

## Investing in real assets as a way to protect against inflation



**Amit Lodha** is the portfolio manager of Fidelity Funds - Global Real Asset Securities Fund.

Amit joined Fidelity as an equity analyst in 2003. Initially covering a number of sectors in the Indian market, Amit took on responsibility for coverage of natural resources stocks and commodities at the start of 2007. He was promoted to the role of portfolio manager in April 2008.

Before joining Fidelity, Amit worked as an equity analyst for Citigroup Smith Barney in India. Amit has both Bachelors and Masters degrees in Commerce and Economics from the University of Mumbai. He is also a qualified chartered accountant and a CFA Charterholder.

### AT A GLANCE

- At a time when inflationary fears are at the top of the agenda, real assets can provide a valuable protection against inflation.
- Many compelling investment opportunities exist within the real assets space. Pricing power and the distinctive nature of particular assets are both important attributes for fund managers hunting the best bargains.

We are now living through a period of rising oil and other energy prices, rising food prices, increased wealth in developing economies, sovereign debt problems as well as fiscal deficits in many developed nations, and more regulation – these factors are all adding to the growing fear of inflation.

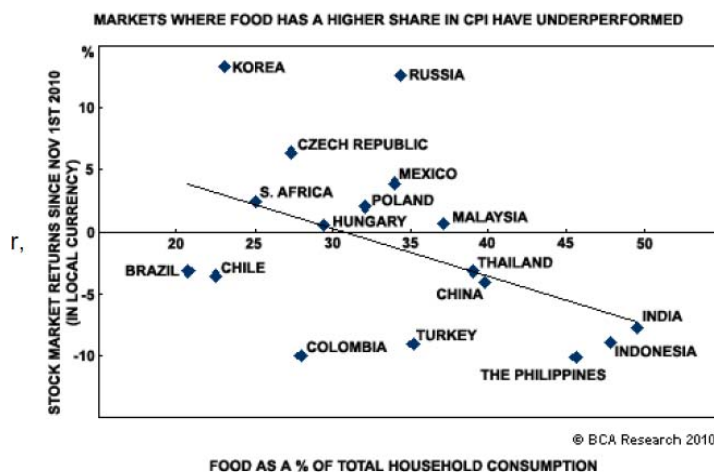
In a time when inflationary pressures are threatening to increase, owning the securities of real assets, whose value and returns are directly linked to rising prices, is a strategy worth serious consideration.

Real assets have intrinsic value. Examples include gold, copper mines, oil fields, real estate, land, etc. Generally, inflation does not erode their value, which makes them an interesting opportunity given the current climate. Portfolio manager of Fidelity's Global Real Asset Securities Fund, Amit Lodha, gives his view on the economic landscape and this investment opportunity that is a unique way to protect against inflation.

### UNCERTAIN TIMES

The global investment environment has been extremely uncertain and through most of 2010 and into this year, many commentators have continued to worry about inflation. This has resulted in the need to vary the level of risk in a portfolio to cope with these uncertain times. My view has stayed the same; inflation is likely to be a problem that all of us will have to deal with sooner rather than later. If we just look at the impact of food price increases - this has had a dramatic effect on the stock market performance by country. The chart below illustrates that where food as a proportion of total household consumption is higher, these countries have underperformed in recent months. Therefore, these countries have been directly impacted by rising food inflation.

### EFFECTS OF FOOD PRICES



Source: BCA Research 2010

## TOP 10 SECURITY HOLDINGS (%)

as at 31.01.11	Fund	Benchmark
EXXON MOBIL	4.9	3.7
ROYAL DUTCH SHELL	3.2	1.1
GENERAL ELECTRIC	2.4	1.4
UNITED TECHNOLOGIES	2.4	0.5
TALISMAN ENERGY	2.3	0.2
BG GROUP	2.2	0.7
SUNCOR ENERGY	2.1	0.6
SIMON PROPERTY REIT	1.8	0.9
INTERNATIONAL POWER	1.8	0.1
WHARF HOLDINGS	1.6	0.3

Source: FIL Limited.

