TRANSCRIPT

Outcome-oriented thematic investing

Chris Peixotto: All right, thanks. And hi, everyone. So my name is Chris Peixotto and I work in our investment product group here at Fidelity. We're really excited to have Pranay and Zach on the call today. Pranay is the portfolio manager of our Fidelity Infrastructure Fund and Zach is the portfolio manager of our new Fidelity US Low Volatility Equity Fund. But before we turn things to them and have them talk more about their funds and approaches, wanted to just provide some quick background on what is thematic investing and how does outcome-oriented thematic investing fit in.

So if we go to slide three to start here, we'll start with so what is thematic investing. Thematic is really an investment approach that allows you to invest in long-term trends and themes that really align with something that you believe in and with your objective. It tends to be a newer investment approach and really differs from traditional investment frameworks. So some traditional frameworks might be like regional investing, thinking about US versus emerging market exposure, style box investing, thinking about say large-caps versus small-cap stocks, sector investing, thinking about something like the energy sector versus the health care sector. Thematic investing tends to cut across these traditional frameworks to really align with a given idea or opportunity or in this case a specific outcome.

As a newer category, we've been trying to publish insights and research to really help investors think about thematic investing, understand what it is, and help to think about the role in a portfolio. And as part of that we've defined five different subcategories within thematic, and I'll go through these here. They're shown on the slide. You've got disruption. So this would be focused on companies with new and innovative business models that are really disrupting established companies and established industries. You've got megatrends, so this would be a focus on long-term trends driven by things like changes and shifts in demographics and resource scarcity.

Then you've got outcome-oriented, which is really our focus here today. These would be thematic funds that can help you pursue a specific outcome in your portfolio, such as trying to get lower volatility of return or some inflation protection in your portfolio. We've got ESG, so this would be investments focused on environmental, social, and/or corporate governance considerations. And then the final category is differentiated insights. These would be other thematic opportunities that don't necessarily fit neatly into one of the other categories. So an example would be the insight that founder-led companies can make great long-term investments.

And as we've been seeing increased interest from investors around different themes in these types of exposures, we've been bringing new funds to market to really give investors more options to get exposure to these themes. Each of these strategies are really designed to leverage our best thinking and research insights here at Fidelity both in terms of what the theme is, how you can get exposure to it, and then what are the best positioned companies within each of these themes.

I mentioned we've got a lot of research insights that we're publishing. A great resource is to go to Fidelity.com/thematic and there's a lot to see, a lot to look at there and to help you understand thematic investing.

If we go to slide four now, here's just a quick reference of our various funds across the thematic categories. A number of these funds we've had on the shelf for some period of time, but as we're seeing more interest in themes and thematic investing we've launched a dozen new funds over the past year. Those are highlighted here. And then I point out within the outcome-oriented category we've got a number of different funds that can help you pursue a variety of objectives. In just a few seconds here we'll have Pranay and Zach start to talk about infrastructure and US low volatility in particular. Another new offering I'd call out is our Fidelity Stocks for Inflation ETF. So the ticker is FCPI. This is a factor ETF, so it's using a systematic approach to tilt toward stocks with certain characteristics. And in this case that strategy tilts toward sectors and industries that have historically outperformed in periods of rising inflation. So really designed that one to give you core US stock exposure while increasing your potential to outperform the rate of inflation.

So that's a quick overview of thematic investing and outcome-oriented. I'll turn things to Pranay now to talk about infrastructure.

Pranay Kirpalani: Hi, good afternoon, everyone, and thank you for making the time. As Chris mentioned, I'm Pranay Kirpalani. I've been at Fidelity for seven years. And my domain of expertise is global infrastructure. I also manage the Fidelity Infrastructure Fund. So, if we could turn to slide six… this is a great snapshot of how we look at infrastructure as an asset class. So you can see it's a highly diverse asset class that includes traditional infrastructure sectors that we're familiar with such as transportation, toll roads, airports, railroads, midstream energy assets, as well as traditional utilities. So the asset class is also super dynamic and includes newer and fast-growing infrastructure industries like data centers, cell towers, warehousing, and logistics. So it's a very diverse and alpha-rich opportunity set.

