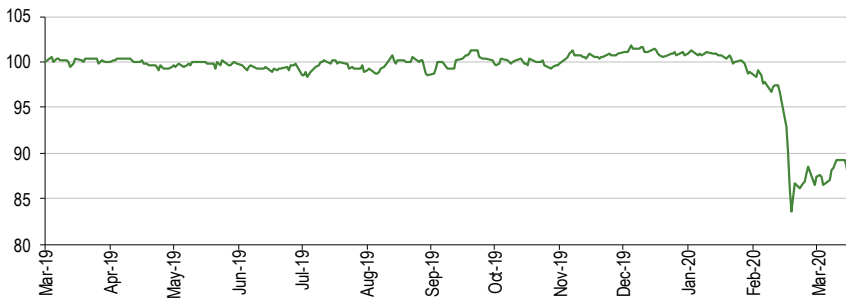


# Fidelity Special Values

Sell-off providing wide-ranging opportunities

Fidelity Special Values (FSV) was launched in November 1994 and is run by Alex Wright (lead manager since January 2014) and Jonathan Winton (co-manager since February 2020). They have a value-based investment style, aiming to generate long-term capital growth – while limiting downside risk – from a diversified portfolio of UK equities, although up to 20% of the fund may be invested in companies listed overseas. FSV's positive long-term relative performance record has been negatively affected by the coronavirus pandemic; however, the managers are taking advantage of what they consider to be mispriced opportunities and are selectively adding to the trust's holdings. FSV currently offers a 3.2% dividend yield.

## Significant coronavirus impact on NAV performance versus the UK market



Source: Refinitiv, Edison Investment Research

## The market opportunity

Following the coronavirus-induced market sell-off, UK stock valuations outwardly look very attractive on both an absolute basis and compared with other developed markets such as the US and Europe. While there is currently a great deal of economic uncertainty, over history, share prices have recovered from significant sell-offs and subsequently set new highs. Investors with a longer-term perspective may consider the recent market adjustment as providing a good long-term opportunity to acquire enduring businesses at attractive valuations.

## Why consider investing in Fidelity Special Values?

- Performance driven by bottom-up, value-focused stock selection, with a bias to mid- and small-cap stocks.
- Managers are finding attractively valued opportunities across a variety of sectors, as a result of significant coronavirus-induced market weakness.
- Wright and Winton are able to draw on the significant resources of Fidelity's more than 150-strong analyst team, including credit and healthcare specialists.
- Reduced ongoing charges, helped by lower investment management fee.

## Currently trading at a premium with a 3.2% yield

FSV is currently trading at a 3.9% premium to cum-income NAV, which compares with a range of an average 0.7% premium to a 2.5% discount over the last one, three and five years. Based on its current share price, the trust offers a 3.2% yield.

## Investment trusts UK equities

20 April 2020

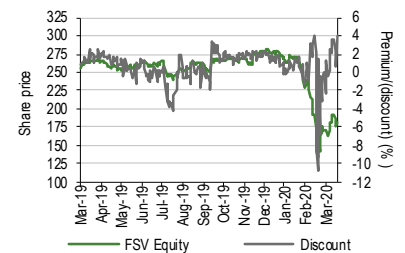
**Price** 180.6p  
**Market cap** £524m  
**AUM** £503m

NAV\* 173.8p  
 Premium to NAV 3.9%

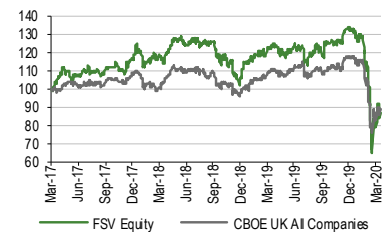
\*Including income. As at 16 April 2020.

Yield 3.2%  
 Ordinary shares in issue 290.0m  
 Code FSV  
 Primary exchange LSE  
 AIC sector UK All Companies

## Share price/discount performance



## Three-year performance vs index



52-week high/low 280.5p 135.0p  
 NAV\*\* high/low 275.5p 150.8p

\*\*Including income.

## Gearing

Gross market gearing\* 7.5%  
 Net market gearing\* 6.0%

\*As at 29 February 2020.

