EDISON

Fidelity China Special Situations

Weak sentiment providing opportunities

Investment trusts
Chinese equities

Fidelity China Special Situations (FCSS) aims to deliver long-term capital growth, following a bottom-up approach to investing in companies listed in China, and Chinese companies listed elsewhere. The trust marks its 10th anniversary in April 2020 and, since inception, it has generated an annualised NAV total return of 11%. Chinese equities have been relatively out of favour for some time against a backdrop of the US-China trade dispute, Hong Kong political protests and, more recently, the coronavirus. The manager, Dale Nicholls, is finding exciting opportunities at attractive valuations, and continues to focus primarily on smaller companies that can benefit from long-term secular growth trends.

Solid NAV outperformance versus the benchmark since inception

Source: Refinitiv, Edison Investment Research

The market opportunity

China's GDP growth rate is slowing, and the recent outbreak of the coronavirus is likely to further reduce expectations for 2020. However, the economy is still relatively robust compared to the developed world. Furthermore, the headline GDP growth belies many areas of economic activity that are vibrant, with strong prospects for multi-year high growth. Investors seeking exposure to Chinese equities may benefit from a selective bottom-up approach, with a long-term horizon.

Why consider investing in FCSS?

- Dale Nicholls has over 24 years' investment experience and a successful track record managing the trust since April 2014.
- Rigorous, research-driven approach to investing in China, supported by Fidelity's well-resourced team of analysts based in China and Asia.
- Offers direct exposure to China's continuing growth, with a bias to less well-researched small- and mid-sized companies.

Proactive board manages discount volatility

In June 2019, the board adopted a formal policy aiming to maintain the discount in single digits. FCSS currently trades at a 9.3% discount to cum-income NAV, and the board has been proactive in helping to stabilise the volatility of the discount and the trust's share price during the coronavirus outbreak. There is scope for the discount to narrow should investor sentiment towards China improve.

19 February 2020

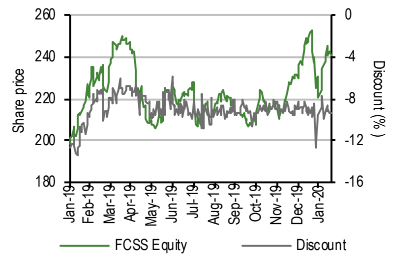
Price	**241.0p**
Market cap	**£1,315m**
AUM	**£1,756m**

NAV*	265.8p
Discount to NAV	9.3%

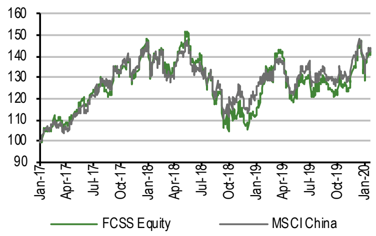
*Including income. As at 18 February 2020.

Yield	1.6%
Ongoing charge	1.0%
Ordinary shares in issue	545.6m
Code	FCSS
Primary exchange	LSE
AIC sector	Country Specialist: Asia Pacific – ex Japan
Benchmark	MSCI China

Share price/discount performance



Three-year performance vs index



52-week high/low	253.0p	205.5p
NAV** high/low	277.5p	226.6p

*Including income.

Gearing

Gross*	23.9%
Net*	19.2%

*As at 31 December 2019.

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Edison profile page

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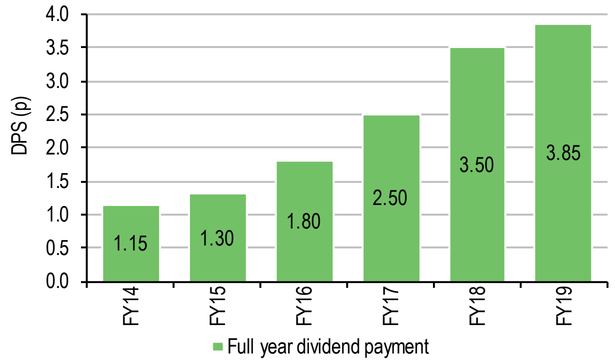
Exhibit 1: Trust at a glance

