TRANSCRIPT

Looking into the future: Sustainable investing with ETFs

Presenters: Sarah Pulsifer, Nicole Connolly & Mike Robertson

Sarah Pulsifer: It's really great to be joined by so many of you to discuss two very exciting topics. Fidelity is celebrating a milestone in our active ETF business. We just passed our one-year anniversary of our first launches, and we recently approached 600 million across seven different investment strategies. And in addition, we had a big day yesterday, we launched five sustainable funds, three mutual funds and two active ETFs to add to our growing sustainable fund family. In today's webinar, we'll focus on the benefits of the active ETF structure, and then we'll dive more deeply into sustainability US equity and women's leadership strategies, our two newest ETFs. So, thanks for putting this up. We're going to just go through what is an active ETF? An ETF is a registered investment company, just like a mutual fund, and it operates under the same general regulatory framework. At the end of 2019, Fidelity received relief from the SEC to offer ETFs to investors that don't disclose holdings every day, and we were among the first to obtain this relief. It was June 4th last year when we offered our first three strategies, Blue Chip Growth, Blue Chip Value, and New Millennium in this structure. So, why might you choose an active ETF? Our innovative structure keeps Fidelity's research safe. It allows us to offer the benefits of the ETF with active management. It's a vehicle that trades intraday like a stock, and it has the potential to be more tax-efficient than a mutual fund. So, how do you know what securities are in the ETF? It works just like a mutual fund. Every month, with a 30-day lag, you can go on Fidelity.com and you can see the actual holdings. So, with that, I'd like to move to discussing our sustainable ETFs, and I'd like to introduce Nicole and Mike, first off, congratulations on the launches. Nicole let's start with you. Tell us a little bit about the sustainable US Equity Strategy.

Nicole Connolly: Great, thanks so much Sarah. And you know, we're so excited to launch this strategy, Sarah. Mike and I have been working on this strategy for about two years, and you know, why might you be interested in a sustainability fund? I think the first reason is that we believe that sustainable investing is a powerful combination of allowing investors to align their money with their values, while also providing, you know, risk management and opportunity enhancement through the evaluation of environmental, social, and governance factors. Because sometimes, you know, you're looking at a company through those factors can tell you things about the company that you might not have seen in traditional financial analysis. This is a strategy that will run against two benchmarks, the Russell 3000, which is a traditional benchmark, and then the MSCI US ESG leaders' index. We thought it, you know, really important to show the commitment to this fund in terms of its ability to outperform traditional benchmarks, but also show that we have a commitment to having a fund that is in keeping with ESG principles that's authentically committed to sustainability, so that's why we chose those two benchmarks.

And then in terms of sustainability and ESG, and I'll use those terms interchangeably, you know, we believe that companies that are focused on these ESG principles may do a better job attracting and retaining talent, they may be more innovative over time because they have more diverse voices in the organization, they may do a better job managing resources and be more efficient in their use of those natural resources, and lastly, through strong governance practices, may do a better job navigating business risks, and I think all of that can lead to a more resilient organization that can do well through different market cycles.

Fundamentally, this is a strategy that's grounded in quality, so looking for companies that have high returns on capital, lower earnings volatility, good management teams, good visibility into revenue longer term, stable margins, but also because we're focused on these ESG themes like renewable energy, electric vehicles, water infrastructure, access to education, I mean, these are themes that have a long runway and that are growing, companies exposed to these themes are growing fast. So, this is a fund that has a higher earnings growth profile than both benchmarks, but at a better valuation. And then lastly, like all Fidelity funds, we will leverage the research engine that is Fidelity with investment professionals across the globe. We also lean heavily on our ESG team, which is a team that researches the material ESG factors for all of the companies that we own in the fund, but also researching ESG themes, and so we feel like, you know, we have access to some of the best research out there. So, that's the strategy, Sarah. Anything else on the strategy, Mike, that you would add?

PULSIFER: Go ahead, Mike.

Mike Robertson: No, I think that really covered it. Yeah, it's a strategy we're really excited about.

PULSIFER: Mike, you're a quant analyst and co-P.M., why don't you talk a little bit about your role and how you and Nicole work together?

ROBERTSON: Sure. So, Nicole and I work really closely on this strategy in terms of selecting stocks. Nicole brings this sort of rich history of fundamental research, and I have a quantitative approach, but we really think about investing in similar ways. You know, we're looking for these big growth names like Nicole described, but at compelling valuations, which have resilient business models that have some quality characteristics that we can key in on. One of the signals, for example, that we like to look at from the quant side is short interest. Right, so we look at stocks which short sellers have really focused on, the stocks that short sellers have the biggest positions in, because they see red flags and they expect the stock prices to decline. Our research has found that short interest is an extremely powerful sentiment signal, and so, short sellers are often well-informed with high conviction in avoiding the names that are most highly shorted has historically been a winning strategy, and when we think about ESG, we actually find in many cases that short sellers have provided negative signals ahead of major ESG-related controversies, so a mining dam collapse or cruise line passenger safety issues, or a food and beverage company having food safety concerns, or chemicals discovered in a building products company. But I kind of bring the quantitative angle, and Nicole provides sort of the fundamental input as well.

