FIDELITY EUROPEAN TRUST PLC

Eight questions for the AGM on 10 May 2022

In this note, we ask eight questions that we would put to the board at the forthcoming AGM on 10 May 2022. Given the extraordinary bull run in most global equity markets since the 2008 GFC and fears around a resurgence in inflation, a lot of this note and the questions will focus on the rapidly changing landscape, and how the fund has coped with periods of uncertainty and instability in the past. Hence, we look at FEV's long-term track record, and remind investors of its philosophy and process.

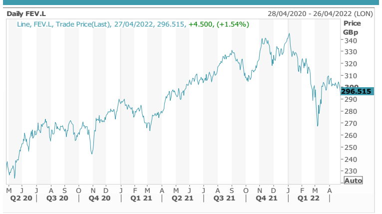
- **Bottom-up focus:** Nobody has a crystal ball, and trying to forecast variables such as inflation, interest rates and market returns is a bit of a fool's game. By focusing on stock-picking and downside risk, FEV has managed to successfully navigate extreme market turbulence in the past.
- **Investment discipline:** FEV's key investment tenets around dividend growth are bottom-up stock-picking, a long-term focus (two to five years' forecast horizon) and low turnover (typically around 20%-30% p.a.). This discipline through different market cycles has meant only short periods of underperformance.
- **Valuation:** 99.9% of investments are valued using quoted prices in active markets (95% is realisable within five days)). The NAV is "real" – so any discount is anomalous. The current discount of 8.5% is below long-run averages, and is in line with FEV's peer group, despite the better performance.
- **Risks:** FEV has seen periods of underperformance when its investment style has been out of favour – typically when the market's preference has been for lower-quality, more cyclical stocks. Worries around performance are bound to resurface, given the current rotation, as well as the outlook for interest rates and inflation.
- **Investment summary:** FEV has outperformed its peers, benchmarks and UK indices over most time periods. Sentiment to Europe may vary – although we believe there is a perception vs. reality issue here. The current market jitters may lead to some return volatility, but, in our view, FEV's long-term track record in a wide range of market conditions should reassure investors that the fund will not be deviating from its tried and tested long-term process and philosophy.

Financial summary and valuation

Year-end Dec (£000)	2019	2020	2021	2022E	2023E	2024E
Gains & losses on investments	183,944	89,664	221,090	130,653	157,495	184,122
Gains & losses on derivatives	17,516	2,768	38,145	38,145	38,145	38,145
Income	34,201	25,552	37,879	47,353	57,082	66,733
Investment mgt. fees	(8,476)	(8,899)	(9,751)	(10,162)	(12,250)	(14,321)
Other expenses	(857)	(845)	(908)	(908)	(908)	(908)
Investments	1,109	1,201	1,448	1,587	1,750	2,046
Cash	9,490	7,070	11,366	11,366	11,366	11,366
NAV (£m)	1,141	1,220	1,474	1,613	1,776	2,072
NAV per share (p)	2.77	2.97	3.59	4.01	4.47	5.39
Discount to NAV*	-6%	-4%	-5.2%	-25%	-33%	-45%
Yield	2.0%	2.1%	2.0%	2.9%	2.9%	2.9%
Dividend (p)	6.47	6.50	6.83	8.89	8.89	8.89

**2018-21 NAV on year-end s/p, 2022-3E NAV on current s/p; Source: Hardman & Co Research*

Closed End Investments



Source: Refinitiv

Market data

EPIC/TKR	**FEV**
Price (p)	**298.5**
12m high (p)	384.2
12m low (p)	256.5
Shares (m)	411
Mkt cap (£m)	1,266.83
NAV (25 Apr, p)	329.33
Discount to NAV	8.5%
Country of listing	UK
Market	STMM

Description

Fidelity European Trust (FEV) aims to achieve long-term capital growth by investing predominantly in equities and their related securities of European companies.

Company information

Chairman	Vivian Bazalgette
NEDs	Marion Sears (SID), Paul Yates, Fleur Meijs, Milyae Park, Sir Ivan Rogers
Fund Managers	Sam Morse (lead), Marcel Stotzel (co)

Contact FIL-FidelityInvestmentTrusts@fil.com
investment-trusts.fidelity.co.uk/fidelity-europe-trust/

Key shareholders

Fidelity Platform/HL/II	25%
Allspring Global	9%
Quilter Cheviot IM	7%
Rathbones	6%
Smith & Williamson WM	4%
Brewin Dolphin	4%

Diary

10 May	AGM

Analyst

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Q1: How badly will the fund be affected by the recent events in Ukraine?

