TRANSCRIPT

There's an ETF for that

Presenters: Bobby Barnes, Denise Chisholm, Scott O'Reilly

Scott O'Reilly: Thank you everybody for joining us today. So in my role, I'm responsible for strategy and development, as well as the ongoing advocacy for Fidelity mutual funds and ETFs, and other types of investment vehicles. And in particular, have a focus on our index funds, sector funds, thematic strategies, as well as factor strategies. So some of those we'll be talking about today.

Denise Chisholm is the director of quantitative market strategy, in her role, she's using historical probability analysis to evaluate and do research on where we are in the markets, and also the implications of different market conditions to investment portfolios, and helping to think about for investment strategies, how certain building blocks can fit into that, and the impacts on those. So things like factors, and sectors, and themes, which we'll talk about today.

And then Bobby Barnes is the head of our quant index solutions team, which is a group that he and his team are developing indices that are basis for strategies that we're going to talk about today as well, that they go into the basis for some of the ETFs we'll discuss.

So with that, want to just touch on a little bit of the agenda. So we're going to talk first about what ETFs are, and some of the trends around them, as well as some of the benefits of exchange traded funds. And then we'll go into, given the topic today, our title of "There's an ETF For That," we're going to hit some of the different potential investor needs, and use cases, and how certain ETFs potentially may help meet those needs.

So, just to -- so ETFs, for those that aren't familiar, exchange traded funds is what ETF stands for. And these are pooled investment vehicles, not that dissimilar from a mutual fund, but that have some different features, which we'll talk about in a second. But the ETF market has been growing quite rapidly in recent years. And there's, you know, both in terms of the number of ETFs that are out there, so the number of funds where I think we're now over 2,500 different types of exchanged traded funds, as well as the assets that sit with, inside them. So at year end, we saw over $7 trillion of assets in ETFs that were listed here in the United States. On the right-hand side of the page, you'll see that in the year 2021, we saw again a record year for flows, or dollars going into ETFs, with over $900 billion in new dollars going into the ETF structure. And then you can see here in this chart that there's -- where the mix of those assets went in, with over -- about three quarters of those new dollars

going into equity strategies, about a quarter of those going into fixed income, a little bit actually coming out of commodity-oriented strategies last year, and then a few percentage going into other strategies, such as multi-asset approaches.

I'd also note that along with the growth that you're seeing here on this chart, the ETF market has evolved quite a bit over time. Initially, going back into the late 1990s, where you might have used ETFs to get exposure just to the U.S. equity market, it's really expanded from there to cover all the major asset classes that clients will be looking for, as well as many, many subsegments to the market. So if you're interested in U.S. stocks versus international stocks, or certain sectors, or certain investment strategies as well, some of which we'll talk about, you can likely get exposure. So again, aligning with the title, if there's a certain investment idea you have or a certain market exposure that you're looking for, there's likely an ETF for that.

So just before we go into some of the use cases or client needs that might exist, let me talk about ETFs and some of the, you know, what it is, and some of the benefits maybe in relation to a mutual fund. So, you know, like a mutual fund, exchange traded funds are portfolios of securities, and so you know, if you don't have the time or capacity to create your own portfolio of stocks, or

your own portfolio of bonds, you can invest in a comingled investment vehicle like an exchange traded fund that gives you instant diversification across many, many individual stocks and bonds. So it's an easy way to get exposure to the market, or to subsegments of the market.

Another benefit often attributed to ETFs is transparency. So many ETFs disclose their holdings on a daily basis. So you can see in that portfolio what the holdings are, and what the exposures are that you have within that fund that you own. Another is low cost. So many ETFs are passively managed, which means that they're seeking simply to track an index, they're not trying to outperform the market index that they're tracking to. And as a result, they have lower costs, they're not hiring research analysts and teams of investment professionals in order to try to find the best opportunities, but rather trying to provide you exposure to certain market opportunities. And so as a result, many ETFs, for that reason, as well as even some of the structural reasons that I won't go into as much detail, may have a slightly, a slight cost advantage relative to mutual funds.

But two of the biggest differences, I think, relative to mutual funds, is that exchange traded funds price intraday, they trade like stocks on an exchange, and then tax efficiency. So on the intraday trading, again, they trade like a

stock, so during normal trading hours in the U.S., if you wanted to put in a trade at 10:00 a.m., and put in a market order, you would get your trade for that ETF executed at what the next available price would be. Related -- versus a mutual fund, where all the trades are accumulated and then executed at the end of the day, typically 4:00 p.m. Eastern Time for mutual funds. So that's one difference is that they trade intraday, like a stock.

