

Fidelity European Values

Keeping focus on value and fundamentals

Fidelity European Values (FEV) invests primarily in mid- and large-cap continental European equities and is focused on cash-generative businesses with strong balance sheets that are exposed to secular growth stories. FEV has a long-term record of outperformance although has underperformed its benchmark since May as demand has shifted towards riskier, more cyclical stocks. It is proposed that FEV's ordinary shares be subdivided (10 for 1) to enhance their appeal to smaller investors.

12 months ending	Total share price return* (%)	Total NAV return* (%)	Total return FTSE World Euro Ex-UK* (%)	Total return MSCI Europe Index* (%)	Total return MSCI World Index* (%)
31/01/11	12.3	15.3	15.3	15.5	19.9
31/01/12	(6.2)	(8.7)	(13.5)	(8.5)	(1.0)
31/01/13	37.6	30.5	23.6	20.7	16.1
31/01/14	6.5	5.2	11.1	10.4	12.6

Note: *Twelve-month rolling discrete performance.

Investment strategy: Continental European equities

FEV invests primarily in mid- and large-cap continental European equities. To manage benchmark risk, the manager looks to construct a portfolio that is broadly balanced, so that FEV's portfolio sector allocations are unlikely to be more than $\pm 5\%$ those of the benchmark allocations. The portfolio typically has a low beta and the manager looks to add value by generating alpha with the stock selection. The manager considers that in the current market environment, dividends are an important component of returns and is focused on companies with a strong ability to grow dividends over the next three to five years. There is also a strong focus on downside protection. The board has reduced the tactical gearing range from 5-15% to 0-10%, which is provided through contracts for difference (CFD) exposure. FEV aims to be a core fund for European equity allocations.

Outlook: Sentiment improving, valuations expanding

European equities produced another year of strong performance in 2013 as concern over economic risks eased (MSCI Europe index was up 23.6%). Looking to 2014, there is evidence to suggest the economic background is continuing to improve although the outlook is clearly not risk free. Share price rises have outpaced earnings increases so that the European index (Datastream) is trading at an historic P/E of 14.7x, above its 10-year average of 13.3x but not yet in clearly extended territory. The manager observes that it has become harder to find attractively valued investment opportunities with robust fundamentals and the market may have already discounted the improving environment, leaving open the potential for disappointment (the portfolio's beta has been reduced from c 0.95 to 0.92 during the last six months).

Valuation: Narrowed during the last two years

The discount has continued to contract during the second half of 2013 probably reflecting improving sentiment towards European prospects. The current cumulative discount of 10.4% is below its three-year average of 12.4% (one-year trading range: 7.6% to 13.7%).

Investment trusts

6 February 2014

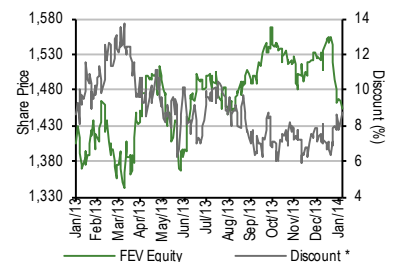
Price 1,455.00p
Market cap* £613m
AUM £740m

NAV* 1,594.68p
Discount to NAV 8.8%
NAV** 1,624.15p
Discount to NAV 10.4%
Yield 1.9%

*Adjusted for debt at market value and excluding income, as at 3 February 2014. **Adjusted for debt at market value, including income, as at 3 February 2014.

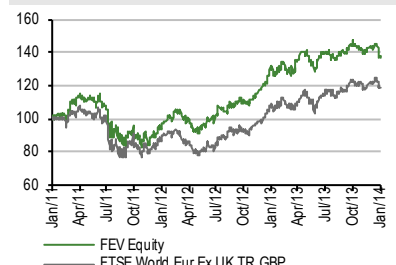
Ordinary shares in issue 42.2m
Code FEV
Primary exchange LSE
AIC sector Europe

Share price/discount performance



*Positive values indicate a discount; negative values indicate a premium.