Increased risk aversion in equity markets, due to Russian invasion of Ukraine

Since Russian troops moved into Ukraine at the end of February, risk aversion in global equity markets has risen substantially. The proximity to western Europe, and the fears that the conflict could spread to some NATO countries and turn into a wider conflict involving most of western Europe, has meant that European markets suffered the worst of the sell-off in the week soon after the invasion. In our view, if any one NATO member is affected, then the whole alliance and, by definition, the whole of western Europe, will be involved, notwithstanding any long-term positives for the region.

Economic impact of conflict could be long and deep

Even if this scenario does not unfold, and the conflict ends up being resolved fairly quickly and remains geographically contained, the spillover effects to most western European economies will be substantial – be they material or psychological. The economic impact of war tends to send ripples far and wide, and we have already seen the largest European migration since WW2.

Russia and Ukraine are also an important part of global commodity markets. These are not just the obvious commodities, such as wheat, oil and gas, but also rare gases for semiconductor chip production, and other important raw materials, such as the chemicals used for fertilisers.

Peace dividend of past 30 years has now gone

What it does mean for Europe in the short term is that, in our view, the peace dividend of the past 30 years has now gone. This will mean much higher defence budgets for most countries, which are already struggling with the cost of the pandemic. Higher commodity prices and friction in international trade could also mean higher inflation for longer. Overall, this raises serious questions about a post-COVID-19 recovery, and increases the spectre of possible stagflation.

YTD performance already reflecting sell-off, with FEV down 12.3% as of 25 April

YTD, the fund is now down 12.3%, slightly underperforming its benchmark, which is down 9.2%. On a one-year basis, it is still up 5.4%, outperforming its peers in the sector. The 52-week range (high/low) is £384.2/£256.5, a difference of 49%, demonstrating the volatility that the fund and European markets have endured over the past 12 months (see Q4 below).The discount to NAV now stands at 8.5%, slightly below the peer average of 9%, which we think is too close, given the much better short- and long-term track record.

FEV is well-diversified, with no big exposures to one sector, and this should help in turbulent markets

As we mentioned in our *initiation note* (September 2021), the portfolio is fairly concentrated, historically, at between 40 and 50 diversified stocks, with no bias to a particular sector or company size. Looking at the top 10 absolute positions to 25 April 2022, there have been some stocks that have gone down in line with the index, or have even performed worse than the index (LVMH -16%, ASML -26%, L'Oréal -20%), but there have been other stocks that have performed much better than the index (Deutsche Boerse +11%, Sanofi +13%). The fund is also not invested in some of the biggest names in the index, which have sold off quite sharply (Siemens -29%, Richemont -20%, Schneider -21%). (Numbers as of 25 April 2022.)

Overall, the fund is well-diversified by sector and country, with no sector accounting for more than 22% on an absolute basis, and no sector bigger than 4% on a relative basis. The well-diversified nature of the fund should stand it in good stead for these turbulent markets. Looking at the performance YTD, since the Russian invasion of Ukraine, and the subsequent sell-off in equity markets, there does not seem to be any obvious discernible pattern in what is driving markets. Financials certainly seem to have suffered the most in the initial sell-off (the fund is overweight in financials by 5.6%); however, overall, a lot of the stocks taking a big hit are the ones that have high valuations (highly rated or expensive, depending on various opinions) and that have been very good performers in recent years. Healthcare (where FEV is overweight by 1.8%) and energy (where FEV is slightly underweight at -0.7%) seem to be two of the better-performing sectors at the moment.

Q2: Given the outlook for inflation and rising rates, what is the fund's overall stance?

30-year bull run may be coming to an end

The past 30 years have been an extraordinary period for global financial markets, and for both equities and fixed income products. Despite two of the largest sell-offs since the 1930s (following the tech bust at the turn of the century and the 2008 GFC), many markets have now been on a strong upward trend for the best part of three decades. Equity markets and valuations have, in many cases, been hitting, or are close to hitting, all-time highs.