Benchmark: MSCI All Countries World Real Asset Composite Index

Top security holdings are those securities in which the largest percentage of the fund's total assets are invested. Holdings in different securities issued by the same company are listed separately and any exposure achieved by derivatives is not shown. This means that the data may not always represent the total exposure of the portfolio to any given company. A full list of holdings, including derivatives, can be found in the fund's annual and/or semi-annual report and accounts.

References to specific securities are for illustrative purposes only and are subject to change without notice. They should not be construed as a recommendation or advice to transact in the securities.

## THE IMPORTANCE OF PRICING POWER

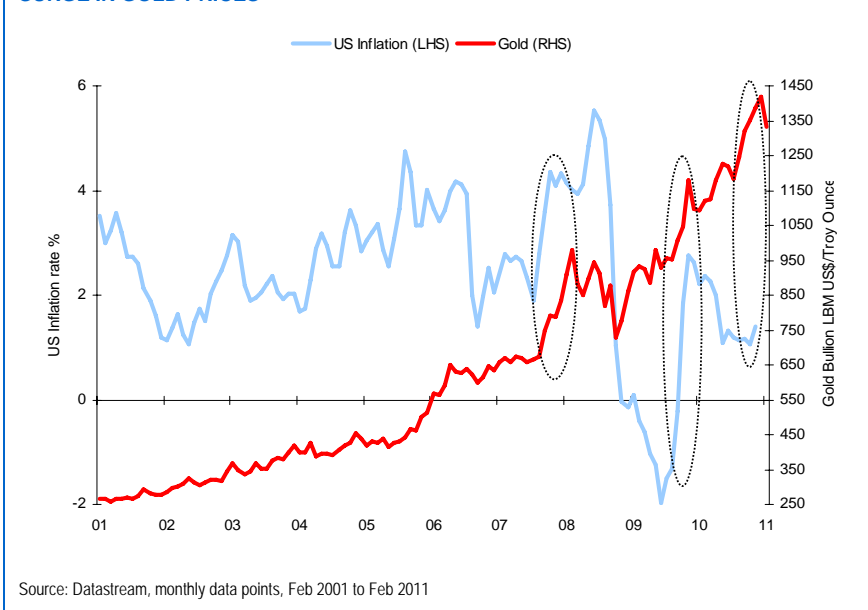
Wealth protection (and generation) will be a function of finding those companies (irrespective of their country of listing – emerging or developed) which have either the pricing power or uniqueness of assets to grow earnings, cash flows and dividends in this environment. My fund is invested in companies based on the strength of their pricing power to withstand inflationary pressures.

An important step in my analysis involves meeting companies across different value chains to build a better picture of the forces impacting their profitability. Our global pool of research analysts enables us to search for the areas of greatest pricing power and competitive advantage and generally leads us to the best investment opportunity at each point in the economic cycle.

For example, there are many ways to take advantage of the significant scope for an increase in car ownership in emerging markets, other than the obvious one - the emerging market car manufacturers. One can invest in raw materials producers (such as the iron ore producers), the dry bulk carriers that transport the raw materials, the mills that manufacture the steel, the auto part manufacturers, the tyre makers, the distributors, and so on. Pricing power in the car manufacturing chain currently lies with the iron ore or copper producers. Both materials are in short supply, are critical for the manufacture of a car and the producers are able to pass on higher prices further along the supply chain. These manufacturers need not be listed in emerging markets. For example, some of the largest mining companies in the world - BHP Billiton and Rio Tinto - have seen huge growth in their revenues and earnings due to the increase in demand for raw materials from emerging markets, yet they are listed in the developed markets of the UK and Australia.

