

# Fidelity Asian Values

Initiation of coverage

Good businesses, good management, good price

Fidelity Asian Values (FAS) is managed by Nitin Bajaj, who aims to generate long-term capital growth by finding 'good businesses' run by 'good management teams' that are available at a 'good price'. The manager also aims to protect capital in periods of stock market weakness. Portfolio positions are only initiated after thorough fundamental research, which enables the manager truly to understand the businesses in which he invests. Bajaj's approach is unconstrained and FAS's NAV has outperformed its benchmark MSCI AC Asia ex-Japan index over five and 10 years, while its share price has outperformed over one, three, five and 10 years. The trust's annual distribution has grown in the last four consecutive financial years; its current dividend yield is 1.5%.

12 months ending	Share price (%)	NAV (%)	Blended benchmark* (%)	MSCI AC Asia ex-Japan (%)	FTSE All-Share (%)
30/09/14	15.9	13.3	6.1	8.4	6.1
30/09/15	(8.4)	(3.7)	(6.3)	(6.0)	(2.3)
30/09/16	53.8	49.5	36.6	36.6	16.8
30/09/17	14.5	10.0	19.1	19.1	11.9
30/09/18	8.9	1.7	4.7	4.7	5.9

Source: Thomson Datastream. Note: All % on a total return basis in pounds sterling.  
\*Blended benchmark is MSCI AC Far East ex-Japan index to 31 July 2015 and MSCI AC Asia ex-Japan index thereafter.

## Investment strategy: In-depth, bottom-up research

Bajaj and his team of five analysts conduct thorough in-depth fundamental research, aiming to generate long-term capital growth from a diversified portfolio of Asian equities. The manager seeks high-quality companies with strong management teams and robust balance sheets, and has three guiding principles: he must understand a company's business; valuation is critical (as it provides a margin of safety); and he avoids 'hot' stocks. Bajaj aims to generate a total return of 50% from each of FAS's portfolio holdings, based on a three-year view.

## Market outlook: Region relatively attractive

While Asia, along with other stock markets, has experienced higher levels of share price volatility compared with the particularly benign levels in 2017, there are reasons for optimism. Asia has significantly higher economic growth potential compared to the majority of other regions, which is driven by factors such as income growth, infrastructure spending and increased productivity. In addition, Asian equity valuations look relatively attractive compared to other developed markets, which may provide opportunities for investors with a longer-term view.

## Valuation: Discount narrowed, now close to NAV

FAS's discount has been in a narrowing trend since the beginning of 2016, and the trust now often trades at a small premium. Its current 1.6% share price discount to cum-income NAV compares with the range of average discounts over the last one, three, five and 10 years of 3.5% to 9.0%. FAS pays a single annual dividend and offers a 1.5% yield.

### Investment trusts

30 October 2018

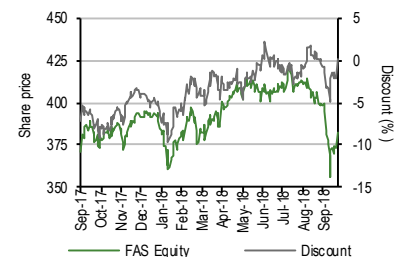
**Price** 374.0p  
**Market cap** £257m  
**AUM** £262m

NAV\* 378.0p  
Discount to NAV 1.1%  
NAV\*\* 380.1p  
Discount to NAV 1.6%

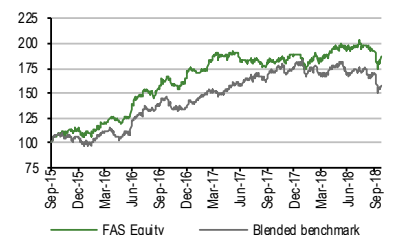
\*Excluding income. \*\*Including income. As at 29 October 2018.

Yield 1.5%  
Ordinary shares in issue 68.7m  
Code FAS  
Primary exchange LSE  
AIC sector Asia Pacific – Excluding Japan  
Benchmark MSCI AC Asia ex-Japan

### Share price/discount performance



### Three-year performance vs index



52-week high/low 423.0p 356.0p  
NAV\*\* high/low 424.4p 374.0p

\*\*Including income.

### Gearing

Gross market gearing\* 0.0%  
Net cash\* 9.1%

\*As at 30 September 2018.

### Analysts

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**Fidelity Asian Values is a research client of Edison Investment Research Limited**

### Exhibit 1: Trust at a glance

#### Investment objective and fund background

Fidelity Asian Values aims to generate long-term capital growth principally from the stock markets in the Asia Pacific ex-Japan region. It is benchmarked against the MSCI All Countries Asia ex-Japan index.

#### Recent developments

- 28 September 2018: results for the year ended 31 July 2018. NAV TR +2.2% versus benchmark TR +5.7%. Share price TR +8.2%. Declaration of 5.5p per share annual dividend.
- 23 April 2018: results for the half-year ended 31 January 2018. NAV TR +0.9% versus benchmark TR +9.2%. Share price TR +0.8%.
- 7 December 2018: announcement of 1.2m share issuance following exercise of subscription rights at 370.75p.

