Review of investment trust range | Investment trusts

27 October 2015

Fidelity Closed End Funds

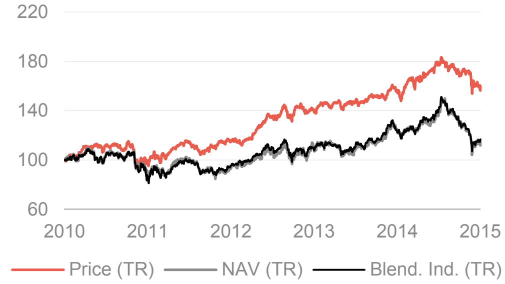
Welcome to the first edition of what will be a regular publication. This edition takes a look at Fidelity and recent developments in three of its investment trusts – Fidelity Asian Values, Fidelity Japanese Values and Fidelity Special Values.

Special feature: New manager Nitin Bajaj settles in at Fidelity Asian Values

In this edition we are focusing on the management changes made to Fidelity Asian Values, with the appointment of Nitin Bajaj, earlier this year. Now that the new manager has had a chance to settle in and the portfolio has undergone its transition, we are taking the opportunity to look at the rationale behind the changes, the drivers that underlie the new manager's strategy and what the implications could be for the trust going forward.

Fidelity Asian Values perf.

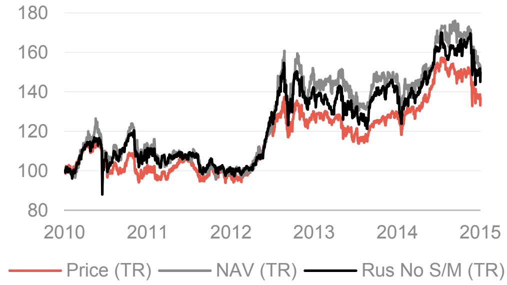
Time period 30/9/2010 to 30/9/2015



Source: Source: Bloomberg, Morningstar and Marten & Co.

Fidelity Japanese Values perf.

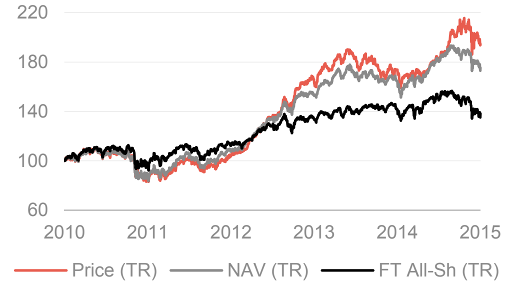
Time period 30/9/2010 to 30/9/2015



Source: Source: Bloomberg, Morningstar and Marten & Co.

Fidelity Special Values perf.

Time period 30/9/2010 to 30/9/2015



Source: Source: Bloomberg, Morningstar and Marten & Co.

Contents

Recent developments at Fidelity

New manager, Nitin Bajaj, appointed to Fidelity Asian Values in April.

With effect from 1 April 2015, Nitin Bajaj assumed responsibility for the management of Fidelity Asian Values' portfolio from John Lo, who had managed the trust since September 2001. The trust's investment objective (see page 5 for details) has remained intact but Nitin's approach, which we discuss in greater detail below, represents a marked change in strategy for the trust. Nitin does not worry about making his portfolio resemble any index benchmark and is focused on generating absolute (positive) returns (he looks for stocks he believes can generate in excess of 50% over three years) whilst avoiding large capital losses. He is also focused predominantly on the smaller companies space as this is where he sees the largest gaps between a company's stock market value and his assessment of its true value. Reflecting the difference between his management style and that of his predecessor, whose investment approach paid more attention to the weights of individual companies and sectors in the index benchmark, portfolio turnover as a consequence of the transition has been in excess of 95%.

New manager, Nicholas Price, appointed to Fidelity Japanese Values in September.

Nicholas Price was appointed portfolio manager for Fidelity Japanese Values from 1 September 2015. In the company profile for Fidelity Japanese Values that is included on pages 9 through 11 of this note, our aim has been to give investors some insight into recent performance and how the trust may be positioned going forward. However, in the next instalment of this series we intend to revisit the trust and take a more detailed look at the rationale behind the change, how the new manager's style differs and how the trust is progressing.

Fidelity Worldwide Investment

Fidelity Worldwide Investment has approximately US$275bn of assets under management. It has a significant presence in London, Hong Kong, Tokyo, Singapore and Sydney.

Fidelity Worldwide Investment is a global investment management organisation that has substantial expertise in equity and fixed income investments, as well as other assets classes. It has c US$275bn of assets under management and offers an impressive range of funds to both private and institutional investors. Fidelity maintains a global network of fund managers, but has a significant presence in London, Hong Kong, Tokyo, Singapore and Sydney. Managers are supported by an extensive analytical team that also has a global foot print (Fidelity has a network of c 350 investment professionals located in over 13 countries) and Fidelity is renowned for both its bottom up stock picking investment process as well as a focus on long-term performance.

Fundamental investment process

Portfolio managers are incentivised based on their long term performance.

Fidelity's managers, whilst having access to extensive analysis of the economic and political situation in countries across the globe, do not have a view of the world imposed upon them. Instead, they get to decide how to allocate the portfolio to different countries and industry sectors. Their incentive schemes are based primarily on the longer-term performance of the funds that they manage. Managers and analysts will typically form opinions taking a three to five-year view. They maintain projections over this time frame and are not encouraged to follow fads or chase trends. The core to Fidelity's approach is that, irrespective of whatever investment strategy they are following (growth, value, etc.), each investment opportunity is researched in depth, from the bottom up (i.e. looking at companies first and industry sectors and country weights after), with a view to ensuring that every holding is a sustainable longer-term investment. Following this approach, consistently, has been a pillar of Fidelity’s success during the last forty years.

Company profile | Investment companies

27 October 2015

Fidelity Asian Values

Moving beyond the transition!

Nitin Bajaj took over management responsibility for Fidelity Asian Values (FAS) on 1 April 2015. Much has happened in equity markets since this time; but six months have now passed since his appointment and the portfolio is now fully aligned with the new strategy, which presents an opportunity to reflect on how the trust is progressing.

Long term growth from small cap Asian ex-Japan

FAS aims to achieve long term capital growth by investing in a portfolio of companies that are listed on the stock markets of the Asia ex-Japan region. The manager picks stocks based on his understanding of the fundamental drivers of their business and the portfolio is overwhelmingly focused on smaller companies as this is where he sees the greatest opportunity to find hidden value given that this section of the market is less well researched. The manager wants to avoid losing money and buys companies because they are attractively valued today rather than on hope that they will grow tomorrow. He wants investments that can make 50% over a three-year period, whilst looking to avoid sharp capital losses. In addition to valuation, the research process places considerable emphasis on company's financial strength, ability to generate cash flows, competitive advantages, business prospects and earnings potential.

