

Fund Perspective

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Income accrual buffers effects of volatility



Bryan Collins portfolio manager of Fidelity Funds - Asian High Yield Fund and is based in Hong Kong. He joined FIL Limited in 2006 as a Fixed Income Trader and assumed his current position in 2009. He became the Asian High Yield discipline lead portfolio manager in October 2009.

Prior to joining FIL Limited, Bryan held a variety of roles in Credit Suisse Asset Management (Australia) Limited in Sydney, starting as a client consultant responsible for Fixed Income in 2000. His most recent role at Credit Suisse was the Senior Trader for Fixed Income and Foreign Exchange between 2003 and 2006.

The third quarter of 2011 has seen the remarkable return of substantial risk aversion with increasing nervousness around the European debt crisis, the recovery in the US and global economic growth uncertainties. The weakness in economic sentiment and growing pessimism triggering volatility in the broader markets set off similar repercussions in the Asian credit market in recent weeks. Bryan Collins, Portfolio Manager of the Fidelity Funds Asian High Yield Fund and Asian Bond Fund, shares his thoughts on the current market volatility and the longer term outlook of the Asian high yield bond market.

HOW DO YOU VIEW THE SELL-OFFS AND VOLATILITY IN THE ASIAN BOND MARKET IN RECENT WEEKS?

The market remains very nervous about Europe, US and global growth and expectations for more meaningful economic impact from the Fed's actions have yet to materialize. The renewed challenges facing the global economy have given rise to heightened risk aversion with investors reevaluating and mostly trimming their appetite for risk assets. In the Asian bond market, high yield in particular has been hit harder relative to investment grade given investors' flight to quality names.

In addition, over the past few days we have seen Asian currencies losing ground as the US dollar continued to act as a safe-haven. Both our Asian High Yield and Asian Bond Funds have not suffered from the pullback as they hold predominantly USD-denominated assets with very low exposures to local currencies.

HOW DOES THE CURRENT MARKET VOLATILITY IMPACT PERFORMANCE OF THE ASIAN HIGH YIELD FUND?

We expect the volatility to continue until we get clearer resolutions or policy responses to the situation in Europe and the US. The market pricing we have seen of late is less representative of fundamentals but are instead reflective of stress and risk aversion leading to broad-based selling across asset classes.

Much of the recent price movement could be attributed to panic selling with weaker liquidity exacerbated by investors staying on the sidelines. There continues to be a bias against the more liquid Asian high yield names which affects their performance versus other names that do not trade as much.

The moves we have seen in the Asian High Yield fund over the past month were largely indicative of the broader market trends which were primarily sentiment-driven and not necessarily justified by changes in fundamentals. However, despite the cash price volatilities, income continues to accrue so yield income is still expected to be a key contributor to return expectations. In addition, contributions from capital gains are more likely over the medium term.

WHAT ARE YOUR INVESTMENT STRATEGIES AGAINST THE BACKDROP OF A TURBULENT MARKET?

In terms of positioning, I am focusing on companies with strong liquidity, flexible capital expenditure plans and earnings visibility. In light of the market conditions, the portfolio has been positioned more defensively to reduce the overall credit beta in some cases using credit derivatives to buy protection against spread widening. Conscious that many good quality names have been oversold and present buying opportunities, I am also managing the Fund's overall liquidity. The Fund remains highly diversified, which is essential for high yield portfolios, with exposure to over 100 issuers across more than 160 securities.

Our investment approach is to always look at the underlying fundamentals from a bottom-up perspective. Particularly in this environment, it is increasingly more important to be able to look at the individual names and exposures to understand how this environment actually impacts individual companies.

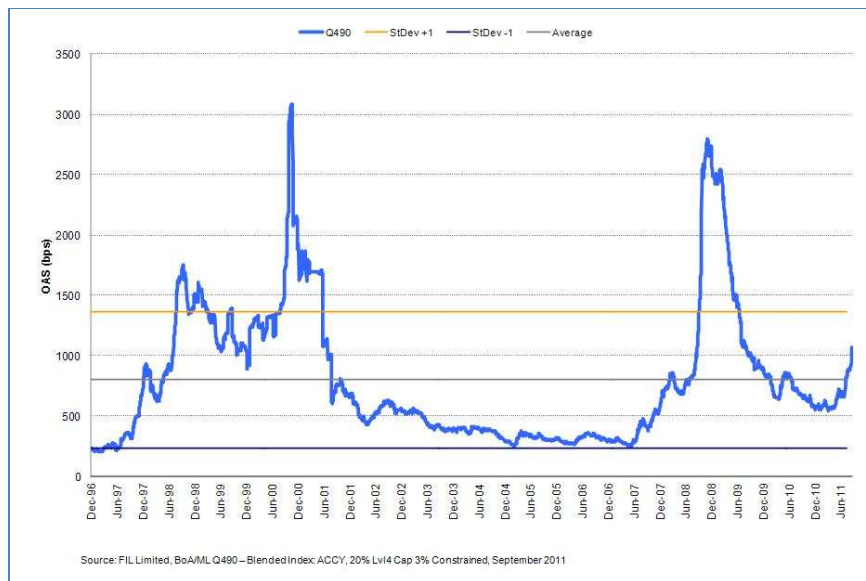
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Bryan Collins, Portfolio Manager,
Fidelity Funds - Asian High Yield Fund

