

## Fidelity Compass

### Institutional Webcast CIO Perspectives: Mid-Year Outlook

**Andrew Marchese**, Portfolio Manager and Fidelity Canada's Chief Investment Officer

**Pamela Ritchie**, Host

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**Pamela Ritchie:** Hello, and welcome to Fidelity Compass. I'm Pamela Ritchie. We stand at the halfway mark of what's been a significant year in the markets so far. Severe tariff changes globally, a shift from U.S. exceptionalism to international investments and government, and policy changes in the United States and Canada have all caused notable fluctuations in markets and in currencies.

As it stands now, what changes in the economic landscape and which factors may drive investment opportunities in the second half of this year? Here to share his overall thoughts on the market and what trends he is keeping an eye on through an institutional lens is Fidelity Chief Investment Officer and Portfolio Manager Andrew Marchese. Welcome. Great to see you, as always.

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**Andrew Marchese:** Great to be here.

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**Pamela Ritchie:** We'll invite everyone joining you here today to send questions in for the next 25 minutes or so. I've been dying to have an opportunity to ask you this question, our biggest trading partner, the United States, is it getting smaller in terms of the way we think of it as the economy in the world?

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**Andrew Marchese:** Its intention is, I think, to be, from everything we've read and kind of consumed from the media, from the words from the U.S. administration, the intention is to be more for themselves. A tougher stance on international trade, trying to reshore manufacturing to the United States, trying to restrict the flow of capital, trying to restrict in some way, shape or form immigration for the purposes of international students attending U.S. universities, that certainly seems to be the tone.

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**Pamela Ritchie:** It's the tone and there are a number of gambles out there that we've heard through the administration's various communication channels that they're sort of taking on tariffs, they're a big part of that. At the end of the day, what is the gamble of trying to bring manufacturing, all kinds of business, into a reshoring back home situation? It's a gamble, that seems to be the goal.

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**Andrew Marchese:** Well, I think the goals are multi-fold. If you listen to various members of the U.S. administration, they talk about servicing their debt, they talk about cutting taxes, corporate and personal income taxes, they talk about bringing back more manufacturing jobs to America. At some level those things all compete with each other. You cannot actually optimize for all three. The answer, the truth, the reality, somewhere down the road lies in between all of that stuff. When you're raising tariffs, the goal is to — effectively, it's a tax on the consumer as we all know — bring in money so that you can service your debt. The U.S. has a huge budget deficit and growing. The intention, the aspiration is also to cut corporate taxes and personal income taxes for the highest earners in America. That's a drag on tax revenue so you have to backfill that with tariffs but if you're successful doing that you can't grow jobs through repatriation of manufacturing, at least in a fuller way, so do you bring back that many jobs?

Now, if the intention is by multi-nationals at some point in time, they take their plants and mills and companies out of other places around the world, bring them back to America, you grow jobs but will the tax stream, revenue stream, from that added labour, and maybe even some consumption, help service your deficit or balance out what you would have lost in tariffs from that good being shipped from China or Germany. They all kind of compete with each other but you can't optimize for all of them.

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**Pamela Ritchie:** But were that to be the situation and you have new manufacturers or locations happening in the United States would it go ahead and spark capex, growth, there would be you'd have to borrow, you'd have to get in there and build.

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**Andrew Marchese:** I think that's what you're seeing right now in the rally off the April 8th bottom and the movement in stocks from about May 1st through the end of May, which was led by the Mag Seven again.

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**Pamela Ritchie:** We're back to that.

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**Andrew Marchese:** Yeah, NASDAQ, beta, even cyclical. I think the answer to your question is it depends on the industry you're talking about. I think certain industries may be ripe for that reshoring, repatriation of capital, labour, plant and equipment. Other industries, it makes no sense to do. You cannot manufacture a good in the United States cheaper than you can manufacture it elsewhere in the world. For those industries, the labour, the manufacturing facilities should stay where they are. That will ferret itself out over time. It's all complicated by the fact that, too, a lot of these positions by the U.S. administration have been done under the auspices of national security. That kind of gives you some kind of inkling and insight into where maybe certain industries are ripe to have some of that capital repatriated.

