



Fidelity China Special Situations (FCSS)



FCSS's exceptional year has captured all of China's recovery and more.

Overview

Update
05 November 2025

Fidelity China Special Situations (FCSS) has delivered exceptional near-term **Performance**, capturing all of the recovery in the country's equity market in the past year, and more, leading to long-term outperformance of both the market and peer group.

Manager Dale Nicholls has not rested on his laurels and instead responded to the changing backdrop by tweaking the portfolio, taking profits from high-performing areas, and adding where he thinks there is value. Consumer-focussed names have been one area Dale has found opportunities, as well as companies that have become global leaders in their industries. The **Portfolio** continues to have a notable small- and mid-cap bias which not only offers differentiation but has allowed stock selection to be the primary driver of returns.

Gearing remains a key feature and will have contributed to performance in the market rally. As this has gone on, Dale has reduced the trust's gearing, although it still has the highest level in the three-strong peer group.

The past year has seen a big increase in the trust's **Dividend** of 25%, resulting in yield of 2.5%, as well as a special dividend for the first time in the trust's history. This was a result of strong underlying revenue generation and one large stock payout, and has also enabled revenue reserves to increase notably.

Despite the strong performance and improving outlook, the trust continues to trade at a c. 10% **Discount** to NAV, wider than its own five-year average. The board has continued to undertake share buybacks to help narrow this.

The trust was awarded Kepler's Growth Rating for 2025.

Analyst's View

We believe there are two key elements to the investment case for FCSS, especially at this juncture. Firstly, there is the broader China narrative, which has improved considerably in the past year from fear to optimism following the sizeable intervention of the government in supporting the economy. Secondly, there is Dale's ability to capture this, through the many facets of his flexible, all-encompassing process offering multiple sources of alpha which has delivered substantial outperformance in the rising market (see **Portfolio**).

The capability to invest in private holdings, flexibility to invest in smaller companies and ability to use considerable gearing have all contributed to the trust being a differentiated option, cementing its place as a fantastic long-term option in our view. Despite the strong **Performance** over the past year, Dale notes that valuations remain very compelling, especially in certain areas, therefore there is considerable scope for future returns too.

This potential is arguably enhanced by the trust's current **Discount**, which remains in line with peers despite the rally and outperformance of comparators. We believe this adds to the trust's upside potential should sentiment continue to improve and the track record be recognised.

Finally, whilst not a core element of the trust, the **Dividend** growth track is impressive. The trust has delivered income growth in every year since inception, with a sizeable jump this year. There are encouraging signs this growth can be sustained following the renewed focus on total shareholder returns by the government. Whilst the yield of c. 2.5% isn't as high as more income-focussed trusts, the income stream is likely to offer differentiation as part of a wider portfolio and could provide solid dividend growth over the long-term.

Analysts:

Ryan Lightfoot-Aminoff

Ryan@keplerpartners.com



Kepler Partners is not authorised to make recommendations to Retail Clients. This report is based on factual information only.

The material contained on this site is factual and provided for general informational purposes only. It is not an invitation or inducement to buy, sell or subscribe to any product described, nor is it a statement as to the suitability or otherwise of any investments for any person. The material on this site does not constitute a financial promotion within the meaning of the FCA rules or the financial promotions order. Persons wishing to invest in any of the securities discussed in the website should take their own independent advice with regard to the suitability of such investments and the tax consequences of such investment.

BULL

Trust has significantly outperformed over multiple time periods, driven largely by stock selection

Current discount offers an attractive entry point

Trust has delivered excellent dividend growth, with a much-improved reserves picture

BEAR

Smaller cap bias and private holdings add risks

Chinese economy still at risk from ongoing tariff tension

High level of gearing can exacerbate downside as well as upside

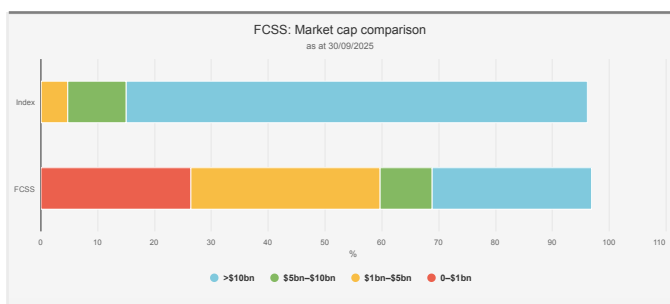


Portfolio

Dale Nicholls, manager of Fidelity China Special Situations (FCSS), has a flexible investment mandate, allowing him to capture a wide range of opportunities from the vast universe of Chinese companies across multiple markets, as well as invest in private companies.

