Fidelity Connects

Jeremy Podger, Portfolio Manager

Pamela Ritchie, Host

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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.

Portfolio manager Jeremy Podger joins us again today, from his home in London. For Canadian investors, Jeremy manages the Fidelity Global Fund, and today Jeremy and host Pamela Ritchie will be discussing his global portfolio positioning and his regional outlooks for the upcoming year.

Jeremy also discusses ESG investing and opportunities he sees in emerging markets. Finally, he will highlight the opportunities and his view on UK equities and the potential recovery ahead for 2021.

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Pamela Ritchie: To help us make sense of what may be next into the new year, the catalysts, the blind spots, the alpha opportunities, we are joined by the Global Fund portfolio manager, Jeremy Podger, from London. Great to speak to you again, Jeremy.

Jeremy Podger: Thanks, Pamela. Yes, it's good to talk to you.

Pamela Ritchie: Jeremy, I'm going to begin with some news that we've been hearing out of the UK. We knew that more significant restriction or lockdown is put on the city of London and other parts of the UK. Just bring us up to date a little bit on what a new regime of lockdowns might mean globally and what it means to you?

Jeremy Podger: I think it's only incremental at this stage. The UK is not as severely locked down as it was initially, but we have, unfortunately, at this time of year, just heard that all the pubs and restaurants have to close so it's bad news for a lot of people but I think it's absolutely necessary. I think what's interesting is to see is how the economy develops because we were recovering very strongly I think until the end of September, and I think that goes for a lot of countries particularly across Europe. If you look at mobility indicators, effectively they peaked around the end of September and they've been going down since in response to this further spike we've seen and further restrictions. Obviously it's going to heal in time and of course we want to see the vaccines roll out, but it's going to be, I think, quite a tough path on the way.

[03:05]

Pamela Ritchie: I want to kind of go back to how you're positioned, but almost first if we can take a look at the month of November. We mentioned in the introduction the vaccine rally, the sort of rotation. There are lots of questions about the sustainability of it to a more value perspective. Tell us how you were positioned going into that.

Jeremy Podger: What we aim to do is to give investors quite a balanced exposure and we have been increasing exposure to value names for a couple of months, in fact, ahead of this. But I think our regional positioning helped in November. November was a very strong month and it was really gratifying to show that we had that flexibility, we were able to take advantage of a value-based rally and a month where momentum factors reversed very, very sharply. I think a lot of people have been chasing momentum throughout the year. That's not the way we operate, but we were rewarded for our positioning, as it happens, last month. So yes, the positioning helped.

[04:11]

Pamela Ritchie: Do you want to break it down for us in terms of the fund positioning right now? I don't know if you want to do that regionally, but it's sort of interesting. It's the international, it's a global fund, so do tell us a bit about sort of where around the world you're invested.

Jeremy Podger: Sure. We've been emphasizing, compared to the benchmark, non-U.S. markets compared to the U.S. for a little while and I think leading into the election we felt that there would be a period of uncertainty. But with the vaccine news, I think people are looking to non-U.S. markets to provide that rebound in earnings. For example, for most of this year we've been around 10% below benchmark in North America, so that means still a little over 50% of the fund. We have been 10% over, or thereabouts, in Europe. So that has really helped us. It's a cheaper market. I think it's going to be very interesting. Next year could be a bit of a mirror image of this year in respect, not just of relative performance, but also the relative earnings growth that we see in the U.S. compared to outside the U.S.

05:28]

Pamela Ritchie: That's fascinating. And where outside the U.S.?

Jeremy Podger: It's probably no surprise that the areas that have tended to see the worst earnings hit this year are the ones expected to grow the most next year. So consensus is looking for European growth of around 40% in earnings per share for next year, which is about twice of the consensus growth from the U.S. A lot of this is to do with composition. The U.S. is a growth dominated market. Companies have actually done pretty well in this very difficult period. The last time we had this outlook of U.S. growth versus, let's say, European potential earnings growth was all the way back in 2003, and that did lead to a period of solid outperformance from the non-U.S. markets in Europe in particular.

