

Fidelity European Values

Maintaining a focus on consistent dividend growth

Fidelity European Values (FEV) provides selective exposure primarily to continental European equities, seeking to achieve long-term capital growth through investing in companies able to grow dividends consistently over a three- to five-year time horizon. FEV has outperformed its benchmark over three, five and 10 years and, while underperforming during the later stages of the recent market rally, has outperformed in June and July 2014 as the market has weakened. While the manager has a cautious view of the European market outlook, he sees scope for FEV to outperform based on the portfolio's potential to deliver dividend growth ahead of the index.

12 months ending	Total share price return (%)	Total NAV return (%)	FTSE World Eur ex-UK (%)	MSCI Europe Index (%)	MSCI World Index (%)
31/08/11	14.8	7.4	3.4	4.4	8.6
31/08/12	8.4	9.1	1.4	4.7	11.5
31/08/13	30.1	25.1	26.3	23.2	21.5
31/08/14	6.9	7.6	10.4	10.3	13.4

Note: Twelve-month rolling discrete total return performance.

Investment strategy: Steady dividend growth focus

To achieve long-term capital growth, the manager seeks to identify companies that he believes can deliver consistent dividend growth over a three- to five-year time horizon. He looks for attractively valued companies with structural growth prospects and strong balance sheets where cash flow forecasts provide scope for dividend growth. The portfolio is constructed through bottom-up stock selection based on fundamental analysis and, while no top-down allocations are imposed, the manager aims to maintain a diversified portfolio with sector weightings within five percentage points of the benchmark. As well as screening stocks by comparing dividend yield against dividend growth prospects, a total shareholder return (TSR) ranking analysis is used to indicate where rebalancing of the portfolio may be appropriate.

Outlook: Slower near-term progression

There has been a significant re-rating of European markets over the past two years with the market rally driven largely by improving sentiment rather than earnings upgrades. This suggests that there is more limited scope for markets to continue to progress higher in the near term while earnings catch up with valuations. This re-rating, combined with the historically low market volatility levels seen in June and July 2014 and geopolitical risks appearing to be on the rise, led to increased concerns over the potential for a market correction. However, volatility has returned to more normal levels accompanied by a downward move in European markets leaving valuations looking less stretched and creating a more balanced outlook.

Valuation: Recent widening of discount

FEV's share price discount to NAV (including income) has recently widened towards the higher end of its 12-month range and currently stands at 11%. This appears to be the result of weakening sentiment towards European markets and provides scope for the discount to narrow as sentiment improves.

Investment trusts

4 September 2014

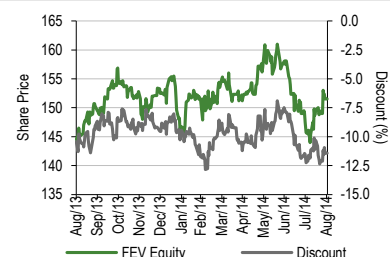
Price 154p
Market cap £640m
AUM £758m

NAV* 168.6p
Discount to NAV 8.8%
NAV** 172.3p
Discount to NAV 10.7%
Yield 2.0%

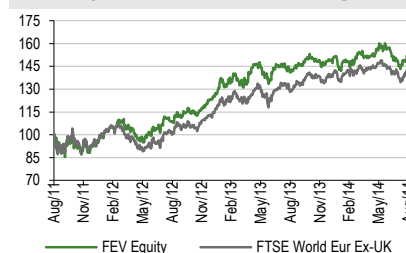
*Excluding income. **Including income.

Ordinary shares in issue 416.4m
Code FEV
Primary exchange LSE
AIC sector Europe

Share price/discount performance



Three-year cumulative perf. graph



52-week high/low 161.0p 144.0p
NAV* high/low 172.4p 158.7p

*Excluding income.

