Fidelity Compass

Repositioning Canadian Equities for Economic Uncertainty

Joe Overdevest, Portfolio Manager

Pamela Ritchie, Host

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Pamela Ritchie: Welcome to Fidelity Compass. I'm Pamela Richie. President Donald Trump has yet to complete his first month in office and he's already signed more than 65 executive orders, the most in any president's first 100 days in more than 40 years. When is the 100 days over? President Trump's latest order, a newly formed energy council that seeks to win the AI race with China, that's the newest one.

As markets react to the uncertainty out of Washington, our next guest says that these are the moments perhaps to find opportunity amid some of the chaos and uncertainty. Amid the volatility, where might the silver lining for institutional investors lie? How are today's macro factors influencing our next guest's investing strategy?

Joining us here today to share his latest thoughts on energy, commodities, and where he is seeing long-term opportunities for institutional investors is Fidelity Portfolio Manager Joe Overdevest. Great to see you, Joe. How are you?

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Joe Overdevest: Very good, yourself?

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Pamela Ritchie: Delighted to have you here and to have a chance to chat with you. We'll invite everyone to send their questions in as well. It is the uncertainty that may cause opportunities. What might happen with just a little certainty?

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Joe Overdevest: I think with tariffs, right now the discussion is will they come on, when they come on, to your point, if you look back in history in the markets certainty is one of the biggest things. Negative events are usually not the biggest issue of the market. The biggest issue is uncertainty: how bad will something be. To your point, a scenario where tariffs may not be 25 % but maybe a number lower, even 5%, yes, it's not great but the stock market, because it's a discounting mechanism, it can price in, okay, that's the pain, let's move forward, sometimes galvanizes a market going forward just knowing how bad something could be.

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Pamela Ritchie: It's really interesting. We're in that moment before we know that. What would you say this moment is providing you as an investor, for institutional investors? This is often when they say make some moves if you can because the uncertainty is discounting lots.

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Joe Overdevest: I think in these environments, number one is don't be emotional. It's very easy, especially with politics, people will get emotional. We're not here to be emotional. We're here to be a steward of people's capital and make money for them.

Number two is look at the portfolio. Are we properly diversified? We obviously know tariffs can affect certain companies, some more than others, so look how much are we leaning in and making sure we don't have major exposures because we can't for sure know how these tariffs will go forward.

Number three is, to your point, where's our opportunities because sometimes the market will be very negative, especially in this uncertain time, and we can look out a number of years and go, you know what, this company's going to be okay even if this scenario plays out, a lot of that's priced in and that's where we're doing a lot of work right now.

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Pamela Ritchie: There are areas where there's obvious exposure to the tariffs story and you'll be looking at companies to sort of figure out what that means, ultimately. Are there areas that are just either more domestically exposed? Where would you see the opportunities? Is it more ones that are exposed to tariffs and they're selling off ,therefore?

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Joe Overdevest: I think it's a mixture of things. I'm sure we'll go into some of the bigger sectors. Certain companies the most exposed would be domestic here in Canada and they're selling their product into the U.S. That's probably the most exposed. Even there you have to watch is that if their competitors are in the U.S. producing U.S., and even if tariffs are a minimal amount, or even worse, the tariffs keep doing this where they're on, they're off, they're on, they're off. Their customer base, depending who they are, be it like business jets or private jets, those are big purchases. Those buyers might even hold off on buying and just holding off on buying even if tariffs don't come in could hurt a company.

Whereas the flip side, there's many Canadian companies that really actually reside mostly outside of Canada. They actually usually have most of the revenues in the U.S. Those are, actually, in some ways benefiting if we have a weak Canadian dollar, which we've had recently.

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I think though the last bucket is there's a lot in between where people are like, you know what, I'm uncertain. When you have to dig into the actual financials, talk to CEOs, the CFOs and go, you know what, this company is not going to be that badly hurt, that's where you can probably take advantage of it and that's usually in ... some even the energy, industrial section of where you'd find those.

