

Fidelity European Values

Celebrating 25 years since fund launch

Fidelity European Values (FEV) recently celebrated its 25th anniversary. It aims to generate long-term capital growth from investment primarily in continental European equities, although up to 20% of gross assets may be invested in companies outside the FTSE World Europe ex-UK benchmark. Since January 2011, FEV has been managed by Sam Morse, who uses a bottom-up process to select companies that have solid fundamentals and are able to grow their dividends over a three- to five-year horizon. FEV's NAV total return has outperformed the benchmark over three, five and 10 years. Revenue earnings are fully paid out as an annual dividend; the current dividend yield is 1.8%.

12 months ending	Share price (%)	NAV (%)	FTSE World Europe ex-UK (%)	MSCI Europe (%)	MSCI World (%)
31/12/12	31.3	25.1	17.8	14.7	11.4
31/12/13	20.8	20.2	25.2	23.6	25.0
31/12/14	8.7	4.8	0.2	0.2	12.1
31/12/15	9.2	7.2	5.3	3.3	5.5
31/12/16	7.6	17.0	19.7	19.5	29.0

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

Investment strategy: Searching for dividend growth

Manager Sam Morse follows a bottom-up stock selection process, aiming to invest in companies with attractive valuations, positive fundamentals, strong balance sheets, solid cash flow generation and the ability to grow dividends over a three- to five-year horizon. FEV's portfolio typically contains 55-60 holdings; it is diversified by industry and geography, although weightings versus the benchmark are unconstrained. Gearing is permitted via contracts for difference (CFDs); at end-November 2016, net gearing was 3.2%.

Market outlook: Improving economy in Europe

The European economy is showing signs of improvement, having lagged some other developed areas, including the US, following the global financial crisis. The European economic sentiment indicator is in an uptrend, central bank monetary policy remains accommodative and the International Monetary Fund has recently increased its European growth forecasts for 2016 and 2017. While European equities have re-rated, they remain at a modest discount to world equities and a significant discount to US equities. For investors wanting exposure to Europe, a fund with a disciplined investment process and positive medium- and long-term relative performance versus its benchmark may appeal.

Valuation: Discount wider than average

FEV's current 13.2% discount to cum-income NAV is wider than the 11.3% average of the last 12 months. It is also wider than the averages of the last three, five and 10 years (range of 8.9% to 11.2%). This suggests scope for the discount to narrow meaningfully if FEV's near-term investment performance versus the benchmark improves or if investor appetite for European equities increases. FEV has grown its annual dividend consistently since 2010; its current dividend yield is 1.8%.

Investment trusts

9 January 2017

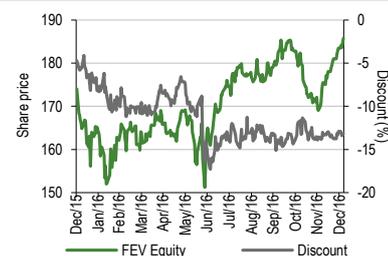
Price 185.8p
Market cap £772m
AUM £919m

NAV* 209.6p
Discount to NAV 11.3%
NAV** 214.0p
Discount to NAV 13.2%

*Excluding income. **Including income. As at 6 January 2017.

Yield 1.8%
Ordinary shares in issue 415.4m
Code FEV
Primary exchange LSE
AIC sector Europe
Benchmark FTSE World Europe ex-UK

Share price/discount performance



Three-year performance vs index



52-week high/low 185.8p 151.2p
NAV** high/low 214.6p 165.9p

**Including income.

Gearing

Gross* 3.2%
Net* 3.2%

*As at 30 November 2016.

Analysts

Mel Jenner +44 (0)20 3077 5720
Gavin Wood +44 (0)20 3681 2503

investmenttrusts@edisongroup.com

[Edison profile page](#)

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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 capital growth from a portfolio of primarily continental European securities. Permitted exposure to stocks listed outside continental Europe of 20% gives the manager investment flexibility. FEV's performance benchmark is the FTSE World Europe ex-UK Index.

