

TRANSCRIPT

Thematic investing with differentiated insights

Presenters: Daniel Kelley, Michael Kim, Chris Peixotto

Chris Peixotto: Thanks, everyone, for joining. So, my name's Chris Peixotto, and I work in our investment product group here at Fidelity, covering our sector funds, and thematic funds. And really excited to be joined by Dan Kelley and Mike Kim today, portfolio managers on our Fidelity Founders Fund and Fidelity Enduring Opportunities Funds, respectively. And they're going to talk more about those funds. But before I turn things to them, wanted to just provide kind of a quick background on thematic investing, what it is, and how do differentiated insights, approaches, and strategies fit in?

So, I'm going to go ahead a couple of slides here, and first the question, you know, what is thematic investing? Thematic investing is really an investment approach that allows you to invest in a specific kind of long-term trend or theme that really matters to you and aligns with your particular interests or objectives. It's really kind of a newer approach or framework in the market that differs from traditional investment frameworks. So, you can think about some traditional investment frameworks like say regional investing, which

would be say, U.S. companies versus emerging market companies. Or style box investing, which might be large cap stocks versus small cap stocks. Or sector investing, maybe thinking about energy stocks versus healthcare stocks.

Thematic really tends to cut across these various established frameworks to align with a particular idea or opportunity. Given that it is a newer category, we've been working on publishing kind of research and insights to help folks better understand, you know, what thematic investing is. And as part of that, have described these five different categories that we show on the screen here.

And I'll just kind of quickly go through each of these, but the first would be disruption, so you can think about these as kind of companies or opportunities with kind of new business models, new technologies, that are really displacing kind of established companies and established industries. Then you've got megatrends, so we think about these as kind of long-term structural trends, driven by things like changes in demographics, or resource scarcity. I've got outcome oriented. These would be thematic approaches that are really geared around a particular portfolio outcome. And that might be trying to protect a portfolio from inflation, or perhaps pursuing lower volatility of

returns. You've got ESG, so these would be approaches focused, you know, in particular around considerations with respect to environmental, social, or corporate governance considerations. And then the last bucket here is really going to be the focus of our webinar today, but this is differentiated insights. And these would be other thematic approaches that really are thematic in nature but may not fit neatly into one of the other buckets. And I think a great example would be the insight that founder-led companies can make great investments. And we're going to have Dan talking about our Founders Fund, which fits squarely in that category.

You know, as we've seen this kind of being a growing area of the market with thematic investing, more and more interest from clients, we've been bringing new funds and new offerings to market to give folks kind of more options, to get exposure to various themes. And really trying to pull in kind of the best of Fidelity and our best thinking collectively across the firm, in terms of what are the particular themes that represent opportunities and are going to matter. And then what are the best ways to get exposure to particular companies within each of those themes? If you're interested in learning more after, we've got a bunch of information on [Fidelity.com](https://www.fidelity.com), and you can just go to [Fidelity.com/thematic](https://www.fidelity.com/thematic) to see more on thematic investing in general, and then learn about particular thematic funds that we offer.

On the next slide here, just kind of a quick reference of the various thematic funds that we offer. So, I talked through these five different categories, we've got a range of funds, giving you multiple kind of options and exposures within each of those categories. And a number of these have been on the shelf and available to investors for quite some time, but we've also been working on offering new funds and have rolled out kind of a dozen or so new funds over the last year and a half to give you more thematic options.

And so, with that, I'll turn things now to Dan to talk more about the Fidelity Founders Fund.

Daniel Kelley: Great, well thanks Chris, I'm really excited to introduce to you the Fidelity Founders Fund, which I believe is a differentiated, relatively new investment product that really aims to harness the potential alpha creation that we think founders bring to the table over time. So just in terms of quick agenda for the next 15 minutes or so, as I plan to review the strategy, I'll first review how this product came to life, and highlight a mindset that we think is unique to founders. I'll review analysis we and others have done that suggests that this group of, this universe is an alpha-rich sandbox to invest in. I'll then

discuss some key traits that embody the types of founders I'm looking to invest in, in this fund.