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Pamela Ritchie: Let's go into energy, this new council that's just been announced today one of the many executive orders that are being announced. It's something to tie up the energy needs of AI, and those can be broad and they can also be very specific, with the energy story, be that natural gas, be that oil, be that plugging something into something, this is sort of where it begins in terms of a research council. What's Canada's role here? What could Canada's role be here?

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Joe Overdevest: Look, Canada's role could definitely be providing natural resources, would be the obvious one. The other thing I would just caution, all these things we're hearing, these executive orders, there's one probably major thing across them is America first. We have to respect that as Canadians, and I'm sure we'll talk about this, is that our partner is becoming very focused on themselves. For instance, one of the things you mentioned was data centres. A year ago, it was, well, we can build data centres here, in particular Alberta, have cheap energy relatively to other parts of the world, and then provide it for our American partners. Probably we will build data centres here in Canada but that we will use the data centres here for our American partners is becoming less and less likely. Because, again, you can see from the President, they would like everything almost to be in America, even manufacturing and probably also data centres as well.

The bigger thing you're probably asking, these orders, will it drive a change in oil and gas dynamics in the US and here in Canada. When we talk to oil and gas executives globally, U.S. or Canada, most of the orders you're seeing from the President in the US don't really seem to going to be changing supply and demand. It probably makes big headlines but when you actually talk to the oil executives, they're like there wasn't really a lot they could have done. I don't think it's going to change their capital plans.

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Really, for them the biggest barometer of why they're not going faster is the oil price and their shareholders are saying, you know what, let's give me dividends and buybacks. I don't see a big change in growth in the U.S. You're talking about give or take a million barrels per day. Here in Canada if we change regulations and make it more easy potentially with the new government or even with the Liberal government changing leadership, I don't see a big change as well in the supply and demand of actually oil and gas because it's not major overhang.

I would say on the margin, though, we probably will see more investment in Canada if we cut out carbon taxes, or at least lower them, and number two, have probably a little easier time permitting. I will say the global energy companies have been selling Canada last few years and those were their two biggest concerns. You could have acquisitions come back where they were divesting of mostly oil and gas the last few years.

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Pamela Ritchie: Interesting, so with red tape, with a more sort of business-friendly welcome in terms of international investment.

Can I just back up to what you were saying about the AI centres perhaps wanting to be within the U.S. if they are to cater to U.S. companies, American companies, could you have it at the very north of North Dakota and just run the line, the plug across the beefed-up Canadian border at this point and plug it in on the other side? There's got to be something there.

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Joe Overdevest: Pamela, I think you need another job also helping the U.S. government so that would be your side job.

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Pamela Ritchie: Can't we just dig it down under the snow and plug it in?

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Joe Overdevest: But you're sniffing up the right tree. The reason why is because the actual data centre and, again, there's a lot of subtleties to data, especially information these days. Even little subtle things we have to watch about the politics, a few years ago here in Canada we started taxing the social media companies. It sounds like a small thing but then all of a sudden those things echo later in time and they echo is like, well, if we have a data centre here in Alberta will you start taxing us on the data and very specific data centre taxes? So that alone you're right but I do think, when you look at North America, we're definitely seeing electrification of the grid, more renewables, more data centres.

For the most part of the last 10 years, actual energy consumption of utility energy consumption was probably flat. We became more efficient with light bulbs and other things that became more efficient. We didn't notice the world was kind of like needing more power and now it's really taking off and we're gonna need especially more gas. We're gonna need more renewables which will definitely draw natural gas from the U.S. and from Canada and also renewables. You're gonna need everything. You're seeing that nuclear is in need, gas is in need, renewables is in need, and nuclear is definitely something we can usually provide from Saskatchewan. The resources that we have are definitely going to be in demand. We just have to make sure we're on the right page with our key trading partner as of right now which is still the U.S.

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Pamela Ritchie: Do we need to diversify as well our trading partners because if we are building LNG terminals ultimately those are usually sitting on the edge of places where you can send it across water.

