

Outperforming India

AT A GLANCE

- Fidelity Funds (FF) - India Focus Fund has outperformed since Teera has been portfolio manager
- Changes to the portfolio have paid off despite difficult conditions for bottom-up stock picking

Teera Chanpongsang is portfolio manager of Fidelity Funds - India Focus Fund.

Teera joined Fidelity in 1994 as a research analyst. In 1998, he became a Portfolio Manager and took over FF-Thailand Fund. Subsequently, he moved to the UK in 2004 to manage FF-Global Telecommunications Fund. He relocated back to Hong Kong in July 2007 and began managing Emerging Asia portfolios.

Teera graduated from Chulalongkorn University, Thailand, with a Bachelor of Arts (Accounting). He also holds an MBA degree from the University of California, Berkeley, in the United States.

It is now just over six months since Teera Chanpongsang took over the FF -India Focus Fund and the value his approach is adding is beginning to come through. Here, Teera explains the changes he has made and talks about India's economic and market environment, as well as his strategy and outlook.

HOW HAS THE PORTFOLIO PERFORMED SINCE YOU TOOK OVER THE FUND?

In the six months from April to the end of September the FF India Focus Fund has returned 98.4% while the benchmark has returned 96.0%. I took over the fund on 20 March 2009. It has been a difficult time for a stock-picker like me as a broad range of stocks have experienced significant gains which have not been linked to fundamentals so I am relatively happy with the returns so far.

The fund's underweight stance towards defensive sectors such as utility and consumer staples has proved rewarding so far over my tenure. Notably, limited exposure to household products firm Hindustan Unilever and ITC has added value. Among utilities, a lack of exposure to power generation company NTPC has aided performance. The overweight in discretionary stocks such as Pantaloon Retail and automobiles manufacturers Bajaj Auto and Mahindra & Mahindra contributed because domestic demand for their products has shown signs of a recovery. An overweight in Bharat Earth Movers and IVRCL Infrastructure benefited from the government's increased spending towards the development of the country's infrastructure.

HOW HAVE YOU CHANGED THE PORTFOLIO?

Since taking over, my focus has been to further diversify the portfolio as well as add positions where investment opportunities are available. I have visited almost every company in which the fund had invested and worked closely with our Mumbai-based analysts to arrive at my investment decisions.

I have reduced positions in some stocks where I thought the risk-reward profile was not favourable. For example, I sold down positions in United Spirits, India's largest brewer, due to the firm's weak balance sheet and rising production costs. I also sold out of Satyam Computers as, at that time, there was not enough clarity on its actual assets and liabilities, including legal obligations, in the aftermath of the revelation of accounting irregularities.

However, I have increased my exposure to the technology services sector, expecting it to do well in the long term, as the global economy improves and companies outsource more to cut costs. I have added to holdings in India's technology bellwether, Infosys Technologies, as well as in the country's largest software services firm, TCS.

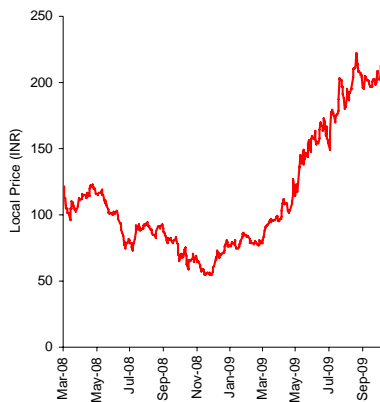
The fund had no exposure to the materials sector when I took over and I initiated positions in the stronger steel and non-ferrous metals producers, such as Tata Steel and Sterlite Industries. These firms should profit from the country's infrastructure development activity. I have also added property names, believing that the real estate cycle in the country is bottoming out. Developers have improved their financial conditions by raising equity. A reduction in the selling price of residential property is also attracting buyers. I took positions in property developer DLF and Unitech.

WHAT IS THE THINKING BEHIND THE FUND'S NEW POSITION?

