Fidelity Upside

Voiceover:

Hello and welcome to Fidelity Connects – the Fidelity Investments Canada podcast – connecting you to the world of investing and help-ing you stay ahead.

In today's podcast we're going to get to know portfolio manager Dar-ren Lekkerkerker. Darren chats with host Emily Anonuevo about how he first got into investing and his investment approach that focuses on quality companies trading at reasonable valuations, with shareholder-oriented management.

For Canadian investors, Darren manages Fidelity North American Eq-uity Class – a concentrated portfolio of high-quality companies in Canada and the U.S. Among a handful of other funds, Darren also manages the equities subportfolio that makes up about 50% of Fidelity Canadian Balanced Fund.

Darren notes how he is maximizing company meetings while working remotely, is optimistic about 2021 and comments on how he is actively positioning his fund for today's market conditions.

This podcast was recorded on February 2, 2021.

[01:47]

Emily Anonuevo: Darren, so happy to see you and glad you could be part of the show today.

Darren Lekkerkerker: Hi, Emily, I'm happy to be here.

00:01:53

Emily Anonuevo: So I want to begin with a bit about you. What sparked your passion for investing? And can you talk to us about your career path, because I know you started out at a bank and then into private equity and then became a portfolio manager — what was your journey like?

00:02:08

Darren Lekkerkerker: So I can remember the day that I learned and became interested in the stock market. And so I was actually really young, I was nine years old. Neither of my parents were involved in or interested in the stock market. I had these two cousins, and they had a distant relative on their side of the family that gave them shares. One got shares in crude oil, and the other got shares in a gold company. And so it sparked this thought process, what's the stock market, what are shares? And so for my 10th birthday, my parents were like what do you want, you know, a bike or something? I'm like, no, I want to get in-to stocks. So I got five years of BCE for my 10th birthday and that really started the passion. It was the first stock I started to follow. And then, when I was a little bit older than that, Peter Lynch was, probably him and Warren Buffett were the most famous investors in the world, and so, Peter Lynch managed the Fidelity Magellan Fund out of Boston. So I read two of his books. I started reading Warren Buffett's annual letter, and from there I ended up during university working at a Toronto-based high-net-worth asset management and hedge fund called Glus-kin Sheff. I still have a good relationship with the CIO, who's retired to-day, Ira Gluskin. And from there, I worked in investment banking, pri-vate equity. I did my MBA in the U.S. at Wharton, and then I joined Fi-delity.

00:03:28

Emily Anonuevo: That's amazing, and you've been in the industry since 2004, I believe, but I didn't know you started out that young, 10 years old, nine or 10 years old, you really became interested in the stock market. That's a really neat story. Darren, you've been on the show, on our shows many times, and you've really articulated well how you ap-proach investing with a certain philosophy and strategy. So for our au-dience today, can you elaborate on your approach to investing?

00:03:56

Darren Lekkerkerker: Sure. So I want to buy high-quality businesses, and I say businesses not stocks because I think that you need to ap-proach investing as to think that you are a minority owner in a busi-ness, as opposed to buying a stock certificate. And so when I'm looking to buy businesses, I'm really looking for three things. Number one, I'm looking for a business that's very high quality, and so what am I looking for? I'm looking for a business that has an economic moat, which I would define as a sustainable, competitive advantage. So, Microsoft is the largest business I own in the North American Equity Fund, and so, their moat would be they have ownership of software; they have many businesses that have that software embedded; it would be very high switching costs for us to switch from Microsoft to another plat-form. CP Rail is another large position for me, and so, they own a rail-way which has a monopoly on many parts of its business. The quantita-tive factor I would look at in defining what's a great businesses is does it have a very high return on its invested capital? Which means that it generates a lot of cash flow for every dollar of capital that they invest in the business. Two, management. And so what I'm looking for, I'm looking for management where their goal is to increase the intrinsic value per share and not to simply just pay themselves more. So, one, I look at are they aligned with us as shareholders, do they own a lot of shares in the business in terms of their pay, do they achieve their bo-nus by meeting goals that would benefit us as shareholders? Like a higher return on invested capital or we're meeting other objective requirements. And then, two, I look at what's their history of capital allocation? By capital allocation I mean investing the excess free cash flow that the business generates, and what have they done with it, and have they used it very smartly and invested it at a high rate of return? So, for example, maybe they bought back shares when their shares were cheap, or maybe they bought a competitor if that was an oppor-tunity available to them, that turned out well. Or maybe they invested in a new plan, and they didn't do dumb things. And then thirdly, valua-tion. So I think the price you pay is important, but I identify with War-ren Buffett when he says that he'd rather have a wonderful business at a fair price than a fair business at a wonderful price. And I think you do better over time owning a higher-quality business that can com-pound its value over time. Just quickly on investment process, I spend a lot of time meeting with people who run companies, CEOs, CFOs, spend an hour asking them about their business, trends that are going on, how fundamentals are changing, what they're seeing, what they're investing in, what's going on with their competitors. And then too we have a really large team. I'm very lucky. I have analysts that support portfolio managers like myself, they tend to be experts in their sector. So for example we'll have an industrials analyst, a software analyst, a tech hardware and so on and so forth. And so I spend a lot of time talking with them and reading the notes that they publish. And then thirdly, I would say risk management. I think the goal is to have the 40 best businesses in the portfolio and to own them and have them com-pound and increase value for shareholders over time.

