TRANSCRIPT

Trading basics part 1: What to trade

Presenters: Nicholas Delisse and Matt Davison

Nicholas Delisse: Hello everyone, my name is Nicholas Delisse. I'm with Fidelity's Trading Strategy Desk, and of course we're joined today by Matt Davison, also with Fidelity's Trading Strategy Desk. We're a group of trading coaches here at Fidelity, teaching everything from options to technical analysis to of course, our trading platform and our different tools. Today, of course, it's going to be a basics class where we're talking about our "how to trade" series. This is our four-week long classroom series. Today is going to be part one of that particular series. With that, if you're interested in learning more about other things that we do, you can take a look at our group coaching sessions at Fidelity.com/Coaching. You can also sign up for a four-week long classroom sessions at Fidelity.com/Classrooms. Those have all of our live sessions. With that, of course, our four-week classroom, our four-part series on trading basics starts off with this first session, of course, we're going to be talking about what to trade. The second session is going to be on research and analysis. The third session is going to be on how to actually place those trades and get that taken care of. And of course we're going to wrap up with the fourth session on managing risk once you've actually placed that particular trade. Now, we're going to break up this first part on the, you know, how to trade with talking

about the importance of creating a trading plan. It's actually one of the biggest mistakes that Matt and I and the others on the Trading Strategy Desk will see people make is they'll begin to trade without having a trading plan. Next, we're going to talk about some of the different investment types that many of you in the audience might already be familiar with, maybe not, but we're going to explain some of those differences for everyone. We're going to address some portfolio management. This is going to be the bigger picture, higher finance, talking about things like asset allocation and splits between different types of investments. To be able to do that, it's going to be important that we understand, you know, what it means to be a specific style or specific sector and we're going to introduce those concepts near the end of the session and wrap everything up, of course, with the importance of position sizing. That's a very, very important, of course, risk metric from that particular perspective. Now, that said, let's go ahead and get started and talk about risk management and the importance of trading plans. Matt, why don't you step everyone through these guiding principles that we have?

Matt Davison: Yeah, absolutely. And you know, the first few that we're going to talk about today, obviously risk management, trading discipline, these are going to be keys and guiding principles to any kind of trading strategy. So I think the natural place to start, right, is risk management, talking about, you know, the

considerations between making money, potential profit, and what is actually being risked. I think as a human, it's a natural tendency to go in there thinking about the winning side of the trade, you know, how much do I stand to make? You know, how much am I going to like the fact that I'm winning on my trade and adding money, hopefully, to my portfolio? But really this should be a secondary consideration and what we really need to think about first is the amount of risk that we're willing to take in order to put on our position, our particular strategy. So that's the first thing that we need to be thinking about, is how much are we actually willing to risk, potentially lose? Because anybody that's traded for any considerable amount of time knows you're not going to be profitable on every single trade. So how do we start doing that? Well, we need to be thinking about what does a trade going against us look like? Maybe that's a dollar amount. Maybe it's a per-share amount. Maybe it's a particular percentage. But when we start focusing and shifting our focus to managing the trade rather than, well, how much we're going to make or how much we thought we were going to make at the beginning of the trade, it can allow us to make better decisions in our trading strategy and hopefully that'll lead, over time, to us being a more successful trader. So one of the first things that, you know, we always try to analyze here is well, what do we think is going to happen with the particular security? And that's very important. You must have an outlook. If you don't have an outlook initially before entering the

trade, that's a mistake by itself. But once you enter the trade, you need to always be reevaluating and analyzing that outlook to see: is it changed? Is the chart telling me something different than what I initially thought? Maybe you're you know, more of a fundamental-based trader and we're going to talk about that more in week two, here, but whatever it may be, if something has changed, we need to consider, well, do I also need to make a change? And those are some of the beginnings of risk management as a principle. The second part of this is trading discipline. So when you go into a trade, you know, it's very easy to say, "Okay, I'm going to enter here and if this happens on the winning side, that's where I'm going to exit. If this happens on the losing side, that's where I'm going to exit." But sometimes when you're actually in that trade, and I can speak from first-hand experience on this, it's difficult to actually take that step and actually execute the plan. So how do we do this? Well the first thing that we might want to do is reduce the emotional attachment. And first of all, that comes with clearly defining what our entry and exit criteria are going to be. If we haven't done that, we need to stop and we need to do that. That's the very first piece of advice that I give to any beginning trader, is you need to have a clear and defined entry, exit strategy. What this helps us do is take some of the emotions at the time of actually executing the strategy out of the equation and hopefully that'll lead us to be more disciplined. The second thing is kind of linked to the third, and that's

trying not to think in only terms of gains or losses, more importantly, trading what's actually occurring, what you're seeing. Whether that be through technical analysis on the chart or through fundamental analysis, if that's your preferred method for making decisions, but actually going in there and not just, you know, saying, "Okay, well I really expected to make, you know, this percentage, or this dollar amount." It's not happening and conditions may be starting to change, therefore we need to take some kind of steps to evaluate that and make a decision. Maybe it's staying in the position. Maybe it's reducing the position size. Maybe it's getting out of it altogether. Either way, it needs to be constantly reevaluated and analyzed, hopefully from a clear perspective without bias from what our initial prediction was going to be. So that kind of takes us into our next slide here, where we're going to talk just a little bit more about having a plan. So before placing the trade, you need to be able to answer several questions. So the first and foremost question: why are we entering into the position? What is the criteria? There should be a specific reason. Maybe it's a fundamental reason. Maybe it's a technical reason. Either way, we need to have a clear explanation for why we believe this is the right choice and why we're entering into said position. If we don't have that, what that means is that we don't have an outlook. Without an outlook, we can't be a successful trader. Second question we need to ask ourselves: how much capital am I willing to allocate to any one idea? So