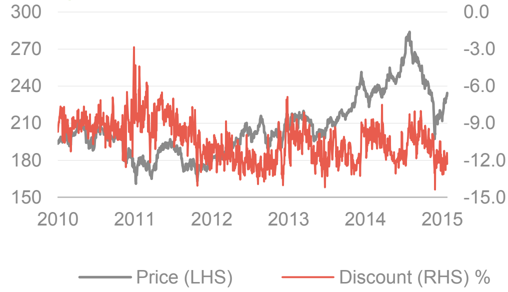
Year Ended	Share Price Total Return (%)	NAV Total Return (%)	Blended B'mark Index TR. (%)*	MSCI World Total Return (%)	MSCI UK Total Return (%)
30/09/11	(10.1)	(13.7)	(12.4)	(3.3)	(3.9)
30/09/12	3.5	10.6	17.6	18.6	17.0
30/09/13	15.2	12.8	7.3	20.8	17.1
30/09/14	15.9	13.4	6.0	12.6	6.3
30/09/15	(8.4)	(4.3)	(6.6)	2.4	(5.7)

Source: Fidelity Asian Values, Bloomberg, Morningstar and Marten & Co. *Note: The blended benchmark index comprises the MSCI AC Far East Ex-Japan Index until 31 July 2015 and the MSCI AC Asia Ex-Japan Index thereafter.

Sector	Asia Pacific Ex-Jap
Ticker	FAS
Base Currency	GBP
Price	234.50
NAV	267.30
Premium/(Discount)	12.3%
Yield %	0.9

Share price and discount

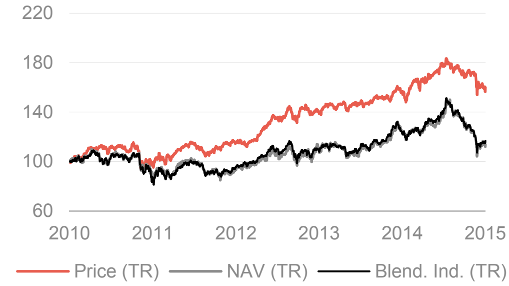
Time period 30/9/2010 to 23/10/2015



Source: Source: Morningstar and Marten & Co.

Performance over five years

Time period 30/9/2010 to 30/9/2015



Source: Source: Bloomberg, Morningstar and Marten & Co.

Domicile	United Kingdom
Inception Date	13 June 1996
Manager	Nitin Bajaj
Market Cap (mlns)	156.6
Shares Outstanding	67.5m
Avg Trading Vol (1yr)	49,417
Net cash	4.4%

Fee reduction and benchmark change

Management fee reduced to 0.9% on first £200m of gross assets and 0.85% thereafter.

In addition to the change of manager and the associated change in strategy, FAS has recently seen both a reduction in its management fee and a change in its benchmark index. Both of these latter changes taking effect from 1 August. The management fee, previously 1.0% of gross assets, has been reduced to 0.9% for the first £200m of gross assets and 0.85% thereafter. The benchmark index is now the MSCI AC Asia Ex-Japan Index (previously it was the MSCI AC Far East Ex-Japan Index). The board opted for this benchmark, rather than an equivalent small cap benchmark, as it is the main benchmark used by the peer group and therefore makes comparisons easier.

Proposed tweaks to the investment policy

Proposals to increase the manager's flexibility to use derivatives to manage the portfolio.

In its recent results announcement, FAS's board advised that, with a view to enhancing returns by giving the manager more flexibility, it is proposing a number of changes to the company's investment policy. The exact nature of the changes is yet to be disclosed but the indication is that they will allow for greater flexibility in use of derivatives. Further information is expected in due course and shareholders will be given the opportunity to vote on the proposals at November's AGM.

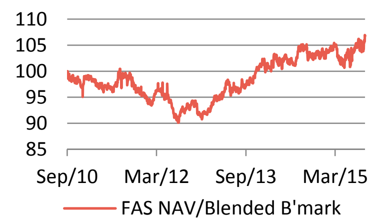
Premium/(discount)

Discount narrowed following Nitin's appointment but has widened more recently.

Following the announcement, at the end of March 2015, that Nitin Bajaj was to take over the management of the portfolio, the discount underwent a period of narrowing from approximately 16% to reach its one year low in the first half of June of 5.7%. However, since this time, the discount has gradually widened so that the trust is currently at a discount of 12.3%. This widening arguably reflects more general concerns over rising interest rates in the US and what impact this could have on emerging markets, coupled with the additional uncertainty created by the marked set back in the Chinese equity market. However, an additional factor may be the negative news flow that began to emerge in June surrounding the company's then largest holding, the Australian legal group, Slater & Gordon (4.8% of the portfolio at 30 June) – see performance section below for additional discussion.

Performance

Figure 1: FAS NAV TR vs Blended benchmark*



Source: Morningstar and Marten & Co.

Nitin's strategy is inherently long term in nature (he's typically looking for companies that can return 50% over three years) and so, with six months having passed it is still too early to judge his performance, particularly as this includes a period of transition (when much of the portfolio was bought and sold). However, it is worth noting that, the NAV performance is ahead of the benchmark over the one, three and six-month periods to 30 September 2015 (see Figure 2 below) all of which cover Nitin's tenure. This is despite the much publicised problems with Slater & Gordon, which was the trust's biggest detractor to performance in the year ended 31 July 2015. Slater and Gordon purchased the Professional Services of Quindell (insurance outsourcer) earlier this year for £673m. News broke at the end of June that the FCA were investigating accounting irregularities at Quindell. The case has subsequently been referred to the Serious Fraud Office. It has also been reported that the Australian Regulator is now looking into Slater & Gordon's Auditor's processes. There has not been any suggestion that Slater & Gordon is implicated in the proceedings and the manager continues to like the fundamental story. However, the news has had a large negative impact on Slater & Gordon's share price (the stock fell 45% between 23 June and 30 June). The manager has now sold out of the position in its entirety as he expects further negative news flow will depress Slater & Gordon's share price for some time. The period of Nitin's tenure, which is highlighted in Figure 2 below, shows outperformance of the NAV vs the benchmark. However, nearer term outperformance as seen in the one and three-month periods is greater. This is because the impact of the underperformance of Slater and Gordon on the trust's NAV largely occurred in the period prior to 30 June 2015.