And just to level-set, when I talk about infrastructure assets, what I'm generally looking for are three things. I'm looking for business models that have a quasi-monopolistic position with a structural barrier to entry. I'm looking for long duration predictable cash flow streams. And relatively inelastic demand. And with that framework I'm able to locate the asset class on a cross-sector cross-geography basis to find the best ideas.

So turning over to slide seven, we can quickly go over the rationale for investing in infrastructure. Infrastructure's return has had competitive risk-adjusted returns over time. It's been able to provide a sustainable income stream, which is something we'll talk about later. It provides lower economic sensitivity and inflation protection. And lastly as I talked about it's a very rich and diverse opportunity set.

So on slide eight, I do think that one of the unique merits of infrastructure as an asset class is the ability to provide an attractive and sustainable income yield. So I wanted to highlight a couple slides to illustrate this. So the simple way to look at this chart is the y-axis is the median dividend yield over 15 years, and the x-axis is the standard deviation or the underlying volatility of the asset class. So what this chart shows us is the income yield you've gotten from infrastructure has been meaningfully higher than the basket of global equities. Or another way to frame that is in order to get that level of income you usually have to buy more volatile asset classes such as real estate. So it's really the ability to provide attractive levels of income with relatively lower underlying volatility that makes the asset class attractive.

Moving over to slide nine, another way of framing the income potential of the asset class is relative to bonds. So global treasuries at this point are yielding basically close to nothing, 10-year treasuries across most major markets are sub 1 percent. So what this chart shows is the spread between the income yield or the dividend yield you get from infrastructure equities versus investing in the government bonds of the countries in which they operate. And as you can see, the spread has actually widened over time, which highlights the relative income stream you're getting from this asset class has become far more valuable versus the fixed-income alternative.

And lastly, on slide 10, inflation protection. So inflation has been pretty benign to date. But I do think in the context of protecting the real value of your earnings and income stream over long periods of time inflation protection is crucial. So the way to look at this chart is it shows the asset performance when inflation surprises to the upside. And as you can see, when we have a positive inflation shock, infrastructure stocks are able to outperform both global equities and global bonds, because they usually are able to protect their earnings and income streams. And this is generally because their revenue or their pricing is tied to inflation, that they can increase their cost base at lower than inflation.

So moving over to slide 11, I wanted to talk a little bit about my investment philosophy and process. At a very high level my job is to scour the globe and from a bottom-up fundamental perspective fund and create a portfolio of 30 to 50 best in breed infrastructure securities. In order to do this there are basically three guiding principles that I use. The first is there are basically two sources of securities that I'm looking for. The first are best of breed firms. So these are firms that have demonstrated the ability to compound their earnings and dividend streams sustainably over long periods of time. So I'm usually looking at 5-, 10-, 15-, 20-year track records of the companies and the management teams. And I want to be able to see that compounding done with low underlying volatility.

And secondly I'm looking for infrastructure stocks that are positively exposed to secular megatrends such as renewables, 5G, data growth, warehousing. And we'll actually talk about some of these trends in a little bit.

And as the second bullet point says, the focus on high quality infrastructure assets should allow the fund to provide an attractive and sustainable income yield over time. And lastly I think what makes the fund and my process somewhat unique is the fund's exposure to dynamic and innovative subsectors like renewables, towers, data centers, warehousing. And the goal here is to create a portfolio that's well positioned today but also own the infrastructure backbone of some of the big emerging growth trends that we're seeing in the market.

So I thought it might be useful to highlight some of the big thematic opportunities in infrastructure that I'm excited about. So if we turn over to slide 12, the first is renewable energy. I think it's become very evident that in order to solve the climate crisis we need to decarbonize rapidly. And I believe over the next two decades we're going to see massive adoption in renewables globally. And as the pie chart shows, renewable energy, which is wind and solar, should grow from about 10 percent of our energy mix today to nearly 40 percent by 2030. And so for me this is a big thematic overweight in my fund, and one of the big secular megatrends in infrastructure over the next decade or so. And because of Fidelity's reach and our deep focus in this area, we've been able to develop relationships and track the progress of all the major global renewable developers over time.

