## Fidelity Connects

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 Patrice Quirion is our guest today. For Canadian investors, Patrice manages Fidelity Global Concentrated Equity Fund and Fidelity International Concentrated Equity Fund, as well as a few private pools.

Patrice explains to host Pamela Ritchie that he feels good about the overall markets for 2021, and because of his global mandate he can go anywhere for opportunities. He is excited about opportunities in the United Kingdom and emerging markets that he is seeing currently.

Today, Patrice also shares his thoughts on inflation, commodities, ESG investing, and the vaccine announcements.

This podcast was recorded on February 3, 2021.



*[01:36]*

**Pamela Ritchie:** Hello and welcome to Fidelity Connects. I'm Pamela Ritchie. The outlook for global equities is the topic for today's discussion in this forum. To that end we're going to welcome portfolio manager, Patrice Quirion. Patrice, as most of you know, is at the helm of four global international mandates. He spends his time looking at research in search of reasonably-priced quality companies exhibiting predictable and durable earnings growth in every region of the world. We're going to dig in to what Patrice is seeing in terms of the health of the global economy, the outlook for different sectors and investing styles, and where there might be outperformance opportunities and how he is positioning in his funds. I want to welcome you, Patrice. Thanks for very much for joining us. Good to see you.

**Patrice Quirion:** Pleasure to be here. Good to see you as well and thanks to everyone for spending a few minutes with us this morning.

**Pamela Ritchie:** Patrice, let's begin with the markets. What are you seeing within the markets? Is there some froth that you can note or you're concerned about? Give us the temperature of the markets from your perspective.

**Patrice Quirion:** Not unlike 2020, 2021 is likely to be a fairly interesting year. Is there froth? Just to answer that straight on, I think there are certainly areas of the market where we are seeing speculative-like behaviour and valuations that are starting to likely disconnect from what long-term fundamentals or long-term fair value of businesses are like. That said, those are generally niches of the market. I can name a few of these signs. We've seen in the headlines over the past week just what's happening with some retail involvement in specific stocks. That doesn't move the market, it doesn't matter. Slightly bigger asset classes, I think of cryptocurrencies; again, it doesn't move the market, it's not an indice. But this is behaviour that I don't like to see. I think it's testament to investors reacting on more speculative grounds as opposed to really thinking of I'm investing here, I'm buying a business, I'm buying a business for future cash flow. This is not what we're seeing in these areas.

We're seeing a lot of hype around IPOs. A lot of interesting businesses, I won't dismiss that, there's good businesses coming public. They're coming public at interesting prices or fair prices, but they start trading and a bad IPO goes up 25%, a good IPO goes up 150% and that just starts to get pretty disconnected from what's the value of these securities. So there are these types of areas.

I could add on concept stocks across technology, or green technologies or biotech, there's just a lot of froth into these niches of the market. That said, as a whole I feel good about the stock market going into this year. A lot of the market cap is reasonably priced, or the context around interest rates we're in currently, and I would add further the part of the market in which I'm active, which is — I'm a contrarian investor, I go into the out-of-favour parts of the market. That has meant going into more cyclicals and manufacturing, industrial types of businesses, and I would argue the prices are still quite reasonable here given the outlook we're facing for the next few years.

*[05:19]*

**Pamela Ritchie:** Let's go into the outlook that we're facing for the next few years. Can you situate us for where we are in the market? There are certain times within markets that you expose yourself to cyclicals more, so what does that mean if we back up to where you think we are in this market cycle?

**Patrice Quirion:** I think by any means we are at the very beginning of the next economic cycle. That's acknowledged by the market right now. A lot of the cyclical stocks are up quite a bit from the March lows. The market has acknowledged that we are entering a new cycle. We are probably pricing in something around a mid-cycle type of environment for most of these stocks. We are pricing, I would say, 80% or 90% of a reopening for the stocks that have been directly hurt by COVID-19. That said, you put that versus other parts of the market which are, in my opinion, overvalued and that looks still the right place to be on a relative basis. And even on an absolute basis I think is right.

