

Strong growth potential for the long term

Nick Price is the portfolio manager of Fidelity Funds - Emerging Markets Fund.

Nick joined Fidelity in 1998 as a research analyst. He spent the next six years covering pan-European chemicals, food manufacturing, tobacco and the telecommunications sectors before being promoted to the role of assistant portfolio manager of FF - European Growth Fund in 2004. He has managed FF- Emerging Markets Fund since July 2009.

Nick has a Bachelor of Commerce & Accounting from the University of Natal and is a Member of the South African Institute of Chartered Accountants. He is also a Certified Financial Analyst.

Nick Price, portfolio manager on the Fidelity Funds - Emerging Markets Fund, discusses his stock selection process, his approach to managing risk and his outlook for the emerging markets universe.

WHAT ARE THE CHARACTERISTICS OF THE STOCKS YOU LOOK TO INVEST IN?

I consider myself, by nature, a conservative investor. At the start of my Fidelity career, I was a chemicals analyst, a time which coincided with the Asian crisis. I then moved on to the telecoms sector just in time for the TMT bubble to burst. Having lived through two major market busts, my overriding philosophy is the preservation of investors' capital.

I look for four main characteristics in the stocks I invest in – high and sustainable returns on equity (ROE), a proven track record of earnings and cash flow delivery, payment of dividends where possible and reasonable valuations both in absolute terms and versus history.

I take a longer term perspective – a number of the stocks I own today have been in the portfolio since I started managing the fund. My ideal stock is one that has a proven track record of sustainable growth through reinvestment of free cash flow. What you won't find in this fund are 'blue sky' stocks or companies who are the flavour of the moment.

HOW DO YOU BUILD YOUR PORTFOLIO FROM THE OVERALL INVESTMENT UNIVERSE?

There are around 3,000 investible stocks of which just over 800 are in the benchmark index (MSCI Global Emerging Markets). The Emerging Market Fund currently has around 80 stocks. To get to this final number I rely heavily on two key 'filters'.

The first is the Fidelity research network of analysts located around the world, and the team of specialist Emerging Markets analysts that I've chosen to cover key sectors out of London. 80% of the benchmark universe has active analyst coverage and the analysts are all remunerated on the success of their recommendations.

The analyst recommendations are used as a source of ideas in the Latin America, EMEA and Emerging Asia regional portfolios. These three portfolios form the basis of my second filter, which is to focus on those stocks selected by the regional portfolio managers.

The Latin America Fund is managed by Alex Duffy and Angel Ortiz who I've worked with for the last five years. The EMEA Fund is run by me, with the help of my assistant portfolio manager Liudmilla Gavrilova. The Emerging Asia pool of stocks is managed by Suranjan Mukherjee, who is based in Singapore.

These three building blocks own around 240 stocks between them, from which I select my preferred ideas. By the time a stock makes it into the Emerging Markets Fund it has been through three layers of analysis and represents our very best ideas from across the globe.

DO YOU HAVE A SPECIFIC BUY AND SELL DISCIPLINE?

Yes I do. I believe it's important to have a disciplined process. Every stock in the portfolio has an exit price, which is determined using an appropriate valuation multiple. Once a stock hits that price it triggers an automatic review. This target price approach works both ways. I also have low target prices that can trigger a buy for a company I like, which until that point has been too expensive. Much of my trading activity is adding to or reducing existing positions as short-term price movements create opportunities versus my target price.