And then another is tax efficiency, and there's a couple different reasons why ETFs have some tax benefits. So one is that because they trade on an exchange, a lot of the activity, the cashflows going in and back and forth, are happening on the secondary market, and don't actually affect the underlying portfolio. So that bit that they're trading on an exchange in a way insulates the fund itself from some of that activity, and because then the fund doesn't need to sell securities to deliver cash out to investors that are redeeming, that helps to prevent realizing capital gains.

There's another benefit there as well, which is that ETFs trade what we call in kind. So when capital does go into or out of ETFs, many of them will transact in kind, meaning instead of having cash going out of the portfolio and having to sell securities in order to realize -- in order to raise that cash, you would

deliver securities out to a market participant who then can deliver the cash to the end client through their broker dealer. So there are some benefits from a tax efficiency standpoint as well.

So at a high level, that's what ETFs are, and some of the features of them. Again, I might just highlight that Fidelity offers a number of different types of ETFs. So I mentioned earlier that in the market, there's over 2,500 different ETFs out there, Fidelity has its own suite, and within that, we have U.S. exposures, U.S. stock exposures, I should say, so like blue chip growth strategies, or a small mid cap strategy. We have international, and emerging market exposures within the bond asset class. We have strategies that give exposure broadly to the bond market, as well as to certain subsegments like high-yield, or to low duration bond securities. We have sector ETFs, so they give you exposure to sectors like information technology, or healthcare. And then we have what we call outcome-oriented ETFs, and we're going to talk a bit more about some of these types, but that give you exposure to a certain strategy, like high dividends, or low volatility.

So, let's get into the meat of the discussion here. I think, you know, Bobby first, maybe we can kick it off with you. I think we wrote a thought leadership paper a few years ago that talked about different ways that you could use ETFs

and in particular some factor strategies, but I think this is also relevant for thematic portfolios. Could you touch a little bit upon that? And then I think maybe we also have some specific use cases we're going to fit into that high level framework.

Bobby Barnes: Thanks Scott, absolutely. So essentially there are three main uses cases for factors. And they are using factors for a strategic exposure, using factors for a cyclical exposure, and then finally, using factors for portfolio construction. And so just to quickly dive into each of those to expound on them further, using factors for a strategic exposure simply entails taking a buy and hold approach to factors. Now the reason that this works is because factors have been found to outperform over time, and thus a buy and hold investor will participate in those long-term benefits. And so if you look into that box there, you'll see two outcomes, as an example, that someone could use from a strategic standpoint. The first being an investor who's looking to use factors as a way of generating income. Another strategic use case would be for those investors who are looking to use factors as a way to get exposure to more growth opportunities.

Moving along, the next way to use factors, as I mentioned before, is cyclically, or tactically. Now, the reason that this works is because factors have been

found to have their own unique performance behaviors, depending on the type of market that we're in. And thus, you could use a factor to tilt a portfolio into that factor that's likely to do well, either in the type of economic environment that we're in right now, or where you think we might be headed, and so in that box, you see a topical example that's at the top of everyone's mind, which is inflation, and how that's going to impact their overall purchasing power.

And then finally you have the last use case, which is using factors for portfolio construction. And the analogy I always like to draw here is that this is similar to taking a vitamin. Now, if you're like me, you might not necessarily get enough of a particular vitamin as you should through the course of your daily diet. For me, that happens to be vitamin D. And so as a result, you take a multivitamin as a way of plugging that hole. Well, as it pertains to your portfolio, you can use factors in a similar way. Whereas you may have an existing portfolio, some combination of stocks or mutual funds, but that portfolio, in aggregate, could be say, deficient in some particular way. If that were the case, you could use factors as a way of plugging that hole, similar to my multivitamin example.

Scott O'Reilly: Thanks Bobby. So I think we're going to talk about a couple of these examples here. Some of which, and maybe we can talk through with both of

you, you may be able to use for both strategic purposes, or cyclical purposes, and also maybe portfolio construction purposes. I think the first one, Bobby, you mentioned, that's on the top of everybody's mind that we want to talk about, is inflation. And so Denise, hoping that maybe you can give us a little bit of your thoughts about what's been, what's led to the recent spike in inflation that we've seen, as well as some of the things that you're looking at, that you think may influence where we go from here with inflation.

