



Martha Wang is the portfolio manager of Fidelity Funds - China Focus Fund.

Martha joined Fidelity in mid-2005 and took over management of Fidelity Funds - China Focus Fund in May 2006. Martha has nearly 16 years experience researching Chinese companies, having worked with Indosuez WI Carr Securities, First State Investments and HSBC Asset Management.

Fidelity Funds - China Focus Fund

China - Recovery Confirmed

Concerns regarding the sustainability of economic recovery in China have abated with continued strength shown in the latest set of economic data. Investors have now shifted focus to questions about withdrawal of drastic policy measures that were undertaken to stimulate domestic demand. Martha Wang shares her fund's current positioning in the given environment.

Q: How have Chinese equities performed recently? What were the driving factors?

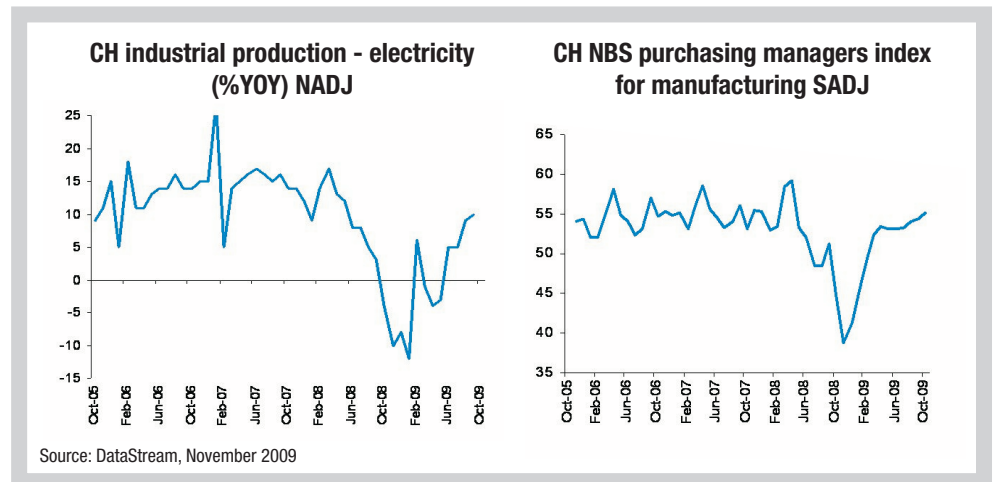
Martha Wang: Overall, Chinese equities have been on an uptrend since March this year given the continuously improving macroeconomic conditions. Earnings upgrades and capital raising efforts boosted investor confidence, driving up Hong Kong-listed names as well. Recently, however, concerns about the government's effort to curb credit growth and potential withdrawal of stimulus measures have limited the advance in share prices. Further, a number of factors including locked-up legal person shares gaining floatable status, the launch of Growth Enterprises Market board for small and medium-sized firms, initial public offerings of new A-shares and existing A-shares' rights issues have created a sudden rise in supply in both domestic A-share and Hong Kong markets, putting pressure on stocks. In this environment, shares in healthcare, internet technology and consumer sectors gained as they are expected to be relatively immune to any policy tightening measures. However, interest rate and macro-economic policy sensitive sectors such as property and manufacturing suffered as the government repeatedly warned of overcapacity. Meanwhile, telecommunications shares continued to lag owing to weak mobile subscription growth and declining fixed line business among most providers.

Q: Could you throw light on what is the latest on the macroeconomic front?

Martha Wang: The latest data shows that China's growth recovery continues. Real GDP growth in the third quarter stood at 8.9% year-on-year, which translates into a double-digit expansion from the previous quarter on an annualised basis. This has been led by domestic demand, especially investment demand, even as exports remained weak. Meanwhile, trade surplus edged lower due to continued fall in exports and recovering imports growth. Further underscoring a strong growth momentum, the official Purchasing Manager Index, an indicator of the health of the manufacturing sector, remained above the expansionary threshold of 50 for the eighth consecutive month in October. Industrial production, power generation and transportation growth, all reflect warming-up of economic activity. Construction activity reaccelerated on the back of the upbeat property market as well as commencement of policy-driven investment projects.