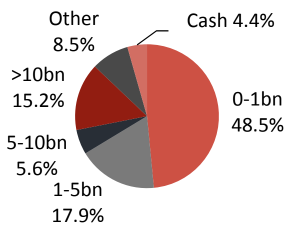
Figure 2: Total return performance to 30 September 2015 (Performance figures in excess of 1 year are annualised)

	1 month (%)	3 months (%)	6 months (%)	1 Year (%)	3 years (%)	5 Years (%)	Since 01/04/2015* (%)
NAV TR	2.1	(9.7)	(17.2)	(4.3)	6.9	3.2	(17.2)
Share price TR	(0.3)	(12.5)	(18.0)	(8.4)	6.9	2.6	(18.0)
Blended B'mark Ind.*	(0.6)	(14.8)	(18.7)	(6.6)	2.0	1.8	(18.7)
MSCI World TR	(2.3)	(4.7)	(9.6)	2.4	11.7	9.8	(9.6)
MSCI UK TR	(3.0)	(6.5)	(9.1)	(5.7)	5.5	5.7	(9.1)

Source: Fidelity Asian Values, Bloomberg, Morningstar and Marten & Co. *Note: Nitin Bajaj was appointed to manage Fidelity Asian Values from 1 April 2015. Fidelity Asian Values blended benchmark index comprises the MSCI AC Far East Ex-Japan Index until 31 July 2015 and the MSCI AC Asia Ex-Japan Index thereafter.

Portfolio transition

Figure 3: FAS Portfolio by market cap



Source: Fidelity Asian Values

The portfolio transition, which saw portfolio turnover in excess of 90%, is now complete with an adjustment cost of just 0.43% of the fund's NAV, which arguably reflects the economies of scale that are offered by an operation such as Fidelity's as well as the large footprint of their activities in Asia. As illustrated in Figure 5, Nitin has constructed a portfolio that is markedly different to the benchmark and noticeably different to that of the previous manager. It should be noted that the shape of the portfolio shown in Figure 5, and discussed elsewhere in this report, is driven by the manager's choice of stocks rather than any target weight to a country or industry sector. A key change has been to the allocations by size of company. Exposure to companies with a market cap in excess of $10bn have been reduced heavily (36.3% percentage point difference) in favour of companies with market caps up to $1bn (26.6%).

Although not illustrated here, the two large geographical changes, during Nitin's tenure, are a reduction in the allocation to China (15.5% percentage points difference in weighting) and a reduction to South Korea (20.1%). The reduction to China, which was put in place prior to August's correction, was a move designed largely to protect value. The manager had both valuation concerns and considers that it is difficult to get reliable information for many companies in China. The largest increase has been to India (8.2%) a market that the manager has a lot of experience with.

In terms of sectoral changes, two that standout are reductions in the allocations to information technology and telecommunication services. These are two areas that were firm favourites of the previous manager but areas which Nitin has not traditionally favoured in his portfolios. With regards to information technology, Nitin considers that they are frequently difficult to understand and often their success hinges on things that are beyond management's control. With telecommunications services, Nitin does not consider the industry structure to be particularly favourable. He observes that, whilst the sector has a strong growth profile, it is highly competitive so that any gains tend to be eroded over time.

Financials is another area Nitin has reduced. Within Financials, Nitin avoids Life Insurance as this is an area that is difficult to understand. Furthermore, whilst banking valuations do not look particularly onerous, there continue to be regulatory uncertainties and many banks in the region have issues with non-performing loans that they are yet to address.

As part of the transition, the gearing, which is provided using contracts for difference (CFDs), has been removed, although the manager intends to employ gearing again in due course. As at the end of July, the portfolio was 9.1% net cash but following the market correction in August, the manager has been better able to find attractive opportunities and has put more cash to work (FAS had net cash of 4.4% as at the end of August). Reflecting this the allocations to China and Hong Kong have both increased to 13.1% and 10.8% respectively (11.2% and 9.6% as at the end of July).

The increases in sectoral allocations are more muted, reflecting the fact that the manager has taken the portfolio from net geared to net cash. However, as illustrated in Figure 5, Nitin also favours companies exposed to the structural growth story of an emerging middle class in Asia. Hence the large allocation to consumer discretionary.

Figure 4: Top ten overweight positions as at 31 August 2015

Holding	Sector	Portfolio weight (%)	Index weight (%)	Percentage point difference	Portfolio weight 31 Mar 2015 (%)	Percentage point change
Power Grid Corp India	Utilities	3.9	0.0	3.9	0.0	3.9
Religare Health Trust	Health care	3.4	0.0	3.4	1.2	2.2
HDFC Bank	Financials	2.9	0.0	2.9	0.0	2.9
Tisco Financial	Financials	2.6	0.0	2.6	0.0	2.6
New Orient Ed & Tech	Cons. Discretionary	2.3	0.0	2.3	0.8	1.5
Intl. Housewares	Cons. Discretionary	2.3	0.0	2.3	0.0	2.3
G8 Education	Cons. Discretionary	2.2	0.0	2.2	0.0	2.2
WPG Holding	Information Tech.	2.2	0.0	2.2	0.1	2.1
Cognizant Tech Sol's	Information Tech.	1.8	0.0	1.8	0.0	1.8
Taiwan Semicon.	Information Tech.	5.1	3.5	1.6	5.9	(0.8)

Source: Fidelity Asian Values and Marten & Co.

Figure 5: Sectoral allocations, as at 31 August 2015

Sector	P'folio wght (%)	Index wght (%)	PCT point diff.	P'folio wght 31 Mar (%)	PCT point chng	Sector	P'folio wght (%)	Index wght (%)	PCT point diff.	P'folio wght 31 Mar (%)	PCT point chng
Cons. disc.	25.1	8.1	17.0	23.2	1.9	Materials	3.3	4.5	(1.2)	1.6	1.7
Financials	18.3	33.4	(15.1)	20.1	(1.8)	Telecomms.	1.4	7.0	(5.6)	6.8	(5.4)
Info. tech.	17.8	20.7	(2.8)	26.9	(9.1)	Energy	1.0	4.5	(3.5)	3.9	(2.9)
Cons. staples	8.9	5.7	3.2	8.2	0.7	Other index	0.0	0.0	0.0	0.0	0.0
Industrials	8.4	9.3	(1.0)	10.5	(2.1)						
Health care	6.2	2.5	3.7	3.6	2.6	Total equity	95.6	100.0	(4.4)	107.9	(12.3)
Utilities	5.2	4.2	1.0	3.3	1.9						

Source: Fidelity Asian Values and Marten & Co.

QuotedData

Company profile | Investment companies

27 October 2015

Fidelity Japanese Values

Under new management too!

Nicholas Price assumed responsibility for the management of Fidelity Japanese Values' (FJV) portfolio on 1 September 2015, picking up the baton from Shinji Higaki, who has managed FJV for 8 years. The board believe that Nicholas' approach, whilst retaining many of FJV's key elements, offers superior potential to perform well vs peers and they hope this will contribute to a narrowing of FJV's discount over time. Nicholas has a proven track record of investing in small and mid-cap Japanese equities. The board believe Nicholas' approach will make the best use of FJV's closed ended structure.

Long term growth from Japanese listed equities

The investment objective of the Company is to achieve long term capital growth from an actively managed portfolio of securities primarily of small and medium sized Japanese companies listed or traded on Japanese stock markets. FJV's objective and its benchmark, the Russell Nomura Mid/Small Cap Index, remain unchanged through the transition.