[06:29]

Pamela Ritchie: As we said off the top, there's sort of a new sense of restrictions coming in and things are slowing again. I guess I sort of wonder on the timing. You can't see through all of this, but are you prepared for out the other side? Do people flock to some safety to get through these winter months? What does safety mean to you? What do you see in the next short term, few months?

Jeremy Podger: I think in the short term there is a danger of a market pullback because I think there'd been a certain amount of euphoria around the announcement of vaccines. That is true. It's also true it's going to take a long time to [audio cuts out] and it's not even clear how much compliance there will be with government recommendations on vaccination. There are a lot of things that could push these recovery factors out, and so I would say to be cautious about the path to recovery. But when we look at the performance of companies that are, shall we say, sensitive to lockdown factors – vaccine beneficiaries if you like –roughly speaking these companies have regained about half of the lost ground compared to the broader market. There is more ground to be made up, it's just it's unlikely to be a straight line, for sure.

[07:59]

Pamela Ritchie: When we spoke a few months ago – I can't remember exactly – we talked a bit about your interest in IT, not necessarily mainstream IT. We've seen the EU move further in the direction of crimping big tech's movements within Europe. Can you lay out for us what you find interesting about the tech landscape right now?

Jeremy Podger: Yes, it is really interesting. There are a number of dimensions to this. Clearly this year has been about big-cap tech in the States in particular. You think of the revaluation that we've seen. A stock like Apple which has seen its earnings grow about 10% year-on-year to the end of their fiscal year, and the stock is up 65% year-to-date; so huge revaluation. Is it justified? I think if you, sort of, drill down and look at the valuations they are not totally unreasonable. We're not into bubble territory, we are not into a repeat for these big stocks, in my view, of 2000 because there's a lot of cash flow being produced. But I do agree that there is more political risk, more regulatory risk and, at the same time, also the earnings growth that they're going to produce, although it will be good, may not look so great against a world that is recovering like mad if we do get that sort of rapid economic recovery. We have participated in a number of these names, but we have been reducing exposure. We are still over benchmark in technology, which accounts for about 28% of the fund, but we've been focusing really on more cyclical cheaper valued tech, not the blue sky valuations. Some of the second tier tech stocks look incredibly expensive at the moment. We have added, for example, memory stocks and this kind of thing, some of the Japanese tech names where we see more upside.

[10:12]

Pamela Ritchie: On Japan – just as you mentioned it there – there's a little discussion about global trade, where it goes after things settle down, to an extent, where there is some normalization, and maybe some new winds within the trade story. How do you look at opportunities where there's real trade sensitivities to the upside? Maybe Japan's part of that.

Jeremy Podger: It's interesting that you should mention that. When we talk to Japanese companies, and when we try to frame it in political terms with regard to U.S.-China trade for example, the Japanese are very shy about saying that yes, they will have a political advantage in this. But in many ways I think that they have gained a bit of an advantage. But more generally I think yes, as we see the economic recovery coming through, then Japan is normally very well placed. The Japanese market is much more sensitive to world trade factors than it is to the domestic economy. It's really a world trade play. It is normally highly cyclical as well, but we think it has a lot [audio cuts out] opportunities and a sort of corporate culture that is becoming increasingly shareholder-friendly. So yes, we like Japan and it's been good for us this year.

[11:37]

Pamela Ritchie: There's a lot of discussion within markets, commentary about a declining U.S. dollar, and you touched on that certainly with the discussion of European equities. But there's also a discussion about EM and what a declining dollar does for the EM trade. Can you let us know whether you're involved in various EM countries or how that fits with your mandate or not?

Jeremy Podger: We have been favouring Asian emerging markets. Korea has been a particular strong point for us this year and we continue to find some really interesting value there. I would say that a lot of the factors that will help emerging markets will also very much help Europe and Japan. So a declining dollar should also be favourable there. Don't forget, in emerging markets you do have a very polarized universe. You've got a lot of technology stocks which will trade very much with other global tech stocks, but then you have domestic stocks and financials, and those financials I think will find it much tougher because emerging market interest rates have been pushed down a lot. So anything that feeds off interest rates – banks in particular – are going to find it hard. That'll be a real headwind for them.

