

Fidelity European Values

Following the same tried-and-tested strategy

Fidelity European Values (FEV) plans to change its name to Fidelity European Trust later this year to better reflect its objectives; however, there will be no change to the disciplined investment process. Manager Sam Morse continues to focus on cash-generative companies with strong balance sheets and significant dividend growth potential. He has increased the trust's level of gearing to benefit from an anticipated recovery in the European stock market, as equity prices typically discount an economic improvement by around six months. However, the manager is continuing to run the portfolio in a measured way, acknowledging that 'there is no big rush to change the portfolio, as costly mistakes can be made'. FEV has outperformed the continental European market over the last one, three, five and 10 years in both NAV and share price terms.

FEV's AGM video with Sam Morse (12 May 2020)



Source: Refinitiv, Edison Investment Research

The market opportunity

In keeping with markets across the globe, European stocks have experienced a significant drawdown in recent months as a result of the negative economic effects of the coronavirus pandemic. Equities have started to recover as investors focus their attention on the prospects for 2021; however, further volatility is likely, suggesting a focus on high-quality, well-financed companies may be appropriate.

Why consider investing in Fidelity European Values?

- Long-term record of outperformance; ahead of the market over the last one, three, five and 10 years. Above-average total returns versus its peer group over these periods.
- Manager is able to draw on the well-resourced Fidelity analyst team.
- Focus on both long-term capital and income growth; ordinary annual dividend has grown each year since 2010.

Discount broadly in line with historical averages

Having experienced valuation volatility during the recent stock market sell-off, FEV's discount is now back within its typical range. The current 7.5% discount to cum-income NAV compares with the 7.8% to 9.0% range of average discounts over the last one, three and five years. FEV currently offers a 2.8% dividend yield.

Investment trusts European equities

19 May 2020

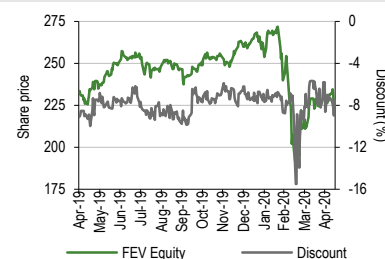
Price 227.5p
Market cap £936m
AUM £1,022m

NAV* 246.0p
 Discount to NAV 7.5%

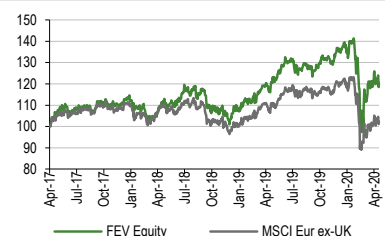
*Including income. As at 14 May 2020.

Yield 2.8%
 Ordinary shares in issue 411.5m
 Code FEV
 Primary exchange LSE
 AIC sector Europe

Share price/discount performance



Three-year performance vs index



52-week high/low 272.0p 187.4p
 NAV** high/low 292.6p 218.2p

**Including income.

Gearing

Gross market gearing* 7.6%
 Net market gearing* 7.6%

*As at 31 March 2020.

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Exhibit 1: Trust at a glance

Investment objective and fund background

Fidelity European Values' investment objective is to achieve long-term growth in both capital and income from a portfolio predominantly comprising continental European securities. Up to 20% exposure to stocks listed outside continental Europe is permitted, to give the manager investment flexibility. FEV's performance benchmark is the World Europe ex-UK Index.

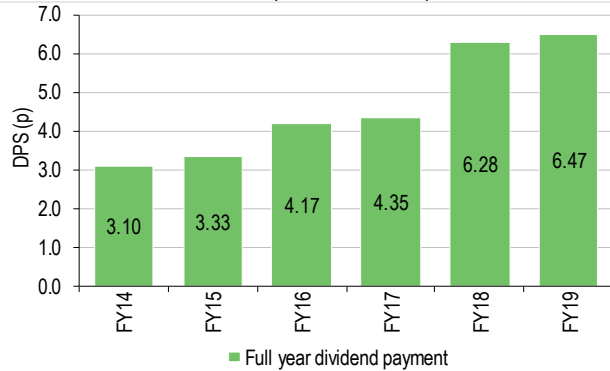
Recent developments

- 6 May 2020: FEV's name change delayed until at least 30 September 2020 due to the coronavirus outbreak.
- 19 March 2020: the trust's name will change to Fidelity European Trust on 12 May 2020.
- 19 March 2020: annual results to 31 December 2019 – NAV TR +23.8% versus benchmark TR +20.4%; share price TR +30.6%. Announcement of final dividend of 3.88p per share.

