FundPerspective:

FIDELITY FUNDS GLOBAL INFLATION LINKED BOND JUNE 2011

A happy third anniversary!!

__Andy Weir__ is the portfolio manager of Fidelity Funds Global Inflation Linked Bond Fund.

Andy joined Fidelity in 1997 as a Quantitative Fixed Income Analyst and was promoted to Director of Quantitative Research in 2002. He became a Portfolio Manager in December 2003 and has managed FF Global Inflation Linked Bond Fund since its launch in May 2008.

Prior to joining Fidelity, Andy spent five years with JP Morgan Investment Management. He holds a BEng from Nottingham University.

On its third anniversary, the Fidelity Funds Global Inflation Linked Bond Fund has beaten its benchmark by 275 basis points since its inception. It has navigated the extreme illiquid conditions at the height of the credit crisis through to the subsequent rally at the start of the recovery. Over the past three years, the fund has remained focused on generating real income for its investors through high quality inflation-linked bonds – portfolio manager Andy Weir looks back over this period and provides his latest views on the asset class.

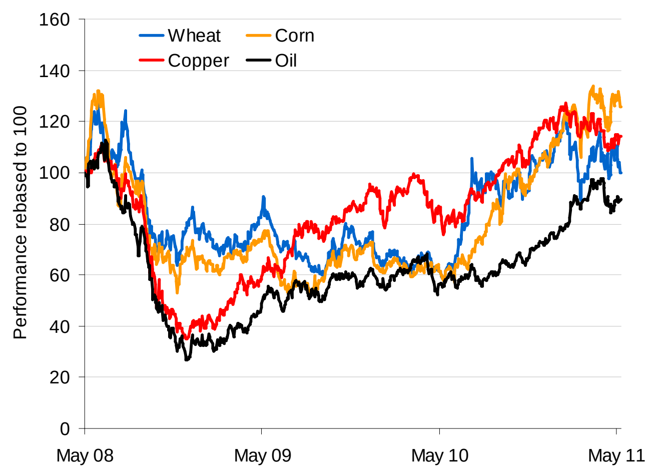
WHAT CHALLENGES HAVE YOU FACED SINCE THE FUND'S LAUNCH?

We launched the fund at a time when inflation pressures were high – in May 2008, oil was about to hit a staggering $140-a-barrel, while food prices soared. At the time, there was real demand from investors for a solution that helped offset inflation risk. The proposition we presented acknowledged that inflation is a global phenomenon and that monetary policy tends to be globally co-ordinated over time. Our truly global approach to inflation-linked bonds offered a solution that provided better liquidity and diversification benefits for investors – it aimed to tackle inflation risk regardless of the geographic location of the investor.

When the financial crisis struck in late 2008, these inflationary pressures were subdued temporarily as the global economy slowed. During the ensuing chaos that followed the collapse of Lehman Brothers, inflation expectations sank into negative territory. In developed economies, markets priced in annual deflation for the next five years. This event was witnessed by negative 5-year breakevens; the spread between 5-year nominal and real yields that acts as a gauge of future inflation expectations. During this period, investors shorted government inflation-linked bonds and bought nominal government bonds instead.

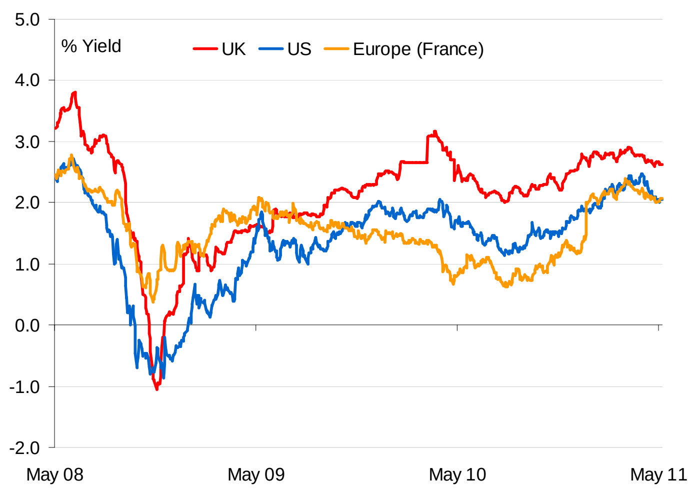
This was hugely significant as markets were pricing in deflation over the next five years in these economies despite massive monetary and fiscal stimulus. Unsurprisingly, inflation expectations bounced back at the start of 2009 with large inflows into inflation-linked bonds. Breakeven levels rose sharply from their distressed levels, realising value for those investors already exposed to the asset class. Since then, inflows have been steady and returns have remained attractive; global inflation-linked bonds rose 16.1% (euro-hedged) versus 7.8% for global nominal bonds over the past two years. Lately, the asset class is receiving increasing attention as consumer price inflation has risen from an annualised 0.6% in April 2009 to 2.8% in April 2011.

