# Fidelity Asian Values

**FAS has a highly differentiated profile: small-cap Asian value with a significant China exposure...**

Update
15 February 2024

## Overview

Fidelity Asia Values (FAS) is managed by Nitin Bajaj who takes a value-orientated approach to building a portfolio of predominantly small-cap companies from across the Asian region. This approach is supported by a simple philosophy of identifying good companies that are run by strong management teams and buying them at an attractive price. Nitin has significant flexibility in where he can invest, including the ability to invest up to 20% in larger companies and Australian-listed businesses which, when combined with the valuation-driven approach, can lead to a **Portfolio** that is highly differentiated from both the benchmark and peer group.

Stock selection is designed to be the primary driver behind **Performance**. Nitin utilises the strength and depth of the on-the-ground analyst team at Fidelity to try to build an informational edge over the market and find value in companies that others overlook. The valuation focus has also led to Nitin finding a number of opportunities in China which is now at its largest overweight allocation in his tenure. He believes these deep-value opportunities offer significant upside if sentiment improves, as well as downside protection through deeply depressed valuations.

In order to capitalise on this value opportunity, the manager has increased the net exposure on the trust to 3.3%. Fidelity's house style is to use derivatives instead of traditional **Gearing** facilities, which also allows Nitin to take short positions in stocks and benefit from a potential fall in value.

FAS continues to trade at a **Discount** to NAV. The level of discount is almost as wide as its nadir in mid-2023 at 9.7%.

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## Analyst's View

We believe FAS offers investors exposure to the Asian region that is not matched elsewhere (see **Portfolio**). Being a small-cap trust with a value-driven process is enough to differentiate the vehicle, but when combined with Nitin's flexibility to go anywhere, taking off-benchmark positions and shorting stocks means that FAS can be seen as a highly complementary trust to hold alongside a larger-cap peer, or even as a diversifier within a portfolio.

Currently, we think Nitin's significant overweight to China offers differentiation to peers, many of whom are underweight the country. As we have discussed in **Performance**, Nitin believes this is an attractive valuation opportunity, offering considerable upside and a margin of safety on the downside. This positioning is further enhanced by the trust's **Gearing**. Nitin significantly increased FAS' level of net exposure at the beginning of 2023, and it remains notably higher than the average of the past five years. Should there be a market recovery in 2024, we expect the gearing to considerably increase the trust's upside potential.

FAS currently trades at a **Discount** to NAV that is in line with the five-year average. The discount has proved volatile in the past few years, though the shares did trade close to NAV in mid-2023 due to ultimately misplaced optimism surrounding China's re-opening. As such, we believe any further volatility could prove an attractive entry point for long-term investors, and the current level could easily narrow if the unique positioning proves prescient.

| BULL |
| --- |
| Value approach offers differentiated and complementary exposure to the region |
| Portfolio generates highest yield in peer group, despite dividends not being a primary focus |
| Portfolio is trading at low valuations but in line for quality metrics |

| BEAR |
| --- |
| Stock selection focus can lead to a very different profile to benchmark |
| Increased gearing can amplify losses as well as potential upside |
| Significant allocation to China would be exposed to further weakness in the country |

# Portfolio

Fidelity Asia Values (FAS) is managed by Nitin Bajaj who takes a value-orientated approach to building a portfolio of predominantly small-cap companies from across the Asian region. This approach is supported by a simple philosophy of identifying good companies that are run by capable management teams and are trading at an attractive price, which we described in detail in **our previous note**.

Nitin, supported by assistant portfolio manager Ajinkya Dhavale, looks to lever the size and strength of the Fidelity team of analysts to gain an informational edge on the market and identify overlooked opportunities, and then benefit from a potential bounce-back as markets latterly recognise them. He wants to know more about a company than the rest of the market and believes this is possible due to the industry-leading team around him. In order to ensure he can capture these opportunities wherever they may appear, Nitin is completely benchmark-agnostic, and allowed the flexibility to invest where he sees fit, including Australia which is in his investment universe. Furthermore, Nitin can invest up to 20% in larger companies which will help diversify the portfolio as well as offer further differentiation from comparators. He also has the ability to take short positions in companies in order to profit from a fall in their share price (see **Gearing**). This strategy has been in place since 2015, when Nitin took over management, though has been in use for longer in an open-ended equivalent.