Three-year cumulative perf. graph



52-week high/low 1,569.00p 1,343.00p
NAV* high/low 1,691.6p 1,468.9p

*Adjusted for debt at market value, excluding income.

Gearing (provided through CFDs)

Gross 7.1%
Net 4.3%

Analysts

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[Edison profile page](#)

Exhibit 1: Trust at a glance

Investment objective and fund background

FEV's investment objective is to achieve long-term capital growth from a portfolio of listed shares in continental European companies. The portfolio manager is not restricted by market cap, country or sector allocation, although a minimum of 80% of gross assets will be invested in companies from countries that are included in the benchmark index (the FTSE World Europe [ex-UK] Index). A maximum of 5% of gross assets may be invested in non-European companies that have some European exposure or connection.

Recent developments

17 January 2014: Announcement of proposals to sub-divide FEV's shares on a 10 for 1 basis.

31 December 2014: Announcement that FEV is suitable for retail distribution.

13 November 2013: Interim management statement for quarter ended 30 September 2013 released.

Forthcoming

AGM	May 2014
Preliminary results	March 2014
Year end	31 December
Dividend paid	May
Launch date	November 1991
Continuation vote	Vote every two years

Capital structure

Ongoing charges	0.98%
Net gearing*	4.3%
Annual mgmt fee	0.85% of net assets
Performance fee	15% over index + 0.5%
Trust life	Indefinite
Loan facilities	None – uses CFDs

Fund details

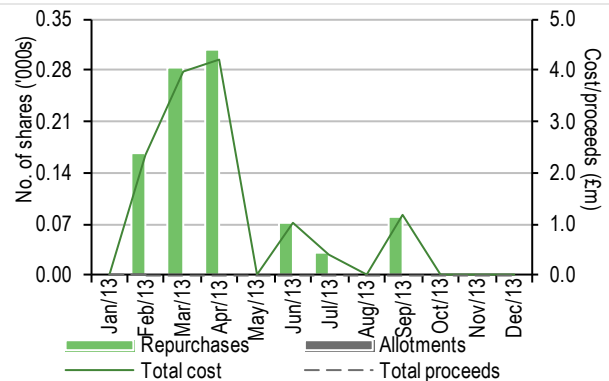
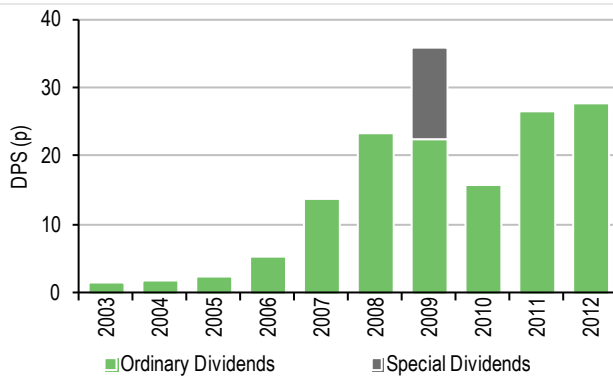
Group	FIL Investments International
Manager	Sam Morse
Address	Oakhill House, 130 Tonbridge Rd, Hildenborough, Kent, TN11 9DZ
Phone	+44 (0)800 414110
Website	www.fidelity.co.uk/its

Dividend policy and history

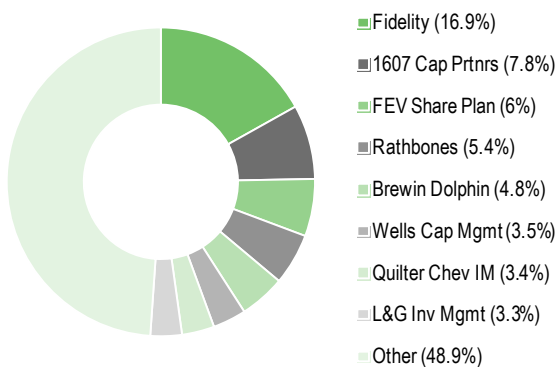
One dividend annually, paid in May. Revenue earnings are paid out in full.