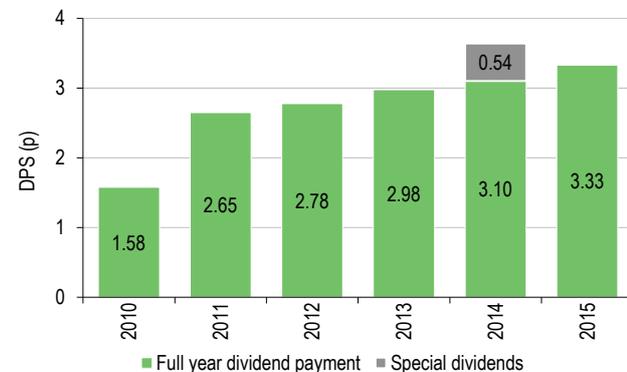
Recent developments

- 20 December 2016: Fleur Meijs appointed to the board as an independent non-executive director, effective 1 September 2017.
- 2 August 2016: Six-month results ending 30 June 2016. NAV TR +7.6% versus benchmark TR +4.8%. Share price TR -3.8%.
- 12 May 2016: Vivian Bazalgette took over as chairman from Humphrey van der Klugt, who stepped down from the board.
- 14 March 2016: Full-year results to 31 December 2015. NAV TR +6.9% versus benchmark TR +5.3%. Share price TR +9.2%.

Forthcoming		Capital structure		Fund details	
AGM	May 2017	Ongoing charges	0.94% (31 December 2015)	Group	FIL Investments International
Final results	March 2017	Net gearing	3.2% (through CFDs)	Manager	Sam Morse
Year end	31 December	Annual mgmt fee	0.85% of net assets	Address	Beech Gate, Millfield Lane, Lower Kingswood, Tadworth, KT20 6RP
Dividend paid	May	Performance fee	None	Phone	+44 (0)800 41 41 10
Launch date	November 1991	Trust life	Indefinite	Website	www.fidelity.co.uk/europeanvalues
Continuation vote	Two-yearly (next 2017)	Loan facilities	None – CFDs used		

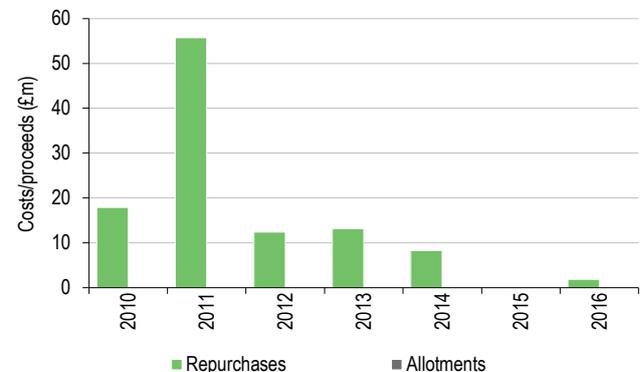
Dividend policy and history

FEV pays an annual dividend in May in respect of the previous financial year. Revenue earnings are distributed in full.

