

# Fidelity China Special Situations

Strong longer-term absolute and relative returns

Fidelity China Special Situations (FCSS) has had a challenging period over the last 12 months, with its performance affected by a significant sell-off in Chinese equities. However, the longer-term performance remains strong in absolute and relative terms, with a 16.9% pa NAV total return over five years clearly ahead of the 14.1% pa return of the MSCI China index. The manager continues to find attractive new investment ideas, such as recent portfolio addition, luxury e-commerce platform Secoo Holding, and points to the opportunities for long-term focused stock pickers that can be created by market volatility. FCSS's discount has recently narrowed below 10% and the board has introduced a formal single-digit discount control policy, which should help reduce future discount volatility.

## NAV total return has significantly outperformed the benchmark since launch



Source: Refinitiv, Edison Investment research

## The market opportunity

The Chinese equity sell-off in 2018 led to a marked decline in valuation multiples, which remain at or near multi-year lows for many parts of China's stock markets, for both onshore and Hong Kong-listed companies. While macro concerns, such as the US-China trade dispute, are weighing heavily on sentiment, corporate earnings growth remains strong and domestically focused companies typically have limited direct exposure to US tariff hikes.

## Why consider investing in FCSS?

- Experienced manager with strong track record through market cycles.
- Portfolio manager is supported by Fidelity's extensive research capabilities.
- Unconstrained approach focused on higher-growth, consumer-led sectors.
- Focus on cash-generative companies has resulted in a steadily rising dividend.
- Active board: recently reduced management fees, revised 75:25 allocation of fees and expenses supporting dividend, new single-digit discount control policy.
- Ability to leverage, take short positions and buy unlisted stocks ahead of IPO.

## Narrowed discount, formal discount control policy

FCSS's share price discount to NAV has historically been strongly influenced by Chinese equity market sentiment and the discount has ranged from 5.0% to 23.4% over the last five years. However, the discount has narrowed below 10% this year, and in June 2019, the board adopted a formal single-digit discount control policy.

## Investment trusts

3 July 2019

**Price** 226.5p  
**Market cap** £1,244m  
**AUM** £1,681m

NAV\* 247.5p  
Discount to NAV 8.5%

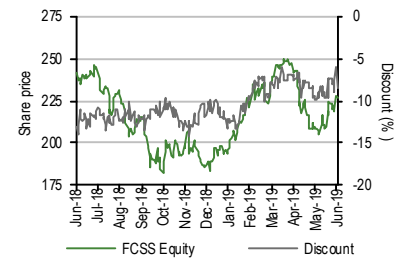
\*Including income. As at 2 July 2019.

Yield 1.7%  
Ordinary shares in issue 549.4m  
Code FCSS  
Primary exchange LSE

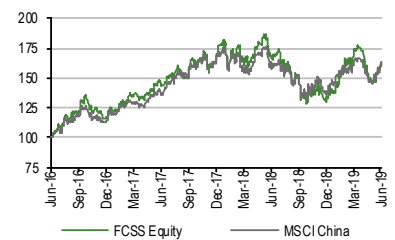
AIC sector Country Specialist:  
Asia Pacific – ex Japan

Benchmark MSCI China

## Share price/discount performance



## Three-year performance vs index



52-week high/low 250.0p 182.4p  
NAV\* high/low 278.7p 204.7p

\*Including income.

## Gearing

Gross market gearing\* 26.2%  
Net market gearing\* 20.2%

\*As at 31 May 2019.

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**Fidelity China Special Situations is a research client of Edison Investment Research Limited**

## Exhibit 1: Trust at a glance

### Investment objective and fund background

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 or Hong Kong and Chinese companies listed elsewhere. It may also invest in listed companies with significant interests in China and Hong Kong. Futures, options and CFDs are used to provide gearing, as well as to take short positions.

### Recent developments

- 05 June 2019: Adoption of formal single-digit discount control policy.
- 05 June 2019: Annual results to 31 March 2019 – NAV TR -5.3% versus benchmark TR +0.9%, share price TR -0.3%.
- 05 June 2019: FY19 dividend increased by 10% to 3.85p per share.
- 1 June 2019: Linda Yueh appointed as non-executive director.
- 23 November 2018: Interim results to 30 September 2018 – NAV TR -9.1% versus benchmark TR -4.0%; share price TR -8.8%.

