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FIDELITY GLOBAL PROPERTY FUND

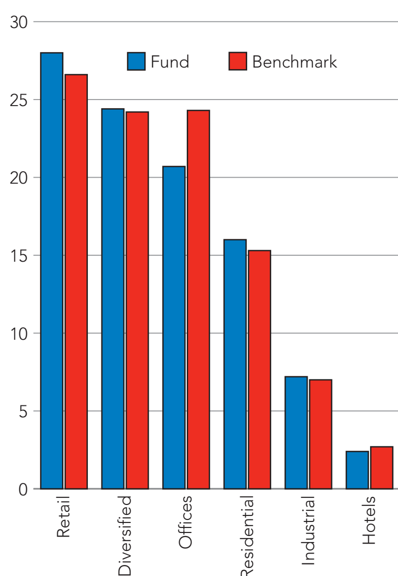
POCKETS OF OPPORTUNITY FOR THE LONG TERM

Steven Buller
Portfolio Manager

Steven Buller joined Fidelity's US affiliate company, FMR LLC in 1992. After a period in the fixed income teams of both FMR LLC in Boston and Fidelity in London, he started covering REITs as a research analyst with FMR LLC in March 1997. He became an Associate Portfolio Manager in December of the same year and a Portfolio Manager in 1998. He now manages a number of institutional and retail products investing in the property securities market on behalf of clients of both FMR LLC and Fidelity.

He has managed Fidelity Global Property Fund since its launch in September 2006.

INDUSTRIAL GROUP WEIGHTINGS (% NET ASSETS) as at 30.04.08



Source: Fidelity

Benchmark: FTSE EPRA/NAREIT Global Real Estate Total Return Index

Against a backdrop of the ongoing credit crunch, property markets never seem to be far from the headlines. Whilst residential markets are the most visibly impacted, there are inevitable consequences for commercial property, as fears of an economic slowdown take hold. Steven Buller, portfolio manager of Fidelity Global Property Fund, believes some of those fears may be overdone and that pockets of value are still to be found in listed property markets. Here, he identifies some of those interesting opportunities within the context of the performance and positioning of his fund.

DO YOU BELIEVE THE SELL-OFF IN GLOBAL PROPERTY SECURITY MARKETS IS JUSTIFIED?

Valuations had become very rich in some property security markets and a correction was needed to bring them into line with fundamental expectations. The weight of money being invested had artificially pushed valuations too high. However, I believe the sell-off has now gone too far in some places as sentiment has turned overtly bearish.

There is confusion between what is happening in residential for sale markets and what we are seeing in the commercial space. People see the headlines around home repossessions and foreclosures and read that negativity across to all property markets. As a result, we've seen a large outflow of capital from property security funds, dragging down market returns. In fact, most property security funds - certainly this one - have very limited exposure to the residential market and, where they do, it is largely to the rental market rather than the for sale market. There is some slowdown in the commercial real estate markets but not to the extent that is being factored into many prices seen today.

HOW MUCH OF AN IMPACT DO INTEREST RATES HAVE ON PROPERTY SECURITIES?

Interest rate cuts will provide some relief to residential for sale markets. Lower rates should help stem the wave of defaults that are putting pressure on the US housing sector (and consequently the US consumer and wider economy). However, the effect on property security markets is much less obvious. In fact, there is a very low (20%) statistical correlation between property security returns and interest rates.

Interest rates have a two-fold effect on property securities. On the one hand, falling interest rates mean the cost of capital is decreasing. In a capital intensive business like property investment, that's good news and positive for stock returns. On the flip side, if interest rates are falling, that tends to mean the economy is not in great shape and so property owners face falling occupancies and struggle to push through any rental increases. It's the latter point which is very much driving expectations for the sector at the moment.

WHAT MIGHT ACT AS A CATALYST TO REVERSE THE CURRENT TREND?

Although it is a very short term thing to comment on, there are some signs of recovery: the market has ended the last two months in positive territory. That recovery has been led by some of the markets where the largest valuation discrepancy has existed. As I look at markets now, in the UK and the US, where the first signs of fundamental deterioration started showing through last year, we now see property securities trading at discounts to net asset value of more than 20%.* I would caution that those NAVs are only our conservative estimates of valuations because there is much less transactional evidence based on properties changing hand but, even with that in mind, such discounts are quite high by historic standards.

Much will depend on the perceived health of the underlying commercial property markets. We estimate something in the order of US$100 billion is waiting to be invested in global real estate markets. The simple matter of that money being put to work should provide a positive fillip to returns.