Denise Chisholm: Yes, let's definitely talk about one of the biggest concerns in the market, which is inflation. You can see it on the left-hand chart, core inflation, going back to 1958, we are now in the top quartile of all of that history. This did not happen last cycle. In fact, I would say what happened this cycle is the counter opposite of the cycle after the Great Financial Crisis, where we really never saw animal spirits engage to the extent that we have this cycle, in terms of the labor market being tighter quicker, and generating wage growth, unlike the last cycle. That's at least a component to the inflation spike we've seen. Certainly there's supply dynamics at play, but I think in some ways, the supply dynamics are really a function of the fact that supply is unable to meet the demand that we didn't have coming out of the last two recessions.

So with that said, you know, it is one of the biggest concerns in the market, and the reason I say that it because I do think that you can actually measure if you're in the market. And the way you can measure it is by looking at valuation spreads. Quite simply, that's the difference between the top quartile in terms of valuations, on PE, or price to book, and the bottom quartile. And I say it's a measure of fear because during times of specific fear, you see investors sell everything they think is risky, buy everything they think is safe, the names change every cycle, but the spread remains the same. And you see that valuation gap, gap out. And what we've seen this cycle is that it's been sustained for the better part of the last two years, and of the 45 macroeconomic variables that I link it to on sort of a monthly basis, inflation is now number one, in terms of the six month correlation.

So the question is, what happens from here? I do think that the setup going into this year is the counter opposite of 2021. If 2021 was the sweet spot for inflation to accelerate, coming out of, you know, a pandemic, into an economic recovery, with wage growth accelerating, what we can see here is we can measure the differences, this going into 2022, and you know, as a function of being versus 2021.

What I find most intriguing about inflation is if you had to pick one macro factor to predict future inflation, it would be past inflation. Because it, more often than not, is actually self-limiting. So the higher inflation it is, the higher the likelihood, and in this case, 70 percent odds, that it decelerates into next year. That's not magic, that's actually the economic cycle happening under the covers. And one is what we've already seen, which is rising interest rates. As much as investors focus on the Fed, a lot of that work is done at the long end, 10-year Treasuries that are correlated to loans and mortgages that actually go up and sort of crimped demand over the last year.

We've seen a top quartile, top decile move, and that change in 10-year Treasuries, suggesting that inflation is likely to decelerate. But that's not the only headwind. It's actually the dollar has appreciated as well. We've gone from a situation where investors were concerned over the twin deficits, to investors were concerned, which they usually are, over which economy is going to grow faster, and who can provide the higher yield, which was the United States. So with higher yields in the United States, what you've seen is a dollar that is appreciating. That usually means that your imports are getting cheaper, which tends to dampen inflation in the year forward.

And I'll say finally, we have another headwind that is basically the most statistically significant of all the headwinds, which is our inventory levels. As much as they haven't kept pace with sales, you can look at it in terms of the ISN inventory diffusion index, you can actually go and Google that, what you'll see is inventories have inflected higher. And when they do that, it creates a very high probability that that inventory level will catch the sales growth you've seen, again, providing that dampening effect. So we may be in a situation where this big concern for the market is actually likely to decelerate into 2022. But, what's important for investors to struggle with is maybe not whether it's going to decelerate, as that does look likely from these levels, but what it's going to decelerate to, can impact what you want to own in your portfolio. And the reason why I think that it's very likely that we stay above historical average levels, like 3 percent, is because the biggest fundamental driver to inflation staying higher than those median levels has been corporate profits. We've seen one of the best corporate profit cycles in history, we surprised to the upside to the tune of 15 to 20 percent, typical recoveries see 3 to 6 percent, and it's been sustained. Earnings have been consistently too low, even as we come into this year that we're saying. So I think that the past profits that we've seen predict higher than average inflation.

So I think inflation, as much as it's likely to decelerate, is also likely here to stay. And that has massive implications of what works in your portfolio. Bobby's going to talk more about it, but I think in the data that I've shown, both in the QSU, and on my charts of the week in LinkedIn, it gives a bias towards those commodity sectors like energy, and does create a sustained headwind for sectors like technology.

Scott O'Reilly: Great, thanks Denise. Maybe Bobby, there's a good lead-in to you to, we have designed a strategy, an ETF, for that. So, could you speak to the construction of this, and some of the thought that went into how we designed it?

