Fidelity Connects

Live from the UK: From Brexit to Global Trade

Tom Stevenson, Investment Director

Pamela Ritchie, Host

[00:00]

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, who joins us today from the UK.

In speaking with host Pamela Ritchie, Tom guides us through the investment implications of Brexit for the year ahead and shares with us his outlook for the global markets, touching on the effects of unprecedented monetary and fiscal stimulus.

Tom looks at how the recovery after the Financial Crisis in '08-'09, is very similar to today's recovery from March 2020. And Tom also comments on the euro, referencing that the strong euro is the biggest issue facing many European companies, as exports are so important to Europe.

This podcast was recorded on January 22nd, 2021.

[01:41]

Pamela Ritchie: Great to see you, Tom. How are you?

Tom Stevenson: Hi, Pamela, very well, thank you.

Pamela Ritchie: Good, great to have you join us. Inflation is massive, or at least the potential for it seems to be massive after we start talking about the American new administration, what it seems they would like to do. Let's just sketch out, first of all, what you see on the horizon or the pitfalls of inflation coming.

Tom Stevenson: I think you look at what is happening in terms of fiscal stimulus, particularly in the U.S. I was looking at some of the figures and, obviously, we may not get all of the fiscal stimulus that we've had promised or is being proposed, but if we were… We're talking about something like $5 trillion over the last 12 months, 25% of GDP. This is an absolutely unprecedented amount of stimulus. It's hard to see that that will not flow through into an inflationary impulse in due course. That is clearly the reflation trade which is driving markets at the moment.

[02:58]

Pamela Ritchie: I want to come back to the reflation trade and how it's working for different regions around the world, which you have some great comments on, but also this topic of inflation perhaps being a longer term situation, one that some say we don't need to work about yet but it's coming. What might be more cause for concern on the horizon nearby is a correction. What are your views on that? There seems to be a lot of voices around this right now.

Tom Stevenson: I think this is a really interesting topic at the moment. We're seeing… it's that time of year, of course, you get a lot of the year end letters to shareholders. We've seen the Jeremy Granthams and the Seth Klarmans, people just raising red flags, beginning to sound alarm bells about the potential for a correction in the markets, worry about some speculative behaviour in the markets, worried about valuations moving to excessive levels. My feeling is that that's largely overstated, but I had a bit of a look at history. You go back 10 years to the recovery from the financial crisis, the market bottomed in March 2009. By the time we got to March 2010 we had a very significant correction in the market. Between the middle of April 2010 and the beginning of June, so a period of about seven weeks, we saw markets fall, the MSCI World Index fall by more than 16% over that period.

So we had a very similar… if you overlay the recovery from the market bottom last March onto the market recovery from March 2009, they're almost indistinguishable to be honest. So having looked at that, then you look at this 16% correction that we saw in 2010, just makes you think that with all this talk about speculative excess, high valuations, I just wonder whether we might get a bit of a correction along the way. If we do, that's fine. I'm absolutely not concerned about that because at the time, back in 2010, if you'd experienced that 16% correction, that would've been a pretty unsettling experience. If you bailed out of the market then, you would've missed out on what is essentially a tripling in the market over that 10 year period. That correction was the first of several in a long, long bull market. So we may get it, I think there are good reasons to think that we may get a bit of a correction, it's not something I'm particularly worried about.

[05:46]

Pamela Ritchie: It's hard to do nothing, but it's sort of one of those things where you do nothing? Is that about right?

Tom Stevenson: I think the hardest thing for investors to do is nothing at all. Don't just sit there, do something, but actually don't do something, just sit there is very often the best approach for an investor.

[06:08]

Pamela Ritchie: There are a number of questions rolling in already. I'm actually going to go to the subject of Brexit because there's questions rolling in about it and I'd really like to get your views. It does get lost in the shuffle a bit right now. There are so many other worries in the world, but I read in recent weeks that big banks that are based in Madrid, for instance, or Frankfurt or *[indecipherable]* that have been trading in London are sort of returning to their European home bourses. I don't know if it has a big effect for the city, but is it symbolic? How do you watch some of these things happening with an actual, a bit of a decoupling going on? What extent do you watch it?