Gearing (through CFDs)

Gross 4.3%
Net 4.3%

Analysts

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[Edison profile page](#)

Exhibit 1: Trust at a glance

Investment objective and fund background

Fidelity European Values' investment objective is to achieve long-term capital growth from a portfolio of investments, consisting primarily of continental European securities. The benchmark for performance measurement purposes is the FTSE World Europe ex-UK Index.

Recent developments

- 29 July 2014: Interim results to 30 June 2014 – NAV total return +3.1%, benchmark +3.1%.
- 2 June 2014: 10 for 1 sub-division of FEV shares.
- 16 May 2014: IMS to 31 March 2014 – NAV total return +2.65%, benchmark +3.03%.

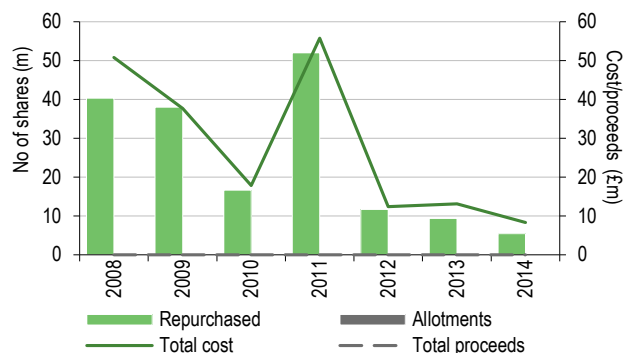
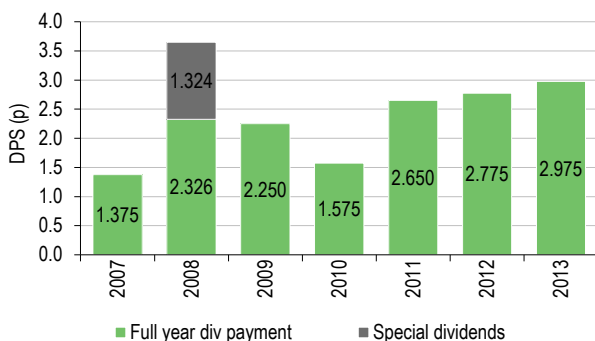
Forthcoming		Capital structure		Fund details	
AGM	May 2015	Ongoing charges	0.96%	Group	FIL Investments International
Preliminary results	March 2015	Net gearing	4.3% (through CFDs)	Manager	Sam Morse
Year end	31 December	Annual mgmt fee	0.85% of net assets	Address	Beech Gate, Millfield Lane, Lower Kingswood, Tadworth, KT20 6RP
Dividend paid	May	Performance fee	15% over index + 0.5%	Phone	+44 (0)800 41 41 10
Launch date	November 1991	Trust life	Indefinite (cont. vote 2015)	Website	www.fidelity.co.uk/europeanvalues
Continuation vote	Vote every two years	Loan facilities	None – CFDs used		

Dividend policy and history*

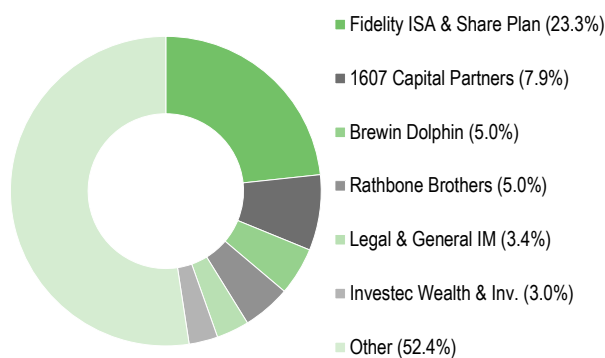
Annual dividend paid in May. Revenue earnings are distributed in full.

