# 🚯 EDISON

# **Fidelity Asian Values**

# Seeking the small-cap 'winners of tomorrow'

Fidelity Asian Values (FAS) aims to achieve long-term capital growth through investment principally in the stock markets of the Asian region, excluding Japan. It seeks to outperform the MSCI AC Asia ex-Japan Small Cap index mainly via stock selection. The manager, Nitin Bajaj invests in good businesses, run by good managers, trading at attractive valuations. He has a bias towards small-cap value stocks, a sector he believes nurtures 'the winners of tomorrow', before they become well known. Recent performance has disappointed, but FAS has delivered outright gains and outperformance versus its previous and new benchmarks over the long term and pays the highest dividend in its AIC sector.



Source: International Monetary Fund, Edison Investment Research

# The market opportunity

The dominance of mega-cap stocks and momentum strategies in global and Asian markets in recent years has seen value strategies underperform. Valuations of these stocks are presently at generational lows. It is not possible to confidently predict exactly when market sentiment toward value stocks will improve, but investors with a long-term focus may eventually be rewarded for their patience.

# Why consider investing in Fidelity Asian Values?

- A time-tested focus on high-quality small-cap growth stocks.
- Asian smaller companies provide opportunities to express stock picking skills with the support of Fidelity, which has the largest research capability in Asia.
- A complementary strategy to those with an all-China or all-India focus, with a good long-term performance track record.
- A means for UK investors to access potential diversification benefits within their portfolios.
- An attractive and growing dividend.

# Board proactively managing the discount

FAS's discount widened significantly during the recent market downturn, reaching a decade-wide 15.7% on 25 March. However, the board has since repurchased shares and they are currently trading at an 8.9% discount to NAV. The discount has scope to narrow as and when value stocks return to favour with investors.

## Investment trusts Asian equities

		21 July 2020				
Price		336.0p				
Market c	ар	£249.5m				
AUM		£272.7m				
NAV*		368.8p				
Discount to NAV	/	8.9%				
*Including income. A	s at 16 July 2020.					
Yield		2.6%				
Ordinary shares	in issue	74.2m				
Code		FAS				
Primary exchan	LSE					
AIC sector Asia Pacific Smaller Companie						
Benchmark MSCI AC Asia ex-Japan Small Ca						

## Share price/discount performance



## Three-year performance vs index



## Analysts

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## Exhibit 1: Trust at a glance

#### Investment objective and fund background

## **Recent developments**

Fidelity Asian Values aims to generate long-term capital growth principally from the stock markets of the Asia Pacific ex-Japan region. From 1 February 2020, it is benchmarked against the MSCI All Countries Asia ex-Japan Small Cap index (previously the MSCI All Countries Asia ex-Japan index).

29 April 2020: Interim results for the half-year ended 31 January 2020. NAV TR -13.2% versus benchmark TR -3.6%. Share price TR -15.0%.

 30 January 2020: Confirmation of benchmark change to MSCI All Countries Asia ex-Japan Small Cap index, effective 1 February 2020.

Forthcoming		Capital structure		Fund details	3
AGM	December 2020	Ongoing charges	0.98% (FY19)	Group	FIL Investments International
Final results	October 2020	Net gearing	0.0%	Manager	Nitin Bajaj
Year end	31 July	Annual mgmt fee	Variable	Address	Beech Gate, Millfield Lane, Lower
Dividend paid	December	Performance fee	None		Kingswood, Tadworth, Surrey, KT20 6RP
Launch date	13 June 1996	Trust life	Indefinite, subject to vote	Phone	0800 41 41 10 or 0800 41 41 81 (IFAs)
Continuation vote	Five-yearly, next 2021	Loan facilities	None (CFDs used)	Website	fidelity.co.uk/fidelity-asian-values

## Dividend policy and history (financial years)

Dividends are paid annually in December.