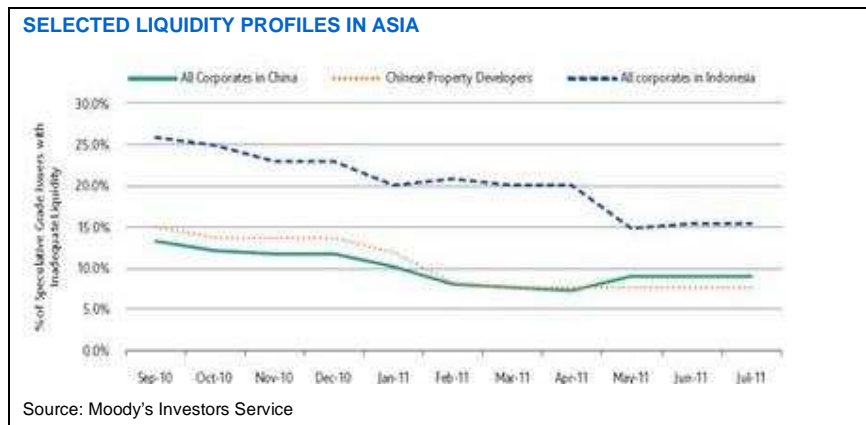
WHAT ARE THE MERITS OF INVESTING IN ASIAN HIGH YIELD NOW?

Despite the challenges we have seen in global markets, we view the standalone fundamental outlook in Asia as fairly stable. Over the last few weeks we have also experienced one of the busiest company reporting seasons ever for the Asian high yield market, with a diverse range of businesses reporting their latest results. In general, I remain constructive over the broader outlook in the medium term and whilst there were some results that were stronger than others, the outlook for credit fundamentals in Asia is balanced.



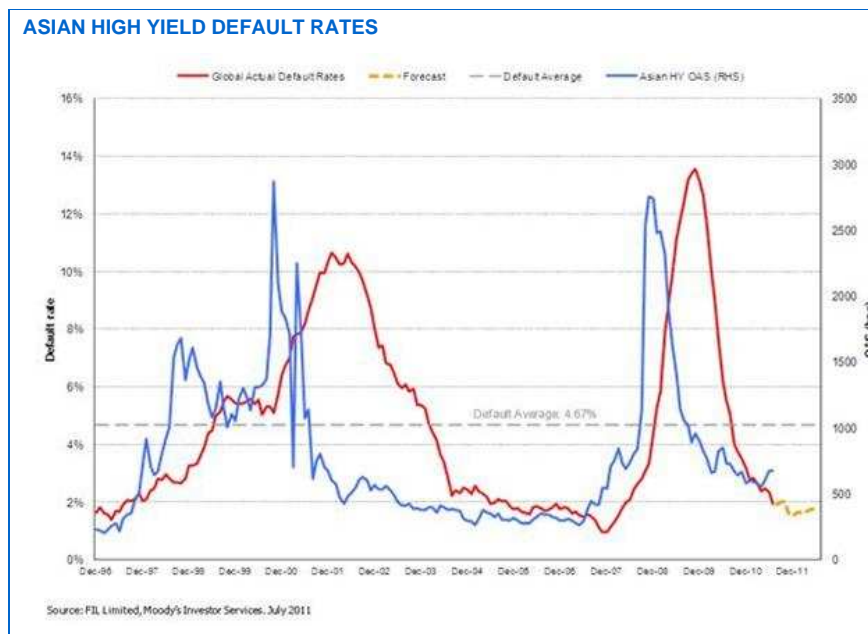
From an asset allocation perspective, Asian high yield remains a diversifier versus equities. It is also particularly attractive based on current valuations. We are currently seeing Asian HY spread levels above their long run average. While there is increasing divergence in credit quality, Asian corporates generally maintain adequate liquidity to withstand difficult market environment in the near term. We note that idiosyncratic risks appear to be on the rise, so corporate governance as well as aggressive expansion beyond balance sheet capacity are some of the things we keep a close eye on.

The outlook for Asian banks rests on their stable fundamentals with strong liquidity profile (average LDR below 100%) and comfortable NPL coverage (over 100% on average). Emerging Asian banks' profitability has returned to pre-crisis levels and is significantly higher than Europe. Overall asset quality is expected to remain stable into early 2012.



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Global and Asian default rates will most likely increase from current low levels especially if the economic slowdown persists. However, they are expected to remain relatively low in Asia, further providing long-term support for Asian high-yield valuations.



To summarize, income from coupon payments continues to accrue. Asian corporates generally have strong fundamentals with lower leverage as compared with historical levels. With a current yield of around 11%, the Asian High Yield fund should be a particularly attractive asset class to the medium term investor. At this point in time, the markets appear to be oversold but investors should expect volatility to persist in the near term given the uncertainties in the market.



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