

Portfolio manager: David Simner

Performance for 12 month periods in EUR (%)

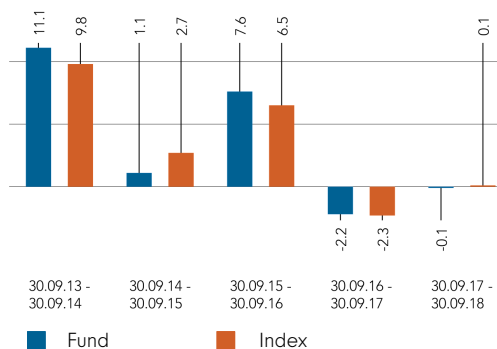
Performance over quarter in EUR (%)

Fund -0.1
Market index -0.7

The BofA ML Euro Large Cap Index

Market index is for comparative purposes only.

Source of fund performance is Fidelity. Basis: nav-nav with income reinvested, in EUR, net of fees. Other share classes may be available. Please refer to the prospectus for more details.



Market Environment

European bonds posted mixed returns, with corporate bonds outperforming core government bonds. Demand for European government bonds remained subdued due to concerns around Italy's budget crisis and the trade war between the US and China. Furthermore, most economic parameters in Europe declined, led by inflation and consumer confidence. Consumer confidence slid sharply to -2.9 in September compared to -0.6 at the end of June 2018, the lowest level in more than a year. Meanwhile, lower composite Purchasing Managers' Index (PMI) readings and waning industrial metrics point to a weakness in the economy, which could be exacerbated by the pullback in global demand and uncertainty over the region's trade relationship with the US. On the political front, the prospect of a chaotic Brexit grew following an informal summit in Austria, during which a number of the UK's proposals were dismissed by the European Union. Risk sentiment took a hit towards the end of the quarter as the Italian government announcement that it would maintain its deficit target at 2.4%, well above market expectations. German business confidence fell slightly in September to 103.7, due to mounting concerns over export-oriented companies given the ongoing trade war between the US and China.

Fund Performance

The fund posted negative absolute returns but outperformed the index over the quarter.

Subordinated financials holdings boosted performance

Investor risk sentiment improved as trade tensions between the US and Europe eased. The fund's exposure to risky credit instruments added value. The allocation to subordinated bonds of Assicurazioni Generali, a large Italian insurer, and BNP Paribas, a large French bank, were the top contributors to returns. Furthermore, an overweight stance in high-conviction Italian corporates such as UniCredit supported performance.

Favourable positioning in consumer sector aided returns

The quarter was marked by volatility as the Donald Trump administration proposed to impose automobile tariffs against European imports. These tensions subsequently eased as both parties agreed to work towards enhancing trade ties. As a result, our European automobile holdings rallied. Over the quarter, we took profits in Volkswagen International and added Michelin to the portfolio at attractive valuations. The fund's overweight position in Job Holdings, which owns a portfolio of companies across the consumer sector, also contributed to returns.

Fund Positioning

The turmoil in European bond markets continues, largely due to continued political tensions in Italy. Towards the end of the quarter, the Italian budget failed to meet market expectations. The government's focus on spending rather than productivity enhancing measures is expected to weigh on Italy's long-term debt sustainability. Consequently, we expect European government bonds to remain volatile. However, corporate bonds should be better able to navigate the volatility.

Moved to short duration position

The fund moved to an underweight duration (measure of its sensitivity to interest rate changes) position from a broadly neutral stance at the end of the last quarter, in anticipation of a tighter global monetary policy. The short duration position in high quality core European government bonds was retained on concerns around quantitative tightening and the US-led trade war rhetoric. However, we added duration through corporate credits during the quarter, with a bias towards non-financials, as spreads are back to 2017 levels in some cases.

Remain long credit beta; bias towards financials

The fund marginally reduced its credit beta (a measure of its sensitivity to credit spreads) over the quarter due to trade related concerns and Italy's budget uncertainty. This gave us the opportunity to add positions at attractive levels, specifically in Renault and Michelin. The fund also remains overweight in financials, with holdings in Generali, UniCredit and Credit Agricole.

Important Information

Past performance is not a reliable indicator of future results. The fund's returns can be affected by fluctuations in currency exchange rates.

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