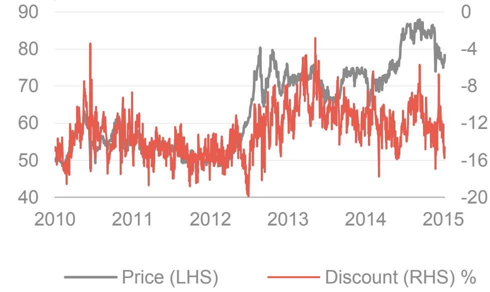
Year Ended	Share Price Total Return (%)	NAV Total Return (%)	Russell/ Nomura Mid-Sm Cap TR. (%)	TOPIX Index Total Return (%)	MSCI World Total Return (%)
30/09/11	11.0	11.3	8.9	2.1	(3.3)
30/09/12	(9.9)	(9.0)	(8.5)	(4.8)	18.6
30/09/13	45.0	37.0	29.0	30.8	20.8
30/09/14	2.1	1.3	3.5	1.2	12.6
30/09/15	3.2	6.7	9.9	6.4	2.4

Source: Bloomberg, Morningstar and Marten & Co.

Sector	Japanese Sm Co's
Ticker	FJV
Base Currency	GBP
Price	81.88
NAV	93.43
Premium/(Discount)	(12.4)%
Yield %	Nil

Share price and discount

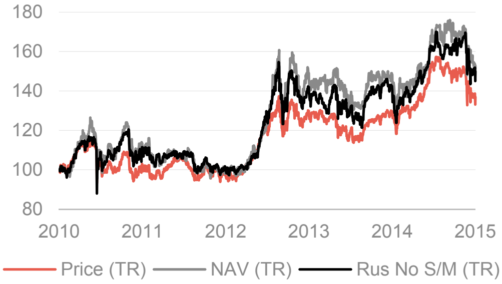
Time period 30/9/2010 to 23/10/2015



Source: Source: Morningstar and Marten & Co.

Performance over five years

Time period 30/9/2010 to 30/9/2015



Source: Source: Bloomberg, Morningstar and Marten & Co.

Domicile	United Kingdom
Inception Date	15 March 1994
Manager	Nicholas Price
Market Cap (mlns)	88.5
Shares Outstanding	114.2m
Trading Vol. (1yr avg)	178,426
Net Gearing	20.1%

The Tokyo Price

Nicholas manages assets of US$1.6bn – split across segregated accounts, sub-portfolios of multi-manager products, the Fidelity Funds – Japan Aggressive Fund, the Fidelity Japan Growth Mother Fund and the FIJ Aggressive Growth Mother Fund.

Based in Tokyo, Nicholas Price has over twenty years of experience of investing in Japanese equities, initially as a research analyst for Fidelity in Tokyo from 1993 and then as a portfolio manager from 1999. Nicholas manages a number of funds including FJV and three open-ended funds, the Fidelity Funds - Japan Aggressive Fund (FF-JAF), the Fidelity Japan Growth Mother Fund and the FIJ Aggressive Growth Mother Fund and has c US$1.6bn of assets under management. Fidelity say that, of all of these funds, The Japan Aggressive Fund, which he has managed since it was launched in August 2006, provides the best illustration of what FJV will look like post transition. However, with FJV the manager will not have to worry about making investments he can easily cash in to meet redemptions as he would for the open ended fund and should be able to make larger allocations to less liquid positions, which offer superior return opportunities but would not have suited the open ended fund. Nicholas is supported by a 24 strong Tokyo based team of dedicated Japanese equity market analysts, however he is also known for conducting his own research and including his own ideas in his portfolios.

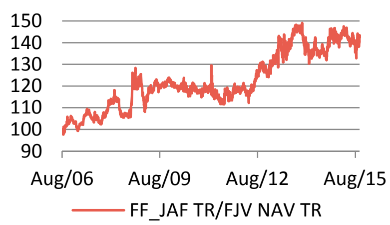
Premium/(discount)

Current discount is towards the middle of its one-year range. Board are hopeful that the new strategy will improve relative performance and a narrower discount.

At the current discount of 12.4%, FJV is trading towards the middle of its twelve month trading range (between discounts of 5.7% and 17.8%). FJV has the authority to repurchase shares but arguably reflecting the current size of the fund, the board has not elected to do this (no shares have been repurchased in the current or last financial year). The board believe that the new strategy offers greater potential to outperform peers and are hopeful that this will lead to a narrowing of the discount. If the discount can be narrowed this would make it easier to undertake new share issuance for the trust. If the trust were bigger FJV Shareholders could possibly benefit from both lower average running costs and improved liquidity. FJV has seen some modest share issuance during the last 12-months as its subscription shares have been exercised.

Performance

Figure 6: FF-JAF vs FJV NAV*



Source: Morningstar and Marten & Co. *Note: since Nicholas Price was appointed manager of FF-JAF.

As illustrated in Figures 6, and 7, the longer term trend is one of outperformance of the FF-JAF over both FJV's NAV and the Russell-Nomura Mid-Small Cap Index, albeit with some volatility. FJV's performance, by comparison, is relatively close to that over 5 years but shows marked underperformance since August 2006 (a period which includes the performance of the manager prior to Shinji Higaki). We observe that FF-JAF has underperformed both FJV's NAV and the index over the six-month horizon but it is worth noting that FF-JAF's portfolio is tilted towards smaller cap-stocks. These tend to underperform during periods of market stress, August being an example, but the strategy has delivered superior long term performance.

In appointing Nicholas, the board have selected a manager whose strategy they believe will both take greater advantage of FJV's closed ended structure, has a more growth orientated, more risk seeking approach and will make more active bets vs the benchmark. As such, the new strategy may well exhibit greater return volatility.

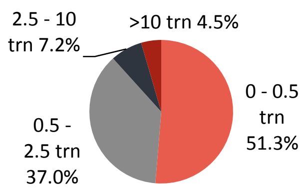
Figure 7: Total return performance to 30 September 2015 (Performance figures in excess of 1 year are annualised)

	1 month (%)	3 months (%)	6 months (%)	1 Year (%)	3 years (%)	5 Years (%)	Since 14/08/2006* (%)
FF Japan Aggressive	(3.7)	(6.5)	(8.5)	12.2	17.9	12.5	4.1
NAV TR	(7.0)	(7.8)	(7.7)	6.7	14.0	8.4	0.2
Share price TR	(6.1)	(9.1)	(8.0)	3.2	15.2	8.8	(0.8)
Rus/Nom Mid-Sm TR	(4.0)	(5.1)	(7.0)	9.9	13.6	7.9	4.1
TOPIX Index TR	(5.1)	(7.6)	(9.4)	6.4	12.1	6.5	2.8
MSCI World TR	(2.3)	(4.7)	(9.6)	2.4	11.7	9.8	7.4

Source: Fidelity Japanese Values, Morningstar and Marten & Co. *Note: Nicholas price was appointed to manage the Fidelity Funds – Japan Aggressive Fund with effect from 14 August 2006.