CONNOLLY: And maybe just to add to that, I mean, Mike and I started working on ESG a few years ago, and we both think about investing similarly, though through different lenses, and are both passionate about sustainability, and what I like about having the quant aspect here is that, you know, it keeps you disciplined, right, so you're kind of taking ideas that you have and running them through all of Mike's tools in his quant tool kit. And so I like the discipline and the rigor that the quant process brings to this, but also, you know, Mike, in his -- with long histories of different data sets and different tools can sometimes see things in a company that maybe I wouldn't be as -- wouldn't be as apparent to me as a fundamental investor, and I think short interest is one of those factors. So, you know, I love working with Mike, and we talk every day on these companies, and really excited to be bringing this to the market today.

PULSIFER: That sounds like a great partnership. So, why don't we go to the next slide, and Nicole, ask you to talk about the three pillars in the strategy.

CONNOLLY: Yeah, great, so I'll use this to talk about the three different types of companies that we look for, and also to talk about some stocks to bring it alive for people. So, there's three buckets, there's best in class, ESG improvers, and impact. And best in class are companies that have been practicing sustainability principles for years, and they understand what the material ESG factors are, they have strategies, they have targets, they measure these factors that they're looking at, and these would be companies like Intuit, Best Buy, Prologis, Sales Force, Microsoft. And you know, Prologis is an interesting one, it's a logistics real estate company cofounded by the current CEO, Hamid Moghadam, and this is a company that's like in the sweet spot of ecommerce penetration, as they lease warehouses to tenants like Amazon, and the beauty of this model is that there's high barriers to entry, because these warehouses need to be located near urban centers, and there's land scarcity issues near urban centers, nobody wants these warehouses built in their neighborhood, and so Prologis has kind of both first mover advantage, but also high barriers to entry because it's hard to get the space, and there's a lot of capital involved. So that gives them pricing power. And then they have this community workforce initiative where they're training people who might be interested in going into logistics and warehouse, and it's a pipeline for their business and also for the tenants of the warehouses, so doing a lot to kind of help disadvantaged communities. And then Mike, you've done some research looking at MIT's study on the impact of ecommerce and carbon, so do you want to talk about that?

ROBERTSON: Yeah, so Prologis has exposure to ecommerce, which really can be a net benefit when it comes to climate, which not everyone may be aware of. So, MIT did a study and found that goods sold through ecommerce actually require an average of 36% less carbon emissions to get the goods into people's homes versus selling them through brick-and-mortar stores, and this is because they're routed to customers much more efficiently. So typically, with ecommerce, you'll send the goods to a warehouse near the customer's home, and then a van will take that good, that item, and maybe others to not only one customer but maybe as many as 100 customers in one trip. And so if you think about it, if you bought it from a brick-and-mortar store, not only would you have to send it to a store, and hope it sold from that store, and if it didn't, maybe you'd have to send it to a different store. But every time a customer wanted to buy that product, they'd have to drive to and from the store, and so it's a lot more miles driven for items that are sold through brick-and-mortar retailers. And there is some extra packaging that's required through ecommerce, but they found that the savings in carbon emissions related to the fewer miles driven was two and a half times greater than the extra emissions related to the packaging for ecommerce. So really, it's a net win, and Prologis's exposure to that really makes an interesting ESG story, I think.

CONNOLLY: Yeah, and the one thing I should have mentioned is that Prologis does a lot to retrofit its warehouses to be energy-efficient, and they were just telling us that that makes them a partner of choice with their customers, so you know, another way that they are both positioned well competitively and also limiting the impact on the environment. In terms of ESG improvers, this is a category of companies that we're really excited about from a performance potential perspective, and that's for two reasons. With ESG improvers, you have companies that are maybe just starting to invest in some of these ESG initiatives and then number two is, you know, as we see more flows going into the ESG landscape, you're going to have fund managers who are looking for companies with positive ESG attributes, which could be a rerating opportunity where the company gets, you know, a higher valuation multiple with more flows kind of going into the company. Names here that we're excited about would be General Motors, where Mary Barra, the CEO there is looking to have a company that has zero emissions, zero crashes, zero congestion. They have big plans on the EV front. They're launching 30 different EV models over the next few years. They also have an autonomous vehicle initiative with Cruise, which we just saw Microsoft take an investment in earlier this year at a $30 billion valuation. And so, you know, this is a company that has got an $89 billion market cap today versus Tesla that has a $600 billion market cap, so a lot of potential room for growth, and that is a company that we think is an ESG improver.

And then lastly on impact, you know, these are companies that are trying to solve the world's greatest challenges, and you know, we show a couple companies here, Orsted and Sunrun, that are renewable energy companies.

Orsted is the largest offshore wind developer, and Sunrun is a leading residential solar company in the US. And then Bright Horizons is one I'm personally passionate about, provider of daycare centers. We saw two million women leave the workforce last year because of the challenges around COVID, and so childcare is going to be a big part of getting these women back in the labor force here. So, that's an example of the type of impact companies that we look for, Sarah.

PULSIFER: Yeah, that's great, Nicole and Mike, thank you. Why don't we drill further into our proprietary ESG ratings and research and tell us a little bit about how you used that in the sustainability strategy?