### Forthcoming

AGM	24 July 2019
Interim results	November 2019
Year end	31 March
Dividend paid	30 July 2019

### Capital structure

Ongoing charges	1.02% (0.93% incl. variable fee)
Net market gearing*	20.2%
Annual mgmt fee	Variable: 0.7–1.1% of net assets
Performance fee	None

### Fund details

Group	Fidelity International
Manager	Dale Nicholls
Address	Beech Gate, Millfield Lane, Lower Kingswood, Tadworth, Surrey, KT20 6RP
Phone	0800 41 41 10
Website	<a href="http://www.fidelity.co.uk/chinaspecial">www.fidelity.co.uk/chinaspecial</a>

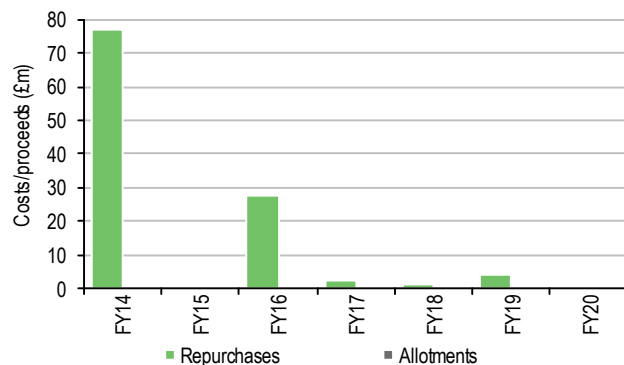
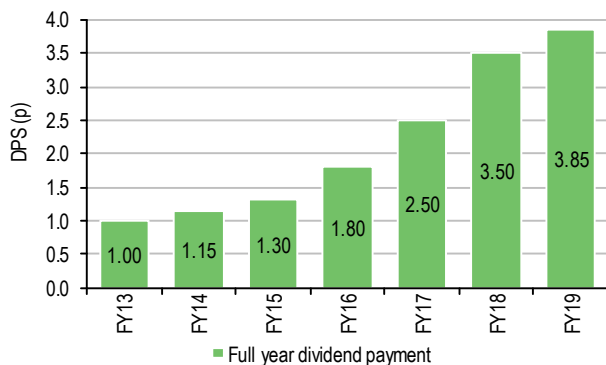
Launch date	April 2010	Trust life	Indefinite
Continuation vote	No	Loan facilities	US\$150m revolving

### Dividend policy and history (financial years)

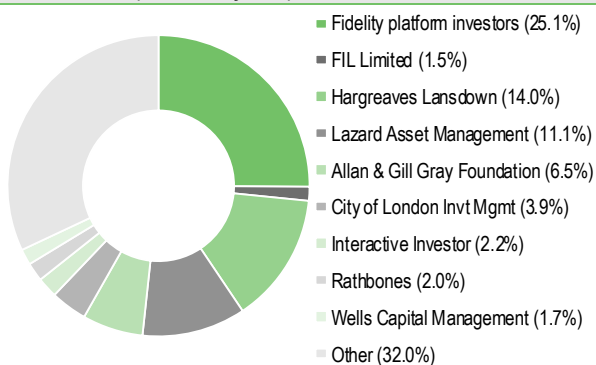
Although focused on capital growth, FCSS pays an annual dividend, which has been increased every year since its inception.

### Share buyback policy and history (financial years)

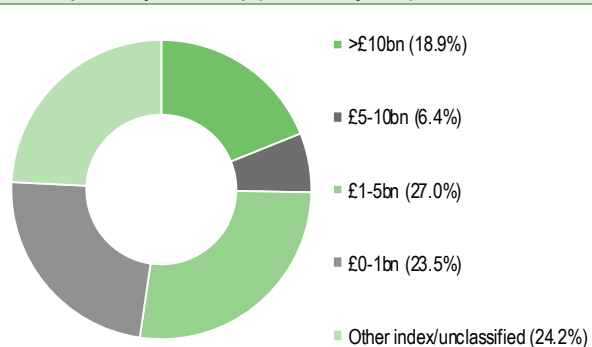
FCSS has authority to buy back up to 14.99% and allot up to 10% of its shares in issue. A formal single-digit discount control policy was adopted in June 2019.