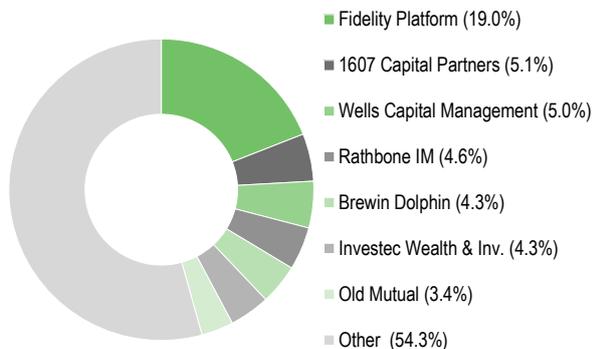


Share buyback policy and history

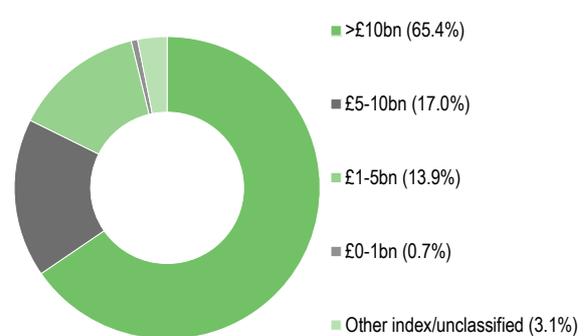
FEV has authority (renewed annually) to purchase up to 14.99% and allot up to 5% of issued share capital.



Shareholder base (as at 30 November 2016)



Portfolio exposure by market cap (as at 30 November 2016)



Top 10 holdings (as at 30 November 2016)

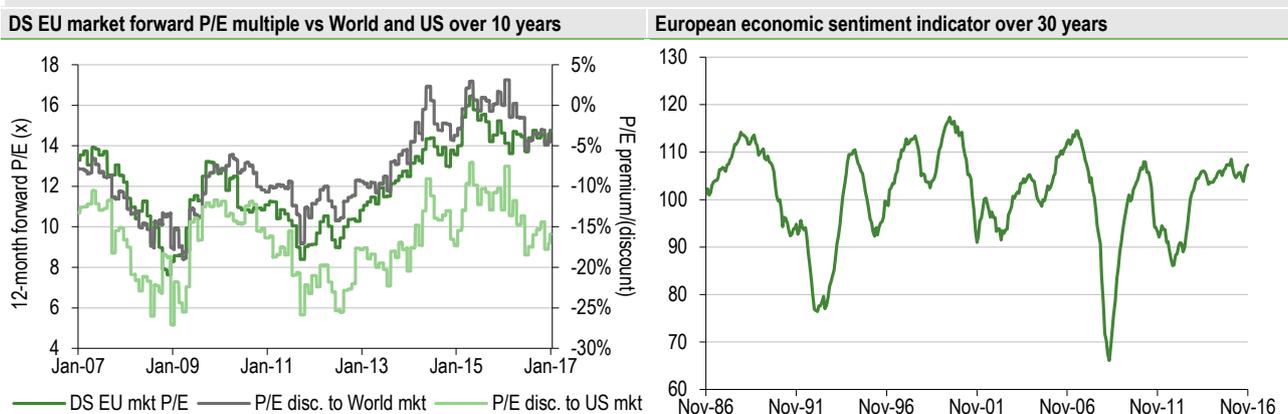
Company	Country of listing	Sector	Portfolio weight %		Benchmark weight (%)	Active weight (%)
			30 Nov 2016	30 Nov 2015*	30 Nov 2016	30 Nov 2016
Nestlé	Switzerland	Consumer goods	6.3	6.1	3.9	2.4
Roche Holding	Switzerland	Healthcare	5.3	5.9	3.1	2.2
Sanofi	France	Healthcare	4.0	3.8	1.7	2.3
Total	France	Oil & gas	3.5	N/A	1.9	1.6
3i Group	United Kingdom	Financials	3.4	2.8	0.0	3.4
L'Oréal	France	Consumer goods	3.1	N/A	0.8	2.3
Sampo	Finland	Financials	3.0	3.0	0.4	2.6
Novo Nordisk	Denmark	Healthcare	3.0	4.4	1.2	1.8
Royal Dutch Shell	United Kingdom	Oil & gas	2.8	N/A	0.0	2.8
SAP	Germany	Technology	2.8	N/A	1.4	1.4
Top 10			37.2	38.0	14.4	

Source: Fidelity European Values, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in November 2015 top 10.