[12:57]

Pamela Ritchie: Any thought that Jerome Powell will do anything to help the dollar rise in the next few hours today? Any thoughts to share?

Jeremy Podger: I'm not a great Fed watcher. My suspicion is that the Fed will reiterate again what it said before that it's looking to the government to add fiscal stimulus. This is what is making people really quite bullish about next year, the idea that you have a combination of fiscal stimulus with very easy monetary conditions. That should then work to get the real economy moving in a way that could be much more effective than it was, say, coming out of the financial crisis in 2009. As far as the dollar is concerned, I think the dollar had been waiting to fall. It's naturally speaking a safe haven, and that had been keeping the dollar up, but interest differentials with the rest of the world had reduced and the U.S. dollar has a twin deficit issue which is normally associated with a weaker dollar. If you go back looking at the rise that we've seen in the dollar in the past 10 years or so, we've retraced about half those gains. It's entirely possible that we've got further weakness ahead, in my view.

[14:26]

Pamela Ritchie: Have you been investing in UK equities? What do you see? We've been watching the discussions around the UK/EU discussions and a lot of people have been positioning for that to work out and therefore seeing a lift in the UK. What do you see so far?

Jeremy Podger: It's an interesting market. It was possible to argue, up until relatively recently, that the UK looks cheap against the rest of the world just because of the sector composition of the market, the type of stocks that were listed. But I think this year it's become very clear that even on a like-for-like basis, UK stocks have become very, very cheap, but international investors just didn't want to know. Nobody wanted to get involved in the UK ahead of a resolution of the Brexit question. In my view, this meant that we moved into this upturn in markets with the UK looking incredibly cheap and basically baking in a worst case scenario. So we have been adding to the UK in recent months and particularly in value type of names. It's been a laggard. I think it's got a lot of catch-up potential, and some deal will be good news. Let's hope there's something. Nothing might see a pullback in sterling, but I think that the equities themselves are attractively valued now.

[16:06]

Pamela Ritchie: Would they be coiled even? A huge jump? Or what do you think?

Jeremy Podger: The UK has been outperforming a little bit that has been partly a currency thing. Yes, I think that next year when this is sorted out one way or the other I think international investors will start to look at the UK and say, "okay, we'll just accept the conditions as they are, what can we find to invest in?" And there are some really attractive stocks there of which I hope we've got a few.

[16:53]

Pamela Ritchie: Excellent. We look forward to checking in with you on all this. One of the other powerful – and it almost gets to the point of geopolitical, we had the Paris climate further discussion over the course of the last several days – is the idea of ESG. I mean, some optimistically hoping that it pulls the world together and we all get on board, and we're all friends and trade issues melt away in the face of this combined effort and so on. That said, is it something that is formidable, would you say, in terms of investment? How do you approach this? There's a lot of hyperbole around it, but there's also some very real movement in shares, how important is it to your fund?

Jeremy Podger: It is increasingly important. If we look ahead over the next couple of years I think you can put question marks over a lot of growth areas that investors have just become fanatical about this year. But when it comes to this particular theme, I don't think it's going away. I think the story of decarbonisation is probably the most powerful growth theme that we've seen and will last for at least 10 years. The difficulty is it's actually quite difficult to find good plays on this theme that are attractively valued. We did an interesting study looking at the correlation between ESG ratings and valuations, and it's very high. Strong ESG companies are very highly rated. There's much more benefit in looking for companies that are relatively overlooked at the moment and are likely to improve. We have good exposure and we are constantly hunting for new ideas. We've got quite a number on the shopping list at the moment.

[18:48]

Pamela Ritchie: When you look for areas of growth within ESG – having listened to what you just said there that they often are quite highly valued at this point – the United States, North America, Canada included, are somewhat behind Europe. There's no question, this has been on the dashboard of European leaders for a lot longer than it has been in other parts. Does that make it more attractive to go after companies that are about to go through the transition, or are you best with the European ESG companies, so-called, that's already on the road?

