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## David Urquhart

Portfolio Manager

*David joined Fidelity in 1996 as a research analyst, covering Australian financials, metals & mining, steel and media sectors. In 2002, he was appointed Financials Sector Team Leader and portfolio manager for the FF Australia Fund. In 2003 he assumed management of the FF Singapore Fund. In 2005, he was seconded to Seoul, Korea and took over management of the FF Korea Fund, while establishing the Korean equity investment team. He relocated back to Hong Kong in 2006 and currently manages Asia Pacific ex-Japan portfolios.*

*Prior to joining Fidelity, David was portfolio manager of Australian equities at Commonwealth Funds Management. He gained investment experience as an analyst at Ord Minnett Securities from 1990 to 1993. Before that he worked at Citigroup Investment Bank in Sydney as an Associate from 1986 to 1988.*

*David graduated from University of New South Wales, Australia, with a Bachelor of Commerce in Economics & Finance. He has a Diploma in Applied Finance and Investment from the Securities Institute of Australia. David is also a Chartered Financial Analyst.*

## FIDELITY ASIAN AGGRESSIVE FUND

# ACCESSING A BROAD UNIVERSE OF OPPORTUNITIES

Stock markets in the Asia Pacific region have performed strongly since 2000 and shown significant relative outperformance of Western developed markets from 2003 onwards. In the five years to the end of December 2007, the MSCI Asia Pacific (All Countries) ex Japan Index has returned an impressive 304% in US dollar terms, sustaining the momentum from previous years and outperforming other major regions; Europe returned 185%, the World 124% and the US 93%.<sup>1</sup> These returns reflect strong corporate earnings, positive fundamentals, continued economic expansion and a strong inflow of foreign funds into the region. Fidelity launches the Asian Aggressive Fund on 18 February 2008, managed from Hong Kong by David Urquhart, one of Fidelity's most experienced portfolio managers. Here, David discusses the reasoning behind the new fund launch, the investment universe and the outlook for the Asia Pacific region in 2008. He gives further insight into his investment style and the types of opportunities in which he looks to invest.

### HOW DOES THE ASIAN AGGRESSIVE FUND DIFFER FROM OTHER FIDELITY ASIA EQUITY FUNDS?

The fund will be managed against the MSCI Asia Pacific ex Japan Index. The geographical remit of the benchmark provides a broader Asia Pacific investment universe that includes Australia, New Zealand, India and Pakistan. This enhanced remit gives investors access to a larger pool of investment opportunities and a different opportunity set than that in other Asia funds. The inclusion of countries such as Australia provides diversity through greater access to mining, media, real estate, gold, agriculture and a more fully developed services sector than many of Asia's emerging markets. It may not be a surprise for investors to learn that 90% of earnings in the Asia Pacific mining sector are driven by Australia, but perhaps less well known is that 50% of earnings in the media sector and 40% of earnings in the property sector are as well.<sup>2</sup>

This provides a balance between the traditional Asia Pacific manufacturing base – (economies dependent on export trade) and countries like Australia that export raw materials, infrastructure and logistics services to the rest of Asia. Critically, this gives me access to companies that have very different factors driving earnings; at the same time, minimising the risk exposure to a US downturn.

<sup>1</sup>Source: DataStream, 31 December 2007. All indices: MSCI total return indices in USD. Period: 31.12.02 to 31.12.07

<sup>2</sup>Source: Factset, I/B/E/S, MSCI Goldman Sachs Strategy Research

### HOW WOULD YOU DESCRIBE YOUR INVESTMENT APPROACH?

First and foremost, I take a fundamental, bottom-up approach to stock selection, constructing the portfolio stock by stock, brick by brick. I run a concentrated portfolio of typically 55 to 85 stocks. I am supported by 38 Fidelity Asia Pacific research analysts<sup>3</sup> based across the region who cover more than 500 companies within the MSCI Asia Pacific ex-Japan Indices (more than 90% coverage), with over 500 more companies lying outside those benchmarks under analysis, providing fundamental research and a list of 300+ 'buy' recommendations. The philosophy behind my focused style is that, when I find a stock that I like, I want to own a lot of that stock. So, if our analysts are looking at over 1000 stocks in the Asia universe, I am targeting the top 5-10% of the best ideas being generated.

<sup>3</sup>Source: Fidelity as at 31.12.07.

***“The enhanced investment universe - which includes Australia, New Zealand, and India - gives investors access to a larger pool of investment opportunities and a different opportunity set than that in other Asia funds.”***

I rank the analyst recommendations in order of the highest potential return and (a key component) the likelihood of a company achieving that return. This is a disciplined process, as I am forced to evaluate all new ideas against those stocks I already own, when deciding whether to include or exclude a stock. When an analyst has a new ‘buy’ idea, I will assess the expected return and the risk factors involved in achieving that return, ranking the stock against its industry peer group and then comparing it more broadly to the whole portfolio. If the stock is expected to add better-than-average returns with a lower level of downside risk, it will be included in the portfolio. Any new position will typically mean that a stock with lower expected returns will be sold.