Nobody has a crystal ball but, given outlook currently, would FEV be gloomy, cautious or cautiously optimistic?

This long equity market bull run, fuelled by low rates, was never going to be sustainable, despite the protestations by some who believed that technology was ushering in a new golden dawn of equity investments, driven by a digital revolution akin to the industrial revolution of the 19th century. But now the tide seems to be turning: inflationary expectations and actual numbers are on the way up, and we could be at a turning point. Could this entail a big rotation away from growth stocks, and even from equities as an asset class? What does it mean for equity markets, and, in particular, what does it mean for FEV?

What general picture emerges from the bottom-up analysis of your companies and from your meetings with management?

Given FEV's process and philosophy, it was always going to be sensitive to the market's appetite for growth and would likely suffer in relative terms were there to be a sharp rotation from growth into value. Historically, one factor driving this trend can be inflationary expectations. Given that inflation is currently at elevated levels, any nervousness among investors is perfectly understandable. The impact of the war in Ukraine on global commodity prices and trade is also a big concern. Higher commodity prices, as well as more friction on global supply chains and trade, could mean inflation remains higher for longer than was anticipated before the start of the conflict.

Q3: Do you think the earnings outlook for your stocks can counter the negative effects of rising inflation?

FEV's underlying philosophy is that good dividend growers outperform over time. Stock selection, with a focus on dividend growth, means positive company fundamentals in structural growth markets; good examples are digitalisation, ecommerce and, increasingly, a focus on B2B technology in Europe. This, by definition, also means businesses with a disciplined use of capital and strong business models. The latter also implies stronger pricing power than the average business, and particularly those of a more cyclical nature, which tend to be price-takers, rather than price-setters.

Q4: Would a sharp style and subsequent sector rotation concern you?

Can you give us some examples of stocks where their strength as price-setters was one of the key variables to buy and/or to remain invested?

FEV's historical performance indicates we can feel relatively reassured that it has navigated periods of turbulence before becoming relatively successful, and there is no reason to believe that it cannot do so again.

FEV invests in companies with sustainable and growing dividends, and these are more likely to be defensive

We believe that the time when FEV would be most exposed to a risk of relative underperformance would be in the event of a sharp rally in depressed cyclical stocks, when deep value is preferred over other investments. Given the fund's dividend GARP style, the current inflationary pressures evident in most European economies, and the sell-off in many long-duration growth stocks, we would expect the current economic situation to be the kind where FEV could struggle on a relative basis, particularly vis-à-vis more momentum-driven, trading-oriented strategies, or old-fashioned value funds. The 12.3% fall YTD (25 April) could certainly presage a tough few months ahead.

We analysed FEV's philosophy and process in detail in our initiation note, but it is worth reiterating the key investment tenets around the strategy, which is centred around dividend growth:

- bottom-up stock-picking;
- long-term focus (two to five years' forecast horizon); and
- low turnover (typically around 20%-30% p.a.).

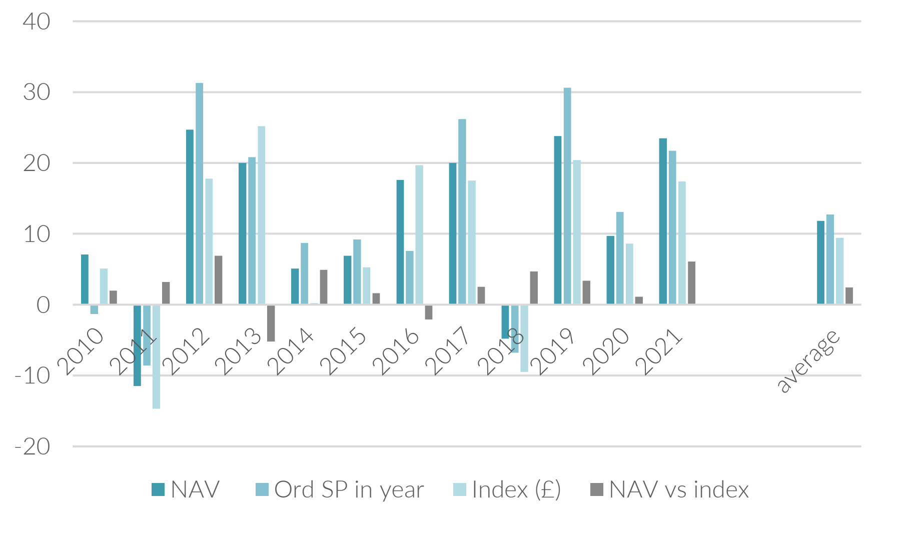
This discipline through different market cycles has meant only short periods of underperformance (as we will see in the section below). By focusing on its stock-picking and downside risk, FEV has managed to successfully navigate extreme market turbulence in the past.