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Joe Overdevest: Yes. I think this is ... we use the word galvanizing or definitely centering now probably Canadians going wow. Everyone's now up to the speed that our biggest trading partner has a lot of leverage on us and especially that we have not moved pipelines to other areas, especially to the coast, for LNG or for oil. Yes, we have LNG Canada, we have TMX. The audience probably has heard those. They're coming on right now this year but they're just not a big deal. The actual grand scheme of things is still a very small percentage. We need more of that otherwise, yes, we are beholden to the U.S. and beholden to whatever they want in terms of tariffs or other needs. If we can get together, because it will take provinces to be agreeing, many of these pipelines don't just go across one province; they go across multiple provinces to hit the coast. It would definitely strengthen our negotiating position next time we're in a situation like this, hopefully never.

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Pamela Ritchie: Hopefully never. Within the sort of discussion of inter-provincial trade barriers being relaxed and partly put to bed, would pipelines come into that or some version of a national project come into that? Would you like to see that as an investor?

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Joe Overdevest: As an investor, yes. Even as a Canadian, generally yes because usually these projects will provide taxes, will provide jobs, and as an investor it just provides opportunities for our companies. If you just want to talk to the actual CEOs themselves, they would definitely want more outlets. Just like any businessperson do you want to sell to one customer or do you want to sell to multiple customers? Of course you would want to sell to multiple customers, get the best price possible and ensure, in particular for Canadians, that we have a stronger foothold for trade negotiations. Again, I think it has to come at a federal level to make sure all the provinces are on the same page.

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Pamela Ritchie: Let's go into sort of a galvanizing effect. I mean, this is a threat, we're living under it right now and businesses are preparing for it and fearing it. Is this the moment ... what do you hope will happen in this moment sort of to find the galvanizing piece?

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Joe Overdevest: I think every event like those there's going to be winners and losers within the stocks but usually too when there's a threat like this to the country, which it is, that's why we use the word galvanizing because it's appropriate. You're seeing different things in the media, and just in terms of general people in society are saying, you know what, we're Canada first now. It's not just U.S.A. first, we're Canada first. What does that mean? It maybe drives, as you said, discussions across provinces that weren't happening the last few years to say, you know what, we need to get on the same page here as a country and less maybe just on provincial focus.

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I think number two that we have to watch is that in these negative times, there's also going to be potential changes going on and all of a sudden if we do that and we say, you know what, let's start looking at resources, let's start cutting red tape, we can actually create a better country going forward than we had before, but you almost need that outside threat to bring everyone together. It's like a team. We need to win this game, we're down, how are we going to do it in the third period? The other thing as Canadians we have to watch, we have a provincial election here in Canada, sorry provincial in Ontario, we have a federal election coming up, that could change things if a federal leader comes in, again, there's changes even the Liberal leadership, will they cut taxes, will that drive growth, will it cut red tape not just for resources but for the entire country?

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Pamela Ritchie: How important is it to cut tax, I'm talking about corporate taxes, in this country right now because there is, I mean, it seems an obvious thing that if you're someone who's going to start a project it would make more sense to start it in the United States right now as a business. Does that need to be moved to kind of the top of the line of cutting taxes for corporations?

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Joe Overdevest: I think the honest truth with corporations or companies we talk to is that the number one concern almost for everybody is tariffs because if the tariffs are still there no matter what the taxes are it can alleviate ... depending on the magnitude take any tax benefit away. If the tariffs are at least known the next thing, to your point, is like as a person who's building a company and selling especially goods across its tariffs and taxes and yes, lower taxes probably make us a little more competitive because even individually and corporate-wise they've been creeping up the last few years. If you look back in history, we used to have lower taxes in/than the U.S. That naturally drives capital flows for new investment if you have a lower tax system so it definitely would not be a negative.

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Pamela Ritchie: When you watch the discussions going on in the U.S., how else would they fund what they need to fund on the deficit front if it wasn't revenue from tariffs, not just from Canada but from around the world. What's their other way?