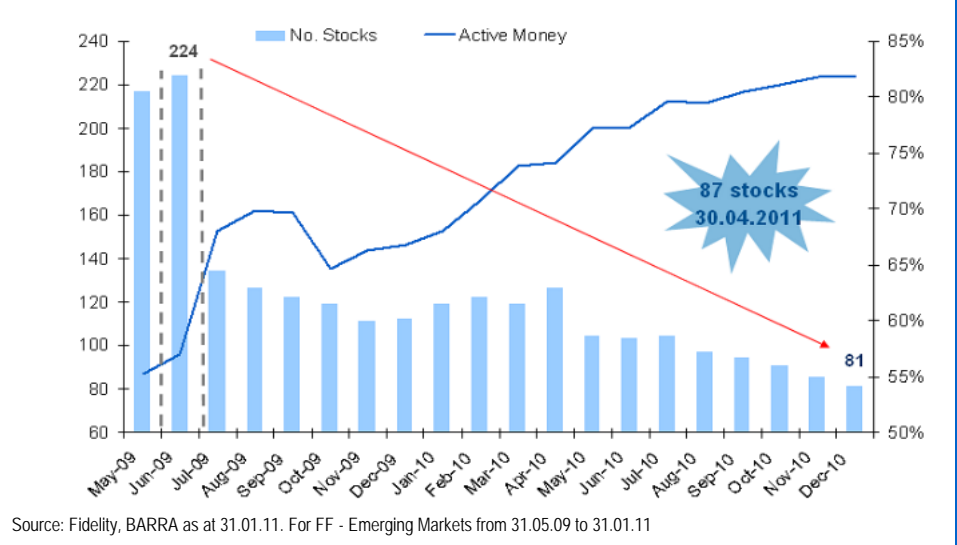
As with most managers, if the investment thesis for a company changes fundamentally then I will sell a position in a stock in its entirety. However, I do take a longer term perspective, so while my relative allocation may change, I tend to hold my positions and avoid reacting to short-term noise such as quarterly earnings announcements.

AT A GLANCE

- *"By the time a stock makes it into the Emerging Markets Fund it has been through three layers of analysis and represents one of our very best ideas."*
- *"On a longer term basis, emerging market stocks represent a fraction of their potential worth. It's a strong statement I know, but look at the facts. Emerging Markets represent 90% of the world's oil reserves, over 80% of the world's population, over 60% of the world's forex reserves, 30% of global GDP, but yet are only 13% of global stock market capitalisation."*
- *"Internet penetration in China is around 30% and should increase to 50% by the year 2015. Smartphone manufacturing is also a long term growth story."*

Nick Price, Portfolio Manger

CONCENTRATED IN BEST IDEAS WITH HIGH ACTIVE MONEY



HOW DO YOU MANAGE RISK IN THE PORTFOLIO?

Risk management is core to the process and happens on two levels. First, as I mentioned earlier, I'm a conservative investor. The types of stocks I buy typically have tried and tested business models. Many of these stocks are often big and liquid. The median market cap stock in the fund is around US\$10.7bn. This focus on robust companies acts to dampen the volatility of the fund.

At an aggregate level, I'm also very aware of the overall construction of the portfolio. My aim is for stock selection to be the main driver of performance. Active money is high, typically around 80%. The main factors that I assess are relative stock weights (usually up to +/- 4% versus the index, but this is not a hard limit), active sector positions (+/- c.7%) and also country weightings (+/- circa. 10%). I also monitor the beta of the fund and aim to keep it close to 1.

Fidelity has invested a lot of money in our risk systems over many years. I personally use one called IMPACT, which gives me a daily risk position as at the close of the previous day's trading. On a quarterly basis, I am required to participate in a thorough formal review of the fund in front of the CIO and risk team – when I say thorough, I'm talking 40 pages of analysis.

HOW DO YOU DEAL WITH CORPORATE GOVERNANCE RISK?

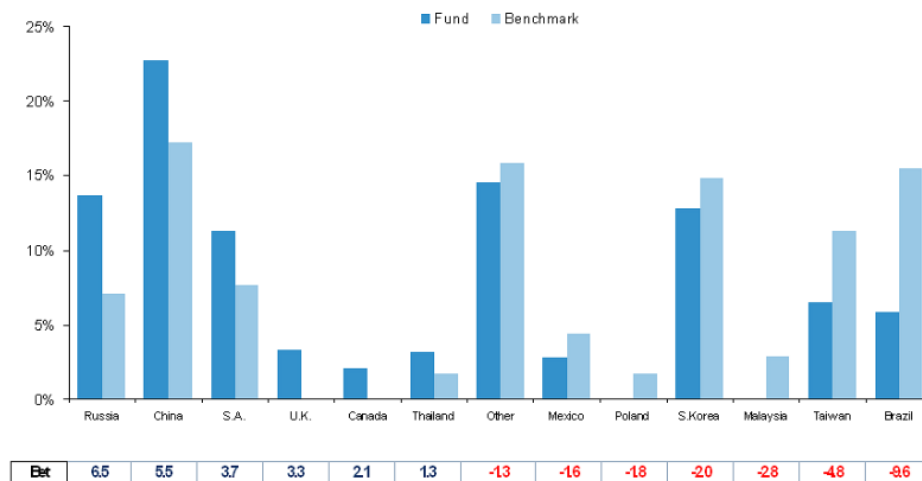
As an investor in emerging markets you have to accept a certain degree of corporate governance risk. It goes with the territory. Having said that, generally we find that at the corporate level, many of the more established companies within this universe have acted to improve their governance over recent years, which is one reason why emerging market valuation discounts to developed markets may have narrowed over time.

