Fidelity Connects

Tom Stevenson, Investment Director
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.

Today's podcast features Tom Stevenson, Investment Director at Fidelity International, based in London.

In this episode, Tom and host Pamela Ritchie discuss the impact of COVID-19 and the U.S. election on the markets in Europe and the UK. He will also shed light on his outlook for the global markets as we head into 2021 and what this new year could bring for equities and fixed income. Tom believes that the positive vaccine news has driven the markets enormously as prospects of getting back to normal next year has risen.

Today's podcast was recorded on Friday, December 4th, 2020.

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Pamela Ritchie: Throughout market history, some might characterize periods following recessions to be good times to be in markets for cyclical and for other reasons. 2021, following the COVID-19 economic devastation with now possible vaccines in place, could be one of those years. We're going to take a look at what the year ahead might have in store and consider forces that could shape the near term and what strategies might be the prudent course for your clients.

We're happy to be joined today by Fidelity's Investment Director, Tom Stevenson. He's joining us from London. Tom is also a columnist for The Telegraph and a regular broadcaster on radio television and podcasts. A warm welcome to you, Tom. Good to see you.

Tom Stevenson: Thanks, Pamela. Nice to be back again.

[02:29]

Pamela Ritchie: You and the rest of the U.K. are coming out – well parts of the U.K. – are coming out of a lockdown this week. How has it gone? Has it been useful from a numbers perspective?

Tom Stevenson: Yes it has. It's quite clear with the national lockdown that we've just been through. We had a full week lockdown which ended on Wednesday. We're just beginning to see the numbers coming through that suggest that it has clearly put a lid on the rise in infections that we were seeing four or five weeks ago, so that's good news. We've gone into a regional lockdown situation now, which in some ways is almost as onerous as the national lockdown for those regions that are most affected; pubs and restaurants are still closed in some areas.

[03:17]

Pamela Ritchie: What's next and what's been announced is the vaccine rollout, approvals that have been made and so forth, in the U.K., but really across Europe, and all the plans that are being made for this rollout.

Any thoughts on what that looks like? Slightly ahead of, perhaps, what North America's rollout is going to look like, or at least maybe different in some way. Could you shed some light?

Tom Stevenson: It does seem that the approval process is being accelerated here. It's gone through pretty quickly indeed. I mean, we have had some critical comments about the speed with which the process has happened over here. It's going to be very interesting to see what the appetite is among people for having this vaccination. I mean, clearly these things normally take a lot longer. The process is much more thorough and rigorous than we've had time to. I think it's great that it's happening, but it remains to be seen just what the appetite is from people to have this vaccination. But it's clearly driven the markets enormously.

[04:27]

Pamela Ritchie: Let's go there. We're going to come back to that... You have a number of very interesting thoughts on where the market goes next year, but why don't we just begin with the vaccine in the sense that the November that was was somewhat extraordinary. It coincided, obviously, with the U.S. presidential election, but the announcement of the vaccine just days later. Put into perspective what has changed.

Tom Stevenson: I think what the news on the vaccinations has done is raised the prospect that we really could get back to some kind of normality next year. There is this enormous pent-up consumer demand that's waiting to be unlocked. The vaccination was clearly the key to unlock that reopening of the economy. I'm not surprised that we had this enormous return of animal spirits in November. I am surprised by the scale of it. November turned out to be a pretty extraordinary month in the markets.

You mentioned the U.S. presidential election. That was clearly a factor, but by itself it would not have been enough. Add in the vaccination part of the equation as well, and that was a fantastic cocktail of events to drive markets higher.

[05:54]

Pamela Ritchie: It was incredible, just as the sentiment obviously, as you said, the enthusiasm. Today we saw U.S. jobs numbers coming out for the month of November. They were big numbers, when I look at it from other countries' perspective, but nowhere near what they had expected or hoped for. Yet markets are okay with that. I don't know if that means stimulus is coming or what it means markets are looking through.

Tom Stevenson: Well, I think those numbers were fairly disappointing. I think that they came in, what was it, 2, 4, or 5,000... It was about half the level that was expected. I think you actually highlight a very important point there, because one of the key drivers of markets at the moment is this promise of co-ordinated fiscal and monetary stimulus. The positive side of slightly disappointing economic numbers like the [*indecipherable*] payrolls is it does suggest that that stimulus is not going to be choked off. It's going to keep coming. Because if you look at the risks to the bull market scenario, one of the keys ones is that stimulus is taken away too quickly. This sort of Goldilocks set of numbers, which are okay, but not that okay, is probably the best that investors can hope for actually. We've seen that today in the markets. On both sides of the Atlantic, markets are pretty buoyant today.

[07:21]

Pamela Ritchie: One of your points is actually in a Telegraph article that we read through. You published it this week. Looking at 2021, and the vaccine is a piece of it, but also the stimulus just going forward, swimming around in the markets through next year is one of the reasons for this thought that buoyancy will continue.