COMMODITY PRICES



Source: Bloomberg, USD, 31.05.2011

FIVE YEAR BREAKEVEN INFLATION LEVELS



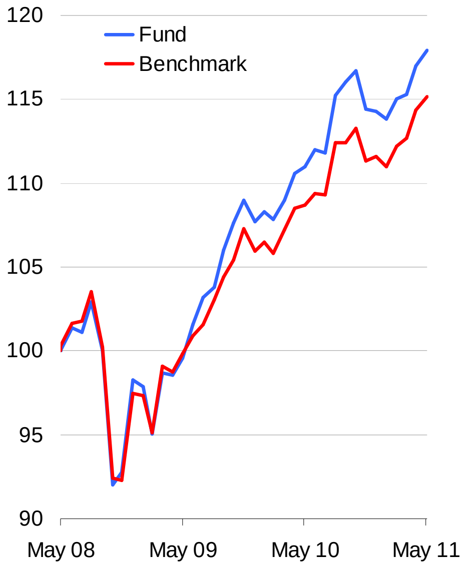
Source: Bloomberg, 31.05.2011

Fidelity INTERNATIONAL

FundPerspective:

CUMULATIVE RETURNS (%)

as at 31.05.11



Source: FIL Limited. Performance in euros, Y-ACC-EUR (Hedged) share class.
Benchmark: Barclays Capital World Inflation-Linked Government Bond (1 – 10 year) index (EUR-hedged).

HOW HAS THE FUND PERFORMED DURING ITS THREE YEAR LIFE?

Since its inception, the fund has beaten its benchmark by a cumulative 275 basis points, surpassing its alpha target of 75 basis points per annum and returning 17.9% to investors, in euro terms after fees. Unsurprisingly the later part of 2008, during the height of the credit crisis was the most challenging period for the fund – its worst month was October 2008, when the fund lost value despite its globally diversified approach and ability to buy conventional government bonds. Nevertheless, the fund reversed these losses during the rebound that followed almost two-and-a-half years ago. The main performance drivers during this period have been a timely overweight position in US Treasury Inflation Protected Securities (TIPS), an overweight position in Japanese breakevens and finally, exposure to French and Canadian inflation-linked issues. Admittedly, the fund did shed a few basis points at the start of 2011 from an underweight exposure to UK linkers – UK inflation remained stubbornly high and has surprised on the upside this year, rising to more than double its government-set target rate.

Overall, the fund's performance drivers since launch have consisted of a mixture of duration strategies related to interest rate sensitivities and strategies related to the yield curve, cross market arbitrage (exploiting the price differences between markets) and inflation breakeven levels.

HOW IS THE FUND POSITIONED?

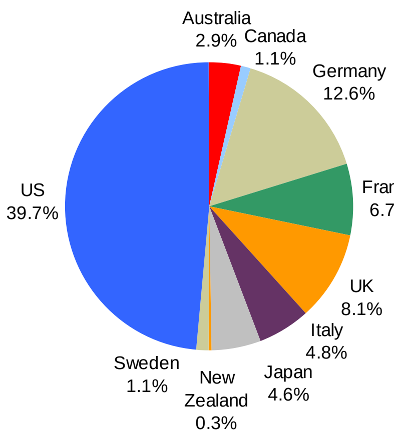
At the start of May 2011, I shifted out of US TIPS as breakeven levels fell, before reversing course back into an overweight position – the rationale was that as the end of "QE2" approaches in June, additional accommodation might be made from time to time to protect US economic growth. Recently, the Federal Reserve has been focusing on making sure the US recovery is sustainable and that the job market improves – any expansionary policy decisions could create additional inflationary pressure.

I have taken an overweight stance on UK inflation-linked Gilts as inflation continues to surprise on the upside. I have done so at the short-end of the UK linker curve through shorter maturities that are more sensitive to inflation expectations and are structurally less expensive than longer-dated linkers. In the latest Bank of England quarterly inflation report, the near-term inflation projection was revised substantially upwards with the potential peak moving from a forecasted 4.5% to 5.0%. Inflation tail risks remain very high and the risk of stagflation persists. The fund also has exposure to Canadian and Australian inflation-linked securities. Conversely, I am underweight European linkers in light of growing expectations of further monetary policy tightening by the European Central Bank (ECB).

Additionally, I have used the fund's flexibility to invest in a limited amount of nominal bonds. I have maintained exposure to German Bunds on the back of my bearish view on the eurozone's economic outlook. I have also maintained a moderate exposure to high quality nominal corporate bonds. The latter is viewed as a diversifying tool, rather than a strategic position.