Bobby Barnes: Yes, absolutely. And that, you're right, that is the perfect tee-up. And so, you know, for anyone who's concerned about inflation, one way to address this is via the investments that he or she makes. And so one such solution is the stocks, the Fidelity Stocks For Inflation ETF, which is summarized here on this slide. And so in spirit, this ETF helps to provide a hedge against inflation by investing in those sectors and industries that do particularly well when inflation is rising. In broad strokes, those sectors and industries can be classified into one of three buckets. The first bucket being sectors that are classified as commodities. The second being sectors that can

be, or that have demonstrated pricing power. And then the final or third bucket is those sectors and industries that have, are classified as real assets and/or infrastructure. And so you can see each of those three buckets listed kind of in the middle of this slide, under the pillars.

And so if we examine the performance of each of these pillars over the last 50 years, as we've done on the left, you can see that each of these has provided a hedge against rising inflation. And so starting to the far left, the first two sets of bars, those are your commodity-related sectors, those being energy and materials. And so what you can see, as represented by the orange bars, is that when inflation is rising, each of these commodity-related sectors have outperformed the market, and thereby provided a hedge against inflation.

If we move to the middle, here's where you see that sectors like consumer staples and healthcare, they typically experience similar returns irrespective of whether or not inflation is rising or falling. Now this is because their profitability is not really affected when costs are rising, because they're able to pass along those increased costs along to the consumers of their goods and services. Hence, we use the word, or the phrase, pricing power, for describing these two sectors.

And then finally, to the far right, you see the real assets and infrastructure bucket. And as you can see here, it has a similar performance profile to the commodities, where you know, these industries outperform when inflation is rising, and then vice versa when inflation is falling.

So putting all of this together, by design, the Fidelity Stocks For Inflation ETF utilizes these insights and overweights each of these five sectors and industries versus -- by 5 percent versus the broader market, while underweighting everything else. And so in doing so, this helps to provide investors with a solution to preserving purchasing power during periods of rising inflation.

Scott O'Reilly: And I think Bobby, we've seen in this period of a spike this strategy has held up quite well, relative to the broader market. I don't know if there's anything more you want to say about that, but --

Bobby Barnes: Yeah, that is correct! You know, while it's only, you know, one year, but as Denise showed a few slides before, the CPI came in, in 2021, at 7 percent, which is the highest level since the early '80s. And so, by design, and in that sort of environment, you would expect things like energy and materials and the like to do very well, and that's exactly what we saw. And so as a result,

this particular solution, given that it's designed for that very moment, it did outperform the broader market as expected.

Scott O'Reilly: Great. Thanks. So another outcome, or use case we wanted to talk about, was dividend strategies, or investors that might be looking for income. And this is one where I think there is, there's both potential strategic, as well as cyclical considerations. And Denise, I know that you've got some thoughts on it from a, you know, a current market opportunity perspective. Do you want to speak a little bit to that?

Denise Chisholm: Yeah, it's certainly an overlap of, I think, strategic and cyclical, in this case. And that gives a good illustration of it. Strategic certainly, investors, you know, as much as we want to complicate the market, investors really want to do only three things. One, beat the S&P, I call that total return. Generate income, which we're going to talk about now. Or protect your downside, or preserve your capital, which we're going to talk about later. But that is a strategic objective, in this case though, I actually think it's quite, you know, I'm going to use Bobby's word, tactical, or cyclical, as well. So first, and I didn't have any charts on this, but you can see the dividend yielding stocks, which provide income, to equity market investors, actually do quite well during times of higher inflation. They also tend to do quite well in times of lower inflation.

So it's sort of almost like a barbell approach where you know that high yielding stocks can sometimes keep pace with inflation, because they provide you additional income, and then when income is very -- or when yield is very scarce, they also tend to do well.

So we're certainly in the earlier part of that cycle, in terms of inflation being a boost, but I actually think that there is something more important than inflation from an odds perspective, and that's the relative valuation of these stocks that also provide income. So the chart on the left simply shows you the relative valuations of high dividend yielding stocks versus low dividend yielding stocks, but it could be versus the broader market, and higher in this case is cheaper, so it's a yield differential, so just to confuse you. And what you'll see is that we haven't been this cheap in quite some time, basically obviously, during the pandemic. And two is, you know, since the bubble. So there's certainly, and this is the way the market becomes a discounting mechanism.