Tom Stevenson: The thing that surprises me a little bit about Brexit is how little anyone's talking about Brexit at the moment. It has been lost in the sort of blanket of COVID, and the reflation trade, Biden in the White House. Actually in this corner of the world, Brexit is a big deal, and if you look at the down page stories, the little news in brief stories, you are beginning to see just some references to the number of companies who are finding deliveries from Europe being held up at the borders, and that's with a much lower level of traffic cross-border that we would normally get because of COVID. We are already seeing both trade frictions arising. So that's interesting.

I think from a financial perspective, you're absolutely right to flag up. At the margin, some of these financial trades are moving to Amsterdam, they are moving to Frankfurt, they're moving to New York. I do think that the city of London has a real challenge ahead of itself to maintain its position within the European financial structure post-Brexit.

[08:09]

Pamela Ritchie: Very interesting. Let's bring currency into it to an extent. I'm looking at the remarks from Christine Lagarde yesterday from the ECB. Some people said it was a rather boring conversation. I don't know if that's fair, but if it was something that you had a reaction to, she sort of said we're here if you need us but we're not doing a whole lot more from here. What was your reaction to the remarks from Christine Lagarde?

Tom Stevenson: I think what Christine Lagarde had to say was a bit dull, and I think markets were maybe a little bit disappointed in what she had to say. I think the tenor of her comments was that the ECB is really struggling to find any traction on the key issues of inflation and the strength of the euro. We've had five months on the trot of ongoing deflation, falling prices in Europe, the ECB is failing to really have any traction on that front. More worrying, I think, is its failure to put a cap on the strength of the euro. The two are related because you can get in this sort of deflationary downward spiral, a strong currency reduces inflation which pushes the currency up even more. I think that a strong euro at the moment is probably the biggest issue facing many European companies. Exports are so important to Europe and we're seeing a recovery in various economies around the world. In Asia, for example, which is a big destination for European exports, a rise in the value of the euro. It makes it very difficult for Europe to really capitalize on that recovery in the global economy. We're seeing that in terms of fund flows. We're just seeing a real hesitation about investing in Europe at the moment, and that's despite the fact that European stock markets are pretty cheap compared to other markets, the U.S. in particular.

[10:41]

Pamela Ritchie: It's interesting because the argument, I'll say before the Christmastime, was the euro's rising, even if stocks in Europe aren't doing exactly what you want them to do, to have exposure there rather than a declining U.S. dollar made sense. Where does that argument fit now or does it still fit?

Tom Stevenson: I think that that argument has shifted a little bit because of this extraordinary level of stimulus in the U.S. I think that we've got this expectation that the dollar is going to decline this year. It wouldn't surprise me actually if the strength of the dollar rather surprised people and we got a bit of a reversal of flows if the U.S. economy really starts to pick up. If we get the kind of… frankly, the overheating of the U.S. economy, which is a distinct possibility given the unprecedented level of the fiscal stimulus accompanied by the monetary stimulus. This is pretty unprecedented. You have to go back to the 1940s and the 1950s before you really find this coordination of fiscal and monetary stimulus. We've had one or the other in the years in between, we've really never had that combination of the two together. That could have a pretty extraordinary impact on growth, overheating, and I think that the flows might start to go back the other way.

[12:13]

Pamela Ritchie: It's actually hard, genuinely, to keep track of all of the trillions, the zeroes. It is, as you say, extraordinary and we've spoken with some other people that whatever stimulus is being talked about in Washington right now is on top of so many other trillions, and so where is the reflation trade going and where is inflation? Maybe we can just hit those, as you say, specifically in the U.S.

Tom Stevenson: What you have to bear in mind is it's not just all the zeroes and the amount of money that's being created. It's where it's going. Go back to the financial crisis, that money didn't really get into the real economy. It was hoarded by the banks, it bolstered the banks' reserves; so it served its purpose in stabilizing the financial system. What it didn't do was feed through directly into people's pocket, but what we've got with these stimulus cheques, we handed over $600 a person before Christmas, potentially another $1,400 a person now. This is a lot of money which… it's going to be spent at some point, so it's a totally different kind of stimulus from what we saw 12 years ago.