CONNOLLY: Yeah, so, this ESG ratings framework is something we think is really differentiated, we haven't seen a framework like this in the market, and we really approached our ESG ratings through two different lenses. On the left is our systematic ESG rating, which is current snapshot and time, it's based on more backward-looking data, and it is a little bit more quantitatively driven, and it's based on a letter rating of A through F. The fundamental ESG rating is completely forward-looking, it's done -- it's completed by our fundamental research analysts, where they go to the companies and they ask these ESG-related questions that are based on material ESG factors. So, for an energy company, they're asking about carbon emissions and health and safety and use of water. For a healthcare company, they're going to be asking about product safety and drug pricing and business ethics. For a tech company, asking about data privacy and cyber. And then for all companies, we're asking about the management of human capital, of talent, and governance. So, we think the combination of the current snapshot with the forward-looking view is really unique, and when you think about the other third-party providers out there, those ratings are often backward-looking, and they have very little correlation to each other, so we felt like it was important for us to come out with our view on what's material from an ESG perspective for these companies, and then how do we rate them from kind of a quantitative and qualitative perspective.

ROBERTSON: And I would just kind of add that these ratings really fit nicely into our process. The different sort of buckets that Nicole was describing earlier, when we have the leaders versus improvers versus some of these impact names, so I mean, a leader is a company that looks great today and has a strong outlook, so that might be something like an A1, where you know, the systematic A says they're doing great today, and then fundamental 1 says they have a positive outlook, management's engaged, and they have a good trajectory ahead, whereas an improver might be something like a D2, where the systematic D says they're not so great today, maybe they lack disclosure or haven't been the best historically, but the fundamental 2 says that management is totally focused, and we expect the company to materially improve going forward. And then the impact names are, they're more about the business model, delivering tangible impact, and these can come from sort of either group, but we definitely tend to see more positive fundamental ESG ratings on these names, because their management teams tend to be so authentically dedicated to delivering impact that we really see a forward positive trajectory from those most of the time.

CONNOLLY: Yeah, and Mike, you've done some interesting work just on the valuation front. Do you want to just hit that, as it relates to the buckets?

ROBERTSON: Sure, yeah, I mean, it's definitely the case that some of the names that are ESG darlings have become a lot more expensive over the past couple of years, and you tend to see that from some of these ESG leader type names. And that's part of this alpha goal that we have from the ESG improvers bucket, because these are kind of undiscovered, underappreciated ESG stories that tend to be a lot cheaper relative to some of the other ESG names out there, and so not only do they have a long runway for earnings growth, but they also have a longer runway for multiple expansion as they become better-appreciated and better-understood by the market.

CONNOLLY: And I think that's one of the things that differentiates this product from a passive product. You know, a lot of the passive ESG funds out there are just kind of focused on this bucket, but you don't get any of the benefit that Mike just described on the ESG improver piece, so we're increasingly looking at that third bucket for stock ideas.

PULSIFER: Yeah, that's great, and you've touched on this in terms of the improvers aspect of the fund, but there are still some people out there that associate sustainable investing with concessionary returns, so can you just talk a little but about what our research has shown on that front?

ROBERTSON: Sure, so of course historical results don't ensure similar returns in the future, and it's still early days, but the signs so far actually show us the opposite, that stocks that are better on ESG have actually performed better than the average stock in the market historically. And again, the track record's very short, you know, 10 years ago, most companies weren't disclosing ESG data that would allow us to understand things like the carbon footprint or employee diversity, but we have been able to do some studies, and we found that over the past seven years, companies with higher ESG ratings from MSCI have actually outperformed the Russell 1000 by about 70 basis points per year on average. And this isn't driven by sector biases we control for that. And then we've also looked at an events study and found that ESG blowups, so companies that undergo severe ESG events like oil spills or major data breeches, they actually, you know, their stock prices decline when the news hits, but they continue to underperform by as much as 13% per year over the three years following that negative event. So, it can really be a sign of a name that you want to avoid. So, again, there's not a huge amount of history here to test, but the signs are really positive on average in terms of ESG really being financially material, and we'll continue to track this, and we also often get asked about the correlation between ESG and quality and whether that's the same thing, but we don't find substantial correlations between ESG and any traditional investment factor. And while it seems that across all the investment factors, the correlation is highest with quality, it's still a pretty low correlation, and so if there's some potential from ESG, it's going to be additive to traditional investment processes because it's capturing new information that we're not already looking at.

PULSIFER: Yeah, that's terrific, Mike, thank you. I think this might -- I'd like to shift gears and talk a little bit about women's leadership. Nicole, women's leadership mutual fund has been in the market since 2019. Why don't you start out by describing the strategy?

CONNOLLY: Yeah, so we launched it two years ago, and so far, we're outperforming the Russell 3000 and the MISCI Women's Leadership Index, and this is a fund that focuses on companies that are committed to gender diversity. And sometimes they're going to be led by a female CEO, and sometimes they're going to have, you know, 40% of their board made up of women, but sometimes they're going to have the initiatives in place, whether that's good parental leave, good pay gap policies, flexible work environment, good pipeline initiatives that are going to get more women into leadership roles. And we've actually developed a proprietary scoring framework across 25 different diversity inclusion criteria to make sure that we really are investing in companies that are authentically committed to diversity, and it's a really impactful strategy and work to be involved with, so really excited about this strategy as well, Sarah.