another common mistake that we run into, it's one that I was guilty of making before I started in my career as a broker, you know, allocating too much to a specific idea and not giving myself, you know, diversification, or at the very least, the ability to be incorrect. So the problem is if we allocate too much to any one idea, and that trade goes significantly against us and we didn't have a strong exit strategy, we could look at devastating results in our account. Maybe this could set us back, you know, months, years, even. So how do we avoid this? Well, think about how much we are actually willing to allocate and maybe that's a percentage of our portfolio, again, maybe it's a dollar amount. It can be a couple of different ways of looking at it. We need to have a clear and defined plan for how much we're going to allocate to one idea. Third one, what is the criteria for entry, specifically at what price? This is generally speaking, where technical analysis is potentially going to help us a little bit more than fundamental. There's certainly arguments to be made on the fundamental side. But again, this goes back to that first idea of why are we even entering into the position? So if we have a clear entry price, what this should be telling us is okay, I have this idea for why I'm entering into the stock. If my idea is invalidated for any reason, what am I going to do about it? Am I going to make a decision? Am I going to exit my position, reduce it, or am I going to let it continue to run, hopefully with the idea that it's going to turn around. None of those decisions are inherently wrong. But what we need to

make sure that we have is a plan for what we're going to do if our entry criteria is invalidated for any reason. And this goes right into the fourth and final point for this slide: what is the criteria for exiting position, both on the winning and losing side of the trade? I talk to a lot of people about trading. Almost everybody can explain what they're looking to get out of it from a winning perspective. And that's natural, I do the same thing, you know, as a tendency. I want to think about well, the reason I'm in the trade is I'm looking to make money. And I want it to you know, be this dollar amount, or this percentage amount. But very rarely do I talk to people that have a clear and defined strategy for what they're going to do if they're wrong on the trade and it's going to happen. Anybody that trades consistently is going to have losing trades. The best traders are the ones that can mitigate those losses. They have a risk management strategy in mind before they even entered the trade, and if it gets there, they actually execute it. That's sometimes the hardest part, is not just having the plan, but going through it, staying disciplined in executing the trade. However, if we don't even have that clearly defined before entering into the trade, it's impossible to execute because we don't even know what it is. So we need to have all four of these things. It should be considered before we even enter into any positions and something that we need to think about at all times while in the trade as well. That said, Nick, I'll let you take back over here. Give us any thoughts on any of those last two

slides and take us to the next.

Nicholas Delisse: Absolutely. A little bit of an anecdote on having a plan and really regarding position size, is you know, if you're having a hard time sleeping at night because you're just worried about the market, likely, your position might be too big. You might want to cut back your position size. And having a trading plan can take some of that worry away that if things don't pan out correctly, if a situation occurs that the market just drops very quickly, well, you already have a plan in place. You know exactly what to do. You don't have to panic. You can just look at your trading plan, your trading plan says, "Well, when A happens, do B. When C happens, do D." You know, regardless of whether that's managing risk on the downside or on the upside, you know, whatever happens, you're prepared for. And that can lift a burden off of your shoulders. Now, we've been talking about risk management and the importance of having a particular trading plan. Something we need to address, we need to talk about is different things you might be invested in. We talked about investments, well, let's address what you might actually be trading. So the first two things, and kind of split up between you know, stocks and bonds, and of course, exchange-traded funds and mutual funds. What a stock is you know, when you're purchasing a stock, is you're actually purchasing a slice of ownership in the company. Now, a company might issue

a million shares of stock and if you purchase one share, you own one millionth of the company. Now, in actuality, you know, maybe companies might actually issue somewhere in the billions of range of shares versus just millions. But either way, whatever you purchase is a small slice of ownership in that particular company. Now, why might you choose to purchase a company? Why might you want a slice of ownership in that company? Well, for its future profit potential. Because if you're an owner in the company and a company makes money, what does that company eventually do? Well, it takes those profits and it distributes them to owners. Typically this is done in the form of dividends, but this might also be in the form of share buybacks or other mechanisms. But in essence, you're purchasing a slice of the company in exchange for wanting to participate in its future profit potential. Now, if you have a company that -- it's future doesn't look very bright, maybe it was one of those really highfliers but in today's market, it just doesn't apply. Some companies that come to mind are you know, think of RadioShack or think of Blockbuster, that in their time, were behemoths, but they just don't have a place in today's society. And as such, they're no longer trading. Well, since a slice of ownership is representing that future profit potential, well, if they're not expected to make any money in the future, well, the worth of that slice of ownership is reduced. Now, if you have a company that well, maybe they're not making any money right now, but they're expected to make a lot of money

