Fidelity Compass

Unlocking Global Potential: U.S. versus Europe and Beyond

Patrice Quirion, Portfolio Manager

Pamela Ritchie, Host

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Pamela Ritchie: Hello, and welcome to Fidelity Compass. I'm Pamela Ritchie.

Global markets have been shaken to the core after months of policy changes, tariff moves from the U.S. administration and as we steer away from this era of U.S. exceptionalism (if you agree with that), eyes are on other investment opportunities across the globe.

How is our next guest navigating complex market currents and what areas is he leaning into? Joining us here today to discuss how he's unlocking global opportunities in China, other parts of Asia, Europe and elsewhere is Fidelity Portfolio Manager Patrice Quirion. Welcome, great to see you. How are you?

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Patrice Quirion: Pleasure to be here. Yeah, good to see you, Pamela.

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Pamela Ritchie: You've actually been travelling to some of those places that we're about to talk to you about, haven't you?

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Patrice Quirion: It's part of the process, trying to be very hands-on, seeing it firsthand. I just came back from a week in China and a week in Japan and going a week in Europe, actually, leaving in a couple of days. We can talk about all that.

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Patrice Quirion: I think we need to rewind the clock to sort of the days and few weeks after the U.S. election where...

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Pamela Ritchie: Okay, November.

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Patrice Quirion: ...we basically, in my opinion, culminated towards that view of all Republican policy decisions would be great for the U.S., terrible for the rest of the world. We've come out of a decade of U.S. leading the charge in terms of outperformance, currency, strength, hosting a lot of the sectors that have been driving the global markets. We culminated with this, basically, U.S. exceptionalism where a lot of investors thought nothing could really go wrong in the U.S. and the rest of the world was, I'll put it in a bit of an extreme manner, but uninvestible or not interesting.

I'm always of the view — I'm a contrarian investor at heart. I think the markets are efficient directionally but markets overreact. There's some short cycles, but you also get some really long cycles and you kind of get those peaks and valleys that get created. In my opinion, sort of the aftermath of the U.S. election sort of brought the markets to this peak positive view on the U.S. stock market, peak negativity on the rest of the world and that has a potential to create a lot of opportunities.

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My positioning is not only since that period, it's been quite a few quarters, a few years that I've been advocating to start looking outside of the U.S. for mostly three main reasons.

The first one is if you think of valuation differential and expectation differentials, it's no secret, it's still the case today that the U.S. gathered a very significant premium that investors are willing to put on its domestic companies relative to Europe and, to the extreme, relative to China. That's only one element and valuation is never what will be the trigger.

The second element I think is probably even more important over time is...as I mentioned, I'm a believer that most patterns, most phenomena follow a cycle. If we think of the economic cycle, or the broad leadership cycle, the economy is driven by three actors. You have consumers that spend, you get the governments that spend through fiscal means and you get the corporate sector that spends. I do spend some of my time ... obviously, most of our time is spent looking company by company but I do spend some of my time thinking where are we on those respective cycle, like small cycles relative to a company or subsector or sector, or a big cycle relative to the economy. On that economic front, I think we are at a starting point where, on the U.S. side, you have a consumer that has been spending, call it aggressively, ever since the reopening post-COVID.

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Pamela Ritchie: This is a U.S. consumer.

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Patrice Quirion: The U.S. consumer, exactly, has been spending all the excess savings that were built during the pandemic, has be releveraging on all sorts of unsecured lending. Everyone had a job, there was huge wealth effect, confidence was peakish which allowed all of that to sustain itself for quite a few years now. You have the fiscal side, the government has been overspending, right? That's why the U.S. has a 7% fiscal deficit which is by all means and according to any expert unsustainable at those levels. I think we're starting at the peak of the cycle for the U.S. The interesting thing is although a lot of the economy is synchronized, we're at a point where if you look at Europe, and to the extreme if we look at China, the consumer is saving a lot of its money. The consumer has delevered, not relevered. The confidence is low, not at the peak. We are starting from a very low point on the consumer but what's interesting, it's not only the consumer it's the governments as well. You look at Germany that suddenly has the fiscal lever that they can pull to their advantage by increasing spending.