The one area touched on in our initiation note was the volatility of returns. We would expect this to continue, but this is more of an asset class issue than a FEV-specific one. With inflationary pressures building and following one of the strongest bull markets in living memory, we would expect a bumpy ride going forward.

Over FY'10-FY'21, NAV average annual return was 11.8%, but ranged from -11.5% to +24.7% (and share price averaged 12.7%, with range of -8.6% to +31.3%).

The chart below shows the volatility of returns in the NAV, share price and index for FY'10-FY'21. While, over this period, the NAV average annual return was 11.8%, it ranged from -11.5% to +24.7% (and the share price averaged 12.7%, with a range of -8.6% to +31.3%).

FEV's NAV, share price and benchmark total returns (%)



Source: FEV Report and Accounts, Hardman & Co Research

As Warren Buffet likes to remind investors: "It is only when the tide goes out, that you find out who has been swimming naked". In that respect, we feel confident that FEV should emerge fully clothed.

Q5: How did you cope in previous periods of risk aversion, and sell-offs?

Let us remind ourselves of what has happened in the past, as this is not the first time that we have seen market turbulence, pull-backs, or turning points, and it certainly won't be the last.

FEV outperformed in 2021, and is still outperforming on a rolling 12-month basis.

To end-December 2021, FEV's NAV annualised growth beat the index by 6.1% over one year, and it has now beaten the index by 4.6% on an annual basis since inception in 1991. On a rolling 12-month basis, as of 21 April, the fund recorded NAV and share price returns of 6.49% and 6.59%, respectively, compared with 2.4% for the index.

FEV management has been very stable

Let us also stress that the management of FEV has been very stable over the last 30 years, with only four different managers over that period. The current manager can now boast to have beaten the index in nine years out of the eleven that he has managed the fund.

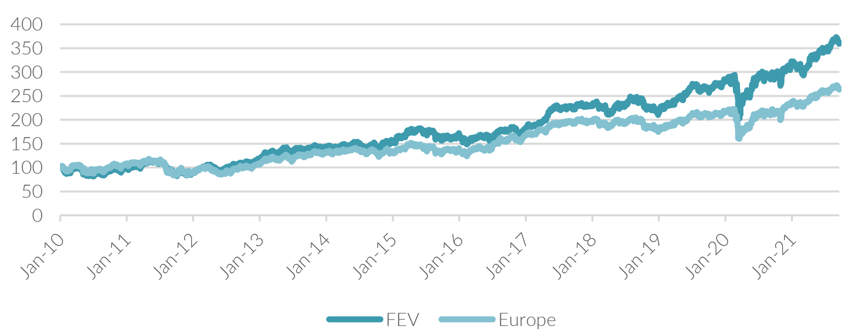
FEV has underperformed benchmark index in only two calendar years of last 11

Over the last 11 calendar years (from 2011 to 2021 inclusive), the fund has underperformed the benchmark index in only two years: 2013 (NAV +20.0% vs. index +25.2%) and 2016 (NAV +17.6% vs. index +19.7%). It would probably be natural to assume that, given the manager's targeted aim of beating the index consistently by around 1%-2% p.a. (but not necessarily shooting the lights out), the fund would suffer in periods of very strong markets, particularly in the event of a sharp rally in depressed cyclical stocks. However, the fund outperformed by 3.4% in 2019, when the index was up 20.4%, and also outperformed in 2017, by 2.5%, and in 2012, by 6.9%, when the index was up by 17.5% and 17.8%, respectively.

FEV has managed to outperform in negative, as well as positive, markets

The fund has managed to relatively outperform in down years as well. In 2011, with the index down by 14.7%, the fund was down only 11.5%, while, in 2018, with the index down by 9.5%, the fund was down only 4.8%. So, FEV has manged to prove relatively defensive, even in down markets.