## Analysts

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## Exhibit 1: Trust at a glance

### Investment objective and fund background

Fidelity Special Values' investment objective is to achieve long-term capital growth, primarily through investment in the equities (and their related financial instruments) of UK companies that the manager believes to be undervalued or where potential has not been recognised by the market. Investments are only made in companies where the potential downside risk is understood, to limit the possibility of losses. The trust's performance is measured against a broad index of UK companies.

### Recent developments

- 30 January 2020: Jonathan Winton appointed as co-manager, effective from 3 February 2020.
- 1 November 2019: 12-month results to 31 August 2019. NAV TR -4.9% versus benchmark TR +0.4%. Share price TR -6.9%. Proposed final dividend of 3.65p (+15.9% year-on-year) and special dividend of 1.50p.
- 24 June 2019: Appointment of two independent non-executive directors – Claire Boyle (with immediate effect) and Alison McGregor (effective from 1 January 2020).

### Forthcoming

AGM	December 2020
Interim results	May 2020
Year end	31 August

### Capital structure

Ongoing charges	0.92%
Net market gearing	6.0% (at 29 February 2020)
Annual mgmt fee	Tiered: 0.85% up to £700m net assets, 0.75% thereafter
Performance fee	None

### Fund details

Group	FIL Investments International
Managers	Alex Wright, Jonathan Winton
Address	Beech Gate, Millfield Lane, Lower Kingswood, Tadworth, Surrey KT20 6RP
Phone	01732 361144
Website	<a href="http://www.fidelity.co.uk/specialvalues">www.fidelity.co.uk/specialvalues</a>

Dividend paid June, January

Launch date 17 November 1994

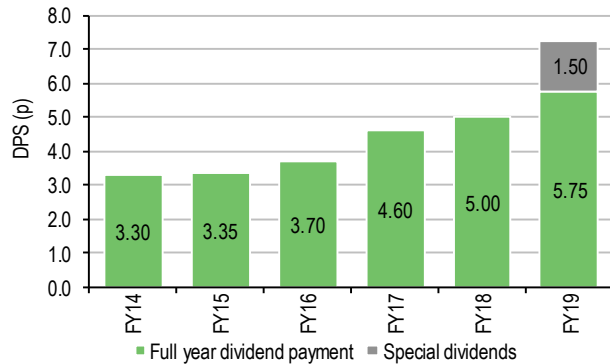
Continuation vote Three-yearly (next 2019)

Trust life Indefinite (subject to vote)

Loan facilities None – CFDs used

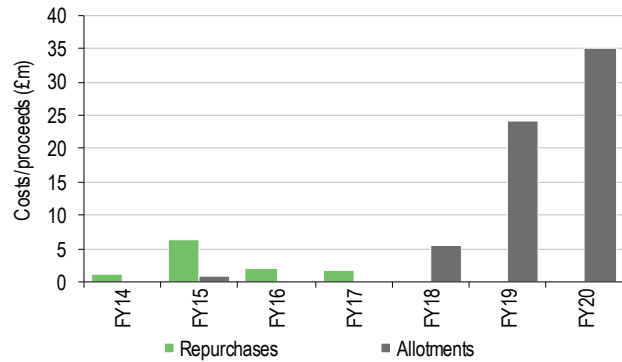
### Dividend policy and history (financial years)

Since 2015, FSV has paid interim and final dividends, in order to smooth the dividend payment for the year.

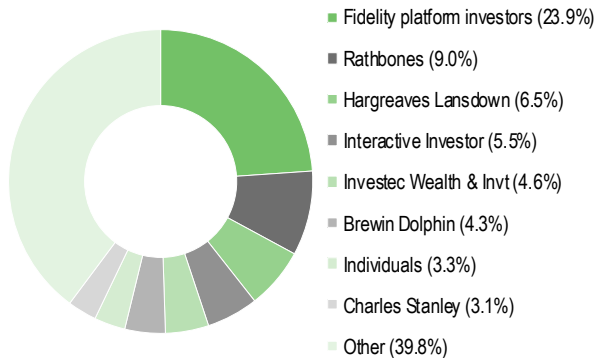


### Share buyback policy and history (financial years)

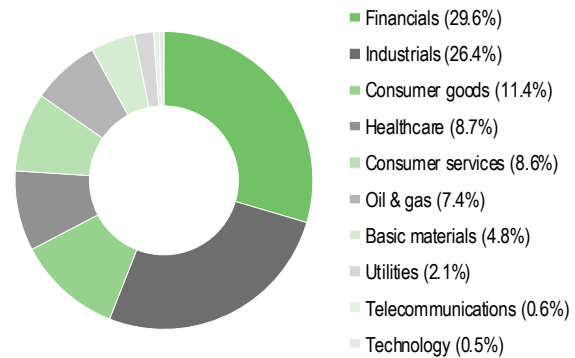
FSV has annually renewed authority to purchase up to 14.99% and allot up to 10% of its issued share capital.



