January 2020

Fidelity Global Emerging Markets Fund
2019 Review

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Fidelity™ INTERNATIONAL

Global Emerging Market Equities

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This commentary has been compiled with reference to the strategy. The content can be viewed in conjunction with the positioning, attribution and performance data for the relevant share class.

Key Takeaways

- 2019 was a mixed year for emerging market (EM) equities, as concerns over levels of global growth, trade relations and country specific events rattled investor nerves;
- In this context, the funds focus on selecting good quality businesses through rigorous screening proved beneficial, enabling the portfolio to deliver strong absolute and relative returns amidst increased volatility;
- Stock selection both at the country and sector level was the primary driver of performance;
- Looking ahead, a variety of factors have emerged that can lend further support to the asset class, such as synchronised monetary easing and improving trade relations;
- The US dollar was somewhat weaker against the basket of EM currencies in recent months which provided some respite for the market in EM.
- The focus remains on identifying the best investment opportunities in the universe, which can offer attractive shareholder returns over the medium- and long-term, whilst mitigating the inherent risks within the asset class, thanks to a focus on the strength of corporate governance and balance sheet structures.

Market Environment

In 2019, emerging market equities posted a 18.4% return, underperforming developed markets by 9.3%*. Throughout much of 2019, the asset class was impacted by a variety of factors which drove investor sentiment. Concerns over weaker growth, a deteriorating economic outlook, protracted, tense trade negotiations and matters of local concern such as social unrest.

2019 had commenced with strong industry inflows that reached +US$22.8bn by the end of Q1, but tensions between the US and China re-escalated and investors de-risked, with cumulative outflows reaching -US$28.4bn by the end of the third quarter. However, by year end, renewed interest in EM equities was evident and abundant inflows meant that outflows lessened to -$US14.2bn**.

Trade tensions between the US and China rumbled on through the course of the year, exerting influence over risk appetite; however, as the year drew to a close risk assets gained significantly after the US and China announced that they had reached agreement on a "phase one" trade deal, and investor sentiment was further supported by China's central bank's decision to ease monetary policy. During this same phase, the dollar weakened and the risk on rally pushed EM Foreign Exchange (FX) higher as the year concluded.

Across the Latin America region performance was very mixed: Brazil outperformed against a backdrop of government reform progress, a dramatic fall in local interest rates and better-than-expected growth in the third quarter. Conversely, Argentina suffered after the results of the presidential elections primaries in August, before rebounding into December when the new President was inaugurated.

In Russia, investors put some of their geopolitical concerns of 2018 to one side; seeking instead access to this attractively valued segment of the market, perceived as insulated from the trade war.

A choppy year concluded with a strong performance in December, with MSCI EM gaining 7.5% and outperforming Developed Markets (DM) by 4.5%*.

*Source: Fidelity International, as at 31 December 2019. Based on the returns of MSCI Emerging Markets Index (Net) and MSCI World (Net), in US Dollar terms.

**Source: Fidelity International, JP Morgan at 31 December 2019.

2019 Performance commentary

Despite such volatile market conditions, in 2019 the Fund solidly outperformed the benchmark. This outperformance was primarily driven by stock selection, both at the country and at the sector level, lending support to the strength of the investment process in selecting long-term winners.

Standard Returns

	1M	3M	6M	1Y	3Y (ann.)
Fund	2.7%	8.4%	9.6%	32%	18.8%
Index	3.4%	7.3%	6.9%	18.6%	12.7%

Source: Fidelity International. Portfolio = Fidelity Global Emerging Markets Fund. Performance is shown net of fees in AU dollar terms, as at 31 December 2019. Comparative index is the MSCI Emerging Markets Index (net, total return).

At the sector level, the largest contribution to performance came from stock selection in Consumer Discretionary and Financials. Within the former, Chinese names were the key drivers of returns. In this context, the leading Chinese sportswear brand, **Li Ning**, was the top contributor for the strategy. The company posted exceptionally strong results throughout the year, whilst continuing to show improvement in all the key financial and operation metrics. Investors also welcomed the announcement of its new co-CEO. Other noteworthy performers within Consumer Discretionary were **Zhongsheng Group** (autos), **Zhejiang Supor** (cookware) and **Midea Group** (white goods).

Among Financials holdings, allocation to **Chailease**, the Taiwanese lease financing provider, to Indonesia's **Bank Central Asia,** and to **Tisco Financial**, the leading Thai auto loan bank, boosted returns.