Share buyback policy and history*

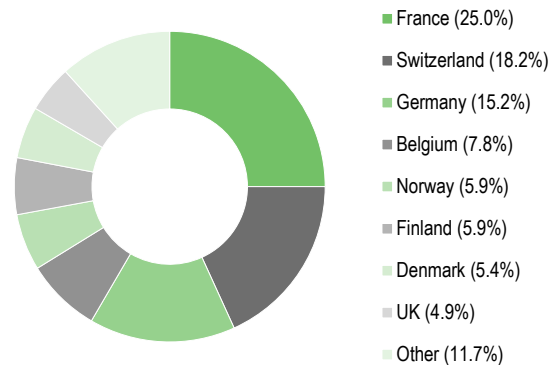
Renewed annually, the trust has authority to purchase up to 14.99% and allot up to 5% of issued share capital.



Shareholder base (as at 8 August 2014)



Distribution of portfolio (as at 31 July 2014)



Top 10 holdings (as at 31 July 2014)

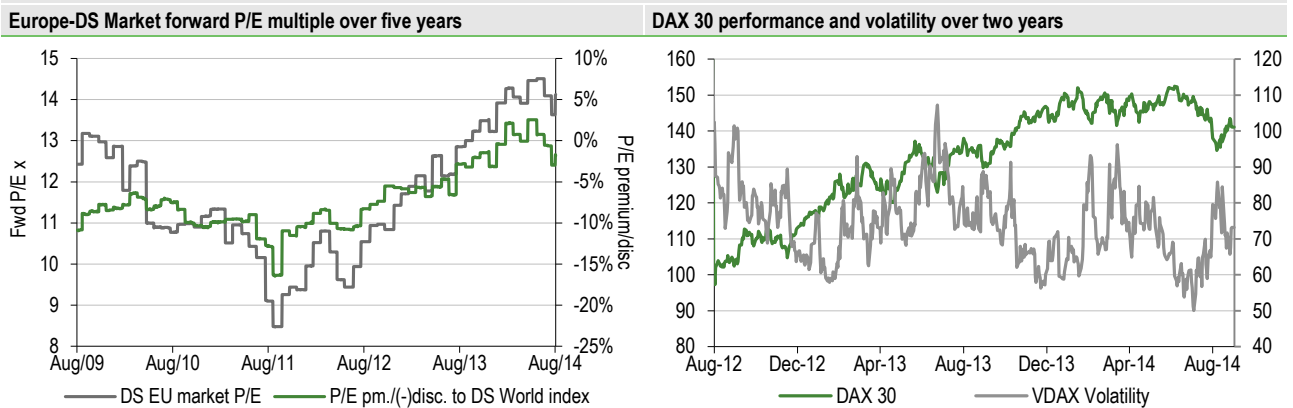
Company	Country	Sector	Portfolio weight %		Benchmark weight %	Active weight %
			31 July 2014	31 July 2013**	31 July 2014	31 July 2014
Nestlé	Switzerland	Consumer Goods	5.4	6.5	3.9	1.5
Roche	Switzerland	Health Care	4.6	N/A	3.3	1.3
Sanofi	France	Health Care	4.2	5.1	2.0	2.2
Novo-Nordisk	Denmark	Health Care	4.2	4.1	1.5	2.7
SAP	Germany	Technology	3.7	2.9	1.2	2.5
Total	France	Oil & Gas	3.4	N/A	2.1	1.3
Anheuser Busch Inbev	Belgium	Consumer Goods	3.3	3.1	1.4	1.9
BNP Paribas	France	Financials	3.0	2.9	1.1	1.9
UBS	Switzerland	Financials	3.0	4.5	1.0	2.0
Sampo	Finland	Financials	2.9	2.9	0.4	2.5
Top 10			37.7	N/A	17.9	19.8

Source: Fidelity European Values, Edison Investment Research. Note: *Adjusted for 10 for 1 share split in June 2014; **N/A where not in July 2013 top 10.

Market outlook: Slower near-term progression

Exhibit 2 illustrates the significant re-rating of the European market since October 2011, highlighting that the market rally over the past two years has been driven largely by improving sentiment rather than earnings upgrades. This re-rating has brought the European market forward P/E multiple to a similar level to world markets compared with its average discount of 9% over the last 10 years. While reversion of the European market rating could occur through the market rising at a slower rate than earnings, there is potential for a downward market adjustment if earnings disappoint.