Holdings are selected from the bottom up, with Dale using the wide resources available to him at Fidelity to uncover undervalued companies that are able to create exceptional long-term returns. As a result, the portfolio tends to have a bias towards small and mid-sized companies as they not only offer better growth prospects, but the market is usually less efficient in pricing these, therefore Dale has identified a number of opportunities here.

Fig.1: Market Cap Breakdown



Source: Fidelity

As we detail in the **Performance section**, China has undergone a remarkable year leading to a changing outlook for several companies and industries. Despite this, Dale believes valuations remain compelling in many areas, and he has continued to find high quality companies trading at attractive prices.

Where he has found the most opportunities, and therefore where largest overweight sectors are, is in areas that are likely to become a bigger part of the Chinese economy in the future, such as healthcare, technology and consumer facing companies. Dale believes the latter of these offer considerable value opportunities at present due to concerns over weak consumer confidence depressing share prices.

This has led to the consumer staples and discretionary sectors being two of the three largest overweight sectors. One theme within this is sportswear. The industry currently has quite low penetration, with just 10% to 15% of the population owning dedicated sportswear, about half of the global average, and considerably less than the leader, the US at 35%. As such, there is a considerable growth potential in the space. Dale has taken a position in domestic champion Xtep. They have been gaining market share, particularly in the running market, through their Saucony brand. Xtep recently announced a jump in profitability, driven by revenue and margin expansion,

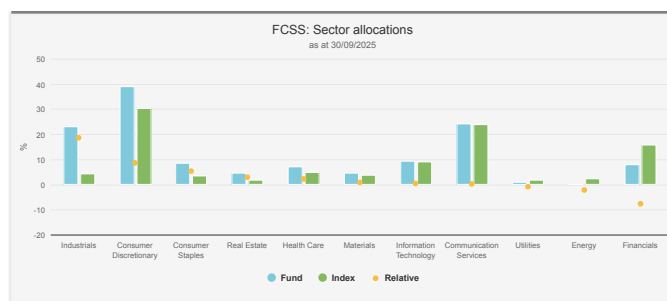
demonstrating the growth potential of consumer facing stocks, when the right ones are identified.

The largest overweight though is to industrials, although the sector is very broad. For example, one of the largest overweight stocks is Tuhu Car, a car servicing company which is arguably a consumer discretionary company. By contrast, a recent addition has been Hesai Group, a leader in lidar sensors used in vehicle autonomy. Despite this having a strong industrial bias, the stock is categorised in the consumer discretionary sector and has been a big contributor to **Performance** in the past year. Elsewhere in industrials, Dale notes the strong R&D spend over many years has created several global leaders in their spaces, such as in robotics and the EV supply chain which he has exposure to. As such, whilst the sector is a notable overweight, it is very diversified by sub-sector and drivers.

Whilst Dale likes the dynamics of the technology sector, the sector is a neutral allocation due to his selectiveness. A key example of what he is looking for is Kingdee International Software, a leading ERP software firm. Whilst business management software is still a nascent market in China, it offers considerable growth potential, which Kingdee have been capturing market share of, thanks to good innovation and incorporation of AI across their suite. The company is forecasting it will achieve profitability in 2025 and if so, could be a turning point for the firm.

Dale has also sold some holdings as their outlook has changed. One tool that has been used to boost the economy is rate cuts, although this has reduced the potential profitability for areas of the finance industry, leading to the manager reducing several names here, especially insurance firms. He has also sold down some consumer financials stocks, although some of this is profit taking from a strong rebound on the government stimulus measures, which caused hopes of a consumer recovery. These changes have contributed to financials being the largest underweight position as we show in the chart below.

Fig.2: Sector Allocations



Source: Fidelity

Despite these sector differences, Dale argues the portfolio remains risk-managed through diversified positioning, including a slightly less concentrated top-ten holdings than previously, with a mixture of underlying performance drivers.



Of these, two are still private companies, including ByteDance, the owner of TikTok. Dale recently added to this position at a single digit forward PE, making it the biggest active position in the portfolio. Elsewhere, previous private holding Pony.ai was listed in the US in November 2024, although the manager has continued to hold the position.