The current positioning at the sector level is a consequence of careful stock selection. However, a key theme that I am playing is further recovery in India's domestic economy. Consequently, the portfolio is overweight in the consumer discretionary, financials and industrials sectors. Within financials, I like non-banking financial companies that lend to power and infrastructure development firms. I am drawn to their bright growth prospects and the relatively attractive valuation. The overweight among software services exporters is because of the prospects for - and India's strong position in - the global outsourcing industry.

Conversely, the fund has an underweight in sectors such as telecommunications, utilities and consumer staples as their outlook is less attractive.

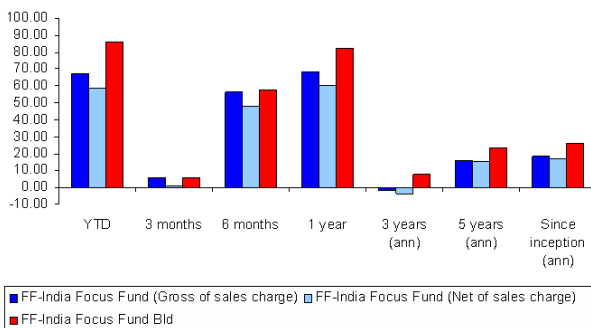
RURAL ELECTRIFICATION GROUP



Source: Bloomberg, as at 30.9.09

FUND PERFORMANCE

as at 31.10.2009



Source: Fidelity. Performance figures are in USD terms NAV to NAV with dividends reinvested. Past Performance is not indicative of future performance

Since inception: 01.09.99

Benchmark: MSCI India Index (Gross) Capped 8%

CAN YOU GIVE AN EXAMPLE AS TO HOW YOU ARE CHOOSING STOCKS IN WHICH TO INVEST RIGHT NOW?

Certainly. Rural Electrification Group is a government-owned company with an objective to finance and promote rural electrification projects all over the country. I am expecting India to demand far greater amounts of electricity in the coming years. India has low per capita power consumption and the government is predicting this will rise sharply. It therefore wants to increase the country's electricity generation capacity by 80,000 megawatts (MW) by 2012 (under the XI plan). Even with the current electricity usage level India has a large power deficit.

As a financier, Rural Electrification Group's asset growth is expected to trace the growth in the power sector. This is not currently baked into the share price. As a good proxy to the power sector it is trading at attractive valuations compared with power generation firms and equipment manufacturers.

Another stock I have invested in is LIC Housing Finance (LICHF), a non-bank housing finance company. My thesis is that we are at the bottom of the property market in India, with the recent property price falls and lower interest rates fuelling mortgage demand. LICHF is attractively priced compared with others in the industry such as Housing Development Finance Corporate (HDFC).

WHAT ARE THE REASONS FOR THIS STRONG RALLY IN INDIAN EQUITIES?

Investors in India have responded positively to better-than-expected economic growth in the first quarter of 2009, signs of recovery in the global economy and favourable political developments. Overall inflows for the year now stand at nearly US\$12 billion, and with another quarter to go, these would more than offset the US\$12.6 billion outflows seen in 2008.

India is one of the fastest-growing among the large emerging economies of the world. Its GDP expanded by 6.1% in the second quarter of 2009, at a time when many global economies faced a recession. The International Monetary Fund expects India to expand by 5.4% in 2009, while the world economy is projected to shrink by 1.4% and emerging economies are expected to grow by an average of 1.5%. Government spending has remained strong, while private consumption and investment have also risen. The expansion in output was largely driven by a revival in manufacturing and pre-election public works spending that boosted construction and electricity output. The country's manufacturing Purchasing Managers' Index gathered pace in September. A broad-based improvement in output, new orders, and inventory stocks driven by the increased industrial activity ahead of the festive season demand in September and October likely led the increase.