### Shareholder base (as at 31 May 2019)



### Portfolio exposure by market cap (as at 31 May 2019)



### Top 10 holdings (as at 31 May 2019)

Company	Country	Sector	Portfolio weight %**		Benchmark weight (%)	Active weight vs benchmark (%)
			31 May 2019	31 May 2018***		
Tencent Holdings	China	Communication services	10.9	11.7	14.6	(3.7)
Alibaba	China	Consumer discretionary	7.2	8.2	13.1	(5.9)
China Pacific Insurance	China	Financials	4.1	3.5	0.7	3.4
China MeiDong Auto Holdings	China	Consumer discretionary	2.9	1.7	0.0	2.9
China Life Insurance Company	China	Financials	2.4	1.8	1.1	1.4
Hutchison China MediTech	Hong Kong	Healthcare	2.4	2.1	0.1	2.3
Kingsoft	China	Information technology	2.1	N/A	0.1	2.0
Kingdee International Software Group	China	Information technology	1.7	1.4	0.2	1.5
21Vianet Group	China	Information technology	1.5	N/A	0.0	1.5
Undisclosed	China	Information technology	1.5	N/A	0.0	1.5
<b>Top 10 (% of holdings)</b>			<b>36.7</b>	<b>35.6</b>		

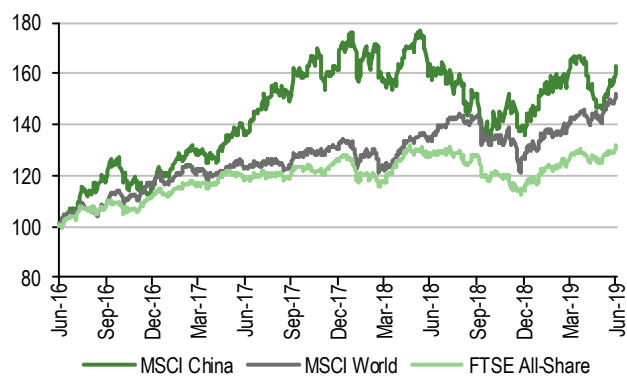
Source: Fidelity China Special Situations, Edison Investment Research, Bloomberg, Morningstar. Note: \*Gearing net of short positions. \*\*Adjusted for gearing and index hedges. \*\*\*N/A where not in end-May 2018 top 10.

## Market outlook: Macro concerns weighing on sentiment

Similar to other major stock markets, Chinese equities have experienced elevated volatility over the last 12 months, although Chinese stock market indices remain some way below their 2018 highs, while the world market is reaching new peaks, as illustrated in Exhibit 2 (left-hand chart). However, the MSCI China index has outperformed the MSCI World index over the last three years and its performance is significantly ahead of the FTSE All-Share index over this period. Market sentiment remains mainly driven by macro concerns, although fears that the US-China trade dispute may slow China's economic growth more than currently forecast are tempered by the prospect of increased Chinese government stimulus. The marked weakness of Chinese equities in 2018 contrasted with resilient corporate earnings growth, which led to a decline in the Chinese stock market forward P/E multiple to 10.0x at end-December 2018. Valuations have moved higher in 2019, but the 11.4x Chinese market P/E multiple at end-June 2019 remains somewhat lower than the 12.1x multiple for emerging markets, and is at a c 23% discount to developed markets (Exhibit 2 right-hand table).

**Exhibit 2: Market performance and valuation**

Chinese equities performance vs World and UK indices (£ terms)



Chinese equities valuation metrics vs World and UK indices

	Forward P/E (x)	Price/book (x)	Dividend yield (%)
China	11.4	1.7	2.1
Developed markets	14.8	2.3	2.6
Emerging markets	12.1	1.6	2.8
World	15.1	2.3	2.5
UK	12.5	1.7	4.5

Source: Refinitiv, Edison Investment Research, MSCI. Note: Valuation data as at end-June 2019.

Although the International Monetary Fund (IMF) recently trimmed its forecast for China's GDP growth in 2019, its latest projections show 5.9% annualised Chinese GDP growth from 2019 to 2024, compared with 3.7% for other emerging market economies and 1.7% for advanced economies. This superior economic growth backdrop underpins strong corporate earnings growth prospects, which supports a positive market outlook, alongside the relatively low valuation metrics. While volatility may remain elevated due to macroeconomic uncertainties, a potential resolution of the US-China trade dispute could act as a catalyst for a re-rating of Chinese stocks in the near term, while increasing investor attention due to the rising inclusion of Chinese equities in global indices may support higher valuation levels in the longer term.

## Fund profile: Consumer-focused Chinese equities

Launched in April 2010 and listed on the London Stock Exchange, FCSS's objective is to achieve long-term capital growth by investing in a diversified portfolio of Chinese equities, mainly comprising companies listed in China or Hong Kong, but also Chinese companies listed on other exchanges. The MSCI China index (sterling adjusted) is FCSS's performance benchmark, but portfolio exposures are not restricted by index weightings. Stock selection is based on in-depth, fundamental analysis conducted by Fidelity's well-resourced research team, which includes 20 analysts covering c 600 stocks in the Greater China (including Hong Kong, Macau and Taiwan) investment universe. The manager favours sectors with strong structural growth prospects – mainly related to rising domestic consumption, China's growing middle class and ongoing structural reforms – and the trust

also has a bias to small/mid-cap companies, where the most attractive opportunities are often found. Environmental, social and governance (ESG) factors also play an important part in the manager's analysis, as his experience in China has shown that companies with higher corporate governance standards tend to make better investments.

