

On a strong growth path

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Allan began his career in Fidelity as an Investment Analyst in 1987. In 1990, he moved on to become a Portfolio Manager. Prior to Fidelity, he worked with The Chase Manhattan Bank as a Business Analysis Officer.

Allan holds an MBA from The Chinese University of Hong Kong and Bachelors in Social Sciences from University of Hong Kong. He is also a Chartered Financial Analyst.

Large economic stimulus programmes and lower interest rates have helped the regional economies of South East Asia to recover. Corporate performance has also improved and the number of forward earnings upgrades now exceeds downgrades. However, doubts remain around the sustainability of the current upturn and so, here, Allan Liu shares his thoughts on the market and how he is responding to current conditions.

HOW DO YOU SEE THE CURRENT ECONOMIC ENVIRONMENT IN SOUTH EAST ASIA?

Broadly, South East Asia's economic environment remains stable. Governments and central banks handled the global financial crisis well by implementing prompt and decisive measures to stimulate growth from internal sources and to compensate for a fall in exports. The results of a variety of measures, including large infrastructure spending programmes, tax incentives, interest rate cuts and cash handouts have been encouraging.

Of course, countries with large domestic economies, such as China, India and Indonesia, fared better, but what's more encouraging is that second quarter GDP data suggests that the pace of contraction has slowed markedly in the rest of the region, including export-dependent economies such as Hong Kong, Malaysia, Singapore, South Korea and Taiwan. Overall, industrial production has started to increase once again, unemployment rates seem to have bottomed out and retail sales are showing signs of a recovery.

Corporate performance also improved in the quarter ended June, driven by cost rationalisation and some recovery in demand. Funding concerns eased as interest rates fell and market liquidity improved, thanks to loose monetary policies and an increase in global risk appetite. Note that while the region did not face a credit crisis like most developed markets of the West, the global crisis had seen liquidity in Asia dry up. However, net foreign fund inflows have turned positive in the last five months and there has also been a sharp rise in new share issuance as companies have raised funds to strengthen their balance sheets and expand. All this optimism is reflected in the recent performance of the South East Asia market, as it outperformed developed markets.

GIVEN THE REGION'S EXPORT-DEPENDENCY, DO YOU THINK THE TREND CAN LAST?

I do think that this trend can continue over the medium-to-long term. It is true that Asia is highly dependent on exports to the US and Europe but their share of Asia's total exports has been shrinking over the past ten years. Meanwhile, intra-regional trade, particularly with China, has been increasing. Also, in recent months, exports from key economies such as Singapore, China, Hong Kong, Korea and Taiwan appear to be bottoming.

More importantly, the region is in a better position to withstand the challenging environment than the West due to its large – and still quite robust – domestic market. A large part of the population, particularly in relatively large economies such as China, India and Indonesia, remained relatively unaffected by the global crisis and continued to consume. In fact, domestic incomes were boosted by the rise in prices of agricultural and other commodities.

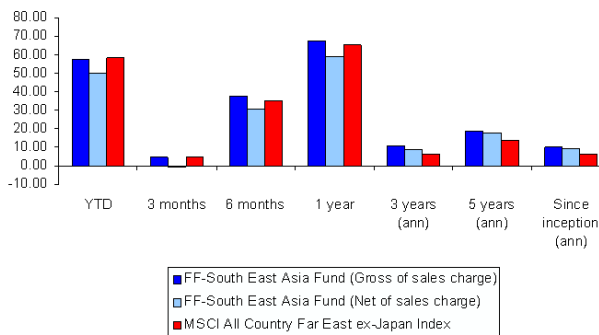
In addition, most South East Asian countries have healthy trade balances and sizeable foreign exchange reserves, giving them more room for further fiscal and monetary policy stimulus. What's more, the banking system is robust and the corporate sector is less indebted than the West.

HOW ARE THESE THOUGHTS REFLECTED IN YOUR PORTFOLIO?