Having said that, I am also aware that stock valuations have reached mid-cycle levels after the recent rally. A shortfall in monsoon rains is also an issue that I continue to watch. Agriculture contributes about 17% to the country's economic output and is important for a large section of rural farm-based demand. For the country as a whole, the rainfall for the season was 77% of its long period average (LPA). Out of 526 meteorological districts for which data are available, 215 districts (41%) of the meteorological districts received excess/ normal rainfall and the remaining 311 districts (59%) received deficient/ scanty rainfall during the season. Based on prior years when rainfall has been deficient, agricultural growth is likely to fall 8% in 2009 (year on year).

Nonetheless, I believe that the impact of rainfall deficiency this year would not be significant because it follows three good monsoon years that left sufficient food stock in the country. The increase in the floor price, called the minimum support price, for certain agricultural commodities should also mitigate the loss due to a fall in output. The government's employment guarantee scheme for rural areas should further support rural incomes.

Meanwhile, corporate earnings forecasts have been revised upwards in recent months. Prudent stock selection is very important in such an environment. Valuation anomalies exist and I am still finding stocks that have attractive valuations and show higher-than-average growth relative to the respective industry and market.

| SECTOR ALLOCATION (%) | | |
|------------------------------|------|-----------|
| as at 30.09.09 | Fund | Benchmark |
| Financials | 32.9 | 28.3 |
| Information Technology | 15.2 | 14 |
| Industrials | 13.7 | 10.4 |
| Consumer Discretionary | 13.3 | 5 |
| Energy | 10.7 | 12.4 |
| Materials | 8.3 | 11.4 |
| Utilities | 2.5 | 6.8 |
| Health Care | 1.7 | 3.7 |
| Cash | 1 | |
| Other | 0.7 | 8 |

| TOP TEN HOLDINGS (%) | | |
|--------------------------------------|------|-----------|
| as at 30.09.09 | Fund | Benchmark |
| Infosys Technologies | 7.5 | 7.9 |
| Reliance Industries (Dematerialized) | 7.3 | 8 |
| Icici Bank (Demat) | 6.4 | 7.3 |
| Housing Development Finance | 3.9 | 6 |
| HDFC Bank (Demat) | 3.8 | 4.7 |
| Tata Consultancy Services | 3.7 | 3 |
| Larsen & Turbo | 3.2 | 3.5 |
| Sterlite Industries (Demat) | 2.7 | 3 |
| Mahindra & Mahindra | 2.5 | 1.3 |
| Jindal Steel & Power | 2.4 | 2.3 |

Source: Fidelity

Benchmark: MSCI India Index (Gross) Capped 8%

References to specific securities are for illustrative purposes and are subject to change without notice. They should not be construed as a recommendation or an advice to transact in them.

Disclaimer

IN VIEW OF THE SHARP GAINS MADE IN REACTION TO ELECTION RESULTS IN MAY, HOW DO YOU ASSESS INDIA'S CURRENT POLITICAL ENVIRONMENT?

The country's political environment is stable, particularly after the new government won a strong mandate in the Union elections held in May this year. Left-wing parties, which are principally against liberalisation and privatisation, have been marginalised. This also increases the likelihood of speedier economic reforms and prudent fiscal policies at a time when India's deficit is deteriorating.

Having said that, the new government's first annual budget lacked detailed measures to further liberalise the economy. However, there were tax incentives for the general public and the allocation for infrastructure development, rural housing and irrigation was increased. The Union budget in India is not the only instrument to address economic issues and there are indications that some of the reform measures might be announced separately in the coming months. For instance, the government has recently come out with a new code to overhaul the existing four-decade-old direct tax laws.

WHAT IS YOUR OUTLOOK FOR INDIAN EQUITIES MARKETS?

I believe that, over the long term, Indian equities should benefit from the country's strong economic fundamentals and improving global environment. Favourable demographics, less reliance on exports relative to regional peers and strong domestic consumption trends bode well. A stable government at the centre for the next five years should drive reforms and fulfil infrastructure development needs.



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