in the future, the value of that future potential could be greater. But the big thing is to remember that when you're purchasing a stock, you're purchasing that potential. You're purchasing that slice of ownership so you can participate in their potential profits if they do have any in the future. Now, a bond, on the other hand -- a bond is a debt obligation that a company has issued. Now, a company might issue bonds for you know, different things. Maybe you want to build a new factory, a new facility. They might issue bonds to raise money to then have that capital to then build that particular facility. One of the big things, though, is if something happens to a company, typically the bond holders get their money back first. And then, the stockholders get whatever is leftover. Another way to think of a bond is many of us might actually be bond issuers after a fashion. Think about if you buy a house, are you going to typically pay all cash for a house or might you borrow money from a bank, like a mortgage, to help you purchase that house? Many of us, that's exactly what we're going to do. And in fact, we're issuing a bond, so to speak, that the bank isn't purchasing. You know, the bank is lending us that money in exchange for interest so that we can then purchase the asset. This is something very, very similar that companies are going to do. Now, with that, if you have a house that is worth, you know, $100,000, maybe you might take a mortgage and have $80,000 be what you're borrowing from the bank. That other $20,000 is that equity. And if the house, of course, grows in value, the

equity grows in value. That's kind of what that stockholder is going to get, is that extra bit over and above that bond issuance. But the big, big, big thing to remember is this difference here, is that a bond, you know, if you're purchasing a bond, you're giving the company money in exchange for interest. You're going to get the interest on that money. You're going to eventually get your principle back, but that's it. If the company takes off, you don't get any more other than that work. With the stock, if a company takes off and is the next big thing, that could potentially grow a lot more, but it has the risk of well, if it doesn't, the bond holder is what gets paid first. So these are the two big, big, big asset classes. It's why I wanted to talk about them first and spent a little bit more time on them. The next two things here, exchange-traded funds and mutual funds are groups of securities. So with this, kind of the difference between them is you know, both of them are going to be a pool of funds that is an investment. And maybe these pool of funds is going to purchase stock. Maybe it's going to purchase bonds. But as such, kind of talking about the difference between them is you know, typically, exchange-traded funds track an index. So what an exchange-traded fund might do is it might seek to track the S&P 500 Index. Well, how is it going to do that? Well, it's going to purchase a basket of securities in the exact proportion needed so that the value of those securities goes up and goes down in relation to the index. And then what it's going to do is going to issue shares against that basket of

securities. Now, these shares can then be traded throughout the day, just like a stock. You know, if you decide that you don't want to hold the shares anymore, you don't want to be long the market, you know, right before the Fed Reserve makes their announcement on a Wednesday, so to speak, well you can go in at noon and you can sell everything. Or you can go in at 11:58 or 9:35, anytime during the day when the market's open, you can sell your shares in ETF at any time. Now, the mutual fund, on the other hand, they're redeemed from the issuer. So as such, you know, they're typically only traded once per day at that 4:00 closing time frame. So with this, you know, they're both this pool of money, but the mutual fund then what it's going to do, it's going to invest according to a specific goal. It typically has a professional manager, an active manager that you're then paying a little bit more to so that they can invest towards that goal. Now, maybe that goal could be to invest in technology stocks. Could be to invest in large capitalization securities. Or a mix between stocks and bonds. A mutual fund could even be indexed as well, where it's goal is stated as to track a particular index. That is okay, but generally, in the past, a mutual fund has been actively managed, invested by a professional manager or an exchange-traded fund has been passively managed and is in essence, managed by a computer to track a index. Now because of that mechanism or an exchange-trade fund, you know, has this basket of securities it shares within issue, well, the value of those shares, what

they're trading on the open market, could be different from the basket of securities they're issued against. They may be trading at a significant premium or discount that price, of course, is set by the market. You know, they're trading on that intraday value. Now, real quick, you know, we do have a chart that kind of addresses some of these different things. Of course, stocks, ETFs, trade continuously throughout the day, where mutual funds, you know, it's kind of one of the old school natures, they're only trading once per day if the market starts to turn south in the morning, well, you've got to wait until that 4:00 closing price before you can get out. Now, frequently, the trade-off has been that mutual funds, if you just wanted to purchase or sell $100 of it, well, you could. Where stocks and ETFs, you had to trade in whole share amounts. Now, Fidelity and many other brokers do offer fractional share trading so that you can simply purchase $100 of a stock or $100 of an ETF or sell that particular amount on that fractional basis and so some of these lines are getting a little bit blurred on the advantages or disadvantages of each type of security. Now, mutual funds have an expense ratio. This is what the fund manager is charging in order to manage the fund. Now, historically, mutual funds have been more expensive than exchange-traded funds because of that active management. But if you have a passively managed mutual fund that is also indexed to a market like the S&P 500, like the NASDAQ, like the Russell, you know, those have traditionally had much, much lower costs are cost

competitive with an exchange-traded fund. Mutual funds, you know, typically they're -- you just have those expenses where stocks, you've historically had to pay a commission. Now, Fidelity and many other brokers no longer charge commissions on stocks or exchange-traded products you're trading. And so that cost has kind of evaporated. Exchange-traded funds still do also have that fund expense ratio, but as I mentioned before, that tends to be much, much lower for indexed funds, for passively managed funds like exchange-traded funds normally are as compared to actively managed funds like mutual funds. That said, there are actually some exchange-traded funds now that are actively managed and do therefore carry a much higher expense ratio, more like a mutual fund. As I mentioned earlier, there are also mutual funds that are passively managed and carry much lower expense ratios, more like that historical exchange-traded fund typically is known for. From a tax perspective, both stocks and ETFs capital gains are typically only realized when you sell the shares. They might also have dividends that are paid out on you know, potentially a quarterly basis for stocks or however it might be, however they've announced for the company or for the exchange-traded product. Mutual funds, though, they might have capital gain distributions and so there might be less flexibility with when that capital gain is realized. ETFs have some mechanisms, though, to help them be a little more tax efficient from its standpoint, and so you don't have those capital gain distributions that you