So in terms of how this idea came to life, it really started when two of Fidelity's legendary fund managers, namely Will Danoff and Joel Tillinghast, together began to identify through their multi decades of investing that founder-led companies tended to be long-term outperformers versus the market. What I find particularly interesting about that is that both Will and Joel have very different styles. Will is much more growth-oriented, Joel is much more value-oriented, yet they identified the same trend.

As I worked closely with Will and Joel to explore the idea further, they highlighted a unique mindset of founders whereby they tend to see a big opportunity to solve a problem, and they have a clear long-term vision that they plan to execute upon to solve that problem. We like to call this the founder's mentality. Founders tend to be passionate; they tend to be bold, willing to take risks, they also empower their employees and they never stop innovating. So, turning to slide six, let's explore the founder's mentality further.

So, in 2014, Bain and Company conducted a study which analyzed the power of the founder's mentality. The study found that from 1990 to 2016, returns to shareholders in public companies where the founder was still involved were three times higher than in other companies. Also, when surveyed, 93 percent of the entrepreneurs considered the founder's mentality a huge competitive advantage for their respective companies.

Moving to slide seven, how has that translated into stock performance? So, in conjunction with our own quantitative research team, we looked at the empirical data, and expanded the list of companies to the Russell 3000, which also, while also eliminating survivorship bias. And we found the analysis to be quite fruitful. Namely, founder-led companies significantly outperformed the rest of the universe by about 200 basis points net of fees over the past decade-plus of returns. So that was enough for us to continue delving into this idea to potentially make it a product.

So, turning to slide eight, you're probably asking why not just index the founders universe? Well we think you can layer on traditional fundamental analysis and stock picking to enhance the overall returns of simply buying the universe. Hence, by leveraging the depth, breadth, and company

relationships we have here at Fidelity, we think we can invest in the right founders to accentuate the returns I just demonstrated.

So, what are the key attributes we're looking for in a founder? Well first and foremost, they are customer obsessed. Great founders often start with the customer experience first, and they work their way backwards to monetization. They also often convert their customers into advocates who market the brand for them, telling their friends, creating a virtuous demand cycle whereby the customer acquisition cost is quite low. A classic example here, in my view, is Jeff Bezos, founder of Amazon, who said the basic idea behind the success of Amazon should be the intense focus on customers.

So great founders are also innovative. I know you hear this word innovation, buzzword, all the time, but they truly are innovative. They think long-term, they see an opportunity to create something different, it often disrupts a market completely. And they never stop this focus on innovation. So, a classic example here would be Phil Knight, the co-founder of Nike. He was a track star at the University of Oregon that really just wanted lighter and higher performing track shoes. He created those, along with his coach, and started a

company, but he did not stop at creating higher performance track shoes. His company ultimately became synonymous with innovation in athletic footwear.

So lastly, great founders are also committed to making their vision a reality, and often have the majority of their net worth riding on it. So, what's important about that is their interests become incredibly aligned with shareholders. So here, I think of Reed Hastings, co-founder of Netflix. So, he had this vision of delivering people great video content whenever and wherever they wanted to consume it, and he believed he could do it at a lower cost than linear television. Interestingly, he had to completely pivot his business model, which as many of you know, was basically mailing people DVDs, as he saw the technology changing, he saw streaming was the way of the future, and so although he had a cash flowing business, he had to disrupt himself and pivot completely, because he knew the best way to provide that vision was to go streaming. So, there was a lot of risk in that, he risked his own net worth, but it was the right thing to do for the long-term vision. And he also had a lot of skin in the game. So, as you look at it now, he's a billionaire multiple times over for making that pivot, and I think shareholders, as a result, benefited tremendously.

So, moving to slide nine, great founders innovate across all industries. Not just technology. I think right now, everyone's focused on technology, the pandemic really accentuated, you know, everything being digitalized, we're all doing this call virtually. And that really accelerated investment in a lot of different technology. So, I'm a big believer in technology, there's a lot of investments in this fund, in the technology space, but I really want to be clear that this is a diversified fund, and it has less than 40 percent of its exposure to technology. To technology and healthcare, actually.