Exhibit 2: European market performance and valuation metrics



Source: Thomson Datastream, Edison Investment Research

During June and July 2014, market participants focused on this downside risk, following a period in which market volatility had fallen to historically low levels, despite geopolitical risks appearing to be on the rise, suggesting the market had become complacent. The second chart in Exhibit 2 shows that, having reached a low in early July, German market volatility (a good indicator of European markets as a whole) has returned to a level similar to its average over the last two years. The downward move in European markets in July 2014 has left valuations looking less stretched, creating a more balanced outlook.

The European economic outlook is clouded by the potential negative impact of the Ukraine crisis, which is weighing on German business sentiment, and a slower than expected recovery in France, raising the prospect of downgrades to growth forecasts. However, European markets have bounced around 5% in August, suggesting that sentiment is becoming more positive. Additionally, recent comments from the ECB suggest that it is moving closer to embarking on a programme of quantitative easing and, based on the US experience, the initiation of large-scale asset purchases could provide a significant boost to European markets.

Fund profile: Focus on continental Europe

Launched in November 1991, FEV is a closed-ended investment trust listed on the LSE. Its investment objective is to achieve long-term capital growth from an actively managed portfolio, consisting primarily of continental European securities. The performance benchmark is the FTSE World Europe (ex-UK) Index, however, the portfolio is constructed through bottom-up stock selection and sector and geographic allocations are not fixed with reference to the benchmark index. The investment approach is to focus on companies able to deliver consistent dividend growth over a three- to five-year time horizon. FEV's investment portfolio is managed by FIL Investments International. Sam Morse has been the portfolio manager since January 2011. He has over 25 years' investment experience and has managed the Fidelity European Fund, an open-ended fund with a similar investment mandate to FEV, since December 2009.

The fund manager: Sam Morse

The manager's view: Signs of an improving earnings outlook

Sam Morse is relatively cautious about prospects for continental European stock markets after their strong performance in 2013 and the first half of 2014, which saw share prices rising in anticipation of future increases in earnings. However, he considers that the earnings outlook has improved slightly during the Q214 reporting season and sees potential support for earnings growth from European Central Bank (ECB) monetary easing likely to weaken the relative strength of the euro, particularly if the US Federal Reserve continues to curtail its own asset purchases. His caution is reflected in FEV's relatively low gearing, which he has held steady at 4-5% since September 2013.

In Morse's view, three to four years of outperformance have left small- and mid-cap valuations starting to look stretched. Although the fund has a tilt towards smaller companies relative to the benchmark (20% exposure to <£5bn market cap companies compared with 10% for the index), he highlights that c 90% of holdings would qualify for the FTSE-100. He sees valuations across peripheral Europe discounting a substantial recovery and has sold holdings such as Italian toll-road operator Atlantia, leaving the portfolio underweight Italy as well as Spain. At 30 June 2014, FEV's exposure to peripheral Europe was 6.4% compared with 17.7% for the benchmark index.

Recent additions to the portfolio include Roche, which has met FEV's main investment criteria for some time, but where there was concern about biosimilar competition for some of its key cancer franchises, which now appears to be less of an imminent threat; Total, due to its increased focus on returns on capital and a positive view on integrated oil companies in general; and Fortum, which is reinvesting proceeds from the sale of highly-valued regulated businesses into generation assets near the bottom of the cycle. FEV's holding in Jeronimo Martins has been sold due to concerns that the discount retailer has potentially gone ex-growth.

Despite his cautious market outlook, the manager sees scope for FEV to outperform, citing the 90% relative dividend yield of FEV's portfolio versus the benchmark as a positive indicator, given its 73% to 94% range during his tenure as manager. He expects c 7% dividend growth from the portfolio and has greater confidence in this being delivered than the c 5% forecast for the benchmark index. Similarly, while the portfolio's 15.7x forward P/E multiple (based on IBES estimates) compares with 14.8x for the benchmark, this is not seen as reflecting the portfolio's superior growth prospects.