FEV has outperformed against European markets



Source: FEV Report and Accounts, Hardman & Co Research

Academic studies have shown that, over time, even the best active funds will tend to have at least two to three years of relative underperformance over a decade. In that respect, FEV is no different. Hence, despite the current concerns, we believe

FEV's philosophy and process have stood the test of time, and, while concerns about the current outlook for equity markets are perfectly reasonable, given the circumstances, we believe FEV is relatively well-positioned to continue outperforming over the long term.

Q6: What new ideas or themes has the pandemic thrown up over the past two years? Can you give us some recent examples to illustrate this?

Has the pandemic thrown up new ideas or themes?

Many things have changed since the start of the pandemic, for both consumers and businesses, not to mention office workers. Some trends that were already growing have accelerated, and some things may never go back to how they were pre-pandemic. In that respect, have the past two years since the start of the pandemic thrown up any new ideas or themes? Digitalisation and ecommerce have been two areas where the portfolio managers have been finding some new ideas, and, whereas the US has been at the forefront of B2C innovation and commercialisation, Europe seems to be at the forefront of the B2B market – and this is another area of interest.

Regular re-evaluation of investment thesis

FEV regularly revisits the investment thesis of every investment, at least quarterly, and *ad hoc* on major developments, reviewing the key screening criteria, the "three reasons to hold" sheet and the expected total shareholder return (TSR) table.

The main drivers for selling a position are when the core investment thesis has changed, with a sustained change in dividend prospects being a good indicator.

Q7: How important are the Fidelity analysts, and Fidelity's global research effort in your process?

How often do the analysts or the fund managers meet with companies in which you are invested, and how many meetings are done annually by the PMs and analysts?

As of December 2021, Fidelity has a team of 32 research analysts covering Europe, and has access to the global resource of sustainable investing and shorting, as well as quant and technical analysts. This global network is a huge competitive advantage compared with its peers, and helps FEV put its European ideas into a wider global context. The research analysts are seen by many fund managers as the unsung heroes of many of Fidelity's funds, and are a huge differentiating factor compared with many other fund management institutions,

How important are company meetings in the investment process?

Remember that, although FEV is a European fund, European sales account for just over a third of FEV's investee companies' revenues – slightly less than the index overall. Therefore, although European in name, and by domicile, around two thirds of the portfolio's revenues are global, and hence more international. This ties in with the globalisation of the past 30 years, and presses home the importance of the global reach of its analysts. Many of the stocks in FEV's portfolio are world-beaters or global champions in their respective fields.

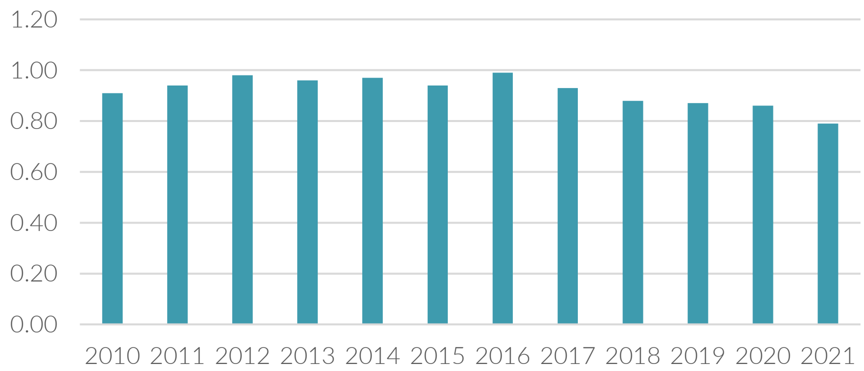
Q8: Industry trends – what is the situation with fees and active share?

Ongoing fee pressure across whole industry, as passive investments make further inroads

Ongoing charges have fallen sequentially every year since 2016, with the largest element being the investment management fee. From April 2021, Fidelity cut the rate of 0.75% that it was charging on assets in excess of £400m to 0.65%, saving investors ca.£0.8m a year. With the growth of passive investments not relenting, we expect fees to remain under pressure. As at the end of April, the sector average ongoing charge was 0.92%.

Relative to the sector, FEV's ongoing charges are slightly below the average on the AIC basis, at 0.79%, as of the end of April. While below previous years, there does seem to be a bit of a levelling off over the more recent years.