Top Ten Holdings

Stock name	Sector	Fund (%)	Index (%)
Tencent	Communication Services	14.3	18.1
Alibaba Group	Consumer Discretionary	9.5	12.9
PDD Holdings	Consumer Discretionary	4.9	3.1
ByteDance	Communication Services	3.7	0
Pony.ai Inc/ca	Consumer Discretionary	2.7	0
Hesai Group	Consumer Discretionary	2.1	0
CATL	Industrials	2	0.7
China Foods	Consumer Staples	2	0
Trip.com Group	Consumer Discretionary	1.9	1.6
NetEase	Communication Services	1.8	1.8
Total		44.9	38.2

Source: Fidelity, as at 30/09/2025

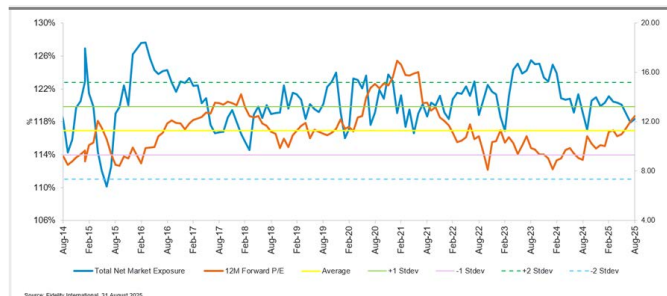
Gearing

Gearing has been a feature of FCSS for much of its history, with the level varying depending on conditions. Dale views the level of gearing as a balance to the level of volatility in markets and valuations. When sentiment is low and the market is attractively valued, Dale will increase the level of gearing, and then when markets rally, this will be reduced.

This is best reflected in the changing level of net gearing over the past few years. As the market rallied in 2021, Dale reduced exposure, before increasing it again in late 2022 as the market began to fall. With markets having rallied in 2025 (see **Performance**), Dale did reduce the level of gearing, from the c. 20% at the end of the previous financial year (31/03/2025) to a net level of 16.6% as at 31/08/2025, although this increased again to 19.6% as at 30/09/2025 and remains the highest level amongst peers. We understand the high levels of gearing have been beneficial to performance over the past year, as markets

have risen, and contributing to the outperformance. The chart below shows the valuation of the Chinese market on the right-hand scale, making it clear how gearing varies as valuations do.

Fig.3: Gearing



Source: Fidelity

Rather than traditional loan facilities, Dale uses CFDs to express his views. These are financial instruments that allow the manager to take more exposure than the amount invested on both the wider index and on individual stocks. They can also be used to take short positions in stocks and the index. CFDs have been the sole gearing facility since February 2024 when the previous loan facility expired, although the board has stated it is willing to use fixed-term facilities in the future should it be able to do so at competitive interest rates.

Performance

Dale has delivered exceptional returns over the past year, capturing all of the recovery in the Chinese market and more to produce both very strong absolute and relative performance for the trust. In the 12 months to 31/10/2025, FCSS has delivered a NAV total return of nearly 50%, considerably more than the trust’s benchmark, the MSCI China Index, which returned 30.8%. This is represented in the chart below by an ETF. FCSS also outperformed the unweighted peer group average, which returned 32.2%. We have used unweighted as FCSS is the largest trust in the sector by a margin.

Fig.3: One-Year Performance



Source: Morningstar

Past performance is not a reliable indicator of future results.



As this performance shows, the Chinese market has rallied strongly in the past year, following the announcement of government stimulus measures in September 2024 which we discussed in [our previous note](#). Markets were pushed higher again in early 2025 after the announcement of DeepSeek, a domestically created AI model which led rallies in several AI-related companies.

However, this optimism was soon interrupted after Liberation Day, with China being a key focus of President Trump’s tariff regime. Whilst this caused a sell-off, which escalated as China and the US issued retaliated tariffs, the countries soon went through a series of negotiations which assuaged the worst fears of effective trade embargoes and contributed to a market recovery, although there have been intermittent flare-ups.

Despite the multiple macro factors in the background, FCSS’s performance has predominantly come from stock selection. In fact, the rally earlier in 2025 was predominantly led by a narrow band of stocks, causing Dale’s small- and mid-cap bias to be a headwind. However, this has since broadened out and has more than been offset by stock selection.

