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 Sam Polyak, manager of Fidelity Emerging Markets Fund for Canadian investors.

Sam has been with Fidelity for 15 years, and today, in speaking with host Pamela Ritchie, Sam will take us through emerging markets across the world and will share where he is seeing faster recoveries and growth opportunities. This includes a look at various sectors and global trends, as well as the value vs. growth discussion within emerging markets. Sam also looks at how emerging markets have been affected by the pandemic and life after the pandemic.

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[01:40]

Pamela Ritchie: Over the airwaves we often hear about investors or policy makers talking about the other side of the pandemic referring to the end of the global pandemic, be it six months, two years or longer. With busy and rather dizzy markets we are often focusing on the present or the very near term. For investors seeking to retire in, say, 10 or more years from today, it's important to look further out in terms of investing. What will the global economy look like? Where will the likely sources of structural growth be? How could investors position today to benefit for tomorrow? One answer might be emerging markets and today we're very happy to welcome portfolio manager of the Fidelity Emerging Markets Fund, Sam Polyak. Sam, great to see you here today. How are you?

Sam Polyak: Hi Pamela, great to be here.

Pamela Ritchie: Very glad to have you join us back to continue some of the conversations that we've had over the course of the last several months. Sam, let's begin with, we've been watching what we've been watching in markets, as we mentioned there in the intro it's a very near-term discussion. How do you want to refocus us to the period after the pandemic or what we're setting up for perhaps later in this year in terms of emerging markets?

Sam Polyak: I think global growth is going to be quite exciting not just for emerging markets but for all markets, whether it be the U.S. or Europe, Asia. As we come out, folks have been basically saving money, paycheques have been coming or in some cases government subsidies. Then when things start opening up, jobs will be created, a little bit of inflation will come in, and a little bit of inflation is actually a good thing. As global growth comes back that should be a big benefit for emerging markets because they will benefit from demand for some exports, they will benefit as just overall growth accelerates.

[03:41]

Pamela Ritchie: One of the big pieces of investors wanting to take a look at emerging markets at this point, there are many reasons, but one of the main ones is the U.S. dollar. We've seen it in decline over a longer period, it's been strengthening lately. We're watching the euro on the move a little bit. There's a currency switch up right now. What do we need to know about the U.S. dollar longer term for [audio cuts out]?

Sam Polyak: I still believe that the dollar will be weaker than it is today. Nothing goes in one direction. We had a big move in the dollar at the end of last year. I think a lot of folks got on to one side of that trade and the market has a way of punishing those that are just chasing. At the same time I'd see that as kind of just a short-term blip in terms of the dollar strengthening in January, and structurally the global growth very much benefits from a weaker dollar. I'm not saying a collapsing dollar, but I'm just saying a slightly weaker dollar, and I think that should be the environment that we're in, especially given what the U.S. is trying to do and the spending that has gone on, that structurally there'll be better opportunities in other markets, other investments, with global growth coming back, and with the U.S. government much more focused on spending than it had been in the past, that should pressure the dollar somewhat.

[05:06]

Pamela Ritchie: Tell us a bit about the fund, a bit about the mandate itself and maybe just touching on the fact that it's not that easy to invest in emerging markets. It's a difficult thing to do. Give us a sense of how the fund is set up.

Sam Polyak: The fund is concentrated. I have less than 50 stocks, but I have some guardrails in place: sector limits plus or minus 5% and individual stock limits of 5% versus the benchmark.

Within emerging markets I think it's a great place for active management in general, not just for myself, but unlike the U.S. where large-cap stocks are all really well known, really well-run companies. In emerging markets you have some poor capital allocators. You have some state-owned enterprises in there where the needs of the state aren't necessarily the needs of minority investors. You also have some bad operators, some individuals that run, and families that run some of these businesses that aren't necessarily for minority shareholders. A lot of times they'll invest in sister companies, in businesses that are non-related just to support other family members and things like that. Because of that, active management really adds a lot of value where we can find those businesses that are run for profit, that are structural growers and there've been more and more of them that have come on in the last 5, 10 years.