[13:36]

Pamela Ritchie: Very interesting. You're not finished with the Brexit questions. There are some fantastic questions coming in and lots of appetite for your thoughts and interest about Brexit. Thoughts on another independence vote, maybe you can expand that even to include how Scotland feels about things, what's happening with ship travel between Ireland and the continent, just the effect on the British market generally from an investment perspective.

Tom Stevenson: This is not what the proponents of Brexit would've maybe imagined in 2016 when we had the vote. I do think that this is potentially a damaging development for the unity of the United Kingdom. We talked about Scotland there, but I think an even more interesting example of this is what's happening in Northern Ireland. Northern Ireland has got this sort of curious hybrid status now where it's sitting with Ireland in the single market, but at the same time sitting within the UK. I'm not sure that that is a sustainable compromise situation in the long run. I do think that the politics of the United Kingdom, in terms of the union, are more unpredictable now than they have been at any point in recent years.

[15:09]

Pamela Ritchie: What does that do to the pound? We've seen it lately, actually; you've got retail numbers in today which maybe is a broader economweic question, but give us a sense on where the pound could go. There also seems to be the pent-up demand story, what are your thoughts?

Tom Stevenson: The pound is very strong at the moment, relatively speaking. Obviously we're not back to the levels that we were at a few years ago. At $1.37 for the pound, this is the highest that sterling has been for several years. What's driving that? I think that the UK economy is particularly exposed to the transition to a post-pandemic world. We're very highly dependent on the service sectors which have been hit so bad during the pandemic, so I think that rolling out the vaccinations – and actually there haven't been many good news stories in Britain du ring the pandemic, but the rollout of the vaccination program actually has been remarkably successful by European standards. We're way ahead of the other European countries in rolling out the vaccinations. So I think that's one of the things that's driving the pound. I think we are going to come out of it in reasonable shape, and probably quicker than the rest of Europe. So I think that is helping the pound.

[16:47]

Pamela Ritchie: That's a very interesting perspective on that and how it offsets perhaps other things going on. I'll just go back to Europe, to the continent. In the last week there's been an enormous amount of, I guess you'd call it headline risk, or just headline news. Italy, its government has been in trouble, it's been in trouble a lot of times. How can you put some of these things into context for us? Germany also has a changing of the guard coming, we know that, but what do investors need to know about some of these individual stories within the countries?

Tom Stevenson: I think the interesting thing about, well… The Italy situation is interesting because I think a lot of people are really quite cross about the way in which the internal political complications of what is a very complex situation on the ground in Italy has been allowed to flare up at a time of crisis, a COVID-related crisis. I don't think that's gone down particularly well, that those tensions have been allowed to come to the fore. We talk about Europe as being a homogenous block now, but of course, it's clearly not. All of these countries have their own domestic political situations to think about as well, and Germany is a good example. I think that the development in Germany is quite a positive one, actually, because it feels like the continuity candidate actually came to the fore there. So I don't think that we're going to see radical change in Germany, which I think is important for European unity going forward.

[18:41]

Pamela Ritchie: I guess to separate the noise from the investment, is it just headline risk? I mean, for investments that perhaps have companies located in these various countries, is there anything to be concerned about due to recent events?

Tom Stevenson: No, I don't think so. I think that the things that we've talked about, it's the euro, it's inflation, it's the COVID situation. Put all those things together, that's what people are really concerned about in Europe at the moment.

[19:20]

Pamela Ritchie: Very interesting. I wanted to ask you a little bit about earnings, valuations – these are all things that start from where we are in the market which you've mentioned before. But is there anything particularly interesting to you on the valuations front? There are a lot of people who are nervous, you talked about that, corrections and so on, but from where you're seated is there anything that also just takes them higher because of all the stimulus that we've talked about?

Tom Stevenson: We talked about the correction and all of that earlier on, but fundamentally the reason why I'm not concerned about the possibility of a short term correction is because looking longer term I think that, because of the stimulus, we are looking at very significant growth in the economy. We're talking about maybe 8% annualized growth in the first quarter in the U.S. That is going to feed through into very significant earnings growth throughout 2021 and into 2022 as well. I think that goes some way to justifying current valuations. The other important thing to think about with valuations is the extremes that people are flagging up as being problems are quite isolated, they're quite restricted to certain parts of the market. There are other parts of the market, the more value focused cyclical areas of the market, which frankly are not overpriced, they're not expensive. I think there is a danger in generalizing too much about valuations. There's a big divergence in valuations.