We place great emphasis on understanding corporate governance issues to the best of our ability. That's part of our analyst review process and is helped by the expertise we have in our team. Liudmila, for example, is a Russian national with extensive previous experience working with a number of domestic companies.

There are three main steps we take to mitigate corporate governance risks as far as possible. Firstly, we pay a lot of attention to the ownership structure of the company. We want to understand who is setting the agenda. We like to invest alongside those who have a vested interest in the success of the company. Where we think we need further independent verification, we employ an external agency to dig as deep as possible into a company's background.

Secondly, we look to invest where possible in companies that pay dividends. We find that payment of a dividend is often a signal that minority shareholders are being well treated. And finally, in our valuation of a company, we apply a discount to what we think a company is worth. Gazprom is a good current example. 50% of the company's share capital is controlled by the government – we are therefore investing alongside the controlling shareholder. It has paid a dividend every year since 1999, and this dividend payment has grown every year over this period apart from 2008. It trades at below 5x P/E, which is significantly cheaper than other energy stories in the index, such as Petrobras. We therefore think Gazprom is an attractive story, which offers a good level of upside to target price even after applying a discount for geopolitical risk.

FIDELITY FUNDS EMERGING MARKETS FUND: RELATIVE COUNTRY POSITIONING



Source: Fidelity, as at 30.04.2011. Index: MSCI Emerging Market Index. Cash Position as at 30.04.2011 = 1.4%

EMERGING MARKETS HAVE WOBBLLED A BIT RECENTLY. IS THIS THE BEGINNING OF THE END OR THE END OF THE BEGINNING?

As an emerging market fund manager you'd expect me to be bullish wouldn't you? Clearly, many of the markets are facing headwinds right now and these may last for some months. But having just come back from China where I spent a week visiting 30 companies with Suranjan, Teera (our Emerging Asia Portfolio Manager) and 4 consumer analysts (recruited, incidentally, from the top universities in China), I remain convinced that the China consumer story is as strong as ever.

On a longer term basis, emerging market stocks represent a fraction of their potential worth. It's a strong statement I know, but look at the facts. Emerging Markets represent 90% of the world's oil reserves, over 80% of the world's population, over 60% of the world's forex reserves, 30% of global GDP, but yet are only 13% of global stock market capitalisation. I am convinced that the longer you look out, the more sure you can be that emerging markets offer great opportunities for the long term.

WHAT DO YOU SEE AS THE GREATEST AREAS OF OPPORTUNITY ACROSS THE EMERGING MARKET UNIVERSE?

Geographically, I think EMEA offers strong growth potential on a long-term basis. Prospects are excellent and there is limited competition, particularly for companies in Africa. Many companies have high and sustainable returns on equity (ROE) which, compounded by 20%+ growth rates, offer exceptional long term value.

In terms of current themes in the Emerging Markets portfolio, I'm bullish on the China consumer story. The luxury end has been in focus recently, but I think valuations are more attractive in the mass-market segment. For example, one of our favourite names is CTrip.com, the Expedia of China. Did you know that only 3% of Chinese have ever ventured abroad? CTrip is a way of participating in the increased spending on travel by the Chinese population, as exemplified by CTrip's air ticket volumes and hotel bookings which are increasing 20% a year.

I'm also positive on energy stocks, where the demand and supply dynamics suggest we will see continued support for oil and gas prices. I also like the gold stocks, where individual share prices have lagged the commodity price. Harmony Gold and Anglogold Ashanti are my preferences.

I'm finding lots of good ideas in the technology sector too. Internet penetration in China is around 30% and should increase to 50% by the year 2015. Smartphone manufacturing is also a long term growth story. Samsung Electronics, a leading component supplier, is our largest individual holding with a 5.4% weighting at the end of April.

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