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**Pamela Ritchie:** And it may not be plastic things from China. It may be much bigger things made out of steel and aluminum.

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**Andrew Marchese:** It could be that or it could be things like microchips. I think that will still be to come and it will ferret itself out over the next four years.

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**Pamela Ritchie:** One of the reactions to what you're talking about is that other countries have started to talk about doing things in their own national interest. Canada is but Europe, lots of countries are, sparking, yeah, there's a defence story there. There's lots of things that go with that. The world becomes, I guess, less, I don't know if globalized is the right word. What's the right word these days? What are we shifting to?

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**Andrew Marchese:** I think we're shifting to an environment where trade partners who were collaborating maybe in a very small way need to collaborate in a larger way. There's going to be new deals struck, new relationships made, maybe more fortified relationships made. Other relationships may be broken entirely or just get a little smaller, get a little bit weaker. That's what is still to come. I don't think anybody in the financial services industry has a great grip on what that means down to the specific company or industry as a whole, but all to say this is a very fluid situation, extremely fluid, which makes managing money, I think, all the more challenging when you're too myopic and you're not keeping your goals more mid-to long-term oriented.

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**Pamela Ritchie:** On that how, ultimately, I mean, we keep hearing the word market neutral being announced because you sort of don't want to get pulled in one direction because they do flip quite. I mean, what do you think of the speed at which something does very well and then there's a reversal very, very quickly, a powerful one too?

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**Andrew Marchese:** Price transmission into the marketplace in my career I don't think has ever been higher which makes it very challenging for active managers. As I said, we came into the year, tariffs weren't really on anybody's mind, not in a big way. February 1st, we get the Trump administration talking about ratifying the USMCA deal. That had a negative effect on markets and on risk. April 2nd with Liberation Day, that had a negative effect on markets and risk. If you actually look at the performance of indices from Jan 1 through April, it was generally a risk-off environment, rest of the world did better than the U.S. Highest beta, i.e. NASDAQ, in the U.S. did the worst. And then May it all flipped. Why?

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**Andrew Marchese:** Well, that's the question. The question is, are the fundamentals in some of those Mag Seven stocks, U.S. large-cap growth and even cyclicals, were they priced enough? Was the worst priced out by the time April 8th rolled around, which I think is where the bottom was kind of in the S&P 500. That's the question. Or things in large-cap tech and growth, are their fundamentals more resilient, i.e. not as economically sensitive but then the question to ask yourself is, whatever was priced out into cyclical stocks like early cycle consumer discretionary, transportation stocks, for example, was that sufficiently priced out? In other words, negative earnings revisions which may or may not come, if they do come whatever valuation we hit on April 8th was that kind of saying, oh, that's the bottom. We can kind of see that six months, 12 months out and then now it's off to the races because that will mark the easiest of comps and then we can kind of look forward in a cyclical turn. That's all kind of to come. But the speed, again, the price transmission and the binary nature that active managers are having to deal with everywhere, it's really challenging. The leadership on a month-by-month basis by sector, by geography, by style has been extremely binary.

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**Pamela Ritchie:** Is there solace in the fact that it appears to be, in fact, you said this in January, long before we knew all this happening, that you thought we were walking into at that point, and perhaps we are now, something that's rangebound, that has a floor and I think has a ceiling. I don't know, is there solace in that? [laughs] No! Not really.

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**Andrew Marchese:** Yes and no. I think I made the comment in January because if you looked at the valuation of the market and how much the equity risk premium had fallen and multiples had expanded by, and if you looked at the earnings stream kind of coming, this was before all the tariff talk, where consensus was pricing out through 2025 and 2026, you're kind of like, well, what we need is the earnings to come through. At the time, the S&P 500 forecast for earnings growth was about 11% and I think slightly higher in 2026. That's been revised down to about 6.8% as we sit here today for 2025.

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**Pamela Ritchie:** It's often revised down at some point throughout the year, not that much.

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**Andrew Marchese:** You're right, absolutely right. But now we rally back, the S&P I think is flat now as we sit here so your market multiple is actually higher. Because you don't have a lot of room for multiple expansion, the earnings really need to come through.