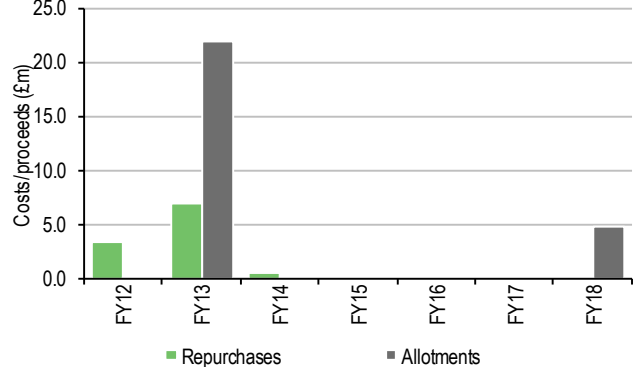
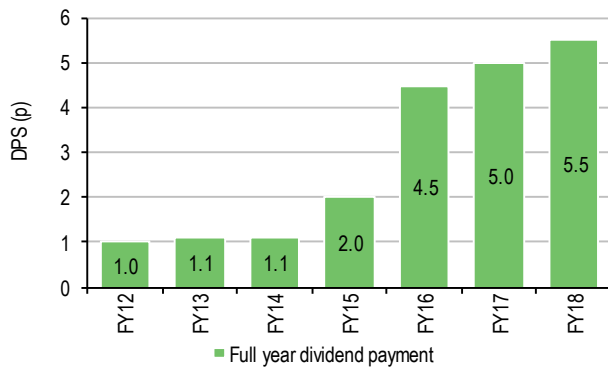
Forthcoming		Capital structure		Fund details	
AGM	December 2018	Ongoing charges	1.17% (FY18)	Group	FIL Investments International
Interim results	April 2019	Net cash*	9.1%	Manager	Nitin Bajaj
Year end	31 July	Annual mgmt fee	Variable (see page 10)	Address	Beech Gate, Millfield Lane, Lower Kingswood, Tadworth, Surrey, KT20 6RP
Dividend paid	December	Performance fee	None	Phone	0800 41 41 10 or 0800 41 41 81 (IFAs)
Launch date	13 June 1996	Trust life	Indefinite, subject to vote	Website	<a href="http://fidelity.co.uk/fidelity-asian-values">fidelity.co.uk/fidelity-asian-values</a>
Continuation vote	Five-yearly, next 2021	Loan facilities	None		

#### Dividend policy and history (financial years)

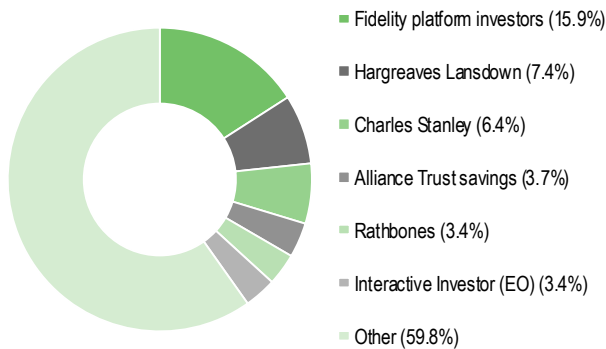
Dividends are paid annually in December.

#### Share buyback policy and history (financial years)

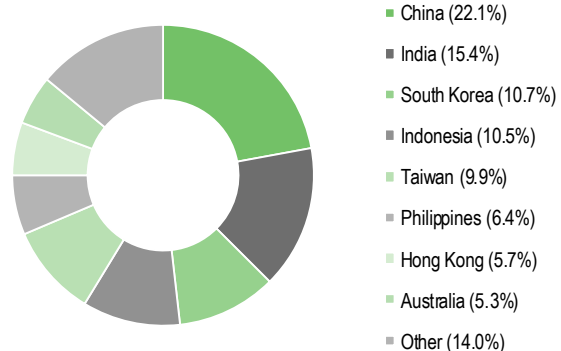
Renewed annually, FAS has the authority to repurchase up to 14.99% of shares and allot shares up to the equivalent of 5% of the issued share capital. Allotments in the chart below include the exercise of subscription shares.



#### Shareholder base (as at 30 September 2018)



#### Portfolio exposure by geography (as at 30 September 2018, excl. cash)



#### Top 10 holdings (as at 30 September 2018)

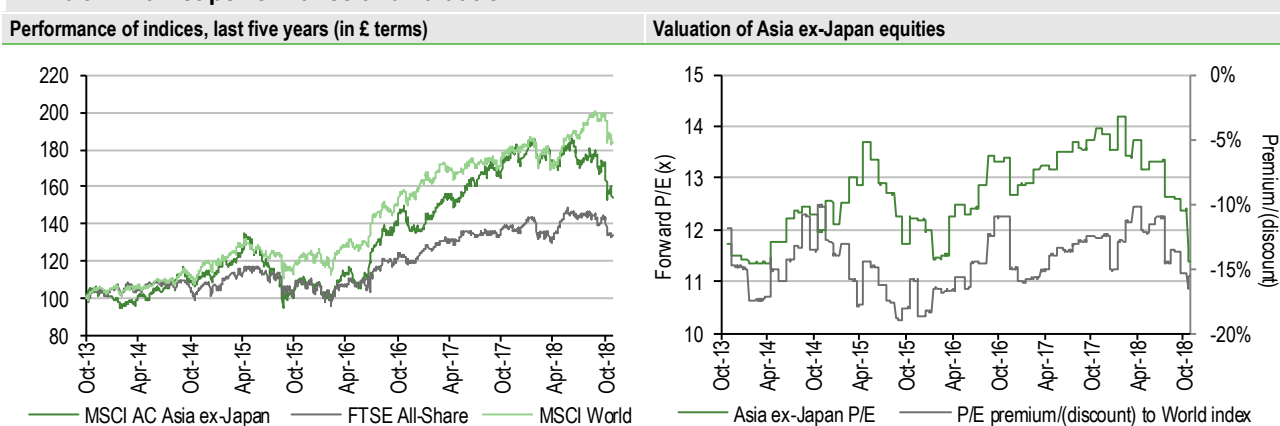
Company	Country	Sector	Portfolio weight %		Benchmark weight (%)	Active weight (pp)
			30 Sept 2018	30 Sept 2017**		
China Mobile	China	Telecommunication services	3.4	N/A	1.3	2.1
Power Grid Corp of India	India	Utilities	3.3	2.9	0.1	3.2
BOC Aviation	China	Industrials	2.7	N/A	0.0	2.7
Fufeng Group	China	Materials	2.2	N/A	0.0	2.2
Cognizant Tech Solutions	USA	Information technology	2.0	N/A	0.0	2.0
Taiwan Semiconductor Manufacturing	Taiwan	Information technology	2.0	2.7	4.6	(2.6)
Housing Development Finance Corp	India	Financials	1.9	2.6	0.8	1.1
HDFC Bank	India	Financials	1.6	1.6	0.0	1.6
Sebang Global Battery	South Korea	Consumer discretionary	1.6	N/A	0.0	1.6
Bank Rakyat Indonesia	Indonesia	Financials	1.6	N/A	0.3	1.3
<b>Top 10 (% of holdings)</b>			<b>22.3</b>	<b>22.4</b>		