Market outlook: Signs of economic improvement

Exhibit 2 (left-hand side) shows the valuation of European equities versus both world and US equities over 10 years. European equities are currently trading at a 3% discount to world equities and a 16% discount versus US equities. While continental Europe has been slower to recover from the global financial crisis than some other developed markets, there are signs of improvement – in its October World Economic Outlook; the International Monetary Fund modestly increased its European growth estimates to 1.7% for 2016 and 1.5% for 2017. As shown in Exhibit 2 (right-hand side) the European economic sentiment indicator has recovered from the depths of March 2009 and has been in an upward trend since September 2012. In addition, the European Central bank continues to adopt an easy monetary policy. For investors looking for exposure to a region with recovery potential, a fund with a disciplined investment process and a medium- and long-term record of outperformance versus its benchmark may be of interest.

Exhibit 2: European market valuation and economic sentiment



Source: Thomson Datastream, Eurostat, Edison Investment Research

Fund profile: Focus on continental European equities

FEV was launched in 1991 and is listed on the London Stock Exchange; it aims to generate long-term capital growth primarily from investment in continental European equities. It is benchmarked against the FTSE World Europe ex-UK Index and since January 2011 has been managed by Sam Morse; he has more than 25 years of investment industry experience. Up to 20% of gross assets may be invested in companies that are outside the benchmark; this includes UK-listed companies. Up to 10% may be invested in unlisted securities and the maximum permitted in a single company at the time of investment is also 10%. The use of derivatives is permitted to protect or enhance investment returns. While this gives scope to take short positions in stocks, this facility has been used selectively as the manager is aware that the risk of losing money can often be greater in a short position than a long position, including when a shorted company receives a take-over bid at a significant premium. Gearing of up to 30% of net assets is allowed, but in practice is much lower (since 2011 it has been between 2.8% and 11.3%); this is achieved via CFDs.

The fund manager: Sam Morse

The manager's view: Relatively cautious stance

In November 2016, FEV celebrated its 25th anniversary; the manager comments that since its launch there have been a lot of important changes in Europe such as the 1993 formation of the European Union and creation of the single market, and the 2008 great recession, followed by the

eurozone crisis and quantitative easing. The manager stresses that he invests in individual companies rather than countries, aiming to outperform the benchmark through different economic periods and social environments. He suggests that two-thirds of his outperformance over the long term has been the result of stock picking, with other factors such as sector allocation or gearing driving the rest of his performance.

With regards to Brexit, the manager suggests potential developments need to be kept in context; he will continue to focus on picking stocks with a two- to three-year investment horizon, where he says corporate profitability and dividend growth will drive shareholder returns. Only a small percentage of European corporate earnings are generated in the UK, while many European companies have global exposure; in aggregate more than 50% of sales are generated outside of Europe.

The manager is currently somewhat cautious on the European market due to elevated valuations (this is reflected in FEV's relatively low level of gearing) – the MSCI large-, mid- and small-cap indices are all trading close to the high end of their 10-year forward P/E ranges. Morse suggests that we are closer to the end of the stock market cycle and hence is cautious over investor sentiment rising and FEV's discount narrowing. He suggests, however, that we may yet see a level of euphoria in the European stock market; in such an environment there is likely to be elevated M&A activity and IPOs. In this scenario, the manager would be more likely to reduce gearing than increase it. Morse comments that he needs to stay open-minded and flexible, but does not consider it in investors' best interests if he tries to second guess the direction of the stock market, as this would increase the risk of underperformance.

Asset allocation

Investment process: Focus on dividend growth

The manager has three principles for equity investing: 1) bottom-up stock selection with a focus on dividend growth; 2) a long-term view, which he believes leads to better investment performance as well as lower costs; and 3) a cautious approach, which takes into account potential downside risk. He seeks companies that are able to sustainably grow dividends over a three- to five-year period based on the belief that companies consistently growing their dividends tend to outperform over multiple time periods. These companies demonstrate positive fundamentals such as structural growth opportunities, disciplined capital allocation and proven business models. Strong cash flow generation is seen as a good indicator of future dividend growth and a strong balance sheet provides a margin of safety with regards to sustainable payment of dividends, while allowing a company to continue to invest for the future. To qualify for inclusion in the portfolio, potential investee companies should trade at a discount to their estimated intrinsic value. The resulting portfolio typically comprises 55-60 holdings.

