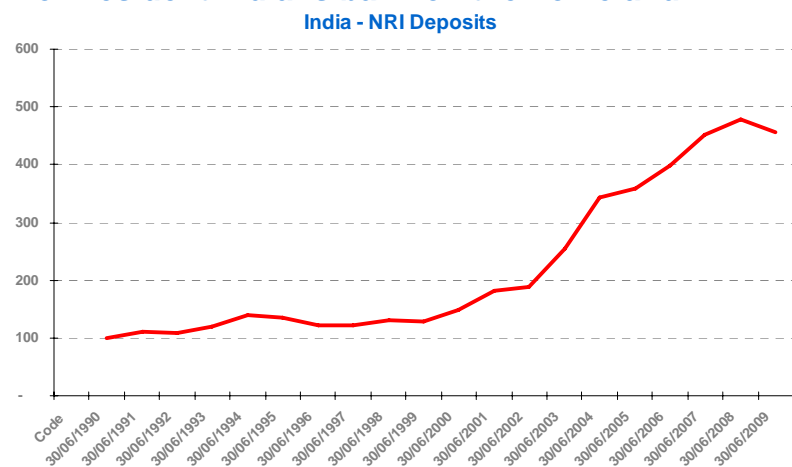


Indians leave home but the funds fly back

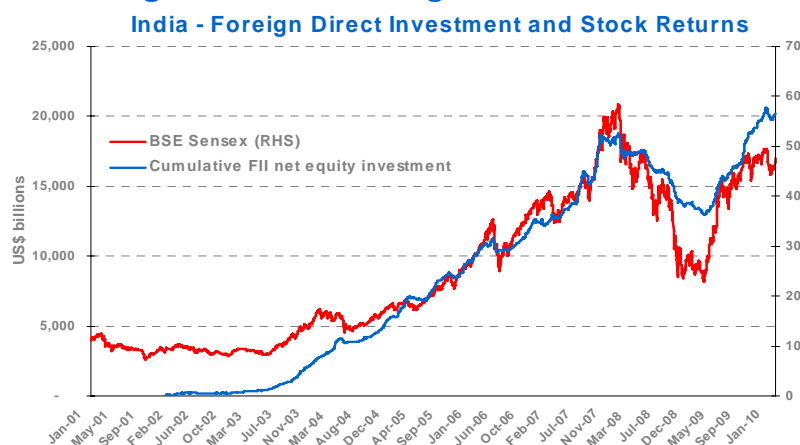
MARKET PERSPECTIVE: INDIA

Non-resident Indians bank on the homeland...



Source: Datastream, Reserve Bank of India

...following the trend of foreign investors



Source: Bloomberg

May 2010

A significant part of India's economic growth story is based on funds sourced abroad. Foreign direct investment has grown substantially over the past decade as institutions weighed in on emerging markets. Increasingly, funds from abroad are coming from Indians themselves as investment alternatives become less appealing. This *Market Perspective* discusses the changing nature of India's foreign-sourced investments.

- The appeal of Indian stocks and other real assets have long been recognised by foreign institutions in search of growth opportunities. Government policies geared towards attracting capital from abroad have also contributed to the flood of funds into the Indian market. But foreign institutions aren't the only ones ploughing money into India. Non-resident Indians (NRI's) are increasingly repatriating funds earned overseas, suggesting there's more to the adage 'home is where the heart is' when it comes to investing in India.

- Fund inflows from NRI's have grown substantially. From April to December 2009, NRI deposits rose 64%¹ over the prior year period to US\$3.47 billion.

- These funds are typically deposited into a specifically designed structure known as a Non-resident Ordinary Rupee account (NRO). This structure allows Indian nationals residing offshore to repatriate savings and invest in the local economy.

- The reasons to drive money home are well founded. Interest rates on Indian rupee-denominated term deposits are around 8%, sufficiently higher than the 1-2% rates offered in the USA. Investing incomes earned in dollars or pounds into Indian bank deposits and stocks while living in countries where inflation is 2-3% and home borrowing rates are 4-5% is a strategy difficult to fault. Bank failures in the US and UK provide a further incentive to keep funds in Indian banks.