[06:29]

Pamela Ritchie: You mentioned value there in slightly different context, but it seems there's an endless amount to say about value versus growth. It's fascinating to watch the debates. The questioning right now seems to be that a lot of value stocks perhaps have seen quite a run up, and there's questionings about where there's further to go and some of those subtleties. What's the discussion broadly for emerging markets? Have they seen that so-called reflation trade to the extent that we've seen across some developed markets?

Sam Polyak: We've seen it a little, but much like developed markets, emerging-market value stocks have really done poorly over the last 10 years. A lot of that has had to do with the fact that we've had a period of very strong dollar and poor global growth environment. Because of that, with the strong dollar a lot of the countries were forced to defend their currencies and raise rates. By raising rates it hurt growth. Because of that, companies that benefit from growth and consumption haven't really done as well as some of the structural growers. Good growth companies, and I myself love them and I own a fair amount, but I do admit to the fact that some of the pro-cyclical businesses, especially in financials, have done so poorly and been de-rated. Where they used to trade at 2, 3 times book value, a lot of them are now at half of book value. Because of that on the margin I've owned a few more in my fund and now I'm overweight financials for the first time in a long time in the fund, which I hadn't been prior. I still own a lot of growth stocks and my fund is much more predisposed to growth, but a lot of them have gotten expensive. So I've been forced to sell just because in working closely with our analysts and talking to management the valuations in some cases don't justify the current growth environment, growth prospects for the company, and so on the margin I've been buying a few more of the pro-cyclical businesses.

[08:40]

Pamela Ritchie: We're going to come back to that in some of the sectors and areas, one thing I just want to ask you about in terms of the fund, the mandate and so on, at the moment we're seeing headlines about Myanmar which is having a complete political upheaval. These happen across the globe all the time. The question from this perspective is, how does that situation affect the way you invest? I don't actually think you invest in Myanmar, correct me if I'm wrong but, for instance, when you see headlines of upheaval give us a sense of how you look at that from an investment perspective.

Sam Polyak: It's a good question, Pamela. A lot of folks think when they see a headline coming out of Syria, or coming out of Myanmar, or Iran, or Venezuela and they perceive that as being, oh, it's an emerging market country, it's something that should have a negative effect on emerging markets. It's true to some extent, but more on the debt side. There's a lot more emerging-market debt investors that invest in some of those countries. On the equity side those are frontier markets. I don't invest in frontier really. I have the capability to, but I haven't done it through the years. Where I see so many opportunities in emerging markets, frontier is something that does really well after emerging markets has done well, after emerging-market stories played out, like, late-innings type of scenario.

We're in the early innings of emerging-markets' recovery. This is when you want to own emerging markets themselves and not bother with the frontier. A lot of times, like the news in Myanmar, it doesn't really have much of an effect on our outlook and how we invest.

[10:28]

Pamela Ritchie: Let's go back to the sectors for a minute. Questions are starting to roll in here. You mentioned financials. When we look at trends across the globe they do tend to be global trends. E-commerce is a global trend, you mentioned some growth companies that you've looked at, but maybe are expensive. Give us a sense of some of the other … perhaps cyclicals, is that an area, do you look at companies that are more pro-cyclical at this point? What do you like about that?

Sam Polyak: There are some great pro-cyclical businesses. There are cement companies, NIA [ph], for example. India has cement consumption that is basically one-tenth on a per capita basis of China, and so India needs this build roads and infrastructure and they are doing that, and you have a very consolidated cement space in India. Because of that, that's an area that you wouldn't figure would be a growth area, but it is a growth area because of the structure in India's very different than the rest of the world. You have infrastructure companies, this is another one that's also in India, it just came to mind, that does E&C, engineering and construction. That has been underspending for a long time, starting to pick up again. So that's an area I'm investing. I mentioned financials before, own financials in Brazil, in Mexico, Peru. Latin America's been an area where I've been investing more incremental dollars as it has lagged, and it benefits from a weaker dollar much more than Asia does. So I'm overweight Latin America versus Asia.