might typically see in that December or sometime throughout the year, when those mutual funds have those particular distributions. With diversification, of course, if you're buying a stock, you're all in on that one company with those particular shares. There is no diversification. Where mutual funds, maybe they might elect to purchase several different companies, or like the S&P 500, 500 potentially different companies to provide some diversification so they don't have that significant exposure to one particular company. Exchange-traded funds also offer this particular benefit of diversification, where you can purchase a basket of securities so that you don't happen to have that all in investment into a RadioShack or into a Blockbuster. So if one company does fail, well, it was one of maybe only dozens of companies that you own, versus it being the one company that you own. Now, from a trading horizon standpoint, stocks and ETFs really do lend themselves very well to a short-term trader. Mutual funds are very, very difficult to trade short term, since you can only trade them typically that once per day. There are some mutual funds that do offer multiple times per day, but they're the rarity versus the norm. So for the type of trader, you want to purchase in the morning and sell in the afternoon, typically you're limited to being able to trade stocks and exchange-traded products. Now, that's not to say that if you're a longer-term trader, if you are looking to trade and invest for retirement that's five years, ten years, twenty, thirty years down the road, you can still trade stocks and ETFs, but

mutual funds have been traditionally what those longer-term investors are looking to hold. That's what you might be trading in in a retirement account or a workplace savings plan, as opposed to an individual account. So stocks, ETFs, really any time frame. Typically, mutual funds, that's longer-term time frame. Now, before we jump into a portfolio analysis, Matt, is there anything that you would like to add on kind of the differences between stocks and bonds or different investment types?

Matt Davison: No, I don't think so, Nick. I think you did a great job of covering the different aspects and considerations that you need to take into account when trying to decide what product might be right for you. So I'll jump right into the portfolio analysis here and what this is going to allow us to do is kind of define at a high level, what amount of risk are we comfortable with taking in our account? So as you can see over to the right, we have this slide here that is showing different pie graphs of allocations that we might have in our portfolio. If we start all the way in the upper-right corner of the graph, it's showing 70 percent US stock, maybe 30 percent foreign stock, and then as we start to move to the left-hand side, we start to maybe adjust that down to where we have some kind of bond exposure, which in general, marketplaces are going to be less volatile than the equity markets. And then as we go all the way to the left, we're going to start to see short-term investments, which it's key to

note that most short-term investments, we're defining that probably as a money market or something along those lines, that's still going to be technically bond exposure, it's just really short-term bond exposure, which is why it's classified slightly differently. And as we can see, as we're moving from right to left, we're lowering our overall risk. Right? So the question that you have to ask yourself is what kind of diversification or asset allocation do I want in my particular portfolio? Do I want to be extremely aggressive and you know, use a pie graph that we have all the way on the right, as an example, you know, it doesn't have to be exactly this asset allocation, of course, you can manipulate that however you see fit. But do I want to be in all stocks and take on a significant amount of risk? Do I want something more in the middle where I do have some equity exposure, I do have some bond exposure, maybe a little bit of cash? Or do I want to be leaning a little bit more on the conservative side, or maybe completely conservative? Right? So these are the first questions that you have to ask yourself about what your portfolio is going to look like and what it really helps you do is to find your risk/reward profile. So the advantage of taking high risk is maybe you're going to get high returns. That's not always going to be the case, though, and right now, as we're recording this, we're experiencing a little bit of volatility in the market, right? And if you're invested all in equities right now, you can see the effects of having a little bit of volatility in the market. Potentially that's going to

negatively affect the value of your portfolio. So that's the risk/reward tradeoff. We're taking more risk but potentially, we're getting more reward, versus do I want to be a little bit safer? Maybe the volatility is going to be smoothed out as we start to move a little bit more towards the left side of our graph. But maybe my reward isn't going to be as great, either. So it's this trade off. It's not a right or a wrong answer. You know, a lot of people always ask, "Well, what's the best? Nick, what's the best thing that we could do here?" Well, that's going to depend on your specific situation, what your investment objectives are, things of that nature. Right? So nobody can define that for you, you have to determine what level or risk you're comfortable with and apply that appropriately to your specific situation. And then once you do that, what it allows you to do is as you consider adding a new position, whether it be a stock or a bond, an ETF or a mutual fund, any one of those four investment vehicles that Nick just talked about, it can help you determine, well, how it's going to affect my asset allocation? Is it increasing my equity percentage? Is it decreasing my bond? Am I wanting to generate more cash? And is this aligning with overall, what you're trying to accomplish from a strategic standpoint? So that's kind of the basis for portfolio analysis and we're going to show here at the end of the presentation how you can use some of our tools on Fidelty.com to analyze what specifically you have currently. Nick, I want to give you a chance because I know you like talking

about this just a little bit, here, (laughter) so I'll give you a minute to jump in and add your thoughts.