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Joe Overdevest: I think they're trying to look at different parts of ledger. Number one is they're just trying to cut costs. They're seeing where there's waste. Number two is raise taxes on the individuals themselves. They don't really want to do that, as you can imagine. Number three, the biggest thing probably is just drive growth. They have a 3-3-3 plan.

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Pamela Ritchie: Grow out of it.

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Joe Overdevest: Grow out of it. Three million barrels per day, 3% deficit and 3% GDP growth. Again, I say that, I wouldn't be surprised whoever our next leader is will have a similar probably strategy because we've seen this in politics, if people like a certain strategy, if, we'll see, in the U.S. if they're successful often you'll see the other countries copy, especially in the G7.

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Pamela Ritchie: This comes from the quivers from the Japanese finance minister, doesn't it, who then became the 3-3-3. Sorry, carry on.

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Joe Overdevest: Oh no, I was just going to say, one thing, you made a good point though about the tariffs, I think we have to watch for this audience and our investors here are listening is right now everyone's worried about the 25%, we have to watch closely. Twenty-five per cent may go away as in they don't tariff us at 25% but there's a second phase here and we have to watch that America right now is being very vocal, they're going to put tariffs on everybody. We just have to be watchful that, to your point, one of the ways they can bring revenue is put tariffs on multiple countries. Now, we can maybe only be 5%, maybe it's individual products but that brings revenue in for them so it's almost in a way a backdoor tax on their people but to the average American some of them will be more comfortable saying I'll pay a little more but I'm not paying higher taxes and by doing that you're almost funding some of their growth initiatives.

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Pamela Ritchie: Does a 5 ... and we're just pulling this number out of air but, for instance, which would be more palatable to Canadians who say 5% rather than 25 but would that stay longer?

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Joe Overdevest: Again, it's as long as U.S. administration wants to do it.

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Pamela Ritchie: A smaller amount would be more likely to stay.

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Joe Overdevest: Yes.

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Pamela Ritchie: Because we would swallow it more easily than we would ... 25% might make a bit of a ruckus.

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Joe Overdevest: Yes, it would definitely ... it would put some companies and some industries almost a death knell, yes, especially industrial companies or autos, 25% usually you cannot run your business like that longer term.

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Pamela Ritchie: For investors who are making sure that those that need to be invested for a very, very long term, what are they taking out of this? What sort of energy renewal ... we'll go into the banks in a second as well and some of the other industries that you like but let's just stick with sort of commodities and energy. Is there a version of a super cycle on the horizon? Is that something that you would want to take a look at if you're investing for many, many years ahead?

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Joe Overdevest: Look, I think that commodities in particular right now, shorter term you have probably a large amount of OPEC spare capacity so OPEC spare capacity kind of caps you a little bit on the top side on oil. The bottom side is that supply really isn't going gangbusters in that it's been pretty constrained, as you said, because even if President Trump opens things up, they're not really looking to speed up drilling so that's good. You're probably in more of a trading range. The longer term view of probably commodities in general though is we're still needing more of this at this point in time and you have to watch that that handoff may not be smooth as in that we're not spending a lot on supply, demand is still creeping up for all these commodities, is that I think everyone hopes there's a nice clean handoff to renewables. There could be a situation where we're not bringing enough supply on for the actual incremental demand that we're still getting.

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Pamela Ritchie: Do you see that being developed by ... so, for instance, if we're a more open country to foreign investors on behalf of this, there's red tape that's cut, do you see Canadian companies being able to deploy business investment, essentially, or is it mostly foreign investment, maybe it doesn't matter but how do you see that unfolding?

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Joe Overdevest: On the resource space we have many great companies here in Canada that can do the monster share if things open up, and if the demand is there and the commodities are strong they can do it and provide it for themselves, would be great for ... as a Canadian investor there's lots of opportunities that we can take advantage of there. There would definitely be also, I would say, global companies would come to Canada because the last few years they've been divesting, I think that would change right and that would open up potentially acquisitions or just even greenfield capital development.