00:07:32

Emily Anonuevo: Yeah and just the breadth of the research team here at Fidelity, you're absolutely right about that. Just curious to know, Darren, you know that we're all working from home, is it easier to set up those meetings with the CEOs these days? Have you gotten to the groove of booking all those? 'Cause I imagine that, we all sort of have more time on our hands now that we're not traveling.

00:07:53

Darren Lekkerkerker: Yeah, it's a good question and the answer is yes. I mean it is easier. And I was impressed at how seamless we transi-tioned from the in-office world to the online stay-at-home virtual world. And so, immediately our team set out, and we had many meet-ings, and especially last March when we were trying to figure out what's going on and then the CEOs were trying to do the same. It was invaluable to speak to people and say, what do you think, what are you seeing in your business? The other point I'll make is normally, some-times I'll travel for meetings, and then I find that there's sometimes there's two or three meetings you really want to do during a day, and you end up doing five others just because you're in that place and you want to make sense. And now, I just do those two or three meetings that I really, really want to do, and then I can do two or three meetings that are in another geography. So I tend to do more meetings and higher-quality meetings.

00:08:52

Emily Anonuevo: So interesting how everybody's process has changed a bit now that we're all here at home. Darren, your approach to invest-ing has led you to a lot of success, outperforming your benchmark and delivering strong returns for investors. I want to know if you can ex-plain to our investors what themes would you say have contributed to your success over the years?

00:09:14

Darren Lekkerkerker: Yeah, I think really it's a couple of things. I think so, one, I think you really need to think in order to outperform, and generate absolute returns and also outperform benchmarks and other competitor funds. What are my best ideas? And you really need to make sure you own those in large size. And so I think that's one thing. And two, you need to be really careful that you cull your least best ideas and you don't just own everything. Because if you own 100 stocks or 200 stocks then your returns will look very much like the market over time, and it'll be hard to produce superior returns for our shareholders. That's not really a theme, but it's more of a process. In terms of themes, I think I've just owned high-quality businesses that have been able to compound their free cash flow per share over time and increase value. So Microsoft has been a really large position, which I mentioned earlier, and CP Rail. I gave them as examples of high-quality businesses. Last year, you're asking me more over time, but last year was a super interesting year from a stock market per-spective. I mean obviously it's a bad year in a lot of ways. But from a stock market perspective, it really made me think, for example, in March, April, when the market was down huge, I was looking at what's on sale? And so, one of the areas that I went into a lot was consumer. And I, 'cause consumer stocks had been killed, they were prices that we were going to have a very deep recession. However, as we now know, the Federal Reserve lowered rates, added liquidity. The government in both Canada, the U.S., gave consumers money. And so you could see, okay, what are people going to spend on from home? And so I owned restaurants that had a strong delivery or order pickup, for example, drive-thru, as well as retailers that had strong brands, with a strong omni-channel, so they could sell online, as well as companies that provided outdoor sports option. So I think those were on sale and then they subsequently did well. That was one of the stronger themes that contributed to results last year.

00:11:37

Emily Anonuevo: So now looking ahead to 2021, we're in it right now. How are you actively positioning your fund to capture much upside and as little downside in 2021? You just mentioned how last year you looked to companies that were on sale. So what is your plan for 2021?

