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[INTRODUCTION]
Sam Slator (SS): Hi, I'm Sam Slator from FundCalibre and today I've been joined by Alex Wright, manager of Fidelity Special Values investment trust. Hi Alex.

Alex Wright (AW): Hello.

[INTERVIEW]
[0:14]

SS: So, your most recent update suggests that you're cautiously positioned in case a second wave of the pandemic is worse than expected. What companies are you favouring to achieve this?

AW: So I'd say the fund is fairly balanced. I wouldn't say we're particularly cautious, but neither are we necessarily that aggressively positioned. And I think that's basically because I'm seeing value across the market. So, it's not just in cyclicals or it's not just in defensives, but certainly in the lower growth stocks I think there's an awful lot of value there. So, we've got some really quite large defensive positions. So, we're quite big in healthcare, in Sanofi and Roche, we've got a big position in an Imperial [Brands], we've got some utilities in ContourGlobal and John Laing, but then we do have some more aggressive positions as well. So, for example, the life insurers, the biggest position in the fund, they're clearly more economically and cyclical, but less so than people perceive. So I think the fund is fairly balanced rather than necessarily being defensively positioned.

But we do have a reasonably small number of sort of directly/heavily affected by the virus, names. So probably only about 4% of the fund in what I would call stocks that can't really get back to their proper earnings potential until the vaccine comes and the virus moves out of general circulation. So I think it's too early to be positioned for that side of the recovery in terms of the very impacted stocks. But we do have stocks which are affected by the economic cycle, which is obviously impacted by how big and how negatively the second wave effects the UK economy.

SS: And those four [%] that you just mentioned then, you must have very high conviction that they're going to come out of it, if you're willing to hold on to them in this period?

AW: Yeah. So these aren't stocks that are closed and aren't earning any money. So I don't own any airlines, for example, or hotel stocks or pub stocks, which are burning cash right now. These are companies, so the biggest of those is Meggitt, which is aerospace after-market business. So they're still getting money because some planes are still being serviced, just less than normal. And then they also have a big military business. So earnings are well down, more than 50%, but there are still earning still, so they are still profitable, same in C&C, which is a drinks business that is very badly impacted and certainly one of their businesses is making a loss cause it's on trade distribution to pubs, but they also sell Magner's cider, which is also an off trade business. So these aren't companies that have a big balance sheet issue in the short term, because they haven't got any earnings, but they have got much more depressed earnings until we see a normalisation of societal conditions.

[3:07]

SS: Okay, thank you. And your gearing is still quite high, it's around 14%, why is that?

AW: So the gearing's moved up over the last year. So if you went back to sort of, towards the end of the year, we were close to only 2% or 3% gearing on the trust because it was more difficult for me to find opportunities. I think, with the market downturn and obviously that the market and the trust has had a really tough time this year, that the good news from that on the other side, the silver lining as it were to that, is the fact there's a lot more opportunities. So I found a lot more attractively priced stocks and therefore we've been buying new names. So the name count has moved up back to about a 100 and we were down at about 90. And the net has constantly moved up as well. And again, some of that is actually defensive stocks. So, we bought Origin, which is an agriculture company, Ericsson and Vodafone in telcos, but also some more cyclicals as well. So we have increased our weight to UK housing by buying into LSL and a couple of UK house builders, as well as buying into Inchcape, which is a motor distributor. So again, showing that there is a lot of value out there and it's actually across the spectrum, those cyclicals and defensive companies.

[4:27]

SS: One of the areas of value traditionally has been the oil and gas companies, but I noticed that your weighting to that's relatively low. Do you think that's a value trap and something to steer clear of?

AW: Yeah. So I'm always very conscious on this strategy to look sort of at value with positive catalysts. So like other value managers, I'm looking for companies that are cheap on price to book where returns are low, but I think differentially from some others, I'm also looking for what will the catalyst be to get returns to rise? And so I'd say compared to other value strategies, and actually there aren't many of them left now in the UK, but in terms of that small subset of competitors, I am very underweight oil and gas and also underweight banks, which is unusual because I think those two sectors based on the work we've done at Fidelity, it's actually very difficult to see the current low ROEs rise. So the stocks are very cheap. There generally isn't a problem with balance sheets. And there's good downside protection in those names, but in terms of returns rising, it looks quite hard. So there are some select stories in oil and gas and banks, which I think the ROE will rise from current levels. But in many cases, I don't think they're going to rise. So I think the stocks will stay cheap. And I guess that is the classic definition of a value trap - a cheap stock remaining cheap.