Where I think a lot of people think of those two sectors as new economy sectors, where the founder is still actively involved and making a difference, I'm finding interesting founder-led companies across all sectors. So, that would be real estate companies, that would be new and exciting ways to treat cancer, that would include gaming companies, even a few interesting financial companies.

So, turning to slide 10, let's dig into the fund a little deeper before I turn it over to Mike. So, the strategy's straightforward. It's really to leverage the extensive resources here at Fidelity to stock pick and construct a portfolio with the best investment opportunities across the founder-led universe.

So, moving to slide 11, another important thing to highlight about this fund is the founder's universe that we target is much broader than the traditional founder CEO concept. The founder can be the CEO, and that's often the case, they're the, you know, managing from the top, but they can also have influence in a variety of ways, they can be on the board, they can be in another C suite role. One common example of that would be chief creative officer. A lot of founders are incredibly innovative, but they don't want to be kind of bogged down with the administrative burden of managing a company day to day. So, I see that. They could also have a large ownership stake in the company, whereby they're still exerting tremendous influence through their ownership.

So, I think let's move to slide 13. Sorry, I just lost my... So, in terms of my investment process, it really leverages the extensive fundamental research platform we had here at Fidelity, as well as my own fundamental analysis for idea screening, to construct a diversified portfolio. The portfolio tends to have between 75 and 150 stocks in it, the tracking error is about 4 to 8 percent, and that's versus the Russell 3000 benchmark.

So, and let's move to slide 14. So, this slide really touches on my buy and sell discipline. So, on the buy side, I'm looking for stocks with earnings growth streams that appear mispriced by the market. Or they have years of underappreciated growth that's more sustainable than the market things. So, they're going to maintain a high rate of growth for quite some time.

Oftentimes, there's mispriced optionality in those revenue and earnings streams. What do I mean by that? So, there could be new business lines, there could be new products in the pipeline that have yet to flow through the monetization phase into revenue and income, there could be tangential businesses that will leverage from their scale, I think of some of the big tech companies that we know of today that have business lines today that they didn't even have years ago, that the market, you know, didn't fully understand and those became, you know, powerful revenue streams. I think of a classic example being Microsoft today, with their cloud platform.

So, in terms of on the sell side, I really only sell in two circumstances. One, when the stock's overshoot my view of fair value, so the consensus growth expectations appear too high, relative to the valuation. Or when my thesis on fundamentals is called into question. Current ideas I'm excited about, you know, in this fund, tend to be powerful long-term secular trends, because they have that duration of growth that I'm excited about, compounding for many

years. That would be things like 5G, machine learning, the Internet of Things, fintech, as we talked about, healthcare innovation, as we talked about. So that would be kind of one side of the ledger.

On the other side in this fund, I'm really excited about, you know, the cyclical outlook for this economy, as we emerge from the pandemic. And believe it or not, there's a number of founder-led companies that are in cyclical areas, whether it be travel, gaming, leisure, retail apparel, housing, etc. So, maybe just in the interest of time, I will turn it over to Mike.

Michael Kim: Great, thanks Dan. Let me just say I'm really excited to be here today to talk to you about this fund, and I'm very excited to be working with Dan again on this. We've actually gone back for quite a few years, and he's been a mentor to me, so I really appreciate this opportunity. To give you some background on myself, I've been with Fidelity for just about 14 years now, and have worked in the industry for almost, well, over 20 actually, feeling my age lately. And in all that time, I've worked as a quantitative analyst, and now as a co-portfolio manager of this fund. What being a quantitative analyst means, generally for my career, has meant working with fundamental investors such as

Dan. Working with them on problems like building stock selection models, working with risk management, and portfolio construction.

So, portfolio construction is my main role on this fund, I am comanaging it with our managing directors of research. They're the people that are managing things from the fundamental research side, and I take all of the ideas that they bring to us and put them through a portfolio construction process. So, kind of like Dan did, I'd like to go back to the origin story of this fund.