The question will be does 2025 mark a lower earnings year? Well, we're already saying that at 6.8. Does it go to 4 or 3? Market can kind of absorb that. If it went negative then I think you've got bigger problems but then that means at some point you will price in a bottom and, hopefully, all things being equal then you positively inflect from an earnings growth perspective into 2026. I think that's what the market's trying to come to grips with. I think for some industries the earnings growth profile looks pretty good and others is a big question mark because we still don't know the impact on consumer

spending or business spending as it relates to tariff impacts.

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**Pamela Ritchie:** We're just waiting for that to still come through. It hasn't trickled through, really. Shot through all of this are central banks trying to hold the line and not either deal with stagflationary impulses or not get on the wrong side of that. How likely are they to succeed?

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**Andrew Marchese:** It's going to be a challenging environment for everybody to deal with because we know, generally speaking, if history is any good, at least initially in the very short term tariffs are inflationary. They eventually hurt growth more so...

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**Pamela Ritchie:** Take everything out.

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**Andrew Marchese:** Right. They become disinflationary at some point. But you have initially an inflationary impulse then slowing growth. At the same time, I think the U.S. administration wants a weaker dollar. By discouraging foreign investment into the United States that will...

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**Pamela Ritchie:** They've managed to do that [crosstalk].

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**Andrew Marchese:** Yeah, you'll lean on that a little bit but by the same point in time if you reduce the demand for U.S. currency and maybe even U. S. Treasuries yield back up, now that increases your cost to service your debt.

All these things are kind of competing with each other and you're a central bank going, okay, I've got to worry about inflation, then I'm going to have to worry about growth but then if I cut rates I'm stoking the inflationary fire and I'm further, probably, accelerating a decline in the U.S. dollar which will cause yields to go up. It's all kind of this iterative kind of discussion and then the implication is how do you price risk assets in that environment?

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**Pamela Ritchie:** That's so interesting. If you get into a story where Treasury yields are cusping higher and getting to a point where they're interfering with how you might look at it as an equity return, and they're, actually, as you mentioned, competing, from there, ultimately, how do you dive in and start talking to us about investing in this market right now? You would think that they would be more correlated at some point if they're actually competing on that level of returns.

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**Andrew Marchese:** I think at some point, and no one really knows what the yield level is in the United States, where you kind of start hitting the equity risk premium. Is it 5%, is it 5.5, is it 6? I think we can all kind of come to our own conclusion on that. At some point, fixed income instruments look a lot better than equities as competing instruments. The other aspect of all this, you mentioned market neutral as a product earlier...

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**Pamela Ritchie:** This is like a strategy right now because you want to wait out the storm.

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**Andrew Marchese:** Yeah, so you ask yourself do you want complete uncorrelated exposure to both markets and fixed income and in a market neutral sense where you're beta neutral the alpha that would be generated in theory would come from complete idiosyncratic security selection.

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**Pamela Ritchie:** That's fascinating because you're speaking to people that would be looking at, actually, choosing stocks in a different way?

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**Andrew Marchese:** If you build a market neutral portfolio, ideally what you're trying to do is maintain a beta of zero in the portfolio, a completely uncorrelated return outcome to both the equity markets and the fixed income markets. I think if you're successful in doing that, depending on the strategy and how you create the parameters, ideally, then you should get somewhere around mid-single-digit returns which are also tax advantage relative to fixed income. The net return to you, because it comes from capital gain as opposed to income, would be superior. That's one aspect. That's a liquid alternative angle.

The other one would be other alternative asset classes. The traditional kind of equity, fixed income and you toggle between those, well, maybe it's adding a liquid alternative where you have idiosyncratic non-correlated returns. Also things, whether it's hard assets, land, gold, some would talk Bitcoin in that same breath, but there's something else.

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**Pamela Ritchie:** Other alternatives.

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**Andrew Marchese:** Obviously, for a lot of our institutional viewers it's things like real estate or infrastructure and whatnot. I think those become more and more important as time goes on and it's all based on the unknown about central bank response, fiscal response, which we haven't talked about. I think at the end of the day those things all will work in concert with each other in some way, shape, or form. Because we're living in this macro world the important thing is from a total portfolio perspective is to probably have your weights to meet your longer term needs. That might, actually, be more important. Then the alpha's going to be more important if the beta's not there. Last decade or so we've been living off of beta. That may not be there. As I said, a volatile type of environment where we have more normalized returns you need something to kind of comfort you on the volatility side.