Share buyback policy and history

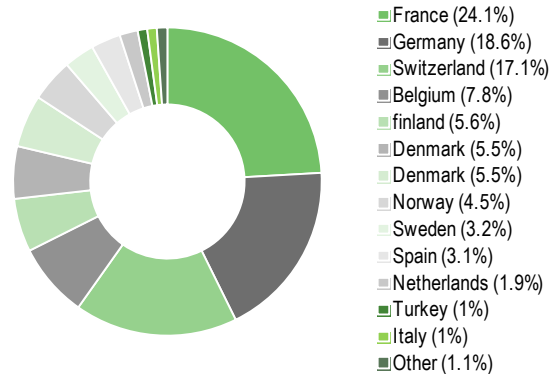
Renewed annually, the trust has authority to purchase up to 14.99% and allot up to 5% of issued share capital.



Shareholder base (as at 31 December 2013)



Distribution of portfolio (as at 31 December 2013)



Top 10 holdings (as at 31 December 2013)

Company	Country	Sector	Portfolio weight %		Benchmark weight %	Active weight %
			31 December 2013	30 June 2013	31 December 2013	31 December 2013
Nestlé	Switzerland	Consumer staples	7.3	6.7	3.9	3.4
Sanofi	France	Healthcare	5.2	5.3	2.0	3.2
Novo-Nordisk	Denmark	Healthcare	4.4	4.1	1.2	3.2
SAP	Germany	Technology	4.2	3.0	1.3	2.9
UBS	Switzerland	Financials	4.2	4.2	1.1	3.1
Anheuser-Bosch Inbev	Belgium	Consumer staples	3.5	3.0	1.4	2.1
BNP Paribas	France	Financials	3.5	2.6	1.3	2.2
Schneider Electric	France	Industrials	3.4	3.5	0.8	2.6
Sampo	Finland	Financials	3.2	2.8	0.4	2.8
Volkswagen	Germany	Consumer durables	3.1	1.9	0.8	2.3
Top 10			42.0	38.2	14.2	27.8

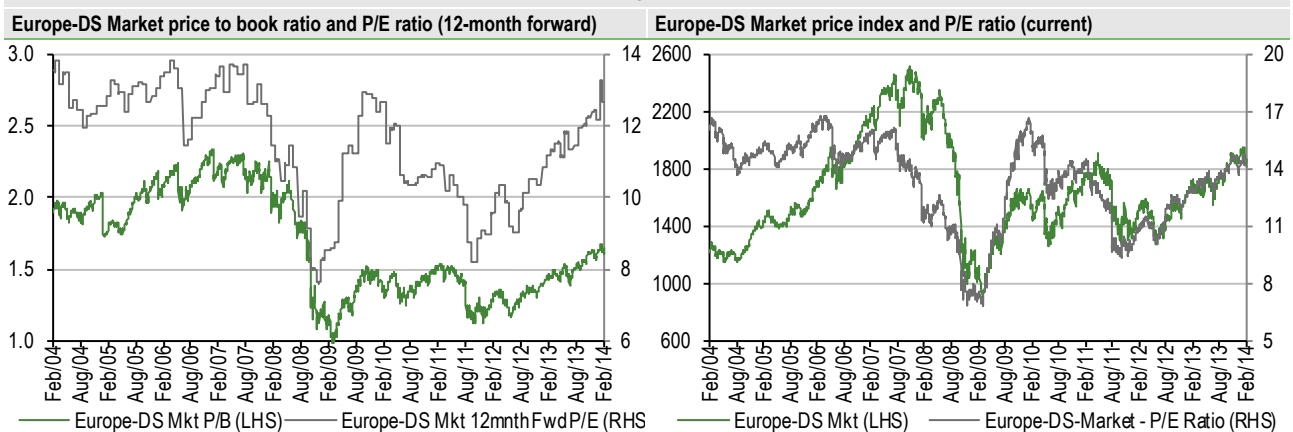
Source: Fidelity European Values, Edison Investment Research. *Note: Gearing provided through CFDs.

