

Chinese Consumer Revolution – a unique opportunity

AT A GLANCE

- The Chinese economy must adapt to sustain its growth rate and therefore the government is re-balancing the economy away from exports and more towards domestic consumption.
- Within the next 15 years, the Chinese middle class will grow to 600 million individuals who will spend a increasing proportion of their incomes on consumer products. The sheer size of this trend makes it outstanding opportunity in the history of investment.
- The Fidelity Funds - China Consumer Fund is a unique opportunity to access this trend as it gives investors direct exposure to Chinese consumer stocks rather than merely indirect exposure through US or European companies.
- The Case for C.A.S.E. Raymond Ma's investment process can be summed up by the acronym C.A.S.E. This stands for the importance of Communication, Analysis, Structure and Expectations.
- Fidelity has long-standing experience in Asia and has an office in Hong Kong. It has 39 Fund Managers and 73 Research Analysts based in Asia and manages around \$20 billion in China alone.

The Chinese consumption story is a unique investment opportunity that could become the most important investment story of our time. Today, China's consumption already amounts to an enormous \$2.1 trillion. According to some estimates, over the next 10 years this figure could grow by around another \$1.6 trillion, which is equivalent to the current Indian economy as a whole. Indeed, by 2025, there will be an estimated 600 million middle class Chinese who will earn higher incomes and will want to spend a greater proportion of those incomes on discretionary consumer goods. In parallel to this trend, the Chinese government, aware that the country needs a new economic model to sustain its growth rate, has already started to rebalance the economy away from exports and more towards domestic consumption. To benefit exclusively from this investment opportunity, Fidelity has launched the Fidelity Funds - China Consumer Fund under the management of Raymond Ma.

CONSUMPTION IN CHINA

Over the past few decades China has changed more than most investors in the West realise. In fact, many have not yet taken the full measure of just how significant the Chinese growth story really is, while others believe that China's Golden Age has already passed. Raymond Ma, however, is convinced that China is about to enter a new period of structural and sustainable growth. Indeed, we could be about to witness in China what can only be described as a 'Consumer Revolution': 5 key drivers are fuelling powerful and fast-expanding domestic consumption, which, in turn, supports the country's overall prosperity:

- Pro-consumption government policies
- Strong economic growth
- Underpenetrated markets
- Consumption upgrades
- Urbanisation

Need for change

In recent years, China has significantly opened up its economy to the world and its success on the international stage is reflected in its astonishing economic growth and the fact that this development was achieved relatively independently from how developed countries fared. Nevertheless, over the past decade, the Chinese economic model has been based on the country's vast supply of cheap labour. This model is now becoming difficult to maintain, partly due to the one child policy. The Chinese authorities recognise this. They are under pressure from the US and Europe to change and are themselves keen to rebalance their economy away from exports and towards domestic consumption. Government policies in the next 5-year plan are likely to reflect this shift, which will be necessary not just to sustain future growth, but also to ensure that the protests that took place in China in 1989 do not re-occur. China's new economic model will seek to strike the right balance between domestic consumption and exports and to facilitate the reinforcement of market principles and the acceptance of private sector growth. In many respects, China has achieved its first step of industrialisation and has done so in a remarkably short time, but now the next step is to take advantage of these improvements and develop a broader and deeper economy and help the size of middle class Chinese grow exponentially.

A Story of evolution and change

Because of the sheer size of China and of its population, the advent of consumption opens up huge opportunities for the country itself and for the Greater China region. But this is not just a story about the scale and size of China. It is a story of evolution and change. In the table below we see how the drivers of the Chinese economy over the last ten years will change over the next decade and, as a result, how the economy will be transformed.

Driver of China's Growth:

Over last 10 years	Over next 10 years
Focus on exports	Focus on imports
Focus on investment	Focus on domestic consumption
Companies aiming for market share grab	Profit-orientated companies
Partly state-owned companies with regulation risk	Private enterprises without regulation risk
Dependence on the US economy for growth	Independence from US economy
Companies starting up and achieving small or mid-cap status	Companies making the move from small or mid-cap status into larger companies and even global leaders

PORTFOLIO MANAGER



Raymond Ma
Fidelity International, Hong Kong

Experience

2009 – Present Director of Research / Consumer Sector Team Leader Fidelity International, Hong Kong

2006 – 2009 Investment Analyst (Consumer / Telecom / Banks / Insurance) Fidelity International, Hong Kong

2000 – 2006 Assistant Director, Consumer Team Leader
BNP Paribas Peregrine, Shanghai, China

1999 – 2000 Teacher / Researcher
Fudan University, Shanghai, China

Total investment experience: 11 years

Education

M. Law, Fudan University, Shanghai, China

B. Law, Fudan University, Shanghai, China

ACCESSING THIS UNIQUE TREND: THE FIDELITY CHINA CONSUMER FUND

'It is my conviction that the consumption story will supersede the export story going forward and that this development will push China into a new Golden Age of growth and prosperity. Going forward we could see somewhere in the region of 50 IPOs in the consumer sector alone in China every year, so opportunities are already surfacing. However, to get the best out of this market takes expertise and fundamental research and here Fidelity has the advantage of a local research team based in Hong Kong to uncover the best opportunities. I was born in China and speak Mandarin, so am aware of the huge changes taking place and I firmly believe that this could be a unique opportunity for long-term investors. My stated aim, therefore, is to outperform both the MSCI China Index over a 3-5 year period.'