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**Pamela Ritchie:** Are we in a full regime change, would you say? Then I'll ask you at about fiscal.

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**Andrew Marchese:** From what...

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**Pamela Ritchie:** I guess there's a few different standpoints but from a very low interest rate environment, which was before, that was a while ago, but in any case, it does seem like we're entering a new ... I don't know, maybe everything will be the same.

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**Andrew Marchese:** Tough to say. Maybe it will be. It's tough to say. The market right now is, at least with respect to the U.S., kind of the consensus is for one rate cut this year. I still go back to the fact that money supply is growing.

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**Pamela Ritchie:** There's some money sloshing around out there.

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**Andrew Marchese:** There's a ton of money sloshing around the system. I think that's one reason, and this would definitely not be my base case, with that much money kicking around sometimes animal spirits have a weird way of showing up and climbing a wall of worry. It would certainly not be my base case, but as we've learned from history when there's ample

liquidity in the system strange things happen.

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**Pamela Ritchie:** That's so, so interesting. One of the ways that more money could slosh around is there is fiscal spending in parts of the world where there's been slightly more restraint than the United States. Part of that, along with other things, have caused an international trade. You can pick that apart how you like, the fiscal spending piece of it. There has been this international, I'm curious whether you think that's sustainable. If it's switched up..

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**Andrew Marchese:** Yeah, that's a good question.

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**Pamela Ritchie:** ..does it go on from here?

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**Andrew Marchese:** Well, going back to your phrase of regime change, I think we're living in a different world and those countries, the leaders of those countries, may see it as such that this is you're getting off the starting block, so to speak. From a sustainability standpoint, if you're thinking about your fiscal discipline differently than you did in older times because you're trying to supplement growth or augment growth through new relationships, then you look at your economy under a different lens and how you fund that.

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**Pamela Ritchie:** You're not going to just do that and switch it up next week on Tuesday.

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**Andrew Marchese:** No, exactly.

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**Pamela Ritchie:** This is a ball in motion, presumably.

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**Andrew Marchese:** I've got to believe it's human nature. Once you've kind of looked at the landscape and said the world

is different and you can comfortably go to bed at night and say, yeah, the world is different then you're not making plans two weeks from Wednesday. You're making plans for the next 10, 20 years, hopefully.

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**Pamela Ritchie:** Is the international trade, it's a broad term and it encompasses a lot of things but is that a ball in motion?

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**Andrew Marchese:** Say that again.

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**Pamela Ritchie:** The international trade switching away from U.S. exceptionalism, I guess is part of the question, is that a ball in motion?

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**Andrew Marchese:** It has to be based on the facts of what we know today. It would generally have to, I think. Could things change? Yeah, because we've seen that over the better part of 60 days, things change. It seems like the world is reacting to predominantly one nation. But I think if you're dealing with a situation that is unpredictable then as a human being you need to take matters into your own hands. If you're a leader of these countries you, basically, have to kinda say, we need to take matters into our own hands. If things get better over here, great, if they don't, well, we've got the ball going.

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**Pamela Ritchie:** We've got the ball going. Great question coming in here, very pertinent to Canada. Put this to you, Andrew Marchese.

How should we interpret the outlook for oil and gas? On one hand, Trump signals support for increased U.S. production but at the same time is pressuring OPEC to increase output, which has happened, to lower prices, proposed tariffs to create some uncertainty, companies assessing feasibility, development timelines. How do you reconcile some of these conflicting signals when evaluating sector prospects? It's a big question. Do you want to start with the oil story? How do you interpret that?

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**Andrew Marchese:** I made a comment back in February that the one thing I think Trump has been consistent about, he's been consistent about a few things, but one thing that really kind of makes my ears perk up is he has a fondness for the past and U.S. manufacturing in the '40s and '50s. That's come through in a lot of his discourse through the media and to the public. If you believe that the U.S., part of its industrial buildout was on the back of very cheap oil. He's talked

about U.S. producers ratcheting up production, just driving up the supply of oil, which drives down prices. There is an abundance of supply.