Source: Fidelity Asian Values, Edison Investment Research, Bloomberg, Morningstar. Note: \*Gearing net of short positions. \*\*N/A where not in end-September 2017 top 10.

## Market outlook: Opportunities in Asia

Exhibit 2 (LHS) shows the performance of indices over the last five years (in sterling terms). Investors have enjoyed above-average total returns since early 2016, due to synchronised global economic growth and the devaluation of sterling following the Brexit vote. Equities have also been rerated due to a high level of liquidity and low yields available on other assets classes such as developed market government bonds and cash. Until Q218, Asian equities kept pace with the global stock market (which is dominated by the US), while significantly outperforming UK equities. More recently, emerging markets in general have sold off as investors have focused on the potential negative effects on global trade from President Trump's 'America First' strategy, the relative strength of the US dollar, and the risks of contagion following economic and financial issues in Turkey and Argentina.

**Exhibit 2: Market performance and valuation**



Source: Thomson Datastream, Edison Investment Research. Note: As at 29 October 2018.

As measured by Datastream indices (Exhibit 2, RHS) Asia ex-Japan equities are trading on a forward P/E multiple of 11.4x; a 15.5% discount to world equities, which is wider than its 14.5% five-year average. Looking back over the longer term, while the forward earnings multiple of Asian equities is modestly above its 10-year average, the region looks relatively attractively valued compared to other markets such as the US and Europe, which are trading at much higher premiums to their historical averages (Exhibit 3). Over time, more Asian companies have started to pay or have grown their dividends, and the region now offers a 2.8% yield. While this is lower than in the UK and Europe, it is meaningfully higher than the 2.0% yield available from US equities.

**Exhibit 3: Valuation of Datastream indices**

	Forward P/E (x)	10-year average forward P/E (x)	Forward P/E as % of 10-year average	Price-to-book (x)	ROE (%)	Dividend yield (%)
Asia ex-Japan	11.4	12.3	93	1.6	12.0	2.8
Japan	12.4	14.4	86	1.3	10.0	2.2
US	15.7	15.0	105	3.2	14.5	2.0
UK	11.9	12.5	96	1.4	12.4	4.0
Europe	12.1	12.1	100	1.5	11.6	3.5

Source: Thomson Datastream, Edison Investment Research. Note: As at 29 October 2018.

In terms of economic growth, Asia has above-average potential. In its October 2018 World Economic Outlook, the International Monetary Fund forecasts output growth of 6.5% and 6.3% pa in 2018 and 2019 respectively for the emerging and developing Asian region. This is higher than the 4.7% forecast for both years for emerging market and developing economies in general, and significantly higher than the 3.7% growth forecasts for world output in both 2018 and 2019. Factors contributing to higher economic growth in the Asian region include higher levels of income driving consumption; infrastructure spending; and increased productivity. While there are valid near-term investor concerns about investing in Asia (and other emerging markets), investors with a longer-

term perspective may be rewarded given the region's relatively attractive growth and valuation profiles.

## **Fund profile: Smaller-cap exposure to Asian equities**

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FAS was launched on 13 June 1996 and is listed on the Main Market of the London Stock Exchange. Since 1 April 2015, the trust has been managed by Nitin Bajaj. He seeks to generate long-term capital growth from a diversified portfolio of equities primarily listed in the Asia ex-Japan region. The manager is a qualified chartered accountant, based in Singapore, and has more than 17 years' investment experience. Bajaj is also the manager of the open-ended Fidelity Funds – Asian Smaller Companies Fund, which has been soft-closed to limit capacity concerns.

The trust adopted a change in strategy starting on 1 August 2015 to focus more on small-cap companies. At this time, the benchmark was changed from the MSCI All Companies Far East ex-Japan index to the MSCI All Companies Asia ex-Japan index, which includes the Indian subcontinent. There is a range of investment guidelines in place. At the time of investment, a maximum 10% of gross assets may be in a single company (although the manager prefers a maximum of 3.5%). Up to 5% of gross assets may be in unquoted companies that are expected to become listed within the foreseeable future. A maximum 5% of gross assets may be in companies that are not listed in the Asian region, but have significant operations in the area. (In this context, the Asian region refers to China, Hong Kong, India, Indonesia, Malaysia, Pakistan, the Philippines, Singapore, South Korea, Sri Lanka, Taiwan, Thailand, as well as Australasia.) Derivatives are permitted, such as long contracts for differences, which are used as an alternative form of gearing to bank loans; to hedge equity market risks; or to enhance investment returns by taking out short exposures on single stocks. Total derivative exposure is capped at 40% of NAV based on gross assets and 30% of NAV based on net market exposure. The board monitors the trust's derivative exposure very closely, and in normal market conditions would expect net market exposure to run in a range of 90% to 115% of NAV.

