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Portfolio Manager

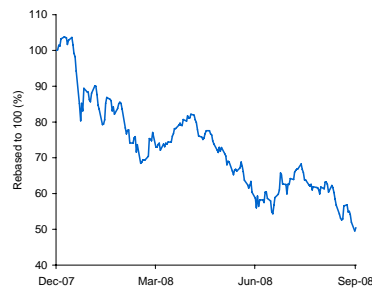
Arun Mehra joined Fidelity in 1997 as an equity analyst in Hong Kong. After covering a number of industrial sectors, Arun began managing Indian equity portfolios in 2005. He became the Portfolio Manager of Fidelity Funds India Focus Fund in July 2006.

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.

MSCI INDIA INDEX (US\$) TOTAL RETURN – PERFORMANCE IN 2007



– PERFORMANCE YEAR TO DATE (AS AT 30.09.08)



Source: Thomson Financial DataStream as at 30.09.08, in US dollar terms.

FIDELITY FUNDS INDIA FOCUS FUND
INDIA'S ECONOMIC FUNDAMENTALS REMAIN INTACT

After its outstanding performance in 2007, the Indian market has experienced high levels of volatility in 2008. Here, Arun Mehra, Portfolio Manager of the FF India Focus Fund, explains why this has been the case and how he has positioned the fund amid current global uncertainty.

WHAT CONTRIBUTED TO THE INDIAN MARKET BULL RUN IN 2007?

Robust domestic consumption and increased infrastructure spending led to strong economic expansion in 2007. External trade also grew at a healthy pace. This led to strong performance by the corporate sector. Cash-rich companies increased their capital spending and merger and acquisition (M&A) activity was brisk. Consequently, the MSCI India Index gained strongly over the year. Additionally, India's growth story was discovered by global investors which led to increased foreign fund inflows into the Indian equity markets.

WHAT IS THE BACKGROUND BEHIND THIS YEAR'S NEGATIVE PERFORMANCE?

Increased global attention and significantly large foreign fund inflows towards the year end caused a distortion in stock valuations. Notably, foreign institutions invested around US\$8-10 billion annually over 2004-2006, but in 2007 they invested US\$17.2 billion. Out of this, over US\$9 billion came in only during September and October¹. Consequently, certain sectors and stocks went up sharply driven by momentum, and due to some hype about future business plans and prospects.

As expected, the markets corrected towards the end of 2007 and in early 2008. The correction was triggered by fears of a US-led global slowdown and credit crisis. Spiralling inflation and subsequent rise in interest rates were other key concerns. Strong global oil prices also impacted India's fiscal deficit.

HOW DO OIL PRICES IMPACT THE GROWTH OF THE INDIAN ECONOMY?

India imports about 70% of the oil it consumes. Thus, the economy is vulnerable to the rise in oil prices. However, the reliance on oil imports should come down over the next 10 years as recently discovered gas and oil reserves, which are quite significant, start getting used.

Volatility in global oil prices will certainly impact the Indian economy. However, as the recently discovered domestic gas reserves start getting used, the dependence on external sources will decline.

Also, the domestic economy remains strong. Favourable demographics, increasing urbanisation and infrastructure development should continue to drive economic growth. Consumer spending has been robust in urban areas due to rising income levels. Rural consumption, which has already expanded with agricultural commodities getting dearer, will get a further boost as road connectivity improves in these areas.

HOW DO CHINA AND INDIA COMPLIMENT EACH OTHER, IF AT ALL?

There are many similarities between China and India, but there are significant differences as well. For example, India is much more insulated from global markets because of its lower reliance on exports. Exports contribute about 17-19% to India's gross domestic product (GDP)². Besides, the two countries have dissimilar political structures. Being a democratic state, India is slow in reaching a consensus regarding reforms and development projects. However, projects and policies are quickly replicated once consensus is built. The direction of policies/reforms is more permanent in nature, despite changes in governments. Another notable difference is that unlike China, growth in India is led by the people. Entrepreneurship plays a vital part in the Indian economy, while the government largely acts as an enabler and policy maker. Most companies across sectors are listed, which provides more investment opportunities.

The stock markets in India are more developed and open to foreign investments than in China. Corporate disclosures have improved significantly. There are better options to invest across sectors. Liquidity is generally sound, particularly in the large- and mid-cap space. Additionally, Indian stock exchanges offer a variety of derivative products, such as stock and index futures and options. Currency futures have also been launched recently.

¹ Source: Bloomberg, June 2008.

² Source: Thomson Financial DataStream, 31.08.08.

