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Arun Mehra

Portfolio Manager

Arun Mehra joined Fidelity in 1997 as an Investment Analyst in Hong Kong. He covered a number of sectors and managed various Indian equity portfolios before becoming fund manager of Fidelity Funds India Focus Fund in 2006. Arun has a Bachelor of Engineering from the University of Delhi, a Master of Science from the University of Arizona and a Master of Business Administration from the University of Chicago.

TOP TEN HOLDINGS (%)

as at 30.06.07

	Fund	BM
Hindustan Unilever	5.5	2.2
Financial Tech	4.8	-
State Bank of India	4.7	1.1
Infosys Technology	4.2	11.3
United Spirits	3.7	-
Reliance Industries	3.2	14.0
Bajaj Auto	3.0	0.9
Cipla	2.8	0.9
Zee Entertainment	2.2	0.8
ICICI Bank	2.0	7.8

FIDELITY FUNDS INDIA FOCUS FUND

India's structural positives coming to the fore

In this Talking Point, FF India Focus portfolio manager Arun Mehra gives his views on the outlook for India. He goes on to identify some of the key drivers behind the continued performance of Indian equities and how he exploits these opportunities within his portfolio.

HOW WOULD YOU DESCRIBE YOUR INVESTMENT PROCESS?

Using Fidelity's team of analysts in addition to my own research, I try to find companies with strong earnings growth (either emerging or unrecognised), before others do and before the market prices in a growth premium. There are two key aspects to my investment approach: I focus on long-term growth stories and I am very conscious of valuations. I want to own businesses that have the potential to deliver superior earnings growth over a one- to two-year time horizon, so I look for companies that cater to India's long term growth trends. I look for 'special situation' stocks and companies with core growth potential – the sort of stocks which are going to grow at 10% to 15% a year. Valuation is the second key consideration in my stock selection and portfolio construction process. Everything has a price and rather than buying 'winners' and momentum stocks, I try to buy early and to sell when the market reflects the inherent value. I can take significant active positions in stocks in which I have strong conviction and I am not constrained by the benchmark or by any target weights.

WHAT THEMES ARE CURRENTLY DRIVING INDIA'S EQUITY MARKETS?

India remains a long-term growth story. Take infrastructure, for example. India needs major infrastructure investment and the government's newly created Investment Commission has recommended lifting restrictions on foreign direct investment in strategic sectors. There are large cities in almost every state that are planning to build mass transit systems, as well as other transportation links. This is creating significant opportunities for companies involved in infrastructure projects. We are also finding interesting opportunities in the mining sector as it is now being opened up to private players and attracts corporate capex. The consumer sector has also expanded with the growth of urban areas and the boom in service industries, largely benefiting retailers and entertainment companies.

Market performance reflects corporate earnings and I see no reason why that should not continue. I think we'll continue to see very strong double digit earnings growth and, with the market trading at 17x March 2008 earnings, I think there is more upside to come.

There are very few India-specific factors that would cause the market to correct. If there happens to be a global correction, then I'm sure India will correct with the global market. Having said that, over the shorter-term, glitches in the corporate or macro landscape may lead to some market volatility and I would use any such correction as a buying opportunity.

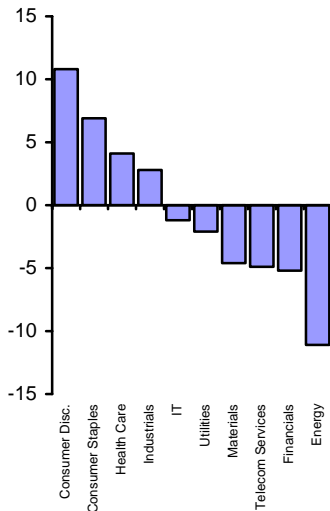
HOW IS THE FUND CURRENTLY POSITIONED?

Recently, I have made a couple of changes to the portfolio. I think this strategy has worked well with the fund returning 1st quartile performance year to date of 20.6%, versus the benchmark return of 16.8%. A longer time horizon sees the fund 1st quartile over one year and ranked 7 out of 27 funds since launch (23.08.04), making it 2nd quartile. I have taken profits and sold down a number of stocks that have performed well. Many were in the media sector or were mid-cap stocks. I have re-invested the proceeds into sectors, such as infrastructure, retail, health care, and hospitals. These offer long-term earnings potential and are starting to look more interesting to me. Another area that I'm interested in is information technology. Traditionally the fund has been underweight this sector, but, as the rupee has appreciated, some stocks have been oversold and are now starting to look attractive. A lot of the exposure to growth stocks has been reduced and I am buying into stocks that I believe offer better prospects.

TALKING POINT

A PERSONAL PERSPECTIVE FROM FIDELITY

RELATIVE SECTOR WEIGHTINGS (%)
as at 30.06.07



Benchmark: MSCI India Index

WHAT STOCKS AND SECTORS ARE YOU FINDING MOST INTERESTING AT THE MOMENT?

Earlier I highlighted certain interesting themes and these are reflected in my stock selection. For example, as the rupee has strengthened, IT companies have been oversold due to their exposure to export markets. This has created a buying opportunity for stocks like Infosys and FCL Technologies. Another important holding is Reliance Industries. Reliance has found a lot of gas and oil off the south eastern coast of India. The amount of gas that has been found, as well as the potential of finding more, could fundamentally change the economics of the country over the next three to five years. We are very well exposed to this value chain through owning stocks that are directly involved in these developments, as well as companies that can benefit tangentially. As this oil and gas supply comes on stream, I believe this should be matched by increased demand and switching effects from high cost fuels and should also be very good for the economy.

WHAT'S YOUR OUTLOOK FOR INDIA?

India's economy continues to grow fairly rapidly. In response to rising inflation, the Reserve Bank of India implemented its tightening policy in October 2004. Since then, the reverse repo rate (borrowing rate) has risen from 4.5% to 6.0% with two hikes occurring in FY07, while the repo rate (or lending rate) has increased from 6.0% in October 2005 to 7.75%. Five out of the seven increases took place in FY07. We are now starting to see inflation come back down below 5% and within the Bank's comfort zone.

So, I think the interest rate hikes have worked and it's going to put the economy on a very solid growth footing and help deliver profitable growth for almost all companies. The macro environment, from a liquidity perspective, therefore continues to look very good.

Taking a three- to five-year view, all indicators suggest that the rupee will continue to appreciate and whilst this will impact certain export-oriented industries, if you take a long term view, a steady appreciation should be good for investors.

I continue to stress that the level of economic activity is very strong. Whether it be infrastructure-related, telecoms, port, airport, retail, investment in infrastructure in other parts of the economy, or capital expenditure, there's been no slowdown. This level of investment on the ground is continuing to create jobs and increase consumption. This is very good news for the economy and, as it feeds into corporate earnings, is positive for shareholders.

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