## Top Ten Holdings

| COMPANY | INDUSTRY | FAS % | INDEX % |
|---|---|---|---|
| Axis Bank | Financials | 4.2 | 0.0 |
| HDFC Bank | Financials | 3.8 | 0.0 |
| PT Bank Negara Indonesia | Financials | 2.9 | 0.0 |
| Genpact | Industrials | 2.6 | 0.0 |
| PT Indofood CBP Sukses Makmur | Consumer staples | 2.6 | 0.0 |
| PTC India | Utilities | 2.6 | 0.0 |
| PT Bank Mandiri (Persero) | Financials | 2.3 | 0.0 |
| BOC Aviation | Industrials | 2.3 | 0.0 |
| Galaxy Entertainment Group | Consumer Discretionary | 2.3 | 0.0 |
| Gold Road Resources | Materials | 2.1 | 0.0 |
| | **Total** | **27.7** | **0.0** |

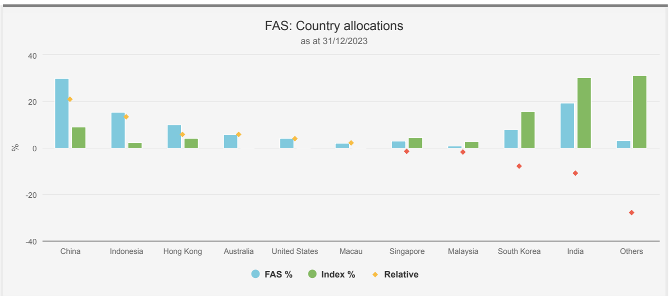
Source: Fidelity, as at 31/12/2023

As a result of the index agnostic approach, the sector and country allocations are purely an outcome of stock selection. Nitin works on one company at a time to decide whether it warrants investment, with sector allocation given little consideration. As a result, the portfolio is likely to look vastly different to the benchmark and the peer group. Of the top ten holdings of the trust, for example, no holdings appear in the trust's formal benchmark, the MSCI AC Asia ex-Japan Small Cap Index. As such, investors can expect FAS to look very different to peers. We believe this could make FAS a complementary holding in a portfolio, particularly those focussed on large-cap growth.

One area where Nitin is currently finding opportunities is China. This has taken the country, including Hong Kong, to its largest overweight position since the manager has been running the trust. He admits the country is experiencing a tough period and a cyclical downturn. However, he believes there are plenty of companies on great valuations as a result, and the country has a strong entrepreneurial spirit which will help capture a recovery. Nitin's quality approach means he typically owns companies that are the top players in their industry, with robust balance sheets and a good history. He argues that this period of economic difficulty means that weaker companies will soon leave the market, allowing the survivors to capture greater market share, with the property and industrial sectors as two key examples of this. He also argues that the negativity will soon pass and when it does, prices will mean revert. He points to the example of the US market going through a similarly tough patch in 2008, before bouncing back strongly. As such, he believes the risk-reward balance in China is very good. His view is that the downside is limited due to low valuations offering a margin of safety, whereas the upside is very strong once this challenging period subsides.

Conversely, Nitin has only one position left in Taiwan. He highlights that aggregate profit margins, earnings and valuation multiples are at all-time highs, despite many firms having very commoditised products. Nitin doesn't believe there is any margin of safety in current valuations and therefore sees limited appeal. He believes there are a number of attractive businesses with good management teams but is remaining disciplined with valuations.

## Fig.1: Country Allocations




Source: Fidelity

Nitin's valuation discipline has led to an aggregate PE ratio at a 40% discount to the market. This marks one of the widest levels in the trust's history. These low valuations have not come at the expense of quality though, as demonstrated by an average ROE figure higher than the market. This is in spite of the country positioning, where Taiwan is at peak ROE levels, whereas China is at one of its lowest points. We believe this is a demonstration of the stock selection capabilities, as Nitin is able to identify similar levels of quality to the market, but at considerably lower valuations.

The focus on valuations has meant that the percentage of value stocks in the portfolio, according to Fidelity, has climbed to 84% as at 31/10/2023, up from 74% at the same time the previous year. This is more than double the current 41% level of the index. As such, we believe FAS will be one of the most value-orientated trusts investing in Asia.