Nicholas Delisse: One big, big thing I like to talk about when we talk about a portfolio mix is I like to address a typical, you know, 50/50 asset mix between stocks and bonds. You know, how risk will change depending on what you're invested in. Now, many traders, you know, acknowledge that an equity portfolio, the market has had a long-term equity return of about eight percent. And so that is inclusive, of course, of having 50 percent draw downs and 30 percent up years, but over that long-term time frame, you know, if you'd invested at the top of the market in 2008, saw your portfolio drop in half, well, fast forward eight years when the market was at 2,200 to 2,400, well including that 50 percent drop, you'd have averaged about eight percent returned per year. So what having this shift will do is it will help produce portfolio volatility, which is that risk metric. Now, let's say you're at 50 percent stock and 50 percent bonds. You know, just for example, this makes the math really easy. And your portfolio -- and the market dropped in half. Well, if the market dropped in half, you only had 50 percent on the market, your portfolio dropped by 25 percent. Then let's say that you had 50 percent in bonds. Typically, when the stock market drops, well, investors will flee to safety. Well, the bond market rallies because investors then purchasing bonds, driving up

prices of bonds. Maybe you might see the bond market rally ten percent. And you can look back and you can compare bonds and stocks with the COVID drop that we had in March to April of 2020. So if the bond market rallies ten percent, well, only half your count is in bonds, therefore it's a net five percent increase to your portfolio. Well, if the average 25 percent down and five percent up, that's only a net 20 percent drop in your portfolio, not a 50 percent drop. Now, why is this important? Well, if your portfolio drops 20 percent, you only need 25 percent returns to come back to break even. If your portfolio drops 50 percent, you need 100 percent returns to come back to break even. If your portfolio drops by 75 percent, well, now you need 300 percent returns to come back to break even. And this kind of describes -- if you look back when the market's dropped, you know, 2001 to 2003, and the NASDAQ bottomed down almost 75, 80 percent, well it took almost 18 years for the NASDAQ to hit new highs, to then come back that almost 400 percent it needed to to reach that. So again, if you can manage risk, keep it from dropping quite so much, you don't need to have those returns to be as great. Now, that said, if you have the bond market maybe averaging four percent a year, the stock market averaging maybe 8 percent a year, well, if you're 50/50, maybe your returns are in the middle, it's only six percent returns. Well, at a six percent return, to have a 25 percent back up, well, maybe you only need four years to come back to break even. Or at eight percent returns, to come

back to break even to have 100 percent return, you know, you might need something closer to nine years to come back to break even. And this can be that advantage to risk, everything comes back to your ability and your willingness to take risk. If you have a greater ability to take risk, that means that you might be able to stand having your portfolio drop to 50 percent now because, well, you don't really need the funds for five, ten, 15 years. But if you're going to use these funds to you know, pay for college education, or you're going to retire or something and you need the funds in a year, well maybe you have a lower ability to take risk and so you want to control how much your portfolio might drop at the tradeoff of having a little bit lower longer-term returns. So this becomes really, really important and you can definitely connect with a financial consultant at Fidelity to dive into this more if you want to. Now, that said, what are some ways that traders will manage risk? That's with diversification. It's with investing in different sectors and different industries. Well, what is a sector? A sector is a group of like stocks, a group of similar companies. What's the importance of sectors and industries? Well, this is for comparison. This way we can compare apples to apples and not Apple to Citigroup or Bank of America. Two very different companies, Apple being a technology company, and you know, Citigroup and Bank of America that we have on here being financials on here. So grouping everything into a sector lets us compare companies. So well, maybe if we

group several different banks, we can then compare those to find the bank that we like best that we want to invest in. And there, of course, some other aspects when it comes to sector rotation in business cycle that we'll dip into next. Now, how are sectors defined? Well, this is actually from the Global Industry Classification system that is done with GICS on here. With GICS, we have 11 sectors. This, of course, used to be ten. For those of you that maybe have been around for quite a bit that are using this as a refresher, real estate actually used to be part of financials. With these 11 sectors, we have different industry groups, and then different industries that break everything down even more. That way, from a technology standpoint, if we're comparing two big tech companies like Apple and Microsoft, it might make sense to compare those. But what about some other tech companies? What about if we looked at semiconductors, like an Intel or an AMD, that are semiconductor companies? Would it make sense to compare Microsoft, a software company, business services company, with Intel? Well, no it would make less sense. But it would make sense to compare Intel with AMD. Now, it would of course make more sense to compare Microsoft and a soft-- a semiconductor company because they're both technology than you know, Microsoft with a bank that is finance. Or Microsoft with a real estate investment trust, or a hospital, or some other type of company that isn't even technology. So that's where this comes into play and everything kind of breaks down more and more and more as you