Portfolio transition

Figure 8: FF-JAF Market cap allocations



Source: Fidelity Worldwide Investment

The portfolio transition is now over 98% complete and Fidelity advise that there is now a maximum of four small illiquid micro-cap positions (each less than 0.5% of the portfolio) that are being worked through. Arguably reflecting the economies of scale afforded by Fidelity's operations, the transition costs have been approximately 0.11% of FJV's net asset value.

Nicholas Price's strategy is markedly different to that of Shinji Higaki's and so it is not surprising that the commonality between FJV's portfolio and that of the Japan Aggressive Fund was in the region of 17%, with portfolio turnover of 80% likely to be required in relation to the transition. There may be some shifts between and within sectoral allocations. Shinji Higaki's largest overweight was to consumer discretionary. This is also a sector that Nicholas Price likes, although he favours companies that are beneficiaries of inbound tourism (primarily the emerging Chinese middle-class). Examples are companies such as Laox (electronics retail with enhanced duty free-shopping services), Zojirushi (cooking appliances – rice cookers and vacuum bottles are popular with Chinese tourists) J.Front Retailing (department store) and H.I.S. Travel (focused on inbound travel). A more general theme, which can be seen across the portfolio, is a preference for companies that have been historically been staid domestic focused businesses but are growing through expansion in to China or the wider ASEAN region.

The next edition of our Fidelity Funds Report will look at the FJV manager change in more detail.

Whilst Shinji was broadly neutral on financials, Nicholas likes certain financial sub-sectors – noticeably those linked to consumption. Nicholas is neutral on banks, does not favour insurance, but likes real estate and credit card financing (e.g. Aeon Financial Services). Shinji was overweight Telecommunications and information technology but these are not areas particularly favoured by Nicholas although he likes businesses with exposure to growth in e-commerce (e.g. Kakaku and Ratuken). Environmental technology and the growing using of semi-conductors with the increasing use of sophisticated electronics in automotive applications is another secular trend the manager likes (Stanley Electric, Nichias and Rohm).

Looking forward, Fidelity suggest that investors should expect to see greater turnover in the portfolio (approximately 80% per annum vs the previous managers 50%). Nicholas has an active policy of taking profits in winning stocks and recycling into new names and believes that a strong sell policy is key to building performance. Recent examples of this would be Pigeon, Sony and Hitachi. The trust will continue to use long CFD positions to provide gearing.

Company profile | Investment companies

27 October 2015

Fidelity Special Values

Following the Wright path!

Three Years have passed since Alex Wright took over management of Fidelity Special Values' (FSV) portfolio in September 2012. During this time there has been a marked uplift in FSV's performance, relative to its FTSE All-Share benchmark and arguably reflecting this FSV's discount has closed from c 15% so that the trust now trades close to asset value today.

UK focused special situations investment trust

FSV aims to achieve long term capital growth by investing in special situations. The portfolio is primarily focused on UK-listed equities and whilst it is an all-cap strategy, there is an inherent bias towards small and mid-cap companies. Alex describes himself as following a value contrarian philosophy. He will typically be looking for companies that have experienced some difficulties (can be both stock and sector related) but where, in his view, the market may not yet fully appreciate their turnaround potential. This creates the opportunity for additional upside as the market becomes more excited about such companies than they are today. FSV invests across the full range of industries represented in the FTSE All-Share. Companies are selected based on analysis of the fundamental drivers of success for their businesses and weightings reflect the outcome of that process. Up to 20% of FSV's portfolio can be invested in companies listed on overseas exchanges.

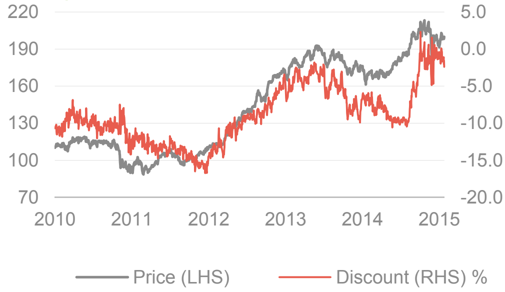
Year Ended	Share Price Total Return (%)	NAV Total Return (%)	FTSE All-Share Total Ret. (%)	MSCI UK Value Tot. Ret. (%)	MSCI World Total Return (%)
30/09/11	(14.0)	(12.8)	(4.4)	0.6	(3.2)
30/09/12	20.6	23.2	17.2	20.1	17.3
30/09/13	57.3	42.1	18.9	16.3	19.9
30/09/14	6.6	7.6	6.1	5.6	12.1
30/09/15	11.9	6.7	(2.3)	(11.9)	1.6

Source: Morningstar and Marten & Co.

Sector	UK All Companies
Ticker	FSV
Base Currency	GBP
Price	200.00
NAV	204.94
Premium/(Discount)	(2.4%)
Yield %	1.7%

Share price and discount

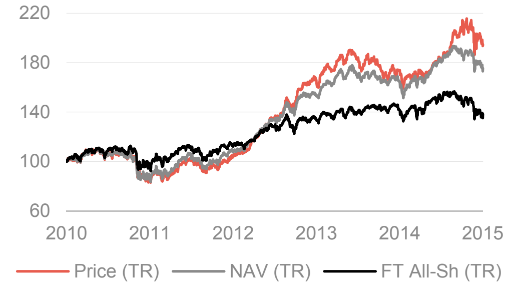
Time period 30/9/2010 to 23/10/2015



Source: Source: Morningstar and Marten & Co.

Performance over five years

Time period 30/9/2010 to 30/9/2015



Source: Source: Bloomberg, Morningstar and Marten & Co.

Domicile	United Kingdom
Inception Date	17 Nov 1994
Manager	Alex Wright
Market Cap (mlns)	528.4
Shares Outstanding	266.5m
Trading Vol. (1yr avg)	120,562
Net Gearing	8.9%

Improved access for retail investors

Stock split allows for more efficient investment for smaller investors.

Following approval at this year's AGM, on 29 June 2015 FSV's shares were split so that for every one old share investors got five new ones. The board recognised that beforehand smaller investors sometimes experienced difficulty trading in FSV.The stock split should allow for improved efficiency when investing smaller sums and be supportive of demand from smaller investors generally.

Premium/(discount)

Clear discount control policy; now aiming to keep cum-income NAV discount in single figures.