At the country level, China was the largest contributor to performance. Despite a volatile year for the Chinese market, driven by ongoing concerns regarding the direction of the trade dispute with the US, the strategy's stock selection was strong. Alongside the Consumer Discretionary holdings previously mentioned, allocation to selected Consumer Staples names also aided gains - among these are **Foshan Haitian** (flavouring) and **China Mengniu Dairy** (dairy).

In terms of detractors, some I.T. names weighed on relative returns. Exposure to **Cognizant** hurt performance. Sentiment towards the US-listed I.T. services company was negatively impacted by the CEO change and management transition. We nevertheless maintain conviction in the name, as its margin structure provides it with a competitive advantage of investing in new technologies and driving industry change. Elsewhere, limited exposure to **Samsung Electronics** weighed on returns, as the market started showing signs of demand recovery and supply discipline, and as the acceleration of 5G deployment lent further support. However, in this context, allocation to **Taiwan Semiconductor (TSMC)** aided performance.

At the stock level, **Alibaba** emerged as a detractor, as the strategy's limited exposure to the stock weighed on returns. As it will be outlined in the following section on positioning changes, this has been increased throughout Q4 in light of increased conviction in the name.

12 Month Rolling Returns

	31/12/2015	31/12/2016	31/12/2017	31/12/2018	31/12/2019
Fund	0.4%	7.5%	30.5%	-2.8%	32.0%
Index	-4.3%	11.7%	27.1%	-5.1%	18.6%

Source: Fidelity International. Portfolio =Fidelity Global Emerging Markets Fund. Performance is shown net of fees, as at 31 December 2019. Comparative index is the MSCI Emerging Markets Index (net, total return).

Positioning changes

At the portfolio level, the fund continues to maintain a sizable exposure to consumer and financials stocks. The focus remains on owning well-managed business with attractive return profiles, an accretive reinvestment opportunity and a valuation that offers an adequate margin of safety on a free-cash-flow basis.

Emerging markets continue to offer many opportunities, supported by structural growth drivers such as urbanization, lifestyle changes and the rising purchasing power of EM. We hold businesses that can capture this trend. In Q4, the portfolio added a position in **Alibaba**. This reflected increased conviction in the company's corporate governance structure's alignment with minority shareholder interests, but also a positive outlook of the stock. **Alibaba** continues to benefit from the structural shift to online retail and from increase in the take-rate on merchandise sales, where we see scope for considerable room for expansion when compared to global peers. Moreover, the online-retailer is also set to benefit from growing segments such as the Cloud and financial services. Elsewhere in consumer discretionary, we trimmed the position in **Li Ning**, following a particularly strong share price performance. In consumer staples, we exited the position in **AVI**, on the back of a weaker macroeconomic environment in South Africa weighing on the consumer space.

We continue to find financials an attractive sector, given the balance sheet quality of dominant, privately owned, retail-facing banking models, as well as the significant growth opportunities, driven by the prevailing low credit penetration levels. An example is **Bank Central Asia**: the 3rd largest bank by assets in Indonesia, it benefits from a leading position in retail and an entrenched cash management business, which enables it to capture a large market share of payroll accounts. This translates in a best in class deposit franchise, providing an abundant source of low-cost deposits and a buffer to weather economic volatility. In the second half the year, we reduced our exposure by trimming positions in the likes of **Itau Unibanco** and **Housing Development Finance**, to reflect an environment characterized by lower global interest rates. Nevertheless, it is important to mention that the opportunity sector in Financials remains strong as, unlike developed economies, emerging markets enjoy high real interest rates.

Throughout Q4, the decision was also taken to increase exposure to industrials, by adding new positions in **Lonking Holdings** and **Weichai Power** in China. **Lonking Holdings** is a leading manufacturer of wheel loaders and forklifts and is set to benefit from a cyclical improvement in demand in construction. The company also exhibits a double-digit dividend yield profile and a strong balance sheet cash position. **Weichai Power** is the largest heavy-duty truck engine maker, benefitting from a consolidating industry and growing market share. In Communication Services, the strategy exited the position in **China Mobile Limited**.

At the country level, throughout 2019, the investment team found some attractive investment opportunities in Russia, adding positions in **Severstal, Lukoil** and **X5 Retail Group**. Not only are these companies characterized by solid fundamentals and growth opportunities, but the the Russian economy also provides them with a benign macroeconomic backdrop, with relatively high levels of international reserves and a twin surplus in its current and budget balances.