00:11:59

Darren Lekkerkerker: I'm optimistic about 2021. I think that the condi-tions look good. And so, one, the interest rates continue to be low, and the Federal Reserve communication has been that they're going to maintain low rates. Two, the government is still sort of providing consumers with money. And that looks to increase with the Biden government in terms of federal stimulus. And then I would say, three, I think we're all hopeful as a society that people are getting vaccinated; we're seeing the case counts, although they're high, they've been dropping in Canada, the U.S. and globally, and so I'm hopeful that that leads to a normalization or something close to a normalization of our society. And I think that'll produce really strong earnings growth. And I think that it puts consumers in a good spot. If you're a consumer and you have an RRSP or a 401k in the U.S., you feel good. Your house is up, your stock portfolio's up, interest rates are low. And for some people that are unemployed or on the lower end, or the middle end in the U.S., are getting checks from the government. So consumer spending should be strong now, that looks attractive. One thing that I'm a little bit cautious on is valuations are high, and so I think it pays to be choosy in terms of what we're paying for, in terms of what the mar-ket is valuing stocks at. Having said that, if we look at what bonds, I mean, bonds are pricing like 1%. So, stocks look like incredibly good value relative to bonds. So some of the positioning of the portfolio, I mentioned I like the consumer. I see a lot of opportunities there in terms of travel and leisure. I try to think about myself and my wife and our family, and what do we really miss doing? I think we have some pent-up demand to travel. I think people, if you're going to go to a par-ty, they're going to need apparel. So these are some of the areas that I've been in. I also think that cyclicals, like resources and industrials, as well as financials like banks, look a lot better. A lot of these were really hard hit, in terms of the stocks, last year in 2020. And fundamentals look a lot better. I mean demand should recover as the economy reo-pens. In the case of commodities, I think supply is constrained in cer-tain commodities, like copper. Agriculture looks really strong with farmer incomes being the highest they are in the past eight years. And I think broadly, some of the other areas. I don't want to go into too much detail here; we'll be here all day so I can answer your question. I like technology, I think technology, it's been a little softer since the vaccine, but I think there's a lot of good companies to pick from here, I think it's still worth. And another area that I've really liked is the in-formation services area, and I think it's companies who develop and sell data. It's not cyclical, there's a long tail to their growth, there's strong incremental margins and a lot of free cash flow.

00:15:15

Emily Anonuevo: Right, so well-rounded perspective there. You men-tioned agriculture and technology, and you mentioned the consumer as well. It's really interesting that you mentioned, just considering the level of pandemic frustration. I mean we've all been in this situation almost a year, so really interesting to see how the consumers behav-iours are going to change this year. You also mentioned vaccines in there as well, Darren. Vaccines we know are being rolled out, so just curious to know, the vaccine rollout, is this affecting any opportunities you're looking for in your portfolio?

00:15:55

Darren Lekkerkerker: Yeah, 100%. Because I think the vaccines are going to determine the reopening, both the speed of the reopening and how does the world look like once we're all vaccinated. So, defi-nitely I have been thinking about the different vaccines, and we got data on two new vaccines last week, the J&J, the Johnson & Johnson vaccine, as well as the Novavax vaccine. And we're getting data on how they do on some of the new variants of COVID in South Africa and the UK, and so on and so forth. So, look I'm not an epidemiologist, I'm not a healthcare specialist, but I think my view is that broadly we're going to reopen this year, and I think that the end of this year is going to look a lot different than it does today, and I think that should be for the better. So, absolutely it influences my stock choices and business-es I find attractive, 'cause I think that there are some businesses that have depressed earnings now, which should really recover. And so one interesting thing I'm thinking at, I'm doing a lot of work on con-sumer is, the pent-up demand of the consumer, as well as the shifting wallet share. What are you spending on now that you may not because you're stuck in your home, that you might want to when you're out of your home? And I mentioned travel and leisure. And so I think some of these businesses may actually have pricing power, meaning that they may be able to charge higher prices after the pandemic than before the pandemic because everyone may want to use their service or buy their products. So that's an area that I find fascinating and I'm doing a lot of work on.

00:17:38

Emily Anonuevo: How do currency movements impact the way you invest?

00:17:41

Darren Lekkerkerker: It's a good question. For the North American Equity Fund, just first off, it's 70% invested in the U.S. and 30% in Can-ada. I think that it's really hard to predict currency movements accu-rately over time. It kind of seems in the short-term, it seems the U.S. dollar has been coming down, the Canadian dollar's been going up. Logically that makes sense, just given that the U.S. dollar tends to be a less cyclical currency, just given their economy is less cyclical, and also the market, when the market goes risk off, the U.S. dollar tends to go up, and when it goes risk on people are buying more stocks, it tends to go down. So, I wouldn't be surprised if that continues, but it's not something where I'm trying to generate a ton of alpha for the fund, just because I don't think that I'm, I or really anyone else is the best at predicting currencies over time. I talked a little bit earlier about my process of how I highlight the types of companies I like and how I try to find them. I try to stick to that, and the reason is because I think that it's the most repeatable, and therefore gives me an edge over the market and other market participants, in order to generate sustainably good performance over time.

00:18:58

Emily Anonuevo: You mentioned the equity fund there, that 70-30 split. Curious to know, any pockets of opportunity, specifically in Cana-da, you're keeping an eye out for?