As the recovery is on track, the tone and language of policy statements have turned increasingly cautious on inflation and overcapacity. In certain areas such as materials, there is a possibility that new investment could be curtailed. For instance, increase in steel inventories has pointed to a potential oversupply in the industry. Nonetheless, there are plenty of other areas where the industry is under penetrated and where there is room for expansion. Furthermore, the State Council has assured that the government will manage inflation expectations while keeping the economy growing relatively fast.

Industrial activity is on the upswing

**Q: How concerned are you regarding policy tightening in China?**

Martha Wang: I expect monetary policy to be further fine-tuned, but real tightening measures are not likely to be introduced until next year. Annual inflation remains muted even though rising food prices are stoking inflation expectations. Some of the measures the government has taken, such as towards curbing loan growth, were necessary in order to avoid an asset price bubble and contain non-performing loans and hence can be viewed in a positive light.

The extreme measures that were previously undertaken to stimulate and support economic growth could be scaled back as the economy has gained traction; however, this pullback will happen only gradually due to the government's focus on ensuring rapid growth by strengthening domestic sources of growth. Hence, I do not expect a meaningful change in domestic demand-boosting policies adopted since onset of crisis, whose positive effects can be seen from the rapid growth in sales of appliances and automobiles.

Going forward, I do expect some of these measures to continue, in other words, the VAT rebate for appliances, and the cash rebate for retiring the old automobiles that do not meet the emission standards and so on will continue in the next year. Old-for-new subsidy is a key driver of the recent improvement in sales in home appliances, as it accounted for about a third of total revenue in participating cities for certain companies. Government is now seeking opinions to assess whether it needs to expand the programme to cover more product categories and regions for extended time. If that goes through, it would be a major positive for the industry. Additionally, for next year, the strength of consumption will likely come from recovering employment and income growth.

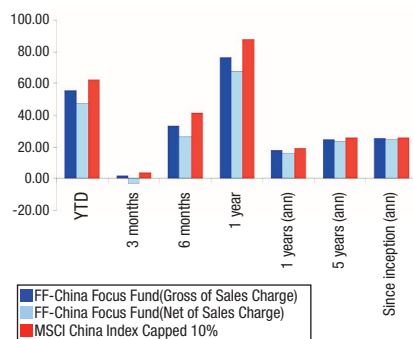
TOP TEN HOLDINGS (%) as at 30 September 2009

	Fund	Benchmark
China Construction Bank H	8.7	7.1
Industrial & Commerical Bank of China	7.3	6.8
China Life Insurance H	5.3	6.4
China Petroleum & Chemical H	5.2	2.7
China Mobile	4.6	10
Tencent Holdings	4.6	2.9
Bank of China 'H'	4.3	6
Ping An Insurance	3.5	2
China Resources Power Holdings	3.4	0.8
Li Ning	3.3	0.4

Source: Fidelity
Benchmark: MSCI China Index (Capped 10%)

References to specific securities are for illustrative purposes only and subject to change without notice. They should not be construed as a recommendation or an advice to transact in the securities.

ANNUALISED PERFORMANCE as at 31 October 2009



Source: Fidelity

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

Since inception date: 18 August 2003

Benchmark: MSCI China Index (Capped 10%)

Q: How have you positioned the fund in this environment?

Martha Wang: I have increased the fund's exposure to companies which will benefit from higher domestic consumption and as such I continue to favour consumer-related sectors. Within staples, the fund has invested in companies which manufacture items such as personal products or wines which thrive on aspiration of adopting a western lifestyle. The fund also has exposure to GOME Electrical Appliances given the buoyancy in white goods sales.