Investment objective and fund background	Recent developments
Fidelity China Special Situations aims to achieve long-term capital growth from an actively managed portfolio made up primarily of securities issued by companies listed in China, and Chinese companies listed elsewhere. It may also invest in listed companies with significant interests in China. Futures, options and CFDs are used to provide gearing, as well as to take short positions.	■ 27 November 2019: Interim results to 30 September 2019 – NAV TR -5.9% versus benchmark TR -3.3%, share price TR -6.0%. ■ 5 June 2019: Adoption of formal single-digit discount control policy. ■ 5 June 2019: Annual results to 31 March 2019 – NAV TR -5.3% versus benchmark TR +0.9%, share price TR -0.3%. ■ 5 June 2019: FY19 dividend increased by 10% to 3.85p per share.

Forthcoming		Capital structure		Fund details	
AGM	July 2020	Ongoing charges	1.0% end-September 2019	Group	Fidelity International
Annual results	June 2020	Net market gearing*	19.2%	Manager	Dale Nicholls
Year end	31 March	Annual mgmt fee	Variable: 0.7–1.1% of net assets	Address	Beech Gate, Millfield Lane, Lower Kingswood, Tadworth, Surrey, KT20 6RP
Dividend paid	July 2020	Performance fee	None		
Launch date	April 2010	Trust life	Indefinite	Phone	0800 41 41 10
Continuation vote	No	Loan facilities	US$150m revolving	Website	www.fidelity.co.uk/chinaspecial

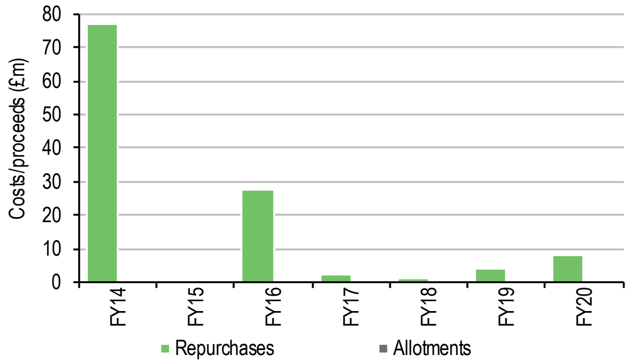
Dividend policy and history (financial years)

Although focused on capital growth, FCSS pays an annual dividend, which has been increased every year since its inception.

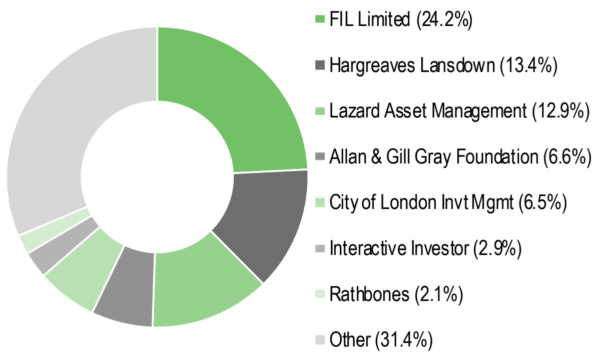


Share buyback policy and history (financial years)

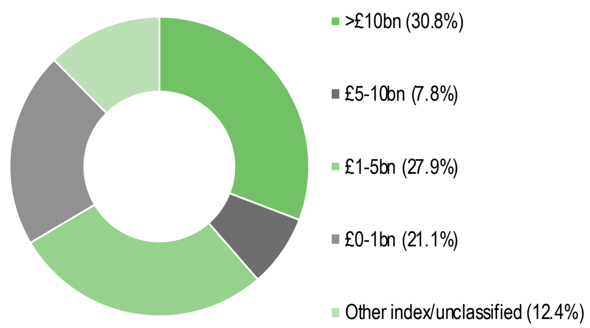
FCSS has authority to buy back up to 14.99% and allot up to 10% of its shares in issue. A formal single-digit discount control policy was adopted in June 2019.