FSV's discount evolution, during the last five years, has tended to reflect that of the performance of its NAV versus the FTSE All-Share benchmark – broadly narrowing during periods of outperformance and widening during periods of underperformance. However, between the end of April and beginning of July this year, the trust's discount narrowed significantly (from a discount of over 10% to a premium of 2.3%). During this period, both the NAV and share price grew strongly but the share price growth dominated leading to a closing of the discount. This shortly followed announcements regarding both the stock split and a commitment to maintain the NAV (including income) discount in single figures. Other supportive factors may include the strong relative performance of smaller stocks, where FSV is overweight, in the post-election rally as well as an extended run of strong performance by FSV against the broader market. FSV is currently trading at a cum-income discount of 2.4%. However, if FSV can continue to trade at close to asset value, the board could give consideration to expanding the size of the trust. If so, this should provide the dual benefits of improving liquidity and reducing the average costs of running the trust.

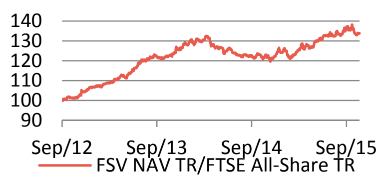
Performance

Figure 9: Total return performance to 30 September 2015 (Performance figures in excess of 1 year are annualised)

	1 month (%)	3 months (%)	6 months (%)	1 Year (%)	3 years (%)	5 Years (%)	Since 01/09/2012* (%)
NAV TR	(3.4)	(5.5)	(2.7)	6.7	17.7	11.9	18.2
Share price TR	(2.5)	(5.2)	7.0	11.9	23.3	14.3	24.2
FTSE All-Share TR	(2.7)	(5.7)	(7.2)	(2.3)	7.2	6.7	7.4
MSCI UK Value TR	(5.1)	(10.0)	(13.2)	(11.9)	2.7	5.5	3.0
MSCI World TR	(2.2)	(4.9)	(10.0)	1.6	10.9	9.1	11.0

Source: Fidelity Special Values, Morningstar and Marten & Co. *Note: Alex Wright was appointed to manage FSV's portfolio with effect from 1 September 2015.

Figure 10: FSV vs FTSE All-share*



Source: Morningstar and Marten & Co. *Note: since Alex Wright was appointed manager.

As illustrated in both the performance chart on page 12, and Figures 9 and 10, Alex has provided a performance that is markedly different from FSV's FTSE All-Share benchmark. Furthermore, Alex's performance has been broadly characterised by strong outperformance of the benchmark although, within this there are marked periods of under and outperformance.

Portfolio developments

Figure 11: Top ten overweight positions as at 31 August 2015

Holding	Sector	Portfolio weight (%)	Index weight (%)	Percentage point difference	Portfolio weight 28 Feb 2015 (%)	Percentage point change
Citigroup	Financials	3.9	0.0	3.9	4.2	(0.3)
Sanofi	Health care	3.7	0.0	3.7	2.6	1.1
CLS	Financials	3.0	0.0	3.0	2.8	0.2
Regus	Industrials	3.1	0.1	3.0	2.6	0.5
Ultra Electronics	Industrials	3.0	0.1	2.9	0.0	3.0
UDG Healthcare	Health care	3.0	0.1	2.9	2.8	0.2
Carnival	Cons. Services	3.0	0.3	2.7	2.0	1.0
Brewin Dolphin	Financials	2.5	0.0	2.5	4.4	(1.9)
Homeserve	Financials	2.5	0.1	2.4	2.1	0.4
Wolseley	Industrials	2.9	0.5	2.4	2.9	0.0

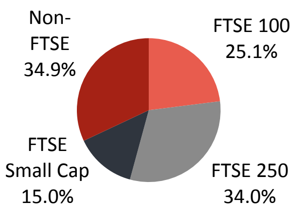
Source: Fidelity Special Values and Marten & Co.

Figure 12: Sectoral allocations, as at 31 August 2015

Sector	P'folio wght (%)	Index wght (%)	PCT point diff.	P'folio wght 28 Feb (%)	PCT point chng	Sector	P'folio wght (%)	Index wght (%)	PCT point diff.	P'folio wght 28 Feb (%)	PCT point chng
Financials	40.2	26.3	13.9	41.1	(0.9)	Technology	2.7	1.5	1.2	2.5	0.2
Industrials	29.7	10.5	19.2	27.4	2.3	Telecom's	2.1	5.2	(3.2)	1.3	0.8
Cons. serv's	17.1	12.6	4.5	16.3	0.8	Utilities	0.8	3.7	(2.9)	1.2	(0.4)
Oil & gas	9.3	11.0	(1.7)	5.6	3.7	Other index	(7.8)	0.0	(7.8)	(10.2)	2.4
Cons. goods	6.8	15.1	(8.3)	9.4	(2.6)						
Basic mats.	4.3	5.5	(1.2)	4.9	(0.6)	Total equity	108.9	100.0	8.9	103.2	5.7
Health care	3.8	8.5	(4.7)	3.7							

Source: Fidelity Special Values and Marten & Co.

Figure 13: FSV Portfolio by index



Source: Fidelity Special Values

> In managing FSV's portfolio the manager is supported by a well-resourced team that includes 6 dedicated small – cap analysts.

FSV maintains a portfolio that is overweight smaller and medium sized companies as this is where Alex currently sees the greatest opportunities. The large financials overweight reflects Alex's view on the banks, which he considers to be one of the most exciting areas of the markets today. HSBC and Citigroup have been top five holdings all year but the portfolio also has positions in Lloyds, Barclays and the Bank of Ireland. Investors have been wary of the banks, post-financial crisis. However, in the manager's view, as the banks are recovering, profits are now rising, balance sheets have strengthened significantly and the regulatory risks are much more manageable and known.

The portfolio is underweight the oil & gas sector but there has been a lot of news flow since the oil price has dropped and this is an area where the manager has done some analysis and added a few small cap names. The position in Shell was also increased by buying BG after the announcement of the bid as the manager sees this as a very good deal for Shell.

The portfolio has had a FTSE 250 hedge in place since 2013. This is a short index position that should offer some protection in the event the UK mid-caps come under pressure. The position cost c £5m for the year ended 31 August 2014 and accounted for c 10% of FSV's gross assets at the end of July. Gearing to the trust is provided through 'contracts for difference' (CFDs). Reflecting the manager's contrarian style, net equity exposure is generally increased following periods of market setback. This proved to be the case following August's market retrenchment with net exposure increased from +3.4% at the end of July 2015 to +8.9% at the end of August 2015.

Special feature: New manager Nitin Bajaj settles in at Fidelity Asian Values

The rationale behind the changes

The decision to appoint Nitin Bajaj as manager followed from a strategy day in January during which the board looked at ways that Fidelity Asian Values could make best use of its closed ended structure. The board were aware of John Lo's long term outperformance against the company's index benchmark (over the thirteen years to January 2015 FAS returned 12.3% per annum beating the benchmark's 10.7%). However, they also observed that, when compared to its peers, its performance had been consistently second quartile and so felt that there was the potential to adjust the strategy with a view to generating an uplift in performance.