PULSIFER: That's great. And I know Mike has done quantitative research as it relates to companies committed to gender diversity, so Mike, do you want to talk about what the research suggests there?

ROBERTSON: Sure, yeah, I have to provide a similar caveat as I mentioned before, where the history is limited, and performance in the past doesn't ensure similar performance in the future, but we can go back a little bit further with the gender diversity data, and so we did a study going back 13 years, and we found that companies with diverse leadership and multiple policies in place that support diversity in the workplace have actually outperformed by about 130 basis points per year. So, again, that's a place where this idea of concessionary returns isn't really being borne out by the data. And then I think what's also interesting that we found in our research was that companies that place greater emphasis on diversity and other social issues tend to also look better on environmental issues, they tend to be less carbon-intensive, less water-intensive. So, it seems that if companies are looking out for some stakeholders, like their employees or their customers, then they also tend to look out for other stakeholders, like the communities or the environment in which they operate. So, I think this intersection of the environmental and the social issues might be the result of the sort of multistakeholder mindset that we're really looking for from the companies that we invest in in both of these strategies.

PULSIFER: Yeah, that's great. Anything to add there, Nicole?

CONNOLLY: No, I mean, I think the reason we're seeing these strong results from Mike's back test is because companies that are outperforming on diversity typically are more innovative, they do a better job attracting and retaining talent, there's more voices when making -- more diverse voices when making decisions, and so for some of the same reasons that we talk about why kind of ESG broadly can outperform, we see those same things playing out from a diversity perspective.

PULSIFER: Thank you. That's great. Why don't we just see if there's anything surprising after running the fund for two --

CONNOLLY: Oh, yeah.

PULSIFER: -- years. Obviously did a lot of work leading up to it, but what have you learned in this time?

CONNOLLY: Yeah, I mean, one of the most rewarding aspects is that, you know, we launched this fund thinking that it would really resonate with women, but 40% of the investor base is actually male, and these are, anecdotally, we think, these are fathers with daughters, with granddaughters, these are, you know, fathers that want to teach their daughters the power of compounding and investing early, and you know, start to kind of teach those, like, financial literacy skills very early. And then also, you know, I had a dad tell me that his daughter was going though holy communion, and he gave her some shares in the fund, and that nine-year-old was so excited to see strong women like her and what she could become longer-term, and so there's this also like female role model aspect to the fund. So, that's been so great to see those stories, and so that would be a highlight, Sarah.

PULSIFER: Yeah, yeah. So, the next birthday, put that on --

CONNOLLY: Yeah, there we go. (laughs)

PULSIFER: So let's move to impact, and you've talked about this obviously when you were going through sustainability US equity, but you know, impact is really important to our customers, so maybe touch on how you're thinking about it with both the women's fund and the equity fund, US equity fund?

CONNOLLY: Go ahead, Mike.

ROBERTSON: Sure, yeah. I would say that we really appreciate that our customers care about impact, and when they invest in a sustainability fund, they'd like to know that their capital's being used by companies that are making the world a better place, either through environmental or social impacts, so first of all, we're really thinking about the United Nations Sustainable Development Goals, or the STGs. These are 17 goals developed in 2015 to reduce inequality, extreme poverty, to promote a better planet. These are widely accepted as good standards for thinking about impact, and we have a goal with having over 80% of companies in our fund being aligned with at least one STG. And then we do look at fund ratings, but we spend a lot of time thinking about more tangible metrics, so do companies we own have a smaller carbon footprint? Do they use less water? Do they take better care of their customers' data, have more diverse managers or employees or policies in place that allow for all employees to be engaged and productive regardless of their race or gender or sexual orientation.

And so when we focus on these types of metrics when selecting companies for the fund, we also expect to see these sorts of trends emerge at the fund level as well, and we can't share fund-level holdings information yet, but this slide shows metrics for the ESG Leaders Index, which is our ESG benchmark, and the Russell 3000, which is our standard benchmark, and we would expect that our portfolio would look more like the ESG index than the standard Russell 3000 index on these metrics, so on the left you can see that the ESG index has about half the carbon footprint of the Russell 3000, this chart is showing the carbon intensity, how much carbon emissions is generated per dollar sold by the companies in this portfolio, and then on the right, we have a few different diversity type metrics. The ESG index, starting on the left, has about twice as many boards with substantial racial diversity, about 50% more boards with substantial gender diversity, and it has many more companies that are considered to be more LGBT friendly as measured by the Human Rights Campaign's Corporate Equality Index, and more likely to be included in the diversity -- sorry, the Disability Equality Index, which is well-regarded as a measure of companies that really support people of all abilities.