Shareholder base (as at 31 January 2020)



Portfolio exposure by market cap (as at 31 December 2019)



Top 10 holdings (as at 31 December 2019)

		Portfolio weight %**		Benchmark	Active weight vs
Company	Sector	31 December 2019	31 December 2018***	weight (%)	benchmark (%)
Tencent	Communication services	13.1	14.9	13.0	0.1
Alibaba	Consumer discretionary	12.9	9.5	16.8	(3.9)
China MeiDong Auto	Consumer discretionary	6.7	N/A	0.0	6.7
China Pacific Insurance	Financials	4.2	4.9	0.6	3.6
China Life Insurance	Financials	3.2	2.9	1.0	2.2
Hutchison China Meditech	Healthcare	2.5	2.7	0.1	2.4
Noah	Financials	2.3	2.2	0.1	2.2
Trip.com	Consumer discretionary	2.2	N/A	0.7	1.5
Kingsoft	Information technology	2.0	N/A	0.1	1.9
WuXi AppTec	Healthcare	2.0	N/A	0.1	1.9
Top 10 (% of portfolio)		**37.1**	**36.9**		

Source: Fidelity China Special Situations, Edison Investment Research, Bloomberg, Morningstar. Note: *Gearing net of short positions. **Adjusted for gearing and index hedges (holdings data may differ from non-adjusted data displayed in FCSS's factsheet). ***N/A where not in end-December 2018 top 10.

The fund manager: Dale Nicholls

The manager's view: well-positioned portfolio

Nicholls believes that investor sentiment towards China has been dented over the past 18 months by media headlines relating to the US-China trade dispute and, more recently, the coronavirus outbreak. On the latter, he believes that the economic impact may be greater than that associated with the SARS virus in 2003, and the recovery period could be more drawn out. The Chinese government has already responded with supportive economic policies, and it may introduce further measures to help underpin the economy. Nicholls believes that the economic impact of the coronavirus will differ from sector to sector, and that some may emerge stronger. For example, online activities should fare relatively well, while there may be a boost for the healthcare and insurance sectors. He believes the trust is well positioned to benefit from these trends, and is closely monitoring how companies navigate this difficult period.

Looking longer term, Nicholls notes that China's GDP growth rate is on a slowing trend, but is nevertheless relatively robust compared to developed economies. Furthermore, he explains that the headline figures belie many areas of very strong secular growth, mostly within domestic sectors. He believes domestic consumption will be the future driver for the economy, and key trends include consumers trading up in goods and services as incomes rise. He also finds leading technological innovation among Chinese companies across a broad range of sectors, including financial services and healthcare.

The portfolio

Chinese equities are relatively out of favour and global portfolios are underweight this market. This has presented the manager with opportunities to add to a number of existing positions where he feels stocks have been oversold relative to their long-term prospects. These include online travel agent, Trip.com. The company has a dominant market position, which Nicholls believes to be unassailable in the mid- to high-end segment. In his view, although the environment for travel is bleak in the short term, prospects for long-term structural growth are very bright, with just 13% of Chinese nationals owning a passport.

The political discontent in Hong Kong has been punitive for its retail sector, especially the luxury segment, and Nicholls added to jewellery retailer Luk Fook. Although the company's origins are in Hong Kong, its growth has been driven by China, which accounts for over half of its profits. The share price has fallen to levels where the manager sees compelling long-term value and, in his view, no longer ascribes value to its long-established Hong Kong business.

Nicholls also added to the portfolio's holding in WuXi AppTec (WuXi), a leading contract research organisation (CRO) for the pharmaceuticals, biotech and medical device industries. The company is the largest CRO in Asia and one of the leading players globally. The manager believes increasing demand for CROs is a global structural trend, and that WuXi is particularly well-positioned to benefit given its strong track record in drug research, and established long-term relationships with its customers (which include all of the top 20 global pharmaceutical companies by 2017 revenues).

The manager topped up the position in internet data centre company, 21Vianet. The company is the leading carrier-neutral player in China, providing hosting, cloud and business virtual private network (VPN) services. Nicholls notes that China's internet infrastructure industry is among the fastest growing in the world, underpinned by increasing consumer usage of the internet via mobile phones, and demand for cloud and IT services from corporates. 21Vianet added Alibaba as a corporate client last year, which reinforced the manager's positive view on the company's competitive advantages.