So if you're worried about sort of high-yielding stocks cutting their dividend, a lot of that might be already priced into the market. And the reason for that is there's always an inherent risk with that top quartile of stocks, but you can see on the right, what you see is the cheaper they are, the more likely they are to outperform, and the more they outperform by. That tells me that valuation

matters, in some cases, more than even the macroeconomic backdrop, like inflation, and the risk/reward not only is that you generate income, but that you generate income and with these stocks, beat the market as well.

The final thing that you should know as an investor in this sort of segment of the market is it is correlated, historically and right now, to cyclicality. So these are economically sensitive sectors, occasionally in aggregates, especially in like, financials and other sectors like that. So there is some economic sensitivity to this quartile of yield, and we can talk about the risks from a business cycle perspective and recession for this sort of top quartile, because where you do see a significant amount of performance, which is sort of my base case, is outside recessions.

So to sum it up, as much as we want to be strategic about income, and I think that they are good buy and hold strategies, from a cyclical or tactical perspective, I think dividend yielding stocks make a lot of sense from a risk/reward right now in your portfolio.

Scott O'Reilly: Great, thanks Denise. And so Bobby, we do have a couple of ETFs for that. Two different strategies that we launched a number of years back that you were instrumental in helping to design. Maybe could you talk about, you

know, maybe expand a little bit upon the strategic piece of it too that Denise was talking about, but then also talk about the two ETFs that we've designed for high dividends.

Bobby Barnes: Sure, absolutely. And you know, Denise laid out very -- several very salient points for, you know, why dividends are attractive right now. But however, there's -- I would submit that there's also a secular trend that makes dividend investing worth considering. And that trend is that we are in an environment today where there are more people retiring ever-- today than ever before. And so historically those people have looked at fixed income as a source of income in retirement. However, that being said, as shown by the orange line on this chart, fixed income interest rates have been declining, and are near record lows. And so they're not necessarily providing the income opportunities in retirement that they historically have. And so given this backdrop, investing in dividend equities is a way to find more income in this low yielding environment. Fortunately, as Scott alluded to, we have, Fidelity has two dividend ETFs that help to provide such a solution.

The first is the Fidelity High Dividend Index, as shown in the green line at the very top. And there you can see that its yield is well above that of Treasuries. And then similarly we've got the Fidelity Dividend For Rising Rates, which is

the dashed green line just below that. And so combined, each of these offer income opportunities that are compelling versus Treasuries. Furthermore, in addition to offering more compelling yields, they also provide shareholders with the potential for capital appreciation, as well.

Scott O'Reilly: Great, thank you Bobby. Do you want to speak a little bit about the differences between the two strategies here?

Bobby Barnes: Yes. So these are pretty differentiated solutions that we launched six years ago. The high dividend ETF, it really focuses on the high dividend objective only. So it's trying to maximize the amount of income or yield that you're going to generate from equities. And it will take some sector tilts as a way of getting there, but in a controlled way, especially when compared to other competing offerings. The Fidelity Dividend for Rising Rates is quite unique in that in addition to having that high dividend objective, it also has the objective of putting you into stocks that are likely to do well in a rising rate environment. And that's important because all things being equal, if you just bought high dividend yielding stocks, you know, they do trade like bond proxies. And so if you don't control for that in portfolio construction, you will have a headwind to performance in an environment where rates are rising. And so you can see that by having that dual objective of both high dividends,

while preserving your purchasing power in a rising rate environment, you do sacrifice some yield, but the benefit on the other side of that is that you protect more purchasing power in a rising rate environment.

Scott O'Reilly: Great, thanks Bobby. So one of the other market trends, or environment considerations folks have been asking questions about is market volatility. So over the -- this is, this chart here shows the CBOE VIX index, which is a measure of market volatility, and you can see that the green line is that VIX index measuring market vol, and then the orange line is the average over this five-year time period. And you can see that for the years from 2017 through roughly the end of 2019, market volatility was relatively low, and then COVID occurred, we had election uncertainty, multiple rounds of new COVID news, that's led to spikes in market vol over the last couple of years. And so, amidst that, we thought that investors might be interested in learning more about strategies that have low volatility tilts. And so again here, Denise, maybe you can speak a little bit to some of the dynamics we see with low volatility securities, and maybe you can kick us off, and Bobby, I know you have thoughts on this too, that maybe you can chime in, as well.