CONNOLLY: And maybe one thing to add here is this is just kind of the beginning of our measuring of impact metrics, you know, as we get more data, we're going to be able to really do more on the impact front, and one of the things that we're thinking about is just how much -- what percent of the employee base at a company is participating in shares of that company, so employee stock ownership, and you know, we think one of the major reasons we've got this wealth equality gap is because you haven't seen the bottom 50% of American households participate in the stock market, and so we would love to see companies giving their employees more stock. And so, we're working with our Direct Data Team, that is a team that has data scientists and all sorts of tools to scrape the web to help us better find these companies. And then also through our engagement, we can talk to the companies about what are they doing for employees from a stock perspective, and so we're excited about doing more work there.

PULSIFER: Terrific. Nicole, do you want to touch on how you think about impact with respect --

CONNOLLY: Yes.

PULSIFER: -- to women's leadership?

CONNOLLY: Yes. So, here, we can show you holdings here, and you know, this is one of the many reasons I get so excited to come to work and work on this fund is that if the S&P looked more like the Women's Leadership Fund, we'd have 170 more female CEOs, we'd have 100 more female CFOs, we'd have, you know, twice the number of boards that had at least 30% female representation, and then we'd have so many more initiatives to help women, whether it's parental leave, leadership development programs, flexible work environments, so I just think that if the world looked more like this, I mean, wouldn't that be a great corporate America for our kids to work in? And so excited about the impact that we can have with this fund.

PULSIFER: Let's talk a little bit about engagement, and you mentioned differences in terms of the research with respect to an active manager and an index manager, engagement is another way, right, for the active side to differentiate. So, tell us a little bit about the issues Fidelity chooses to engage on and why and any specific examples you might be able to share.

CONNOLLY: Yeah, so Fidelity takes our stewardship and engagement very seriously. We evaluate every shareholder proposal that comes in through proxy season on a case-by-case basis, and you know, when you think back to that ESG improver strategy, a big lever to try to get that improvement is talking to the companies about what we would like to see them do, and so these are some of the topics that we engage on, but maybe to help bring it alive for people, three recent engagements that Mike and I have been a part of, we talked to an industrial company where carbon emissions is a major ESG factor for the company, and based on feedback that the ESG team and our analyst Janet Glazer gave the company back last fall, they are now going to report in line with the TCFD, which is the Taskforce for Climate-related Financial Disclosure, it's considered best in class from a climate disclosure perspective, and I think having that disclosure will help them better manage emissions, and that could translate into better costs longer-term. Secondly is a company, a large-cap tech company that we engaged with around pay gap. So, they were conducting gender and racial pay gap, so looking at how women and people of color are getting paid versus their white counterparts, but they weren't considering bonus and equity, which was a big portion of the compensation package, so based on our feedback, they then did a more holistic look at compensation and included those factors, which gives us a better picture of is pay really fair at this company, and then also gives the employees that same picture. And then lastly, we were talking to a large-cap company who has had to deal with some employee walkouts and harassment issues, and some high-profile female departures, and they announced that they were going to tie ESG metrics to compensation, which we thought was great and sent a great signal about their commitment to ESG, and but our feedback was just make sure that you consider the social or the S as part of that compensation scheme, because I think that's where we really wanted to see some improvement. So, that's the type of engagements we have, and how we're helping companies progress on their ESG journey.

ROBERTSON: I would just add from the data side also that when I mentioned earlier that 10 years ago, data was really limited in a lot of different areas with respect to ESG, but it's still the case that in many areas, disclosure's not quite where we'd like it to be. You know, not all the information we want to know about a company is on their website, and so being able to sit across from management can really give us a good sense of where a company stands. You know, as we're still waiting for data to develop and for exposure to get better, and that's especially true of some of the smaller companies out there that maybe don't have robust reporting infrastructures in place. So, the engagement can really be a critical sort of data gathering exercise for us as well.

PULSIFER: Yeah, that's great, and I know Nicole, you mentioned this, but it might be helpful to just hit on given some of the data gaps, obviously engagement being one place, but just where Fidelity, kind of the resources that Fidelity can put against gathering data with respect to our data scientists and our AI teams and that's a real differentiator as well.

CONNOLLY: Yeah, so, one thing that we're hard at work on right now is racial diversity data. This is data that is only now starting to be disclosed by companies, and so we have enlisted our direct data team, we're also working with our administrative assistants who are looking for more mission-based purposeful work, so they are helping us with our S&P 500 racial diversity data gathering, and so you know, I don't know that there's many investor -- many asset managers out there that have the direct data capabilities that we have in-house, and that's such an advantage in the ESG space.

PULSIFER: I think it's probably a good time to turn to audience questions, and there are a lot of good ones coming in, so let's just start with it seems like all of a sudden, everybody's talking about sustainable investing or ESG, and so why are we hearing a lot more about it? Is there anything different about now than say 20 years ago where this information is more powerful or helpful in the investment process?

ROBERTSON: Yeah, so I think there are a few reasons, and Nicole, feel free to jump in, I mean, I think first of all, we have young people seriously focused on environmental and social impact like never before, and maybe that's been driven in part by social media and greater connectivity. These are customers who vote with their wallets, and companies are realizing that they can't just ignore the demands of their customers when it comes to social and environmental issues in the way that maybe they could have gotten away with before. But I think we're also seeing a couple of other trends playing to this as well. You know, businesses have gradually become less capital-intensive, and we've seen that a much greater share of a company's value is tied to intangibles, things like patents or human capital, and the value of these are strongly impacted by ESG issues. Nicole, I don't know if you have other thoughts --

CONNOLLY: Yeah.