Tom Stevenson: Yes, I think that's right. You put all of that together, you add it to the fact that company results are coming through a bit stronger than expected, the third quarter earnings season was pretty strong. You add all of that together, and I think that 2021 does look like being a better year in the markets. That's clearly the view that investors have taken. You put those pieces in place in November, and we had that extraordinary rise of about 13% for the MSCI World Index. European shares actually were even stronger; about 15% in Europe. The U.S., which is obviously more dominated by the kinds of stocks which are not beneficiaries necessarily of opening up the tech stocks, was a bit less. But even in the U.S., an 11% rise, so it's pretty much across the board.

People have talked about this as being a bull market of everything. With the exception of U.S. treasuries and gold, the two most obvious safe havens, everything is on the way up.

[08:57]

Pamela Ritchie: Does that give you pause?

Tom Stevenson: Yeah, it does. It does give me pause. I've been around in the markets for long enough to remember 20 years ago when we really last had this sort of sense of euphoria in the markets, which we haven't experienced in the 11 years since the financial crisis. It's been a really unloved bull market. It's been very grudging. Markets have gone up, but people haven't really believed in it until the last month or so. Suddenly we've had this return of animal spirits, that risk appetite has increased. It just reminds me a little bit of what happened 20 years ago in '98, '99 as markets got into that dot com bubble. It became widespread. Someone was making a bit of money, they were telling someone else they were making a bit of money. We had this fear of missing out and it, sort of, feeds on itself. I just wonder whether we're moving into that phase again, where it becomes self-fulfilling, self-feeding. I think we're a long way off the kind of exuberance that we got at the top of the market 20 years ago, but I suspect we're on our way towards it.

[10:14]

Pamela Ritchie: One of the things pushing equities higher is less interest in the bond market. That just seems to be a fact. We have interest rates, we know where they are, we've been promised they'll be low for a long, long time. It seems there are rotations all over the place to small caps, to EM, to Europe, but also from the bond market just into equities generally. What does that present as an opportunity or something to be flagged, again, for 2021?

Tom Stevenson: I think it's a real factor in the performance of the equity market. If you think about the size of the bond market, you think about how much money has been parked in money market funds, but in bonds generally. If some of that money starts flowing back into the equity market – and we saw over a three-week period in November, we had something like $90 billion flowing into equity funds, that was the highest ever for a three week period –, that money is coming from somewhere. I suspect a lot of it is coming from those places where they've been parked; safe havens. If that continues, then I think that is a serious bull point for the equity market.

[11:30]

Pamela Ritchie: Let's talk a little bit about the other rotations. There are many, as you said, in the market right now in equities. There is certainly a rotation – the U.S. dollar has a lot to do with this – to emerging markets, to Europe as you said. We've been watching the euro. I wonder when policymakers get worried about euro levels. But, in any case, we see the rotation to interest in stocks across Europe. Tell us a bit about that; how you look at that. We might zero in on the U.K. in a minute after that, but just [*audio cuts out*] part of the rotation.

Tom Stevenson: As you say there are lots of rotations going on because it does feel like something of a watershed moment in markets. I think we've got this rotation from growth into value. That is really happening. If you look at the rises and the fallers in any market –I've been looking just today at the U.K. market – the winners are these cyclical value-related stocks, the things that have been beaten up most during the pandemic. So we've got that rotation going on. But related to that is a rotation away from the markets which are most defensive and growth oriented, like the U.S., to the world's markets which will do well in a generalized economic recovery. Emerging markets clearly fall into that category, especially if the dollar declines, and we're seeing the dollar weaken. I think a lot of people feel that emerging markets will be a strong performer next year.

You talked earlier on about if this give me pause for thought. One thing that really does give me pause for thought is that everyone is saying the same thing at the moment. Everyone is talking about this growth to value rotation. Everyone is talking about non-U.S. markets outperforming the U.S. When everyone starts talking about same thing, that's not a very good sign.

[13:29]

Pamela Ritchie: I know. It's becoming somewhat ubiquitous. Maybe we don't have enough to talk about. That could also be the result of staying at home. It's sort of the thing we're zeroing in on – Netflix and the stock markets. I don't know about that. But certainly a huge interest within this. We actually spoke to Nicole Connolly, who is the ESG for Fidelity across North America yesterday, and we got some very interesting points on sustainable investing, but it looks like there's no reason for that to be interrupted; that interest. So far it's only gaining. Is that part of your thesis for the years to come?

Tom Stevenson: Absolutely. I really think that, looking forward to the next year, and indeed the years beyond that, the sustainability theme in investment is absolutely here to stay. We've done research here. I think we've talked about it in the past, which shows this connection between sustainability and stock market performance. It's a clear, positive correlation between the two. I think people are understanding that, and I think the pandemic has focused attention on the social aspects as well as the environmental aspects of ESG. I think that sustainability will be a key focus next year.