### Shareholder base (as at 31 March 2020)



### Portfolio exposure by sector (as at 29 February 2020)



### Top 10 holdings (as at 29 February 2020)

Company	Country of domicile	Sector	Portfolio weight (%)		Benchmark weight %	Active weight %
			29 Feb 2020	28 Feb 2019*	29 February 2020	29 February 2020
CRH	Ireland	Industrials	5.4	4.5	1.0	4.4
Roche	Switzerland	Healthcare	4.2	4.4	0.0	4.2
Imperial Brands	UK	Consumer goods	3.7	N/A	0.7	3.0
Phoenix Group	UK	Financials	3.6	3.8	0.2	3.4
John Laing Group	UK	Financials	3.6	4.1	0.1	3.5
Legal & General Group	UK	Financials	3.3	N/A	0.7	2.6
Royal Dutch Shell	UK	Oil & gas	3.2	4.4	6.4	(3.2)
BP	UK	Oil & gas	3.2	4.0	3.8	(0.6)
Serco Group	UK	Industrials	3.2	N/A	0.1	3.1
Meggitt	UK	Industrials	3.1	2.8	0.2	2.9
<b>Top 10 (% of portfolio)</b>			<b>36.5</b>	<b>35.7</b>		

Source: FSV, Edison Investment Research, Bloomberg, Morningstar. Note: \*N/A where not in end-February 2019 top 10.

## The fund managers: Alex Wright, Jonathan Winton

### The manager's view: Sell-off creating interesting opportunities

Lead portfolio manager Wright has a contrarian and value-based approach to investing, which differentiates FSV from its peers. He says the market sell-off, as a result of the coronavirus, and the significant decline in the oil price have created very interesting opportunities, with the UK market looking particularly attractive versus other developed markets. However, the manager notes that due to the significant outperformance of growth versus value stocks in recent years, there are still many higher-valued companies whose share prices could be at greater risk in volatile markets. When investing, Wright looks for downside protection as well as the potential for capital appreciation. He looks at analogies from the past to see what one could expect from company earnings in different environments. The manager analyses company balance sheets to ensure that he is not taking undue financial risk in FSV's portfolio, and believes that investing at low valuations can afford a degree of downside protection. He also considers potential catalysts to determine what may cause companies to re-rate in an improving economic environment. Wright believes that his stock-specific, bottom-up approach, coupled with the ability to draw on the significant resources of Fidelity's investment team, provides a competitive advantage. He says that FSV's portfolio typically has asymmetric risk, with unsuccessful positions losing less than the gains achieved from successful investments. Having recently adjusted his upside/downside analysis of individual holdings to reflect recent developments and calls with company managements, the manager estimates a weighted aggregated portfolio upside potential of 65%, with only a 15% downside risk.

In recent weeks, Wright, along with the rest of the Fidelity analyst team, has been undertaking hundreds of company meetings to understand what is happening on the ground. His view is that beyond the initial lockdowns, there will be a global recession that has the potential to be worse than that experienced during the global financial crisis. Fidelity economists suggest that the global economy could contract by between 10% and 25% in Q220, a much larger fall than the worst quarterly c 8% decline during the financial crisis in Q408. In addition, government support measures will mean significantly higher government debt-to-GDP ratios for countries that have had to lock down, many of which are already highly indebted. While it is difficult to assess the duration of any recession, Wright says that significant and wide-ranging dividend cuts are inevitable.