FEV tends to perform better in difficult stock markets; the manager has outperformed 75% of the time in declining markets and tends to lag in rising markets. His cautious approach is reflected in FEV's portfolio beta; during the manager's tenure, it has ranged from 0.92 to 1.03, with an average 0.96 (at end-October 2016 it was 0.93). Portfolio turnover is c 25% per annum, and illustrating the long-term investment approach, 60% of stocks in the current portfolio were held five years ago.

Current portfolio positioning

At end-November 2016, FEV's top 10 positions accounted for 37.2% of the total portfolio, a modest decrease in concentration from 38.0% at end-November 2015. In terms of active weights, the top 10 were between 1.4pp and 3.4pp above their respective benchmark weightings, with the largest overweight position in UK-listed financial company 3i Group, which is not included in the benchmark. 3i has three complementary businesses: private equity, infrastructure and debt management – the stock has been performing well and the manager expects this to continue.

FEV's portfolio has a large-cap bias; the manager suggests that large-cap financials and oil stocks are out of favour with investors and offer attractive yields. He sees good value in these sectors, such as Norwegian bank DNB and London- and Amsterdam-listed oil company Royal Dutch Shell. DNB is the largest bank in Norway with a 35% market share; it has positive fundamentals, a strong balance sheet, is cash generative and has a reasonable valuation. Royal Dutch Shell has a history of poor capital allocation, which led to low returns in a buoyant commodity price environment. Now that the oil price is considerably lower, Royal Dutch is actively reducing costs, allocating capital more efficiently and is expected to benefit from the acquisition of BG Group; recent results are showing improvement and the manager suggests the dividend may be covered in 2017.

The manager highlights top 10 position Novo Nordisk, a Danish pharmaceutical company. Its share price has been weak in recent months due to competitive pressure and concerns about product pricing in the US. However, the company has exhibited strong fundamentals over the long term, with dividends compounding at an annual rate of 20% over the last five years. Although 2016/17 could be a transition period for Novo, the manager is confident in the long-term outlook as the company's key products address diabetes, where the number of patients being diagnosed is rising rapidly across the world. A strong pipeline of new products, if successful, will offer higher pricing to offset pressure on existing products. Novo is currently trading on a forward P/E ratio of 16.4x on reduced earnings and offers a 3% dividend yield, which is expected to grow over time.

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

	Portfolio end-November 2016	Portfolio end-November 2015	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/index weight (x)
Financials	20.0	22.8	(2.8)	21.7	(1.7)	0.9
Consumer goods	17.9	18.7	(0.8)	19.8	(1.9)	0.9
Industrials	17.4	15.4	2.0	15.3	2.1	1.1
Healthcare	16.2	17.8	(1.6)	12.6	3.6	1.3
Technology	7.5	4.3	3.2	4.4	3.1	1.7
Consumer services	6.2	7.2	(1.0)	5.6	0.6	1.1
Oil & gas	6.2	4.4	1.8	4.4	1.8	1.4
Basic materials	4.0	4.3	(0.3)	8.3	(4.3)	0.5
Utilities	3.5	3.5	0.0	3.9	(0.4)	0.9
Telecommunications	1.2	1.4	(0.2)	4.0	(2.8)	0.3
	100.0	100.0		100.0		

Source: Fidelity European Values, Edison Investment Research. Note: Adjusted for gearing.

In terms of sector exposure, as shown in Exhibit 3, FEV has the largest overweights in healthcare and technology (this sector saw the largest percentage point increase in exposure over the last 12 months), with the largest underweights in basic materials and telecoms.

