The long and short of it

FEML's Polish investments show the attractive potential the trust offers – as well as the managers' unique approach to markets...

Update
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Two decades ago Polish GDP per capita was a quarter of the European Union average (EU). Today it stands at half of that amount, with research from Oxford Economics suggesting that will increase to three quarters over the next decade.

The country's prior success and the prospective growth ahead means Poland continues to display many of the archetypal traits emerging market investors look for. At the core of that is consistently high real GDP growth, starting from a low base level, that sees the country closing the income gap on developed peers.

Consequently, Poland presents a number of attractive opportunities for investors today. The country is just 1% of the MSCI Emerging Markets Index, meaning the level of research coverage is much lower than in more developed markets and there is thus more scope for an informational edge for active investors. Company revenues are often driven more by endogenous economic factors as well, resulting in investors gaining diversification benefits and the ability to take advantage of the local economic growth story.

As such, it's unsurprising that the **Fidelity Emerging Markets (FEML)** team visited Poland in April of this year. FEML looks for long-term growth opportunities among quality businesses in emerging markets. The trust is unique among its peers because managers Nick Price and Chris Tennant can also use derivatives to take short positions, providing the ability to generate positive returns in falling markets.

Fidelity took up the mandate for the investment company in October 2021, although Nick has been running the same strategy via one of the asset management group's open-ended vehicles since 2011. Although the investment company had a difficult period of performance initially, we've seen a dramatic shift in the last 12 months, with FEML shares up 21.1% on a total return basis to the end of April, compared to equivalent returns of 10.3% in the MSCI Emerging Markets Index.

The recent trip to Poland also gives some insight into how the managers approach emerging markets and the types of opportunities they look for. An obvious one here is simply research. The FEML team regularly make company visits to get a 'boots on the ground' view of how they're performing.

At the same time, the team can rely on more than 50 emerging market analysts – a huge number – who are spread across the

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globe. Having such strong research resources is part of the reason the managers are able to take a 'go anywhere' approach to markets, which can also result in having off-benchmark holdings too.

For the long book, the managers look for companies that are valued attractively but which have the potential to deliver sustainable earnings growth over the long-term. They also look for businesses which can achieve this with minimal leverage, meaning they can drive self-funded growth, rather than having to tap equity or debt markets.

Auto Partner is one example of this. The company, currently a FEML holding, delivered annualised earnings growth of close to 40% from 2019 to 2023. Growth was self-funded and the company has increased net assets almost three fold in that time to over PLN 1bn (£200m) – or about a third of the company's current market capitalization.

Growth is still on the horizon as well, with expansion plans in both the domestic Polish market, as well as the UK and European Union. Preliminary results published by the company for the first quarter of the year show revenues up almost 20% year-on-year relative to Q1 of 2023.

Companies in the short book have to meet a rather different set of standards. Typically the FEML managers look for stocks which have significant downside potential, as well as where they can take a differentiated view versus the consensus. Another key factor is a structural flaw or change in the business model.

The managers met with one company in the short book on their Polish trip. This company's margins have come under substantial pressure in recent years, forcing them to pivot into a completely unrelated sector to the core business. The pivot isn't proving to be successful and it looks likely debt will increase over the course of 2024.

Poland is obviously only a fraction of the emerging market universe and FEML's net exposure to the country is broadly in line with the benchmark's. However, the country is a good example of an emerging market story playing out, as well as illustrating the opportunities investors can benefit from when that takes place.

And as readers can infer, FEML's strong research team and on the ground approach means it's well placed to take advantage of these opportunities when they present themselves. That can be true of a growth story like Auto Partner but also with the short book, which can be used to drive outperformance from poorer performers.

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