Raymond Ma, Portfolio Manager, Fidelity Funds - China Consumer Fund

Investors eager to find growth in a seemingly low-growth world might find the Chinese consumption story highly interesting. Indeed, they might ask themselves what is the best way to access this story. By buying a fund that invests in Chinese stocks, investors would get exposure to China in general. However, they would not necessarily get access to the Chinese consumer stocks. Moreover, they may be exposed to partly state-owned names that carry regulation risks. Another possibility would be to buy one of the consumption-themed funds that are available in the market place. However; these funds typically have a Global, Asian or Emerging Market scope and do not focus solely on China. The Fidelity Funds - China Consumer Fund focuses specifically on China and specifically on consumption stocks. Thus, it provides direct exposure to the Chinese consumption story and is almost unique in the market place.

Investment universe

Fund manager Raymond Ma likes to describe the Fund as a 'Greater Consumer' fund. Indeed, the fund invests only in consumer-related stocks. These stocks can be in sectors that are traditionally known as consumer sectors, such as luxury goods for example. The portfolio manager also finds consumer-related stocks in sectors that are not traditionally seen as consumer sectors per se. For example, Raymond is invested in the telecoms sector. He believes that the Chinese consumer will have an important role to play in the expansion of this sector, where penetration is still very low at the moment. Undoubtedly, penetration rates will rise, with the field of mobile data growing particularly strongly. Also, the telecoms sector offers liquidity during challenging environments where market liquidity is hard to find. Raymond is also looking at consumer-related insurance stocks. In this sector penetration is also currently very low in China, which represents a real growth opportunity.

Investment process

Raymond's first ideas come from four key areas: Fidelity analysts are responsible for many of the first ideas as they produce around 1000 research notes a year. Company meetings are also key with there being around 300 meetings a year. Other ideas concerning IPOs etc., will come from various sources for stocks that we do not cover. In addition, ideas will be gained from companies themselves when discussing their thoughts about competitors or suppliers up or downstream from them.

Raymond views companies in five particular ways: Great companies, growing companies and companies with inherent potential which make up 70%-80% of the portfolio and companies with attractive valuations and special situations that account for 20%-30% of the portfolio.

FUND FACTS

Tracking Error

3 – 6% p.a.

Benchmark

MSCI China Index

Number of Stocks

80 – 120

Stock Weights

+/-5%

Regional Weights

+ / - 7%

Sector Weights

+ / - 7%

Risk and Investor Profile

Very high risk (equity)

May suit a growth investment strategy and most likely to be appropriate for investors who are investing for long-term capital growth who are willing to accept very high market volatility. Such a fund should form a small part of one's overall portfolio.

SHARE TYPE BREAKDOWN OF THE BENCHMARKS

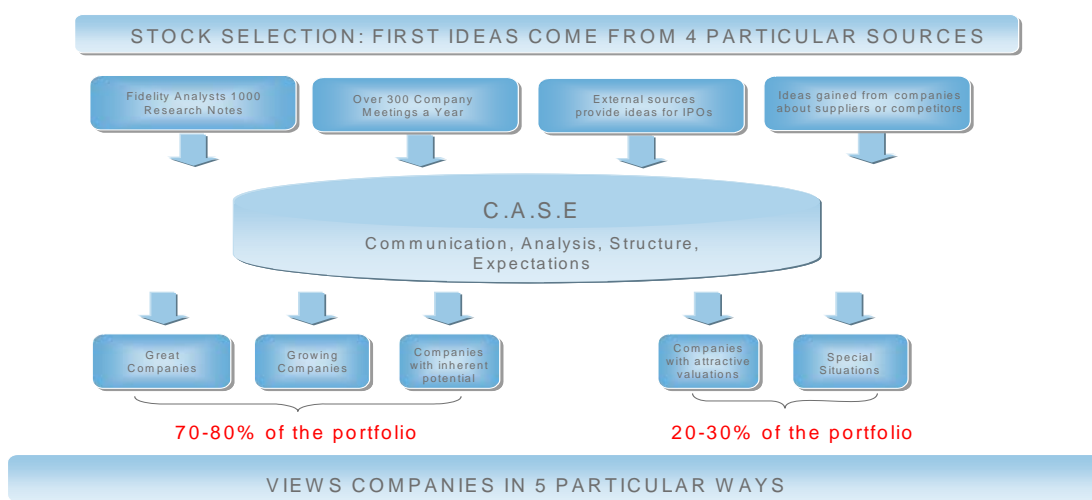
	MSCI China
A-Share	0.00
B-Share	1.18
H-Share*	51.00
Red Chips*	24.48
Other Stocks Listed in HK**	23.33
China Stocks Listed in US	N/A
Taiwan	N/A
Total	10000

Source: FIL Limited, as at 28 February 2011.