The portfolio typically comprises 120–150 long exposures, with up to 10% in unlisted investments and up to 15% in short positions. Gearing is permitted up to 30% of net assets, and is typically held above 20%, with contracts for difference (CFDs) used in addition to bank borrowings. Fidelity International is FCSS's investment manager, with Dale Nicholls serving as portfolio manager since April 2014. Based in Hong Kong, Nicholls has more than 15 years' experience investing in China.

## **The fund manager: Dale Nicholls**

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### **The manager's view: Attractive long-term opportunities**

Nicholls acknowledges that 2018 was a challenging year for Chinese equities, but emphasises that factors driving stock market volatility, such as the US-China trade dispute, should have limited direct effect on portfolio companies, given FCSS's low exposure to exporters, with c 90% of portfolio company revenues coming from Greater China. He reiterates that the slowing of China's economy needs to be kept in perspective, pointing out that c 6% growth is impressive for one of the world's largest economies, with faster growth in consumption set to remain due to the structural rebalancing of the economy. While noting that expectations have been tempered somewhat, he still anticipates aggregate earnings for portfolio companies to grow well above the rate of GDP growth over the next 12 months. Nicholls also highlights that market volatility can create opportunities for stock pickers focused on the long term, observing that the recent market fall has driven valuations to levels at or near historical lows for many parts of China's 'A' share market.

While FCSS has underperformed the benchmark over the last year, partly due to the effect of the trust's relatively high gearing, Nicholls highlights the strong returns achieved by a number of the portfolio's longer-term holdings including Macau telecom operator CITIC Telecom International, hot pot condiment manufacturer Yihai International Holdings and car dealership China MeiDong Auto Holdings, a top 10 holding. CITIC Telecom continued to report stable earnings and cash flow, while increasing its dividend payout. Yihai's shares rose strongly as its restaurant partner Haidilao International Holding continued to roll out new restaurants across China and listed successfully on the Hong Kong Stock Exchange, while Yihai itself grew third-party sales. China MeiDong Auto once again reported rising profits despite a tough environment for auto sales, supported by ongoing growth in the margin-accretive after-sales care and servicing business. Nicholls notes that the three largest detractors from FCSS's relative performance during FY19 actually came from not owning large, relatively defensive and mostly state-owned enterprises (SOEs): China Mobile, CNOOC and Ping An Insurance.

Among FCSS's recent new investments, Nicholls highlights the exciting potential of ByteDance, an unlisted company that operates various content platforms including Toutiao, the leading news aggregator in China, and Douyin, a strongly growing short video platform, which is also growing strongly overseas under the name TikTok. He views TikTok as ByteDance's 'killer app' for developed markets, with over 350m monthly active users. However, he emphasises that ByteDance has more strings to its bow, especially within China where its Toutiao and Douyin apps rank among the top 10 mobile apps in China by downloads, with 285m/135m and 520m/280m monthly/daily active users, respectively. To put these figures in context, he notes that Uber has only around 91 million users globally for its ride-sharing and Uber Eats apps combined. ByteDance's key drivers for monetisation are selling advertising on its China apps, with further opportunities from its overseas ventures from 2020. E-commerce and internet search developments are also in the pipeline, with search expected to be a revenue generator in 2019.

## Asset allocation

### Investment process: Research-intensive, bottom-up selection

Manager Dale Nicholls seeks to maintain a portfolio of highly cash-generative companies run by capable management teams and he focuses primarily on industries that have structural growth prospects above that of the overall Chinese economy. No restrictions are imposed on sector allocations and stock selection is driven by a research-intensive analysis of company fundamentals; the portfolio manager is supported by Fidelity's team of 20 research analysts (based in Hong Kong, Singapore and Shanghai) who cover Chinese equities. Nicholls often finds the most attractive investment opportunities among smaller companies, which tend to be under-researched with valuations not reflecting the companies' long-term growth prospects, which leads to FCSS's portfolio having a bias to small- and mid-cap stocks. Company meetings and site visits are key aspects of the process pre- and post-investment, with risk management taking on increased importance when investing in small-cap stocks, which can carry higher risks.

