

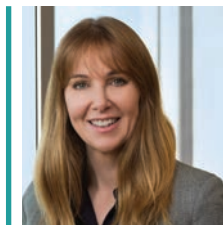
Financial Year
2017-2018

The year in review



Fidelity[™]
INTERNATIONAL

The year in review



Alva Devoy
Managing Director
Fidelity International

As another financial year comes to an end I look back with a mixed feelings. As investors, we've been the beneficiaries of a continued appreciation in markets, with most major regions and asset classes shaking off late cycle concerns and managing to circumvent high valuations and geo-political risk - not least a Trump-led trade war! As a firm we're in the fortunate position of being independently owned and answerable only to our clients, however we've watched the unfolding events of the Royal Commission closely; firstly to gauge the impact on the industry but more importantly to see how we can share our investment expertise to make a broader contribution to the changing environment.

Our core function is of course to provide outperforming funds, and on that note we've had some notable milestones. Our flagship offering, the Fidelity Australian Equities Fund, managed by Paul Taylor, turned 15 years in June. Paul has an enviable track record of delivering long-term returns for clients; in fact, if you'd invested \$10,000 on day one, it would now be worth over \$57,000, outperforming the index by 2.76%.¹ Through thick and thin, Paul has maintained his investment style, investing in quality management teams and companies, especially those using technology to disrupt both their own businesses and others.

This investment approach is much aligned with the Fidelity ethos, where as a firm we look to take a long-term view. With this in mind, I'm happy to report that Fidelity is stepping up

its growth plans for the Australia business. We continue to broaden our offering to clients, building on the wonderful Australian Equities franchise which boasts four portfolio managers: Paul Taylor, Kate Howitt, James Abela and now Anita Costa, who has recently joined the bench to manage funds for our Asian clients. This team is supported by our new Director of Research, Viral Patel, who recently joined from T-Rowe, and nine analysts.

Our Fidelity Australia growth strategy currently has three initiatives in train: (1) broadening our investment offerings to clients across all asset classes, (2) growing our investment team on the ground here in Australia - watch this space for more news on international strategies being managed from Sydney - and (3) improving the ease with which clients can access actively managed Fidelity funds, through our Active ETF program, which will launch later this year. We're also committed to developing a range of retirement solutions and, to that end, Richard Dinham has joined the team to help design and develop this capability in consultation with our investors and clients.

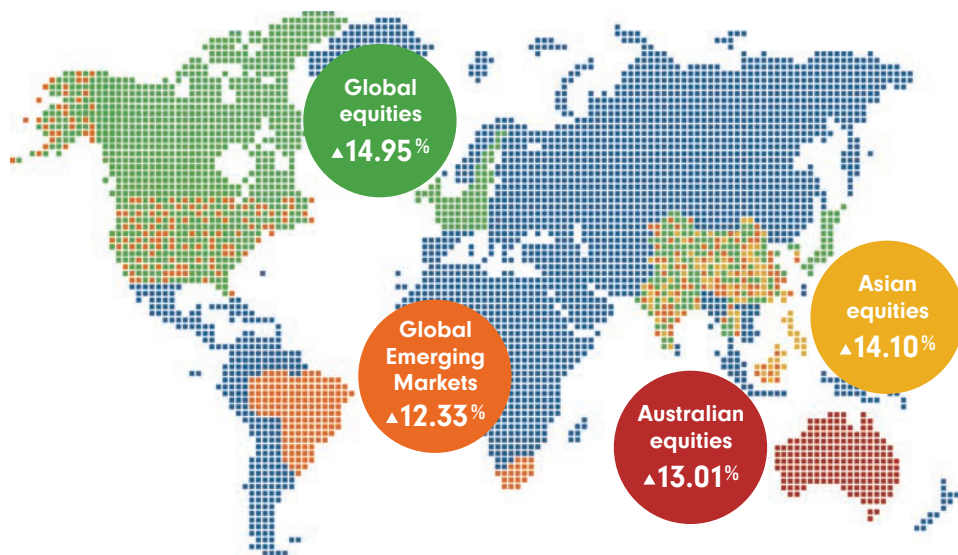
At a time when financial services are grappling with significant change, we're choosing to invest and grow our offering for Australian clients. We're committed to delivering on our objectives and improving the ease with which clients can access our products and our investment expertise. Our team is excited for the year ahead!

Our investment expert views

Performance over the last year²

30 June 2017–30 June 2018

Around-the-world snapshot



Australian equities



Paul Taylor
Head of Australian Equities
and Portfolio Manager
Fidelity Australian Equities Fund

Australian equities have again shown considerable resilience to domestic and global headwinds in 2017/18. The ASX 200 Accumulation Index rose 13.3% during the 12-month period ended June 2018, against the backdrop of rising US interest rates and subdued economic and company earnings growth, geopolitical tensions and increasing protectionism and government interventions.