Forthcoming		Capital structure		Fund details	
AGM	May 2020	Ongoing charges	0.88%	Group	FIL Investments International
Interim results	August 2020	Net market gearing*	7.6%	Manager	Sam Morse
Year end	31 December	Annual mgmt fee	Tiered: 0.85% up to £400m net assets, then 0.75%.	Address	Beech Gate, Millfield Lane, Lower Kingswood, Tadworth, Surrey KT20 6RP
Dividend paid	November, May	Performance fee	None	Phone	+44 (0)800 414110
Launch date	November 1991	Trust life	Indefinite (subject to vote)	Website	www.fidelity.co.uk/europeanvalues
Continuation vote	Two-yearly (next 2021)	Loan facilities	None – CFDs used		

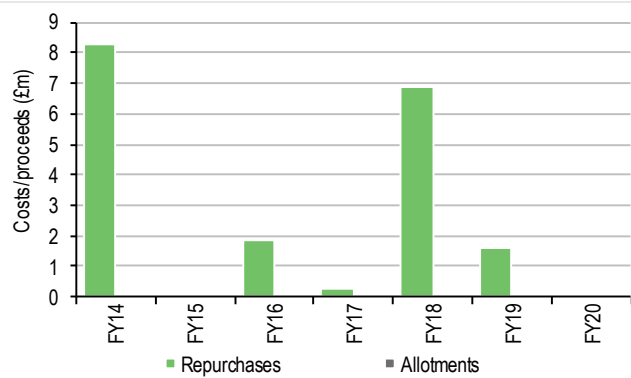
Dividend policy and history (financial years)

Until FY18, FEV paid an annual dividend in May. From FY19, an interim dividend is also paid in November. FY18 distributable income rose partly due to the shift to a 75:25 allocation of fees and expenses between capital and revenue.

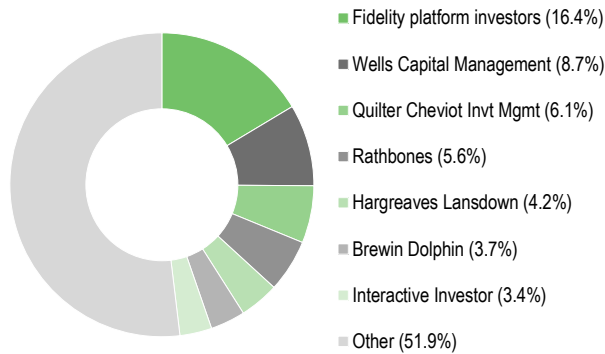


Share buyback policy and history (financial years)

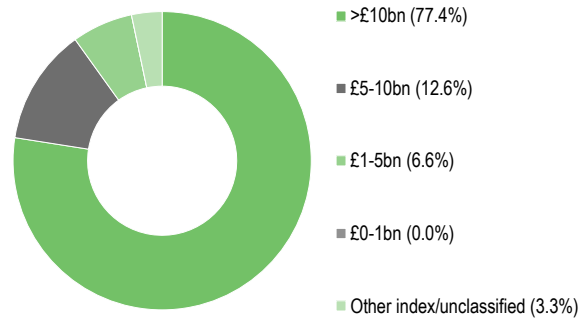
FEV has annually renewed authority to purchase up to 14.99% and allot up to 5% of its issued share capital.



Shareholder base (at 30 April 2020)



Portfolio exposure by market cap (at 31 March 2020)



Top 10 holdings (at 31 March 2020)

Company	Country of listing	Sector	Portfolio weight (%)		Benchmark weight (%)	Active weight (pp)
			31 Mar 2020	31 Mar 2019**	31 Mar 2020	31 Mar 2020
Nestlé	Switzerland	Consumer goods	8.0	7.0	5.4	2.6
Roche Holding	Switzerland	Healthcare	6.5	5.3	4.3	2.2
SAP	Germany	Technology	4.2	4.0	2.0	2.2
LVMH	France	Consumer goods	4.0	3.7	1.7	2.3
Sanofi	France	Healthcare	4.0	3.4	1.7	2.3
Novo Nordisk	Denmark	Healthcare	3.7	3.2	1.8	1.9
L'Oréal	France	Consumer goods	3.5	3.3	1.1	2.4
ASML Holding	Netherlands	Technology	3.5	3.3	1.9	1.6
Total	France	Oil & gas	3.4	4.1	1.7	1.7
Swedish Match	Sweden	Consumer goods	3.0	N/A	0.2	2.8
Top 10 (% of portfolio)			43.8	40.2		

Source: FEV, Edison Investment Research, Bloomberg, Morningstar. Note: *Gearing net of short positions. **N/A where not in end-March 2019 top 10.