The portfolio is predominantly domestically focused, with around 90% of revenues for the underlying holdings derived from Greater China (China, Hong Kong, Macau and Taiwan), and just 1.5% exposed to the US. During Q419, the manager shifted the portfolio, becoming slightly more defensive, including reducing net gearing from 22% to 19% by end-December 2019. More recently, in response to the increased uncertainty for near-term market prospects caused by the coronavirus, he has also used derivatives to add downside protection to the portfolio.

Performance: Solid track record

As shown in Exhibits 3 and 4, FCSS has a solid performance track record, and its NAV total return has outpaced its benchmark over most periods shown, with the exception of three years. Over that period, the performance of the MSCI China Index has, at times, been led by a relatively narrow set of large-cap names. FCSS's focus on investing with a long-term horizon, and with a bias in favour of small- and mid-cap companies, means the trust's returns can diverge meaningfully from the index. FCSS has significantly outperformed the MSCI China Small Cap Index over all periods shown.

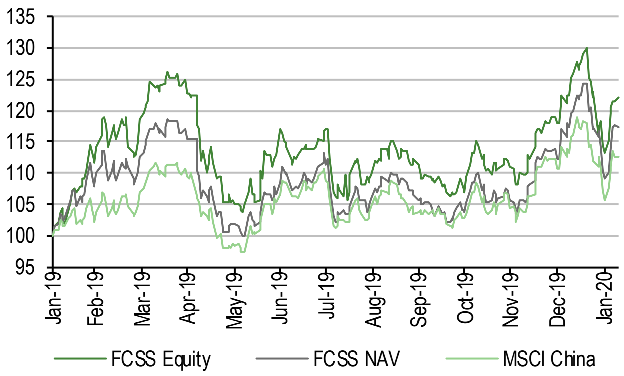
Exhibit 2: Five-year discrete performance data

12 months ending	Share price (%)	NAV (%)	MSCI China (%)	MSCI China Small Cap (%)	MSCI World (%)	CBOE UK All Companies (%)
31/01/16	(9.4)	(4.7)	(16.5)	(6.5)	1.1	(5.3)
31/01/17	49.2	42.3	39.5	30.0	32.8	20.9
31/01/18	45.0	40.6	43.8	14.0	11.9	11.3
31/01/19	(21.5)	(20.3)	(13.3)	(13.9)	1.6	(3.9)
31/01/20	13.2	9.2	5.8	(4.9)	18.2	10.5

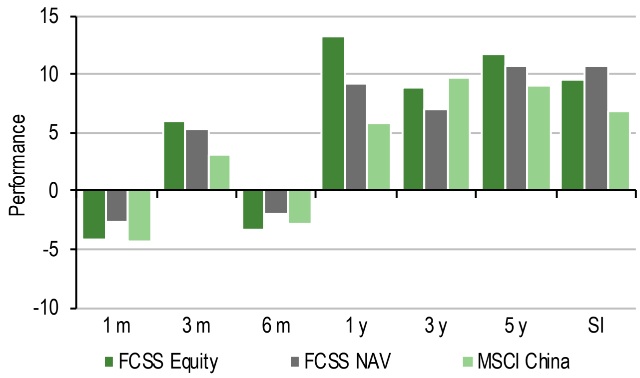
Source: Refinitiv. Note: All % on a total return basis in pounds sterling.

Exhibit 3: Investment trust performance to 31 January 2020

Price, NAV and benchmark total return performance, one-year rebased



Price, NAV and benchmark total return performance (%)



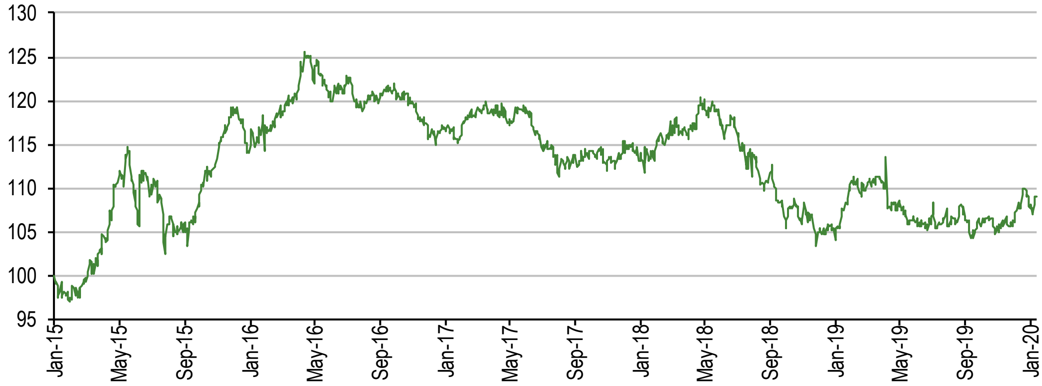
Source: Refinitiv, Edison Investment Research. Note: Three-, five- and SI (since inception) performance figures annualised. Inception date is 16 April 2010.