get down into this pyramid. And so you have companies that are very, very similar with each other and are competitors, versus just being a completely different company. Now, why is this important? Why is it important to shift everything over and sift everything into this company standpoint? Well, this then comes into business cycle analysis. The business cycle is the bigger look at the economy. And one thing you have to keep in mind is the market itself is actually a leading indicator of the economy. So with this, you know, many analysts look at the economy and go, "Well, we're in a recession." And those that are trading the market might go, "Well, no duh, the market's been down for three months. You're just now saying it's in a recession?" Well, it's because that you know, the coinciding indicator describing the economy, they might take a little bit of time. Where with the market, you know, people will vote with their wallets. If they are expecting the business cycle to turn down, they might start to sell those companies because, you know, keep in mind when you're having shares of stock, you're purchasing for a shared future of profit potential, well, if you see those profits kind of turning down because the economy, well maybe you might start to sell some of that. With the business cycle, the business cycle typically lasts on average about 7.8 years. So it's almost about eight years that this lasts. It lasts for a very long time frame. This isn't cyclical like how different companies do better in the winter over Christmastime compared to summer, this is that much, much longer-term

approach. And to kind of think about why or how different types of companies do better in different parts of the cycle, well, I like to kind of you know, use an example to bring this home. Now, think about the economy with the business cycle. You know, let's say you're at work and you're seeing things turn down. You know, you then see that your company is getting fewer contracts, there's less work. When people leave, well, they're not being replaced, your team is shrinking. And you're worried about layoffs, you're worried that you might not have your job in three months or six months. What might you be more inclined to do? Well, maybe you might cut back on those vacations. You might put off buying that new washing machine or the new car. You might be more likely to go to the grocery store and purchase groceries and eat at home versus going out to eat and eating at restaurants. So what might do better during that part of the economy? That late cycle when things are going down, you know, before that recession really hits. Well, consumer staples. Things like grocery stores. What might not do so well? Consumer discretionary on there. What about when things are on the upswing? When your company's getting more of those contracts, they're starting to hire? There's just too much work for your smaller team, they're trying to expand it? You know that your job's going to be there in six months. As a matter of fact, maybe your boss is giving you a bonus because they want to keep you around. Well, now that washing machine purchase you've been delaying, or that car purchase you're -

-been delaying, maybe you go ahead and you make that purchase. And maybe you go out to eat with your spouse, you take those vacations, and you tend to go to the grocery store less. What might benefit? What might not? Well, consumer discretionary in this early part of the business cycle starts to do better. Consumer staples, not so well. And this is just on that personal, home economic standpoint versus the corporate standpoint. On all these other sectors are impacted by different parts of the business cycle, just like that. You know, describing what might happen. Now, with this, looking at something like consumer staples, looking at the early part of the business cycle, well, just because consumer staples tends to underperform, doesn't mean it goes down. Consumer staples could be up, say, 15 percent. But if the market's up 20 percent, did it underperform or did it overperform? Well, it underperformed, even though it was still up. What about if the market drops 30 percent? And consumer staples only drops ten percent? Did it underperform or did it overperform? Well, it outperformed. It outperformed because it didn't drop as much as the market. Did it go up? No, it didn't. So utilizing something like this doesn't mean that well, if you're looking at it in recession, you just trade these companies that tend to outperform the recession that you're going to be -- you're going to have gains, so to speak, it might simply mean that you don't lose as much as the broader market might go down. And this becomes a very, very, very important concept for a longer-

term investor. Now, that said, now, I've been talking about different types of companies so far, what then also becomes important is to think about style. How big or small the company is. Matt, before you jump in, too, and we talk about value or growth or market cap, is there anything you might want to add on the business cycle?

Matt Davison: Yeah, I think it's just, you know, important to keep in the context. You know, exactly what you said about under and over performance in the context of what the overall market is doing, right? You explained it, I just kind of want to double-down on it and maybe reiterate it for a minute. Just because something has historically overperformed in a bear market, doesn't mean you're making money, necessarily. It could mean that. But it doesn't necessarily mean that. Just because something is underperforming in a bull market, where most things are doing well, doesn't mean that you're losing money, you're just making less than something else that maybe did a little bit better. So you know, it's important to also keep in the context, you know, a lot of these pieces of information and research that has been done, it's going back in time, looking at you know, several secular cycles within the market. Meaning, you know, bull markets, bear markets, going back decades. It doesn't mean that every single time it's going to work out exactly this way. And it's very important to keep that in the context. Especially if something is

different about this time than potentially the last time we went through a bear market, or the last time we were in a bull market. So things can be different and you know, we do a quarterly sector and market update, which explain that a little bit further, it's a great resource that I would recommend if anybody's interested in doing business cycle analysis, investing in sectors, it's definitely something that you should check out and it's something that we make available. With that said, yeah, let's talk a little bit about style and the valuation, here. So you know, these are two critical terms that you're going to want to know. And what they're going to basically break down into: there's the first one, which is your style, right? Which is going to be basically the valuation, the market cap of what the different companies are that might be in your portfolio. Let's say we're using, you know, valuation as our first basis here to determine, you know, what we want to invest in. Do we want value? Do we want growth? Maybe we want something of a blend. And you can kind of see that in the chart that we have over on the right, if you look at the bottom, we have value, blending, growth. It breaks into those three categories. Growth is going to be defined as something that is "more expensive." And we have that in quotation marks because just because it's relatively expensive as compared to their sales or their profits or any other type of metric or ratio that you want to create, doesn't necessarily mean that it can't go higher. And the reason why, typically, these growth stocks are going to be more expensive is because