Elsewhere, the overall exposure to the A-Share market was reduced throughout the year, reflecting the trimming of positions in strong performers, namely **Midea Group**, **Zhejiang Supor Cookware** and **Foshan Haitian**, and the reallocation of capital to other pockets of the market.

Outlook

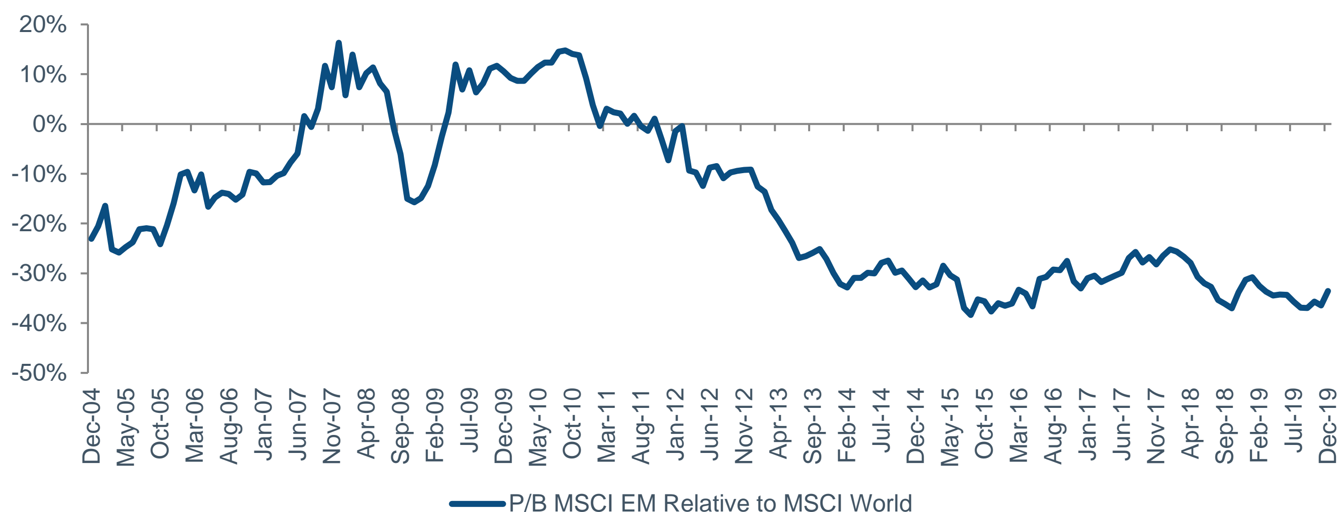
Looking forward, certain factors have emerged, that have the potential to support sentiment as 2020 progresses. Synchronised easing from central banks, growing potential for a US-China trade deal, as well as reforms in parts of the global economy (i.e. Brazil and India) are just a few examples, which could help unshackle growth potential.

As we look forward, investors will continue watching closely the interest rate environment, both in the US and across the EM investment universe. Overall, cuts are expected to lend some support to improving economic conditions (although from levels). Confidence in global growth rebound is indeed also on the rise, as governments across EM and DM have embarked on fiscal policy changes to drive opportunities. In this context, trade is expected to continue to create headlines in 2020, with the amelioration of US-China trade tensions being key in restoring investor confidence. Downward pressure on the renminbi is also expected to ease on the back of these developments.

However, the US dollar remains a conundrum, posing a risk to the asset class in the case of a sharp appreciation. In face of heightened volatility, it has been perceived as a safe heaven, representing a potential headwind. More recently, EM FX has edged higher supported by abating social protests in Latin America and US-China trade developments. Such factors coupled with a US twin deficit which should be more conducive to a weaker dollar over the long-term and a more positive backdrop for EM currencies.

As stated in previous commentaries, emerging markets continue to exhibit compelling valuations, trading at significant discount to developed markets. The valuation gap between EM and DM is trading at its widest in 15 years; -35% on a price-to-book basis (Figure 1). Looking at the year ahead consensus estimates place EM earnings growth above DM, providing reason to feel positive about the year ahead.

Figure 1: Price-to-Book (MSCI EM Index relative to MSCI World Index)



Source: Fidelity International, Bloomberg, monthly data for 15 years to 31 December 2019

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