Exhibit 4: Portfolio geographic exposure vs benchmark (% unless stated)

	Portfolio end-November 2016	Portfolio end-November 2015	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/index weight (x)
France	28.7	26.2	2.5	22.0	6.7	1.3
Switzerland	17.5	22.6	(5.1)	19.8	(2.2)	0.9
Germany	13.1	11.2	1.9	20.4	(7.3)	0.6
United Kingdom	7.1	6.5	0.6	0.1	7.0	70.8
Belgium	6.2	6.6	(0.4)	2.9	3.3	2.1
Spain	6.0	4.7	1.3	6.7	(0.7)	0.9
Finland	5.1	5.2	(0.1)	2.3	2.8	2.2
Denmark	4.3	5.7	(1.4)	3.7	0.6	1.2
Norway	3.7	3.4	0.3	1.4	2.3	2.6
Netherlands	3.3	2.7	0.6	6.4	(3.1)	0.5
Other countries	5.0	5.2	(0.2)	14.4	(9.3)	0.4
	100.0	100.0		100.0		

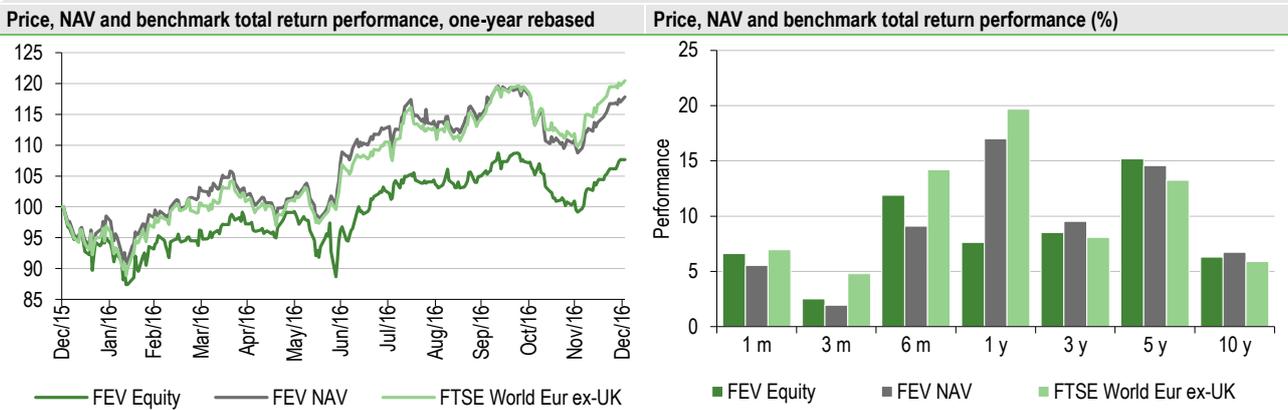
Source: Fidelity European Values, Edison Investment Research. Note: Adjusted for gearing.

FEV's portfolio is unconstrained by geographic weightings; therefore its country exposures may differ significantly versus the index. At end-November 2016, the largest overweights were in the UK and France, with the largest underweight in Germany. A notable change over the last 12 months is 5.1pp lower exposure in Switzerland.

Performance: Outperformance over the mid/long term

FEV's current manager, Sam Morse, took over running the trust on 1 January 2011; since then to end-October 2016, FEV's NAV and share price total returns of 10.2% pa and 11.1% pa compare to the benchmark's total return of 8.1% pa.

Exhibit 5: Investment trust performance to 31 December 2016



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

FEV's absolute NAV and share price total returns over the last six months have been boosted by the weakness of sterling following the result of the UK's European referendum.