- Living abroad means the NRI community learn of the investment opportunity from a foreigner's perspective. Anecdotal evidence of investment opportunities may also flow from contact with relatives and friends telling of changes taking place back home and the opportunities they present. The trend for the rural-based population to move to the cities is an example. Rapid transfer of people leads to increased demand for new housing. Goldman Sachs estimate that a further 140 million rural dwellers will move to major cities by 2020³, prompting Property developers to seek funds to undertake new projects.

- Much of the NRI funds may have been directed towards real estate or stocks and the investments have produced results. The return on Indian stocks last year was 101%, while real estate stocks were up 139%².

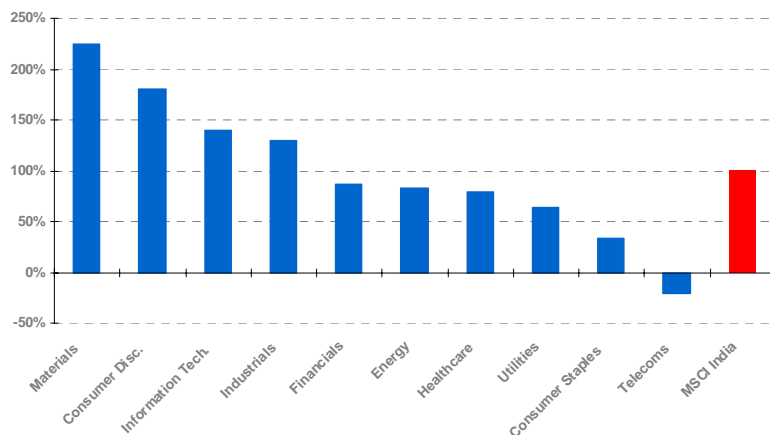


Fund flows underpin growth, but inflation lurks

MARKET PERSPECTIVE: INDIA

Foreign inflows drive investment and returns....

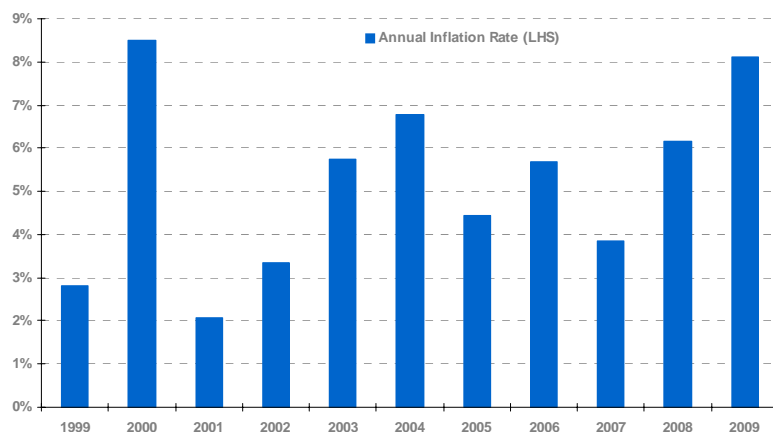
India - 2009 Sector Performance



Source: Rimes, MSCI India total returns in US dollars

...but excess funds are fuelling inflation

India - Annual Inflation



Source: Datastream

- NRI's don't need to look far to find opportunities. India's home builders have been visiting NRI's to attract capital back to the homeland to fund new developments. Early in May, the 'Your gateway to India 2010' real estate exhibition was staged for the first time in the USA. Twenty leading developers including Hiranandani Group, DB Realty and The Wadhwa Group converged upon California and New Jersey, two major NRI hubs in the USA, to showcase the residential and commercial development opportunities. The drive to source earnings by Indian nationals from abroad can be expected to continue.

- The flood of money into India is not without its consequences. One direct consequence is inflation. The Reserve Bank of India has raised its benchmark interest rate three times this year to reduce excess liquidity and control price pressures. Further rises are likely in the near term.

- Government spending policies may have also contributed to inflation. Public debt has now risen to 86% of gross domestic product, a level which requires action. Rampant inflation may make India less attractive as an investment destination and lessons from Greece highlight the need to control deficits and protect borrowing costs from rising to excessive levels.

- The gap between foreign and domestic fund flows may narrow over the long-term as the Indian investor becomes more sophisticated and its national savings policies are reformed. At present, less than 13% of the working population has access to a formal pension scheme. Extreme poverty in the country also makes saving to invest for the future a distant dream for the many.