The fund also has exposure to commodities including gold producers that benefit from rising inflation. The attraction is that investors see gold and other commodities as a hedge since historically gold has moved higher when inflation gathers pace. This is because investors prefer to hold gold when cash starts to lose its worth, as can be seen in the chart below.

### SURGE IN GOLD PRICES

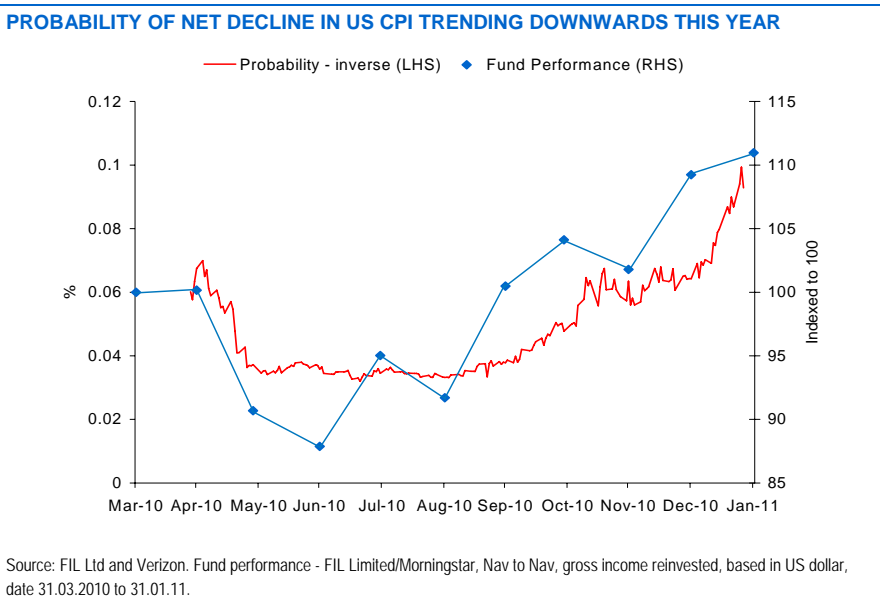


While US policymakers, and other countries, continue to favour an approach that ensures the economy gets the necessary kickstart (through extra money being pumped in), rather than worrying unduly about higher inflation, there will be little sign of the end of the commodities cycle just yet. Within the portfolio itself, I have holdings in Goldcorp, Detour Gold, Lonmin and Xstrata, which all benefit from rising commodity prices.

Additionally, the fund is invested in real estate which is to a certain extent a beneficiary of a higher inflationary environment. Again, this is a form of looking to see where the pricing power is. I look for periods when owners of property are able to pass through inflation to their tenants. Currently, my fund has exposure to Real Estate Investment Trusts (REITs) including Simon Property and Digital Realty and also to Hong Kong real estate company, Wharf Holdings, with interests in Hong Kong, China and Singapore.

## CORRELATION BETWEEN INFLATION EXPECTATIONS AND THE PERFORMANCE OF FIDELITY FUNDS GLOBAL REAL ASSET SECURITIES FUND

If one looks at the prices of Treasury Inflation-Protected Securities (TIPS) with similar maturity dates in 2015 from the Atlanta Fed, it shows that the probability of a net decline in the consumer price index over the five-year period starting in early 2010 has been trending down this year – i.e. the probability of inflation has risen. As can be seen These expectations when inverted tend to follow the performance of Fidelity Funds Global Real Asset Securities Fund.



### FINAL WORDS

In conclusion, pricing power and the uniqueness of an asset are key attributes of the businesses that I like. Equities of such businesses, which have good valuation support that gives a fair margin of safety on investment will become part of the portfolio. The asset allocation decision between different themes is driven by the research and valuation work that we do at Fidelity and in my view is a better approach to investing in these cyclical sectors individually. Most of the value-added comes from stock picks rather than a call on the macro environment, although it is important to consider the impact interest rates, currencies, inflation etc can have on company earnings.



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