The same research-intensive, fundamentals-based approach is applied to making investments in listed and unlisted companies, as well as taking short positions. Portfolio restrictions include a 15% limit on individual holdings at the time of acquisition, a 10% aggregate limit on unlisted investments and a 15% limit on total short exposure. Investments in China 'A' shares are made using Fidelity's Qualified Foreign Institutional Investor (QFII) licence, Stock Connect, and brokers who hold a QFII.

### Current portfolio positioning

The portfolio is diversified across 120–150 holdings, but includes significant (although underweight versus the benchmark) core positions in tech giants Tencent (10.9%) and Alibaba (7.2%), making FCSS's exposure relatively concentrated in the top 10 holdings, which accounted for 36.7% of the portfolio at end-May 2019 (Exhibit 1). Changes to certain Global Industry Classification Standard (GICS) sector definitions in September 2018 led to the reclassification of Tencent and Alibaba from information technology to communication services and consumer discretionary, respectively. This accounts for the largest changes in sector exposure over the year to end-May 2019 (Exhibit 3).

**Exhibit 3: Portfolio sector exposure vs benchmark (% unless stated)**

	Portfolio end- 31 May 2019	Portfolio end- 31 May 2018	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
Consumer discretionary	27.0	23.0	4.0	22.5	4.5	1.2
Information technology	17.1	33.7	(16.6)	3.0	14.1	5.7
Communication services	16.2	1.9	14.3	24.2	(8.0)	0.7
Financials	14.8	11.9	2.9	23.0	(8.3)	0.6
Industrials	9.2	11.2	(2.1)	5.6	3.6	1.6
Healthcare	7.5	6.9	0.6	3.2	4.3	2.3
Consumer staples	3.9	6.4	(2.5)	3.2	0.7	1.2
Materials	1.9	0.4	1.5	2.1	(0.2)	0.9
Energy	1.4	2.6	(1.3)	4.6	(3.2)	0.3
Real estate	0.8	1.4	(0.6)	5.7	(4.9)	0.1
	<b>100.0</b>	<b>100.0</b>		<b>100.0</b>		

Source: Fidelity China Special Situations, Edison Investment Research

FCSS's portfolio exposures are highly differentiated from the index, with a notably large overweight position in information technology and significant underweights in financials and communications services. Sector weightings broadly reflect the manager's focus on faster-growing areas of China's economy, which are benefiting from rising domestic consumption and structural reforms. No bank shares are held, and FCSS's 10 largest underweight stock positions include four banks, which together represent 11.0% of the index. Within financials, the underweight in banks is partly offset by significant overweight positions in China Pacific Insurance and China Life Insurance.

Two of FCSS's unlisted holdings, Aurora Mobile (mobile data solution platform) and Meituan-Dianping (online group buying services platform) listed during 2018. Aurora Mobile made a

significant contribution to FCSS's FY19 performance and is still held in the portfolio as the manager sees strong potential for continued growth, while Meituan was sold due to the perceived risks relating to increased competition across its online services. Three new unlisted stocks were added to the portfolio in 2018: SenseTime – an artificial intelligence technology company, SZ DJI Technology Company – a leading drone manufacturer, and ByteDance, which operates internet entertainment and social media platforms globally (as mentioned above). At FCSS's March 2019 year end, unlisted investments represented 4.8% of the portfolio, including existing holdings Didi Chuxing (global ride-hailing network) and Shanghai Yiguo E-commerce Company (China's leading fresh food e-commerce platform). Some short positions, particularly in more cyclical stocks, were closed as share prices fell during the second half of 2018, but new short positions were added, and short exposure equated to 3.0% of net assets at end-May 2019.

## Performance: Medium- and long-term outperformance

**Exhibit 4: Five-year discrete performance data**

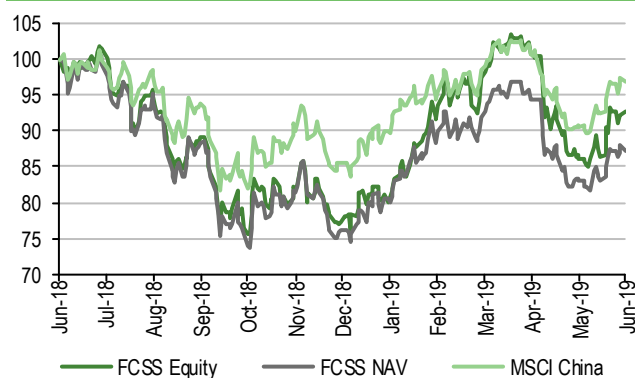
12 months ending	Share price (%)	NAV (%)	MSCI China (%)	MSCI China Small Cap (%)	MSCI World (%)	FTSE All-Share (%)
30/06/15	50.5	58.0	35.8	39.1	10.9	2.6
30/06/16	(3.5)	(0.4)	(9.6)	(15.2)	15.1	2.2
30/06/17	44.4	34.3	36.2	17.8	22.3	18.1
30/06/18	18.4	18.1	19.5	13.8	9.9	9.0
30/06/19	(7.3)	(12.8)	(3.1)	(10.7)	10.9	0.6