Asset allocation

Investment process: Bottom-up stock selection

The manager seeks to identify companies that he believes can deliver consistent dividend growth over a three- to five-year time horizon and looks for the following main characteristics:

- positive fundamentals – companies with proven business models operating in markets with clear structural growth prospects.
- ability to generate cash – with free cash flow forecasts providing scope for dividend growth.
- strong balance sheet – where funding requirements are considered unlikely to restrict the cash available for dividend payments.
- attractive valuation – relative to peers and history when taking growth prospects into account.

The manager is able to draw upon Fidelity's team of pan-European analysts in completing the analysis required to assess whether a stock meets the investment criteria. He also places a strong emphasis on regularly meeting company management, which provides a more qualitative insight.

The portfolio is constructed through bottom-up stock selection in order to deliver outperformance over a three- to five-year investment horizon. As well as screening stocks by comparing dividend

yield against dividend growth prospects, a more comprehensive total shareholder return (TSR) analysis has recently been introduced to rank stocks in the portfolio. The TSR analysis considers earnings growth, dividend yield, re/de-rating potential, liquidity and volatility as well as Fidelity's internal analyst recommendation. The TSR ranking is compared with stock weightings within the portfolio and significant differences indicate where rebalancing of the portfolio may be appropriate. Although the TSR analysis may lead to an increase in portfolio turnover, it is expected to improve the overall execution of the investment process.

While no top-down geographic allocations are imposed, at least 80% of the portfolio must be invested in countries included in the benchmark index and up to 5% may be invested in non-European companies with some European exposure. The manager aims to keep portfolio sector weightings within five percentage points of the benchmark. Up to 10% can be invested in any one quoted company at the time of acquisition and there is a 5% limit on the aggregate holding in unquoted securities. A maximum of 10% may be invested in other investment companies.

Current portfolio positioning

FEV's portfolio is relatively concentrated with exposure to around 55 companies. As at 31 July 2014, the top 10 holdings represented 38% of the portfolio and the top 20 represented 61%, which compares with 23% and 35% respectively for the benchmark index. As shown in Exhibit 3, at 31 July 2014, principal overweight exposures are in healthcare, technology and consumer services sectors, while the portfolio has underweight exposure to basic materials, telecommunications and industrials. The most significant changes over the last 12 months are increases in oil & gas and healthcare sector exposures and reductions in consumer goods and financials.

Exhibit 3: Portfolio sector exposures as at 31 July 2014

	Portfolio weight 31 July 2014 (%)	Portfolio weight 31 July 2013 (%)	Change (%)	Benchmark weight (%)	Trust active weight (%)	Trust weight/ benchmark weight
Financials	22.5	24.5	-2.0	23.2	-0.7	1.0
Consumer Goods	17.7	21.4	-3.7	17.7	0.0	1.0
Health Care	15.7	12.2	3.5	12.7	3.0	1.2
Industrials	12.2	13.6	-1.4	14.2	-2.0	0.9
Consumer Services	7.5	8.3	-0.8	5.4	2.1	1.4
Oil & Gas	7.1	3.0	4.1	5.7	1.4	1.2
Technology	6.7	6.5	0.2	3.9	2.8	1.7
Utilities	4.4	3.3	1.1	4.5	-0.1	1.0
Basic Materials	4.4	5.3	-0.9	8.3	-3.9	0.5
Telecommunications	1.8	1.8	0.0	4.3	-2.5	0.4
	100.0	100.0		100.0		

Source: Fidelity European Values, Edison Investment Research

As shown in Exhibit 4, the portfolio is broadly diversified by geography although individual country exposures can differ appreciably from the benchmark due to the bottom-up stock selection process. It is worth noting FEV's 5% UK exposure compared with 0% for the benchmark, although this is not the largest overweight country exposure in the portfolio.