ROBERTSON: -- on this.

CONNOLLY: Yeah, I mean, one thing that ESG is meant to bring to the table is thinking about externalities, or risks that aren't really maybe impacting a company today, but could if they came to fruition, impair the quality of the business longer-term, and you know, cybersecurity is one that fits that bill. And so, with cyber now starting to impact oil pipelines, meat packing, 911 dispatch systems, this is a far-reaching issue, and so -- and there's a theme that we're playing in the fund, but I think those are some of the reasons in addition to what Mike mentioned that are leading the acceleration of ESG interest.

PULSIFER: So we have a question about the effect of COVID on sustainable investing, and I know, Nicole, you mentioned as you were talking about the impact on women in the workforce, but specific to investing, how else are you seeing the pandemic having played out?

CONNOLLY: Yeah, I think the pandemic really moved the S or the "social" of ESG front and center. I think it had investors asking how are my investments aligned with the way companies are treating employees and keeping those employees healthy and safe. I also think that there's always been this skepticism about whether ESG can outperform, and ESG had never really been tested in a market downturn, I think many people thought it was a bull market phenomenon, but I mean, we really had a major test for the asset class of ESG in 2020 and ESG funds outperformed non-ESG funds by about 10% in 2020.

PULSIFER: This is a space where there are always questions about authenticity, and we have a great question about greenwashing. We talked about, you know, as you and Mike and all the others at Fidelity who are rating companies, how do you see through those that have a good talk, if you will, versus those that are really doing the right thing from the sustainable standpoint.

CONNOLLY: Yeah, that's a great question. So, I think the most important thing is that we're an active manager, right? So, we can look at the data and score the companies, and we have these ratings, but we have access to these companies, to their CEOs, but also to the people doing the ESG work. And so, you know, Mike and I have found examples where, like, things looked great in the corporate sustainability report or in articles that we read about the company and the press, but when you talk to the company, you didn't get that same feeling that ESG was a priority. So, I think the active management piece is critical. And then from an authenticity perspective, I mean, that's one of the reasons we launched these ESG ratings. We really wanted to make sure that there was a rigorous analysis of the companies where we tried to quantify many of these ESG factors, and I think that combination of like the active management approach, which is more of the art, with these ESG ratings, which is more of the science, is really powerful.

PULSIFER: We have a question about not just coverage, but what parts of the market really have a ways to go in terms of, you know, how they're I guess coming out from ESG ratings perspective, you know, where's the, really, the work needed?

CONNOLLY: Yeah. So, we structured our ratings - let me just go back to the ratings slide - on a sector relative basis. We felt like it was important to give our fund managers options in every sector of, like, best in class in say fossil fuels, right? So, Mike and I won't really play in traditional fossil fuels, but a traditional fund manager at Fidelity may want to, and we wanted to tell that fund manager who is furthest along in their ESG journey. And so, the sector relative approach is important. And then sectors that still have a ways to go, I mean, I don't know, Mike, what you think, but I feel like you have best in class ESG leaders, I mean, they're not perfect, but they exist in every sector. I would say maybe from a diversity perspective, we, the real estate sector has a ways to go. Maybe unsurprisingly, the energy sector has some ways to go. But I think there are companies in every sector making a lot of progress on different aspects of ESG.

ROBERTSON: Yeah, I totally agree with that. I think just, and coming from the quant angle, I'm more focused on the data, right, and I know that the data is lacking for some of the smallest companies out there, and in emerging markets as well, and I think that's partially driven by the lack of standardization, right? If you're a small company and you don't have a ton of resources to devote to ESG disclosure, and everyone's asking you for different data points, you don't really know what to put on your -- maybe you don't put anything out there, and that's where the engagement piece is really important for us, because the data's just not there for a lot of the smaller sort of under-resourced players out there that might be doing great things, and they might be leaders, right, but they just don't always appear that way on paper because, you know, they don't have the tools in place yet to disclose all of this information.

CONNOLLY: Mike, that's such a good point. I think it's less about sectors and more about geographies that might be further behind, and I think emerging markets is definitely one of those geographies.

PULSIFER: Yeah, that's great, actually, that was a question that came in to talk about non-US, so I'm glad you touched on that. In terms of getting back to, you gave some specific examples of companies with diversity in terms of leadership and culture versus those companies that don't have that, and we have a question just asking to talk a little bit more deeply about how you look for that when you talk to companies and what you've really seen in terms of the results and the data that supports that.

CONNOLLY: On the diversity side?

PULSIFER: Yeah.

CONNOLLY: Yeah, yeah, yeah, so we spend a lot of time in our ESG engagements talking about, you know, what are the policies and initiatives that are in place to help support women in your organization, especially now with COVID, like, how flexible are those work environments, how are you bringing people back to work is a big theme that we're focused on in our ESG work. I believe that a big part of having people, employees feel motivated is to have them feel like they're getting paid fairly, and so this gender and racial pay gap is an important part of the process. We want to know what a company is doing to bring in more diverse talent, so we'll talk about the initiatives in place there. And so those are some of the key things that we focus on, but yeah, so hopefully that gives some clarity.