Fidelity platform investors (15.7%)

Hargreaves Lansdown (7.0%)

Charles Stanley (5.4%)

Brewin Dolphin (4.2%)

Rathbones (3.8%)

Other (55.5%)

Interactive Investor (5.4%)

Smith & Williamson (3.0%)





## Portfolio exposure by geography (as at 30 June 2020)

Share buyback policy and history (financial years)



## Top 10 holdings (as at 30 June 2020)

Shareholder base (as at 30 June 2020)

			% of NAV		Benchmark	Active weight
Company	Country	Sector	30 June 2020	30 June 2019*	weight (%)	(pp)
Power Grid Corp of India	India	Utilities	2.5	3.8	0.0	2.5
HDFC Bank	India	Financials	2.5	N/A	0.0	2.5
Redington India	India	Information technology	2.1	2.1	0.1	2.0
Granules India	India	Healthcare	2.0	N/A	0.1	1.9
Sinopec Kantons Holdings	China	Energy	1.9	N/A	0.1	1.8
Tianneng Power International	China	Consumer discretionary	1.9	N/A	0.2	1.7
Fufeng Group	China	Materials	1.8	3.0	0.1	1.7
Chaowei Power	China	Consumer Discretionary	1.7	N/A	0.0	1.7
Taiwan Semiconductor MFG	Taiwan	Information Technology	1.7	N/A	0.0	1.7
SK Hynix	South Korea	Information Technology	1.5	1.5	0.0	1.5
Top 10 (% of NAV)			19.6	21.3		

Source: Fidelity Asian Values, Edison Investment Research, Bloomberg, Morningstar. Note: \*N/A where not in end-May 2019 top 10.



# The fund manager: Nitin Bajaj

## The manager's view: Seeking value in cash flows, not dreams

The COVID-19 crisis has changed the value of companies and will adversely affect most businesses says Bajaj. However, it has not changed his approach to investment. 'I am still a cash flow investor, because it is indisputable that the long-term value of any business is driven by its ability to generate free cash flow. I continue to look to buy, business by business – investing in good companies, with high returns on capital, run by competent and honest people, at good prices'. The manager's intention is always to hold for the longer-term. Bajaj looks for stocks which can generate a 50% increase in value over three years. He acknowledges that portfolio returns depend on his skills as a stock picker.

Bajaj is concerned by the ease with which stock markets have dismissed the COVID-19 crisis as a short-term phenomenon. He is doubtful that the global economy will be back to full employment next year, as many expect. 'At the moment, people are not investing in cash flows, they are investing in hype and dreams'. Since well before the outbreak of the virus, stock markets were dominated by the mega-cap growth stocks and momentum strategies. This trend has been exacerbated by the crisis, with the technology and biotech sectors coming into particular favour, often in the absence of evidence to support high and rising valuations. 'Growth stocks haven't been so expensive versus value stocks since 1999. People are psychologically incapable of resisting price rises' says Bajaj.

In this environment, the manager's value approach to investment has proved unpopular. He notes that this year has seen the most significant underperformance of value stocks for twenty years. 'Yet most of the businesses we own have continued to deliver as expected and have generated superior returns on capital and earnings relative to the stock market' says Bajaj. He says it is challenging to explain why, for example, a value stock priced at 6x earnings, is still considered cheap, while a mega-cap company competing in the same markets is valued at 60x earnings, but not considered expensive. Bajaj says many of the portfolio's holdings are subject to similarly irrational valuations.

Although value stocks are presently out of fashion and FAS's near-term performance has lagged accordingly, the manager remains very confident in the philosophy and fundamental logic of his value-driven process. 'It is a time-tested way to invest' he says. Avoiding bubbles and unsustainable valuations is key to long-term compounding, no matter how painful it is in the short-term. In defence of his value approach, he notes that during his 25 years of market experience, small-cap value stocks have grown earnings faster than small-cap growth stocks in every rolling five-year period. 'Over time, the market will reward businesses with high-quality fundamentals. I continue to invest on that basis' Bajaj adds.

'We don't know the future' says the manager, 'and we can't say when the market will turn and view these value stocks more favourably, but we do know probabilities'. And probabilities suggest that Bajaj's approach should continue to pay off for patient investors with a long-term view. In fact, he argues that 'now is a once in a generation opportunity to buy value stocks at such attractive prices'.