This is best demonstrated in the attribution figures for the 12 months to 31/08/2025. In this period, FCSS outperformed the index by 17 percentage points, with the vast majority of this (16.4pp) coming from stock selection. This was particularly notable in the consumer discretionary and industrials sectors, which, as we discuss in [Portfolio](#), are key areas of focus for Dale. The only sector in which stock selection detracted from returns was information technology.

The stock selection impact is even more evident on an individual holding basis. Of the top ten contributors to performance, only two holdings are in the index, with one of these being just 0.1% of the index, although as we note in [Portfolio](#), FCSS has a SMID bias versus the predominantly large-cap index. The top contributor was Hesai Group, a smaller company which makes sensors for automobiles. After passing an operational inflection point, the company delivered strong revenue growth, as well as being a beneficiary of the AI-related rally linked to autonomous driving. Dale’s holding in the firm added over 500 basis points of alpha in the 12 months to 31/08/2025.

Another top contributor was LexinFintech, which provides consumer finance services. The holding contributed over 300bps of alpha to performance after a strong share price run earlier in the period, following a sizeable jump in profits, as well as a pickup in sentiment surrounding the consumer. Furthermore, the firm announced a share buyback and an increase in dividends in the period. This is one example of a wider trend in the country, of improving shareholder returns following government incentives. The market aggregate recently turned from net issuance to buybacks, whilst also seeing an increase in dividend

payouts, something reflected in FCSS’s increased ordinary and special **Dividend**. Dale notes this could be an ongoing driver of market returns going forward.

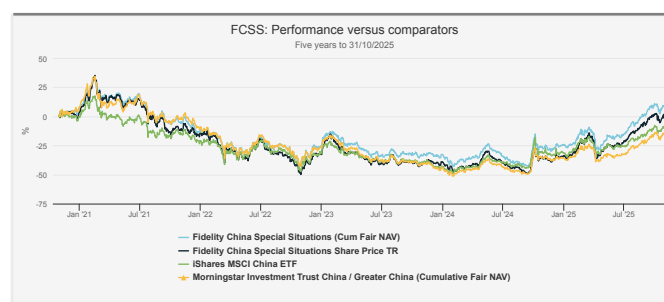
The next biggest contributors came from the industrials and technology sectors, through high-end tool maker Precision Tsugami China and data centre firm VNET respectively. Each added c. 200bps of alpha to performance, further demonstrating the wide range of stocks supporting performance.

The top detractor in the period came from a short position in a tech company, which, alongside the underweight position, caused a 259bps drag to performance. We understand shorts have positively contributed over the long-term, although this demonstrates that they can be riskier positions in rising markets. In total, there were three short positions in the top ten detractors. Despite the impacting of shorts, FCSS has broadly achieved outperformance of the index with lower risk over the long term. This has come about through a lower variability and better diversification of returns, demonstrated by the top ten contributors all delivering over 100bps of alpha. By contrast, only the top three detractors impacted the trust to such an extent.

Despite the rally in the past year, Dale believes valuations remain compelling in many areas, especially when compared to the US, with valuations around a 50% discount to American peers, despite similar earnings growth forecasts. This is an outcome of low sentiment for the Chinese economy’s growth expectations which Dale argues creates an opportunity for a further market rally.

To support this, Dale argues there is scope for further government stimulus measures, although they may wait until the tariff picture is clearer before committing to this. One area this will likely focus on is consumer confidence, which is critical to the recovery. Dale notes that consumers in China have the capacity to spend more, but aren’t doing so due to low confidence. However, should this improve, it will likely drive the next leg of the China recovery, and be supportive for Dale’s positioning.

Fig.4: Five-Year Performance



Source: Morningstar

Past performance is not a reliable indicator of future results.



Therefore, whilst the recent rally has been exceptional, the context of it can be seen in the five-year chart below. Here, the market as a whole is still in negative territory, having returned -8.2% to 31/10/2025 despite the recent recovery. It should be noted though that FCSS has considerably outperformed in this longer period too, having returned c. 8%, demonstrating the potential of the approach.

Dividend

Dale’s strategy primarily focusses on growth opportunities, although the trust does have a strong dividend growth track record, having raised its dividend in every year since inception in 2010.