Outlook: Sentiment improving, valuations expanding

Against the backdrop of very low 'risk-free' returns that have prevailed since the financial crisis and the easing of existential fears over the eurozone, European equity markets provided strong absolute returns in total during 2013 (the MSCI Europe index was up 23.6%), broadly in line with global markets (MSCI World Index returned 25.0%). Volatility during 2013, particularly in reaction to talks of tapering, highlights that considerable uncertainty remains. However, there is evidence to suggest the economic outlook is improving and that market participants are factoring in a lower probability of a new eurozone crisis and some revival of growth.

Exhibit 2 shows that price rises have recently outpaced earnings increases, so that equities are not as cheap as they have been previously and, following a period of strength, the market may be more vulnerable to a correction. However, the Europe-DS Market Index is trading at a historic P/E of 14.1x which, while above its 10-year average of 13.3x, remains below its 12-month high of 16.8x. The approach of tapering, and the improved economic outlook that is a pre-requisite for this, has led to a shift in the premium that investors are prepared to pay for perceived safety. For example, 10-year German bonds currently trade at a yield of 1.76%; this represents a 19bp increase during the last 12 months, while 10-year Italian bonds are trading at a yield of 3.81%; this represents a decrease of 38bp during the last 12 months. However, broadly speaking, improving investor confidence has led to a reduction of the yield premium offered by equities (Europe – DS Market average yield 2.99% at 31 December 2013 vs 3.49% at the 31 December 2012). However, many investors still see the potential for superior performance if earnings surprise positively against an improving economic backdrop or there is a significant rise in inflation as a key argument in favour of equity exposure.

Exhibit 2: Europe-DS Market valuation metrics over 10 years



Source: Thomson Datastream

Fund profile: Medium- to long-term value play

Managed by Fidelity since its launch in November 1991, FEV is a UK-registered investment trust focused primarily on mid- to large-cap continental European companies. Sam Morse has managed European equities for Fidelity since January 2010 and has led the management of FEV since January 2011. His style is consistent with that of his predecessors, who have all followed Fidelity's bottom-up, value-oriented investment approach. The portfolio is managed using a three- to five-year time horizon (portfolio turnover is typically in the range of 25-30% per year) and exposure to the UK has been kept below 5% throughout FEV's life.

Proposed sub-division of ordinary shares on a 10 for 1 basis

FEV's board is seeking approval at the May 2014 AGM to subdivide FEV's 25p ords into 2.5p ords, to enhance the FEV's appeal to smaller investors generally and by facilitating investment through regular monthly savings plans. The change is expected to allow smaller sums to be invested more efficiently.

The fund manager: Sam Morse

The manager's view: Ability to grow dividends still remains key

The manager has become more cautious over market levels during the last six months. In his view, the market has not significantly overshot but, given the current pace of earnings growth, valuations have moved into more expensive territory and it is increasingly difficult to find opportunities, on a bottom-up basis, that are attractively valued and have robust fundamentals. Moreover, following such a period of strength, the market may now be more vulnerable to a correction and, while the outlook for Europe is improving, the manager considers this risk may be under appreciated. FEV has exposure to certain large-cap dividend paying equities, which due to their yield and relative capital security, have been an attractive alternative for some traditional fixed income investors while interest rates have been unusually low. These stocks have lost some of their relative attraction as tapering has approached. The manager advises that he has actively reduced FEV's exposure, but that this affected performance during 2013. During the first half of 2013, FEV maintained a significant overweight to financials. Financials underperformed the market in Q2, following Bernanke's surprise comments on the prospects for tapering, detracting from FEV's performance. In H2, financials rallied, reflecting improvements in the global economic outlook. The manager has been reducing the financials exposure in favour of stocks he believes will benefit from rising interest rates. Reflecting the shift in outlook, gearing has been reduced during the last six months, which has reduced FEV's NAV beta from c 0.95 to 0.92.