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Pamela Ritchie: The end of stranded assets, or many of them anyway, potentially.

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Joe Overdevest: We've had a number of years in Canada where there really hasn't been a lot of resource development on the most part and this could be the awakening that the last few years have been very little activity.

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Pamela Ritchie: If, and this is a big if because we're at the very beginning of one of the many sort of geopolitical issues, this is Russia Ukraine, but there are a lot of minerals there and Russia obviously is part of OPEC+, just curious if there was a new amount of supply, what does the conversation become? If there was some peace and some business done and things were slightly neutralized enough to have that international market back in, does it change anything for Canada one way or the other?

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Joe Overdevest: There's a number of commodities it touches so Russia-Ukraine crisis, just like anything we're talking about there's always gonna be winners and losers and things change. We always live in a very dynamic world and investing just is a microcosm of the world itself.

Russia/Ukraine, if there is peace there one of the things you might see is for fertilizer companies here in Canada, it might be negative. All of a sudden more potash comes out, more nitrogen comes out and also the knock-on effect, and this is where investing is multiple layers to it, nitrogen, the biggest input is natural gas. Because Russia-Ukraine crisis, the pipelines of gas from Russia to Europe have been drastically changed. If that goes back and all of a sudden they start flowing gas, gas prices in Europe start falling and all of a sudden nitrogen producers can make more money in Europe and so now there's competition at a lower price and our Canadian nitrogen players all of a sudden have to now lower their price. Right now the high cost producer is Europe because gas prices are so high.

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The one thing, though, the nuance is gold, which always is a topical thing for investors, is does that change because what happened is we look at all the stats, and again, back to what I said before, kind of like the echo effect, almost the butterfly effect. I remember very vividly when they said we're going to freeze the accounts of the Russians. At the time, it makes sense for what you were trying to do politically. I remember thinking in my head, there's big ramifications of what this means. The ramifications we're now seeing play out. What they are is it scared everybody going, oh, no, if I didn't have a different political view or I step in the wrong term view of the Americans, they'll freeze my accounts going forward. Almost every big country that wasn't super friendly with the U.S. or just okay friends all of a sudden diversified their assets away from the U.S. dollar into gold. Gold purchases by central banks have been up massively.

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Your next question will be, well, if Russia and Ukraine becomes peaceful does that go down? I would suspect it may not come out as much you think. I think the actual day it does because people say there's peace, gold is an asset you own when things are risky or there's turbulence but the actual central banking buying may not totally come off because, again, that concern that if we ever get in trouble they can freeze our assets, gold is a diversifier of that. That's why gold's actually had quietly a very big bull run here. We always talk about oil and gas but quietly gold's had a massive run.

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Pamela Ritchie: It's right up there with Bitcoin. Let's go into some of the other sectors. We have a few minutes left. Let's go into banks, industrials, industrials have turned into something else, they're an AI play so they have a different story, but go through sort of the financials in Canada maybe more broadly as well. They're also seeing some red tape, it looks like, being cut.

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Joe Overdevest: The banks are benefiting potentially from lower in terms of demand for how much capital they'll have to raise or keep on the balance sheet. The banks in general, what they're facing is a little higher credit losses, more yellow flag on the mortgage side. The Canadian economy as we stand here today is okay, not doing amazing. We're debating 1 or 2% GDP growth. But the banks in general are having generally decent in terms of valuation. You're probably paying around 11 times earnings, give or take. You have a 5% dividend yield depending on the stock. Once you get past this in terms of the mortgage renewals you potentially have stronger earnings growth. Again, we'll see how the tariffs go.

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Some of the more exciting companies, probably insurance, property and casually. They're seeing great pricing, negative for owners of insurance but great for insurance companies. Many of these companies that my clients who invest with me would know, they've been there for a little while, are having huge demand in terms of their product and the pricing power is really on the insurance side, in particular property and casually.