The fund's positioning at sector level is a result of bottom-up stock selection. However, I have positioned the fund to take advantage of the healthy domestic demand in the region and a global economic recovery. Broadly, the fund is overweight in the consumer discretionary, financials and information technology stocks. I also have a marginal overweight in the industrials sector, given the increased infrastructure spending in the region. Meanwhile, I am underweight in relatively defensive sectors such as telecommunications and consumer staples.

Within financials, the fund holds larger-than-benchmark stakes in China Construction Bank, Wing Hang Bank and Bank Rakyat Indonesia. The overweight in the information technology sector is

FUND RETURNS (%) as at 31.10.09



Source: Fidelity. Performance figures are in USD terms NAV to NAV with dividends reinvested. Past Performance is not indicative of future performance

Since inception:01.10.90

Benchmark: MSCI All Country Far East ex-Japan Index

LARGEST OVERWEIGHT POSITIONS (%)

as at 31.08.09	Fund	Relative
BYD 'H' Shares	2.1%	1.9%
Taiwan Fertilizer	1.8%	1.6%
Kingboard Chemical	1.7%	1.6%
Largan Precision	1.6%	1.6%
Hyundai Mobis	1.9%	1.5%

LARGEST UNDERWEIGHT POSITIONS (%)

as at 31.08.09	Fund	Relative
China Mobile	1.0%	-2.6%
Singapore Telecom	0.0%	-1.0%
CLP Holdings	0.0%	-0.8%
Oversea-Chinese Banking Corp	0.0%	-0.8%
China Shenhua Energy	0.0%	-0.8%

Source: Fidelity

Benchmark: MSCI All Country Far East Ex-Japan Index

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largely due to the holdings in domestic focused firms such as China-based BYD Company and Tencent Holdings. BYD manufactures batteries, mobile components and electric cars and is gaining market share with Nokia and its battery and automobile divisions are also growing rapidly in local markets. The networking and internet messaging firm Tencent is also benefiting from strong growth in user base and improved monetisation of its services. Certain exporters of technology products that have competitive advantages, such as Taiwanese mobile camera lens manufacturer Largan Precision and Hong Kong-listed laminates maker Kingboard Chemicals are held in anticipation of a recovery in demand. The fund's overweight in the consumer discretionary sector is largely due to significant positions in Hyundai Motor, as well as its components manufacturing unit Hyundai Mobis. Hyundai's portfolio of more fuel-efficient cars worked well in the US, despite an overall decline in the industry, leading to an increase in the firm's market share. Its vehicles are also gaining more popularity in China. Within industrials, I like commercial vehicles and construction equipments manufacturers such as Sinotruk and Doosan Infracore.

HOW HAS THE FUND PERFORMED IN RECENT MONTHS?

The fund has outperformed its benchmark over all standard periods to end of September. In the past three and six months, the outperformance has largely come from stock selection within the information technology and consumer discretionary sectors. Among technology stocks, shares in BYD Company and Tencent Holdings contributed the most. Hyundai Mobis proved particularly rewarding within the discretionary space. In addition, the overweight in Indonesian coal-miner Bumi Resources and packaging and paper products manufacturer Nine Dragon Paper and Lee & Man Paper enhanced relative returns as they benefited from a recovery in demand. Conversely, select holdings in the real estate and utilities sectors hampered performance.

WHAT IS YOUR OUTLOOK FOR THE REGION?

I believe that Asian equity markets should continue to outperform the developed world over the long term. Economic fundamentals remain strong and should support superior GDP growth rates due to a number of structural changes. A healthy population growth and the trend towards urbanisation and industrialisation will require infrastructure development in urban and rural areas. Existing penetration levels of consumer and financial products remains low across the region and growing working age population and increasing affluence should drive consumption. Low household debt levels and high savings rate also bodes well. In the near term, regional economies should benefit from lower interest rates compared with history. Improved political environment in countries such as Indonesia, Thailand and Malaysia is another positive.

Corporate performance has improved and, in recent months, more companies have seen their earnings revised upwards than have faced a downgrade. However, there could be volatility in the near term. Investors will closely monitor corporate earnings growth and compare it against market expectations. We must remember that the global economy has not fully recovered from one of the worst financial crisis in history.



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