[14:47]

Pamela Ritchie: It's interesting how that ultimately will be layered over other, as we said, rotations; layered over EM, layered over so-called value stocks, smaller cap. It'll be fascinating to watch this all, but as you say it just seems full-steam ahead.

We'll take a look at Europe specifically, and actually the U.K. There's no way not to talk about Brexit. The clock is seriously ticking here, although I feel like we've been here before. Bring us up-to-date on what we need to know at this moment about whether Brexit, there'll actually be a deal.

Tom Stevenson: I feel like we've said the clock is ticking and we're at crunch time many times in the past. We really must be at crunch time now, because the year-end is a cut-off and we're now in the final month of the year. We're in December.

Just looking today at the headlines, there is clearly some last minute jockeying for position by both sides. They're beginning to play slightly hardball at the moment. I actually take that as a bit of a positive, because what that's telling me is that both sides think that we are within reach of some kind of a trade deal, and because of that each side is making sure that they don't give too much away at the last minute. It's the real sort of crunch time in these talks, but if you look at the headlines today it doesn't look very positive; but then look what the stock market has done today, up very strongly. I think that is saying we see this as last minute posturing, rather than something really to be concerned about.

[16:28]

Pamela Ritchie: Let's say that that comes to the fore in the next, I don't know, week or soon obviously, is there in fact a bit of a relief trade or relief rally on that? Or have we just already been hearing about it and therefore doesn't cause a full liftoff? How do you look at that?

Tom Stevenson: I'm not sure that there will be a massive relief rally on this, because I think people are starting to price it in. But having said that, I think that the underperformance of the U.K. market recently, and actually over quite a long period, has been so significant and so meaningful that any slightly bit of good news is going to impact positively on the market. I think the risk/reward ratio for U.K. investors is pretty favourable at the moment. Valuations are pretty compelling, and I think a lot of the bad news has already been priced in. The U.K. is definitely one of my more positive calls for 2021.

[17:31]

Pamela Ritchie: Let me ask you this. Now that we have all worked from home, traders have traded from off-site locations, the market has kept its liquidity... It's one of the surprises I think for a lot of people, this year, how well market technicals have continued to occur. Does it matter whether London is or isn't the physical location in the same way for the European financial markets? Does that debate get muted slightly? It doesn't have to move to Paris or Dublin? What do you think?

Tom Stevenson: I think the U.K. has a lot of advantages in terms of time zone and language, and just the surrounding infrastructure of legal services, accountancy, all of the peripheral ancillary services that make it possible to trade. I think that, yes, being able to trade from home means that location is less important than it was, but I think physical location is still important.

[18:40]

Pamela Ritchie: Okay, interesting. When we look to the election in the United States, the Biden administration has made many announcements about who will be in various positions. Janet Yellen is certainly one that speaks to the fact the administration is likely to work closely with the Fed, or maybe more closely with the Fed. What does it mean on the tax front? What does it mean on the some of the blue wave discussions that people had, and what it would mean for the economy, one way or the other, going into 2021? Do you see that landscape changing?

Tom Stevenson: I think a lot depends on what happens in early January, in Georgia in this final Senate piece of the jigsaw because, at the moment, the markets are working on the assumption that we have a Democrat in the White House and we have a very narrow Republican majority in the Senate. That divided government is actually good news, as far as investors are concerned. Gridlock is good in Washington. If it stays that way, I think people will be happy. If we get a small Democrat majority in the Senate – which is still possible with the casting vote of the Vice President – then I think at the margin makes some of the more negative things a bit more likely. It makes tax rises a bit more likely. But I think the market is fairly happy with the set-up in Washington. It seems balanced enough that nothing too serious is going to happen to upset the apple cart.

[20:21]

Pamela Ritchie: Interesting. It's perhaps one of the scenarios people didn't think about as much until perhaps the days just before the election. It's an interesting outcome.

Lots of questions coming in here. Not unlike in London where you have metals and materials making up a good chunk of the industry. In Canada it's the same thing. The TSX is made up of lots of metals and materials and so on. I find we're always interested in Canada, of where some of these commodity prices are going. The question rolling in here is with the global push towards carbon neutrality, do you see a rising demand in cooper, other based metals, batteries to replace carbon fuels. How do you look at that space?

Tom Stevenson: If you look at the price of those metals over the last few weeks, that is painting a really positive picture for demand. Clearly, demand for some of those metals comes from this transition of the economy to a more sustainable future in terms of electric vehicles, etc. We talked earlier on about the performance of some of those cyclical sectors, and if I look at the leader board over the last month – as I was doing just before we came on-air actually – the Anglo-Americans, the Glencores, the PHPs, they are right up there. That sector is, I think, a real beneficiary of this opening up trade that we're seeing.