Denise Chisholm: Yeah, and I see your VIX chart wasn't updated. Yeah, I think the intraday high yesterday on the VIX was close to 40, so we're back in the thick

of volatility, literally as we speak, and we're always happy to take questions on that in Q&A. So if you think about volatility and you sort of segment the market into the least volatile stocks, or the bottom quartile, and the most volatile stocks, what we're talking about is the least volatile stocks. They move the least on a month to month basis. And what you can see is the performance of that on the left-hand chart, annually, the average is 2 percent. Right? So let's just say that they hang in. They're sort of market performers. If we looked at it over the last five years, they would underperform. The prior five, you would have said they outperform. Let's just say that they hang in.

But I think that the real rationale to own low vol stocks is the chart on the right. When the market fluctuates, the market fluctuates in most of the years, what these group of -- what this basket of stocks really provides you is less fluctuation, or less volatility. So during all periods, you can see sort of the green bars, they provide about -- the difference in those numbers is about 20 percent. But especially during times of high volatility, the dark blue bars, 30 percent less volatility. So to the extent that you're getting closer in time to needing your capital, that normal volatility and in this case elevated volatility of what I say is equities just being equities, need to -- you sort of need to see less volatility. So this is a way to gain equity market investment, but with less bumpy ride, or less bumpy returns.

So if you go to the next page, you can sort of see the highlights in terms of the peak losses and the peak gains. Now remember, this is a basket of equities, they do fluctuate, they just fluctuate less than the overall market. So if you look back from 1990, the peak loss, this is monthly information, for the S&P 500 was during the financial crisis, it was almost a 50 percent loss. But that group, or that basket of low vol stocks, at that same time, had only lost about 30 percent. But that's still a big loss, but it's substantially less, especially if you're willing to sort of hold it for the longer term, which you think if I'm willing to be a long-term investor here, I know that it broadly, throughout cycles, will likely keep up with the market.

Now you should also know that you give up some gains for that over time, too. So if the market is in a strong environment, you might not have as big gains. So if you looked at the biggest rally over any, you know, 12-month period since 1990, in coming out of the Great Financial Crisis, 61 percent, almost 62 percent, but these low vol stocks don't quite keep pace, not a bad return itself at 45, but a big lag in that relative performance. So I think as an investor, you need to understand your objective, your objective is not total return to beat the market in all frameworks, but if you're a long-term investor and you're

willing to concede that these stocks keep up, it could offer you a solution to that bumpy ride that is very much the equity market these days.

Scott O'Reilly: Great, thank you. Bobby, anything that you'd like to add?

Bobby Barnes: Yeah, I mean one of the things I've often shared with clients, and my thoughts on low vol, is that in a lot of ways, it saves you from yourself. And you know, yesterday's market was a great example of that, where I think their -- behaviorally, we're all humans and we're wired to sell at the bottom. And so one of the ways that you help mitigate that effect is to allocate to a low vol strategy so that you're not down as much in the first place, and hence you've kind of protected you from yourself, and that inclination to want to sell at the bottom. As Denise said, you're ensuring a less bumpy ride for your investment portfolio.

Scott O'Reilly: Great. And then another example we have here is maybe how you could use it from a portfolio construction perspective. So earlier, you were talking about, I liked the vitamin example, I may have too many vitamins, I don't know how we remove that from the diet. But could you speak a little bit to this example that you came up with, talking about portfolio construction, how you can combine low vol with other strategies?

Bobby Barnes: Yes, that's right. And I'll say it at the outset, is that this is kind of in that same vein or spirit of thinking where you're, you know, trying to ensure a smoother ride for your investment portfolio. And so, in this particular example, what we have here is an investor may hold a specific mutual fund, because they like that manager's stock picking skill. But that fund may have an unintended bias associated with that, and in this case it could be the fund, while it outperforms the market, it is also more volatile than the broader market. And so as you see here, by adding a factor strategy to offset that bias, and so in this case we would just combine -- here we're combining a low vol factor ETF, naively 50/50 with this particular portfolio manager, what you can see is that we're -- that combination is able to take advantage of that portfolio manager's strong stock picking skill, while counterbalancing the other risks. And so just to kind of orient you and walk you through the data that's here, you see the -- we're showing the risk, the annualized risk and return, return in green, risk in blue, for this growth manager, to the far left, the overall market in the middle, and then the growth manager combined with the low vol to the far right. And so what you can observe here then is if you focus on the far right, that combination still outperforms the broader market, as shown in green, over this decade. But it does so while generating lower volatility. And this is to say

that the returns are stronger and more consistent over time. And so that makes for a great shareholder experience and outcome.