This resilience was a result of still-attractive dividend yields, low single digit earnings growth and valuation multiple expansion.

Meanwhile, Australia's current economic environment remains largely supportive. Despite headwinds from weaker housing prices and its wealth effect, the country is seeing steady growth in GDP, supported by an increase in government spending and

Our investment expert views

consumption. More recently, investment in the non-mining sectors seems to be picking up. In addition, unemployment levels have remained low as employment growth has been strong.

The longer-term structural rebalancing of the economy continues to gather pace with the composition of growth shifting away from goods and towards services. As a result, the share of services (both business and consumer) in consumption, production, employment and exports continues to rise. In this regard, the theme of China moving away from infrastructure investment towards domestic consumption is likely to benefit Australia's tourism and education services sectors.

Looking ahead, we think Australian corporates remain in a strong position with quality balance sheets and good underpinning fundamentals. Our stock market has been the best-performing market in the world over the long term, driven by strong population growth, excellent and low-cost natural resource base, strong corporate governance environment, high dividend yields and high real dividend growth. These key fundamentals should continue to drive Australian equities in 2018/19 and beyond.

If you had invested \$10,000 on day one of the Fidelity Australian Equities Fund, it would be worth over \$57,000¹ today.

Global equities



Amit Lodha
Portfolio Manager
Fidelity Global Equities
Fund

2018 started on a strong note for global equities, boosted by a supportive macroeconomic backdrop, moderately rising inflation, tightening labour markets, positive corporate earnings outlook and the confirmation of a major tax reform in the US. The increased confidence amongst corporates is also evidenced in the heightened merger and acquisition (M&A) activity this year. Globally, M&As have totalled close to \$2 trillion year to date, mainly on the back of strengthening corporate balance sheets and a need to invest in disruptive technologies across sectors. Our anticipation is that this pace will only increase, with specific focus on the pharmaceutical and technology sectors.

Despite a seemingly benign backdrop, the last few months have been characterised by a spike in market volatility. Higher US wage growth led to fears of faster interest rate hikes by the US Federal Reserve (Fed), while concerns over the US administration's approach to global trade, especially relating to ongoing trade frictions with China and tensions in the Korean peninsula, also hampered market sentiment. Investors were also concerned over the implications of the political turmoil in Italy and Spain on the Eurozone.

At a regional level, the outlook for US equities appears positive, with the passage of the tax reform bill. Business optimism remains high

From a valuation perspective, regions outside the US appear relatively more favourable and the recent sell-off in emerging markets has also thrown up some interesting opportunities.

and the capital expenditure cycle, triggered by tax savings by corporates, augurs well for economic expansion. Our focus remains on bottom-up stock picking, so the regional weightings of the portfolio are not necessarily a reflection of our top-down view of the markets. However, from a valuation perspective, regions outside the US appear relatively more favourable and the recent sell-off in emerging markets has also thrown up some interesting opportunities.

Meanwhile, despite increased market volatility and Brexit-related concerns this year, UK stocks remain attractive from a historical valuation perspective and a weak sterling has provided a tailwind for large-cap exporters – an area where the fund has been overweight.

In Japan, despite the slowdown in GDP growth in the first quarter, the economy is likely to return to growth this quarter, led by strong overseas demand, although trade frictions, rising oil prices and geopolitical factors pose immediate risks to the export-reliant economy.

Overall, given the above macro uncertainties, we continue to believe that stock-specific fundamentals will remain the key driver of equity returns. Consequently, the portfolio continues to focus on companies that demonstrate strong pricing power, are led by talented management teams, and are

available at reasonable valuations. Our aim is to link all the information globally and leverage Fidelity's global research capabilities to identify the best ideas and investment opportunities, with an eye on quality, sustainability of returns and predictability of expected returns.

Asian equities



Anthony Srom
Portfolio Manager
Fidelity Asia Fund

2018 has been a challenging year to date for Asian equity markets. Our expectation is an upward bias to volatility combined with moderating global growth and US dollar strength. Equity markets are likely to struggle in this environment given where valuation multiples currently stand. We have long maintained a cautious view and still do not believe potential risks ahead have been fully priced in, particularly in the technology sector. Given this, we continue to be very selective and have been focusing on companies with above market earnings expectations and strong balance sheets.