It's also an area that I'm personally very passionate about. In March of last year, a time when we were allowed to travel, I went to visit the Burbo Bank Offshore Wind Farm, which is off the coast of Liverpool, England. So that picture on the top right was taken during the trip. And the size and scale of these wind farms are truly spectacular. Some of the latest ones nearly the size of the Eiffel Tower. And so it's pretty incredible. And I think trips like this really add a lot of perspective for us as we research and own a lot of these stocks.

The second theme on page 13 that I want to talk about is the growth of data usage. So if we go to the next slide that's it. Right. So the growth of data usage, which is fueling the need for data centers. So really there are two big subtrends here. The first is the amount of Internet usage is massively increasing as we start to use more data-intensive applications. And if we think out 5, 10 years and imagine the use cases of AI and connected cars and the Internet of Things, the data intensity is only going to increase massively.

And the second trend here is the move from on-premise to the cloud, which is creating demand for large hyperscale data centers from companies like Amazon Web Services. So data centers have become a very valuable infrastructure asset class and a sector that I'm invested in. They allow you to increase the utilization of your network by collocating different companies next to each other, and add meaningful value to the end customers.

And the last thing I want to talk about on slide 14 is warehousing and logistics. So all of us with an Amazon account know just how big e-commerce and online shopping has become. But it's still only 15 percent of retail sales and will continue to grow from here. And the growth of e-commerce is fueling the need for warehouses and logistics centers. And you're starting to see blue-chip names emerge in both US and Europe that have a warehousing and distribution network that create an infrastructure-like business which adds enormous value to both e-commerce companies as well as the end customer. And again this is a key area of focus for me and the fund is positively exposed to this theme.

So on slide 15, just to tie it all together, I think infrastructure is an attractive equity asset class, especially given the need for products that can provide an attractive and sustainable yield over time. I also think the Fidelity

Infrastructure Fund is a unique product given the focus on best of breed companies and exposure to secular megatrends and I think the focus should hopefully allow the fund to drive competitive earnings, dividends, and total return over time. So with that, I'll turn it over to Zach, who will be talking about the low volatility fund.

Zach Dewhirst: Thanks, Pranay. So my name is Zach Dewhirst. And I'm the portfolio manager for the Fidelity US Low Volatility Equity Fund. And while this fund is new to the retail market, we've been running a similar portfolio for institutional clients going on eight years. Over the next 15 or so minutes I hope to give you a better understanding of what low volatility investing is, what differentiates the strategy I manage, and the merits of low volatility strategies in general.

Let's get started on page 17. So equity markets have been very strong over the past three decades, providing investors a 2,400 percent return since June of 1988 or 25 times your money. But if we move to the next slide we see that these strong returns have not been without some volatility. In gray here we've highlighted each of the market sell-offs of more than 5 percent. So even during this very strong market stocks have lost value 34 percent of the time, and have suffered corrections of over 5 percent 16 different times when looking at monthly returns.

What if I told you that you could have invested in a strategy that generated 75 percent of the market return during rallies and 67 percent of the market return during losses? So what I mean there is if the market was up 10 percent the strategy would only earn 75 percent but if the market was down 50 percent the strategy would only lose 33 percent. Many of you are likely saying, "No thanks. The market has gone up more often than it has gone down. It's generated strong returns. And I'm probably thinking that you can't win by only capturing 75 percent of the market return during rallies even if I'm only capturing 67 percent of the market losses."

If we move to the next slide, I think you'll see that that kind of thinking is actually flawed. Over this period low volatility strategies which we proxy here with the MSCI USA Min Vol index in blue generated exactly that, capturing 75 percent of the rising markets and 67 percent of the falling markets. And that resulted in a return of over 2,700 percent. That's outperformance of 300 percent with about two-thirds the risk.