TOP TEN HOLDINGS (%)

as at 31.03.08

	Fund	Index
WESTFIELD GROUP STAPLED UNITS	3.9	4.2
SUN HUNG KAI PROPERTIES	3.8	3.9
UNIBAIL-RODAMCO (NL)	3.7	-
SIMON PPTY GROUP REIT	3.4	2.8
PUBLIC STORAGE	3.2	1.5
PROLOGIS (REIT)	3.2	2.0
MITSUBISHI ESTATE	2.9	3.4
GENERAL GROWTH PROPERTIES	2.5	1.3
LAND SECURITIES	2.4	1.9
BRITISH LAND	2.2	1.3

Source: Fidelity

Benchmark: FTSE EPRA/NAREIT Global Real Estate Total Return Index

"I still believe that through-the-cycle returns of 7-10% are what investors should expect from property securities. That return won't come in a nice, smooth line. Some years, like last year, will be negative. We are invested in equity markets and must accept equity market volatility, after all. But there are some real signs of value emerging in many of the worst-hit markets and that should translate into some good, positive gains in the months and years to come."

Steven Buller, Portfolio Manager

Before that can happen, however, we need to see debt markets settle down. As a capital intensive industry, buyers need to be able to borrow in a stable market place. At the same time, prices need to adjust to levels reflective of the fundamentals. We've seen some correction in the UK already and, as transaction volumes pick up again and there becomes more visibility around pricing that should encourage institutional buyers to start to invest.

WHICH COUNTRIES DO YOU THINK HOLD THE MOST VALUE?

I think that the Australian LPT (Listed Property Trust) market looks interesting now. That market has suffered a severe correction where some of the stocks have sold off approximately 35% in recent months. The sector is now trading at a discount to NAV of around 13% and provides some attractive opportunities.*

The fund is also overweight in the US. The US was one of the first markets to sell off, after the UK, and I think it should be one of the first to recover. The fundamental deterioration that is being priced into these stocks is overdone.

ARE THERE ALSO SECTORS YOU FIND MORE APPEALING THAN OTHERS RIGHT NOW?

I don't take active top-down positions, any sector allocations are a by-product of my stock selection. That aside, I would say that I am generally underweight in the office sector. In some markets like the UK and the US, the office stocks are simply fully-priced for what we believe the effect of the economic slowdown might be.

In contrast, I find the storage business attractive. One of the unfortunate side effects of the correction in the residential market is a need for people who have foreclosed on their mortgages or suffered repossession to find somewhere to store their possessions. I would highlight Public Storage as an example of a company that is doing well in this environment. It was one of our best-performing stocks in 2007/2008 and yet still trades at a sizeable discount, given the rate of earnings growth it shows.

I also think the hotel industry is attractive. Even in the face of a slowing economic environment, I think the global tourist industry will hold up. My level of conviction in this can be seen in the off-benchmark position in Starwood Hotels & Resorts Worldwide in the top ten.

WHY DO YOU THINK DISCOUNTS TO NAV ARE TOO LARGE?

One thing to keep in mind in considering the fundamentals of property companies is that 80% or so of their cash flows are contractual rental streams. I can therefore take comfort that 80% is known for at least the next year, unless we start to see large tenant defaults. If we do get into a situation where there are large scale defaults, then the world is pretty ugly and property should, in itself, outperform by simply not doing as badly as other asset classes like equity. But let's take the retail sector as an example. It is an interesting fact that most retailers file for bankruptcy in January if they don't have a good Christmas season. Bankruptcy filings in January were actually less than they were last year. It's hard to believe that we are now going to see a large increase in defaults this year.

That other 20% of the business cash flow is a combination of leases which are due for negotiation this year and cash flows that come from those businesses whose model also includes a portion of residential for sale. The latter are mainly in the emerging markets or Asia, where business models tend to be more diversified and where the economic picture is generally more attractive than in some western markets. That 20% obviously does introduce more risk to the valuation but we take a pretty conservative view on these factors when we are estimating the NAVs for companies in our universe.

Our US team has recently met with the management of more than 60 US REITs and all came back with the view that the market is not nearly as bad as prices suggest. I'm not saying that we don't expect a slowdown; just that we don't think it's going to be as bad as the financial markets think.

** Source: Citi Investment Research, Reuters, Bloomberg, Factset, Company Documents, EPRA/NAREIT (March 2008)*

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