In light of rising expectations of monetary tightening, I added positions in sectors which are relatively immune to interest rate changes such as gas utilities and information technology. Notably, shares in Xinao Gas, China Gas and Lenovo Group were added to the portfolio. I like China Gas given its dominance in the industry, good distribution network and low utilisation rates. I also hold an overweight position in power utility China Resources Power given double-digit growth in electricity production and the company's favourable position in the industry. Among my top bets is China's number one instant messaging services and social networking site, Tencent, which has over 70% of the country's 300 million internet users as members of the virtual community. The company enjoys user loyalty and stickiness due to good product offerings including virtual pets, blogs, auctions, advertisements and games. Higher monetisation of services and strong brand equity should see the firm gain further market share.

Within financials, the allocation to the insurance sector was increased to a neutral stance by adding to existing positions in names including China Insurance, as higher interest rates would increase the yield on investment and because China is an under-penetrated market, which is on a long-term structural growth path. Meanwhile, I have reduced the exposure to banking stocks due to expected changes in policy, which could curtail loan growth. Chinese consumers are not highly leveraged and have a low level of outstanding loans and almost no credit card debt exposure. However, I have scaled back exposure to real estate firms due to concerns regarding valuations.

Q: Which sectors/stocks have contributed to fund performance and which have detracted?

Martha Wang: Over the three-month period ending October the fund lagged its benchmark performance, primarily due to the positioning in the energy sector. The portfolio's underweight stance towards a number of oil producers detracted as advance in crude prices along with improved global economic outlook supported these stocks. I am, however, apprehensive due to their rich valuation and maintain a below-benchmark exposure to the sector in aggregate terms. Having said that, within the sector, I prefer natural gas plays and refineries that stand to benefit from anticipated reforms in pricing of refined product. In view of this, I retain an overweight in China Petroleum and Chemical, popularly known as Sinopec.

The holding in Li Ning hampered returns over this period as the stock succumbed to profit taking following robust profits at the firm. I trimmed the exposure slightly due to fuller valuations but continue to favour the sports branding company due to its market share gains in the mid-segment space.

The positive stance towards utilities limited gains as defensive stocks were generally out of favour given evidence of a strong recovery. Incidentally, the substantial underweight in telecommunications major China Mobile was among the top performers. Shares in the networking and internet messaging firm Tencent contributed, benefiting from strong growth in user base and improved monetisation of its services. The non-benchmark holding in department store chain operator Golden Eagle Retail and one of the fund's top holdings, namely wine producer Yantau Changyu Pioneer contributed. These stocks are benefiting from strong domestic consumption and the former is arguably one of the best-run department stores in the country.

Q: What is your current outlook on the market?

I remain positive about China given the economic growth momentum and government's inclination to ensure the rapid pace of expansion. The crisis management programmes deployed at the end of 2008 could be gradually scaled back as stimulus measures gain traction and market participants and policy makers feel more confident that recovery is sustainable. However, the government is focused on transforming the economy into one which is more reliant on domestic sources of demand and hence some of the measures are expected to continue. The rollback undertaken so far has mainly focused on preventing risks associated with overheating of the economy, such as dropping incentives on second mortgage lending. In its latest report, the Asian Development Bank revised its forecast for China's economic growth this year to 8.2% from its 7% estimated earlier, and expects it to grow 8.9% next year, on likely maintenance of its fiscal stimulus while the global economy recovers moderately.

At the same time, equity market sentiment will probably remain volatile until investors are convinced that there is indeed a meaningful gap between the end of easing and the beginning of tightening.

Corporate performance has been improving and subsequently earnings estimates have been raised. However, the recent rally has pushed up valuations and it becomes more critical in this environment to look for good quality firms which have room for further upgrades and positive surprises. I, therefore, am quite cautious towards valuations and remain disciplined in my investment approach. Nevertheless, there are some sectors where I see more attractive value such as within the consumer discretionary space. Certain plays here are supported by robust domestic demand and are likely to benefit from further policies to support demand.

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