Jeremy Podger: The answer is, unfortunately, it's complicated and it varies. Certainly there is a lot to be said for companies that are improving, but I think European companies just really understand this an awful lot better at the moment. So at least, looking over the next few years, I think companies are going to be encouraged or forced to give greater and greater disclosure, but European companies are already better placed to do that. So from a pure disclosure point of view, I think European companies are better placed; and I think that U.S. or North American companies will catch up, but I don't see that as a single opportunity, if you like, to buy laggards. We'd rather buy the leaders.

[20:20]

Pamela Ritchie: Right. There's a question coming in from one of the investors here, the idea that with a Canadian dollar doing what it's doing, we've been very linked to the United States in terms of investments and so on. Many see that there is move away from that, or maybe an opportunity to take a look outside. Hhow does this fit? What sort of exposure should those earning in Canadian dollars take a look at international equities for? Should it be EM, should it be more your mandate? Can you give us some context?

Jeremy Podger: I'm going to be quite biased because I think you want to have a global opportunity set.

Pamela Ritchie: We want your thoughts.

Jeremy Podger: Currency is only part of the solution here. It is true that if a region sees a relatively strong currency, it does, in that period, tend to outperform. Even if it's an exporter like Japan and Germany. So from that point of view, investing in a global fund, I think, is a good way of doing it. Most of our stocks are essentially global stocks and therefore they have activities around the world. When you get a sharp currency move you actually have to pay attention to where their cost base is. So sometimes a company may have a cost base in a currency that has risen very sharply recently, that would give us a note of caution. But generally speaking, we want global exposure and we're very bottom-up driven. We find some great opportunities outside the U.S. at the moment.

[22:12]

Pamela Ritchie: With your lens to the world I want to ask you a little bit about a known/unknown and then perhaps your best guess for an outlier unknown/unknown. I'm going to suggest the known/unknown really is the vaccine rollout, to an extent. We have to sort of see how effective it is on a number of different levels. Your thoughts on that first, or the types of risks or concerns you have around that, and then I'm going to ask you about your unknown/unknown thoughts. But on the vaccine rollout, what are you concerned about and maybe where the opportunities are to kind of get in line?

Jeremy Podger: As I said earlier, I think it's not going to be entirely straightforward and it's going to take time. It's going to take quite a while to get a level of immunity that you want. That's going to constrain people for quite a number of months. I think commentators are being reasonably sensible about this, and they do see proper recovery as being more of a second half thing than a first half thing for next year. But I think the market is willing to look through that, but nevertheless, as I said earlier, I think we may see some consolidation in the market first. So I don't have a particular angle on this, but I do know also that there's a lot of further work that people need to do to understand the technology between the different vaccines. So that will be important, and how many further follow-ups and this kind of thing are going to be required. A lot of unanswered questions.

I think on the unknown/unknown, there's been a consensus developing amongst strategists looking at global markets that next year will all be about buying value, about favouring non-U.S. over U.S., where growth perhaps takes a back seat. But I think value won't really start to work until we get signs of a pickup of inflation – which is likely to be later rather than sooner – solid economic growth and higher bond yields. I think those three things have to fall into place to get a really sustained value rally. So if there's a hiccup along the way, then I don't think it'll play out as the strategists are forecasting right now.

[24:54]

Pamela Ritchie: Right, because none of us have the crystal ball that we all wish that we did. We have to be patient. What would you like to leave investors with? A thought about your fund, something that you're looking at, or just for them to kind of think over?

Jeremy Podger: Normally the first thing that we tell investors is that the [audio cuts out] stock selection and we have three distinct categories which are designed to try to extract alpha in different ways and work at different stages in the market cycle. So we have corporate change, we have exceptional value and we have unique businesses. By getting ideas in each of those categories and capitalizing on them when they arise, we can build a balanced and quite flexible portfolio. This is a fund which should be able to perform in most market conditions. So those three categories and a balanced and flexible approach, that's essentially the main message that we like to give investors.

Pamela Ritchie: Jeremy Podger, it's been a pleasure to speak with you. Thank you. Have a very good holiday season and we look forward to seeing you in the new year.

Jeremy Podger: Thank you very much and have a great holiday.

Pamela Ritchie: Thank you very much. You as well. All the best

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