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

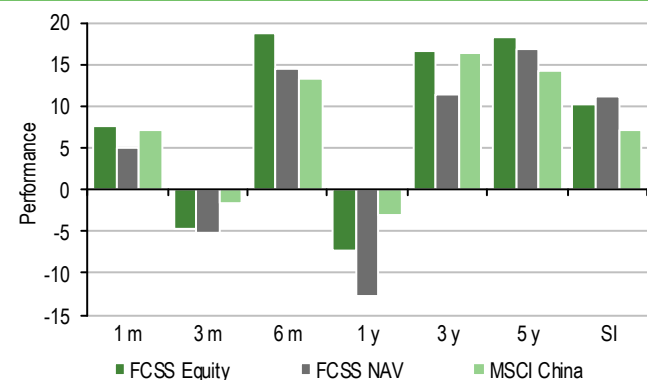
As illustrated in Exhibit 5, FCSS's disappointing performance over the 12 months to end-June 2019 largely resulted from the significant sell-off in Chinese equities during the period, with the trust's underperformance of the benchmark not unexpected given its c 20% net market gearing, which amplifies positive and negative returns. Another contributing factor is that small-cap stocks have lagged the 2019 market recovery. However, despite this short-term weakness, FCSS's longer-term returns to end-June 2019 have been strong in absolute and relative terms, with its 16.9% and 11.1% annual NAV total returns over five years and since its inception in 2010, respectively, clearly outperforming the 14.1% and 7.2% annual returns of the MSCI China index over these periods. We note that the differential between the annual returns over five years and the nine years since FCSS's inception can primarily be attributed to a significant fall in Chinese equities during 2011, although we also note that the five-year returns were affected by a notable decline in Chinese equities during 2015. Although FCSS did not match the benchmark's strength over three years, it performed well in absolute terms, with 16.6% and 11.5% annualised share price and NAV total returns, and it only modestly lagged the MSCI China index over the first two years of this period.

**Exhibit 5: Investment trust performance to 30 June 2019**

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 6: 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	0.5	(3.2)	4.9	(4.4)	0.5	18.9	27.9
NAV relative to MSCI China	(2.0)	(3.5)	1.2	(10.0)	(12.2)	12.6	38.5
Price relative to MSCI China Small Cap	5.7	(0.9)	9.8	3.8	32.3	63.0	95.7
NAV relative to MSCI China Small Cap	3.1	(1.3)	5.9	(2.3)	15.6	54.4	112.0
Price relative to MSCI World	1.9	(10.7)	1.1	(16.4)	6.3	21.0	(11.5)
NAV relative to MSCI World	(0.7)	(11.0)	(2.5)	(21.4)	(7.2)	14.6	(4.1)
Price relative to FTSE All-Share	3.8	(7.7)	5.1	(7.8)	22.4	69.5	26.8
NAV relative to FTSE All-Share	1.2	(8.1)	1.3	(13.2)	6.9	60.5	37.4

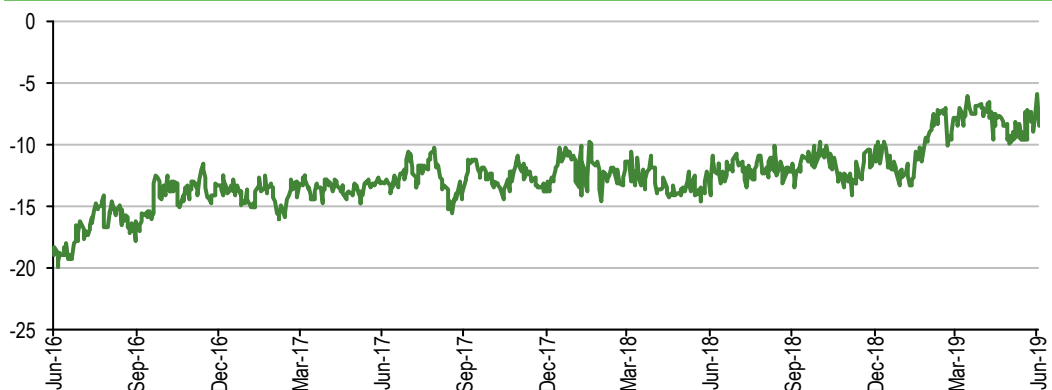
Source: Refinitiv, Edison Investment Research. Note: Data to end-June 2019. Inception date is 16 April 2010. Geometric calculation.