Scott O'Reilly: So you're showing a blend of two different strategies, one high growth strategy with higher return, but also higher risk, and then a lower volatility strategy with solid return, but lower vol, and then, you know, the outcome being a pretty attractive blend from a risk/return standpoint.

Bobby Barnes: Right.

Scott O'Reilly: Great. So we talked about inflation, income, and lower volatility. One other thing that clients are often interested in is where is the growth opportunities? So I know Denise, you know, you have some changing perspectives recently about growth in the technology sector, but could you speak a little bit to some of the dynamics there, and then, you know, how you're thinking about where else there might be growth opportunities in the market?

Denise Chisholm: Yeah, certainly growth and technology have been synonymous for I would say the better part of a decade. And it's true, when you think about the tailwinds that I identified there, positive fundamentals have been

consistent, especially since the bottom of their fundamentals, from a profitability perspective in the year 2000, right? We are at the best EBITDA margins, or profitability, that this sector has seen. So there is no sort of problem with fundamentals in the technology sector, but we've already identified one of the headwinds, and you can see it in FCPI, the ETF that Bobby highlighted, in terms of inflation. You do see around inflationary times, if you're like me, and willing to expect, you know, decelerating, but stickier inflation relative to the last cycle, technology doesn't seem to do as well as sectors like energy, specifically our commodity-based sectors. You know, you really have only 33 percent odds, which are not zero, but versus the 70 percent odds that you've seen historically when inflation is much lower than average, lower than 3 percent.

So that's really headwind number one. But that's not the only headwind. The headwind that you see on the chart on the left is valuation. Now there have certainly been investors that talked about technology being expensive for years, and that usually tended to be on a different valuation metric, like price to book. And I think that to some extent, that that doesn't get to the fact that fundamentals have improved, cycle to cycle. So earnings were higher cycle to cycle, so the stocks, despite being very expensive on asset-based measures, were still very cheap on earnings and free cashflow-based measures, which

have been more predictive to the market. So what you saw going into the pandemic was that little blip actually got down to bottom quartile levels, so technology, as much as it was leadership coming into the pandemic, actually got cheaper during a recession, because it outearned the S&P 500 so quickly. Well fast forward to today, we're not only out of the bottom quartile, we're into the top quartile of history.

And that's headwind number one, this has been a predictive factor since 1977. And you'll see on average underperformance after you get to that top quartile. What's important for investors to understand is we haven't been here since 2005. So this has been a long run of technology very correlated to technology being cheap. So valuation is really headwind number two. Headwind number three is really the decelerating fundamentals that we're likely to see. Again, going back to the pandemic, what you had was a very unique situation for technology to be very good leadership. It was bottom quartile in terms of earnings, valuations, and you knew with pretty strong probabilities the profitability was going to get better in an economic recovery, if you were willing to bet on that.

Well fast forward to today, that's largely played out. So even margins or profitability have expanded back to their top decile levels that you've seen in

history, the next move from here is not a downtick in profitability, but it's a deceleration that often correlates to underperformance. That's headwind number three. Headwind number four is let's at least acknowledge the cyclicality of technology cycle to cycle. Look, technology was certainly defense this cycle, in the sense that it outperformed during a recession. But really, when you think about technology, you get really strong odds at the bottom of leading economic indicators, or at the bottom of expected growth, and that's sort of when you want to own it. And then you get less favorable odds after you've seen those leading economic indicators recover to the extent that we have. Well where we are in the economic cycle is more like peak recovery, which again diminishes the odds to technology going forward. None of this is to say that it has to be the worst sector in the market, but all of the sudden, you have to acknowledge the data has shifted from technology being secular leadership, to a headwind in the market, which means that if you're a growth investor, you might have to look elsewhere to get that growth in your portfolio.

Scott O'Reilly: And so one of the things that we've thought about, in terms of ways to get exposure to growth, outside of, you know, what's been synonymous with growth in recent years, has been through themes. And I know Denise, you do a lot of thinking about how themes can fit into a portfolio, so maybe you can speak to that as well as potentially these themes, and Bobby, you

know, maybe you can add in a little bit too, as your teams help to design the indexes behind these thematic strategies.

