

# Fund Perspective

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January 2012

## China's Consumer Sectors to benefit from the upcoming policy easing

**Raymond Ma** is the portfolio manager of Fidelity Funds - China Consumer Fund.

Raymond joined Fidelity International (Hong Kong) Ltd. in 2006 as an Investment Analyst and has covered China Telecoms, Financials and Consumer stocks. Raymond was made the Consumer Sector Leader in 2009. He was promoted to Director of Research in 2010 and then Portfolio Manager in 2011.

Raymond has over 10 years of experience in researching companies in the China market. His extensive research experience in the consumer universe gives him an edge in understanding regulations, industry trends and competition within the region.

Raymond graduated from Fudan University, Shanghai, with a Bachelor of Law. He also holds a Master of Law degree from the same university.

### TOP 10 OVERWEIGHT HOLDINGS (%)

as at 30.11.11	Fund	Benchmark
AIA Group	6.7	0
China Unicom Hong Kong	5.3	2.2
Li & Fung	2.7	0
China Mengniu Dairy	3.4	0.8
China Life Insurance H	5.8	3.4
Belle International Holdings	3.8	1.4
Ping An Insurance H	4.4	2.1
Chunghwa Telecom	2.3	0
Tencent Holdings	5.7	3.4
Sands China	2.1	0

Source: FIL Limited.

Benchmark: MSCI China Index

Top overweights are those securities that had the largest active positions relative to the benchmark holding. 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.

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.

**Raymond Ma, the portfolio manager of Fidelity Funds China Consumer Fund, believes China's consumer sectors should outperform in 2012 as they are less impacted by external factors and should benefit from the upcoming policy easing. In times of volatility, prudent stock selection will remain the key to alpha generation and Raymond will focus on identifying oversold, turnaround and sustainable growth companies.**

### HOW DID THE FUND PERFORM RECENTLY?

Despite significant market volatility, the Fund still managed to outperform its benchmark over the 1-month, 3-month, 6-month and since inception periods. Positive positioning within consumer staples and financials as well as careful security selection within telecom were the key drivers of the fund's outperformance:

- **Overweight in consumer staple sector proved fruitful.** Defensives outperformed the broader market against the backdrop of continued uncertainty over the resolution of the European sovereign debt crisis and fears of a double-dip recession in the developed world. Consequently, an overweight exposure to the consumer staples sector enhanced returns. The overweight stance in China's leading personal care products manufacturer Hengan International contributed to performance as the company is expected to benefit from falling wood pulp prices and capacity expansion.
- **Underweight in financials added value.** An underweight exposure to Industrial & Commercial Bank of China and not holding Bank of China supported returns as investors moved away from risky assets.
- **Favourable stock selection within the telecom sector helped relative returns.** The position in telecommunication company China Unicom supported returns in light of increased risk aversion. The company also reported strong growth in its 3G subscriber base in October. The holding in Taiwan Mobile added value on the back of strong third-quarter earnings as well as healthy performance during October.

### WHAT IS YOUR CHINESE MARKET OUTLOOK FOR 2012?

The growth in the Chinese economy will be moderate in 2012, as the negative impact from the European debt crisis filters through. However, I believe that the risk of a hard landing in China is minimal. While the slowdown of growth in the western developed markets would hurt the outlook for export-related industries, the real impact on China's GDP growth should be immaterial given the insignificant contribution of exports to GDP growth (~1%). Meanwhile, the growth in domestic consumption and infrastructure should remain resilient in light of a decent rise in income and continuing government support.

More importantly, the recent slowdown in inflation gives the Chinese government some room to spur growth by means of the monetary easing policy. After the surprise cut in banks' reserve requirement ratio (RRR) in early December, the RRR is expected to be further reduced in the first half of next year, improving the liquidity in the market.

Within equities, I believe the Chinese market should outperform their US and European counterparts in 2012 as growth will remain resilient in the former. In particular, Chinese equities have underperformed global equities since 4Q10 as a result of the tightening measures. If an easing policy starts to kick in, the Chinese market should bottom out and start to lead the market.

Overall, Chinese corporates are expected to deliver top-line growth of around 15% in 2012. Sector-wise, consumer sectors are expected to outperform as they are driven by solid domestic demand and are less impacted by external and policy factors. While consumer staples were under huge margin pressures in 2011 on the back of soaring input costs, margins will once again expand in 2012, benefiting from falling commodities prices. Meanwhile, consumer discretionary should continue to benefit from robust income growth and the pro-consumption policy.

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## IS CHINA'S RETAIL SALES GROWTH SLOWING DOWN?

Despite the macro tightening policy implemented since 4Q10, China's consumer market has remained relatively stable over the past year. Retail sales grew 17.3% yoy in November 2011, compared to 17.2% in October 2011 and 18.7% in November 2010. This exceeded the market consensus of 16.8%. Thanks to discounts offered by e-commerce websites and bricks and mortar shopping malls, most merchandise witnessed sales growth acceleration on a year-on-year basis. Meanwhile, gold and jewellery sales growth slowed markedly to 16.2% in November 2011, from 32.3% in October 2011 and 67.0% in November 2011, as the recent plunge in gold price dampened investment in gold.

In view of the slowing global growth, I expect China's GDP growth and domestic consumption to slow down marginally in 2012, with retail sales growth down to 15% in 2012 from 17% in 2011. Overall, China's consumer market should remain resilient in 2012 as boosting domestic consumption is a key focus of China's 12<sup>th</sup> Five Year Plan. Unless there is a systematic shock to the Chinese economy (e.g. the Asian Financial Crisis in 1997, the bursting of the Tech Bubble in 2001-02 and the Global Financial Crisis in 2008-09), China's retail sales growth seldom falls below 10%.

## APART FROM MONETARY EASING, WHAT SORT OF POLICY IS LIKELY TO BE INTRODUCED IN 2012 TO SUPPORT GROWTH/CONSUMPTION?

Apart from monetary easing, the Chinese government may introduce tax cuts for small and medium enterprises (SMEs) to improve their profitability and margins. This may, in turn, lead to an increase in employment by over 100 million. Moreover, the Chinese government may reduce its interference on the micro economy and some signs of deregulations may emerge. More importantly, the Chinese government will continue to support further income growth to boost domestic consumption. This will benefit Tier 2-4 cities and mass market consumption.

## HOW WOULD YOU POSITION YOUR PORTFOLIO UNDER THE CURRENT MARKET CONDITION?

I believe China's upcoming policy easing would trigger a re-rating of cyclical names and consumer discretionary. While the growth of consumer discretionary may decelerate, their value will start to emerge upon attractive valuations. As such, I will focus on identifying oversold, turnaround and sustainable growth companies. Consumer staples may see some margin expansion driven by lower producer prices. Insurance stocks may benefit from an improving market sentiment. Overall, prudent stock selection will remain the key to alpha generation.



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