As shown in Exhibit 6, while it has underperformed the MSCI World and FTSE All-Share indices over one year, FCSS's NAV total return is ahead of both indices over five years and it has also outperformed the FTSE All-Share index over three years and since the trust's inception.

## Discount: New single-digit discount control policy

While FCSS's share price discount to NAV has historically been strongly influenced by investor sentiment towards Chinese equities, in June 2019 the board adopted a formal discount control policy whereby it will seek to maintain the discount in single digits in normal market conditions.

**Exhibit 7: Share price discount to NAV (including income) over three years (%)**



Source: Refinitiv, Edison Investment Research

As illustrated in Exhibit 7, FCSS's share price discount to NAV (including income) largely remained in a 10–15% range from October 2016 to February 2019, when it moved decisively below 10%, and has subsequently stayed in a 6–10% range. On 1 July 2019, the discount touched 5.9%, its narrowest level since September 2014, which represented a significant narrowing from its three-year wide point of 19.9% in July 2016. FCSS's current 8.5% discount is towards the wider end of its recently established range but is narrower than its 10.5%, 12.6% and 13.3% averages over one, three and five years respectively. The current discount is also at a similar level to its 8.4% average since FCSS's launch in April 2010. This includes a period of more than a year during which FCSS's shares traded continuously at a premium to NAV, which reached as high as 13.2%.

## Capital structure and fees

FCSS has 549.4m ordinary shares in issue, with a further 21.9m shares held in treasury. The trust has authority to buy back up to 14.99% of its outstanding shares at a discount to NAV and allot up to 10% of issued capital at a premium. Until June 2019, there was no formal discount control policy, and buybacks have been very modest since FY17 (Exhibit 1), with a total of 1.8m shares (0.3% of issued capital) repurchased in FY19. Since the adoption of the single-digit discount control policy,

only one repurchase of 150,000 shares has been made (on 12 June 2019 at a price of 211.26p per share, representing a 10.3% discount to the prevailing 235.58p NAV per share), and the discount has remained at below 10%, based on daily closing share prices and NAV figures.

Total gearing is permitted up to 30% of net assets, with borrowings restricted to 25%. FCSS utilises a US\$150m credit facility (which is fully drawn – equating to c 7% gearing), supplemented by long CFDs on a number of portfolio holdings, which add gearing more cost effectively. The credit facility charges interest at a fixed 3.01% pa and runs to February 2020. CFDs are also used to take short positions on individual stocks as well as to hedge market risk, alongside index futures and options. Net gearing is typically maintained in a 10% to 30% range, and at end-May 2019, FCSS had 26.2% gross market gearing and 20.2% net market gearing (net of short positions).

Since July 2018, FCSS has paid a 0.90% pa management fee on net assets, with a  $\pm 0.20\%$  variation fee based on NAV returns relative to the benchmark. Previously a 1.0% management fee was paid, supplemented by a 15% performance fee, with total fees capped at 2.0% of net assets. Management fees and finance costs are allocated 75% to capital and 25% to revenue, reflecting historical contributions to total returns. Largely due to the reduced fee structure, the FY19 ongoing charge was 1.02%, compared with 1.11% (excluding interest charges) in FY18, with the variable fee element reducing the FY19 ongoing charge to 0.93%.

## Dividend policy and record

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FCSS pays an annual dividend in July/August each year, distributing at least 85% of its revenue earnings. The trust has a capital growth objective and has made no commitment to grow or maintain the dividend. However, the portfolio has consistently produced a material level of income, as a result of the manager's focus on cash-generative companies, and FCSS's dividend has been increased every year since its inception. The allocation of management fees and finance costs between revenue and capital accounts was revised to 25:75 from FY18 (previously 50:50), which increased the level of revenue earnings available for distribution. This supported a 40.0% increase in the FY18 dividend to 3.50p (Exhibit 1), which was fully covered. For FY19, the dividend has been increased by 10% to a fully-covered 3.85p, which equates to a 1.7% dividend yield at the current share price. While portfolio income generation may vary each year, FCSS has built up revenue reserves equating to 2.27p per share, which could be used to smooth future dividend distributions.