The fund manager: Sam Morse

The manager's view: Maintaining a stock-by-stock approach

Morse says that while the outcome of the COVID-19 outbreak is very difficult to assess, it is worth trying to determine what shape the economic recovery will be. He suggests that a 'V' is out of the question and a long 'U' is more likely, but the shape will ultimately be determined by whether the European Union and the individual country governments have done enough to stimulate their economies. Morse says that consensus earnings estimates are 'wrong' and share prices are not pricing in what is to come. He explains that analysts look at companies' guidance and adjust their estimates according to their own expectations; however, almost 50% of European index constituents have not yet revised their guidance as they do not know themselves how much they will earn or lose, hence consensus earnings estimates are not offering a complete picture. The manager expects aggregate earnings declines as a result of the coronavirus pandemic will be larger than those experienced in the global financial crisis. 'We are dealing with a very difficult beast here', he adds. Morse says the pace of recovery will be very different on a sector-to-sector basis – construction may be one of the earliest, while travel could take quite some time to improve, as we may experience social distancing measures into 2021.

The manager comments that fiscal stimulus measures seen in Europe are lagging those in the US and Asia to a certain extent. Looking at Germany and France in isolation, total stimulus as a percentage of GDP is high – 30% in Germany and 15% in France – but Morse suggests it is important to differentiate between real fiscal stimulus (5% of GDP in Germany and 2% in France) as opposed to guarantees on loans to avoid corporate bankruptcies. Europe has been working to keep its budgets under control since the global financial crisis, but the manager believes deficits will become so large as a result of measures to offset the negative effects of the coronavirus that there are bound to be 'consequences'.

Morse continues to look at FEV's portfolio on a stock-by-stock basis, rather than positioning it for the macro environment. He notes that along with the coronavirus outbreak, another defining event so far this year has been the collapse in the oil price. The manager wonders if there will be a third disruption to global markets; 'maybe a weather-driven event', he suggests. Part of FEV's investment strategy is seeking companies that can generate sustainable dividend growth. However, this approach cannot be reliably employed when so many companies are cutting their dividends. Along with individual corporate decisions about whether dividends will be paid, governments are asking banks to suspend their distributions and in France utilities are being discouraged from paying dividends. The manager says this is a tricky, very fluid situation, which is made more confusing due to pressure from governments and regulators. In aggregate, he believes dividend payments will fall more than earnings will decline, but company managements that have chosen to suspend their dividends may change their minds by the end of the year.