On page 20 we'll explain how this is possible. And the answer is the power of downside protection. Through downside protection a lower risk strategy can outperform in the long run even in a strong upward-trending market. We all likely learned in grade school that 50 minus 50 equals 0. This is obviously in general. It's not true when compounding returns. If your portfolio generates a 50 percent positive return and then a 50 percent negative return the next, you're not even.

For example, let's say you invest $100. If you lose 50 percent you have $50. If you then get a 50 percent return you have $75. So you're still down 25 percent. And note that the order of those returns is irrelevant.

As you can see in this chart if you lose 50 percent you need 100 percent to get back to even. If you lose 30 percent you only need 43 percent to get back to even. And if you lose 10 percent we only need 11 percent to get back to even.

Hopefully you can see that as the negative returns grow the positive return needed to get back to even grows much quicker. This is to say that negative returns have a much greater impact on your wealth, and avoiding drawdowns is critical to wealth creation. Let me emphasize this again. The way the math of compounding and wealth creation works dictates that negative returns are far more impactful to ending wealth than positive returns. And thus avoiding big drawdowns is critical to maximizing wealth creation.

To provide another example, let’s say we have a market sell-off resulting in a 30 percent decline. During the sell-off a more defensive strategy say loses 20 percent. This means the defensive strategy outperformed by 10 percent and only captured 67 percent of the decline. So that’s similar actually to what we observed in the US low vol returns that we witnessed over the past 30 years.

Suppose the market then rallies back by 43 percent to break even. If the investor in the market didn’t panic and pull money out during the sell-off, they’re now even. Though we know from watching investor behavior that many investors do panic and thus suffer worse outcomes than depicted here.

But what could their experience have been with a lower risk strategy? If the defensive strategy that lost 20 percent in the market downturn generated anything above 25 percent return, it has outperformed the market and provided investors with a more stable ride and less cause for panic. So in this simple two-period example the low risk strategy outperformed by capturing 67 percent of the market sell-off and anything above 58 percent of the rally while also being lower risk.

If you think back to the results of the low vol strategy over the past 30 years it captured 67 percent of the market declines and 75 percent of the market return during rallies.

Some of you may be thinking why do I care if the strategy is lower risk, all I care about is the ending return. We already touched on one reason that this is not true, because investors panic in the midst of a market sell-off and they will panic, pull out after losing money, and then they likely miss the bottom getting back in. So their outcome is even worse than the market. The second stable path is critical, especially for a retiree that is pulling income from their investments, because they need the same amount of income regardless of whether the market is up or down, and so by taking money out when the market is down, this makes the hurdle even higher to break even. So definitely the case that the importance of downside protection is even more critical for retirees or anyone drawing income from their investments.

Hopefully this example and discussion highlights the importance of downside protection and helps you understand how a low volatility strategy can outperform in the long run, even in an upward-trending market. And also why it makes an ideal allocation for any investor but especially for risk-averse investors or retirees that still want to participate in the strong equity markets.

Now that we've discussed the importance of downside protection and how low volatility strategies can outperform, let's shift our focus to the question of what is low volatility investing on the next page. So conceptually you can think of low volatility investing as winning by not losing, as we seek to invest in lower risk stocks with the objective of providing investors with a stabler, more steady return outcome. Low volatility strategies are equity strategies which seek to provide lower risk than the overall equity market through risk management and risk-focused stock selection. Unlike balanced funds or asset allocation funds we're not dampening risk in the portfolio by investing in other asset classes like bonds. This is purely an equity portfolio. We also do not dampen risk by maintaining large cash positions which can act like a banker in strong bull markets. We dampen risk through detailed risk analysis of companies we consider for investment.

Why do we invest in low risk stocks? Well, whether you look at very long-term research we have done going back to the 1920s, the index proxy that we discussed previously going back the last 30 years, or the strategies that I've been managing for the last 8 years, the evidence points to low volatility stocks outperforming high volatility stocks, especially on a risk-adjusted basis, through the strong downside protection that we discussed earlier. As a result, low volatility strategies have been able to generate marketlike returns or even better in certain periods with less risk over the long run.