FEV's ongoing charges (%)



Source: FEV Report and Accounts, Hardman & Co Research

Focus on active share: would FEV benefit from being even more concentrated?

The other effect that the growth of passive investments is having on the industry, and on active funds in particular, is to illuminate closet-indexers, or funds that charge active fees for not doing much more than replicating the index by having a large number of stocks in their funds. This can easily be measured by the active share of a fund, which shows you how closely the fund is tracking the index, and how much is, by contrast, genuinely active.

While FEV is relatively concentrated, particularly compared with many of its competitors, and holds only 40-50 investments, it does raise the question of whether the fund should move to an even more concentrated number of investments, given that most academic studies seem to suggest that benefits of diversification tend to start dissipating after 15-20 stocks. On the other hand, 40-50 stocks seems to be a substantial number of investments, providing investors with a good risk-return profile over the fund's history, and also providing ample diversification without diluting the performance. At the same time, it gives the portfolio managers ample room for manoeuvre without feeling too constrained by a subjective number.

Portfolio

Historical sector split

The table below shows the evolution of the portfolio by sector over the past five years. There have been relatively few changes, which is unsurprising, given the long-term focus of the fund. Financial services, healthcare, industrials and technology are the biggest overweights relative to the index.

Gross asset exposure as percentage of net assets by sector, 2017 to March 2022

	2017	2018	2019	2020	2021	March'22	Benchmark
Consumer goods	18.7	17.1	18.8	20.7	*	*	*
Financial services	5.6	5.3	8.9	9.9	10.1	22.0	16.4
Other financials (incl. banks/insurance)	15.6	13.5	11.5	10.1	13.3	combined	combined
Healthcare	18.8	20.3	19.5	19.7	17.6	18.5	16.7
Industrials	19.1	19.1	15.7	16.2	19.5	19.3	17.3
Technology	11.2	10.1	11.3	14.0	13.8	12.6	8.9
Basic industries	7.2	6.0	6.2	6.3	6.0	5.1	5.0
Consumer services	6.6	4.8	3.5	4.6	*	*	*
Utilities	2.0	2.9	1.0	4.5	3.1	2.9	4.2
Oil & Gas	7.0	8.0	7.0	3.2	3.2	n/d	n/d
Telecoms	1.4	3.0	3.7	2.6	1.8	1.8	3.6
Total	**113.2**	**110.1**	**107.1**	**111.8**	**111.1**	**112.5**	**100**

**Factsheet disclosure shows consumer discretionary at 13,4% (index 12.5%) and consumer staples at 10.1% (index 9.5%)*

Source: FEV Report and Accounts, Hardman & Co Research

Historical geographical split

The table below shows the evolution of the portfolio by country over the past five years. There have been relatively few changes (again unsurprising, given the long-term focus).

Gross asset exposure as percentage of net assets by country, 2017 to March 2022

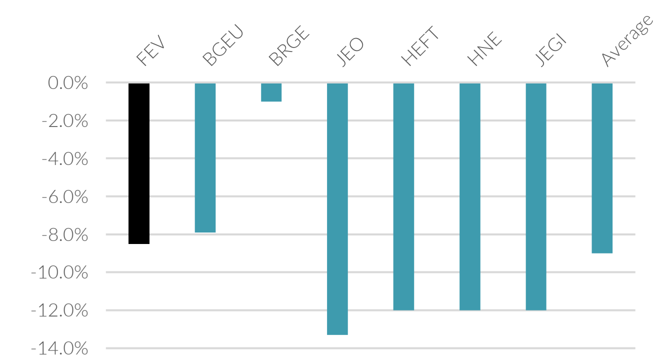
	2017	2018	2019	2020	2021	March'22	Benchmark
France	31.6	30.1	29.0	29.7	30.3	29.7	21.8
Switzerland	17.3	18.0	18.9	25.0	25.3	24.9	20.7
Germany	19.2	13.7	19.6	17.4	13.9	11.1	16.9
Netherlands	8.8	8.6	6.1	7.6	7.9	7.1	8.8
Italy	5.1	4.9	4.7	5.9	5.7	5.7	5.2
Norway	4.3	5.2	5.4	4.9	n/d	3.5	1.8
Sweden	n/d	n/d	3.7	3.9	5.9	6.1	7.1
Denmark	4.9	4.2	n/d	4.2	4.5	4.8	5.2
Spain	5.5	6.5	4.8	4.2	3.9	4.0	4.8
UK	n/d	3.4	4.7	3.7	4.5	4.5	0
Finland	5.2	5.7	3.4	n/d	3.6	n/d	n/d
Others/unclassified	11.3	9.8	6.8	5.3	5.6	11.1	7.6
Total	**113.2**	**110.1**	**107.1**	**111.8**	**111.1**	**112.5**	**100**