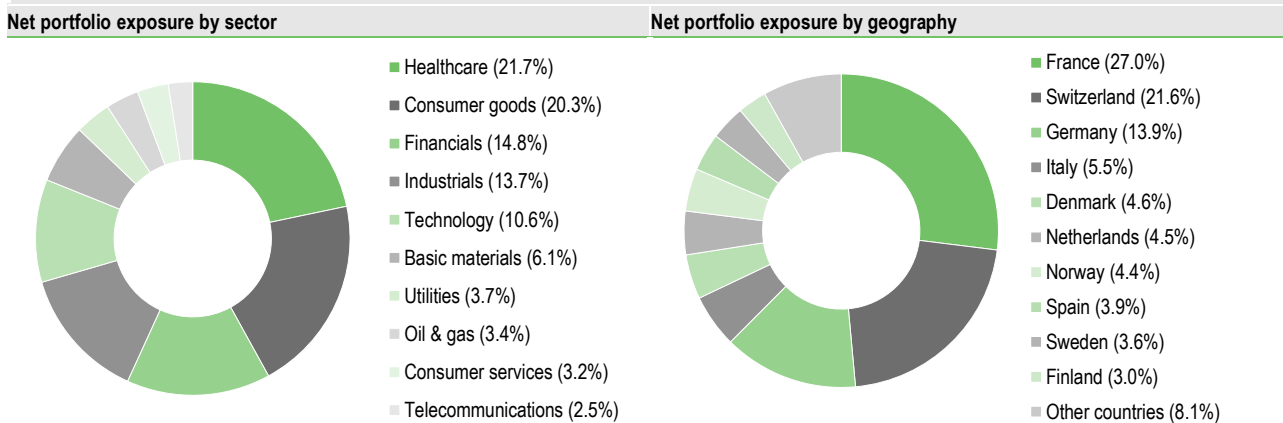
The portfolio

At end-March 2020, FEV's top 10 positions made up 43.8% of the portfolio compared with 40.2% a year before; nine positions were common to both periods. The trust is broadly diversified by both sector and geography, as illustrated in Exhibit 2.

Morse's instinct during the recent market crash was to 'sit on his hands and watch' due to rising trading costs and the risk of making costly mistakes. As an example, he considered selling the position in lift manufacturer KONE in late January/early February due to the economic slowdown in China. However, with hindsight it was a good decision not to sell the stock, as it has held up relatively well despite an initial sell-off; KONE has a strong balance sheet with a net cash position.

FEV has a position in DKSH Holding, which offers international market expansion services with a focus on Asia, helping businesses grow in existing markets and expand into new ones. The manager considered selling this holding, but he believes that the company should be a long-term beneficiary from the coronavirus lockdown. ‘You need to make slow and measured portfolio responses’, he suggests. Morse has increased FEV’s level of gearing due to stock market volatility (now c 8% versus a historic average of c 5%), closed all three short positions, which were positive contributors to Q120 performance and increased long futures exposure. The portfolio now has 47 long positions. Over the medium and long term, the manager believes the trust can keep pace with the benchmark during a recovery. He says it was not prudent to increase gearing in 2019, as the market looked very stretched. ‘Now is the right time – if not now, then when?’, he says, adding: ‘I do not want to miss out on a market recovery’.

Exhibit 2: FEV’s net portfolio exposure by sector and geography at end-March 2020



Source: FEV, Edison Investment Research. Note: Exposures are net of short positions, adjusted for gearing and index futures.

While FEV’s portfolio turnover is modest, typically 20% to 30% per year, Morse highlights important changes to the fund in recent months. He started selling Royal Dutch Shell in early December 2019 as the outlook for higher dividends kept being pushed back. The company has invested heavily in renewable energy and there were question marks about its ability to raise margins. Proceeds from the Royal Dutch sale were reinvested into Enel, which the manager had been monitoring for some time. He considers the company to be attractively valued as it is being priced as a traditional utility conglomerate, which he considers ‘unfair’. The manager says that estimated income growth of c 8% per year for the next three years, along with a c 5% dividend, offers an attractive potential total return that could be higher if the stock is revalued. ‘Enel is accelerating its renewables business; the company is in good shape and its cost of debt is declining’, he adds.

The remainder of the position in French telecom company Iliad was sold. Morse says he had given its management team the benefit of the doubt but decided the original investment thesis is no longer valid. The manager highlights the company’s stretched balance sheet, negative free cash flow and a lack of dividend growth. FEV has a new position in SIG Combibloc Group, which was listed in September 2018. It is a competitor to packaging firm Tetra Pak, with a number two global market position; both companies have different technologies. SIG generates high margins from selling machinery and then provides servicing contracts and consumables. Research from Fidelity shows that the company is taking share from Tetra Pak, helped by its Chinese exposure and shifts away from plastic packaging to cartons. Morse says this is a small position in a small-cap company and a somewhat unusual holding for FEV, but the analyst covering the stock has high conviction in this name and it provides differentiated exposure within the portfolio. Some of the trust’s positions in more leveraged companies have been trimmed, including Fresenius Medical Care, which has a meaningful US exposure. A high percentage of its costs are nurses’ wages, which are expected to rise. The manager is also closely monitoring other more leveraged portfolio names, including Italian infrastructure company Atlantia.