*As classified in the website of HKEx

**Non-H-share and non-Red-Chip companies listed in Hong Kong, held by the benchmarks

There are four separate stages in filtering the investment universe down to the number of stocks that are held in the portfolio. The initial screening stage looks at all the investment possibilities in the Greater China universe as well as some Chinese companies that are NASDAQ-listed by looking at liquidity as well as country and industry factors. The next stage narrows the number of stocks down to 400-600 relevant consumer stocks, which Raymond exchanging views with our analyst team then whittle down to a more manageable 200 stocks through using their various models and tools. In the final stage of the process Raymond selects the best 80-120 opportunities for the Fidelity Funds - China Consumer Fund.



- **Communication** – builds conviction through belief in management
- **Analysis** – believes fundamental research can add value and avoid pitfalls
- **Structure** – likes to have this in place to build best balance between risk and return
- **Expectations** – Raymond aims to outperform the index over 3-5 years

THE CASE FOR C.A.S.E

Crucially, Raymond's investment approach is informed by what he calls "C.A.S.E". The 'C' in this acronym stands for **Communication**: Raymond maintains close contact with the senior management of the companies he considers, which gives him better access to information. Raymond is also personally very well-connected with the business community in the region and he builds conviction in a stock through his belief in its management team. Interestingly, in China the term for these vital business relationships comes under the term *Guanxi*, which is taken extremely importantly there. The 'A' stands for **Analysis** as Raymond believes that the strength of the fund is the detailed analysis of the available opportunities by himself and by the team of Fidelity research analysts. In particular, he benefits from the 1000 research notes produced by the analysts every year. The 'S' is for the **Structure** of the portfolio and reflects Raymond's objective of achieving the best possible balance between risk and growth. Finally, the 'E' stands for **Expectations**: Raymond is clear that he hopes to outperform MSCI China Index over a 3-5 year period.

Investment style

Raymond describes his style as a “Mosaic” approach with about 70% of the stock picks coming from fundamental bottom-up research, while around 10% come from technical analysis another 10% come from industry analysis and 10% are top-down choices. This is very much an active Fund, which gives Raymond the freedom to find all sorts of companies and thereby give investors exposure to some of the most exciting areas of the market. In terms of stock weightings he can go +/-5% and this is why he might have a small holding in one of the couple of the few very large index constituents, such as China Mobile, which is 8.8% of the MSCI China Index, as of 31 January 2011.

Focus on consumption rather than exports

Raymond believes that there are currently two big themes in China: investment and consumption. Of course, his focus will be on consumption rather than investment. Therefore, the Fund will not be investing in the export segment, such as shipping, machinery and textiles. Raymond will also broadly not be investing in the banking sector as in China the banks are mainly lending money to companies rather than being involved in consumer lending. There could, however, be the odd exception where he may invest in a bank. He will also be broadly avoiding the construction sector. He believes that the future focus of Chinese growth must switch from areas like banking which are already fully priced with little growth potential towards consumption where there are more opportunities.

Raymond believes that the weighting of the consumer sectors within the MSCI China Index should move upwards over time to reflect the growing importance of these areas to the Chinese economy. The banks in China already constitute a huge weighting in the MSCI China Index, with several Chinese banks being among the top ten banks in the world in terms of market capitalisation. Raymond believes that the Index could be rebalanced over time with the consumer sectors playing a more important role and he cannot see that the banks have much room to grow. This is a primary reason why he believes the consumer sector in China will outperform the broader Chinese index.

FIDELITY EXPERTISE IN CHINA

Crucially, Fidelity is not new to the Asia region. In fact, Fidelity's focus on global resources and local expertise means it's already thriving in Asia. As of 31 December 2010, Fidelity managed \$55.7 billion in the Asia Pacific ex Japan region and around \$20 billion in China alone. Raymond, who was born in China and speaks Mandarin, has over decade of experience in the Chinese consumer sector and is well-connected to the market.

CONCLUSION AND OUTLOOK

Raymond Ma, the portfolio manager of the Fidelity Funds - China Consumer Fund, has conviction that the Chinese consumption story offers investors unique potential and he firmly believes that this burgeoning area will outperform the broader Chinese market. The Chinese consumption story is a unique investment opportunity. Allied to Fidelity's experience in Asia and its locally-based research team, Raymond aims to find the best consumer opportunities and outperform the MSCI China Index over a 3-5 year period. All this makes the Fidelity China Consumer Fund the ideal investment vehicle to gain exposure to this huge and developing story.

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Past performance of the manager and the fund(s), and any forecasts on the economy, stock or bond market, or economic trends of the markets that are targeted by the fund(s), are not indicative of the future performance. Prices can go up and down. The value of the shares of the fund(s) and the income accruing to the shares, if any, may fall or rise. Investors investing in fund(s) denominated in a non-local currency should be aware of the risk of exchange rate fluctuation that may cause a loss of principal when foreign currency is converted back to the investors' home currency. Exchange controls may be applicable from time to time to certain foreign currencies.

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