The Fidelity Asia Fund currently holds overweight positions in the materials such as gold, property, utility and energy sectors, all of which are unlikely to be consensus positions. Within property, we own Sun Hung Kai Properties, a Hong Kong/China property company, as we believe it benefits from a supply constrained Grade-A office market in Hong Kong with a likely improvement in retail rents. The stock trades at a wider than historical average discount to NAV due to

Our investment expert views

concerns about rising interest rates, but its strong balance sheet means it can adopt capital management initiatives, for example share buy-backs, which are likely to be value accretive to shareholders.

We continue to believe that crude oil prices will be higher for longer due to limited supply growth. This should underpin earnings for companies exposed to such a dynamic. The Fidelity Asia Fund holds China Oilfield Services due to an undemanding valuation and a likely improvement in cash flow from rising rig utilisation and sales of technical services as industry capital expenditure grows to meet a tightening supply gap. The portfolio holds close to its maximum allowed cash position and we will look to deploy this into ideas at more attractive valuations. We have begun to accumulate some positions in Chinese companies as markets have pulled back but they are yet to build into more meaningful exposures.

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Global emerging markets



Alex Duffy
Portfolio Manager
Fidelity Global Emerging
Markets Fund

Global emerging markets (EM) provides numerous attractive investment opportunities in an otherwise relatively low-return global investment landscape. The challenge for investors however is that whilst the structural opportunities are widely understood there is also a cyclical overlay to the asset class which can lead to substantial equity market volatility.

Navigating this volatility is a critical element to preserving the long-term compounding of returns which the structural backdrop provides. A key factor impacting the cyclicity of the asset class today is the direction of US interest rates and more specifically what a rising interest rate environment means for funding costs across the asset class and the implications for the exchange rates. For the most part, emerging markets are in a far better place than they were in previous cycles to weather rising global interest rates.

The exchange rate volatility caused by the global interest rate environment is further exacerbated by a busy election year particularly in the second half in Latin America where key markets Brazil and Mexico are due to go to the polls. Brazil in particular is an economy which, from an equity market perspective, needs a stable and effective

government in order to push ahead with social reforms. These are desperately needed in order to arrest the fiscal position of the country, attract foreign direct investment and ultimately stabilise the currency.

Whilst we remain positively disposed to a handful of individual companies within Brazil, we did reduce our exposure earlier this year due to the valuations of equities not necessarily reflecting the balance of risks as we saw them at the time.

A core focus of our work over the coming months will be in identifying where the winners and losers are within this evolution.

Outside of politics and currency, another area where we've been increasingly cautious over the last six to nine months has been general valuation levels in EM equities. Rising global interest rates have a direct impact on the discount rate used to value equities and it has been our view for some time that certain pockets of the equity market are not reflecting the true cross-cycle discount rates which should be applied. This gives rise to the potential for a moderate de-rating of such stocks and the portfolio took steps to address this issue from a positioning point of view at the end of 2017. Should such a de-rating occur, it will likely provide an opportunity for us to acquire good businesses at better prices. Staying close to such companies and being attuned to the opportunities as they present themselves will be a key area of focus throughout the second half of 2018 and into 2019.

A final key area of focus worthy of mention is the rate of innovation we are currently witnessing across EM, and particularly in China. Investment in education and research and development (R&D) is critical to improving the long-term growth rates and structural health of an economy and more specifically creates reinvestment opportunities and intrinsic value for investors. Over the last 10 years, China has moved from being a 'fast follower' of technology to a genuine leading-edge innovator as is demonstrated by the increase in R&D as a percentage of GDP from 1.2% in 2007 to 2.1% today (a growth rate of 6.8% pa). Such investment in innovation is creating multiple new growth opportunities for Chinese companies, be it in factory process automation, security and surveillance, or even the use of facial recognition technology in dynamic advertising.

Within all industries across global EM, technology is being embraced at a significant rate and is leading to true differentiation in the growth outlook and financial prospects of many businesses. Perhaps most excitingly, this isn't confined to the technology titans alone. Rather, the technological intensity of all industries is increasing, which is creating new leading companies and attractive investment opportunities within the asset class.

A core focus of our work over the coming months will be in identifying where the winners and losers are within this evolution and seeking to take advantage of any market volatility to increase our ownership of the long-term winners at attractive valuations.

1 Performance is as at 30 June 2018. Total net returns represent past performance only. Past performance is not a reliable indicator of future performance. Returns of the Fund can be volatile and in some periods may be negative. The return of capital is not guaranteed. Benchmark: S&P ASX 200 Accumulation Index.

2 All performance is 1 year to 30 June 2018. Benchmark breakdown below:

Australian Equities: S&P ASX 200 Accumulation Index

Global Equities: MSCI ACWI

Asian Equities: MSCI Asia ex Japan

Global Emerging Markets: MSCI Emerging Markets

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