And it's funny, because you know, it all comes back to the same people, which is Will Danoff and Joel Tillinghast, you know, we're really lucky to have resources like that at Fidelity, because you know, they're deep thinkers, and they think about the investment world in lots of different ways. So about 10 years ago, Joel actually came to the managing directors of research, and he asked if there was a way for our analysts to think about things beyond just a traditional, you know, what's a company going to earn in the next quarter, what's a company going to earn over the next year? And really think about things in a more holistic sense. You know, understanding the businesses, what are the types of businesses that we want to own for a long investment

horizon? Not just the next quarter or year, but maybe the next three to five years, or even through an economic cycle.

And so, what we did was, the managing directors went, you know, they put their heads together, and they gave the analysts the opportunity to flag in our research database, flag specific companies that they feel meet this criteria.

And one thing led to another, we actually realized that there was something compelling in this signal, so you know, we started investing in these names.

And in 2019, we launched this fund, which is built around this idea of investing for the long-term.

So, if we go to the next slide, we can get right into the investment philosophy.

As I said, you know, for this fund, we are looking for best of breed companies.

These are the companies that we think, as Dan mentioned, we're looking for earnings compounders, growth compounders, we want to hold these

companies for longer than just the short-term. And the key to that is using

fundamental research. You know, this isn't the sort of thing that you can

necessarily just punch numbers into a spreadsheet, and get the answer, right?

You really need to understand these companies in a more holistic sense.

That's something that we do really well at Fidelity, I believe. So, this kind of fits right into our competitive strengths.

In terms of the kind of companies that we're looking for, you may have heard, in the investment world lately, a lot of talk about moats, right? Finding businesses with moats. That's sort of what we're getting at here, but I think, I'll expand on this idea later, but it's more than just an economic moat. But, so for sure we're looking for companies that have sustainable competitive advantages, attractive industry characteristics, you know, long-term growth opportunities. And the key is also, we're looking for strong management teams. And you know, this is something that is kind of a cousin to what Dan was talking about with founders. I think that strong management teams, that's something that's very underrated in the investment community, and I'll give some specific examples, so hopefully we can talk about that a little bit more.

You know, I've mentioned a few times that for this fund, we're looking for a longer investment horizon. And the reason we target a longer investment horizon is because we feel there's this inefficiency, in that, you know, if you think about trying to predict a company's earnings over three years from now, it's not realistic to get an accurate estimate, you know, right down to the

penny. A lot of times the companies themselves don't know what's going to happen exactly three years out from now. And as we've all discovered in the last year, things can happen that no one really quite expects.

So, you know, there's the, you know, as you go out further in time, the earnings estimates, you get less confident around it. But if you do the real deep fundamental research, and by that I mean understanding the business drivers, understanding the growth opportunities, understanding the market, you know, where the competitive stresses are, you can have confidence in an investment without actually needing to be accurate to the penny for what the earnings are going to be three years out.

Now the reason why we think there's an inefficiency there is because shorter-term investors, as they're coming in and out of the name, you know, by the time they get clarity on the earnings number that is right now three years out, so maybe it's like two years from now, by the time they get clarity on that, you know, the market's pretty efficient, it will have already started moving towards that new earnings number. They might be late to the game. For us, because we're long-term investors, we're going to hold it through that whole period,

and we're going to reap the benefit of all of the people coming back into the name as they get clarity. That's what we hope to capture anyway, in this fund.

And finally, on this page, you know, a really important part, because we're investing for the long-term and we hope to hold these names for a long period of time, we really have to have a systematic way to build the portfolio. And the reason for that is because when you're holding a lot of names for a long period of time, you could be subject to behavioral biases. And I'll talk a little bit, I have a slide in a few slides, talking more about that.

But behavioral biases, you know, you may have heard them a lot, but I mean the classic example that I can think of right now that's very topical is FOMO. No one wants to miss out on these names. That's a type of behavioral bias. I'll talk more in a few slides about it, but I think, you know, having a systematic rules-based portfolio construction process around your portfolio, that's a way to kind of ameliorate any of the negative effects that you might get from behavioral bias.