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Pamela Ritchie: And they were careful not to for a long time.

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Patrice Quirion: Exactly. That discipline of the past versus, call it, maybe a bit of indiscipline in the U.S. now puts them in a different position to face the shock that we are seeing at the moment. A very similar picture in China. I think from a cycle perspective the U.S. is starting at a high point. The rest of the world is starting at a relatively low point, most of the rest of the world, and that creates an opportunity as it is combined with low expectations and low valuation on the rest of the world. I think the story of the first quarter is the market starting to doubt that very positive view on the U.S. and starting to realize that some of those policies might not be all that great for the U.S., the confidence that has been carrying the U.S. consumer through this, the corporate sector through this. I think that requestioning from a very elevated starting point is essentially what we are witnessing now. A little bit of the unfolding of that happened through the first quarter, then we got to April with Liberation Day, created a ton of noise through that but I think that underlying rotation, leadership of the market, people from international markets bringing money back home, prospects on a relative basis starting to improve at the margin in China, for instance, while maybe prospects at the margin are starting to deteriorate in the U.S. is creating that rotation which I think has very likely more to go.

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Pamela Ritchie: That is one of the big, big questions. We saw this through the beginning of the year, it was really a Europe story, and elsewhere, China at the end of last year and through the beginning of this year but it was really, yeah, it's not a value trap anymore. It's, actually, a value story and we're ready for it. That was the catalyst, was it?

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Patrice Quirion: Yeah, I think we could very well look back at this period and think that was the catalyst where the market, basically, started to doubt a little bit all the very positive expectations that were put on the U.S. market. Let's remind ourselves, there's two big economic poles, one that has been doing very well for the past decade in the U.S., and China which is the other big pole which matters to all of Asia, even matters for Europe to some extent, which has been on a declining path, especially since 2018, 2019. If it was to revert, I think it will be that inflection point that has the potential to help us understand where the leadership for the next 5, 10 years could come from after a decade of U.S. exceptionalism.

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Pamela Ritchie: You happen to be landing in this seat talking to us right now the night after huge tech earnings where the CEO went right ahead in his conversation and guidance and so on and sort of waded right into the trade war, basically, and said, absolutely, China's economy, its innovation, everything is coming right now. There's no way, from his perspective, we're gonna stop selling our product there because we can't. He's probably one of the only people in the world who can say something like that quite so boldly. It was interesting to hear. Do you agree?

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Patrice Quirion: Yeah, I do agree.

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Pamela Ritchie: Maybe not with the company, what they're doing, but that sentiment.

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Patrice Quirion: I do agree. I just came back from a week in Shanghai, actually, where we met a lot of companies but a lot of companies more in the innovation space, a lot of AI companies, self-driving companies, electric vehicle companies. I think there is that impression that I have each time I go to China, and I go once or twice a year since many, many years, if we rewind the clock a few years back, it was sort of a quick catch-up to, call it, Western standards of quality of products. Now it's starting to be more than just that.

We're starting to see fields where I think they are clearly starting to take the leadership and other fields where I think a lot of people think that they are years behind. Let's think of semiconductors as an example, where they are clearly, behind but what's thought to be five years behind is maybe one year behind. The pace of innovation is pretty staggering right now. This is in a context where a lot of Western companies have been sort of slowly losing their market share within their market as those local Chinese (and it's not only in China, by the way, but China's the big country in Asia) where those local companies have gone up the quality spectrum, have started to build brands and are still at a meaningfully lower cost or price point.

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Pamela Ritchie: And they're starting to get competitive.