China had done really well, and I had a huge overweight position in China going into COVID and it worked extremely well 'cause China was the first one in and first one out, but on the margin with the re-rating I see less opportunity there and I see more opportunities in other markets, so I've been redeploying some of that capital to places like Korea, Taiwan. I mentioned India, I'm still underweight India, but I've been increasing my exposure in India a fair amount. Also Greece and Latin America.

[12:03]

Pamela Ritchie: I could spend an hour on each of those countries. I'm absolutely fascinated. Tell me about oil, tell me about Russia. Alexei Navalny is not creating a good situation for Putin, but it's a political headline. I don't know if it's something that you put aside when you look at an oil price. It seems to be stabilizing for now. Your thoughts on oil companies being connected to a political situation, Russia, Russia being an interesting place to invest. What do you think?

Sam Polyak: Russia has some very interesting companies. To put politics aside, there are some really good businesses. There's a terrific e-commerce company, there's a terrific bank, a great oil company. I only own three stocks in Russia, but they are three very good companies. Yes, the Navalny risk is significant and the protests could escalate, and things could get worse. But a lot of that has had to do with the fact that the oil price has been low, and so because of that growth in Russia has been low. Russia's still very much dependent on the oil price. If we get a global recovery, then all of a sudden the oil price should spike as demand for oil should pick up, and if the oil price moves up from whatever, $40, $50 up to $60, $70, which it would likely do in a recovery, Russian growth would pick up and people would feel better about their position and perhaps things will stabilize a little bit. I'm not a macro investor. I'm not just chasing this country versus that country; it's something that plays into my process, but the process always starts with the company. Is it a good company, is it a good business, is it growing, is it going to be much bigger in a few years, what's the white space for that growth? Those companies that I mentioned before are all really good companies and I'm happy to own them.

[14:35]

Pamela Ritchie: Layer on the vaccine rollout for us and just to what extent … you've mentioned it begins and it ends with a company, but that said, countries are in charge of rolling out the vaccine. It's been mentioned that emerging markets may see the rollout more slowly because governments perhaps are not in a position to roll it out as quickly. We have our own hiccups in lots of countries so no one wants to get too much hubris on this. But that said, does it affect the investing environment, or could you look right through the vaccine rollout in emerging markets?

Sam Polyak: It does affect it a little bit, but it's on a country-by-country basis. You look at how successful China, Korea, Taiwan have been in limiting new infections. Yes, there are slight outbreaks, but it's not like the country's mostly locked down like we have been in the U.S. for the last few months. It's mix and match. Brazil's had a real tough time. Brazil has had more and more outbreaks, and they've had the lockdown again. Mexico has had a tough time, and so they've had to re-lockdown again. Things are going to be slower in terms of vaccine, but I do believe that the vaccine will come and there's a lot more different vaccines that are being approved. Some of the countries that are hurt more today will probably be benefitting more coming out of it. I mentioned some Latin American countries. Peru's had a tough time too, but on the back side of it I think they'll be in good shape coming out.

The negative for places like China, Korea, Taiwan is because they never really went down and China actually had growth last year, GDP growth, while the rest of the world collapsed. You're not going to have that type of recovery, pickup in demand like we will in these other countries where's there's so much pent-up demand. You look at a country like Brazil, they've had such a tough time the last 10 years where you had the issues with former President Dilma. She was forced out of office, the currency collapsed, consumption collapsed and the currency continued to weaken with the strong dollar. You had a corruption investigation, and so because of that there hasn't been much job creation, there hasn't been much consumption, so there's pent-up demand. And then the virus hits them just when they were getting ready to recover. Once things start to recover there I think job growth will pick up. There's pent-up demand, people will start buying cars and houses and there's going to be big knock-on effects, and I'm excited about growth for Brazil coming out of next year. It's a non-consensus call because a lot of folks feel strongly about Asia and some of those markets, how they'll do. I still like them and I own some really good companies in Asia, but on the margin I've been deploying more my capital in Brazil where I just think there's a fire sale and there's some catalyst for growth there right around the corner.

