18:24]

Pamela Ritchie: I was going to move into ESG a bit later, but it's so perfect the way you just talked about that. If you've owned this through much of your career, you're clearly a step ahead in this particular company on the theme as well. Can you talk a little bit about being a step ahead in ESG? A lot of people are just getting up to speed on it right now and thank goodness they are in many ways. I wonder if you can just talk about coming to the plate, where you've already seen opportunities, and where we're all going to find ourselves in the next little while in terms of investment.

Ramona Persaud: Absolutely. It is an incredible theme that's taken hold in the marketplace that we all operate in. I don't know if I'm a step ahead, but it's possible that I might think a little bit differently about it, if only because of my background. My formative training is in environmental science and engineering, so I actually intrinsically love the topic of environmental sustainability, and I remember when I first started in the investment business, and my coverage was paper and packaging and home builders. It was tangible stuff, so I always had conversations with people in the field or at home-building sites, in the packaging plants about the materials going into the products and the sustainability of the materials, and I imagine they might have thought I was a little crazy. It was 20 years ago when we didn't really care that much, but it's sort of intrinsically interesting to me. I think it has always shown up in my investment process naturally.

I respect companies more who take the environment seriously, and I do believe they do better over time because ESG is essentially an all-stakeholders approach to running a business, which means all stakeholders have a role in the success of the business, so you have to attend to all stakeholders and that's truly my belief. I had an engineering job at a very young age at an oil and gas company that did not take the environment seriously, and frankly, was pretty deficient on the social aspects as well. It was just a very bad culture, and I think that really left an impression on me in terms of what it takes for businesses to succeed. I quickly concluded this would not be a successful business relative to its peers and relative to other business generally if they didn't get the environment right, and if they didn't get people [indecipherable]. I voted with my feet. I left and went to the financial services because it has less of an environmental impact and it's way more merit and performance-oriented.

So it was very formative and ever since then coming into Fidelity investing in companies, I always intrinsically look for the E because of my scientific training, and I look for the S because of my personal experience with things like talent, and meritocracy, and bias and community, coming from a communal culture. And then the G part is what we do at Fidelity. G is a core value at Fidelity. So I've gotten that from Fidelity, and I combine that with my core values in E and S. So I think it comes through in the process, and you can see that in outcomes. My funds consistently score higher than their benchmarks on ESG metrics. I don't explicitly target it, I think it just naturally comes through.

[ESMC?] is an example. I own a lot of Microsoft in part because they are best in class in ESG. Apple is pretty good. There's a company called Amgen that's extremely thoughtful, very cheap, good business, so I get everything I want - good dividends, good sustainability focus, social focus and great valuation. Roche is a pharmaceutical company that is best in class. So what I think I can bring to this discipline is the science of really understanding what is truly good ESG and what's not, as well as personal experience with the S, and then the Fidelity experience with the G, but also there are lots of companies that are excellent on ESG that the market doesn't know about. We can use our fundamental research … markets obsess with wind, and solar and carbon neutrality, which is fine, but those things get overvalued very quickly potentially. What we can do is bring our incredible fundamental research in getting ahead of the crowd, we're good at that, to ESG where there's a ton of inefficiency in how ESG is understood. I'm really excited about that.

Pamela Ritchie: I am too and there's clearly more to discuss with you on this front. I will come back to it.

Ramona Persaud: That was a lot, I know.

[23:08]

Pamela Ritchie: No, but it's fascinating to … I'd kind of like to know what you think about those that are rushing to it right now with perhaps not the background that you just described. More on that in a second. You've touched on a couple of different sectors by talking about some of the names that you mentioned there. This question is about financials. Financials have been part of the value, the reflation trade, if you will. Your thoughts on financials.

Ramona Persaud: Financials are cheap. They're always structurally cheaper than the market because they're not as high-quality businesses than the market, but they're even cheaper than they should be because there's been a belief up until very recently that rates will stay low forever. Obviously they're interest-rate sensitive, but there's also been so much concern that credit is going to just obliterate them, credit cycle, and what's interesting about financials having covered global financials for a long time, having some expertise there, is they are so much better positioned this cycle than prior cycles. I know you've heard this from lots of other presenters who have kind of a value bias. They get excited about well-capitalized, cheap financials, and now that you're seeing steepening of yield curves, they finally have a chance to improve margins. As long as we don't get a massive credit cycle, which it doesn't seem like we are, in part because of the provision of all this stimulus, so the government balance sheet is taking it instead of the financials per se, you can get decent earnings growth that are not being anticipated by the market.