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**Pamela Ritchie:** And that's happening.

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**Andrew Marchese:** Right. So, supply is outstripping demand globally as we speak. Unless something radically changes on the demand side or you turn off the spigots, that balance favouring supply continues to be out there. What that means for the exact price of oil, I mean, that will all get ferreted out. There is some investment demand that we've also heard for oil because of talk on the inflationary side or higher bond yields. There might be some competing buying from an investment perspective, which is kind of odd. The supply-demand imbalance certainly favours supply. We have to remember, one of the greatest stimuluses to the U.S. economy, in/and any developed world economy, is lower gasoline prices. It correlates very, very...

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**Pamela Ritchie:** It just works.

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**Andrew Marchese:** It works like clockwork. I think more supply of oil.

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**Pamela Ritchie:** Take us back to, you were talking about perhaps the role of alts and different alts within the alts world, the actual allocation story. 60/40, again, it's an overarching view but that is shifting as well. How do you see this, say from today going forward, how has this changed?

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**Andrew Marchese:** One thing that's kind of transpired over the last 20, 30 years is there's been more financial engineering and more ways to invest in things than we ever could in the past. Part of the 60/40 equity fixed income balanced portfolio was born out of what's available..

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**Pamela Ritchie:** There were stocks and bonds.

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**Andrew Marchese:** --what's available to you. Now there's more things available to you. I think to the degree that they can show less correlation with each other or amongst each other the better. I think what clients need to decide is really based on their risk profile, their timeline or duration to hold the mix of, let's say, equities, fixed income, real estate, infrastructure, whether you want to include gold or stores of value in there, some hard assets in there, I think that's really going to be dependent on the client and the risk profile and the return profile, obviously, and the duration by which you can liquidate some of those otherwise illiquid assets. I think it is a real thing that all ... whether you're institutional clients or even a retail client you need to think about probably more so than you ever have in the past.

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**Pamela Ritchie:** Fascinating. What's one, it doesn't have to be the only one, interesting investment theme. If you read the headlines today one of the themes that's been talked about for a while sort of coming to fruition, the idea of hyperscalers actually plugging into nuclear energy. I mean, that's sort of been discussed. It's actually happening at this stage. That's one theme, may be investable, maybe it isn't. What's a really interesting theme you like right now in the markets? Is that it?

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**Andrew Marchese:** Certainly renewable energy, particularly nuclear, is gaining a lot of traction right now in discussion. I think anybody who knows even a little bit about the merits of nuclear energy will say it's the densest, most efficient form of energy. There's all the negative things that we know about. I think we're kind of overcoming those as a global society so that could be very real. The energy demands in the world are going up, not down, and they're going up in big, big way. The ability to mobilize, use nuclear energy as a source, a real source for the globe going forward is definitely a theme.

The other theme would be with all this CapEx build out in terms of AI the next point in the future will be how do we use it, and how quickly does it erode maybe certain industries or jobs, and how quickly does it aid certain jobs and productivity, what's the balance of those two things, what does the transition look like, and what does that mean for future growth. That's also very exciting. It's a very, very big question. I don't think anybody's got a complete crystal ball view of that but there's a lot of things to like.

We talked about rates and inflation and all this but one of the things that we've always talked about is one of the ways you can service debt is you either inflate your way out of it or you grow your way out of it. Now, if we have major productivity gains coming in the future, whether it's renewable energy or whether it's AI to basically increase productivity and accelerate growth in a way that we currently can't really foresee, that's really exciting. It deals with all the other negative things that we talked about at a government debt level going forward. As always, innovation is usually your best way out of everything. We'll see if it happens.

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**Pamela Ritchie:** That's fascinating. We'll leave it there. Andrew Marchese, thank you very much for joining us today.

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**Andrew Marchese:** Thank you, pleasure.

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**Pamela Ritchie:** And thank you for joining us here today on Fidelity Compass. As always, if you've got suggestions for future topics or guests that you'd like to see and hear from go ahead and share your ideas with us. Stay tuned for more Fidelity Compass webcasts in the weeks and months ahead. Thanks for watching, thanks for joining us. I'm Pamela Ritchie.

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