Exhibit 4: Portfolio geographic exposures as at 31 July 2014

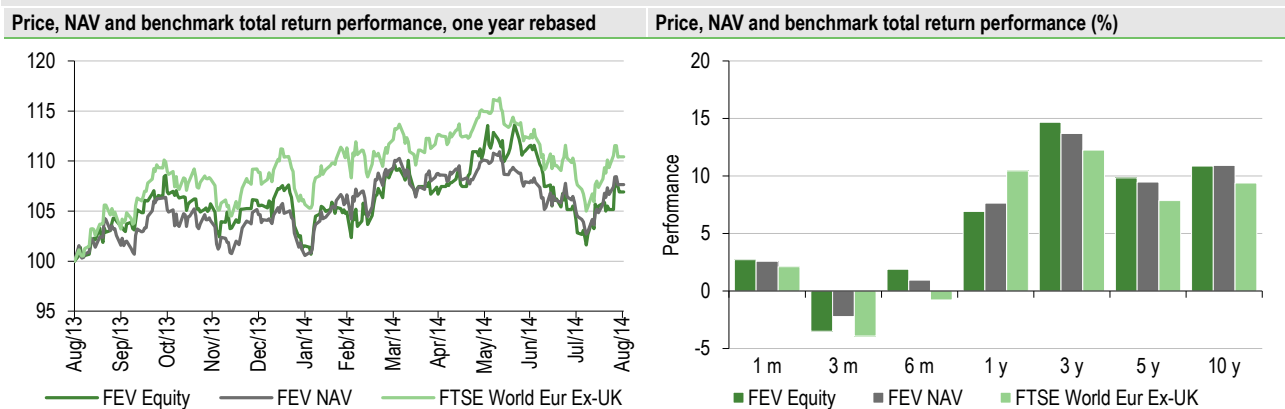
	Portfolio weight 31 July 2014 (%)	Portfolio weight 31 July 2013 (%)	Change (%)	Benchmark weight (%)	Trust active weight (%)	Trust weight/ benchmark weight
France	25.0	23.4	1.6	21.2	3.8	1.2
Switzerland	18.2	18.0	0.2	19.7	-1.5	0.9
Germany	15.2	16.4	-1.2	19.5	-4.3	0.8
Belgium	7.8	7.0	0.8	2.6	5.2	3.0
Norway	5.9	4.7	1.2	1.8	4.1	3.3
Finland	5.9	4.9	1.0	1.9	4.0	3.1
Denmark	5.4	5.3	0.1	3.5	1.9	1.5
UK	4.9	3.9	1.0	0.2	4.7	24.4
Spain	3.3	2.8	0.5	8.1	-4.8	0.4
Sweden	3.1	4.7	-1.6	6.6	-3.5	0.5
Other	5.3	8.9	-3.6	14.9	-9.6	0.4
	100.0	100.0		100.0		

Source: Fidelity European Values, Edison Investment Research

Performance: Outperformance over 10 years

FEV has outperformed its FTSE World Europe ex-UK benchmark in terms of price and NAV total return over three, five and 10 years. While underperforming over one year, NAV total return has outperformed the benchmark over six months. Exhibit 7 illustrates the trust's strong relative performance from October 2011 to April 2012, particularly evident as the market declined in March and April 2012, and the underperformance during the later stages of the market rally from May 2013 to January 2014, which was not supported by improvements in the corporate earnings outlook. Also highlighted is FEV's outperformance in June and July 2014 as the market weakened.