The sum of all short exposures, excluding portfolio hedges, is a maximum 10% of NAV. Bajaj commenced a three-year trial of running short positions c 12 months ago, although he says it will take a complete business cycle to determine whether the strategy has been successful. During this trial period, the manager will limit short exposure to 5% of NAV. There are no restrictions on geographic or sector exposure versus the benchmark, although the manager prefers to have less than 25% of the portfolio in a single country. The trust's currency exposure is generally unhedged, and any positions undertaken are against the US dollar or other Asian Pacific currencies rather than sterling. In May 2018, the manager took out a hedge against the Philippine peso, allowing him to buy positions in individual companies in the country, without taking on currency risk.

## **The fund manager: Nitin Bajaj**

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### **The manager's view: Retains positive long-term outlook**

Bajaj explains his preference for value over growth stocks is due to their long-term history of outperformance. He says investors have high expectations for growth stocks and reward them with high valuations. Incorrect forecasts lead to earnings disappointments and multiple contractions, and as a result, poor returns. In the case of value stocks, Bajaj says that investor expectations and valuation multiples are low, so when a company is able to meet earnings expectations there is the likelihood of a revaluation, and relatively better investment returns.

The manager's view on the current investment backdrop is that Asian stock markets are trying to find a base. So far in 2018, he says earnings have been reasonable, interest rates are starting to

rise, valuations are not too expensive and investor sentiment is neither too bullish nor too bearish. While there are a couple of upcoming presidential elections in the region, he does not see these as an undue risk. Bajaj believes stock markets will be influenced by corporate activity and credit conditions in China. The authorities there are attempting to moderate the shadow banking system, and the risk of a downturn in the Chinese property market has led to a sell-off in Chinese equities, resulting in attractive valuations in the country. The manager believes Asian stock markets will remain choppy, which provides opportunities for active stock pickers.

Given the above-average returns of Asian stock markets in 2016/17, Bajaj says he needs to be even more vigilant in seeking companies that provide a valuation margin of safety. As a precaution, given the potential for increased stock market volatility, the manager purchased some put options in H118, which are still in place. He remains cautious on the technology sector, unlike in 2013 when the stocks were out of favour. The manager notes the sector contains a vast number of companies, some of which have a competitive advantage, but he wonders how sustainable this position will be for many of them. Bajaj cites touchscreen technology company TPK Holdings as an example, a former high-flier whose stock price fell dramatically when it lost a contract to supply Apple. Within the portfolio, he tends to focus on technology companies with more industrial rather than leading-edge operations.

The manager is more cautious on the outlook for Asian stock markets in the shorter term, given their strong performance in recent years and the current macroeconomic environment, where risks include a slowdown in global trade due to the US's protectionist policies, as well as developments in China. However, he remains optimistic with a longer-term view. Within Asia, the economies are maturing, which is leading to broader growth; the workforce is becoming more educated; there is more investment in science and productivity; and improving standards of living are driving growth in consumption. In addition, reforms such as capacity reductions in inefficient industries in China, and a revamp of the tax regime in India, are supportive of long-term economic growth.

## **Asset allocation**

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### **Investment process: Buying a business rather than a stock**

Bajaj selects stocks on a bottom-up basis and is able to draw on the investment ideas of a team of five dedicated small-cap analysts, along with those of the well-resourced, broader Fidelity Asian team. Along with aiming to generate long-term capital growth, he seeks to minimise losses in periods of stock market weakness by investing in good companies with strong balance sheets, at a reasonable price that provides a margin of safety (this is at the core of the investment philosophy). He aims to generate a 50% total return from each portfolio holding within a three-year period.

The fund manager has three guiding principles: to understand a firm's business – this is the starting point when analysing a company; valuation is critical – the manager wants to invest in companies when they are ignored or misunderstood by the market; and beware of chasing hot stories – well-loved stocks and sectors tend to trade on rich valuations. Bajaj is more interested in companies where expectations are low and which investors are overlooking.

The manager seeks to invest in companies with good management teams and where there is an element of a 'special situation' such as a corporate or industry restructuring, or the potential for a takeover or industry consolidation. When assessing a company's management team, Bajaj says it needs to be competent and honest. He looks at what it has achieved over the long term, such as how capital was deployed and what level of returns have been generated. The manager reads at least a company's last five annual reports before meeting with its management team, when he will expect credible responses to any questions that he may have on a firm's prior performance.

Bajaj's investment style means the trust may lag during periods of strong stock market performance. The manager seeks companies whose share prices can compound at a reasonable rate over three to five years, so he suggests investors should assess the trust's performance over longer rather than short-term periods. Bajaj favours smaller-cap companies for three reasons:

- this area of the market provides opportunities to find the 'winners of tomorrow' before they are widely recognised by investors;
- smaller companies are generally under-researched, which provides greater opportunities to find mispriced securities; and
- there are more than 18,000 listed companies in which to invest, providing the manager with plenty of reasonably priced opportunities.

In terms of relative performance, the manager explains there are two primary sources of investment errors: 'errors of omission': companies not owned whose share prices appreciate, which is an opportunity loss; and 'errors of commission': companies in the portfolio whose share prices decline, which is a real loss. Bajaj's primary focus is to avoid 'errors of commission' by not investing where there is a likelihood of losing money, such as in companies with high levels of debt, unsustainable earnings, poor management teams and trading on high valuation multiples. He focuses on the potential of each portfolio holding to generate capital growth, rather than considering their index weightings. Given the manager's unconstrained investment approach, FAS's geographic and sector weightings can vary considerably versus the benchmark, and the trust has a high active share, typically above 90%. Active share is a measure of how a fund compares to a benchmark, with 0% representing full replication and 100% no commonality with the index.