# The portfolio

The manager has conducted stress tests to assess the impact of COVID-19 on all portfolio positions and made some pre-emptive adjustments. Most of the businesses held at the beginning of the crisis would have coped with a usual recession, but Bajaj's analysis showed that a few would struggle to cope with forecast revenue declines of 30-50% or heavy debt burdens. His response has been to sell out or materially reduce exposure, including in aircraft leaser BOC Aviation and outdoor apparel and equipment manufacturer Kathmandu Holdings. The recent market sell-off has



also provided the manager with opportunities to buy companies that he has followed and admired for some time, at newly attractive prices. Some of these new acquisitions are companies the portfolio has held previously, but sold, due to their expensive valuations. For example, the manager has built fresh positions in Bapcor, a leading auto parts retailer, in Australia and NZ, and Vinda International, a manufacturer of household paper products. However, there has been no material change to the bulk of the portfolio, as the manager has always focused on investing in 'best in class' businesses, with very well-financed balance sheets, which should weather the crisis and possibly emerge in a better competitive position. He notes in particular Dream International, a Hong Kong-based toy designer, manufacturer and retailer, which is performing very strongly but has so far been overlooked by the market.

The portfolio currently holds about 155 stocks, which is higher than usual, but the manager aims to reduce this to around 100-120 over the next 12-18 months, continuing an ongoing effort to reduce the number of positions. As at the end of June 2020, FAS's top 10 holdings comprised 19.6% of the portfolio, broadly in line with the positioning 12 months previously (Exhibit 1).

Exhibit 2 illustrates FAS's small-cap bias. At the end of June 2020, 57.4% of the portfolio was held in this sector, unchanged from the previous year. Exhibits 3 and 4 illustrate the manager's unconstrained investment approach. Compared to its MSCI All Countries Asia ex-Japan Small Cap benchmark, which FAS adopted on 1 February 2020, the portfolio maintained significant overweights to consumer discretionary (+9.8pp) and financials (+5.5pp), and lesser overweights to consumer staples (+3.2pp), utilities (+2.5pp) and energy (+1.1pp). It was notably underweight real estate (-7.4pp) and information technology (-6.6pp), with smaller underweights to communication services (-2.8pp), healthcare (-2.7pp) and materials (-1.5pp). Over the past year, the most notable shifts in sectoral allocations have been an increase in FAS's overweight to consumer discretionary, reductions to its overweights to financials and utilities and a cut in its underweight to healthcare.

On a geographical basis (Exhibit 3), India and Indonesia have been two of the hardest-hit markets in the region. But the portfolio's overweight to these markets (+6.9pp and +6.8pp, respectively) has been maintained on the manager's view that particular businesses in these two countries have better long-term growth prospects, higher returns on equity and cheaper valuations than similar businesses in other countries. He cites for example, India's national electricity company Power Grid Corporation, which is a defensive business with high visibility earnings from regulated assets and the capacity, according to Bajaj, to maintain its current levels of strong growth over the long term. He also expects HDFC Bank, India's largest private bank, to benefit from strong asset quality and a low cost of funds to finance growth in market share. The Trust is also overweight China (+7.2pp) and Australia (+5.4pp), but significantly underweight Taiwan (-18.4pp) and South Korea (-7.3pp), where high-quality, attractively priced businesses are more difficult to find.

Annual portfolio turnover has increased to 45%, up from the usual 30-40% range as the manager has reduced exposures to businesses vulnerable to the crisis and taken opportunities to initiate positions at attractive prices. Short positions have been reduced over recent months and currently represent about 2.5% of the portfolio, comprising six small positions.