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Patrice Quirion: We are seeing that gradual transition where Western companies, European, American, Japanese companies who dominated most of the industries historically, even up to 10 years ago, have now, in a lot of cases, lost the majority of their market share in China. I think the big question we need to think about as global investors for the next 5 to 10 years is I think we did witness and we are largely done on that substitution domestic versus foreign companies in China but now all these Chinese companies have moved up to the point where they are starting to be ready to take over the world — or that's too strong of a term but starting to broaden their operations outside of China and targeting emerging markets first. We need to pay a lot of attention to that because this is not one thing that will change overnight. I think this is a trend that's going to be really hard to reverse.

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Pamela Ritchie: So there's more to say, I want to ask you more detail on that. In light of that and in light of the tariff story that's going on right now, just speak a little bit more to sort of the tectonic shifts with China having more influence with very good products, globally competitive leadership products that you're talking about. Do we actually need a few tariffs?

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Patrice Quirion: I am of that opinion though it's great that you bring this up. The market, if we look over the past month or so, gradually the market started to dismiss the risk of tariffs because we went from a catastrophic scenario in early April with Liberation Day to all those tariffs being sort of postponed and hopes of negotiation with some countries. I think we're at a point where the market has maybe not forgotten but has not priced in much negative outcome from those tariffs. Maybe we have the proof point of that today where yesterday we got a court ruling which, by the way, there's going to be ways around that but you get something that, basically, indicates that tariffs may take longer to be implemented, or not be implemented at all in some cases, and the markets are basically flat. I think if that had happened...

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Pamela Ritchie: I mean, there are also some big tech earnings as well but that said, are we just sort of resilient to the tariff story a little bit?

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Patrice Quirion: I think that would be the optimistic way of looking at it. I am a little bit more in the opinion that maybe the markets grew a little bit complacent about the risk of tariffs or the impact of tariffs even if it's at those lower levels.

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Pamela Ritchie: So not pricing it in well enough at the moment, perhaps.

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Patrice Quirion: I suspect there are a lot of cases where that is the case. Back to your prior question, I am absolutely of the view that the Western markets, the U.S., Europe to a good extent, will need to have some of these tariffs going forward because that wave of exports coming out of China by increasingly competitive companies...

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Pamela Ritchie: Not small plastic things.

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Patrice Quirion: No, no, this is cars, it could be semiconductors at some point, could be artificial intelligence at some point, things that really matter now. I think the Western world will need to protect itself against that through tariffs or, who knows, do we get in a scenario where you need to see a very strong appreciation of the Chinese renminbi to protect in other sorts of ways, and there's a lot of ways to protect yourself in non-tariff ways like non-tariff barriers and I think at the moment we are using a little bit of all of that trying to mitigate the pace at which we go because it has the risk of creating a lot of collateral damage in the process, like tariffs. I think the direction is likely here to stay and I would caution about that complacency the market has at the moment.

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Pamela Ritchie: It's very interesting. For years I think you've been underweight the U.S. markets. Is that correct? Just tell us a little bit about your underweights and how those have worked quite recently because things have happened for different reasons in the last little while but you have, actually, been underweight the U.S. for a while.

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Patrice Quirion: It's been the case. I think part of it in the global mandate, I know the indices are saying the U.S. was almost 70% of the world's market cap, I've never really been comfortable saying I will put 70% of our global allocation to the U.S. There's a little bit of that but more deeply, the reality is since the year after the pandemic the expectations, the price the market was willing to pay for securities in the U.S. relative to pretty much everywhere else across the globe just diverge into like an historically almost unprecedented way.

Given my mandates have huge flexibility in terms of sector allocation, style allocation but also country allocation, if I am offered a multinational X in Europe at a big discount to a very similar multinational Y in the U.S., my preference will be to shift to the cheaper alternative. Over the past quite a few years that cheaper alternative was found outside of the U.S. That's been a big part of the reason.