FAS typically holds 100–200 positions in its portfolio (160 at end August 2018). The number of holdings has been reduced opportunistically in recent months, as the manager is concentrating the fund by either adding to, or exiting, some of the trust's smaller positions. While Bajaj wishes to run a more concentrated fund, he is mindful that smaller-cap stocks can be thinly traded. To provide adequate levels of liquidity he also holds 20–25% of the fund in large-cap companies, and typically has 5–7% in cash. Based on three-month trading volumes for investee companies, data from Fidelity suggest that c 70% of the portfolio could be liquidated in 10 days and c 80% within 20 days. Portfolio turnover is typically 25–30% pa, which implies a three- to four-year holding period.

Bajaj has a watch list of companies that he or his team of analysts have researched but do not meet his strict valuation criteria. Over the last five to six years, c 4,000 companies have been analysed; included in each research report are 'bull' and 'bear' theses and share price targets. There are around 1,000 companies on the watch list.

## Current portfolio positioning

At end September 2018, FAS's top 10 positions made up 22.3% of the portfolio, which was broadly in line with 22.4% a year earlier; four positions were common to both periods. The portfolio breakdown by market cap is shown in Exhibit 4. FAS's small- and mid-cap bias and unconstrained investment approach is clear, as more than half of the fund is invested in companies with a market cap below £1bn, and this segment is only 0.2% of the benchmark.

<b>Exhibit 4: Portfolio exposure by market cap (% unless stated)</b>						
	Portfolio end- Sept 2018	Portfolio end- Sept 2017	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
>£10bn	21.1	13.8	7.3	59.0	(37.9)	(0.4)
£5-10bn	3.5	4.7	(1.2)	16.1	(12.6)	(0.4)
£1-5bn	25.3	22.1	3.2	16.4	8.9	2.5
£0-1bn	53.2	60.9	(7.6)	0.2	53.0	1.1
Other index/unclassified	(3.2)	(1.5)	(1.7)	8.3	(11.5)	0.1
	<b>100.0</b>	<b>100.0</b>		<b>100.0</b>		

Source: Fidelity Asian Values, Edison Investment Research. Note: Adjusted for cash.



Exhibit 5 shows the trust's geographic exposure. The largest changes over the last 12 months are a higher weighting in China (+8.2pp), where low valuations are providing a lot of attractive investment opportunities, and a lower weighting in Taiwan (-4.9%), where the stock market is dominated by technology stocks and smaller-cap companies generally have low liquidity. Compared to the benchmark, FAS remains meaningfully underweight in China (-13.2pp) and South Korea (-6.2pp), with the largest overweight positions in Indonesia (+8.3pp) and India (+5.7pp). The manager is not influenced by the fact that China 'A' shares are now included in the MSCI AC Asia ex-Japan index. He says these companies often do not report their financial statements in English, and their management teams have different attitudes regarding minority shareholders compared with those in other parts of Asia. Bajaj says he will continue to assess companies based on their own individual merits.

FAS holds c 5% of its portfolio in Australian equities. While this country is not included in the benchmark, the manager explains there is a vibrant small-cap market in Australia, especially in the healthcare sector, and he is able to find companies that fit his strict investment criteria.

**Exhibit 5: Portfolio geographic exposure vs benchmark (% unless stated)**

	Portfolio end- Sept 2018	Portfolio end- Sept 2017	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
China	22.1	13.9	8.2	35.3	(13.2)	0.6
India	15.4	16.7	(1.3)	9.7	5.7	1.6
South Korea	10.7	12.0	(1.4)	16.9	(6.2)	0.6
Indonesia	10.5	6.5	3.9	2.2	8.3	4.8
Taiwan	9.9	14.8	(4.9)	14.0	(4.1)	0.7
Philippines	6.4	6.8	(0.4)	1.1	5.3	5.8
Hong Kong	5.7	5.6	0.1	11.2	(5.5)	0.5
Australia	5.3	8.3	(3.0)	0.0	5.3	N/A
Thailand	4.8	3.1	1.7	2.8	2.0	1.7
Singapore	4.7	6.7	(1.9)	4.0	0.7	1.2
Other	4.5	5.6	(1.1)	2.8	1.7	1.6
	<b>100.0</b>	<b>100.0</b>		<b>100.0</b>		

Source: Fidelity Asian Values, Edison Investment Research. Note: Adjusted for cash.

In terms of sector exposure (Exhibit 6), FAS has higher exposure to financials (+7.1pp) and lower exposure to technology (-5.2pp) compared with a year ago. The largest negative deviations versus the benchmark are the trust's underweights in financials, technology and communication services as the manager is finding more attractive investment opportunities in other parts of the market, such as industrials and utilities.

**Exhibit 6: Portfolio sector exposure vs benchmark (% unless stated)**

	Portfolio end- Sept 2018	Portfolio end- Sept 2017	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
Financials	16.9	9.8	7.1	23.3	(6.4)	0.7
Consumer discretionary	16.0	20.1	(4.1)	12.2	3.8	1.3
Industrials	13.2	12.1	1.1	6.9	6.3	1.9
Information technology	11.7	16.9	(5.2)	18.0	(6.3)	0.7
Utilities	8.9	6.9	2.0	3.1	5.8	2.9
Consumer staples	7.5	12.2	(4.8)	4.9	2.6	1.5
Communication services	6.7	0.8	5.9	12.7	(6.0)	0.5
Healthcare	6.3	10.0	(3.7)	3.1	3.2	2.0
Materials	5.3	3.3	2.0	4.9	0.4	1.1
Energy	4.1	2.9	1.2	5.1	(1.0)	0.8
Real estate	3.4	4.9	(1.5)	5.8	(2.4)	0.6
	<b>100.0</b>	<b>100.0</b>		<b>100.0</b>		

Source: Fidelity Asian Values, Edison Investment Research. Note: Adjusted for cash.