	Portfolio end- June 2020	Portfolio end- June 2019	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)				
>£10bn	13.2	16.0	(2.8)	0.0	13.2	1.2				
£5-10bn	6.0	0.8	5.2	0.6	5.4	0.2				
£1-5bn	20.4	25.7	(5.3)	41.6	(21.2)	(1.2)				
£0-1bn	57.4	57.4	0.0	54.9	2.5	23.0				
Other index/unclassified*	3.0	0.1	2.9	2.9	0.1	1.1				
Total equity exposure	100.0	100.0		100.0						

## Exhibit 2: Portfolio exposure by market cap (% unless stated)

Source: Fidelity Asian Values, Edison Investment Research. Note: \*Includes short positions.



## Exhibit 3: Portfolio geographic exposure vs benchmark (% unless stated)

	Portfolio end- 30 June 2020	Portfolio end- 30 June 2019	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
China	21.7	19.6	2.1	14.5	7.2	1.5
India	19.7	21.8	(2.0)	12.8	6.9	1.5
South Korea	11.9	8.7	3.2	19.2	(7.3)	0.6
Indonesia	8.9	10.8	(1.9)	2.1	6.8	4.2
Taiwan	8.7	10.0	(1.4)	27.1	(18.4)	0.3
Hong Kong	7.7	5.5	2.2	7.5	0.2	1.0
Other	6.3	6.9	(0.6)	8.8	(2.5)	0.7
Australia	5.4	3.2	2.1	0.0	5.4	N/A
Singapore	3.4	4.8	(1.4)	7.0	(3.6)	0.5
USA	3.4	N/S	N/A	0.0	3.4	N/A
Philippines	2.9	5.5	(2.7)	0.9	2.0	3.2
Thailand	N/S	3.1	N/A	N/S	N/A	N/A
	100.0	100.0		100.0		

Source: Fidelity Asian Values, Edison Investment Research. Note: N/S is not separately stated.

## Exhibit 4: Portfolio sector exposure vs benchmark (% unless stated)

	Portfolio end- 30 June 2020	Portfolio end- 30 June 2019	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
Consumer discretionary	23.5	17.5	6.1	13.7	9.8	1.7
Information technology	14.1	13.3	0.8	20.7	(6.6)	0.7
Financials	12.6	16.5	(3.9)	7.1	5.5	1.8
Industrials	11.7	13.4	(1.7)	12.7	(1.0)	0.9
Healthcare	8.8	6.1	2.7	11.5	(2.7)	0.8
Consumer staples	8.4	6.5	1.9	5.2	3.2	1.6
Materials	7.2	6.6	0.6	8.7	(1.5)	0.8
Utilities	4.9	8.5	(3.6)	2.4	2.5	2.0
Real estate	4.5	4.9	(0.5)	11.9	(7.4)	0.4
Energy	2.7	4.4	(1.7)	1.6	1.1	1.7
Communication services	1.7	2.3	(0.6)	4.5	(2.8)	0.4
	100.0	100.0	. ,	100.0	. ,	

Source: Fidelity Asian Values, Edison Investment Research

# Performance: Long-term outperformance

## Exhibit 5: Five-year discrete performance data

12 months ending	Share price (%)	NAV (%)	Blended Benchmark (%)*	MSCI AC Asia ex-Japan (%)	MSCI AC Asia ex- Japan Small cap (%)	CBOE UK All Companies (%)
30/06/16	19.3	24.1	3.1	3.9	0.4	1.7
30/06/17	35.6	20.9	30.8	30.8	19.3	18.3
30/06/18	6.3	2.2	8.4	8.4	5.2	9.5
30/06/19	10.0	8.2	3.6	3.6	(4.2)	0.3
30/06/20	(25.9)	(15.7)	5.0	5.0	(1.6)	(13.6)

Source: Refinitiv. 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 ex-Japan to 31 January 2020. From 1 February 2020 the benchmark is MSCI AC Asia ex-Japan Small Cap index.

As Exhibit 6 (RHS) shows, FAS has delivered outright gains over five- and 10-year periods. It has outperformed its recently adopted benchmark (MSCI AC ex-Japan Small Cap index) over five and 10 years. UK investors may be interested to note that FAS has also outperformed the UK market over five and 10 years (Exhibit 7). However, its recent performance has been disappointing. This is due in part to the fact that the trust's small-cap bias and value style have been out of favour with investors, as large growth companies, particularly large-cap technology stocks, which the fund does not hold, have been the major driver of Asian share price returns.