Asset allocation

Investment process: Bottom-up fundamental analysis

The manager looks to construct a portfolio that is broadly balanced with respect to the benchmark, so that risk is managed at the sector level. As such, FEV's portfolio allocations are broadly kept within $\pm 5\%$ of the benchmark weightings. In terms of stock selection, within the sector allocations, the process is driven by bottom-up fundamental research. Fidelity has an in-house pan-European research team of c 40 analysts and the manager draws heavily on their expertise. When evaluating stocks for inclusion in the portfolio, the manager looks for companies with a strong ability to grow dividends over the next three to five years. These typically:

- Have positive fundamentals – companies that are operating in structural growth areas, disciplined in their use of capital and with proven business models (the manager avoids blue-sky investments).
- Are cash generative – companies with good free cash flows to support dividend growth.
- Have strong balance sheets – conservative commitments that do not pose a threat to the dividend.
- Have an attractive valuation – while unlikely to be the cheapest stocks in their sectors, FEV holds companies considered to be attractively valued, given their growth prospects.

The portfolio typically has a low beta (currently c 0.92) and the manager looks to add value through stock selection. There is a strong focus on downside protection. FEV's tracking error during the last 12 months has been 4.4%. FEV has an ex-UK benchmark and, since launch, has always had less than 5% in the UK. The manager has an extensive watch list, but is conservative when adding new names to the portfolio, looking for suitable entry points.

Overview: Focused European equity portfolio

As at 31 December 2013, FEV had 54 equity investments and three CFD positions. The top 10 equity holdings, including CFD exposures, accounted for 42.0% of the portfolio, cash -4.3% and the remaining equity investments 42.0%. As shown in Exhibit 3, FEV's sector allocations have moderate differentials from those of the benchmark index, reflecting the actively managed nature of the trust, but broadly remain within the 5% active weight boundaries used to manage benchmark risk.

Exhibit 3: Sector allocations as at 31 December 2013				
	Portfolio weight (%)	Benchmark weight (%)	Trust active weight (%)	Trust weight/benchmark weight
Consumer goods	21.9	18.2	3.7	1.20
Consumer services	9.0	5.4	3.6	1.67
Technology	7.5	4.1	3.4	1.83
Financials	25.8	23.3	2.5	1.11
Healthcare	12.8	12.0	0.8	1.07
Industrials	14.3	14.9	(0.6)	0.96
Utilities	3.2	3.9	(0.7)	0.82
Telecommunications	1.9	4.2	(2.3)	0.45
Basic materials	6.0	8.6	(2.6)	0.70
Oil & gas	1.9	5.4	(3.5)	0.35
Net cash	(4.3)	0.0	(4.3)	N/A
	100.0	100.0	0.0	

Source: Fidelity European Values, Bloomberg, Edison Investment Research

Exhibit 4: Geographic allocations as at 31 December 2013				
	Portfolio weight (%)	Benchmark weight (%)	Trust active weight (%)	Trust weight/benchmark weight
Belgium	8.2	2.6	5.6	3.15
Denmark	5.8	1.6	4.2	3.63
Finland	5.8	2.0	3.8	2.90
UK	3.9	0.2	3.7	19.50
France	25.1	21.7	3.4	1.16
Norway	4.7	1.8	2.9	2.61
Germany	19.4	20.5	(1.1)	0.95
Switzerland	17.9	19.7	(1.8)	0.91
Netherlands	3.8	5.8	(2.0)	0.66
Sweden	3.4	7.1	(3.7)	0.48
Other Europe	6.3	17.1	(10.8)	0.37
Cash	(4.3)	0.0	(4.3)	N/A
	100.0	100.0	0.0	