they’re anticipating that they’re going to have better numbers into the future. Now, what makes the market? That may be true, it may not be true. And that’s what you have to decide. Right? Because just because it is a growth stock, doesn’t mean they’re going to actually reach that level of growth stock that they need to maybe become profitable. So these are some of the more fundamental questions that you might ask yourself when you’re breaking down whether you want a growth or a value stock. On the flip side, you see value stocks, and we have those as “less expensive" in quotation marks because their stock prices are going to be relatively low as compared to their sales or profits. And the idea here being that maybe the market has mispriced these. Maybe it should be higher because their sales and their profits are pretty good. So you have to try to determine. Are you looking for you know, the growth side of things? Are those companies actually going to be able to make that happen? On the value side, are you looking at a marketplace that’s saying, “Okay, we understand that maybe these are relatively low compared to their price or sales, but the reason why is because we don’t see that potential in the future for them to continue to grow." So it may not be a worthwhile investment. Maybe we want to go and explore another path where we think there might be more potential. There’s inherently, again, not a right or wrong answer. In different times, one might be doing better than the other. There’s ways to compare that. You know, this is something I commonly do with

technical analysis, is go and compare: what are the value stocks doing in relativity to the growth stocks? See which ones are doing better and you can do that on multiple time frames. You can do it for a month, a year, the last decade, so on and so forth. The second thing that we might be looking at here is the market capitalization, which is simply measured by calculating the amount of common shares outstanding by the current market price. That's going to break down into three major categories. In recent years, we've seen a few companies launch into kind of a fourth one, which would be the mega-cap stocks, and then, I guess, you could argue under these smaller, there's micro-cap stocks. But generally and historically speaking, there's been three major categories here, which are large-cap, medium-cap or mid-cap, and small-cap. And as you can see, the market is dominated -- if we look over here at the Dow Jones US Total Market Index, it's dominated by the large-cap stocks. You can see it's relatively split between value, growth, and blend. So what we basically have here is an allocation for the test account that we all have, that we use here on the Trading Strategy Desk. And I think now's probably a good time to jump into the screen share and start to show you how you can use some of these tools on Fidelity.com to analyze your portfolio and how it compares. So what we're going to do, I'll flip over to Fidelity.com right here. Once we get on Fidelity.com, what we're looking to do -- this is the main launch page. We're going to go over to the analysis tab, which is right here.

And we're going to select that. Once we select the analysis tab, it's going to perform an analysis and that usually takes a couple seconds here. And then it'll launch our actual account. And you can see, you can -- you know, we only have this one test account here, but if you have other ones, you can deselect and select whatever accounts you want to include in the analysis. But the first thing it's going to do is give you the asset allocation. So it's going to break down -- we talked about this, you know, midway through the presentation today. How much domestic stock do we have? How much foreign stock do we have? Bonds in short term? And there's a couple of other things if you know, we're not able to determine exactly what it is. Usually if it's more of an advanced position, it might show up in one of these other two. Generally speaking, it's going to be in one of these four categories here. And what you'll notice is you know, for this particular account, we have about 45 percent in equities, nothing in bonds, and 53 percent in short term, which in this particular case, is just cash. So we could you know, first of all, start by looking at this and asking ourselves, "Well, is this the actual allocation that we want to have? Do we want to have maybe more equities? And further, do we want more domestic stock or do we want to increase that by adding more foreign stock? Do we want to reduce some of our cash and allocate it into potentially bonds or maybe bonds and equities? Or do we want to raise more cash? I mean, that's certainly an option as well. In this particular case, we'd have to

take from one of these two sources. But if you have bonds in there, that could be another option. So you can analyze exactly what your asset allocation is, simply by clicking on that analysis tool. Now, we talked just now about the style and the valuation and you can see that by clicking stock analysis right here. And this is going to launch, first of all, by style. So going up, looking at style, what we can do on the left hand side, here, this is our selected accounts. So it gives us the breakdown. It breaks down into these nine tiles here. What it does over on the right hand side is it compares it to the Dow Jones US Total Market Index. I want to be very clear about this, does it mean just because the Dow Jones US Total Market Index has allocated this way that this is correct? We don't have to have ours allocated like this. Maybe we're intentionally deviating from that because we see more potential in mid or small-caps rather than large-caps. Maybe we think that there's more valuation in growth versus value, or value versus growth. See, we want to allocate more heavily towards one direction or the other. But simply what it's trying to do is just allow you to compare to what a general index is doing, and that's the US Total Market Index. So from here, we can determine, you know, do we want to leave this level of large-cap, mid-cap, small-cap, or do we want to reallocate into one of the different valuations -- or, I'm sorry, market caps? Or, conversely, do we want to look at value versus growth? Maybe we feel like we're too allocated towards growth so we want to go to value. Or we're too allocated towards

value, we want to go to growth. Or maybe we want blended companies. So we can do that all through the style tool. And then further, we talked about sectors. If we switch over to the sectors tab, what this allows us to do is see how we're allocated by sector in comparison to again, the Dow Jones US Total Market Index. And if you just hover over any one of these bars, you'll notice if we hover over that, it'll give us that pop-up that says, "This selected account is allocated 26 percent towards financials." The index is allocated 12 percent and it tells us the difference. So we have 14 more percent in financials in this particular test account than we have in the index, right? Maybe that's intentional. Maybe we want to do that. Completely fine if we do. But maybe we think that's too high and we want to get it more back in line with the index, or maybe we want to be lower than the index. What this simply allows us to do is to determine where we're at. We can see our overall allocation right up here. And if we want to go and actually divest out of something and into something else. We can also see if we scroll down at the bottom, here, it'll list out the specific positions that we have. And it'll tell us which sector it's actually in. So we can see Zynga, here, Communications Services Financials, we have Citigroup, so on and so forth. We can go in there and see how it's allocated. The mutual funds, they're going to have a blend of a number of different investments and we can see the dollar amounts, roughly, that are allocated to each of those sectors. So this is a very valuable tool, if you're interested in

your asset allocation, sectors, style, this is going to be very valuable for you to be able to determine where you're currently at, how you compare with a broad, general index, and if you want to make any changes. So with that being said, Nick, I know you want to take us through one final thing, here. I will turn it back over to you.