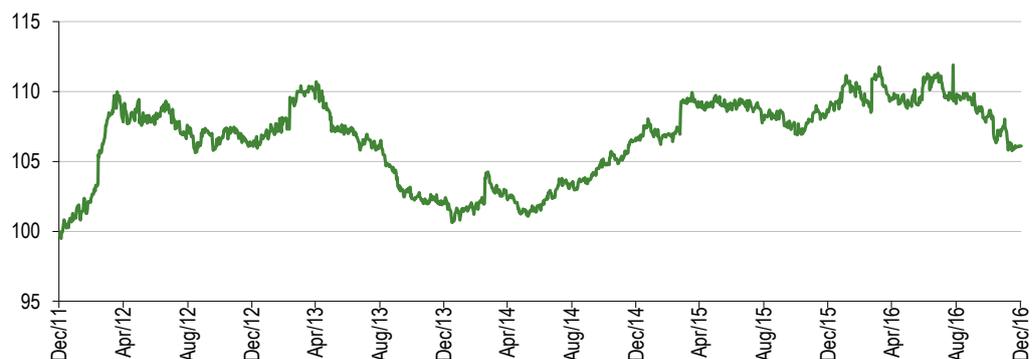
Relative returns are shown in Exhibit 6; FEV's NAV and share price total returns have outperformed the benchmark over three, five and 10 years, but have lagged over one year as sterling weakness has held back relative performance due to FEV's UK exposure. The largest detractor to performance has been the healthcare sector including positions in Sanofi and Novo Nordisk, which have been affected by competitive issues and drug pricing pressure in the US. FEV has also outperformed the MSCI Europe Index over three, five and 10 years. Underperformance versus the MSCI World Index is primarily attributable to the strong performance of US equities in recent years; the US now represents c 60% of this index.

Exhibit 6: 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 FTSE World Eur ex-UK	(0.3)	(2.2)	(2.0)	(10.1)	1.2	8.8	3.8
NAV relative to FTSE World Eur ex-UK	(1.3)	(2.7)	(4.5)	(2.2)	4.0	6.1	8.0
Price relative to MSCI Europe	0.2	(2.1)	(1.6)	(10.0)	3.3	15.6	5.7
NAV relative to MSCI Europe	(0.8)	(2.7)	(4.0)	(2.1)	6.2	12.7	9.9
Price relative to MSCI World	2.9	(4.4)	(3.4)	(16.6)	(16.2)	(4.5)	(24.5)
NAV relative to MSCI World	1.9	(4.9)	(5.8)	(9.3)	(13.8)	(6.9)	(21.4)

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-December 2016. Geometric calculation.

Exhibit 7: NAV total return performance relative to benchmark over five years



Source: Thomson Datastream, Edison Investment Research

Discount: Towards the wider end of three-year range

FEV's current 13.2% share price discount to cum-income NAV is wider than the 11.3% average of the last 12 months; over the last year, the discount has ranged from 4.1% to 17.3%. The widest discount occurred on 5 July 2016, soon after the result of the UK's European referendum, which led to higher investor risk aversion and wider discounts for investment trusts in general. The current discount is also wider than the averages of the last three, five and 10 years of 8.9%, 10.2% and 11.2%, respectively. This suggests potential for the discount to narrow meaningfully if FEV's near-term relative investment performance improves or if there is increased investor appetite for European equities.

Exhibit 8: Share price premium/discount to NAV (including income) over three years (%)



Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

FEV is a conventional investment trust with one class of share; there are currently 415.4m ordinary shares in issue. Share repurchases restarted on 30 March 2016, the first since July 2014; since then 1.1m shares have been bought back at an average price of 168.7p per share. The board considers that a modest level of gearing can enhance investment returns; FEV generally employs a low level of gearing via CFDs. At end-November 2016, net gearing was 3.2%. FEV pays an annual management fee of 0.85% of net assets; no performance fee is payable. In FY15, the ongoing charge was 0.94%, a slight reduction from 0.97% in the prior financial year. FEV is subject to a two-yearly continuation vote; the next is due at the May 2017 AGM.