The manager is keen to stress that all FAS's investments are made on a bottom-up basis. Included in the top 10 holdings is Indian mortgage company Housing Development Finance Corp (HDFC), which is taking market share from traditional bank lenders as it can offer lower-cost products to its customers due to lower funding and operating costs. In India, there is no buy-to-let market and the maximum loan-to-value is 70%, which means the level of non-performing loans is low. The manager says housing affordability in India is the best it has been in 10 years as house prices are

not rising, interest rates are low and wages are growing. Mortgage penetration in the country is less than 10%, which coupled with above-average GDP growth is leading to c 15% pa growth in mortgage lending. The manager says he was able to buy the HDFC position for a single-digit earnings multiple despite its sustainable competitive advantage and attractive growth profile.

Another company in the trust's top 10 list of holdings is large-cap China Mobile, which dominates the Chinese mobile phone market with a c 65% share. The company has a large cash pile on its balance sheet and generates significant amounts of cash flow, which the manager believes will continue for many years. China Mobile's stock price has suffered as investors have gravitated to large-cap technology companies such as Alibaba and Tencent. The company is trading on a reasonable P/E multiple and offers a c 4.5% dividend yield. Bajaj believes the stock can deliver a total shareholder return of 50% over the next three years via dividends, earnings growth and a revaluation to an EV/EBITDA multiple more in line with its peers. He suggests that investor concerns about the capex involved in the rollout of a 5G mobile network are already reflected in China Mobile's share price.

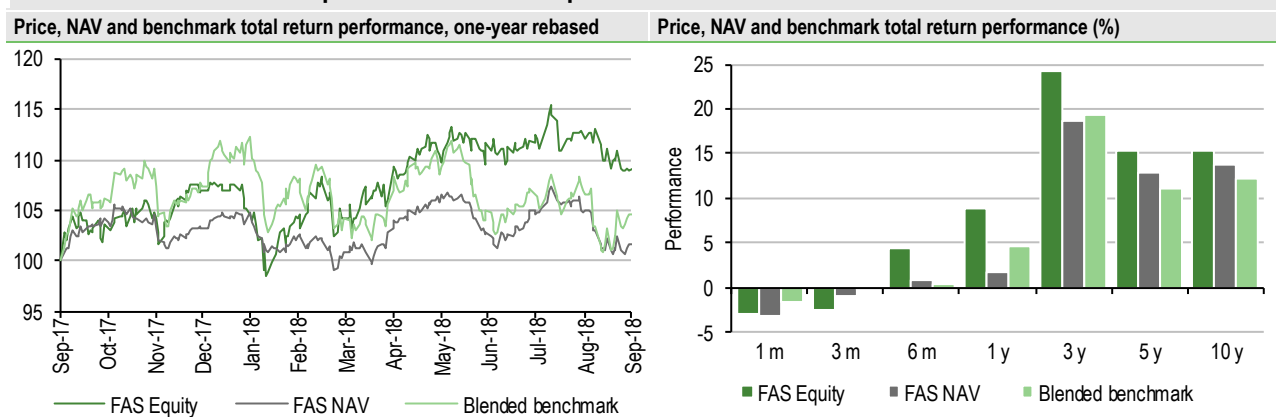
Some of the more recent purchases in FAS's portfolio include:

- Bank Rakyat Indonesia – a state-owned leader in microfinance. The company has a strong competitive position, is selling non-core assets and has low balance sheet risk. Bajaj was able to initiate a position during a period of share price weakness and he believes the stock can compound capital returns over the long term.
- Manila Water – a water utility company based in the Philippines. The company is subject to a regulatory reset, which the manager believes has a high chance of allowing Manila Water to charge a higher tariff. The stock is trading on a single-digit P/E multiple and Bajaj believes there is potential for a positive earnings surprise.
- Fufeng Group – a Chinese company with a c 50% global market share in monosodium glutamate. The manager says it is the lowest-cost producer, is broadening its product offering and has a clean balance sheet. Despite these positive attributes, the company is trading on attractive valuation multiples.

## Performance: Long-term record of outperformance

In FY18 (ending 31 July), FAS's NAV and share price total returns of +2.2% and +8.2% respectively, compared with the benchmark +5.7% total return. Positive contributors to performance included toy company Dream International and Texhong Textile Group. Bajaj explains that these are examples of 'hidden gems' – small companies, with businesses generating attractive returns on capital, run by talented management teams.

**Exhibit 7: Investment trust performance to 30 September 2018**



Source: Thomson Datastream, Edison Investment Research. Note: Three, five and 10-year performance figures annualised. Blended benchmark is MSCI AC Far East-ex Japan index to 31 July 2015 and MSCI AC Asia ex-Japan index thereafter.



As shown in Exhibit 7 (RHS), over 12 months to the end of September 2018, FAS's share price total return of +8.9% outpaced its +1.7% NAV total return (benchmark total return of +4.7%), which led to a narrowing of the discount. Positive contributors to performance included: BOC Aviation, a Chinese leasing company with an improving earnings profile; and Tianneng Power International, another Chinese company, which has delivered positive results in the first two quarters of 2018. It is benefiting from a more favourable operating environment and high demand for its motive battery products and Bajaj believes the company will continue to grow its market share.