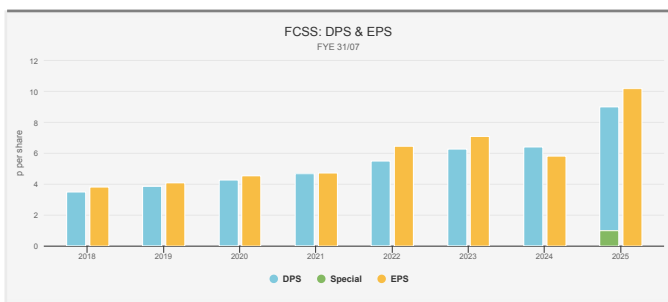
The latest annual dividend, paid on 31/07/2025, was 8p per share and was 25% higher than the year before, meaning dividends have now grown at an annualised rate of c. 28% over 14 years. This sizeable increase was a result of strong revenue generation in the portfolio, driven by a push to improve shareholder returns from Chinese companies, as we discuss in [Performance](#).

In addition, the trust paid a special dividend of 1p per share. This is the first special dividend that has been paid in the trust’s history and is largely a result of an exceptional dividend paid by portfolio holding Lufax. This approach has allowed the trust to pass on the elevated revenue generated whilst also maintaining a reasonable base from which to continue to pursue the progressive dividend policy that has been achieved so far.

Revenue equated to 10.2p per share, including the Lufax dividend, almost double the 5.8p earned in the previous year. As a result of this strong generation, the trust has seen revenue reserves grow to 5.6p per share, equal to approximately 70% of the latest ordinary dividend.

The latest ordinary dividend offers an historic yield of c. 2.6% as at 31/10/2025. As such, we believe the dividend should be treated as an additional element to the investment case, rather than the core reason for investment, especially as dividends are only paid annually and future growth is not guaranteed.

Fig.5: EPS & DPS



Source: Fidelity

Past performance is not a reliable indicator of future results.

Management

Dale Nicholls has been managing FCSS for over ten years, having taken over management from Anthony Bolton, the trust’s first portfolio manager, in April 2014. Dale worked with Anthony for some months before taking over full management responsibilities. He has 29 years of investment experience and also manages the open-ended Fidelity Funds Pacific Fund. This gives him a regional perspective on the markets, which should be helpful in building a picture of the competitive position of companies in China.

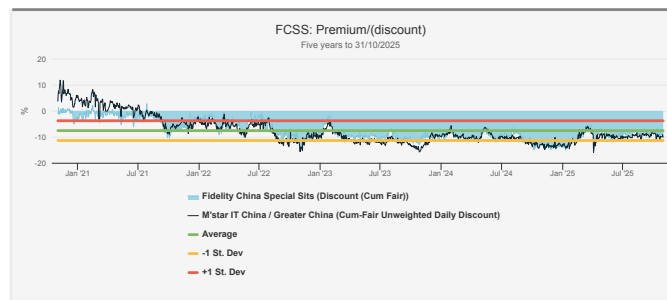
Dale spends much of his time speaking to management teams and competitors of companies in which he invests or may choose to invest, engaging with hundreds of companies each year. He began his career with Fidelity in 1996, working in the Japanese equity analyst team and covering various sectors. Dale was promoted to portfolio manager for the FF Pacific Fund in 2003 and portfolio manager for the FF Asian Smaller Companies Fund in 2011. He is based in Hong Kong and draws on the work of 16 dedicated Greater China analysts based in Shanghai and Hong Kong, with a further eight sustainable and derivative analysts, as well as their regional colleagues and one dedicated China small-cap analyst.

Discount

FCSS has traded at a discount for much of the past five years, in line with the unweighted average of the peer group. The trust traded close to NAV in the early part of this period, when China was managing the Covid pandemic well and the economy was doing well, although the discount widened from mid-2022 onwards as the economy started to struggle as others opened up. This hit a nadir in late 2024, although both the discount of the unweighted peer group average and FCSS have narrowed this year as confidence has returned following the announcement of several government initiatives to stimulate economic growth, as well as a resurgence in the country’s AI sector which has attracted investment.

Despite this, FCSS’s current discount is c. 10.4%, slightly wider than its own five-year average of 7.6% and close

Fig.6: Discount



Source: Morningstar



to the unweighted average of the peer group of 10.1%. We have used the unweighted average as FCSS is by far the largest trust in the three-strong peer group and otherwise distorts comparisons to peers. This equal rating is in contrast to FCSS's sector-leading Performance over multiple time periods, and as such, we believe it does not reflect the strength of the process nor ability of the manager.