Even within the small-cap index, there has been significant divergence in recent performance between individual markets. Hong Kong, China, Korea and Taiwan have outperformed India and Indonesia. The fund's overweight exposures to Indian and Indonesian stocks have detracted from relative performance and stock selection in these countries has also been a drag. These adverse



effects on returns have been partially offset by positive contributions from stock selection in Singapore, Malaysia and Vietnam and in real estate and materials.



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

## Exhibit 7: 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	(1.7)	(7.2)	(23.2)	(29.5)	(26.6)	(11.9)	(10.3)
NAV relative to blended benchmark	0.5	3.5	(12.1)	(19.7)	(20.9)	(11.9)	(9.3)
Price relative to MSCI AC Asia ex-Japan	(1.7)	(7.2)	(23.2)	(29.5)	(26.6)	(12.6)	(8.3)
NAV relative to MSCI AC Asia ex-Japan	0.5	3.5	(12.1)	(19.7)	(20.9)	(12.6)	(7.3)
Price relative to MSCI AC Asia ex-Japan Small Cap	(1.9)	(14.1)	(21.7)	(24.7)	(12.6)	18.0	28.3
NAV relative to MSCI AC Asia Ex-Japan Small Cap	0.3	(4.3)	(10.4)	(14.3)	(5.9)	18.0	29.7
Price relative to CBOE UK All Companies	4.6	(1.3)	(4.3)	(14.3)	(8.7)	22.6	5.6
NAV relative to CBOE UK All Companies	7.0	10.0	9.6	(2.4)	(1.7)	22.6	6.7

Source: Refinitiv, Edison Investment Research. Note: Data to end-30 June 2020. Geometric calculation.

# Valuation: Discount actively managed

In normal market conditions, FAS's share price often trades close to NAV. However, recent market turbulence saw the discount widen sharply to 15.7% in late March (Exhibit 8). Over the past year, FAS has traded at an average discount of 1.6%, compared with average discounts of 1.6%, 4.8% and 7.5% in the past three, five and 10 years respectively. The current share price discount to cumincome NAV is 8.9%.

The board has authority, renewed annually, to repurchase up to 14.99% of shares in issue and allot up to 10% in issue. The board uses this authority to actively manage the discount. Since late March 2020, it has repurchased a total of 1.3m shares (1.8% of the share base).



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

Source: Refinitiv, Edison Investment Research



# Peer group comparison

Due to its small-cap exposure, FAS is now classified as a member of the AIC Asia Pacific Smaller Companies sector, as opposed to the AIC Asia Pacific sector. Exhibit 9 shows that the fund's NAV total returns rank second over one- and three-year periods, first over five years and third over 10 years. Its discount of 8.9% is the narrowest and its ongoing charge of 1.0% is competitive with its peers. No performance fee is payable. Its gearing level is in line with the average of its peers and it pays the highest dividend in the sector, 0.8pp above the average.

Anish 3. Alo Asia Facine Sinaner Companies Sector as at 175019 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 Asian Values Ord	249.4	4 (15.1)	(5.9)	43.2	107.2	(8.9)	1.0	Yes	101	2.6
Aberdeen Standard Asia Focus Ord	322.0	) (11.7)	(1.8)	33.0	136.8	(13.7)	1.2	No	101	1.5
Scottish Oriental Smaller Cos Ord	247.	7 (18.6)	(14.2)	14.6	112.7	(14.1)	1.0	Yes	100	1.4
Average (3 funds)	273.	1 (15.1)	(7.3)	30.3	118.9	(13.0)	1.0		101	1.8
Trust rank in sector		2 2	2	1	3					

Exhibit 9: AIC Asia Pacific Smaller Companies sector as at 17July	2020*
Exhibit 5. Alc Asia Facilic Sinaller Companies Sector as at 17 July	2020

Source: Morningstar, Edison Investment Research. Note: \*Performance to 16 July 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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