Exhibit 5: Investment trust performance to 31 August 2014



Source: Fidelity European Values, Thomson Datastream, Edison Investment Research

Exhibit 6: Share price and NAV total return performance, versus benchmarks (% points), to 31 August 2014

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price versus FTSE World Europe ex-UK	0.6	0.4	2.7	(3.2)	6.6	9.6	14.3
NAV versus FTSE World Europe ex-UK	0.5	1.8	1.7	(2.5)	3.9	7.8	15.1
Price versus MSCI Europe	0.6	(1.1)	1.8	(3.1)	5.9	4.2	19.0
NAV versus MSCI Europe	0.5	0.2	0.8	(2.4)	3.2	2.5	19.8
Price versus MSCI World	(1.2)	(6.8)	(4.7)	(5.7)	(1.8)	(11.4)	17.5
NAV versus MSCI World	(1.3)	(5.5)	(5.6)	(5.1)	(4.3)	(12.9)	18.4

Source: Fidelity European Values, Thomson Datastream, Edison Investment Research. Note: Geometric calculation.

Exhibit 7: NAV total return performance relative to benchmark over five years



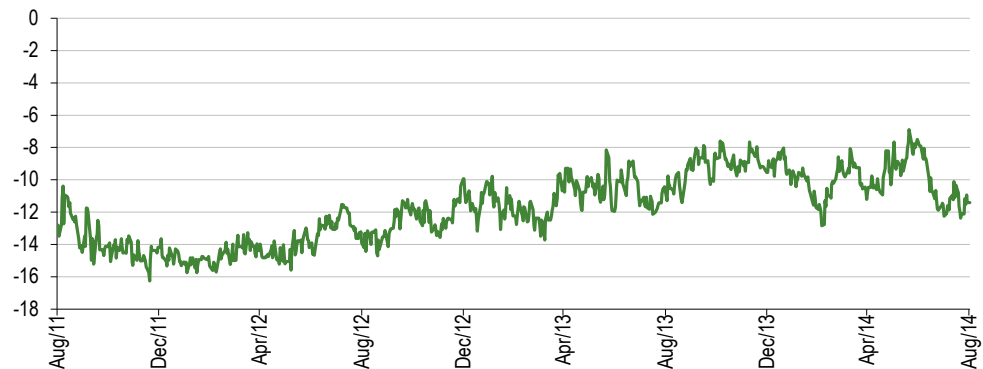
Source: Fidelity European Values, Thomson Datastream, Edison Investment Research

Discount: Narrowing trend from early 2012

The board has an active discount management policy and share buybacks are made regularly. While the primary purpose of the buybacks is to reduce share price volatility in relation to NAV, repurchasing shares at a discount also results in an enhancement to NAV per share.

While the discount has been following a narrowing trend since the start of 2012, this has recently been interrupted as the discount moved to the higher end of its 12-month range and currently stands at 11%. The recent widening appears to reflect weakening sentiment towards European markets and provides scope for the discount to narrow as sentiment improves.

Exhibit 8: Share price discount to NAV (including income) over three years



Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

After a 10 for one sub-division of its shares effective on 2 June 2014, FEV has 416.4m ordinary shares in issue. Since 1 January 2014, 1.2% of the outstanding shares have been repurchased, which represents a similar rate of share buybacks to that during 2013. In total, since 1 January 2011, 15.9% of the outstanding shares have been repurchased.

FEV's normal policy is to be geared in the belief that long-term investment returns will exceed the costs of gearing. While borrowing is permitted, gearing is currently obtained through the use of contracts for difference (CFDs) to obtain exposure to securities selected by the manager. Gearing is restricted to a maximum level of 30% and the current gearing range set by the board is 0% to 10%.

FEV pays annual management fees of 0.85% of net assets (excluding investments in other funds managed by the manager). In addition, there is an annual performance fee of 15% of any change in NAV in excess of the returns on the FTSE World Europe ex-UK index plus 0.5%. In the event of underperformance, no performance fee is payable in subsequent years until all cumulative underperformance has been recouped. The performance fee is subject to a cap of 1.0% of net assets with excess outperformance offset against future underperformance but not counted towards future performance fees. For the year ended 31 December 2013, the management fee was £5.8m, no performance fee was payable and ongoing charges were 0.96%.