Denise Chisholm: Yeah I'll go quickly first. I mean I think in some ways, the way to think about themes as it relates to sectors specifically is that they're likely to be the next sectors, or the sectors of the future. So it's getting in early to what will likely be a big aggregate of stocks. I think that the differences, versus sectors or factors, is more likely a time horizon perspective. When I think about that from a critical mass perspective, thematic investing, or themes, tend to be longer term horizon in terms of those growth outcomes, and may have more variability than sectors or factors, at least early on. So in some ways, when I think about thematic investing as the plug to the growth section of your portfolio, it's almost as a set it and forget it type plug, as the growth portfolio, but you need to understand that it may vary more than an aggregate sector that's very, very diversified.

Scott O'Reilly: Yeah, and here you've got a couple of themes, while there are some, there is some technology exposure underlying these, there's also a lot of exposure in both of these to other subsegments of the market. So clean energy, there's been a lot of interest in that area, given government actions

and broader trends towards a cleaner environment. But this also includes companies in the utilities sector, industrial sector, and other groups.

And on the electric vehicles, and transportation, that does include some technology, as things like semiconductors make up a big part of the input to the new technologies for transportation, but the auto manufacturers are in the consumer discretionary sector, you have parts and equipment makers that are in the industrial sector. So you're seeing growth in other subsegments beyond technology that are driven by these longer term trends.

Bobby, anything that you'd want to add, just about how we're designing these, or your thoughts on these themes?

Bobby Barnes: Yeah, I mean the two of you captured it, a lot of the key points. You know, the -- I think, you know, I would just reiterate that, you know, as Denise said, and you said as well, that technology used to be analogous with growth. But there are a number of headwinds today, but that being said, you know, there are still opportunities for growth, but you have to go about finding them in a different way. And so, you know, the thematics which cut across sectors allow investors to get opportunities for growth.

And so when you look at these two particular themes, clean energy on the left, electric vehicles and future transportation on the right, what you can observe from these charts is that the commonality between the two is that they're both expressions of older technologies that are being disrupted and having market share taken away by newer emerging technologies. And so on the left, you see that with the bar charts that basically show, the decomposition of the U.S. energy mix, between renewables and then the legacy energy providers. And so the renewables, which is shown in green, is expected to grow up to be 50 percent of the overall mix, as we forecast into the future.

In a similar vein, if you look on the right, and just focus on two lines. One being the gray line, which is the cost of an electric vehicle, and the blue line, which is just the cost of an internal combustion engine, or gasoline engine. And what you can observe from those two lines is that as it stands today, an electric vehicle costs $10,000 more than an electric vehicle does. But just like we did with clean energy, if we project these trends out into the future, what you can see is that relationship is actually going to flip. And so in -- at some point in the near future, the cost of an electric vehicle is going to be $10,000 less than that of a gasoline engine. And so as a result of that dynamic, you can expect the market share to continue to shift from gas to electric, and in doing

so, this will, you know, this ETF will expose investors to the potential growth opportunities that are associated with that shift in market share.

Scott O'Reilly: Great, thanks Bobby. So to wrap up, maybe before we get to question and answer period, I just wanted to summarize. So we've talked about some of the different merits of ETFs, the growth in the ETF market segment and some different end use cases of ETFs, and in particular we talked about how you could use ETFs for both strategic, cyclical, and portfolio construction purposes, and then within that more specific use cases, like trying to protect against inflation, looking to generate income, which could be either in a low interest rate environment, and you're thinking more strategically as you near retirement, or potentially you're thinking about dividend strategies, because valuations look attractive. Low volatility, we talked about how you could utilize this, either because you're concerned about market volatility and current conditions, or perhaps you just want to have a more steady, less bumpy ride over time.

And then lastly, we just talked about growth opportunities, and how you can think about using themes like electric vehicles, and future transportation, and clean energy, to get exposure to some of the growth trends in the market, and how that differs perhaps from sector exposures.

And so, I also just want to put in a quick plug that the ETFs that we're speaking to here are also pretty competitive from an expense ratio standpoint. So the four on the left-hand side, starting from left to right, the four on the left side of the page are all priced at 29 basis points, or 0.29 percent, and then the two on the right-hand side of the page, the two thematic strategies, FTRV and FRNW, are priced at 39 basis points, or 0.39 percent. And those are a global mandate, so they have slightly higher expense ratios.

So to learn more about ETFs generally, whether it's these or other Fidelity ETFs, or other ETFs in general, you could go to Fidelity.com/ETFs, or from the main navigation page on Fidelity.com, you could go to the investment products bar, and then from that, ETFs, and from there you can learn a lot more about both these, as well as other exchange traded funds that Fidelity makes available.

END OF AUDIO FILE

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