Nicholas Delisse: Sure, and you know, while we're addressing and talking about value versus growth, I kind of -- a comparison I want to make is you know, think about Warren Buffett. You know, Warren Buffett is a very well-known value investor. And what he will do is he will compare two similar companies. Maybe he's comparing two insurance companies. Both of them are about the same size. Both of them are making about the same amount of money. But maybe one of them has a lower valuation in comparison to how much money they're making. This could then give him a value play with that particular company. It has a greater value because it's trading at a greater discount compared to the profits it is generating. Value is looking at the books like that to see, you know, what company might be undervalued, which company might have a lower price in relation to you know, what the fundamentals might say. On the flip side, if you have a company that's growing a lot, you know, it may be to think of a company that's one of the top five in the NASDAQ right now, Tesla. You know, a couple years ago, Tesla wasn't even making a profit.

But traders were purchasing that particular company on the expectation of what it's going to do in the future. Same story can be said of Apple 15 years ago. You know, when Apple launched you know, the iPod, you know, the iPad, the iPhone. You know, before those launches, Apple was simply a computer company. You know, but of course, it was in growing. Traders might then purchase that based on that growth, that expectation it's going to grow into this bigger company and have greater profit potential as opposed to looking for that value of what it might be making now. Little bit of a comparison between those two. Now, something I would like to share is -- pulling up my screen, I'm looking at the stock market and sector performance page. This can be gotten to by going to news and research, and then markets and sectors. And specifically, what I'm wanting to show everyone is over here on the right has this research, sectors, and industries and of course, you waiting recommendations. This is where you can look at and see what energy breaks down into two different industries: energy equipment and services, and oil and gas consumables. Likewise, information technology breaks down into those other subindustries like I was talking about: software versus semiconductors and such. We're going to look through -- you can find companies that are within those particular sectors of those particular industries. Now, I'm going to click on research, sectors, and industries, which is going to pull us into a different page where it zooms in just a little bit more

and we can see of course, the market cap of all these different sectors to see information technology is the big gorilla in the room with those. Now, I'm actually then going to click on weighting recommendations. This then, of course, shows all the different sectors. What market weight is, like what the slides are showing us, we can then compare all different sectors and see what market weight is. Fidelity then works with CFRA and Argus to actually also provide weighting recommendations on whether you should overweight, underweight, or keep market weight in those particular sectors. Now, when an analyst says to overweight, or underweight, like Matt was saying, they're not saying to go all in on one particular sector, sell everything else and go all in. They're saying to lightly put your finger on the scale. Because as we can see, you know, with CFRA, they're saying overweight, simply add a percent. If you're market weight in eight percent in your portfolios is in industrials, well make it nine percent. Just a little bit extra on the scale. And so we then have a little bit of a pie chart, here, showing, of course, where analysts are agreeing, where they're disagreeing, and you know, where they're agreeing to say overweight, underweight, or market weight, very quickly, easily at a glance. Now, this might be based on the separate analysts view on where we might be in the economy, or what their view is on specific sectors. But you can then come over here into this business cycle tab to dig in and do more research. On this business cycle tab, there's some fantastic links to learn more.

Something I would encourage all new investors to do is to take a look, of course, starting with understanding business cycle white papers that we have. Talking about the business cycle approach to equity sector investing. Which has that diagram that we were showing on the slide, showing well, typically during which part of the business cycle should you overweight or underweight different sectors, what's done better in the past. Now, that's not to say it's going to be the same in the future, but this is just what we've seen historically. We also have the business approach to asset allocation, allocating between different asset types. It's very, very, very informative white papers with that. Also over on the right hand side, we have the review the most recent business cycle analysis as provided by FMR Co. I'm just clicking on this link to pull it up and we can see the business cycle update. Then it, of course, shows the four quarters of 2021. It's a little bit delayed because right now, we're still in quarter one of 2022 and we'll have to finish the quarter before actually showing that information. We can click on United States, you can of course see that quarter one, quarter two, quarter three, quarter four, where everything is going as we've then gone from early to mid, going from recovery to expansion. And this is where we are, of course, in quarter four. There are additional updates down here, like Matt was mentioning, you know, where you can see the quarterly sector updates that we might have. And of course, all this is provided by the Fidelity Institutional, up here. Very, very good

resource to learn more about different sectors and the different markets. It can be a very valuable resource for Fidelity investors. With that, that does wrap up what we're looking to cover today. We do, of course, want to thank everyone for joining us for this particular session. And of course, take a look at sessions two, three, and four that we also have as part of this four-part series. Thank you for joining us, everyone.

END OF AUDIO FILE

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