Fund perspective

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Fidelity Asia Fund

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Key points

- The risk-reward profiles of Chinese consumer stocks have shifted following the re-opening rally and we have started to reduce exposure.
- The semiconductor and information technology (IT) hardware sector has seen some negative market sentiment, but long-term tailwinds and a shifting market cycle have created selective buying opportunities.
- India is underweight in the portfolio given it is relatively expensive.
- We see opportunities in the aviation space as the Asia Pacific region is fully re-opened.
- Global inflation and interest rates could remain higher for longer. If we enter a more difficult market environment, our focus on firms with dominant market positions and strong balance sheets should hold the portfolio in good stead.

Performance

Performance – Fidelity Asia Fund
Standard period returns net of fees, AUD (%)

Period	Fund (%)	Index (%)	Excess (%)
1 month	-3.2	-0.8	-2.4
3 months	-0.7	0.7	-1.4
Year-to-date (YTD)	5.6	4.8	0.8
1 year	6.8	1.1	5.7
3 years (ann.)	7.5	2.9	4.6
Since tenure (ann.)	12.6	7.5	5.1

Source: Fidelity International, as at 30 April 2023. Performance basis: NAV to NAV with income reinvested in AUD terms, net of fees rounded off to one decimal place. (pa) = Annualised figures. The Fund is Fidelity Asia Fund. The Fund's reference index is the MSCI AC Asia ex Japan (Net) Index. Past performance is not a reliable indicator of future results. Returns may be affected by changes in currency exchange rates.

Chinese consumption stalling?

The Fund has outperformed the benchmark year-to-date as at end of April 2023 with discussions dominated by China as investors tried to assess the impact of re-opening policies and pent-up consumer demand. These supportive policies from the Chinese government boosted market sentiment, and we have seen strong rebounds in consumer-related stocks such as Yum China, Trip.com and Focus Media. However, it is important to note that income levels throughout the country have been impacted by the pandemic, which could affect the viability of a sharp consumer rebound.

As a result of recent market movements, the risk-reward profile of some stocks has altered, and we have begun to reduce exposure to some areas. While we have seen somewhat of a return to normality in China over the first quarter of 2023, there are signs that the rebound could stall without further support and consumer spending might not meet buoyant expectations in the second half of 2023. Within this context, opportunities will need to be re-examined, and thus we have already begun to reduce weighting to China at a country level.

Semiconductor cycle is primed

The semiconductor industry has undergone a painful period in recent quarters due to factors such as an inventory build-up and news of IT capex cuts leading to a subsequent de-rating of these stocks. However, there are opportunities on a multi-year fundamental view. We are in a negative ebb of the semiconductor and IT hardware cycle and have seen producers such as SK Hynix and Samsung Electronics respond by cutting expenditure and being very disciplined about production levels. We have maintained exposure across several names in this area, as this discipline makes them attractive and the tight industry structure means they now have better control of supplySamsung Electronics has been a new addition to the portfolio in Q1 2023. The company provides additional exposure to what is likely to be a strong growth area in the coming years at an attractive valuation. In addition, Asian companies have taken the lead in many parts of the semiconductor supply chain, whether it be memory, microchips or integrated circuit boards. This exposure allows us to take advantage of the long-term structural growth opportunity in semiconductors.

A broader view

The Asia Pacific region more broadly presents some interesting opportunities on a fundamental level, but caution is needed to find those that present an attractive risk-reward profile. India is a large underweight in the portfolio due to it being relatively expensive. We maintain our exposure to HDFC Bank as it will benefit from further deposit and loan growth, and is a very well-managed bank. Additionally, there are pockets of the Indian market that have recently been sold down, which could present opportunities at the right price.

While there are well-documented beneficiaries of the energy transition, we remain confident in the investment case for very large crude oil carriers on a multi-year view. Shipyards are prioritising the supply of Liquified Natural Gas (LNG) carriers due to higher margins and this, alongside falling demand for traditional crude carriers due to ongoing regulatory changes, has constrained supply. This will likely lead to better rates for those vessels in the coming years. China Merchants Energy Shipping, for example, has the largest fleet of very large crude carriers in the world and has a relatively young fleet meaning they could provide alpha opportunities in the coming years.

We also see opportunities in the aviation space as the region fully reopens. As air traffic rebounds, more aircraft will be needed and BOC Aviation, an aircraft lessor, fills a gap in the market. Its narrow fuselage product seems to be favoured by airlines at the moment and we believe this can translate into strong profit growth at a very attractive valuation.

The risks to monitor

We believe there are a variety of opportunities present in the Asia Pacific ex-Japan region, but it is important to not lose sight of potential risks. We have kept an eye on inflation over the past months and we maintain our view that global inflation and interest rates will be higher for longer. If rates remain high, we run the risk of entering a global economic downswing as firms and individuals face the reality of higher refinancing and mortgage costs. We must consider the possibility of a difficult scenario for markets in the second half of this year and focus on firms with dominant market positions, and strong balance sheets.

That said, we continue to believe that careful stock selection, underpinned by rigorous company research, can effectively mitigate areas of risk, and successfully capitalise on the beneficiaries of the region's long-term growth story. Indeed, with strong structural growth drivers, well managed companies, solid balance sheets and valuation support, there are reasons to be optimistic on the risk-reward outlook for the stocks we own in the portfolio.

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