So, if we go to the next slide, I'll just talk a little bit, you know, I talked a little bit about moats, and how it goes beyond just economic moats. So, in the first

column here, we see competitive advantages. I think this is how most people think about moats. You know, and these are kind of the traditional -- this is nothing new. I mean Porter talked about these things years ago. You know, these are the type of things like economies of scale, network effects, you know, having pricing power, brand recognition, brand loyalty, threats from substitutes, these are kind of the classic ways to think about moats.

The part that I said was underrated are something that Dan touched on, having these strong management teams, and really, you know, you can only identify these by meeting the companies face to face, talking with them, you know, asking pointed questions to the management teams. This isn't something that you can just get out of a spreadsheet. You know, the strongest management teams, they know how to allocate the capital efficiently, they know where to make good investments, you know, for the long haul, for future growth. As Dan was talking about, customer obsessed. Customers are what, you know, drive the business. Without customers, there is no business. So, it's very important to, for us, when we're looking at management teams, we want to see management teams that stay focused on the customers.

And that brings us to the next point, which is stakeholder equity. You may have heard shareholder equity; we always talk about shareholder equity. More and more we're talking about stakeholder equity, and what stakeholder equity is, is this idea that it's not just the shareholders, the owners of the business, that you need to be concerned about. The stakeholders can also include things such as the customers and making sure that they're satisfied with the service or business that you're providing them. It's also business partners, and very importantly, it's also employees. You know, keeping happy employees and productive employees, that can be a moat in and of itself.

And then the final point on strong management teams is obviously, we're looking for strategic vision. It's not enough to just have a moat around your business, we want to see growth, we want to see, you know, something down the line in the future that makes us want to invest in the company.

And the third pillar that we're looking for when we talk about our investment philosophy is industry characteristics. You know, Dan touched on this as well, we're looking for secular, long-term growth opportunities, you know, if you think about things like high power computing, crypto, you know, all those things, those would fall under the industry characteristics.

And that actually leads into, you know, I'd love to talk about a specific example, and see how it fits into all three of these lenses. And that name is one of our top holdings, Taiwan Semiconductor Manufacturing Corp. Now as the name implies, they make chips that go into pretty much any kind of electronic device you have now. If you think about it, first from the industry lens, obviously there's a huge demand for chips now, between the high-powered computing, the stuff that I mentioned, the Internet of Things, communication devices, even cars. I think, you know, some of you may have heard in the news recently about how, you know, car demand for chips has just, you know, exploded and they can't even keep up. So obviously there's a lot of momentum behind, you know, behind needing chips.

In terms of competitive advantages, you know, semiconductor manufacturing is a highly capital-intensive business. I mean it takes a lot of money to set up a fabrication plant. So, you know, even within the industry, there are companies that will decline to go into certain areas of business because they simply can't make the investment necessary to create those chips. So, there's an advantage there that Taiwan Semiconductor has, in that they've been able to develop and use their capital to develop these fabrication plants that other companies just can't get into.

I should note that they also have a strategic relationship with Apple, so they manufacture chips for Apple, right? That's the sort of thing that, you know, it becomes harder and harder for a competitor to overcome that sort of, you know, that sort of relationship that they have.

And in terms of management teams, you know, again a lot like what Dan was talking about, up until 2018, it was a founder-led company, the current CEO has been with the company for a very long time, they have a proven track record of making smart capital allocation decisions, you know, there have been times in the past 10, 15 years when they've zigged while others in their industry have zagged, and it made all the difference. You can just look at their track record of growth over the last 10, 15 years, and that pretty much tells you what you need to know.

So, you know, this is an example of how we're using these three lenses to figure out if we like a stock. This stock clears all three lenses very well. That might not be the case for obviously like, you know, we don't invest in just binaries, whether it does or doesn't, right? You know, all of our companies

have some elements of some of these, some may be stronger under a certain lens than others, but generally like, this is ideally what we're going for here.