[5:48]

SS: And what are your thoughts on Brexit as we've got another deadline looming? What do you think could be the impact on UK companies - you've got quite a weight to small and mid caps at the moment, are you worried at all?

AW: Yeah so Brexit is an ongoing risk to the portfolio as it has been for the last five years. And that's one of the reasons that investors have been shying away from UK equities and one of the reasons they remain extremely cheap compared to other markets. I think what's interesting though, is that, well probably 12 months ago, you could say Brexit was the biggest macro risk for the UK. Clearly the COVID pandemic is a much bigger macro risk than Brexit. And also I think it's somewhat of the same nature. So the real risk isn't the change in the relationship. So it's the suddenness of a potential 'no deal 'coming in on January the first, but actually the disruptions in supply chains that I and others have been worrying about if that comes to pass, I think is not that dissimilar to the disruptions in supply chains we've seen because of COVID. So effectively there being a shortage of inventory, you're not being able to get things through borders, being longer checks, things take longer.

So actually, a lot of UK companies have done reasonably well with dealing with the logistics of COVID because they had that hard Brexit planning in place already. And so I think actually how damaging that sort of 'no deal' Brexit will be, is probably in my eyes, less of a risk than maybe I thought it was, because firms have unfortunately had a sort of a dummy run there and they know what to do in those circumstances. So while I think if there was a no deal Brexit, it would be negative for UK companies in the short term, and I would expect the pound to full on that. I don't think it's as big a risk as I perceived it to be previously. And certainly as I think the market continues to perceive it to be a very large risk, and therefore you are being compensated in valuations. And that's the reason that I'm overweight pound earning equities in the fund compared to the market.

So actually, because UK domestic equities have done so poorly over the last five years, they only make up about 25% of the UK market today. So actually 75% of the market is now international earners. So actually, a weakness of the pound ,for pound based investors is actually really good for the value of their portfolios. And we have about 35% of the portfolio invested in pound-based earnings. So actually, in a hard Brexit, if you are measuring the returns in pounds, actually I still think it would be positive for the fund in absolute terms - albeit negative in relative terms compared to the market or more overseas markets.

[8:47]

SS: And you do own a couple of overseas holdings, don't you? Could you perhaps talk us through one or two of them and why you like them?

AW: Yeah. So the trust has regularly made use of the 20% that we're allowed to invest overseas. And actually, consistently that we've had maybe sort of between 15% and 20% invested overseas over my tenure since 2012. That has come down a bit more recently actually, as some of the US names that I've owned historically I've sold down. So we only have Mylan in the US now in the healthcare space, having sold out of Citi[bank], which was a very big position for us and has done actually quite well, which is unusual for a bank. Most banks have underperformed, Citi has actually outperformed over the period that we owned it.

In terms of today, the big weights in the overseas holdings are in the healthcare space. So I think when you look at the UK healthcare space, it's a very narrow universe. You've basically got Glaxo and AstraZeneca. And certainly in the case of AstraZeneca, that is an extremely expensive company. So investors are very excited about the growth that's coming out of that business. And indeed in the short term, there is some very strong growth coming from that company, but you're very much paying up for it. And when, if you look across the wider universe into Europe, there's a lot more choice in healthcare companies and I own, Roche and Sanofi. Their geographic exposure is very similar to a Glaxo or Astra[Zeneca], but the valuation is much, much better. So Astra[Zeneca] is over 25 times earnings now, Sanofi and Roche are more like 13 to 15 times earnings. And actually I think their long term growth prospects - so outside of the very high growth that Astra[Zeneca]'s seeing for the next couple of years because of new drug launches - is actually quite similar. So that valuation gap to me is really attractive. The fact that you've got companies with reasonable long term prospects, good balance sheets, very diversified earning streams and dividends at a very large discount, not just to the sector, but to the available UK peers.

SS: That was really interesting, thank you.

AW: No problem. Thank you.

SS: And if you'd like to find out more about the Fidelity Special Values investment trust, go to fundcalibre.com and don't forget to subscribe to the Investing on the go podcast.