[17:41]

Pamela Ritchie: Here's a question for you that gets discussed sometimes, these so-called changing supply lines that we become less dependent, perhaps, on Asia for some of the things we consume, and maybe more so on Latin America because in theory you could get in a car in Argentina and you could technically drive it all the way up to Canada and we're more connected. I don't know how strong that argument is. But does Latin America take on some of the role that China has played in terms of production and labour?

Sam Polyak: I would drive that car through to Brazil, but then I would stop once you get towards Venezuela and Central America 'cause I don't know how safe it would be going through Honduras and Guatemala these days on your way up north. Anyways, that is an aside. I do believe the supply chains are changing and they're changing quickly, and it's benefitting a country like Mexico a lot where a lot of suppliers and to the U.S. have built up their supply chain, especially the auto industry, but not just the auto industry. Manufacturing for white goods have moved somewhat from China into Mexico where you get lower cost and with the currency having weakened so much, one of the flip sides of the real tough environment that a place like Mexico has had over the last 10 years is because of the weaker currency. The currency's value has fallen by more than half. One of the positives of it is that they've become much more competitive. So while Chinese currency has held up better, with wage hikes in China, and with the strong currency they become less competitive on the export side. A lot of companies are near-sourcing into Mexico to export into the U.S. That's definitely been a trend.

There aren't many ways to play it in terms of individual companies, but I think consumption in Mexico should pick up as a lot more job creation will happen, and I do have exposure there through a consumer company and a bank.

[19:47]

Pamela Ritchie: You mentioned autos and I was talking about a car, are those cars all EVs? Is that the only auto trend that you see globally for instance?

Sam Polyak: Not necessarily. EV's are definitely a trend and they do have ways that I play it through the fund, and automation is a big trend. A lot of the EV companies are going to do extremely well. The tricky part is a lot of folks believe that EVs are just going to take off tomorrow, and there's just not the infrastructure. Not everybody lives in a house that they can charge their car, have high-power voltage to charge the car at night. People need to drive long distances, the EVs don't have that capacity and you'd have to stop at a gas station and hope that they have an EV charging location. That'll take you anywhere from a half hour to an hour to charge your car. So yes, EVs are a definite trend, but you need the infrastructure to be better for people to just give up their gasoline internal combustion engine. I believe that, whether it be a traditional electric vehicle or hydrogen vehicles for commercial vehicles and buses, those are all trends that are happening and there are different ways to play it. I do have that exposure in the fund, but I don't think that car companies are just going to disappear and the internal combustion engine is just going to disappear tomorrow. It's a balancing act.

[21:23]

Pamela Ritchie: Question coming in on the fund itself about your turnover. Perhaps there's a difference and I don't know, is there a difference between your average turnover and maybe what you saw throughout the early months of the pandemic? Can you give us a sense of the turnover rate?

Sam Polyak: Because of what happened in the last year, the turnover was a little bit higher. It was closer to 70% which is higher than I would like, but some of that had to do with … it's not every year that you get two fat pitches and I got fat pitches in March when the market just collapsed because of the pandemic, and so a lot of great companies just went on sale, so I turned over the fund a fair amount just because I had to sell some companies that had held up, some of the ones in China that I mentioned earlier for some just fire sale and some really good businesses which have recovered.

Mind you, then in the second half of the year, especially some of the Chinese growth businesses that I had owned got re-rated to crazy multiples, and then with the vaccine coming I had this second fat pitch where I sold some of the really well-performing growth companies that had done well and bought some of the more pro-cyclical businesses, especially financials which I had been underweight before, which I'm now overweight relative to the index because of that opportunity and the prospects of a vaccine that gave me confidence for growth.

[22:55]

Pamela Ritchie: Is agriculture increasingly a discussion? Maybe that fits with a trade discussion as well, but agriculture and things like fertilizers have done very well recently, how does that work in emerging markets in terms of opportunities?