That said, I think the next question we really need to ask ourself, we are re-entering an economic cycle, what do the next couple of years look like? We know they will be better. The question is how much better are these next few years going to be? On that front I would be in the optimistic camp. I think we could see an economic recovery that's going to be meaningfully better, faster, stronger than what most are expecting at this point. I say that based on a few reasons. I think first the consumer globally is in good financial condition. Savings rates went up through the pandemic because people literally couldn't spend money on the services they usually consume. Interest rates are low, even lower than they were. Asset prices went up being either real estate, or the stock market or fixed-income instruments. So there's a lot of wealth effect. You combine that with … I think there is a real desire to spend that's going to come back under the form of pent-up demand for a lot of categories of goods that could start creating a better-than-average economic environment. I don't think that environment is reflected into the stocks that would benefit from that at this point in time. That's why I'm still positive and that's why my pro-cyclical positioning remains today.

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**Pamela Ritchie:** I'm curious what you think about the global consumer, but I'm more interested in this industrial that you mentioned at the beginning. Is there scarcity and therefore is there demand on an industrial, global level? Can you paint that picture for us?

**Patrice Quirion:** I think the cyclical setup is quite good from that manufacturing cyclical sector standpoint. As you'll remember, this sector is not only under pressure only since the pandemic early last year. That's a sector that's been under some sort of pressure going back to 2018 when the trade war between the United States and China started to take place. As a result, we had businesses across a variety of manufacturing sectors postponing investment decisions, in a lot of cases simply not knowing where should I build my additional capacity. At the same time you had a slowing global economy, especially a slowing China, you had commodity prices that were weak, industrial demand that was weak and that led to that backdrop. Now we're starting to see signs of that turning around. In my opinion, we will see demand coming back, we are already seeing … those are maybe isolated cases, but not meaningless cases of shortages of components. As we speak today, there's a shortage of semiconductors, especially for the automotive industry and as a result some auto manufacturers are forced to shut down production lines. Not because there's no demand, because there's not enough semiconductors or other components.

There's not enough lumber to build the number of single family dwellings that demand is for today in the U.S. Housing starts are improving, but they could be even better if it wasn't for this lumber shortage. We're seeing shortages of containers in seaports all over the world. Shipping has just been a terrible business for most of the past five years and nobody invested. I think all of that will come back with the backdrop of probably a lot of pent-up demand, a good economy, a better-than-expected, probably stronger-than-average, economy and those shortages will start to manifest themselves, more so probably leading to some pricing power and I think a shift of corporate budget allocations away from — let's think about it, the past few years you didn't need to build a new plant, you didn't need the additional capacity, so you invested on technology to lower your cost, to allow you to work from home more lately. I think that budget envelope will shift back, at least to some extent, towards, call it the old economy where investments are needed right now.

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**Pamela Ritchie:** Your mandate is global and you mentioned something recently that I thought was so interesting. You said you can't really invest *[inaudible]*, you can't go country by country. From your perspective are the themes just simply global? I'll ask you that, but also to outline your mandate in the funds that you manage.

**Patrice Quirion:** To answer your first question, I think those trends are clearly global. The world is quite synchronized at the moment. There are subtle differences here and there that impact the economy today that doesn't impact the stock market quite as much, because the stock market is a forward-looking mechanism. The U.S. is certainly doing better because they decided not to lock down the economy, and they're getting their vaccines first and faster than other countries, which is not the case in Canada or in many countries across Europe. That said, the market at this point is looking past that and the market is focused on what does the economy look like into a reopened scenario with COVID in the rear view mirror. It does not fully price this, but largely price this. This is consistent globally. This pandemic just impacted everyone.

I think what will matter more is from a country perspective, when we think about investing in indices, for instance, or at large, what matters is the constituents of these stock markets locally. The U.S. has a lot more technology and health care into the mix, as opposed to the rest of the world tends to have more financials, and more industrials and consumer stocks that are more cyclical, and that's why my optics is maybe more so favourable on the rest of the world, but it's really a function of the types of companies we find in these markets. By the way, I'm finding a lot of pro-cyclical businesses in the U.S. as well. It's really stock by stock, more tied to the thematic, the positioning that the market sees as opposed to a country perspective.

On my mandates, I run global and international mandates. The global mandate allows me to invest everywhere across the globe. My exposures right now are mostly through Europe, especially the UK, overweights in emerging markets, with underweights against that in Japan and the U.S. My international portfolios *[audio cuts out]* out North America, so it's to give a better diversifier to a lot of your clients' portfolios, which tend to be very North American-centric and as a result, and to my international funds it will be just larger weights into all these other geographies, notably Europe once again.

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**Pamela Ritchie:** Can Mario Draghi fix everything if he becomes prime minister of Italy?