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On top of that, as we discussed earlier, I think we were starting to look incrementally sort of towards the peak of the cycle, economic cycle in the U.S., incrementally towards the trough of the cycle, especially in China, in Europe in the aftermath of the Ukraine-Russia invasion so that will add a part to play as well.

The last part, and an important part, is the U.S. has been increasingly driven by a very relevant tech sector, the Magnificent Seven, semiconductors, artificial intelligence and that became a meaningful part of the U.S. market which is just not in my investment style to be chasing those stocks all the way up. I am more contrarian value focus. I ask a lot of questions about what does a company look like in 10 years and to go into those very fast moving where change is happening in a very favourable way but maybe that could unfold or go into another way a few years down the road, it's just not what I'll be chasing. I've also had a very large tech underweight, especially in the U.S.

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It's the combination of all these factors that increasingly pushed me towards the rest of the world. It's been a multi-year process. It's sort of peaked just as we started to see that reverse and where am I today, the portfolio was very extreme in its positioning where I had sort of low 20 percentage point exposure to the U.S. while it was almost like two-thirds of the world's market cap. There was a point where I think I had more China exposure than U. S. exposure in the portfolio if we go mid last year.

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Pamela Ritchie: So, you caught that stuff at the end of 2024 where the Chinese market just flew.

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Patrice Quirion: We did benefit from that. We were there before that as well so it's not all been a fantastic story yet but it certainly helped in a major way over the past six months or so.

Where I was going with that is that I think there's potentially more to go on that trade as well, or that allocation. I think we're starting to see early signs of not only the rest of the world outperforming... If we look back over the past 5 to 10 years, we certainly had episodes where China did better, where Europe did better. I think what's different this time as opposed to those prior episodes is this time capital seems to be moving. In prior episodes, nobody reallocated their U.S. exposure into Europe or into China or into Japan. Now we are seeing that money moving and that's, I think, interesting and different.

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Pamela Ritchie: Let's talk a little bit about where the money that you're managing is moving and how this is looking. Let's begin with Europe. Europe was often a story of banks and so on and cheap valuations. What is interesting to you in Europe right now given, actually, a lot of valuations have come up pretty substantially in the last six months?

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Patrice Quirion: It is changing in quite a meaningful way, actually, where my preferences are in Europe.

The first thing I'll say is it seems everything we're discussing right now is very macro in nature. The reality is we are deep down stock pickers. I'm trying to reflect that at a high level but it's always stock by stock or subsector by subsector. In my portfolios the story in Europe for the past number of years has been European financials which were, I think, too cheap, victim of interest rates that were too low for too long. We've seen a lot of that coming back in a pretty impressive way. I think it's still interesting but much less than it used to be.

What is becoming interesting now is I think that notion of broad reacceleration of Europe probably driven to a decent extent by reconstruction, and I don't only mean that from reconstruction of Ukraine which will happen at some point, but the real estate market has been sort of flat and depressed ever since 2013. Banks, like loan growth has been anemic, has been none over the past 12 years. There's been a lot of deleveraging taking place. I think you're starting to see governments pulling on that fiscal lever to stimulate infrastructure.

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Pamela Ritchie: And there are leveraged loans going out for exactly that right now.

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Patrice Quirion: I think that could be the story for the next few years, more of a reconstruction or bringing some dynamism back into Europe, more from an old industry standpoint in a way.

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Pamela Ritchie: That's really interesting.

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Patrice Quirion: Europe probably won't be a hotbed of innovation if we're realistic but there is opportunities in that. Again, just as over the past few years it was more targeted towards the banks in my case, now we're more targeted towards construction-related type of companies or chemicals. This is very different than saying I'm buying Europe at large because if you buy Europe at the index level, you get a whole lot of multinationals that have basically very little to do with Europe, especially almost nothing to do with Europe reconstruction in a way.