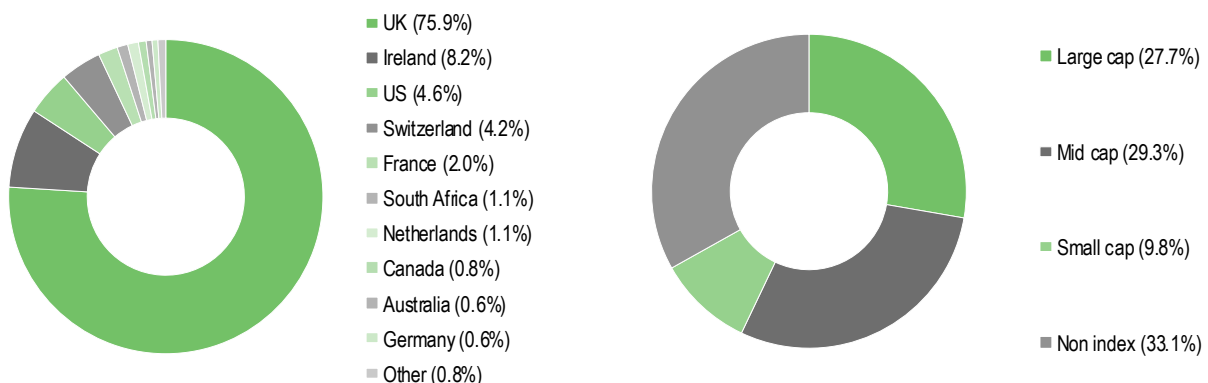
### The portfolio

At end-February 2020, FSV's top 10 positions made up 36.5% of the portfolio, modestly higher than 35.7% a year earlier; they are a mix of financials, resources, other GDP-sensitive companies and defensive businesses.

**Exhibit 2: Portfolio geographic and market cap exposures at end-February 2020**

Portfolio geographic exposure by company domicile

Portfolio market cap exposure



Source: Fidelity Special Values, Edison Investment Research. Note: Figures are adjusted for gearing and index futures.

In the 12 months to end-February 2020, in terms of sector exposure, FSV's weightings to consumer goods (+4.9pp) and industrials (+3.6pp) have risen, with lower exposure to financials (-4.6pp) and oil & gas (-2.4pp). The trust retains a meaningful overweight to the industrial sector (+14.4pp).

**Exhibit 3: Portfolio sector exposure vs benchmark index (% unless stated)**

	Portfolio end-February 2020	Portfolio end-February 2019	Change (pp)	Index end-February 2020	Active weight vs index (pp)	Trust weight/index weight (x)
Financials	29.6	34.2	(4.6)	27.3	2.3	1.1
Industrials	26.4	22.8	3.6	12.0	14.4	2.2
Consumer goods	11.4	6.5	4.9	14.8	(3.4)	0.8
Healthcare	8.7	7.4	1.3	9.5	(0.8)	0.9
Consumer services	8.6	10.2	(1.6)	11.8	(3.2)	0.7
Oil & gas	7.4	9.8	(2.4)	10.5	(3.1)	0.7
Basic materials	4.8	5.9	(1.1)	7.1	(2.3)	0.7
Utilities	2.1	1.5	0.5	3.5	(1.4)	0.6
Telecommunications	0.6	0.0	0.6	2.4	(1.8)	0.2
Technology	0.5	1.6	(1.2)	1.0	(0.5)	0.5
	<b>100.0</b>	<b>100.0</b>		<b>100.0</b>		

Source: Fidelity Special Values, Edison Investment Research. Note: Figures are adjusted for gearing and index futures. Numbers subject to rounding.

While Wright says it is a good time to buy UK equities, he is not an indiscriminate purchaser; however, he increased FSV's gearing from c 2% to c 12% in recent months. The trust has its highest ever defensive weighting, typified by companies such as Imperial Brands, which is trading on a single-digit forward P/E multiple and offers a c 13% dividend yield, but Wright is also finding interesting opportunities in a variety of areas including GDP-sensitive stocks. He has added an unloved telecom operator to the portfolio (name withheld) that is growing revenues and reducing costs, and has increased the holding in Ericsson (communication equipment), which entered the portfolio early in Q120 in anticipation of an increase in telecom-related capex. The manager has initiated positions in two small-cap gold miners, whose share prices had halved despite a rising gold price, thereby increasing the fund's exposure to gold-linked equities to c 3%. He has reduced FSV's exposure to major oil companies BP and Shell given the significant fall in the oil price, as, at these levels, the companies cannot cover their high dividend payments.

Wright has also been working through the portfolio to assess where a deep recession and/or the current lockdown will likely cause company balance sheet problems, looking to sell those businesses where he believes there is a real bankruptcy risk. However, the manager explains that this is not straightforward, as some sectors are experiencing such significant revenue declines that even companies with net cash positions could burn through these reserves very quickly. It is also important to monitor the levels of government support and responses from the banking sector, which remain in a state of flux.