## Peer group comparison

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Exhibit 8 shows a comparison of FCSS with a peer group of open- and closed-ended funds that invest in Chinese equities. JPMorgan Chinese is the only other fund in the AIC Country Specialist: Asia Pacific ex-Japan sector that focuses on China, so we show averages for the AIC Asia Pacific sector, which has c 40% aggregate exposure to Greater China. Also included are IA China/Greater China sector funds larger than £300m with more than five years' track record.

FCSS's NAV total return is lower than the open- and closed-ended peer group averages over one and three years, but is the highest of all funds shown over five years and over the 9.2 years since its inception in April 2010. Given the scale of the Chinese market correction in the second half of 2018 relative to other markets (MSCI China index fell 25% in sterling terms) and FCSS's relatively high gearing, which amplifies positive and negative returns, the trust's weak relative performance over one year is not unexpected. FCSS's ongoing charge is lower than the AIC Asia Pacific sector average, and is the lowest among its open- and closed-ended single-country fund peers. Even excluding the variable element of the management fee (0.09% credit), the ongoing charge was a very competitive 1.02%. The trust's gearing is significantly higher than average among its closed-



ended peers, even when considering its net market gearing (net of short positions), which is slightly more modest at c 20%. FCSS's 8.5% share price discount to NAV is one of the narrowest in the AIC Country Specialist: Asia Pacific ex-Japan sector, and is only moderately wider than the AIC Asia Pacific sector average. Although focused on capital growth, FCSS has a healthy 1.7% dividend yield, which is above average among single-country and regional peers.

#### Exhibit 8: Selected peer group investing in Chinese equities as at 2 July 2019\*

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR SI**	Discount (cum-fair)	Ongoing charge	Perf. fee	Net gearing	Dividend yield
Fidelity China Special Ord	1,244.4	(9.4)	44.3	128.6	170.8	(8.5)	0.93	Yes	126	1.7
JPMorgan Chinese Ord	219.2	(3.2)	66.2	96.8	138.6	(11.4)	1.34	No	108	1.2
<b>Asia Pacific average</b>	<b>364.1</b>	<b>6.2</b>	<b>46.8</b>	<b>81.7</b>	<b>129.5</b>	<b>(4.8)</b>	<b>0.99</b>		<b>103</b>	<b>1.4</b>
Allianz China Equity	422.4	(2.1)	40.4	78.6	71.8		2.29	No		0.0
AS SICAV I Chinese Equity	474.7	8.0	55.5	68.4	79.4		1.98	No		0.0
Barings Hong Kong China	1,261.0	0.5	49.5	87.3	66.1		1.70	No		0.3
Fidelity China Focus	3,719.8	3.0	53.7	120.1	108.4		1.91	No		0.9
First State Greater China	488.3	2.8	58.6	87.5	152.0		1.81	No		0.5
HSBC GIF Chinese Equity	980.3	(5.2)	43.2	81.7	61.2		2.40	No		0.0
Invesco Hong Kong & China	382.2	2.7	54.0	90.2	139.0		1.69	No		0.3
Janus Henderson China Opps	1,347.4	0.7	63.3	111.7	121.6		1.72	No		0.4
JPM Greater China	455.8	(0.6)	56.7	88.6			1.83	No		0.4
Schroder ISF Greater China	1,134.4	0.3	62.7	106.6	118.7		1.85	No		2.4
Templeton China	315.2	1.6	51.1	75.6	59.7		2.44	No		0.0
<b>Open-ended funds average</b>	<b>998.3</b>	<b>1.1</b>	<b>53.5</b>	<b>90.6</b>	<b>97.8</b>		<b>1.97</b>			<b>0.7</b>

Source: Morningstar, Edison Investment Research. Note: \*Performance to 1 July 2019. \*\*SI is since FCSS's inception in April 2010. TR=total return. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

## The board

Following the appointment of Linda Yueh on 1 June 2019 and the upcoming retirement of David Causer at the July 2019 AGM after more than nine years' service, FCSS's board will comprise five independent non-executive directors, with a wide range of skills and experience. Yueh is fellow in economics at St Edmund Hall, Oxford University, and adjunct professor of economics at London Business School, also serving on the policy committee of the Centre for Economic Performance at the London School of Economics and acting as chair of The Schiehallion Fund. The other board members, who have varying backgrounds and extensive experience across corporate finance and investment management, are Nicholas Bull, chairman (appointed director February 2010, chairman July 2016), Elisabeth Scott, senior independent director (appointed November 2011), Peter Pleydell-Bouverie (appointed February 2010) and Mike Balfour (appointed October 2018).

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