[22:01]

Pamela Ritchie: Interesting. A new CEO on the books, I think, for Glencore, at least the current CEO is on his way out, I noticed this morning.

Another question rolling in here. How do you see the valuation of the pound going forward?

Tom Stevenson: The pound is pretty strong at the moment; well, I say pretty strong, but it's all relative by recent history. At a $1.35, that's as high as it's been in the last year. You talked about a sort of relief rally. I think if we do get a deal on Brexit, then we may see a little bit of a further push on the pound. It's not necessarily good news for the equity market because they tend to move in opposite directions here in the U.K. But I think it's quite asymmetric. I think that the pound could go a little bit higher. I think if we get a bad Brexit outcome, then there could be a bit more downside.

[23:00]

Pamela Ritchie: Interesting. It's really something that we're kind of watching as it rolls in, this story.

Another question. We started out talking about vaccines and where things are going. This question has come in. Everyone is also talking about vaccine development, but this investor says nobody is talking about the fact that 90%, the effectiveness of the vaccine, is sort of unprecedented, this high number of effectiveness. Do you see hypersensitivity in the market if the vaccine isn't rolled out effectively, or if there are issues with the vaccine?

Tom Stevenson: I think that's one of the key question marks over this whole bullish case that we've seen in recent weeks. I think there is a world of difference between finding a vaccine, and even finding what seems to be a very effective vaccine, and actually rolling it out to effectively seven billion people around the world. That is a massive logistical task, which will be easier in some countries than in others. I think there's still quite a lot that can go wrong, and things that can go wrong around the vaccine. Sometimes it's better to travel than to arrive. Clearly, the early news on the vaccine is great. Everyone sort of breathed a sigh of relief, "oh, we're getting back to normal". But we've got the hard yards to do now.

[24:29]

Pamela Ritchie: It's fascinating. Yesterday we saw what is available in terms of supply chains. It's tough to predict through some of this.

Is there anything else across Europe that you're watching particularly carefully? Is the ECB, we seem to see Christine Lagarde at the ready to do pretty much whatever is needed. But what are some the nuances with the ECB position in the next year?

Tom Stevenson: I think the ECB needs to do something. As you say, Christine Lagarde stands ready to act and I think that that's absolutely right because, if you look at what's happening in Europe with the second wave and the lockdowns that we've had – not just here in the U.K. but across Europe – that's recovery is pretty fragile. I think that the Central Bank in Europe is going to have to step up and increase that quantitative easing program if it's going to keep on top of things here.

[25:38]

Pamela Ritchie: Very interesting. What would be the three things you'd like to leave investors with in terms of where things can go on a positive sense in 2021, and maybe one levelling piece?

Tom Stevenson: I think the positives are on the vaccine front clearly; clearly a positive. On the fiscal and monetary stimulus, clearly a positive. I think those wrap up together to deliver a strong backdrop for equity markets in 2021.

My caveat to all of that is the speed with which animal spirits have returned and the unanimity of positive sentiment towards the equity market at the moment. I just want a bit of dissent. I want some people saying "no, we're not off to the races" and at the moment it doesn't feel like anyone is offering that dissenting voice.

[26:44]

Pamela Ritchie: We spoke earlier about the big rotation of money, or money coming out of the bond market into the equity market, as one of the pieces of why things look very bullish for stock markets next year; where is the downside protection? Bonds are not the only downside protection, but they are certainly one of them. Do you see any issues with that?

Tom Stevenson: Yeah, a balanced portfolio is necessary. One of the problems with the bond market being where it is, in terms of the level of yields, is that there is a risk that the bond market is no longer able to perform that function as a diversifier. If bonds are not doing it, then investors are going to have to look elsewhere for alternative investments. It's quite hard to see what could replace the bond market, the scale of the bond market, in that diversification quest. I think that is a slight concern.

[27:48]

Pamela Ritchie: Final question coming in here. What is your outlook for gold? That can be a diversifier. It hasn't really been through much of this year, but how do you look at gold?

Tom Stevenson: I think actually gold has been a good diversifier. It's not performed well recently, but I think that's because it's doing its job as a diversifier. As the equity market has picked up, the gold market has come off the boil. It depends what you're using gold for. If you're using it for growth, then you may be a bit disappointed in the performance over recent weeks. If you're using it as a diversifier, as an insurance policy, then I think it's done its job.

[28:30]

Pamela Ritchie: Fascinating. We'll leave it on that note. It's fabulous to get your thoughts for the year to come. I know we'll look forward to speaking to you in the year to come. Tom, thank you very much and have a good weekend.

Tom Stevenson: Thanks very much, Pamela.

[28:46]

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