Exhibit 4: Share price and NAV total return performance, relative to indices (%)

	One month	Three months	Six months	One year	Three years	Five years	SI
Price relative to MSCI China	0.2	2.9	(0.5)	7.0	(2.3)	13.4	27.5
NAV relative to MSCI China	1.7	2.2	0.9	3.3	(7.2)	8.0	41.1
Price relative to MSCI China Small Cap	0.2	8.1	8.5	19.0	38.0	53.6	116.2
NAV relative to MSCI China Small Cap	1.8	7.3	10.1	14.8	31.1	46.3	139.2
Price relative to MSCI World	(4.0)	2.5	(3.8)	(4.2)	(4.1)	(3.4)	(15.5)
NAV relative to MSCI World	(2.6)	1.8	(2.4)	(7.5)	(8.9)	(8.0)	(6.5)
Price relative to CBOE UK All Companies	(0.7)	4.2	(3.0)	2.5	9.1	28.9	23.9
NAV relative to CBOE UK All Companies	0.8	3.5	(1.6)	(1.1)	3.6	22.7	37.1

Source: Refinitiv, Edison Investment Research. Note: Data to end-January 2020. Inception date is 16 April 2010. Geometric calculation.

Exhibit 5: NAV total return performance relative to benchmark over five years

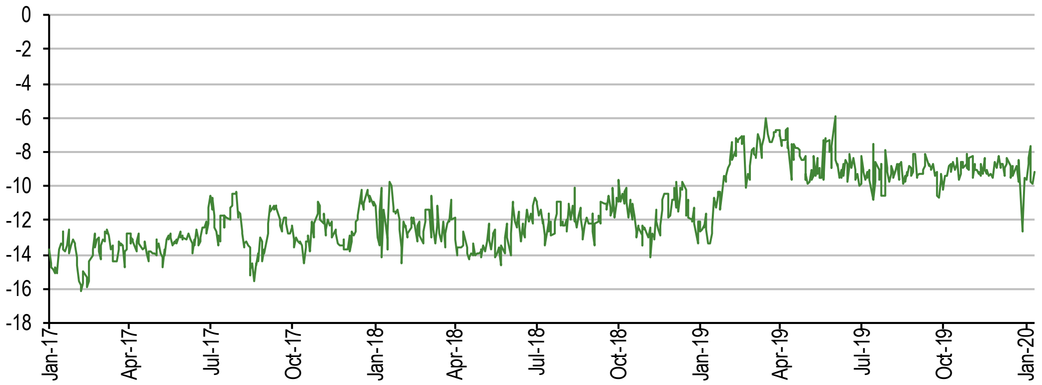


Source: Refinitiv, Edison Investment Research

Valuation: Board promotes share price stability

FCSS is currently trading at a 9.3% discount to its cum-income NAV, which is below its three-year average of 11.4%. In June 2019, the board adopted a formal discount control policy, which seeks to maintain the discount in single digits, in normal market conditions. It has the authority (renewed annually) to repurchase up to 14.99% of FCSS shares in issue, which it recently exercised to stabilise the discount and share price volatility during the coronavirus outbreak. As shown in Exhibit 6, this has helped restore the discount to within its recent single-digit range. Investor sentiment towards China has been weak since the onset of the US-China trade dispute some 18 months ago. Should this improve, there is scope for FCSS's discount to narrow.

Exhibit 6: Share price discount to NAV (including income) over three years (%)



Source: Refinitiv, Edison Investment Research

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