Sam Polyak: It depends. Country by country there are some companies that sell fertilizer, there are some companies that sell seeds, but it's not a huge part of emerging markets. Where agriculture does play a big role is inflation where, if agriculture prices go up a lot, you get inflationary concerns and so it's something that emerging markets actually try to stamp down, and most of my investments would be hurt by higher commodity prices because I invest in more consumption-related businesses and consumer-facing companies. So if people have to spend more money on food, then they'll have less money left over for discretionary spending. Mind you, I do own a supermarket and then the supermarket benefits from that because higher food prices, they make more of it in terms of revenues, but it's a smaller part of the way the fund is positioned.

[24:12]

Pamela Ritchie: Someone was reading your mind here ‘cause the question that’s just come here is that plus a little more. The question is, many emerging markets are actually heavily exposed to commodities, are you seeing a rotation into commodities in the near future? Maybe just some more discussion around that. You kind of mentioned it.

Sam Polyak: Historically emerging markets have had a high correlation with commodity prices and a lot of that has to do with a weak dollar. If we have a weaker dollar then hard assets like commodities would be beneficiaries of that. But emerging markets benefit on that as well. Yes, it’s kind of a circular reasoning because all of a sudden you do get higher inflation if commodity prices go up, but inflation’s been so taped down globally that it’s good to get a little bit of inflation because we’ve been so worried about deflation the last few years. If we get a little bit of inflation without it getting out of hand that’s not the end of the world. There is a lot of pent-up demand and people have been saving a lot of money, so there is that ability to spend much more so. Once people feel comfortable about being in public, going outside, travel, that sort of stuff, I think there will be that spending that will happen.

[25:28]

Pamela Ritchie: If you can just stitch this together, complete the circle for us. The global asset allocation team in Canada often looks at the Canadian dollar longer term. We often talk about the U.S. dollar and the impact that it has on emerging markets, and therefore it makes it an interesting play if you’re mostly in U.S. dollars. But from a Canadian investor perspective can you just add that link? Our currency looks not bad next to the U.S. dollar these days because it’s been okay, but broadly the exposure to EM fits for a Canadian investor, why?

Sam Polyak: One, this is a negative part, is that there is a correlation between the Canadian dollar because the Canadian dollar historically has traded as in inverse to the U.S. dollar. That’s the negative. So you don’t diversify as much when you invest in EM as a Canadian investor because of that link, but the flip side of that is Canada has struggled for growth for a number of years and emerging markets do offer that growth and there are some really good businesses in emerging markets. We’ve talked about this before. There are few really good businesses in Canada. When you look at the blue chips of emerging markets, the Taiwan Semiconductor, the Ten Cent, the Samsung Electronics, there just aren’t those type of businesses in Canada, and so by investing in emerging markets you get that sort of exposure to those type of businesses that are doing extremely well.

[27:05]

Pamela Ritchie: And that’s, I think, part of the reason the global asset allocators are allocated to emerging markets so that does cut a complete circle. I have to ask you about your office. You have an awesome office and actually I think you told me a while ago, there’s a story that goes with it so just bring that to our attention.

Sam Polyak: I bought this house 12 years ago and it needed a lot of work. It was an old house and we’ve done a ton of work, but the one room I haven’t touched is this room. The reason why is the previous owner was a guy named Frank Modigliani, and some of you that were in finance might have heard of the Modigliani theorem. I don’t want to get into what the theorem means, but he won a Nobel Prize for it working out of this office so I was hoping that it would be good vibes for me, that if I just didn’t touch it … I just filled up the bookshelf with my books and things like that, but otherwise it’s exactly the way it was in the ‘60s and ‘70s when he was doing all his work here.

[28:03]

Pamela Ritchie: Wow. Sam Polyak thank you for joining us, we hope to see you again soon.

Sam Polyak: Thanks Pamela. It was my pleasure.

Pamela Ritchie: Great to speak with you.

Ending: [28 :10]

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