00:19:09

Darren Lekkerkerker: I think Canada does well in the reopening. Can-ada is more cyclical than the U.S. By that I mean we have, as a stock market and economy, we have more exposure to economies that tend to go up and down more with the business cycle, like materials, ener-gy, banks, and so I think, as a result, Canada should do a little better even in the reopening. And so I like that I have that exposure to Cana-da. I think in the long-term, I think the U.S. is a great market to be. It has higher exposure to growthier sectors like technology and healthcare, and I have a lot of high-quality growth companies. I also think the U.S. is a big market, they tend to give a lot of cash flow back to investors in the form of dividends or share buybacks. I like the set-up of the fund. I like to have some Canadian exposure, and I think that, longer-term, I think the fund should do well, that does revert at some time back towards the U.S.

00:20:06

Emily Anonuevo: In 2020 and 2021, discipline, sticking to your convic-tions and focusing on the long-term, despite the ups and downs, have been and will be key, I would say. And financial advisors add so much value in these particular areas. Darren, what helps you stay disciplined and focused through all the market up and downs?

00:20:30

Darren Lekkerkerker: I think it's really hard, Emily. So my goal, look at last week, look at the ups and downs we had day to day last week. Last week was just a really volatile week, and so for me, my goal is to try to just be very stable, try to dull any natural motions/emotions? I may have and try to add value through the volatility. For example, last week I had some stocks that I own that were down a lot for no apparent rea-son, and so I added to them, and I had some stocks that were up a lot for no apparent reason and I thought, I'm going to sell this stock and add a little to this other one. So I think that I'm trying to add value through that. Actually, another thing I would say that I do that really helps is we really know our stocks. If it's just a stock and you see it go down, you get really worried, but if you've done your work and you're okay, I've actually talked to the CEO multiple times, our analyst is an expert on this sector, this stock, they have a financial model which they forecast the income statement, balance sheet, and cash flow statement. And I have a simple thesis which is like two sentences on this stock, which is, maybe it's something like, hey they're going to get higher pricing this year, higher volumes and incremental margins, which is going to really increase cash flow beyond what people think this year, for example. Something like that. Then it's easier to stick to it and have conviction in that thesis when you see your stock down 6% on no news and you don't know why.

00:22:11

Emily Anonuevo: You mentioned a little bit earlier about a lot of fiscal spending, how's that changing your approach this year?

00:22:18

Darren Lekkerkerker: Yeah, I think that's an issue on both sides of the border, in Canada and the U.S. And, I think the answer is, we don't re-ally know how it's going to impact us, but I don't think that the impact is going to be borne this year. You may see higher taxes in Canada, you may see higher taxes in the U.S. I think in the U.S. they may not come this year. I think that, typically when the economy is still in a recovery, it's not usual that the Federal Government raises taxes, although it has been part of both Prime Minister Trudeau and President Biden's plat-form, so I guess we could get a little bit. I think down the road inflation is a risk, but I don't think that's a risk today, if you have too much gov-ernment debt and deficit. That's something to keep an eye out for, but I don't think it's a big risk today. I do think that, if it does happen, it ac-tually could benefit some areas of Canada, like the resource sector as well as the Canadian dollar.

00:23:22

Emily Anonuevo: Coming towards the end of the show and I just want-ed to switch gears a bit quickly and ask you if you weren't a portfolio manager, what would you be doing do you think?

00:23:30

Darren Lekkerkerker: I wish I had some crazy answer for you, like I would have tried to be a rock star or, you know, like a mountain guy. When I was a kid, my dad owned a small business, and I actually worked there from ages 10 through 20. I worked in a warehouse and it made a big impression on me as a kid, and I was lucky to learn about business from my dad at a young age, and so probably I would be an entrepreneur or trying to do something entrepreneurial.

00:24:04

Emily Anonuevo: There you go. Okay, and one last question, Darren, if there's one message you'd like to leave?

00:24:09

Darren Lekkerkerker: What I would leave investors with is just, hey, first off just thank you so much for your support, if you're in either of my funds, Fidelity Canadian Balanced Fund or Fidelity North American Equity Fund, or even other funds with us, I really appreciate it sincere-ly from my heart. Please know that I am working as hard as I can, and I appreciate it. And then also for the Fidelity North American Fund, I'm actually the largest retail shareholder in the fund. So I'm aligned with the other shareholders here, and for me it's the largest asset I have in my life, and every year I tend to put more of the money I earn from work in that fund, and I'm doing it to save up for my own family's re-tirement, and so I'm aligned well. And other than that, I think the fund is well positioned. I like what I own, and I like that, I like that 30%-Canada 70% U.S. split. I think it makes a lot of sense for Canadian inves-tors, particularly now. I think it's timely right now with the reopening. So I'll leave it there. Thank you.

Ending: [25:13]

Voiceover:

Thanks for listening to the FidelityConnects podcast. If you haven't done so already, please subscribe to FidelityConnects on your pod-cast 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 more information on future live webcasts - and don't forget to follow Fidelity Canada on Twitter. Thanks again, see you next time.

[End of podcast]