Performance: Very strong relative track record

Exhibit 3: Five-year discrete performance data

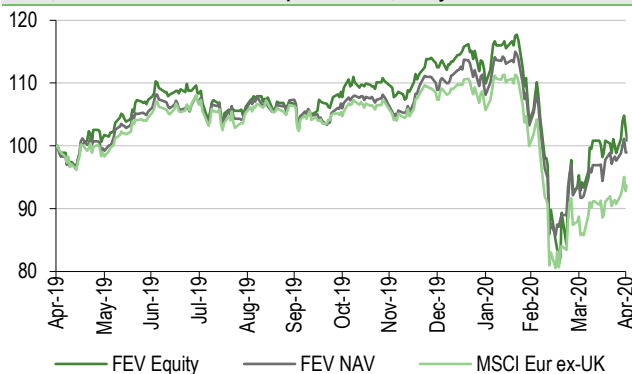
12 months ending	Share price (%)	NAV (%)	MSCI Europe ex-UK (%)	MSCI World (%)	CBOE UK All Companies (%)
30/04/16	(4.3)	(3.1)	(4.1)	1.1	(5.6)
30/04/17	25.8	25.5	28.9	30.6	20.3
30/04/18	6.8	10.3	7.2	6.9	8.1
30/04/19	12.5	9.1	3.2	13.1	2.5
30/04/20	2.8	(1.1)	(7.2)	(0.2)	(17.2)

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

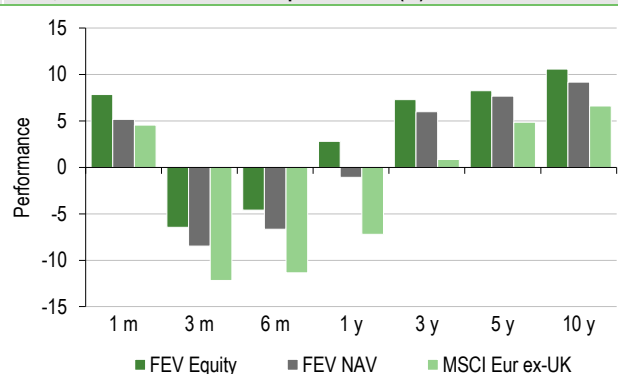
In FY19 (ending 31 December), FEV's NAV and share price total returns of +23.8% and +30.6% respectively were meaningfully ahead of the benchmark's +20.4% total return. The outperformance was primarily the result of successful stock selection, although gearing also contributed positively. The top contributors on a relative basis were semiconductor equipment maker ASML Holding (+1.2pp) and luxury goods company LVMH (+0.7pp). ASML's shares almost doubled as investors anticipated a recovery in demand for memory chips and trade tensions between the US and China began to ease. The company experienced strong demand from logic chip makers and its third-quarter earnings report revealed its strongest-ever order intake. LVMH benefited from the spending power of the Chinese luxury consumer and announced the takeover of US high-end jewellery retailer Tiffany's. The largest detractors to FEV's relative performance were ABN AMRO Bank (-1.0pp) and telecommunications company Telenor (-0.7pp). Investors had concerns about ABN's lack of robustness in its anti-money-laundering processes, while Telenor failed to complete the mooted merger of some of its Asian operations with local competitor Axiata.

Exhibit 4: Investment trust performance to 30 April 2020

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



Price, NAV and index total return performance (%)



Source: Refinitiv, Edison Investment Research. Note: Three, five and 10-year performance figures annualised.

Morse notes there was indiscriminate selling during the coronavirus-led market decline in March, although certain areas such as some consumer, travel and cyclical businesses were particularly badly hit. The manager explains that FEV has a balanced portfolio, so has some exposure to the worst-affected areas of the market; however, relative performance has held up well, helped by its healthcare and consumer staples exposure such as Novo Nordisk, Roche, Nestlé and Swedish Match. Its focus on companies with strong balance sheets has proved beneficial in an environment of widening credit spreads and many firms finding it difficult to pay their bills. Recent detractors to relative performance include financials ABN Amro, DNB, Intesa Sanpaolo and KBC Group, and travel-related businesses such as Amadeus IT Group and MTU Aero Engines.

The trust has outperformed the continental European market over all periods shown in Exhibit 5, in both NAV and share price terms. It has also significantly outperformed the broad UK market over all periods shown.