What I love about financials and banks specifically today is I can get better valuations, higher dividend yields than utilities. So higher dividend yields than utilities at better valuations. That is a great setup for alpha, certainly versus defensive parts of the market. So that's why I own a lot of those. Some examples are Capital One. So much skepticism in that stock because it's very economically sensitive, very credit sensitive, and it's just extremely cheap as a result. It's reasonably well run with good capital allocation. Wells Fargo, an extremely dislocated financial in the U.S. that has a lot of potential to get better. Even on the ESG front, their corporate governance is going from pretty bad to just okay, and that's a great trajectory for market appreciation of that steepness of change.

[25:35]

Pamela Ritchie: Can I ask you just to add, you mentioned global financials, can you situate us a little bit? Are there areas of financials globally that you look at a bit more right now or less?

Ramona Persaud: Some of the UK financials, just because the UK overall is super dislocated, if you look at — so let me just step back to just give you a picture of UK. If you look at UK free cash flow yields versus the U.S., it's just so dislocated. That's interesting to an investor that likes valuation, that likes to find a deal in the marketplace. So UK is just a very target-rich environment and certainly in economically sensitive stocks. So there's some names there that I find interesting.

In France, there was an asset manager that's fairly well run, pretty good on the ESG front, reasonable valuation, good dividend yield, decent management, and I actually know people who work there, so I can kind of back it up with anecdotal stories.

In Asia, I've in the last nine months or so bought very high-quality banks in India and Indonesia that I've known for 15 years. I've known them really well, so it's easy to buy them when you get the valuation you've been waiting for for years, and years and years. So I own some of those.

In the U.S. though what's happening in property in casualty insurers, and you saw this in the last earnings cycle, so think of Travellers, or Chubb or some of the smaller ones, good pricing power. They've had some catastrophes that justify raising prices. This is an example of real pricing. If you care about inflation, you want businesses that can give you real pricing, pricing after their costs have gone up, right? The stocks are really cheap. They're actually low beta, so very defensive, uncorrelated to the market because it's based on catastrophes which have nothing to do with the market cycle, and you're getting pricing. I mean, it's pretty cool. So sometimes the apathy in those stocks, like when growth stocks are doing really well, you can buy those stocks extremely cheap and just wait for the pricing after catastrophes. I tend to like P&C insurers within financials all over the world, and I own some of those in the UK as well.

[27:50]

Pamela Ritchie: Turnover within the fund. Maybe it's been an extraordinary year as it [audio cuts out] but can you comment on that?

Ramona Persaud: Yes, my turnover tends to be on the low side. My holding period is two, three years, so that's pretty low turnover relative to average. But that's not fixed. I learned from Joel Tillinghast, as so many of us value-oriented people, that turnover, high turnover is just a cost, a drag on your ultimate performance. So that really left an impression on me, and I wanted to just lower my turnover. But there are times in the market when certain types of names just get so dislocated that you need to just go for it. My turnover tripled last spring when we got this massive explosion in valuation differences, valuation spreads, and you just sort of had to add risk because risk was so cheap.

There were a couple of times last year where turnover went up a lot because the market was paying you to go into the storm. But in general, my turnover is in both strategies sort of 30 to 40%, which is pretty low.

[29:02]

Pamela Ritchie: When someone says to you what themes do you like, how do you answer that question?

Ramona Persaud: I'm not a thematic investor, so the only themes that you ever hear me talking about are valuation. The themes that I get into are like, look at these valuation spreads, that's what excites me. Like last March. It was even more exciting 'cause last March was really scary 'cause the level of understanding of the range of outcomes for the pandemic was very, very low. But, going into the fall, coming out of the summer and going into the fall last year was extremely exciting because we were coming out of wave two, we were going into wave three, and the U.S. was freaking out about the election. So you just had so much uncertainty, but what we as investors had was way more certainty than we had in March because therapeutics had gotten a lot better, and this is me relying on our health care team again, our exceptionally strong health care team that is packed with scientists, so we could have conviction in therapeutics like Regeneron and Gilead's products.

We could have increasing conviction in vaccines, and we kind of knew when the data was coming, so what I love is when the research gives you an investment edge to build conviction, and the market's not there yet, so you've got great valuation opportunities. Spreads blew out again, and I was able to add a lot of risk at that point. Not only did we get an election outcome that did not roil the market, we also got vaccine data right after that, so it was great for having positioned into risk right before that. That kind of gives you some insight into the process.

[30:46]

Pamela Ritchie: It's a pleasure speaking with you and fascinating to hear some of your background, how you approach ESG. Ramona Persaud, thank you for joining us.

Ending: [30:54]

Voiceover:

Thanks for listening to the FidelityConnects podcast. If you haven't done so already, please subscribe to FidelityConnects on your podcast platform of choice - and if you like what you're hearing, leave a review or a 5-star rating.

You can visit fidelity.ca for more information on future live webcasts - and don't forget to follow Fidelity Canada on Twitter. Thanks again, see you next time.

[end of podcast]