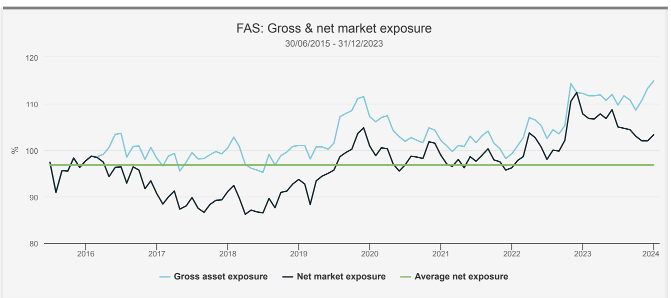
# Gearing

The strategy employed to gear up the trust is to use derivatives rather than traditional borrowing facilities. Specifically, the manager uses derivative products called contracts for difference (CFDs). These are financial instruments that allow the manager to take more exposure than the amount invested, hence acting as gearing without the traditional borrowing facilities. They also allow the manager to take short positions. It also allows for specific gearing on individual stocks, rather than for gearing to be applied across the whole portfolio.

The level of net gearing will depend on the number of opportunities the manager identifies, as well as the number of short positions (see **Portfolio**). Particularly because of the large number of value opportunities in China, net gearing rose significantly at the beginning of 2023, albeit this has come down to c. 3.3% as at 31/12/2023. Gross exposure (i.e. the long positions plus the short positions) was 114.9% of net assets.

Whilst this level of net exposure has come down throughout the year, it is still higher than the manager has typically exercised over the past five years, as we have shown in the chart below. Nitin is able to take gross exposure to 40% of NAV, with short positions a maximum of 10%, and 30% in long positions. However, in practice, the board has set a goal for net market exposure to be between 90% and 115%.

## Fig.2: Gearing




Source: Fidelity

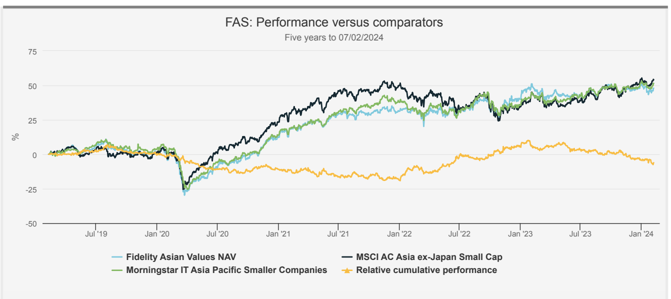
# Performance

Nitin's benchmark-agnostic approach means that stock selection is intended to be the primary driver of performance. He believes that he can gain an informational edge on the market due to the quality and depth of his research, supported by a team of specialist, on-the-ground analysts. He believes smaller companies offer the best opportunity for this due to the low levels of analyst coverage in the market which should enable outperformance over the long term.

The value-driven process will also have an influence on relative performance. This approach often creates a highly differentiated portfolio which may lead to periods of performance that are significantly different to that of the trust's formal benchmark, the MSCI AC Asia ex-Japan Small Cap Index. Nitin highlights that over the long term, value as a factor has outperformed growth in smaller companies which is supportive for the long-term performance potential. The period of ultra-low interest rates from 2008–2021, most notably 2020, was an exception to this though, with growth stocks performing strongly. Nitin was able to offset a considerable amount of this through stock selection. This reversed in early 2022 as higher interest rates led to value becoming the dominant style factor again which was a tailwind to performance.

We have shown the cumulative relative performance of FAS relative to the benchmark on the chart below. The yellow line climbs notably in 2022 as the value style became a tailwind, leading to cumulative outperformance of almost 20 percentage points in early 2023. Relative performance has slipped back recently due to the overweight to China in the latter half of the year, but regardless, the trust is broadly in line with both the benchmark and the peer group over five years.

## Fig.3: Five-Year Performance




Source: Morningstar

***Past performance is not a reliable indicator of future results.***

Nitin's focus on picking the best companies at excellent valuations, with little regard for relative positioning, has been most starkly demonstrated by performance through 2023. In the 12 months to 31/10/2023, FAS outperformed the benchmark by 0.6%, returning 13.7% versus 13.1%.