So, if we go to the next slide, one more after the animation. Just get into some of the investment process here. Obviously we talked about idea generation, fundamental analysis, portfolio construction, we're trying to keep this -- this is a global investment fund, so we keep about 55 percent in the U.S., we have some exposure, about 35 percent, to international developed names, and about 10 percent in emerging markets.

Within each of those regions, we keep an equal bet on all of the stocks, and the reason for that is because this is a fund where the analysts have direct input into what goes into the fund. In other words, we're almost in a sense crowdsourcing our investment ideas from our analyst part-- from our research department. That's a little bit unique. And the reason why we do that is because we feel like there's, you know, there's a lot of wisdom in that crowd, and this is not just an average crowd, this is a very experienced set of investors, right? And so, we feel like there's a signal there, we don't want to love any of our children, any of our stocks, more than others. We think that the

collective wisdom is what we want to invest in. So, we take equal bets across there.

We have buy-sell discipline concerning, you know, their weighting in their portfolio, as names become successful, and sometimes in the short-term, they become very successful, more than we anticipate, in that situation they'll be over our target weight, and we'll naturally, we have it in our process, and this is part of my job, is to make sure that we get that bet scaled back, reallocate the capital to some of the other names that might like that might be under our target weight. So, we have a very disciplined process in the portfolio construction.

And the part that's not talked about here is, we have a feedback loop. I mentioned that I comanage this product, I have about seven other comanagers on this who are the managing directors of research. Their job is to go back to the analysts, you know, test the thesis, you know, give them feedback, ensure that the names that we own right now are still the names that we want to have in the portfolio. So, it takes a whole team of people to make this thing happen, but I think it's, you know, I think it's a great approach and I'm really excited for it.

On the next slide, I just want to circle back to this idea of behavioral biases real quick. You know, because you hear these things talked about a lot, but you don't often get a specific example. One of the biases you might see here is what we call anchoring bias. And you know, in general anchoring bias means that our perspective on something is biased by some presupposition that we have, right? Whether it's a number or just information, something that biases our forward-looking perspective because of how we see things in the present. Let me give you a specific example.

Let's say there's a stock, XYZ, that you really like. It's the type of stock that you want to own. But, you know, it's trading at, I don't know, say \$60 right now. And you feel like that's a little rich, I'd like to get into it at about \$50, I think \$50 is a fair entry price. And so, you kind of file it away, and you don't act on it. And then a few months later, you look, and now the stock's at \$90, right? And it never got back down to 50, so you never got in it, and so now what do you do with it? The stock has run 50 percent, you're experiencing that FOMO, what do you do? Do you get into the name now? You know, is it too late? It's already run the course, should I have done it? You're kicking yourself. These are things that, when you have a systematic portfolio process, you don't have to worry about those things as much.

Look, if we got into the name at \$60, and it did get down to that \$50, that's fine. You know, similar to how we talk in personal investing, it applies to professionals as well. If we like the name, and we're going to hold it for a long period of time, we can dollar cost average it down. Now if we get in at \$60 and it does take off from there, you know, we don't have FOMO, because we didn't miss out. So, we really just want to make sure, we want to take that element out of this portfolio. And just really let the fundamental stock pick shine. So that's something that I think is a little bit unique right now in our product offering, and I'm really excited to be a part of this.

So if we go to the next slide, this is just the summary, you know, we've talked about, you know, taking a long-term view on investments, like you know, seeking companies that have moats and competitive advantages, sustainable competitive advantages. So, you know, attractive industry characteristics, great management teams. If you think about where this portfolio, where this fund would fit in your personal portfolio, this is a global growth fund with very low turnover, and a long investment horizon. I think of it as like a core global growth holding, if that's what you need, I think that this would kind of fit the bill.

And, you know, what's our competitive advantage? We have a great network of equity analysts across the globe, you know, Boston, London, Hong Kong, Tokyo. So, you know I think that we can offer you something that really meets your needs, and at the same time, you know, will deliver competitive returns.

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Past performance is no guarantee of future results.

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. Securities selected using quantitative analysis can perform differently from the market as a whole. The advisor's applications of the founder-involved strategy may not achieve its intended results and the fund could underperform the market as a whole.

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