The manager sold FSV's modest airline holdings once it was evident that the coronavirus had spread outside of China. He made a substantial gain in Dart Group, despite only having held the position since last autumn, and a small loss on the Wizz Air holding, which he was in the process of building up. Fundamentals in the airline industry were looking positive with the Boeing 737 Max out of action; however, this thesis is now broken due to the collapse in demand as a result of the pandemic. Wright says that looking out to 2021, if the effects of the virus are washed through the system – which is his base case – there will be 'an awful lot' of 737 Max planes delivered, so the airline industry would need a significant increase in demand to soak up the extra capacity.

Life insurance is an area that the manager has been adding to, and it now represents around 12% of the portfolio. Holdings include Aviva, Legal & General and Phoenix, which are all trading on very reasonable valuations. Business is robust, helped by demand for bulk-purchase annuities, there is limited new competition, and these companies' balance sheets are strong, unlike during the global financial crisis.

Wright has added to CRH (construction materials), which is now the largest position in the fund. The company has a significant exposure to US infrastructure and there is a clear political desire from both sides of Congress to spend more money in this area. CRH's largest input costs are oil-based bitumen and diesel, so oil price weakness should be positive for the firm's margins. The manager thinks that the company offers good value, and it also has self-help measures in place to support earnings growth.

FSV also has a position in McCarthy & Stone, which is a developer and manager of retirement communities. Wright generally does not own UK house builders as he finds their valuations unappealing, but says McCarthy & Stone is more attractively valued. The manager points out that the company dominates its niche, with a 70% share in retirement living, and demand is strong; in the UK c 5% of the population live in retirement homes, much lower than 10–15% in other countries such as the US and Australia. There has been a decline in secondary transactions for UK retirement homes, but the manager believes this is a short-term issue. McCarthy & Stone can also adapt its business model to emphasise its rental operations, which could generate higher margins. Meanwhile, the company has net cash on its balance sheet.

Pearson remains in FSV's portfolio, and has outperformed during the recent market turmoil. Wright says the company is countercyclical, generally performing better when the economy does badly. It is a stock-specific turnaround story, as around a quarter of its business is in the US higher education market, which has been under significant pressure. However, the company also has a growing digital business with recurring revenues. Wright reduced the Pearson position in H219 to 1.5% of the fund (although it is now larger due to recent outperformance), following changes in the senior management team, as he believes the new CEO and CFO will take time to bed in.

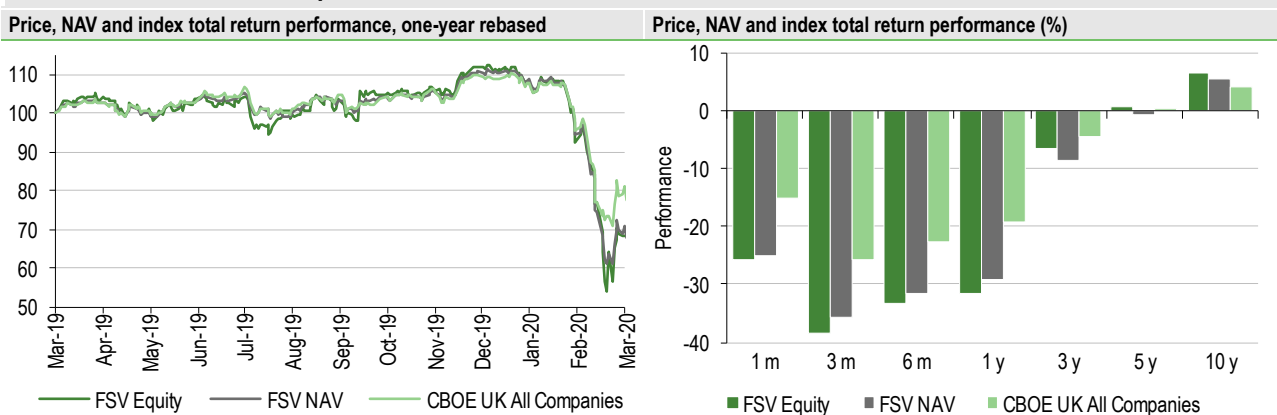
## Performance: Outperformance over the long term