- Like other emerging economies, foreign direct investment remains the key to sustaining India's economic growth. Longer term however, the mix between domestic and foreign sourced funds may look very different.

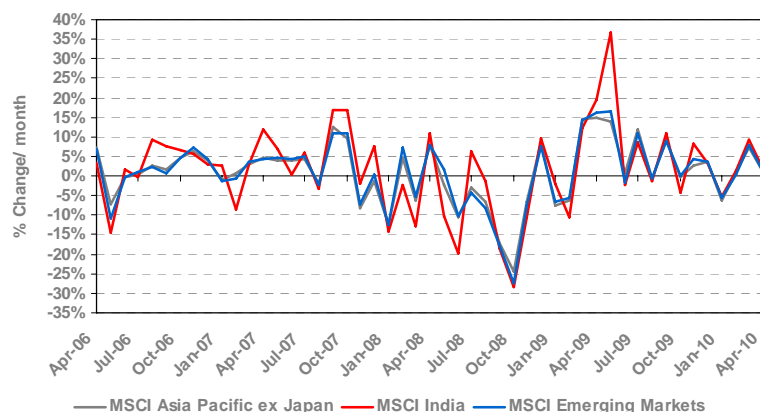
Sources:

1. Reserve Bank of India
2. Rimes, MSCI India total return index (US\$)
3. Goldman Sachs "India's Rising Growth Potential", January 2007
4. CLSA Asia-Pacific Markets, February 2010
5. Rimes, MSCI India sector returns (local currency)

Market review: Indian stocks move higher, Reserve Bank follows

MARKET PERSPECTIVE: INDIA

India vs Emerging Markets vs Asia

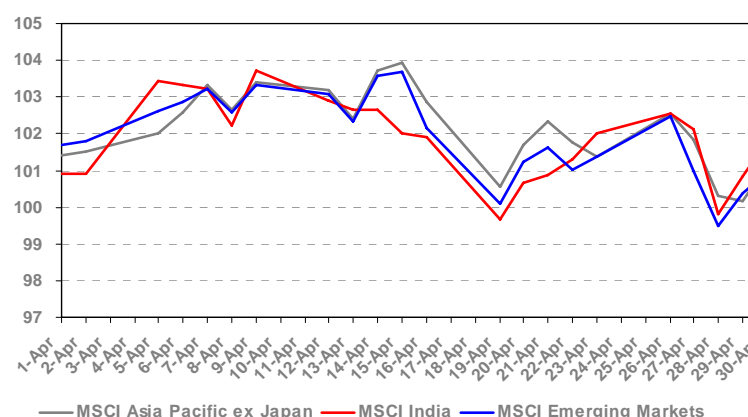


April 2010 performance		
MSCI Asia Pacific ex Japan	MSCI India	MSCI Emerging Markets
1.2%	1.8%	1.0%

Market Review

- Indian shares rose for the third consecutive month in April after higher profits and upbeat assessments on future earnings overcame concerns that Europe's debt crisis might derail global growth.
- The Mumbai Stock Exchange Sensitive Index (or Sensex) edged up 0.2% over the month. The MSCI India Index added 1.9% in US-dollar terms.
- Companies such as Ballarpur Industries, India's biggest papermaker, and software maker HCL Technologies were among companies that reported higher earnings. Escorts, which makes tractors and other farm equipment, soared to a 10-year high during the month after second-quarter profit soared more than five-fold.

India vs Emerging Markets vs Asia - Intra-month Performance



Source: Rimes, Monthly Price Index returns (in US\$)

- Many stocks were helped by optimism about India's economic outlook. For instance, Tata Motors, the owner of Jaguar Land Rover and the builder of the world's cheapest car, ended April at its highest in more than three years. The government forecasts the economy to expand 8.2% this financial year compared with 7.2% last fiscal year.
- A report that showed the nation's food inflation is receding was another boost. An index measuring wholesale prices of agriculture products rose 16.6% in the year ended 17 April, from 17.7% for the period ended a week earlier.
- In March, the Reserve Bank of India increased the benchmark reverse repurchase rate to 3.5% from the record-low 3.25% because higher food prices due to poor monsoon rains last year have fed into wholesales inflation. The government is forecasting a better monsoon season this year, which lasts from June to September.

Market review April 2010



Important information

MARKET PERSPECTIVE: INDIA

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