Dividend policy

FEV's objective is long-term capital growth and the board does not seek to influence the manager to determine the level of income of the portfolio. Consequently, distributions to shareholders may vary from year to year. Earnings are paid out in full after charging all management expenses against income with only performance fees charged against capital. As a result of recent changes in tax and company law, investment companies are no longer prohibited from paying dividends out of capital profits. While the board has no current intention to pay dividends out of capital profits, at the 2014 AGM, FEV revised its Articles of Association to provide this flexibility should circumstances warrant it in the future.

Peer group comparison

Exhibit 9 illustrates a comparison of FEV with the AIC Europe sector peer group. While the majority of the peer group do not have any UK exposure, FEV has around 5% UK exposure while Jupiter European Opportunities has around 25% and Sanditon Investment Trust has over 50%. FEV's NAV total return performance is lower than the peer group average over one, three, five and 10 years, and it ranks seventh, seventh, seventh and fourth in the peer group over the respective periods. FEV's Sharpe ratio is the lowest in the peer group over one year, and while its Sharpe ratio is below one over three years, it is similar to the peer group average. FEV's ongoing charge and gearing are both in line with peer group averages, while its discount is wider than the peer group average. Although it has a capital growth focus, FEV's dividend yield is in line with the peer group weighted average.

Exhibit 9: Europe closed-ended sector peer group as at 2 September 2014

	Market Cap £m	NAV TR 1 Year	NAV TR 3 Year	NAV TR 5 Year	NAV TR 10 Year	Sharpe 1y (NAV)	Sharpe 3y (NAV)	Discount (ex par)	Ongoing Charge	Perf Fee	Net Gearing	Dividend yield (%)
Fidelity European Values	641.0	6.8	52.1	64.0	178.4	0.1	0.5	(9.2)	0.94	Yes	104	2.0
BlackRock Greater Europe	250.3	5.1	48.1	72.2		0.1	0.5	(3.5)	0.95	Yes	101	2.0
European Investment Trust	317.6	13.1	52.9	66.3	107.9	0.7	0.6	(8.4)	0.62	No	97	1.9
Henderson European Focus Trust	169.3	17.9	73.6	89.5	243.5	0.9	0.9	(1.3)	1.00	Yes	108	2.3
Henderson EuroTrust	164.7	10.8	60.4	85.5	228.6	0.4	0.7	(1.6)	0.96	Yes	101	2.2
JPMorgan European Growth	204.9	10.5	52.7	61.3	131.2	0.4	0.5	(10.7)	0.86	Yes	102	3.1
JPMorgan European Income	75.0	17.5	62.1	79.3		0.9	0.8	(9.2)	1.06	Yes	109	4.1
Jupiter European Opportunities	395.3	7.2	72.6	156.2	318.1	0.4	1.0	(2.0)	1.13	Yes	108	0.8
Sanditon Investment Trust	53.0							5.2		Yes		
Simple average		11.1	59.3	84.3	201.3	0.5	0.7	(4.5)	0.94		104	2.3
Weighted average		9.4	58.1	85.5	200.8	0.4	0.7	(5.9)	0.93		103	2.0

Source: Morningstar. Notes: TR=total return. The Sharpe ratio is a measure of risk-adjusted return. The ratios we show are calculated by Morningstar for the past 12- and 36-month periods by dividing a fund's annualised excess returns over the risk-free rate by its annualised standard deviation. Net gearing is total assets less cash/cash equivalents as a percentage of shareholders' funds.

The board

The board consists of five non-executive directors, four of whom are considered independent of the investment manager. The independent directors are Humphrey van der Klugt (appointed director June 2007, chairman May 2010), James Robinson (senior independent director, appointed June 2007), Robin Niblett (appointed January 2010) and Marion Sears (appointed January 2013). Simon Fraser (appointed July 2002) spent 27 years at Fidelity, acting as CIO for Fidelity International from 1999 to 2005 before retiring at the end of 2008; he is also a director of Fidelity Japanese Values investment trust, managed by FIL, and is therefore not deemed to be an independent director.

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