**Exhibit 4: Five-year discrete performance data**

12 months ending	Share price (%)	NAV (%)	CBOE UK All Cos (%)	CBOE UK 100 (%)	CBOE UK 250 (%)	CBOE UK Small Cos (%)
31/03/16	5.5	3.2	(4.1)	(5.2)	4.0	5.3
31/03/17	21.1	21.9	22.6	23.5	14.5	18.9
31/03/18	19.3	7.2	1.2	0.4	5.6	7.0
31/03/19	0.1	1.2	6.2	7.5	(0.9)	(3.1)
31/03/20	(31.5)	(29.2)	(19.1)	(18.6)	(21.7)	(25.3)

Source: Refinitiv. Note: All % on a total return basis in pounds sterling.

**Exhibit 5: Investment trust performance to 31 March 2020**



Source: Refinitiv, Edison Investment Research. Note: Three-, five- and 10-year performance figures annualised.

FSV's relative returns are shown in Exhibit 6, and underline that it has had a tricky period of performance over the last year. However, it has outperformed the broad UK market in both NAV and share price terms over the last 10 years, while its share price has also outperformed over the

last five years. It is notable that the bull market in recent years has been led by growth rather than value stocks and the divergence between these asset classes has grown wider over the last 18 months, which has proved a headwind to FSV's relative performance.

**Exhibit 6: 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 CBOE UK All Cos	(12.6)	(17.3)	(13.7)	(15.3)	(6.0)	2.2	23.3
NAV relative to CBOE UK All Cos	(11.5)	(13.5)	(11.4)	(12.5)	(11.8)	(5.5)	12.2
Price relative to CBOE UK 100	(14.5)	(19.1)	(14.4)	(15.8)	(6.9)	1.6	31.1
NAV relative to CBOE UK 100	(13.5)	(15.3)	(12.1)	(13.0)	(12.6)	(6.1)	19.3
Price relative to CBOE UK 250	(0.8)	(6.6)	(9.4)	(12.5)	(0.2)	7.0	(3.3)
NAV relative to CBOE UK 250	0.4	(2.3)	(6.9)	(9.5)	(6.4)	(1.1)	(12.0)
Price relative to CBOE UK Small Cos	4.2	(7.3)	(11.3)	(8.4)	5.5	7.6	88.4
NAV relative to CBOE UK Small Cos	5.4	(3.0)	(8.8)	(5.3)	(1.0)	(0.5)	71.4

Source: Refinitiv, Edison Investment Research. Note: Data to end-March 2020. Geometric calculation.

Wright explains that as the coronavirus crisis broke, he believed that FSV's portfolio had its highest-ever defensive exposure. However, some of the names that he considered to fit in this category have been disproportionately affected by the lockdown, such as C&C (a drinks distributor and brewer) and Photo-Me (ID photos and laundry machines). In addition, some other businesses that are not particularly affected by the virus have also been indiscriminately sold down by investors, including Babcock (engineering services), ContourGlobal (power generation), Imperial Brands (tobacco), Mylan (generic and speciality pharmaceuticals) and Serco (provider of public services). The manager considers these share price moves to be an overreaction, and has been topping up the trust's positions in the latter group. FSV's overweight exposure to mid- and small-cap companies has also been a headwind to performance, as these firms' shares tend to underperform those of larger corporates in periods of stock market weakness.