Source: Fidelity European Values, Bloomberg, Edison Investment Research

Recent activity and current portfolio positioning

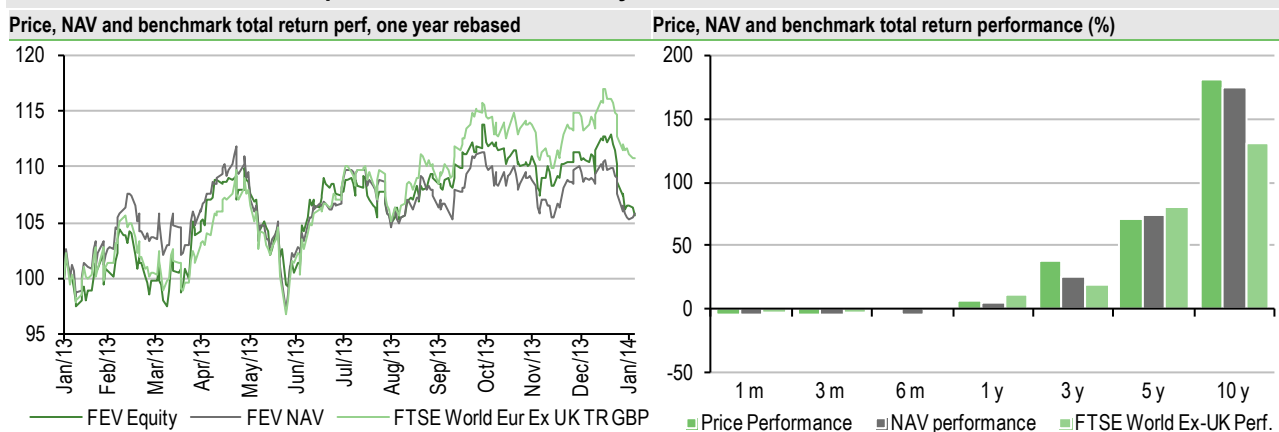
The sector active weights largely reflect the strength of individual ideas rather than any strategic allocation across sectors. The financials overweight has been reduced during the last six months, reflecting their strong performance during 2013 coupled with concerns over yield expansion as tapering takes effect. The financials allocation has also been shifted towards stocks that are expected to benefit from rising interest rates.

Recent portfolio additions include Sodexo (catering services and facilities management) and Legrand (electrical equipment). For Sodexo, the manager believes a traditional focus on long-term investment is now complemented by a strong emphasis on efficiency and near-term profitability, which will lead to an acceleration in dividend growth to a double-digit rate. For Legrand (electrical components), the manager considers it offers a reasonable yield and prospects for decent dividend growth with the company benefitting from a restocking cycle as the economic outlook improves. Recent sales include Snam (natural gas infrastructure in Italy) and Modern Times Group (Free to air and pay TV in Scandinavia).

Performance: Strong 10-year performance record

As illustrated in Exhibits 5 and 6, FEV has outperformed its benchmark in terms of price and NAV total return performance over three, five and 10 years. 10-year performance is especially strong. As shown in Exhibit 7, FEV's NAV lagged during the market rally from March 2009, a result of its defensive positioning, although the lost performance was subsequently recovered.

Exhibit 5: Investment trust performance to 31 January 2014



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

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

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price versus FTSE World Europe ex-UK	(0.9)	(2.0)	(2.9)	(4.6)	18.7	(8.3)	49.5
NAV versus FTSE World Europe ex-UK	(0.9)	(1.3)	(5.3)	(5.9)	6.7	(6.3)	43.4
Price versus MSCI Europe	(0.7)	(2.3)	(2.5)	(3.9)	15.6	(11.8)	55.3
NAV versus MSCI Europe	(0.8)	(1.6)	(4.8)	(5.2)	3.6	(9.7)	49.2
Price versus MSCI World	(0.9)	(3.0)	(0.0)	(6.1)	8.0	(20.3)	62.8
NAV versus MSCI World	(0.9)	(2.3)	(2.3)	(7.4)	(4.0)	(18.3)	56.7

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

Exhibit 7: FEV NAV total return vs benchmark total return, over ten years, rebased to 100