The largest detractor from performance was G8 Education, an Australian operator of day-care centres. Having been a top 10 holding because of strong share price appreciation, the company issued a negative trading statement in late 2017. The stock has retraced more than 50% from its peak and now trades on a single-digit earnings multiple. The manager is confident about the company's long-term prospects and continues to hold a position.

The trust has delivered strong absolute returns for shareholders; over three, five and 10 years its NAV and share price total returns have been in a range of c 13% to c 24% pa.

**Exhibit 8: Share price and NAV total return performance, relative to indices (%)**

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to blended benchmark	(1.3)	(2.2)	4.0	4.0	12.6	20.2	31.2
NAV relative to blended benchmark	(1.5)	(0.8)	0.4	(2.9)	(1.8)	7.8	14.7
Price relative to MSCI AC Asia ex-Japan	(1.3)	(2.2)	4.0	4.0	12.6	17.2	32.4
NAV relative to MSCI AC Asia ex-Japan	(1.5)	(0.8)	0.4	(2.9)	(1.8)	5.1	15.7
Price relative to MSCI AC Far East ex-Japan	(2.2)	(2.3)	4.5	3.9	10.2	18.3	29.1
NAV relative to MSCI AC Far East ex-Japan	(2.4)	(0.9)	0.8	(3.0)	(3.8)	6.0	12.9
Price relative to FTSE All-Share	(3.6)	(1.6)	(3.6)	2.9	38.5	41.8	75.3
NAV relative to FTSE All-Share	(3.8)	(0.2)	(6.9)	(4.0)	20.8	27.1	53.2

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-September 2018. Geometric calculation.

The trust's relative returns are shown in Exhibits 8 and 9. FAS's share price total return is ahead of the benchmark over all periods shown, with the exception of the two most recent periods, while its NAV total return is ahead of the benchmark over six months, and five and 10 years. For UK-based investors, it is interesting to note the magnitude of outperformance compared with the FTSE All-Share index over three, five and 10 years.

**Exhibit 9: NAV total return performance relative to benchmark over three years**



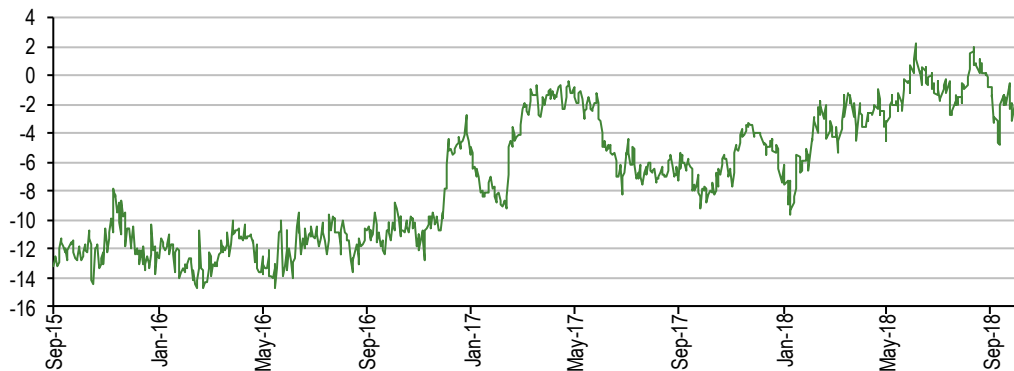
Source: Thomson Datastream, Edison Investment Research

## Discount: Meaningful narrowing in the discount

Having broadly traded between 10% and 14% for a number of years, FAS's discount to NAV has been in a narrowing trend since the beginning of 2016 and the trust now often trades at a small premium. There has been increased investor demand for FAS following the soft closing of the Fidelity Funds – Asian Smaller Companies Fund, an open-ended vehicle also managed by Bajaj. The trust's 1.6% share price discount to cum-income NAV compares with a range of a 2.3%

premium to a 9.6% discount over the last 12 months and the average discounts over the last one, three, five and 10 years of 3.4%, 7.1%, 8.6% and 8.9% respectively. Approved annually, the board is permitted to repurchase up to 14.99% and to allot up to 10% of shares in issue (increased from 5% at the December 2017 AGM). Shares will only be repurchased when incremental to NAV. Shares are held in treasury rather than cancelled and will only be reissued at or above NAV. Any subscription shares repurchased would be cancelled.

**Exhibit 10: Share price premium/discount to NAV (including income) over three years (%)**



Source: Thomson Datastream, Edison Investment Research

## Capital structure and fees

FAS is a conventional investment trust with 68.7m ordinary shares outstanding. At the 2 December 2016 AGM, the trust's shareholders approved a bonus issue of subscription shares on the basis of one subscription share for every five ordinary shares held. On 30 November 2017, 1.2m shares were exercised at a price equivalent to the 2 December 2016 NAV price of 366.88p +1% (370.75p). There are 12.3m subscription shares outstanding, which can be exercised in the 25 business days preceding the last business day in November 2018 at a price of 366.88p +4% (381.75p), and in the 25 business days preceding the last business day in November 2019 at 366.88p +7% (392.75p). At the end of September 2018, FAS had no bank debt and 9.1% of the portfolio was held in cash.

On 1 August 2018, FAS adopted a new management fee. Historically, Fidelity was paid 0.90% of gross assets up to £200m and 0.85% of gross assets above £200m. There is now a base management fee of 0.70% of NAV with a plus or minus variance of 0.20pp depending on how the trust performs versus the benchmark. Therefore, the management fee will be in a range of 0.90% to 0.50% of NAV based on out- or underperformance. There has been no change in the investment process following the amendment to the management fee.