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Pamela Ritchie: With our minutes left I want to make sure that ... you just mentioned, actually, Europe may not be a hotbed of innovation. What you've been describing about China absolutely is, though. Tell us a little bit about when you're looking at China, you're not looking at real estate, you are not looking at some of the areas where things are (inaudible) but big savers, a consumer that probably does need to take over the reins at some point from the export story?

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Patrice Quirion: Absolutely. I think China is a centrally governed economy and you see where they went and you see where they're going. The story of 10, 15 years ago was all about real estate and infrastructure and they did that and overdid that. Then for the past five years, more or less, it was all about developing, upscaling their manufacturing sector and developing exports. We are there. This is done to a large extent. What's going to be next is, in my opinion, very likely to be a pivot towards building more of a developed style consumer economy. Today in the U.S. or in Canada or in Europe, the consumer makes up 60 to two-thirds of GDP for our countries. In China, the consumer is still only 40% of GDP.

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Pamela Ritchie: So there's a lot to move there.

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Patrice Quirion: A lot to go. The savings rate, as you mentioned, we're used in the Western world to more or less 5% savings rates. In China, it's more in the 20 to low 30% savings rate. There is an ability to spend more, especially on services, on travel. If you go below the tier-one cities, the four biggest cities in the country, if you go below that there's still between 500 million and a billion people that are not consuming the same way that most of the rest of the world does. I think this is going to be a multi-year shift that I think the government will try to incentivize. I think we're starting to see early signs of that taking place.

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Pamela Ritchie: Does it become leadership?

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Patrice Quirion: I think it has the potential to become. Obviously, one of the big questions right now is every decade tends to add a different market leadership. Go back to oil in the '70s and '80s and Japan and then the internet and then China, actually, in real estate and commodities leading to the financial crisis of 2009. Now it's been the U.S. and tech over the past 10 years. Odds are it's going to be something different the next decade. I can't guarantee you what it is. I think a lot of people are searching for that answer. I think the market consensus is it's going to be AI. I think it has the potential to change the world but I also think there's a risk that AI is like the internet in 2000 where it takes much longer before it really changes the world. I think that China transition, more competitive export sector, shift to the consumer economy, I think that could be a story that is certainly not consensus right now that could be the big driver of the next decade.

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Pamela Ritchie: It's so exciting, Patrice, honestly, fascinating. Now, are you in the habit when you travel around the world to visit companies, of just meeting central bank governors? Is that part of what you do? You mentioned you've been back from Japan and I thought I heard you say you were meeting with the BoJ.

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Patrice Quirion: Yeah, yeah.

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Pamela Ritchie: What'd you do in there?

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Patrice Quirion: Most of our time is spent spending time with our analysts, with experts on the ground meeting corporates but we have a lot of doors that can open for Fidelity. I think it's my role, it's our role as a team to take advantage of those. I think there is potentially a really interesting story in Japan developing around sticky inflation, raising interest rates. We talked briefly about the impact of higher rates on European banks and I suspect there might be a very similar story developing in Japan right now, started to reallocate some European bank exposure to Japanese bank exposure. Obviously, if it's an idea where the main driver is the interest rate environment we'll try to open the door of the central banks of those countries. We did have a meeting with not only the Bank of Japan but the Ministry of Finance. This is just an example among so many others on a yearly basis where we do open doors that are maybe less available to other investors and let's try to use that information to our advantage.

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Pamela Ritchie: Well, we're grateful that you came here and opened a door and let us peek into some of the travels that you've been doing, who you've been meeting with and building consensus. Patrice Quirion, thank you very much for joining us.

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Patrice Quirion: Pleasure to be here. Thank you.

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Pamela Ritchie: Thank you for joining us on Fidelity Compass. If you've got any suggestions for future topics or guests that you'd like to see and hear from on the show do go ahead and share your ideas with us. You can stay tuned for more Fidelity Compass webcasts in the weeks and the months ahead. Thanks for watching. I'm Pamela Ritchie.