Source: FEV Report and Accounts, Hardman & Co Research

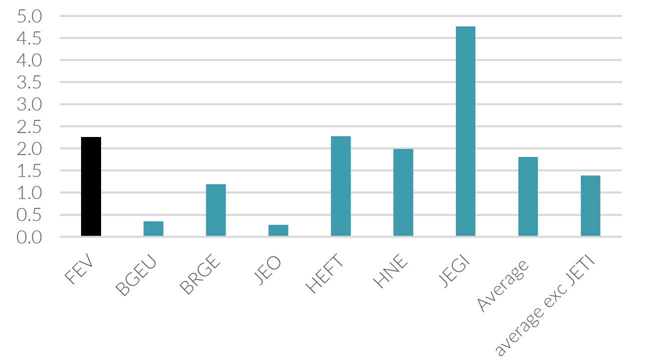
Valuation

As can be seen in the charts below, FEV's discount to NAV is broadly in line with that of its peers in the AIC Europe sub-sector, while its dividend yield is above the average of the sector. It is worth noting that, since we wrote our initiation report on the fund, there are now only seven funds in the sector, as JPMorgan merged its two funds JPMorgan European Growth (JETG) and JPMorgan European Income (JETI) into one fund – JPMorgan European Growth and Income (JEGI).

FEV and peers' discount to NAV (%)



FEV and peers' dividend yield (%)

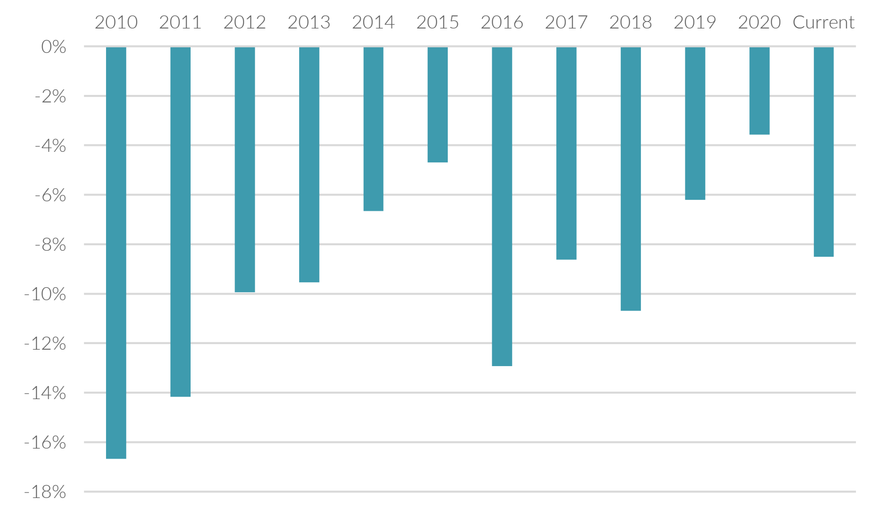


Source: NAV announcements LSE, dated 21 April 2022, Hardman & Co Research

Current discount to NAV slightly higher than seen in past couple of years, reflecting recent rise in risk aversion

As can be seen in the chart below, FEV's discount to NAV has been trending at low- to mid-single-digit levels, and is currently slightly above this level, at 8.5% (25 April), reflecting the latest rise in risk aversion following the events in Ukraine. The discount is, however, in line with the levels of the past 10 years.

FEV's historical discount to NAV (at end-Dec) and latest



Source: FEV Report and Accounts, NAV announcements LSE, dated 21 April 2022, Hardman & Co Research

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The full detail is on page 26 of the full directive, which can be accessed here: https://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-2031-EN-F1-1.PDF

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