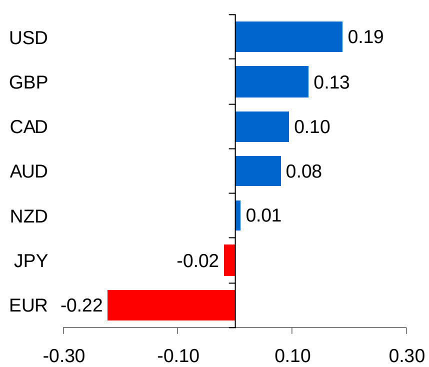
The fund's overall duration is currently 4.8 years versus the index at 5.1 years. The composition of the fund is 81.8% in inflation-linked bonds, 9.0% in nominal government bonds, 7.8% in nominal corporate bonds and 1.4% in cash.

EXPOSURE BY COUNTRY (%)



Source: FIL Ltd., 31.05.2011

DURATION POSITION VERSUS BENCHMARK (YEARS)



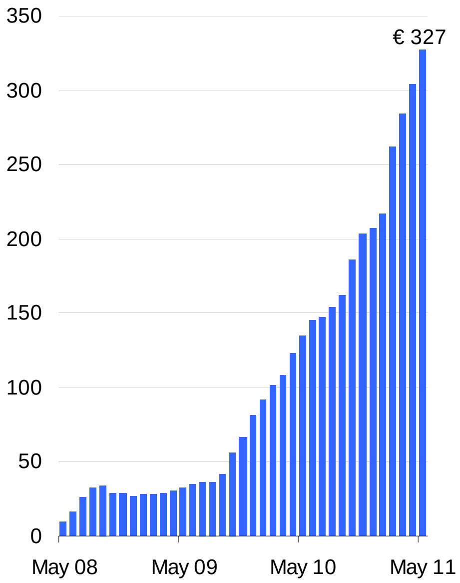
Duration	Fund	Index	Relative
Overall	**4.81**	**5.06**	**-0.25**
Nominal	-0.50	0.00	-0.50
Real	5.31	5.06	0.25

Source: FIL Ltd., 31.05.2011

Positioning by currency is shown in years of real interest duration of the fund relative to its benchmark. Real interest rate duration is a measure of the sensitivity of an asset's price to real interest rate movements A real interest rate is an interest rate adjusted for inflation. According to the Fisher equation, the real interest rate is defined as the nominal interest rate minus the expected rate of inflation.

One of the main risks to investing in inflation-linked bonds is the risk of rising interest rates. In order to implement a more flexible approach to the fund's duration management process, the benchmark was changed on 7 March 2011 and the benchmark duration was subsequently lowered from 10 years to 5 years. The fund's duration will be kept within a band of +/-2.5 years relative to the index. This provides the fund with a definite edge against its competitors and aims to minimise risks if interest rates rise, while preserving a global inflation carry.

TOTAL NET ASSETS (EUR MILLIONS)



Source: FIL Ltd., 31.05.2011

WHAT IS THE OUTLOOK FOR INFLATION GOING FORWARD?

Headline inflation has increased over the past few months although expectations are that core inflation, which strips out energy and food costs, will moderate this year. I expect policy in the US to remain accommodative and do not anticipate rate hikes as long as the unemployment rate remains above 7.0%. Looking forward, wage growth in developed markets is likely to remain constrained by high levels of unemployment. I expect core inflation in the US and Europe to drop to 0.5 - 1.0% this year, despite a rise in indirect taxes. In the UK, the consensus is that core inflation will fall as austerity measures kick-in and the secondary effects of indirect taxes and commodity prices fade. Japan on the other hand will probably experience slight deflation this year, though this may be higher than priced by bond markets. There has, however, been a significant acceleration in wage growth in emerging markets. Further rises in commodity prices and potential overheating in emerging economies will have to be monitored closely.

Overall, I believe inflation-linked bonds still offer value, particularly in light of current inflation tail risks. Although core inflation in developed markets remains subdued there is a strong risk that in the long-term it will rise, particularly if wages increase. Over the coming year, our forecasts point to headline inflation remaining elevated; this is good for the carry return aspect of inflation-linked bonds as they are indexed to actual inflation levels. Additionally, breakeven levels are not particularly wide by historic standards as headwinds to economic recovery are still placing downward pressure on inflation expectations.

I still firmly believe that a global approach to investing should be favoured. Global inflation-linked bonds are highly correlated with domestic inflation and an investment in global inflation-linked bonds benefits from greater liquidity than a domestic orientated approach. The possibilities for generating returns are greater, given the wider opportunity set. European investors would have not only have been protected by investing in a global (euro-hedged) portfolio, they would have earned additional return relative to an investment in euro inflation-linked bonds. The need for global diversification has been reinforced over the past two years as global linkers (euro-hedged) have returned 16.1% versus 7.6% for domestic euro linkers. I believe that over the long term global linkers continue to offer the better option for inflation protection.

"There is greater liquidity and are more opportunities available in global markets, offering the potential for greater returns. Returns on inflation-linked bonds are correlated across the globe, which means investors can still protect themselves against domestic inflation whilst adopting an actively managed global approach"

Andy Weir, Portfolio Manager