So how do we identify low risk stocks? Well, the focus of our strategy first and foremost is on risk management. To gain a deep understanding of the risks of investing in each company we consider for investment, we leverage Fidelity's roughly 160 fundamental industry specialist analysts across the globe as well as statistical-based risk assessments. Each analysts undertakes a thorough risk-reward assessment based on stock-specific, industry, market forces, etc. Stocks that are deemed to be attractive risk-reward opportunities by our vast team of fundamental analysts are combined to produce a portfolio with what has typically been 60 to 80 percent lower risk than the broader equity indices.

Now let's shift our focus to how investors could have benefited from low volatility strategies in their portfolios on slide 22. So historically low volatility strategies have allowed investors to either enhance return with a comparable level of risk, or reduce risk with a comparable level of return. As an example, circled in blue here we can start off with a pretty standard 60 percent equity 40 percent fixed-income allocation.

Over the past 20 years that allocation generated a return of 6 percent and risk of 9 percent. An investor seeking enhanced returns with comparable risk could have shifted that allocation to 80 percent invested in the low volatility equity strategy and 20 percent invested in fixed-income. As you can see here that allocation generated almost a percent and a half of additional return per year with comparable risk.

On the other hand an investor seeking reduced risk with comparable return could have shifted that allocation to 40 percent invested in low volatility strategy and 60 percent invested in fixed-income. You can see here that that allocation generated 4 percent lower risk, almost half the volatility, while still generating slightly higher returns.

On page 23 we can look at some additional performance characteristics. So here we see that the return-enhancing allocation shift, that orange box to the left, even though we had higher equity allocation, had an average return in down markets which was better by about 4 percent. We also see that the risk-reducing allocation shift resulted in an average return in down markets which was better by almost 17 percent with a maximum drawdown that was less than half.

Up to this point most of the discussion has been focused on the concept and merits of low volatility investing. On slide 24 let's shift the discussion to focus more specifically on the strategy I manage and what differentiates it from other low volatility strategies.

So as I mentioned at the top, I manage the Fidelity US Low Volatility Fund and it seeks to capitalize on all the merits of low volatility investing. The power of downside protection, good upside participation with strong downside protection, winning by not losing. But by doing so in an actively managed low volatility strategy. Now Fidelity is not the only firm that offers low volatility strategies. But we are unique in that we combine both fundamental assessments of risk-reward from our vast team of experienced industry-focused fundamental analysts with a statistical-based risk estimation to get a deep understanding of the risk of investing in every stock we consider for inclusion in the portfolio.

Most other strategies in the space rely solely on historical risk numbers, or on the statistical risk assessments, and thus they miss many of the insights our team of fundamental analysts can provide. While our competitors typically only require a favorable risk assessment from backward-looking statistical processes, any company we invest in has essentially gotten two favorable risk assessments, the risk-reward has to be viewed as favorable by both a fundamental analyst and our statistical process to make its way into our portfolio.

We think this approach combines one of Fidelity's great strengths, in-depth fundamental research, with disciplined portfolio construction and risk management techniques to manage an active equity portfolio. We believe that this strategy will continue to help investors participate in the strong capital appreciation of the US equity market over time while dampening the impact of the inevitable market downturns.

END OF AUDIO FILE

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. Although the fund's strategy is designed to identify stocks with lower volatility than the broader market, there is no guarantee that these techniques or the fund's low volatility strategy will be successful.

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Because of their narrow focus, sector funds tend to be more volatile than funds that diversify across many sectors and companies. Non-diversified sector funds may have additional volatility because they can invest a significant portion of assets in securities of a small number of individual issuers.

Diversification does not ensure a profit or guarantee against loss.

Stock markets, especially foreign markets, are volatile and can decline significantly in response to adverse issuer, political, regulatory, market, or economic developments.

Before investing in any mutual fund or exchange-traded fund, you should consider its investment objectives, risks, charges, and expenses. Contact Fidelity for a prospectus, offering circular, or, if available, a summary prospectus containing this information. Read it carefully.

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