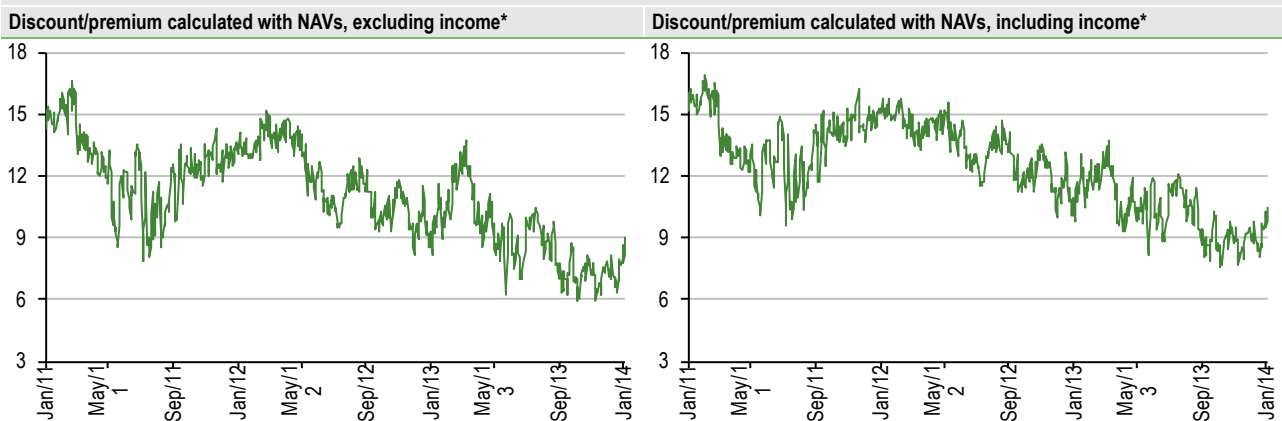
Source: Fidelity European Values, Thomson Datastream, Edison Investment Research

Since the beginning of May, FEV has experienced a period of underperformance, relative to its benchmark (see Exhibit 7). FEV is focused on cash generative businesses, with strong balance sheets that are exposed to secular growth stories and the manager highlights that, with the global outlook improving and the approach of tapering, demand has shifted towards riskier more cyclical stocks. There have also been other stock-specific issues. Sanofi had poor Q2 and Q3 earnings (problems in their animal health and emerging markets businesses). Royal Dutch Shell had a difficult Q2 and Q3 (FEV's holding had already been cut significantly). In contrast, KBC Bank performed well (the market responded positively when it started to repay its bail out loan) and Volkswagen performed strongly during H213.

Discount: Sustained narrowing during the last two years

FEV has a share repurchase policy aimed at reducing share price volatility, although a formal discount target has not been set. Exhibit 8 illustrates FEV's discount over three years. The discount reached its five-year high in October 2010 and the overall trend has been narrowing since, albeit with considerable volatility, arguably reflecting the uncertainties within the markets in which it invests. As Exhibit 1 shows, repurchase activity reduced significantly during H213, while the discount continued to contract, mirroring sentiment in European markets. The current cum-income discount of 9.8% is below its three-year average of 10.4% (one-year range: 7.6% to 13.7%).

Exhibit 8: Discount over three years



Source: Thomson Datastream, Edison Investment Research. Note: *Positive values indicate a discount; negative values a premium.

Capital structure: Conventional, modest gearing

FEV has one class of share in issue – 25p ords (see page 4 for details of proposed subdivision). FEV is permitted to have an aggregate equity exposure of up to 130% of total net assets and, at 31 December 2013, had gross gearing of 7.1% and net gearing of 4.3% (all achieved through CFDs). The management fee is equivalent to 0.85% of the company's net assets per year. There is also a performance fee, subject to a high-water mark, of 15% of any outperformance of the company's net assets over the FTSE World Europe ex-UK Index, plus 0.5% in total return terms. The maximum performance fee that can be paid in any one year is limited to 1.0% of net assets. If the cap is exceeded in any particular year, the excess outperformance is carried forward and can be used to offset future underperformance. No performance fee was accrued or paid for the years ended 31 December 2010-2012. The management contract can be terminated at six months' notice. FEV's ongoing charges were 0.98% for the year ended 31 December 2012 (2011: 0.94%). FEV has an indefinite life but there is a continuation vote every two years (next vote at the 2015 AGM).