Changes in the way that external research is paid for following the introduction of the MiFID II regulations on 3 January 2018 will have a modest positive effect on the trust. Fidelity will cover the costs of external research, which it estimates will reduce the ongoing charge by 2–3bp pa. In FY18, FAS's ongoing charge was 1.17%, which was 5bp lower than 1.22% in FY17.

The trust is subject to a five-yearly continuation vote; the next is due at the 2021 AGM.

## Dividend policy and record

FAS pays out a single annual dividend in December. Distributions are only made out of revenue reserves, which are determined by the income that the trust receives, so investors should not expect regular dividend growth. However, over the past five years, the dividend has compounded at

an annual rate of c 38%, and the 5.5p per share announced for FY18 is 10% higher than 5.0p in FY17. Based on its current share price, FAS is offering a dividend yield of 1.5%.

## Peer group comparison

FAS is a member of the AIC Asia Pacific – Excluding Japan sector. In Exhibit 11, we highlight the 15 funds with a market cap greater than £100m; FAS is one of the smallest. It has outperformed the peer group average over all periods shown despite its defensive investment approach, ranking second, third, second and fourth over one, three, five and 10 years respectively.

The trust has a higher-than-average ongoing charge, although the change in investment management fee highlighted in the capital structure and fees section should be considered when making a comparison. Given its focus on capital growth rather than income, FAS's dividend yield is 1.0pp below average, ranking ninth out of 15 funds.

**Exhibit 11: Selected peer group as at 29 October 2018\***

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (ex-par)	Ongoing charge	Perf. fee	Net gearing	Dividend yield
Fidelity Asian Values	256.8	(3.0)	53.1	71.7	393.0	(1.1)	1.2	No	100	1.5
Aberdeen Asian Income	334.0	(7.8)	35.0	24.6	276.1	(10.0)	1.1	No	108	4.8
Aberdeen Asian Smaller	329.8	(7.0)	36.9	26.6	440.6	(14.4)	1.2	No	110	1.3
Aberdeen New Dawn	225.5	(11.7)	35.0	29.1	265.7	(12.5)	0.8	No	112	2.2
Edinburgh Dragon	616.2	(11.0)	34.5	31.2	255.0	(9.5)	1.1	No	103	1.0
Henderson Far East Income	412.2	(7.2)	36.6	35.1	223.2	4.3	1.1	No	104	6.7
Invesco Asia	175.2	(13.1)	45.5	66.8	363.3	(10.8)	1.0	No	100	2.2
JPMorgan Asian	288.8	(9.1)	55.2	68.1	290.9	(11.3)	0.7	No	100	5.1
Martin Currie Asia Unconstrained	119.8	(11.2)	36.5	29.3	151.2	(13.4)	1.1	No	103	2.4
Pacific Assets	291.3	(1.1)	38.6	66.9	367.2	(5.1)	1.3	No	100	1.1
Pacific Horizon	165.1	(15.2)	49.4	55.4	283.2	1.4	1.0	No	105	0.2
Schroder Asia Pacific	640.1	(14.3)	46.6	63.6	391.1	(9.3)	1.0	No	108	1.5
Schroder Asian Total Return Inv Co	286.9	(9.4)	55.3	73.0	323.9	3.9	1.0	Yes	104	1.5
Schroder Oriental Income	585.1	(8.6)	38.0	48.7	440.2	3.0	0.9	Yes	108	4.2
Scottish Oriental Smaller Cos	262.3	(12.8)	26.0	34.8	433.3	(14.6)	1.0	Yes	100	1.3
<b>Average (15 funds)</b>	<b>332.6</b>	<b>(9.5)</b>	<b>41.5</b>	<b>48.3</b>	<b>326.5</b>	<b>(6.6)</b>	<b>1.0</b>		<b>104</b>	<b>2.5</b>
<b>FAS rank in sector</b>	<b>11</b>	<b>2</b>	<b>3</b>	<b>2</b>	<b>4</b>	<b>5</b>	<b>2</b>		<b>11</b>	<b>9</b>

Source: Morningstar, Edison Investment Research. Note: \*Performance to 26 October 2018. TR, total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

## The board

There are five directors on FAS's board; all are non-executive and independent of the manager:

- Kate Bolsover (appointed to the board on 1 January 2010, assumed the role of chairman on 9 December 2014). She is a director of Montanaro UK Smaller Companies Investment Trust, chairman of Tomorrow's People Trust and a director of a number of affiliated companies. Bolsover formerly worked for Cazenove Group and JP Morgan Cazenove within its mutual fund and corporate communications operations.
- Philip Smiley (appointed on 1 January 2010, assumed the role of senior independent director on 30 November 2015). He is a director of the Arisaig India Fund and the Endowment Fund SPC and is chairman of the PXP Vietnam Emerging Equity Fund and the advisory board of the Emerging Beachfront Land Investment Fund. Smiley has 31 years' experience of working in the Asia-Pacific region.
- Grahame Stott (appointed on 24 September 2013). He is a director of China Motor Bus Company. Stott is a qualified actuary with a background in consultancy, which includes 20 years based in Hong Kong.

- Michael Warren (appointed on 29 September 2014). He is a director of Carrington Investments, and an operating partner of private equity firm LivingBridge. Warren has a background in investment management.
- Timothy Scholefield (appointed on 30 September 2015). He is chairman of City Merchants High Yield Trust and of the Investment Management Certificate panel. Scholefield is a director of F&C Capital and Income Investment Trust and Standard Life UK Smaller Companies. He has over 25 years' experience in investment management.

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