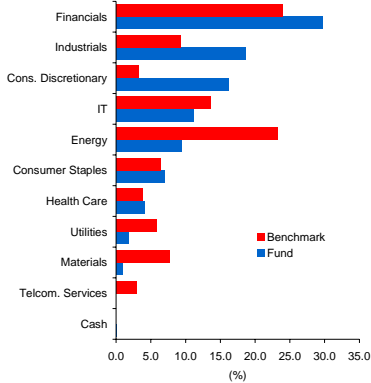
TALKING POINT

**TOP TEN HOLDINGS (%)
AS AT 30.09.08**

	Fund	BM
ICICI BANK	7.4	5.4
RELIANCE INDUSTRIES	6.7	16.7
UNITED SPIRITS	6.3	0.8
TATA MOTORS	4.6	1.0
SUZLON ENERGY	4.5	-
FINANCIAL TECHN	4.2	-
TATA CONSULTANCY SERVICES	3.7	1.7
MULTI COMMODITY EXCHANGE OF INDIA	3.4	-
BAJAJ AUTO	2.8	-
PIRAMAL HEALTHCARE	2.2	-

Source: Fidelity
BM: MSCI India Index

**RELATIVE SECTOR WEIGHTINGS (%)
AS AT 30.09.08**



Source: Fidelity
BM: MSCI India Index

A PERSONAL PERSPECTIVE FROM FIDELITY

WHAT POLITICAL FACTORS WILL IMPACT THE INDIAN ECONOMY AND STOCK MARKET?

The political system in the world's largest democracy is very well developed. Over the years, various political parties and coalition governments have come into power but the democratic system of governance has remained intact. In the past two decades, different coalition parties have been in power. But the process of economic liberalisation, started in the early 1990's, has remained on track. I believe the reforms process in India can get delayed with changes in governments, but it is unlikely to get derailed.

WHAT DOMESTIC AND EXTERNAL ISSUES NEED TO BE ADDRESSED TO STABILISE THE INDIAN MARKET?

Being an emerging economy, market volatility in India is expected to be higher. I believe it is prudent to invest for the long term to maximise the potential benefits from strong economic fundamentals. Investing for the long term should also help to ride out short-term market movements.

In terms of issues that need attention, I think inflation is the primary concern in the near term. Its causes are largely external – high oil and commodity prices – and these are not under the government's control. However, if oil prices settle down as expected, inflation should moderate. Also, the base effect will come in towards the end of the year. Subsequently, the central bank may cut interest rates to promote economic growth.

The government also needs to speed up economic reforms and boost spending on infrastructure. Some elements of reforms that may get implemented in the near term include: privatisation of public undertakings, bank reforms and liberalisation of overseas investments limit in the insurance sector. Recently, the government implemented some pension reforms and allowed pension funds to invest a part of their corpus in equities. Having said that, elections are scheduled for next year and this may lead to a slowdown in the reforms process in the interim.

HOW IS THE FUND POSITIONED AT THE SECTOR LEVEL?

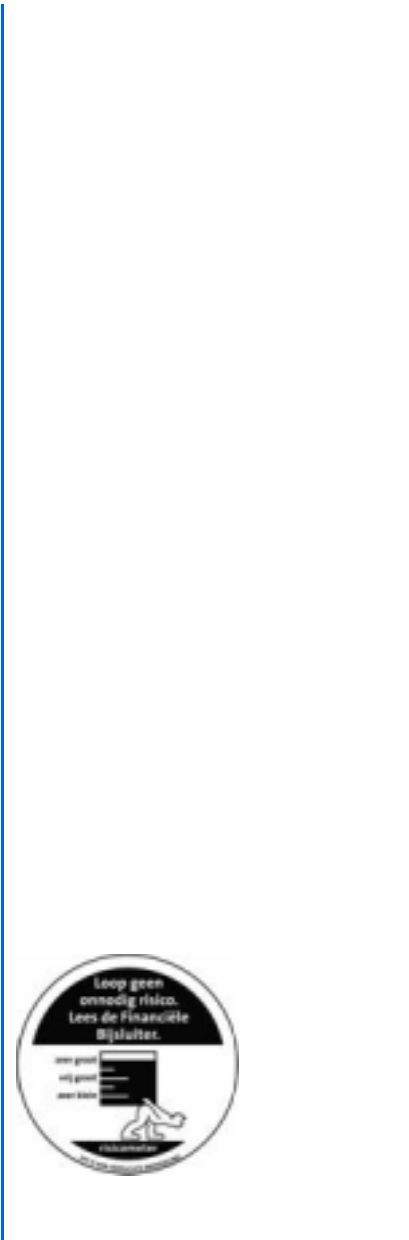
Post the market correction, valuations have become attractive and I am finding various investment opportunities across sectors. I have added to my positions in banks at compelling valuations, since they continue to have strong balance sheets despite the global crisis and are benefiting from healthy credit growth. I have also selectively bought some retailers after the correction in their share prices. I favour consumer discretionary stocks, in view of the healthy growth in domestic demand. I retain a bias towards the software and services sector expecting that the global slowdown will encourage foreign corporations to cut expenses by outsourcing to low-cost destinations such as India.

Conversely, I am underweight in materials and utilities shares, where margins are under pressure from rising commodity and energy prices. Finally, I do not own telecommunications services firms because I am finding better opportunities elsewhere.

WHAT IS YOUR OUTLOOK?

My view is that the global slowdown will have a relatively lesser impact on India because its reliance on exports is low. Also, the Indian banking system has not been affected by global credit crisis.

I believe India's economic fundamentals remain robust. While there may be some volatility in the near term, robust domestic growth and supportive government policies should benefit equities over the longer term.



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