Exhibit 5: Share price and NAV total return performance, relative to indices (%)

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to MSCI Europe ex-UK	3.2	6.5	7.6	10.8	20.4	17.3	44.2
NAV relative to MSCI Europe ex-UK	0.6	4.2	5.3	6.6	16.0	14.1	26.7
Price relative to MSCI World	(1.1)	1.4	0.0	3.0	2.3	(6.6)	1.9
NAV relative to MSCI World	(3.6)	(0.8)	(2.1)	(0.8)	(1.4)	(9.2)	(10.5)
Price relative to CBOE UK All Companies	2.7	15.6	16.0	24.1	34.7	42.9	67.5
NAV relative to CBOE UK All Companies	0.2	13.1	13.5	19.4	29.8	39.0	47.2

Source: Refinitiv, Edison Investment Research. Note: Data to end-April 2020. Geometric calculation.

Exhibit 6: NAV total return performance relative to index over 10 years

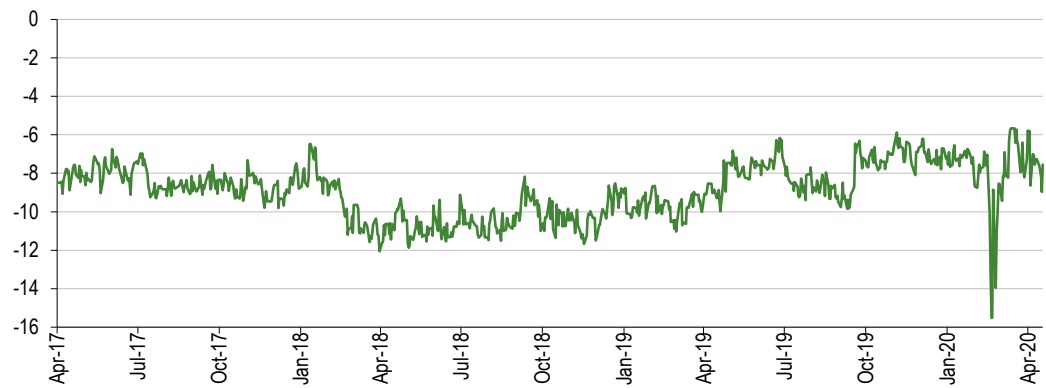


Source: Refinitiv, Edison Investment Research

Valuation: Discount back into normal range

In keeping with many other investment trusts, FEV's discount to NAV widened considerably during the recent period of coronavirus-led stock market weakness, reaching a three-year widest point of 15.5% on 18 March. Its current 7.5% discount to cum-income NAV compares with average discounts of 7.8%, 8.9%, 9.0% and 10.6% over the last one, three, five and 10 years respectively.

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



Source: Refinitiv, Edison Investment Research

Peer group comparison

There are eight funds in the AIC Europe sector, of which FEV is the largest. Its NAV total returns are above average over one, three and five years, while lagging modestly over the last decade, ranking fourth over the last 12 months, second over three years, fourth over five years and fifth over the last decade. All of the peers are currently trading at a discount; FEV's is narrower than the mean. It has an average ongoing charge, a higher-than-average level of gearing, and a below-average dividend yield.

Exhibit 8: AIC Europe sector peer group as at 15 May 2020*

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (cum-fair)	Ongoing charge	Perf. fee	Net gearing	Dividend yield
Fidelity European Values	936.1	0.8	13.5	44.3	149.3	(8.6)	0.9	No	108	2.8
Baillie Gifford European Growth	311.5	8.1	1.6	21.3	99.5	(9.2)	0.6	No	103	3.6
BlackRock Greater Europe	296.8	2.6	19.3	54.1	156.9	(4.4)	1.1	No	100	0.8
European Opportunities Trust	769.7	(5.1)	11.5	44.8	258.1	(10.0)	0.9	No	108	0.8
Henderson European Focus Trust	234.9	(2.6)	(2.3)	28.8	161.8	(11.7)	0.8	No	102	2.9
Henderson EuroTrust	222.4	6.4	11.6	50.9	179.5	(14.7)	0.8	No	105	3.0
JPMorgan European Growth Pool	170.8	(8.7)	(8.9)	20.9	100.2	(16.2)	1.0	No	100	3.8
JPMorgan European Income Pool	93.0	(21.7)	(18.7)	7.5	95.5	(14.0)	1.1	No	106	6.4
Average	379.4	(2.5)	3.4	34.1	150.1	(11.1)	0.9		104	3.0
Rank in peer group (8 funds)	1	4	2	4	5	2	5		2	6

Source: Morningstar, Edison Investment Research. Note: *Performance to 14 May 2020 based on ex-par NAV. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

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