Even at the expensive end of the market, I think you can make quite a strong case for the valuations of those high growth technology companies actually being justified. These are very different companies from the tech stocks of, say, 20 years ago during the dot.com bubble. The growth potential for these companies, the cheapness with which they can add growth and move into new areas is remarkable. I think that goes somewhere to justifying the valuations.

[21:47]

Pamela Ritchie: It's very interesting, because they look sky high to so many but there's a lot in that. Two things I want to make sure we talk about before we let you go. One is ESG, the other is China and particularly the investment deal that was done with Europe, with China before – I guess it was in December. There's some thoughts that maybe there was a jumping of the gun, perhaps from an American foreign policy perspective, before Biden was elected. What are the consequences of Europe trying to make sure it's exposed enough to the Chinese economy? There's a little bit of a rope that it has to tow there. Can you comment on that?

Tom Stevenson: I think Europe is in a tricky position when it comes to its relationship with the two major economic powers in the world. It is necessarily squeezed between the dominance of the U.S. and the increasing power of China. It needs to keep both of those constituencies relatively happy. That's a challenge, that's a diplomatic challenge, that's a trade challenge that it's always going to face, but that's the reality for the foreseeable future.

[23:09]

Pamela Ritchie: On the ESG front, we've spoken before about Europe being far further down the road of having this in the front of its psyche and being in that zeitgeist earlier than North America which looks like they're going to get going on it and have got going on it, but it is a tale of two cities. How much do you see this… is there a big transition for European investors to transition into various companies that are either ESG aligned, or in fact producing types of energy and so on that are of interest to investors? Is there a lot left in that trade in Europe versus the North Americans cracking into it more seriously now?

Tom Stevenson: You know what? I think that whole environmental… We talk about ESG, but specifically it's talking about the climate change challenge, the environmental challenge. I think that we are just at the very beginning of a remarkable story of investment and change. I think, going back to my earlier comments about why a short term correction is not something I worry about, I think the 2020s is going to be a remarkable decade of investment both in the general infrastructure which, in most of the western world and the United States in particular, is crumbling, is very old and needs replacing. Then on top of that, the climate change challenge. I think that the 2020s could be a decade of innovation and very big and exciting investment in those areas. I think the E of ESG is a fantastically interesting area for investors now.

[24:59]

Pamela Ritchie: An investor just wrote in to ask for your comments, from a Canadian perspective, looking perhaps to exposure globally, your comments on a view of Europe versus Asia from that perspective.

Tom Stevenson: From an ESG perspective?

Pamela Ritchie: No, not from an ESG perspective. A Canadian investor seeking exposure abroad and trying to figure out where to take a look at Europe versus Asia which is, I know, a broad look, but….

Tom Stevenson: I think they are not necessarily incompatible. Because of what we've talked about, the importance of exports to Europe and also the European expertise and know-how in these industries of the future, alternative energy, etc., those kinds of things. Actually the growth in Asia which naturally you'd think well, I want to invest in Asia, but actually investing in Europe can be a kind of proxy for investing in Asia. So by splitting that investment, to give yourself that balance, that diversification, that's a sensible way, but in both cases you're playing the same trends.

Pamela Ritchie: I think I got what you said there, but is Asia more likely to look at various technologies that would help it develop on an ESG front – and mostly the environmental I'm talking about – versus looking at North American companies doing something similar? Is that just sort of a given?

Tom Stevenson: I don't think they're more likely to look at Europe, and also, to be fair, they are developing these technologies themselves. There are pockets of strength and expertise in these areas in all three of those regions.

[26:56]

Pamela Ritchie: Where does it leave commodities? The ESG discussion, the ramp-up of new types of technology that need different types of materials for instance, it's certainly a big subject for trading in London. Commodities are a big part of the story there. How do you see commodities? They've had a huge lift in certain pockets recently.