Dividend policy and record

FEV aims to generate long-term capital growth, but also has a history of growing dividends (see Exhibit 1); revenue earnings are distributed in full. Annual dividends are paid in May; the FY15 ordinary dividend of 3.33p per share was a 7.4% increase versus the prior year. FY14 benefited from a special dividend of 54p per share as a result of the trust recovering £2.3m of French withholding tax and interest. Based on the current share price, FEV's dividend yield is 1.8%.

Peer group comparison

Exhibit 9 shows a comparison of the trusts in the AIC Europe sector, of which FEV is the largest by some margin. FEV's NAV total returns are ahead of the weighted average over one year and broadly in line over three years. While below the peer group average over five and 10 years, we

note that FEV's performance remains ahead of its benchmark over these two periods (see Exhibit 6). In terms of risk-adjusted returns as measured by the Sharpe ratio, FEV is broadly in line with the sector average over both one and three years. FEV's discount is modestly wider than average, while its gearing is lower than average. Both FEV's dividend yield and ongoing charge are in line with the peer group average, and like most of the trusts in the peer group, FEV does not have a performance fee.

Exhibit 9: AIC Europe sector peer group as at 2 January 2017

% unless stated	Market cap £m	NAV TR 1 Year	NAV TR 3 Year	NAV TR 5 Year	NAV TR 10 Year	Sharpe 1y (NAV)	Sharpe 3y (NAV)	Discount (ex-par)	Ongoing charge	Perf. fee	Net gearing	Dividend yield (%)
Fidelity European Values	762.2	17.1	32.5	97.8	88.8	(0.1)	0.0	(10.9)	0.9	No	103	1.8
BlackRock Greater Europe	266.7	15.6	27.6	94.2	108.3	(0.2)	(0.1)	(5.1)	1.1	No	103	1.9
European Investment	333.3	22.3	19.7	80.2	38.8	0.1	(0.2)	(13.1)	0.6	No	100	2.0
Henderson European Focus Trust	227.7	18.7	38.6	121.5	148.1	(0.1)	0.1	(7.5)	0.9	Yes	107	2.4
Henderson EuroTrust	201.3	21.4	38.1	115.4	147.5	0.1	0.1	(9.9)	0.9	Yes	102	2.1
JPMorgan European Growth Pool	200.7	15.7	31.8	105.6	73.2	(0.2)	0.0	(13.6)	1.1	No	101	2.3
JPMorgan European Income Pool	128.0	21.2	41.5	115.8	112.3	0.1	0.2	(14.5)	1.1	No	97	3.5
Jupiter European Opportunities	609.8	2.2	39.5	129.4	209.3	(0.8)	0.1	(6.2)	1.0	Yes	115	1.0
Weighted average		14.8	33.3	107.0	120.8	(0.2)	0.0	(9.6)	0.9		105	1.8
FEV rank in sector	1	5	5	6	6	5	5	5	5		3	7

Source: Morningstar, Edison Investment Research. Note: TR=total return. Sharpe ratio is a measure of risk-adjusted return. The ratios shown are calculated by Morningstar for the past 12- and 36-month periods by dividing a fund's annualised excess returns over the risk-free rate by its annualised standard deviation. Net gearing is total assets less cash and equivalents as a percentage of net assets.

The board

There are five directors on the board of FEV, four of whom are considered independent. Chairman Vivian Bazalgette was appointed as a director on 1 December 2015 and assumed his current role on 12 May 2016 following the retirement of Humphrey van der Klugt, who had served on the board for nine years, including six as chairman. The other directors and their dates of appointment are Simon Fraser (26 July 2002), James Robinson (1 June 2007), Robin Niblett (14 January 2010) and Marion Sears (17 January 2013). Simon Fraser spent 27 years at Fidelity before his retirement in 2008, including six years as chief investment officer for Fidelity International; therefore he is deemed a non-independent director.

On 20 December 2016, FEV announced that a sixth board member has been appointed, effective 1 September 2017. Fleur Meijs will be an independent, non-executive director; she is a chartered accountant with experience of complex audits at major financial institutions and was recently appointed to the board of Invesco Asia Trust.

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