**Patrice Quirion:** No, he won't be able to. I think we're not betting, and we don't need to necessarily believe in Europe going back to being a great environment for the economy over the next few years. At this point, the valuations are still at considerable discounts and things will get better as the economy reopen, and especially as manufacturing economies like Germany, like Eastern Europe to a large extent, like the Scandinavian countries start to reopen and as in the case of the UK, business confidence slowly starts to come back in now that we have some resolution around Brexit. It's maybe not the ideal scenario that many hoped for, but at least we know and decisions can be made once again, which was what was desperately lacking over the past few years.

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**Pamela Ritchie:** It's astonishing what just a little bit of … couple of things you can count on that you know even if they're bad, it sort of changes the way we are in such an uncertain environment. You've mentioned scarcity of certain things that you find interesting. Semiconductors is one, the shipping industry and so on, how does inflation fit into us all coming back to the table, needing things at the same time and obviously the stimulus that's involved?

**Patrice Quirion:** It is something that's top of mind. I honestly think it is probably more a concern we need to pay attention to next year as opposed to in 2021. But it's coming in my opinion. Why am I saying that? I think there's simply too much liquidity in the system at the present time. I think we are setting up the stage for an economy that rebounds very strongly. At the same time we have some pressures around minimum wage, for instance in a lot of countries that will start to trickle in. I think we can go back to full employment fairly quickly. Interest rates and monetary conditions are probably too loose, not for today, but for where the economy is going. Despite that I suspect, and I think the central banks have made it as clear as they can, that they will not be in a rush to cool things down. I think this economy could potentially overheat for a couple years, and the inflation is simply a function of how tight is supply and demand. If we go into an environment where that gets a lot tighter, we should expect prices to go up. That could have some profound implications on what we want to own in clients' portfolios.

The obvious one is the central banks might not move short term, but the market will see that coming, and TIPS or inflation break-evens and longer dated fixed-income instruments will start to reflect higher interest rates. This is what the market uses to price long-dated cash flows. So think of companies that maybe are not super profitable today but are expected to be potentially very profitable in the future. When interest rates are zero, you're willing to pay quite a bit for that future profitability. If rates start to go up, the willingness of the market to pay for that will decrease. On the flip side, sectors that have been left aside because they are hurt by lower interest rates, I'm thinking notably the financial sector, either banks or insurance companies, could start to benefit from that. I think it has the potential to create a second lag into that rotation that we are starting to see in the market, and it's something to watch for. The market will see that and price that before it is obvious, and I think it could become more obvious starting next year.

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**Pamela Ritchie:** You mentioned cyclicals, you mentioned industrial, we talked about manufacturing, this is a specific question on your views about commodities.

**Patrice Quirion:** If we split commodities between energy and metals, I am clearly in the positive camp around metals and in the muted camp around energy. I'll elaborate a little bit on that first on how I'm positioned. By having an approach that's focusing on predictable, durable, quality businesses, it is really difficult for me to buy miners or energy producers. Much of the exposure you should expect me to have in the portfolios is through the supply chain of higher-quality businesses exposed to the same trends. But if we are wrong for whatever reason, where there's no existential threat on the viability of these businesses. If you look in my top 10 holdings, you will see a couple names exposed to the mining recovery theme. You see Kamatsu, the Japanese mining machinery manufacturer, and you'll see Finning, a Canadian Caterpillar distributor in Western Canada, Latin America and *[audio cuts out]*. To me those are good ways to get exposure to that, protecting your downside on better quality businesses than going out there and buying whatever mining company there might be that, if we're wrong and commodity prices collapse, they're burning a lot of money and might not make it through. So that's one theme.

On energy, I actually think the short-term setup might be positive. I just have question marks on where are those businesses 10 years out, which is always something I want to be comfortable with. As a result I have zero energy exposure into the portfolio, although I think they might be set up relatively well for the short term here. I'd rather get my exposures to cyclicals on businesses where I just have greater visibility over the long term. Keeping ESG in mind, I'm not the one who will be chasing green energy stocks to unbelievable valuations, but you should also expect me to avoid any company that has some questionable ESG footprint. That's my approach.

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**Pamela Ritchie:** That's great. I was going to ask you exactly where ESG fits in and you've just answered that right there.