The other one is asset management side. We're seeing huge demand for private equity, infrastructure, renewables and there's a few companies we can have advantage there ownership wise are really seeing huge growth. Those are some of the things that are happening in financials.

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Pamela Ritchie: That has long legs, we think.

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Joe Overdevest: On the alternative side, definitely. In terms of the asset allocators of Canada, the U.S., and the world we're seeing pretty big demand still from diversifying away a little bit into some of these buckets. There's only a few major companies in the world that can do that and some are here in Canada.

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Pamela Ritchie: We're weaving AI through here quite nicely. It's not the headline, because it often is which is pertinent. In terms of software, for instance, there's some discussions that software will be sidelined, AI will sort of run amok. Tell us a little bit about where you see some winners and losers in this country in particular.

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Joe Overdevest: Ai is very dynamic and there's definitely some winners and losers. I would say, obviously, on the loser side right now you just have to watch, basic companies are providing a customer service centre for instance, or customers that are not in touch with their actual client base. They're very non-computer-friendly.

What we're seeing definitely the winner wise, here in Canada we have some companies providing chips, what they call A6 chips and the most detailed chips you would use with the hyperscalers are actually coming from a Canadian company here. Also, you're seeing in the legal space it's a great way for lawyers to say, you know what, draft me the first version of this legal document, take all this information in, or search for something in this huge database of a case that looks like this, and then I will review it before I give it to my client. It saves a huge amount of time to actually let them more think as opposed to going through a whole bunch of papers.

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Lastly on the software side we're seeing in Canada certain companies we're working with, it's cutting their R&D spending so they can either have less engineers coding or use those engineers for more products, or on the sales side figuring out how to market and also even helping their customers connect with the actual clients.

An example would be you want to go buy a couch you go to AI and go tell me the top three couches and AI goes into the marketplace and finds all the different companies out there selling couches and brings you back a summary. Again, an example of you have to do less leg work and you're more thinking.

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Pamela Ritchie: No, you just sit on the couch, while you're looking for your new couch. I think that sounds great.

Quick note on Europe, what we're seeing ex U.S. exceptionalism, if that's what we're seeing, I don't know. It seems to be a consensus coming into this year that U.S. exceptionalism continues, which doesn't seem wrong necessarily but there are some other options out there. What do you think?

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Joe Overdevest: I think it's an example where the market is a discounting mechanism and everyone was very bullish on particular markets, the U.S. As you see here, yes, quietly Europe's doing well. Canada even with all these negative headlines is doing pretty decent, especially versus the U.S.

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Pamela Ritchie: Don't tell anyone.

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Joe Overdevest: Don't tell anyone. It's our little secret. That's an example for this audience, don't get emotional. Number two, look to make sure you're diversified just in case something major happens. Number three is try to look for opportunities. Again, lots of negative headlines. If you actually pull back, there's many great companies. Here at Fidelity. we're not trying to own the market, we're not trying to own the index, we're trying to own the best portfolio that our clients would have for the best-of-breed of Canda.

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Pamela Ritchie: Fantastic, statesman for Fidelity. What would you leave as sort of a final note on maybe just the Canadian moment.

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Joe Overdevest: I think the Canadian moment is that this is a great opportunity to galvanize ourselves as a country, number one, maybe make ourselves better, hopefully. Number two for investors especially out there, just understand that many of our Canadian companies don't just sell products across Canada. They stay domestically, they may sell more into the U.S. and actually have operations in the U.S. Lastly, always try to look for opportunities, especially at times like this where there's a lot of volatility. If you can turn over enough rocks sometimes you find some great opportunities.

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Pamela Ritchie: Joe Overdevest, great to have you at the helm. Thanks for joining us today.

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Joe Overdevest: Appreciate it.

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Pamela Ritchie: Coming up on Fidelity Compass, if you have any suggestions we'd love to hear from you, any ideas, people you'd like to see here and discuss. Do stay tuned for more of Fidelity Compass webcast coming up in the weeks ahead. Thanks for watching and joining. I'm Pamela Ritchie.