The chart on page 5 of this note also provides an illustration of the extent to which the performance of Fidelity Asian Values' NAV has moved closely with that of the benchmark. This arguably reflects the bias to medium and large sized companies (which dominate the index benchmark) preferred by John Lo. They concluded that a possible approach to improving performance could be to use the trusts' closed ended structure to take a longer term view and invest in what may be less liquid, potentially smaller stocks, offering superior returns over the longer term. The board met a number of Fidelity managers including Nitin Bajaj. Of all the managers the board felt that Nitin's focus on investing in smaller companies and on not losing money would be most appropriate fit with the trust's investment objective and offer the best opportunities for outperforming its peers over the longer term. They also found the performance of the Fidelity Funds – Asian Smaller Companies Fund, an open-ended fund run by Nitin since September 2013, compelling.

Nitin Bajaj – A small cap value investor in Asia

Based in Singapore, Nitin Bajaj is a fund manager within Fidelities Asian Equities team. He has worked for Fidelity since 2003, having previously been an analyst for KPMG in India. Nitin initially worked at Fidelity in London as an analyst and then as an assistant portfolio manager. In 2009, he moved to Mumbai in India, managing the Fidelity India Special Situations Fund and the Fidelity India Value Fund. When Fidelity sold their Indian business in 2012, Nitin stayed with Fidelity and moved to join their Singapore operation where he took over the management of the 'Fidelity Funds – Asian Smaller Companies Fund', which he continues to run. As of 1 April 2015, Nitin has had responsibility for the management of the portfolio for Fidelity Asian Values.

Nitin Bajaj's investment approach is focused on bottom-up (looking at the company first and foremost), fundamental research of companies. His investment universe comprises approximately 16,000 listed companies, which is substantial, but Nitin is supported by a 50 strong team of analysts at Fidelity that are focused on the Asian Ex-Japan region. This team covers approximately 1,000 stocks. However, Nitin is known for liking to complement this with his own research activities, and always keen to include a few of his own ideas in the portfolios he manages.

His style is unreservedly about identifying value opportunities. He tends to be biased towards small and mid-cap companies as these tend to be less well researched and he believes that he is much more likely to find valuation anomalies in this space. However, whilst he does not have to be concerned about inflows and outflows for

Fidelity Asian Values, as he is for his open ended fund, Nitin does not tend to invest in companies that are valued below $100m. This is because Nitin feels, in Asia, companies below US$100m can often be too illiquid even for a closed-end fund.

Why focus on small cap value investing in Asia?

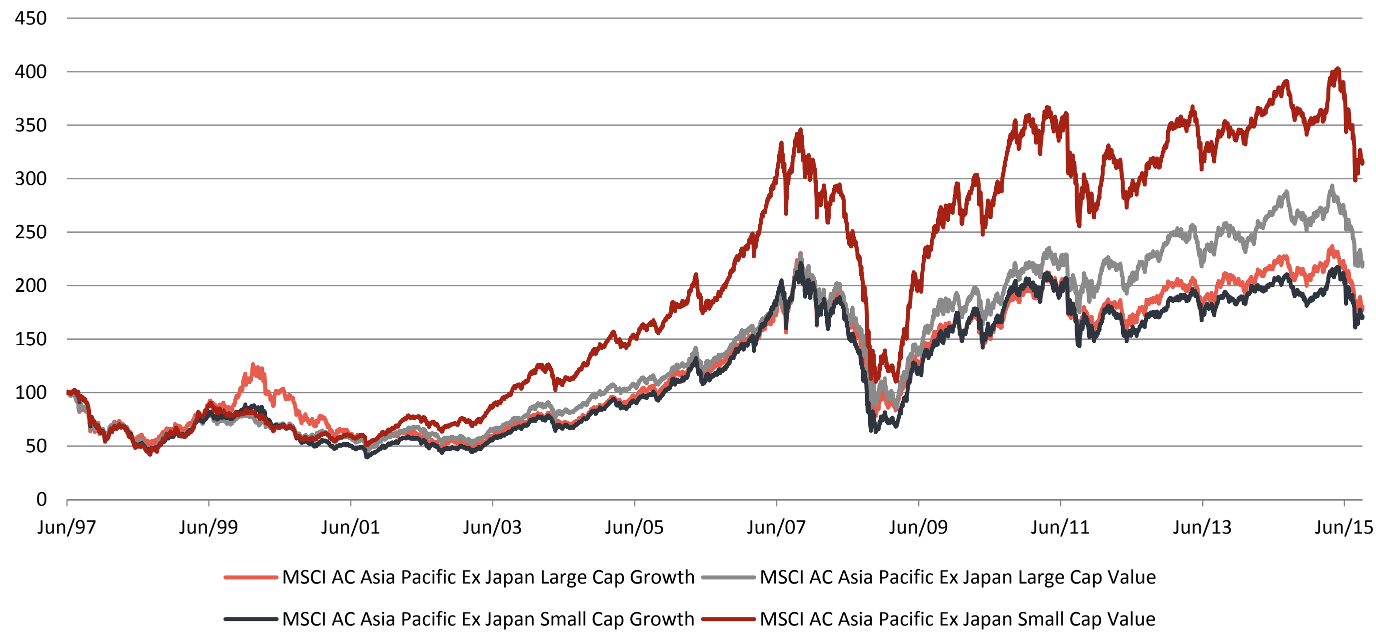
Figure 14 below provides an illustration of the long term returns provided by the Asia Pacific Ex-Japan region according to investment style (both value vs growth and small cap vs large cap). It shows that, over the 18 years to the end of June 2015, value style equities (whether large or small cap) have beaten the performance of growth style stocks in the region. In addition, Figure 14 also illustrates that within this space, small-cap value has outperformed large cap value during the period.

The manager's explanation for this longer term outperformance is that high growth stocks will, on average, lead to relatively higher expectations of future growth (Nitin believes that both investors and analysts tend to get over excited about the future growth prospects of such companies. In Nitin's view, this tends to lead to bias in forecasts and higher (overly optimistic) valuations the result. Where such stocks then disappoint, this leads to a lowering of expectations, as well as earnings, investors value them on lower multiples of earnings and ultimately poor performance.

However, in his view, value stocks will tend to have, on average, less hope-value built into the markets' expectations of their future growth prospects (potentially cyclical stocks towards the bottom of a cycle). In his view, if a stock has recently underperformed, investors and analysts will tend to overestimate the period during which that underperformance will continue and will be biased towards lower expectations of its growth prospects going forward. This inherently leads to lower overly pessimistic valuations.

He also suggests that it is, on average, easier for value stocks to meet or beat these overly pessimistic expectations. This can then lead to a virtuous circle of improving earnings expectations and multiple expansion that ultimately give rise to superior returns over the longer term. The manager notes however that such an approach can take time to come to fruition and so it requires a longer term investment horizon.