PULSIFER: Yeah, that's great. We have a lot of people asking about how to get started, which I think is a great question, and you know, you've talked about the challenges even as investors, you know, the challenges of the space with respect to data, etc. I mean, I'll start just from what we have offered on Fidelity.com, we have our Sustainable Investing webpage which gives not only some information and research but would also have information about the newly-launched funds, so that's a great place to begin. But any other suggestions in terms of resources or ways for someone to get started with sustainable investing?

CONNOLLY: I mean, I like to tell people, you know, when you're considering a fund, to look at the holdings to see if those, if the names there are ones that resonate with you, and maybe one point to that is sometimes we'll be invested in a company that we think has ESG improvement opportunity, and that where we think our voice at the table is important in that conversation, and so back to the engagement piece. But I think there are some great podcasts out there, I think Barron's does a great job every weekend talking about different sustainability themes, but I don't know, Mike, anything else on your end?

ROBERTSON: No, you know, I really agree with your point about just looking at the holdings, I mean, we have Peter Lynch, famous Fidelity veteran, really said you want to know what you own. And I think with ESG, there's really no sort of uniform definition to it, and so different managers are going to have different approaches, and it really matters how they go about thinking about and defining sustainability, the approaches that Nicole and I described here are our approach, right, and that might differ from what you see in another portfolio, and so it's really important to kind of drill in and look at what are the holdings, and are they aligned with what you expect when you're looking for sustainability-themed product.

PULSIFER: We have a really good one that just came in which says what do you do with a name that you thought was a good, sustainable name, and it fails to meet up -- it fails to deliver. So, Nicole, you want to start?

CONNOLLY: Yeah, I mean, had this recently in the women's fund where I'm worried about product safety issues, and I just didn't hear enough from the company about what they were doing to really ensure product safety, and so I sold that stock. So sometimes it's divestment, sometimes it's repeated engagement, and those are kind of the two levers, you know, that we have. And so, I think it's just a matter of how material do you think that ESG factor is to both long-term financial performance and this impact that we're trying to achieve.

PULSIFER: We have one that has a little bit more sort of the other side, you know, this all sounds great, but.

CONNOLLY: Yeah.

PULSIFER: And so, you know, is -- and you brought up the challenges, certainly, with comparability, with data, for sure. What risks do you see in terms of investing this way?

CONNOLLY: That's a good question. You know, there are certain names that are big in let's say the Russell 3000 benchmark that we do not feel like are far enough in their ESG journey to own. And so, the risk is that some of those companies do really well, but the magic of having Mike as the comanager on this fund is that we're able to look at things like tracking error from single securities to help us see, like, okay, by not owning that name, how much risk are we introducing into the portfolio? So, we try to manage that very closely, but you know, there's a possibility that maybe that stock just does -- those stocks do so well. So, I think that would be the major risk.

PULSIFER: Great. Well, I want to thank you, Nicole and Mike, for your time. I just want to remind people the Sustainable Investing page on Fidelity.com is a great resource, as well as many of the other resources Nicole and Mike suggested.

END OF AUDIO FILE

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Fidelity US Sustainability Index Fund: Stock markets, especially foreign markets, are volatile and can decline significantly in response to adverse issuer, political, regulatory, market, or economic developments. The securities of medium-sized, less well-known companies can be more volatile than those of larger companies. The performance of the fund and its index may vary somewhat due to factors such as fees and expenses of the fund, transaction costs, sample selection, regulatory restrictions, and timing differences associated with additions to and deletions from its index.

Fidelity Sustainability Bond Index Fund: In general, the bond market is volatile, and fixed income securities carry interest rate risk. (As interest rates rise, bond prices usually fall, and vice versa. This effect is usually more pronounced for longer-term securities.) Fixed income securities also carry inflation risk and credit and default risks for both issuers and counterparties. Unlike individual bonds, most bond funds do not have a maturity date, so avoiding losses caused by price volatility by holding them until maturity is not possible. Foreign securities are subject to interest rate, currency exchange rate, economic, and political risks. The performance of the fund and its index may vary somewhat due to factors such as fees and expenses of the fund, transaction costs, sample selection, regulatory restrictions, and timing differences associated with additions to and deletions from its index. Leverage can increase market exposure and magnify investment risk.

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Fidelity Environment & Alternative Energy Fund, Fidelity Women's Leadership Fund, Fidelity Sustainability U.S. Equity Fund, Fidelity Water Sustainability Fund:
Stock markets, especially foreign markets, are volatile and can decline significantly in response to adverse issuer, political, regulatory, market, or economic developments. Foreign securities are subject to interest rate, currency exchange rate, economic, and political risks, all of which are magnified in emerging markets.

In addition to the risks above, the below are additional risks for each fund as stated:

Fidelity Environment & Alternative Energy Fund: Sector funds can be more volatile because of their narrow concentration in a specific industry. The environment and alternative energy industries can be significantly affected by government regulations and subsidies, changing supply and demand for traditional energy sources, and availability of funding for remedial cleanup efforts or development of new technologies and can be subject to risks associated with hazardous materials. The fund may have additional volatility because it can invest a significant portion of assets in securities of a small number of individual issuers.