The board has looked to support the discount narrowing by buying back shares. In the most recent financial year to 31/03/2025, the board bought back c. 31m shares, equivalent to 6% of the opening share count. In the period since, a further c. 6.5m shares have been bought back. These buybacks have also been NAV accretive.

Charges

FCSS's charging structure has been in place since the 2024 financial year, at which point it was reduced in order to reflect the economies of scale achieved through the merger with former peer abrdn China (ACIC). This involves a tiered structure, with the first £1.5bn of assets being charged at 0.85% of net assets, with a charge of 0.65% above this.

According to JPMorgan Cazenove, net assets were £1.65bn as at 14/10/2025. This equates to a management fee of 0.84% although this will move as performance changes. The trust's latest OCF is 0.89%, by far the lowest of the three strong peer group, reflecting the benefits of economies of scale with FCSS being the largest trust in the sector, accounting for 78% of total assets. We note that the OCF reflects charges already incurred in the NAV, and is not deducted from the share price.

ESG

ESG considerations are embedded in the investment process, primarily through the implementation of the Fidelity Proprietary Sustainability Rating. This is a forward-looking and holistic assessment of a company's ESG risks and opportunities, based on specific indicators appropriate for companies, depending on the subsector they are located in. Additionally, analysts produce a Climate Rating, which captures their assessment of which companies are in the best position to transition to net zero, or which have a positive trajectory towards transition. The responsibility falls first on the analysts working on the business fundamentals, but they are supported by a Sustainable Investing Team responsible for consolidating the approach to ESG firm-wide and who assist with ongoing engagement. Managers can also consider external ratings before internal ratings are available, but the internal ratings are ultimately relied upon. Dale is not prohibited from investing in companies which score poorly, but he does have to justify the ESG ratings and carbon footprint of the portfolio in the quarterly fund reviews with

Fidelity's CIO, alongside investment risks, such as beta, tracking error, and any concentrated positions.

FCSS scores above average on Morningstar's Sustainability Rating, earning four out of five globes. We note that only c. 75% of the portfolio is covered by their ratings likely due to the small- and mid-size bias, as well as the private companies in the portfolio.



Disclaimer

This report has been issued by Kepler Partners LLP. **The analyst who has prepared this report is aware that Kepler Partners LLP has a relationship with the company covered in this report and/or a conflict of interest which may impair the objectivity of the research.**

Past performance is not a reliable indicator of future results. The value of investments can fall as well as rise and you may get back less than you invested when you decide to sell your investments. It is strongly recommended that if you are a private investor independent financial advice should be taken before making any investment or financial decision.

Kepler Partners is not authorised to make recommendations to retail clients. This report has been issued by Kepler Partners LLP, is based on factual information only, is solely for information purposes only and any views contained in it must not be construed as investment or tax advice or a recommendation to buy, sell or take any action in relation to any investment.

The information provided on this website is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation or which would subject Kepler Partners LLP to any registration requirement within such jurisdiction or country. In particular, this website is exclusively for non-US Persons. Persons who access this information are required to inform themselves and to comply with any such restrictions.

The information contained in this website is not intended to constitute, and should not be construed as, investment advice. No representation or warranty, express or implied, is given by any person as to the accuracy or completeness of the information and no responsibility or liability is accepted for the accuracy or sufficiency of any of the information, for any errors, omissions or misstatements, negligent or otherwise. Any views and opinions, whilst given in good faith, are subject to change without notice.

This is not an official confirmation of terms and is not a recommendation, offer or solicitation to buy or sell or take any action in relation to any investment mentioned herein. Any prices or quotations contained herein are indicative only.

Kepler Partners LLP (including its partners, employees and representatives) or a connected person may have positions in or options on the securities detailed in this report, and may buy, sell or offer to purchase or sell such securities from time to time, but will at all times be subject to restrictions imposed by the firm's internal rules. A copy of the firm's Conflict of Interest policy is available on request.

PLEASE SEE ALSO OUR TERMS AND CONDITIONS

Kepler Partners LLP is authorised and regulated by the Financial Conduct Authority (FRN 480590), registered in England and Wales at 70 Conduit Street, London W1S 2GF with registered number OC334771.