My focus is to try and maximise ownership of strongly performing stocks, those that have potential to deliver strong share price performance, and minimise those that have the potential to be average or poorly performing. Fewer ideas in the portfolio make it easier to ensure I am on top of the investment thesis and manage any downside risk. This enables me to evaluate quickly and effectively any new data on an individual position.

While my approach is primarily bottom-up driven, I am aware of the macroeconomic backdrop. One of the advantages of running a concentrated portfolio is the ability to put a company in the context of the wider trading environment. If or when the macroeconomic climate changes - which could impact the earnings potential of a particular company - I am aware of this change and what it means to a company's earnings prospects. A key factor on which I am focused this year is the inflationary impact of rising raw materials and labour costs.

#### **WHAT TYPE OF COMPANIES DO YOU LOOK TO OWN?**

The emphasis is on evaluating company fundamentals and filtering the research analysis to focus on ‘quality’ companies in attractive businesses that can deliver a high return on equity and assets. I favour companies where the earnings power is not reflected in the share price – typically, this means they are mis-priced or misunderstood. Typically, these are companies: which have a proven ability to execute on their strategy and are in charge of their own destiny; that generate a high return on equity invested (ROE); or who are leaders in niche markets with a strong competitive advantage, high barriers to entry and pricing power. In addition, I am interested in companies where change is occurring through new management strategy, products or technology. Companies that are mis-priced, under-researched or where the earnings potential is underestimated represent attractive investment opportunities. This mix of characteristics typically results in a blend style with a growth tilt.

One of the key factors I like to see in a stock is the track record of management executing on their strategy. As a result, I tend to be more invested in mid cap and large cap stocks. So, this actually means that the portfolio remains relatively easy to trade.

I will avoid companies that: operate in highly competitive industries; that are open to regulatory infringement; or are overly impacted by government economic policy, such as interest rate or currency movements.

Although I am benchmark aware, the actual portfolio weightings will be determined more by the risk/reward profile of a stock rather than its benchmark weight. The degree of deviation from the benchmark depends on my level of conviction and the valuation of a stock. Typically, the ideas with my strongest conviction will be up to 600 plus basis points and the minimum bet size would be approximately 75-100 basis points.

**David Urquhart favours companies where the earnings power is not reflected in the share price (mis-priced or misunderstood):**

- **Proven ability to deliver strategy**
- **Pricing power / competitive advantage**
- **High barriers-to-entry**
- **Leaders in niche markets**
- **High return on equity (ROE)**
- **Change is occurring**

#### **HOW DO YOU VIEW THE OPPORTUNITY IN ASIA AT THIS TIME & WHAT ARE YOUR GENERAL EXPECTATIONS FOR THE NEXT 12 MONTHS?**

I think Asia still has the best growth prospects of any region in the world, and therefore companies in the region have a good ability to deliver strong earnings growth in a world that is finding this harder to achieve.

Looking at the composition of performance across the Asia Pacific ex Japan region reveals that it is not just China that has been delivering robust returns. There have been very strong performances in Australia, Pakistan, India, and Indonesia that have actually beaten China. Although China gets a lot of focus, there are certainly other Asia markets that are performing very strongly.

Over the next two years, consensus economic forecasts that Asia will deliver healthy, consistent GDP growth, even as other parts of the world slow. Estimates for 2008 and 2009 forecast that Asia Pacific ex Japan as a whole is expected to deliver more than double the growth rates of the US, Europe and Japan<sup>4</sup>. Also, Asia is expected to deliver growth higher than that of emerging Europe and Latin America; and this is likely to present a number of opportunities for investors.

There is a clear correlation between GDP growth rates and expected earnings per share. Even in those markets, such as Australia, where GDP growth is slower in the region, we are still seeing (estimated) healthy double-digit earnings growth rates.

In addition to strong earnings increases, valuations in the region are attractive. Current valuations are not that significantly different to levels witnessed over the past ten years, but they are offering more growth than before.

There may still be periods where investors are nervous, but the market outlook, for GDP growth, earnings growth and valuations are not extreme. So, although I expect that there will be continued volatility in the short-term, companies in the Asia Pacific region should still be able to deliver double-digit returns.

<sup>4</sup>Source: MSCI, Morgan Stanley Economic Forecasts, November 2007

#### **DOES THE MARKET VOLATILITY FORCE A CHANGE IN YOUR INVESTMENT APPROACH?**

No, the process is the same - looking for the stocks that have strong earnings power that is not reflected in the share pricing. The only difference in the current environment is that the focus on risk becomes even more important. I think that we can all agree that there are some increased macroeconomic risks – risks that are related to a US recession - and this has already impacted Asian economies and companies, so far in 2008. For me, I will still be looking for stocks that have the potential to deliver strong returns and also that have limited exposure to these and other potential risks.

The team of Fidelity analysts that supports me has proven that it can add value in bull and bear markets. So, that backdrop gives me great confidence in our ability to generate good ideas and returns. In 2007, there were three episodes of market correction - in February, August and again in November. I expect there will be more this year, but we will continue to focus on buying good companies that have the ability to deliver robust earnings in the current environment and those with fewer factors to go wrong in achieving their earnings potential. These kinds of companies will eventually be priced by the market and will then deliver strong share price performance.

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