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Alex Duffy
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Fidelity Global
Emerging Markets
Fund

Prudence delivers in emerging markets

The Fidelity Global Emerging Markets Fund allows investment opportunities to prosper over medium-term horizons, taking a careful approach in an often unpredictable and volatile asset class.

Investing in emerging markets means dealing with factors that are often multi-faceted and complex in nature. But this should not be seen as a barrier to entry, rather it offers exciting opportunities to move with growing global trends and innovations.

Fidelity Global Emerging Markets Fund portfolio manager Alex Duffy says when investors generally think about emerging markets they often come back to the notions of unpredictability and volatility.

Themes such as currency movements, commodity price movements, and political events can regularly create dislocations in emerging markets – and while it creates challenges for businesses operating in these markets, it equally creates opportunities.

"I quite like those periods of dislocation and difficulty because it's when good businesses show their true colours and bad businesses also show their true colours – we get disparity and differentiation. There will always be these challenges but good businesses can navigate them consistently well over time," Duffy says.

Looking back as far as 2009, one could argue it's been a challenging environment for the asset class as it dealt with headwinds such as currency devaluations and declining commodity prices. Yet over the last 12 months Duffy says there's been a reasonable pick up in emerging markets.

"The stabilisation we've seen in commodities in terms of supply and markets rebalancing, as well as seeing prices rise, combined with an improvement in the global growth outlook due to China infrastructure stimulus, alongside more positive signs in Europe and the US - that really is starting to drive global trade, and terms of trade is really starting to pick up for emerging markets," Duffy says.

In that context, he adds, there are more reasons for optimism and he expects emerging markets to continue its current bright spot.

"Viewed through that lens it's quite an attractive backdrop as it sits today," he says.

Highlighting this recent pickup, the Fidelity Global Emerging Markets Fund produced positive absolute returns in the first quarter of 2017, also outperforming its benchmark (MSCI Emerging Markets Index NR). Since inception in December 2013, the fund has returned 8.16% net of fees and delivered an excess return of 0.6% over its benchmark as at 30 April 2017.

It's here the fund's investment philosophy comes to fruition, Duffy says. A patient and prudent process allows Fidelity to own those good businesses which benefit and thrive from opportunities presented by market dislocations.

"I'm incredibly prudent in terms of how I allocate capital in the fund with a strict focus on corporate governance and balance sheet structures at the outset – so we manage downside risk through appropriate governance and balance sheets," he says.

The fund, informed by more than 40 on-the-ground analysts, goes beyond headline company data and is focused on understanding the underlying cashflow drivers of each business it invests. It also learns how these businesses allocate capital incrementally, what the return on that reinvestment is, and what that reinvestment means for cashflow generation over a three to five year time period.

Regardless of whether the team is investing in emerging markets or elsewhere, Duffy views robust corporate governance as being the bedrock of investing, particularly within global emerging markets. It comes down to the critical issue of trust between himself, fellow shareholders and the management team of the company in which he's investing – ensuring they "treat our capital with the respect that it deserves and ensure they allocate it prudently."

"It's that prudent capital allocation which drives sustainable earnings growth in businesses and ultimately drives intrinsic value – but you wouldn't be able to have that growth or valuation improvement without governance at the outset. So really governance is the starting point of all investment decisions," he says.

The portfolio manager adds this is where the fund benefits from the power of compound from good businesses over time.

Once the investment team identifies a good stock idea, once it finds a business it can understand in great detail and where Duffy can establish a good alignment with the business' management team, he is patient in letting the investment thesis play out.

"It results in a concentrated portfolio with relatively low turnover and really owning businesses to let them develop and generate strong returns for shareholders over a medium-term investment horizon," he says.

One such business is South African health and life insurer Discovery. Duffy says the financial services firm has a particularly innovative way in engaging with its customer base through technology.

"It's a product called Vitality which customers can sign up to and it works as a reward system – so when you sign up you may be given a discount on an iWatch or be given a FitBit. It's a device you engage with and Discovery has access to that data," he says.

"They use that data to determine how often you go to the gym, how many steps you walk a day, how you sleep at night – and that gives them insight in to the lifestyles you lead, which then has obvious implications as to how they price you from a health and life insurance perspective."

Duffy says this is actually encouraging Discover's customers to alter lifestyles in a positive way. In turn it increases the insurer's competitive advantage, allows them to lower premiums and increases its company value.

The Discovery example provides great insight to Duffy's current thinking. Compared to its benchmark the fund is overweight financials by 6%, and it makes up more than 30% of the investment portfolio. It is also overweight in geographies such as South Africa and India.

The fund's top holding is Indian bank and financial services company HDFC, making up 5.4% of the portfolio. In his most recent investment update, Duffy said the Indian Government's controversial decision late last year to demonetise its 500 and 100 rupee notes to curb 'black money' may be an incredibly positive development long-term , given the limitations which informality imposes on the ability of an economy to continue to develop.

"To my mind, investing, particularly in emerging markets, always requires a patient, judicious approach…The list of issues to worry about is a long one: exchange rates, interest rates, growth rates, political uncertainty… Globalisation has driven ever greater linkages across geographies and asset classes, any perceived interference therefore creates volatility which is immediately transmitted across the investment universe," he says.

"From a longer term perspective, emerging markets continue to offer many opportunities, supported by structural growth drivers. This is because favourable demographics, infrastructure spending, rising incomes, lifestyle changes and associated consumer spending will continue to drive structural demand in these markets." **FS**

The quote

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