Tom Stevenson: Yes. Clearly, if you look at the longer term view, then it's a different set of commodities which maybe will be required. But in the short term, commodities are very quickly responsive to changes in demand, and what we're seeing with China being first in and first out of the pandemic, we saw the GDP growth figures early this week from China, the 6½% growth back to pre-pandemic levels, that is feeding through into very strong demand for traditional commodities.

[7:57]

Pamela Ritchie: It's a fascinating trend. It's just amazing how quickly it's gone. It probably comes back to some of the reflation we discussed as well. Thank you for spending what would be your Friday early evening with us. We appreciate it, Tom. I hope you have a great weekend.

Tom Stevenson: It's always a pleasure. Thanks, Pamela.

Pamela Ritchie: That's Tom Stevenson joining us from London.

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

You can visit fidelity.ca for information on future live webcasts – and don't forget to follow Fidelity Canada on Twitter. Thank you, see you again.

[end of webcast]

Commissions, trailing commissions, management fees, brokerage fees and expenses may be associated with investments in mutual funds and ETFs. Please read the mutual fund or ETF's prospectus, which contains detailed investment information, before investing. The indicated rates of return are historical annual compounded total returns for the period indicated including changes in unit value and reinvestment of distributions. The indicated rates of return do not take into account sales, redemption, distribution or option charges or income taxes payable by any unitholder that would have reduced returns. Mutual funds and ETFs are not guaranteed. Their values change frequently, and investors may experience a gain or a loss. Past performance may not be repeated.

If you buy other series of Fidelity funds, the performance will vary largely due to different fees and expenses. Investors who buy Series F pay investment management fees and expenses to Fidelity. Investors will also pay their dealer a fee for financial advice services in addition to the Series F fees charged by Fidelity.

Any reference to a company is for illustrative purposes only. It is not a recommendation to buy or sell, nor is it necessarily an indication of how the portfolio of any Fidelity Fund is invested. The breakdown of fund investments is presented to illustrate the way in which a fund may invest and may not be representative of a fund's current or future investment. A fund's investment may change at any time. Mutual Fund and ETF strategies and current holdings are subject to change.

The statements contained herein are based on information believed to be reliable and are provided for information purposes only. Where such information is based in whole or in part on information provided by third parties, we cannot guarantee that it is accurate, complete or current at all times. It does not provide investment, tax or legal advice, and is not an offer or solicitation to buy. Graphs and charts are used for illustrative purposes only and do not reflect future values or returns on investment of any fund or portfolio. Particular investment strategies should be evaluated according to an investor's investment objectives and tolerance for risk. Fidelity Investments Canada ULC and its affiliates and related entities are not liable for any errors or omissions in the information or for any loss or damage suffered.

From time to time a manager, analyst or other Fidelity employee may express views regarding a particular company, security, and industry or market sector. The views expressed by any such person are the views of only that individual as of the time expressed and do not necessarily represent the views of Fidelity or any other person in the Fidelity organization. Any such views are subject to change at any time, based upon markets and other conditions, and Fidelity disclaims any responsibility to update such views. These views may not be relied on as investment advice and, because investment decisions for a Fidelity Fund are based on numerous factors, may not be relied on as an indication of trading intent on behalf of any Fidelity Fund.

Certain Statements in this commentary may contain forward-looking statements ("FLS") that are predictive in nature and may include words such as "expects", "anticipates", "intends", "plans", "believes", "estimates" and similar forward-looking expressions or negative versions thereof. FLS are based on current expectations and projections about future general economic, political and relevant market factors, such as interest and assuming no changes to applicable tax or other laws or government regulation. Expectations and projections about future events are inherently subject to, among other things, risks and uncertainties, some of which may be unforeseeable and, accordingly, may prove to be incorrect at a future date. FLS are not guarantees of future performance, and actual events could differ materially from those expressed or implied in any FLS. A number of important factors can contribute to these digressions, including, but not limited to, general economic, political and market factors in North America and internationally, interest and foreign exchange rates, global equity and capital markets, business competition and catastrophic events. You should avoid placing any undue reliance on FLS. Further, there is no specific intentional of updating any FLS whether as a result of new information, future events or otherwise.