However, when looking in more detail, stock selection was very strong and contributed 12.1% percentage points of outperformance. This was almost entirely offset by country selection which contributed -10.5%. This was due to very weak performance in China and Indonesia, both of which were significant overweights, as well as strong performance from Taiwan and India which were both notable underweight positions. As we discuss in **Portfolio**, Nitin's country allocation is purely an output of where he finds stock opportunities and therefore, there can be short-term periods where positioning can impact relative performance. This has been particularly acute in the past year.

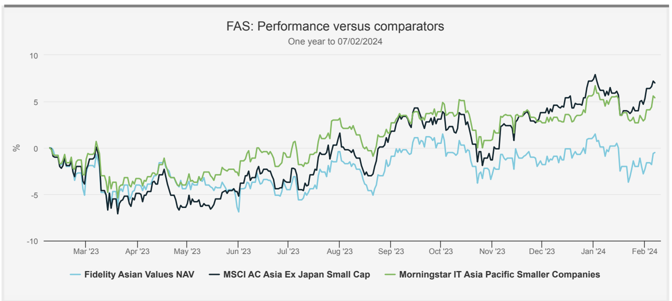
Despite this, the biggest contributor to performance was Taiwan Union Technology which Nitin has attributed to the positivity surrounding AI. However, he admits it has limited exposure to AI and has therefore sold the holding. Nitin believes Taiwanese shares will begin to fall as investors realise fundamentals are not keeping up with valuations therefore, he remains underweight. Should this occur, it would have a positive impact on relative performance.

PTC India was the second biggest contributor to the trust over this period. Nitin bought the power trading company when it was trading on a PE of 5x and a dividend yield of 13% and has enjoyed a strong recovery in performance throughout 2023, when the share price more than doubled. He also collected dividends along the way, which provided a total contribution of over 1% relative return in the year to 31/10/2023. Nitin has taken some profits from the holding but is allowing the rest of the position to run.

Indonesian tile-maker Arwana was a detractor to performance. Nitin highlights that success in this industry is all about efficiency, in which Arwana is a leader. However, investors have concerns over industry margins hence the company's shares fell. The manager points to the firm experiencing growing volumes from a structural growing housing sector, having net cash on the balance sheet and offering a 10% dividend yield as reasons to be positive over the next five years and is confident the stock will perform well when sentiment reverses.

Nitin believes his stock selection approach will be critical for performance going forward, especially so with the big divergence in performance of different countries in Asia over the past year, which Nitin believes has the potential to reverse looking forward. As we discuss in **Portfolio**, he has allocated heavily to China, as negative sentiment has made it optically cheap, and away from Taiwan which he believes is expensive. As such, the allocation to Chinese companies will likely have a big impact on performance next year due to the sizeable overweight. Whilst this has had a negative impact on performance over the past year, as we have shown in the chart below, Nitin believes further downside is limited due to the margin of safety in low valuations, whereas the upside potential is huge which would drive both absolute and relative performance.

## Fig.4: One-Year Performance

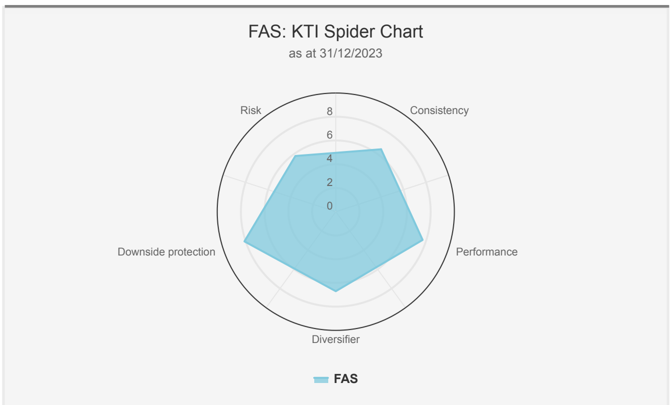



Source: Morningstar

***Past performance is not a reliable indicator of future results.***

Our proprietary KTI Spider Chart is shown below. This shows how FAS has performed versus a wider peer group of 14 investment trusts over the past five years, in some key categories. Each category is scored out of ten and scores are normalised to the peer group, with a higher score indicating a superior characteristic. This wider peer group includes large-cap and income funds. FAS scores above average for each metric. The best score is for downside protection which is a result of strong relative scores for both its worst five-month period and for downside capture. FAS also scores very highly for performance due to the strong alpha generation of the trust. We would attribute this to the stock selection capability which is a strong focus of the manager. The above average score for risk comes primarily from a lower volatility score which we believe is impressive considering the smaller companies portfolio is compared against a wider peer group including large-cap focussed trusts. FAS scores above average as a diversifier, largely due to low correlation to bond indices relative to peers, and the benchmark. We would expect this considering the benchmark agnostic approach and differentiated portfolio. FAS' lowest score is for consistency, although we note it is still above average in the wider peer group.