**Exhibit 7: NAV total return performance relative to CBOE UK All Cos over three years**

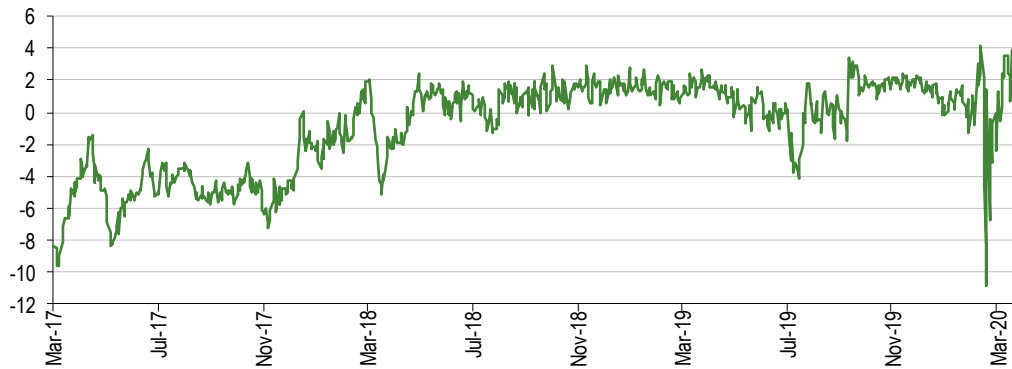


Source: Refinitiv, Edison Investment Research

## Valuation: Recent coronavirus-induced volatility

Similar to many investment trusts, FSV's valuation has been volatile since the coronavirus outbreak. The current 3.9% premium to cum-income NAV compares with the range of a 4.1% premium to a 10.8% discount over the last 12 months. Over the last one, three, five and 10 years, FSV has traded at an average premium of 0.7% and average discounts of 0.9%, 2.5% and 6.0% respectively. The trust's board seeks a single-digit discount or a small premium to NAV in normal market conditions. Renewed annually, it has authority to purchase up to 14.99% and allot up to 10% of FSV's issued share capital. In FY19, c 9.6m shares (c 3.6% of the end-FY18 share base) were issued, raising c £24.2m. As shown in Exhibit 1, allotments have continued at an accelerated pace in FY20; so far, a further c 13.9m shares (c 5.0% of the end-FY19 share base) have been issued, raising c £35.2m.

**Exhibit 8: Share price premium/discount to NAV (including income) over three years (%)**



Source: Refinitiv, Edison Investment Research

## Peer group comparison

FSV is the second largest fund of the 12-strong AIC UK All Companies sector; the peers follow a variety of investment approaches. The trust's NAV total returns are below average over the periods shown, ranking 11th over one year, 11th over three years, ninth over five years and eighth over 10 years. FSV is the only fund currently trading at a premium and it has a higher-than-average ongoing charge, although no performance fee is payable. The trust's level of gearing is above the mean and, unsurprisingly given its focus on capital growth rather than income, it has a below-average dividend yield.

**Exhibit 9: AIC UK All Companies sector as at 17 April 2020\***

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (cum-fair)	Ongoing charge	Perf. fee	Net gearing	Dividend yield
Fidelity Special Values	523.7	(34.3)	(28.2)	(11.1)	57.6	1.1	0.9	No	111	3.2
Artemis Alpha Trust	98.8	(16.3)	(14.2)	(6.3)	17.1	(14.5)	1.0	No	100	2.0
Aurora	111.1	(28.1)	(18.0)	(10.2)	(26.1)	0.0	0.4	Yes	100	2.6
Baillie Gifford UK Growth	237.1	(17.8)	(10.9)	(1.3)	63.4	(6.4)	0.5	No	100	2.8
Henderson Opportunities Trust	56.0	(26.3)	(19.9)	(11.6)	104.2	(18.1)	0.9	Yes	117	3.6
Independent Investment Trust	217.6	(26.7)	(10.6)	39.5	144.2	(7.2)	0.2	No	100	3.3
Invesco Perp Select UK Equity	43.0	(23.5)	(22.6)	(7.8)	106.4	(1.5)	0.9	Yes	107	4.9
JPMorgan Mid Cap	193.9	(27.1)	(18.9)	0.4	128.6	(8.7)	0.9	No	103	3.6
Jupiter UK Growth	27.5	(39.6)	(42.2)	(40.6)	(0.4)	(4.2)	1.2	Yes	106	4.8
Keystone	154.3	(26.4)	(26.2)	(20.7)	57.2	(12.8)	0.5	Yes	112	4.6
Mercantile	1,432.7	(19.7)	(5.9)	13.8	118.6	(0.3)	0.5	No	106	3.6
Schroder UK Mid Cap	148.5	(26.2)	(17.4)	(2.5)	123.0	(7.4)	0.9	No	108	4.4
<b>Average (12 funds)</b>	<b>270.3</b>	<b>(26.0)</b>	<b>(19.6)</b>	<b>(4.9)</b>	<b>74.5</b>	<b>(6.7)</b>	<b>0.7</b>		<b>106</b>	<b>3.6</b>
<b>Trust rank in sector</b>	<b>2</b>	<b>11</b>	<b>11</b>	<b>9</b>	<b>8</b>	<b>1</b>	<b>3</b>		<b>3</b>	<b>9</b>

Source: Morningstar, Edison Investment Research. Note: \*Performance to 16 April 2020 based on ex-par NAV. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

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## New Zealand

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