Fidelity Women's Leadership Fund/ETF: Stock markets are volatile and can decline significantly in response to adverse issuer, political, regular market, or economic developments. Different parts of the market, including different market sectors, and different types of securities can react differently to these developments. Foreign markets can be more volatile than the U.S. market due to increased risks of adverse issuer, political, regulatory, market, or economic developments and can perform differently from the U.S. market. The value of securities of small to medium size, less well-known issuers can perform differently from the market as a whole and other types of stocks and can be more volatile than that of larger issuers. The Adviser's applications of the fund's strategy criteria may not achieve its intended results and the fund could underperform the market as a whole. Non-diversified funds that focus on a relatively small number of stocks tend to be more volatile than diversified funds and the market as a whole.

Fidelity Women's Leadership ETF: Non-diversified funds that focus on a relatively small number of stocks tend to be more volatile than diversified funds and the market as a whole.

Fidelity Water Sustainability Fund: The water sustainability industry can be significantly affected by demographic, irrigation and industrial usage trends, viability of infrastructure projects, conservation practices, pollution, waste, and environmental factors, including weather, droughts, flooding, as well as the performance of the overall economy, interest rates, consumer confidence, and the cost of commodities. Regulations and policies of various domestic and foreign governments may affect water usage, contamination, and reusability. The fund may have additional volatility because of its narrow concentration in a specific industry. Non-diversified funds that focus on a relatively small number of stocks tend to be more volatile than diversified funds and the market as a whole.

Fidelity Sustainability U.S. Equity Fund: The fund's adherence to its ESG ratings process may affect the fund's exposure to certain companies, sectors, regions, and countries and may affect the fund's performance depending on whether such investments are in or out of favor. This process may result in the fund forgoing opportunities to buy certain securities when it might otherwise be advantageous to do so or selling securities for ESG reasons when it might be otherwise disadvantageous for it to do so. The value of securities of small to medium size, less well-known issuers can perform differently from the market as a whole and other types of stocks and can be more volatile than that of larger issuers.

Fidelity Sustainability U.S. Equity ETF: Stock markets are volatile and can decline significantly in response to adverse issuer, political, regulatory, market, or economic developments. Different parts of the market, including different market sectors, and different types of securities can react differently to these developments.

Foreign markets can be more volatile than the U.S. market due to increased risks of adverse issuer, political, regulatory, market, or economic developments and can perform differently from the U.S. market. The fund's adherence to its ESG ratings process may affect the fund's exposure to certain com sectors, regions, and countries and may affect the fund's performance depending on whether such investments are in or out of favor. This process may result in the fund forgoing opportunities to buy certain securities when it might otherwise be advantageous to do so or selling securities for ESG reasons when it might be otherwise disadvantageous for it to do so. The value of securities of small to medium size, less well-known issuers can perform differently from the market as a whole and other types of stocks and can be more volatile than that of larger issuers. Non-diversified funds that focus on a relatively small number of stocks tend to be more volatile than diversified funds and the market as a whole.

Any retirement plan investors should consider Department of Labor ("DOL") guidance for the selection and monitoring of investments for employee benefit plans and plan fiduciaries may wish to consult with ERISA counsel regarding the evaluation and selection of investments or investment courses of action that incorporate non-pecuniary or other ESG factors in accordance with recent DOL guidance.

Fidelity Environmental Bond Fund: In general, the bond market is volatile, and fixed income securities carry interest rate risk. (As interest rates rise, bond prices usually fall, and vice versa. This effect is usually more pronounced for longer-term securities.) Fixed income securities also carry inflation risk and credit and default risks for both issuers and counterparties. Unlike individual bonds, most bond funds do not have a maturity date, so avoiding losses caused by price volatility by holding them until maturity is not possible. Foreign securities are subject to interest rate, currency exchange rate, economic, and political risks, all of which are magnified in emerging markets. The fund normally invests in issuers whose products or services are intended or likely to have a positive environmental impact. Some industries and sectors might be more likely to issue environmental bonds, and events or factors impacting these sectors may have a greater effect on, and may more adversely affect, the fund than they would a fund that does not invest in issuers with a common purpose. The fund also will be affected by a decrease in governmental or other support for environmental initiatives. Leverage can increase market exposure and magnify investment risk.

Fidelity Climate Action Fund: Because the fund focuses its investments in equity securities of climate aware companies, it will be more susceptible to events or factors affecting these companies. The fund is particularly exposed to such developments as changes in global and regional climates, environmental protection regulatory actions, changes in government standards and subsidy levels, changes in taxation and other domestic and international political, regulatory, and economic developments. Scientific developments, such as breakthroughs in the remediation of global warming, and changes in governmental policies relating to the effects of pollution may affect investments in pollution control, which could in turn affect these companies. As a result of these and other factors, the market prices of securities of companies involved in climate aware-related industries tend to be considerably more volatile than those of companies in more established sectors and industries.

Before investing, consider the fund's investment objectives, risks, charges, and expenses. Contact your investment professional or visit fidelity.com, i.fidelity.com, or 401k.com for a prospectus, or a summary prospectus if available, containing this information. Read it carefully.

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