## Fig.5: KTI Spider Chart




Source: Morningstar

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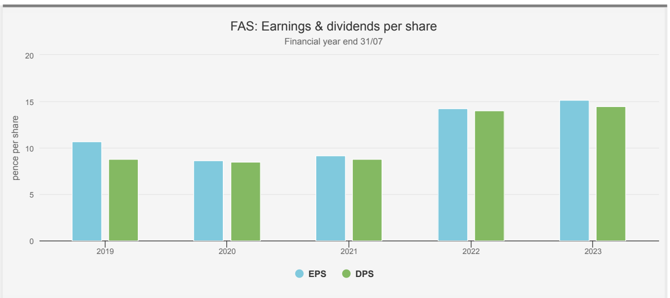
## Dividend

Nitin's primary goal is to generate capital growth by investing in a portfolio of undervalued, quality companies. As an output of this though, he tends to identify companies trading on above-average dividend yields as an outcome of their low share prices. The focus on quality also identifies companies with good free cash flow and stable balance sheets which can support a dividend, as well as being run by management teams which have an appreciation for minority shareholders. Nitin believes paying a dividend is a good demonstration of this. As such, whilst it is not an explicit goal for the trust, the portfolio often generates a decent amount of income which is paid to investors through an annual dividend.

Since the current strategy was adopted in 2015, the dividend amount has increased considerably, from 2p in 2015 to 14.5p in the most recent financial year. This was an increase of 3.4% on the previous year and represents a yield of 3.0% based on the current share price. This is higher than both peers, AAS and SST, which yield 2.4% and 1% respectively, despite AAS making its dividend a feature of the investment case. FAS' dividend was also fully covered by revenue, which increased by 6.8% on the previous year and allowed for an increase in revenue reserves. As of 31/07/2023, these stood at the equivalent of 1.5x the most recent annual dividend paid.

Despite the strong growth over the years and healthy dividend position, we believe FAS' capital growth potential is likely to be of most interest to investors. The board has reiterated the dividend is an output of the process and therefore there is no guarantee the current level will be sustained going forward. The manager believes the dividend is a demonstration of the process' success in identifying value which suggests a dividend will continue to be an element of total returns, though not the primary driver.

### Fig.6: EPS & DPS




Source: Fidelity

## Management

Nitin Bajaj is the lead portfolio manager of Fidelity Asian Values (FAS), having taken over management in April 2015. Nitin has been at Fidelity since 2003, where he started out in the London office as a research analyst before becoming assistant portfolio manager for the Fidelity Global Special Situations fund, one of the most well-known open-ended funds in the UK. In 2009, he moved to Mumbai to take over management of Fidelity's domestic Indian equity funds, before moving to Singapore in 2013 to assume management of FAS, as well as the open-ended version Fidelity Asian Smaller Companies. Nitin is a chartered accountant, as well as a holder of an undergraduate degree from the University of Delhi and an MBA.

He is supported by assistant portfolio manager Ajinkya Dhavale, who is also based in Singapore and has been working on the trust since June 2020. Beyond this, the two have access to the wider Fidelity research teams across Asia, including offices in Hong Kong, Shanghai and Singapore. This is one of the largest on-the-ground research teams in the sector and includes specialist teams for IPOs and shorting, of which Nitin is one of the analysts.

Despite this wide shared resource, each portfolio manager is allowed to undertake their own investment style. Nitin has a bias towards value investing, although he still has a strong focus on quality.