Figure 14: Long term returns by style – Asia Pacific Ex-Japan



Source: Bloomberg and Marten & Co.

The emerging Asia growth story

As illustrated in Figure 15, emerging and developing Asia is expected to provide GDP growth that is attractive relative to both developed and emerging markets over the next few years. Furthermore, as these economies (notably China) move from investment led growth to growth that is driven by consumption, there is the opportunity to benefit from rising consumer incomes that support both discretionary consumer spending and increasing demand for health care.

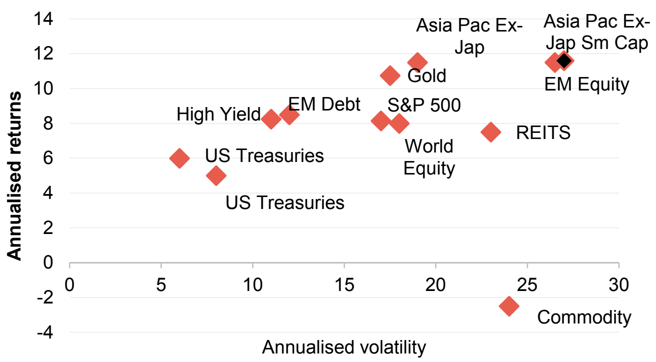
The manager likes the Asian consumption story although tends to favour other Asia-Pacific Ex-Japan countries over China. He is also attracted by the size of the investment universe and the risk-return profile it offers (see Figures 16 and 17 below).

Figure 15: IMF GDP growth rate estimates, by country group, 2015 to 2019

Country group	2015	2016	2017	2018	2019	Average
World	3.1	3.6	3.8	3.9	4.0	3.7
Advanced economies	2.0	2.2	2.2	2.2	2.0	2.1
Euro area	1.5	1.6	1.7	1.6	1.6	1.6
Major advanced economies (G7)	1.9	2.2	2.1	2.1	1.9	2.0
Other advanced economies	2.8	2.3	2.7	2.9	2.9	2.7
European Union	1.9	1.9	2.0	1.9	1.9	1.9
Emerging market and developing economies	4.0	4.5	4.9	5.1	5.2	4.7
Emerging and developing Asia	6.5	6.4	6.3	6.4	6.5	6.4
Emerging and developing Europe	3.0	3.0	3.4	3.3	3.3	3.2
ASEAN-5	4.6	4.9	5.3	5.4	5.5	5.1
Latin America and the Caribbean	(0.3)	0.8	2.3	2.5	2.7	1.6
Middle East, North Africa, Afghanistan, and Pakistan	2.5	3.9	4.1	4.3	4.4	3.8
Middle East and North Africa	2.3	3.8	4.1	4.1	4.3	3.7
Sub-Saharan Africa	3.8	4.3	4.9	5.0	5.0	4.6

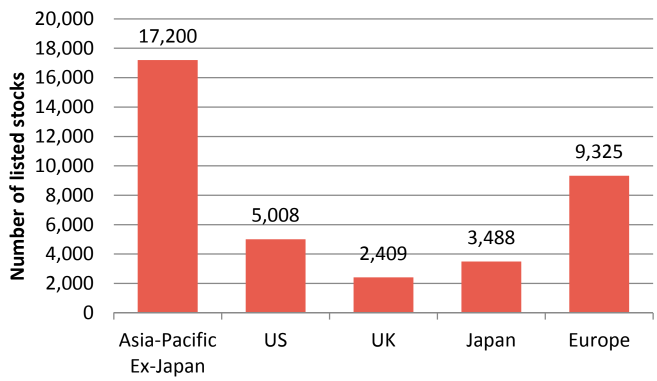
Source: IMF World Economic Outlook – October 2015.

Figure 16: Risk-return profile by asset class



Source: Fidelity Worldwide Investment

Figure 17: Listed stocks by region



Source: Fidelity Worldwide Investment

Not hugging the benchmark

With regards to portfolio management, Nitin is focused on two key things. The first is to generate absolute (positive only) returns. When selecting portfolio companies, he is looking for those that have the potential, in his view, to return 50% over a three-year period. Concurrent to this, he has a strong focus on identifying and excluding companies that may lead to significant capital losses. He distances his approach from those of some other managers who have a relative return approach. Their objective may be to broadly match the benchmark with some modest outperformance although this strategy does not generally protect in falling markets.

Nitin's view is that his approach is more akin to how an individual investor would manage his own money but acknowledges that his approach may be more likely to underperform in strongly rising markets. It also relies heavily on the skills of the manager and the resources he has access to.

Given the differences in Nitin's style with that of the previous manager of Fidelity Asian Values, it seems reasonable to us that investors should expect greater deviations from the benchmark in terms of performance going forward. However, there should also hopefully be less chance of values falling back violently.

Investment process

In selecting investments, Nitin considers himself to be making a longer-term investment in a business rather than purely purchasing a stock. He is therefore focused on the fundamental drivers of success for that business as well as entering at an appropriate valuation.

What does Nitin look for in a stock?

Nitin will not include companies in his portfolios whose businesses and business models he cannot understand. Examples of these would be life-insurance companies and some technology companies. Nitin likes companies that are exposed to longer term structural growth stories and have pricing power. He devotes considerable time to analysing the competitive pressures that a company may face and is wary of companies that might experience tightness in their own supply chain that could erode their profitability. Management quality is also paramount. Nitin looks for companies have management with strong records both in delivering shareholder value and maintaining high standards of corporate governance.

Nitin also has a strong focus on a company's ability to generate free cash flows and whether these cash flows are sustainable. He is therefore wary of companies that have high debt levels, are experiencing high margins relative to history or have a high proportion of contractual revenues that are derived from one theme. As a value investor, Nitin also looks for an appropriate entry point based on valuation and will avoid companies that are trading at valuations that are high relative to their historic values. Finally, where Nitin finds a company that he likes, he then looks to back it with conviction.

QuotedData

QuotedData is a trading name of Marten and co, which is authorised and regulated by the Financial Conduct Authority
123a Kings Road, London SW3 4PL
0203 691 9430

www.quoteddata.com

Registered in England & Wales number 07981621,
135a Munster Road, London SW6 6DD

Edward Marten
(em@martenandco.com)

James Carthew
(jc@martenandco.com)

Matthew Read
(mr@martenandco.com)

About QuotedData

We offer resources for investors who want access to equity research on UK and European listed companies, but like most without a research budget, find it hard to get hold of. One thing we cannot do is offer you advice on your investments – the aim of what we do it to give you the information you might need to make your own investment decisions. If you are still unsure it is best to use a financial adviser but, hopefully, at least you will have a better understanding of what she or he is telling you.

We hope you find QuotedData useful but if there is anything you think we could do to improve our content, or even if you interested in hosting/republishing our work, please get in touch.