**Patrice Quirion:** If I can elaborate for a second. Don't get us wrong, I think most investors at this point, at least in large investment organizations like us, we want to be good corporate citizens. We are pushing hard to have companies improve. There's a lot of discussions on expectations that we have around their practices. There's a ton of that going on. What there is also a lot of going on is investors turning that goodwill-like ambition into a way to make money and a way to speculate on stocks that are, in my opinion, really unproven concepts especially around green energy. That made sense at the valuations of a year ago, but now that they went up three-fold, five-fold, ten-fold are getting to valuation levels that are, to me, like speculation. It's really hard to see a scenario where in aggregate — there will be some winners, but where in aggregate, the current market cap of all these companies is justified. So I think we need to be careful within ESG of how do we express that into a portfolio without just really ratcheting up the risk profile. For me, it's to avoid the bad stuff and to really keep engaging through our analysts with all the companies on the portfolio. To make sure they're doing the right things, and for us to remind them that their owners, which is all of us as investors, are maybe, as opposed to in the past, not only considering profitability as the right thing to do for these businesses. I think that message is resonating quite clearly and especially so in Europe.

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**Pamela Ritchie:** It's so interesting to get your thoughts on that because, as you say, it's something that really is top of mind for everyone to get clarity on how you're working it in, but thinking about it. We talked a little bit about pockets of scarcity, for instance, and this is a specific question about supply chain interruption and car parts, not being able to have the supply chain working well enough to actually put the cars together on some level. How do you witness that and then see the opportunity?

Patrice Quirion: I think we need to get used to the idea that we will see more. What does it lead to? It usually leads to pricing power because it's basic supply and demand. If there's demand for cars that aren't getting produced, you might have to pay a little bit more for your car than what you would have hoped so otherwise. How do we express that into a portfolio? Really putting the focus on companies that have pricing power versus not. If we start, not if, we are starting to see industrial components prices going up. We're not seeing it so much in the broad inflation, but on the industrial inputs we are seeing that. It will be important for companies to be able to push that cost increase through to the price of their final products. Pricing power will become more important than it has been in the past, which to me says those higher-quality businesses that are leaders in their niche, in their markets, that are seen as a go-to, that has some sort of moat, some sort of IP around their processes, will be better protected than going into lower-quality businesses that are price takers, and that might see a margin squeeze in the next years.

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**Pamela Ritchie:** I just want to quickly go to the vaccine trade. In November it was announced. We're all in the rollout right now, we're all wondering when we get it and how that works, but when it actually was announced in November, it sounds like many of the things that you're talking about are exactly what got that lift.

**Patrice Quirion:** If I step back a little bit, I'm a fundamental believer that the market always overreacts. I'm not talking today versus yesterday, I'm talking on trends that have some lasting power, six months to three years. As a result what becomes universally acknowledged, either good or in a bad way, gets overpriced or underpriced in the market. If we step back, all of what I talked about, about the difficulties around the industrial economy, that was well acknowledged even going back to 2019, and I started to take more and more positions into these kinds of stocks as a contrarian investor willing to be more patient than others. Then COVID happened. As you can imagine I was not positioned the right way for COVID. That was something that, sadly was unforeseen, where I got caught into with the wrong positioning because it happened when I was betting on an economic recovery which I, to this day, think we would have gotten ex-COVID. What did we do then? We screened through the portfolio, increased the exposure, but high-graded the exposure and really did a lot of work to make sure that the companies we own have the balance sheets to make it through until better days. The better days, the market is a forward-looking, discounting mechanism, so we don't need to wait until the world is back to normal. We need to wait until the market believes the world will get to normal. That happened when the vaccines were first announced in early November. In a way that's what I was waiting for. This was the catalyst that nobody wanted to bet because you didn't know if it was going to be in November, or December or January, hopefully not *[audio cuts out]* but at some point later this year, but it did happen and it was going to happen, and as a result the stocks we held were more exposed to the cyclical reopening of the economy, renormalization of the world essentially. The market priced a fair bit of that pretty quickly. I still think there's more to go on that trade, as I mentioned earlier, but that's what as a contrarian investor I'm trying to do is look for areas where the market is overly pessimistic in terms of what's embedded in the value of a company, and buy them when nobody wants them or few people want to own these companies, and just wait for things to get better on the companies that we know time is on our side, and they will make it through to better days.

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**Pamela Ritchie:** It is great to speak with you, Patrice. Thank you. I feel like we've been on a bit of a trip around the world and great examples that you've given us to help illustrate what you're doing. Thank you for joining us.

**Patrice Quirion:** My pleasure. It's really nice to be with you and all the best to everyone onto what could be another interesting year this year.

**Pamela Ritchie:** Exactly. Stay safe. Good to see you. That's Patrice Quirion joining us.

*Ending; [28:14]*

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