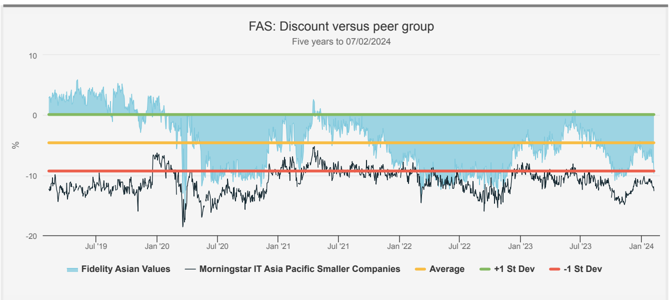
## Discount

At the time of writing, the shares of FAS trade at a discount to NAV of 9.1%, compared to a five-year average of 4.4%. The discount has been volatile in the past two years as investor sentiment has fluctuated with market gyrations. The shares traded at a double-digit discount through most of 2022, before briefly narrowing to NAV in mid-2023. This quickly reversed, with the discount again hitting double-digits in October, before narrowing again at the end of the year to their current level.

We believe this volatility could be seen as an opportunity for long-term investors. The shares trading close to NAV when sentiment was more positive shows, in our opinion, there is investor appetite for the trust when the outlook improves and therefore, should the region recover, we believe there is potential for the discount to close also. As we have discussed in **Portfolio**, the manager has increased the number of Chinese companies in the portfolio. Should the country perform a turnaround, we think it is likely to lead a broad recovery in the region. We believe this could lead to a double effect of the NAV capturing the market upswing due to the trust's exposure to China and the discount benefitting from improved sentiment and enhancing returns.

The board has indicated its willingness to buy back shares to manage the volatility of the discount. As FAS has been trading at a narrower discount than its peers, they have not bought back any shares since November 2022.

### Fig.7: Discount




Source: Morningstar

## Charges

FAS has a unique charging structure in the peer group, in that the management fees can vary depending on relative performance. The base management fee is 0.7% of net assets, though up to 0.2% can be added or taken away based on NAV performance relative to the trust's benchmark. This is calculated daily and based on three-year rolling performance. For each percentage of outperformance, 0.033% is added to the management fee, to a maximum of 0.2%, with the inverse for any underperformance. We believe this approach incentivises the managers, not only by increasing the reward for outperformance, but also by reducing the fees levied to investors if they underperform.

This has contributed to an OCF of 0.96% for the most recent financial year ending 31/07/2023 which compares to a weighted average for the sector of 0.94% according to figures by JPMorgan Cazenove as at 03/01/2024, although this group only consists of three trusts including FAS. The KID RIY is 1.37% versus a weighted sector average of 1.47%, though we would caution that calculation methodologies may vary.

## ESG

The consideration of environmental, social and governance (ESG) risks is integrated into the stock analysis across the Fidelity business. They are considered alongside the fundamental analysis performed on each company by the analyst within each investment team and given a proprietary score called the Fidelity Proprietary Sustainability Rating, which has been in place since 2019. This incorporates factors from 99 individual and unique subsectors.

Nitin cites ESG risks as one of the key characteristics to look for when determining whether a potential holding is a good business, rather than simply a good stock. Whilst all factors are considered, governance is paramount. He believes that the quality and conviction of management teams is vital to the investment case and this analysis has been part of the process for a considerable time. He believes that in smaller companies, the influence of management teams is particularly important, hence the strong focus in FAS. Environmental and social issues are now more formally incorporated into the process since the implementation of the new model and are driven by Nitin's belief in the stewardship of investors' capital. He is conscious of the nuances of the Asian market when considering the proprietary ratings derived by the analysts, which he uses alongside the fundamental scoring, although he is not driven by these scores. It is true that those companies with poorer ratings are often those that are detractors to the portfolio, but a low score does not preclude investment. One factor he does consider is engagement. If a management team are willing to engage in order to address issues that the analyst identifies, this is looked upon favourably by Nitin.

Morningstar rate the trust as 'below average' for ESG, scoring the trust as only one out of five globes on their sustainability rating. However, we believe a significant contributor to this is the level of coverage, with only c. 78% of the portfolio analysed. This means that nearly a quarter of the portfolio is given no score for sustainability factors, which reduces the validity of the rating in our view.. That being said, whilst the process does incorporate ESG factors, they are not used as a reason for exclusion which means the portfolio may contain companies that investors, for whom ESG is a key consideration, may find disagreeable.

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