Dividend policy: Revenue earnings paid out in full

Dividend policy is to pay out revenue earnings in full and a single payment is made in May of each year. A consequence is that the level of dividends may fluctuate (see Exhibit 1). For the year ended 31 December 2012, FEV paid a dividend of 27.75p, an increase of 4.7% over the 2011 dividend of 26.5p, and during the last five years has increased its dividend by 101% (15.1% annualised). The revenue return for the year ended 31 December 2012 was 27.78p per weighted average share (2011: 26.94p) and, as at 30 June 2013 FEV had revenue reserves of 47.0p per share. No guidance has been provided with respect to revenue income growth in H213; however, a key determinant is the euro:sterling exchange rate. Comparing the average exchange rates for H212

and H213 shows a c 6% appreciation of the euro; a positive for revenue income in H213. We expect FEV will at least be able to maintain the dividend for 2013 and a modest increase may be possible.

Peer group comparison

Exhibit 9: Europe sector, as at 4 February 2014

Company *	Share price total return on £100				Ongoing charges (%)	(Disc)/prem. (%)	Net gearing (100=no gearing)	Five-year dividend growth (%)	Div. yield (%)	Sharpe ratio NAV one year	Sharpe ratio price one year	NAV volatility one year	Price volatility one year
	One year	Three years	Five years	Ten years									
Fidelity European Values	105.0	136.2	174.4	178.0	1.0	(10.2)	104.0	4.3	1.9	1.3	1.3	14.3	14.8
BlackRock Greater Europe	116.1	131.0	214.1		0.9	0.0	105.0	7.4	1.9	1.5	1.6	14.6	17.5
European Investment Trust	122.6	137.8	207.5	117.2	0.6	(8.5)	100.0	6.5	1.9	1.9	1.8	14.5	15.0
Henderson European Focus	130.2	156.7	213.6	272.3	1.0	(0.6)	113.0	8.8	2.4	1.9	2.5	15.4	12.2
Henderson Eurotrust	123.6	152.3	211.1	259.3	1.0	(3.4)	102.0	13.6	2.2	2.1	2.3	14.8	13.9
JPMorgan European Growth	120.6	132.9	217.1	161.7	0.6	(7.4)	109.0	(3.2)	3.0	1.7	1.6	15.4	17.6
JPMorgan European Income	126.9	141.5	232.4		1.1	(5.7)	107.0	1.2	3.9	1.9	1.9	13.9	17.2
Jupiter European Opps.	115.9	161.9	405.4	412.8	1.1	0.6	111.0	0.0	0.8	1.9	1.9	12.7	13.9
Sector weighted average	116.2	142.9	236.5	295.2	0.9	(5.2)	105.9	5.3	1.9	1.7	1.7	14.3	15.1
Sector median	121.6	139.7	213.9	218.6	1.0	(4.6)	106.0	5.4	2.1	1.9	1.8	14.5	14.9
Fidelity European Val. Rank*	8	6	8	4	4	8	6	5	6	8	8	6	5
Number in group	8	8	8	6	8	8	8	8	8	8	8	8	8

Source: Morningstar. *Note: Ranked in descending size order.

The Europe sector has eight constituents. Jupiter European Opportunities (JEO) has a significant weighting to the UK market (c30% as at end of December 2013) and so its inclusion partially distorts the comparison as the UK market has outperformed continental Europe modestly over three years and significantly over five years. Within this group FEV ranks eighth over one and five years (seventh excluding JEO), and sixth over three years (fifth excluding JEO), in terms of share price total return. FEV has the lowest one-year Sharpe ratios for both price and NAV.

The board

All directors are non-executive and, with the exception of Simon Fraser, all are independent of the investment manager. Average length of service is 5.9 years. The directors, with year of appointment as director in brackets, are Humphrey Van Der Klugt (chairman, 2007), Simon Fraser (2002), Robin Niblett (2010), James Robinson (2007) and Marion Sears (2013). Simon Fraser retired in 2008 after 27 years with Fidelity. He was chief investment officer for Fidelity International from 1999 to 2005.

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