



Come fly with me

A flexible mandate allows FCSS to fully harness China's innovation.

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In *Back To The Future II*, Marty McFly and Doc Brown travel forward 30 years, to 2015, where they encounter all manner of futuristic inventions, including flying cars. In 2025, we're still a long way away from widespread adoption of flying cars, but the dream is coming closer, thanks in part to China's clear innovation.

Guangzhou's EHang Holdings has become the first electric vertical take-off and landing (eVTOL) maker in the world to receive a licence to carry passengers commercially. The EH216 model is a two-seat electrified, fully autonomous aircraft, able to take off like a helicopter and cruise through low-altitudes like a plane.

For decades, inventors have dreamed of building air taxis. As far back as 1926, Henry Ford unveiled the Ford Flivver, a dream that ended after a fatal crash over Florida two years later. In 1970, *Tomorrow's World* reported on the Aerocar, a German invention that was essentially a helicopter with a chassis. It never took off, if you'll pardon the pun.

Today, it is artificial intelligence (AI) that commands investors' attention, with the US, home to the AI hyperscalers, hogging the headlines when it comes to innovation. Silicon Valley has certainly been at the vanguard of technological leaps for decades now. However, China is catching up fast and, in many areas, has already overtaken America.

eVTOL may not be a particularly catchy name, and the technology will likely only be used for tourism, cargo deliveries, fire-fighting and medical supplies for the foreseeable future, but it's possibly the closest we might get to a flying car (sadly minus the time-travelling abilities of the DeLorean), and China accounts for c. 50% of the world's eVTOL models, according to industry estimates.

Innovation drive

China's prowess in battery technology, its mature electric-vehicle (EV) supply chain, and supportive regulators have helped local companies to grow fast. But China's innovation drive isn't limited to automobiles – it encompasses sectors such as life sciences and AI, among others.

Chinese private companies have compounded their research & development (R&D) spending at over 20% annually over the past 15 years, to dramatically close the gap with the US and both countries are well ahead of the rest of the pack.

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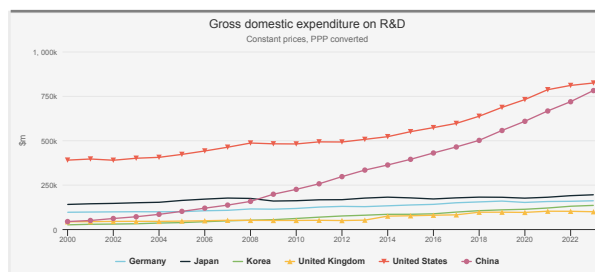
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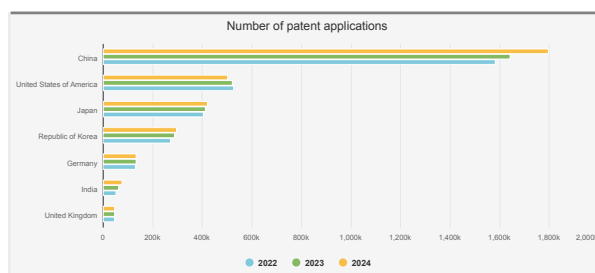
Fig.1: Closing The R&D Gap



Source: OECD, as at 2023

When it comes to patent activity, China has a commanding lead over the rest of the world: in 2023, China had a 47.2% share of global patent applications. This has all led to China being the

Fig.2: Highest Level Of Patent Activity



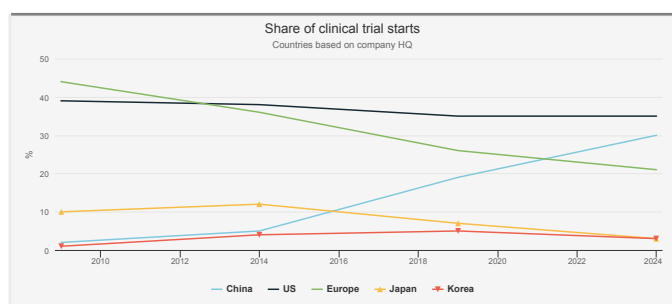
Source: World Intellectual Property Organisation



global leader in five key technologies – Unmanned aerial vehicles, solar panels, graphene, high-speed rail, and EVs and lithium batteries – according to Bloomberg.

China has also emerged as a global leader in clinical trials, with a structural shift from focusing on generic drugs to innovative drugs. Indeed, within the past ten years, China's share of trial starts has gone from 5% to 30%, whereas America's has fallen slightly, from 38% to 35%. China also has a lead in gene and cell therapy trials.

Fig.3: A Global Leader In Clinical Trials



Source: Citeline Trialtrove, Jan 2025; IQVIA Institute, Jan 2025

Some investors have become wary of China in recent years, after some measures enacted aimed at reigning in profitability of some high-tech sectors through 2021, but the reality is that innovation has real government support in China, whether that be through tax incentives, government grants and state-backed venture capital funds.

China tends to be a country where competition is rife, particularly within the EV market and some of the renewable energy industries, but we've seen a more recent focus from the government to address this with the "anti-involution" campaign.

Some of these policies should support consolidation within many of these industries and in many of them we are already seeing the likely winners emerging – providing active fund managers such as Dale Nicholls at **Fidelity China Special Situations (FCSS)** with numerous opportunities.

The deep expertise of FCSS's management and analyst team is the key in determining which companies will be the winners of this innovation and which areas are less attractive from an investment perspective.

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 can also draw on the work of the 16 dedicated Greater China analysts based in Shanghai and Hong Kong, with a further eight sustainable and derivate analysts, as well as their regional colleagues and one dedicated China small-cap analyst.

Harnessing innovation

FCSS's flexible investment mandate also allows Dale to harness this innovation fully, as it allows him to capture a wide range of opportunities from the vast universe of Chinese companies across multiple markets, as well as to invest in private companies.

As mentioned previously, some have been wary of China as an investment destination, but the country's stock market has undergone a remarkable turnaround, with the MSCI China Index having risen 56% in sterling terms since the government launched its most recent fiscal stimulus in September 2024 to 08/12/2025. FCSS's share price total return of c. 85% has eclipsed that.

Despite this rise, valuations remain compelling in many areas and FCSS's gearing is at the high end of its range, showing Dale's view that there are lots of opportunities out there.

The industrials and consumer discretionary sectors are two key overweights for FCSS, and they are two sectors where, in some ways, two worlds collide. For instance, one of the trust's largest overweight stocks is Tuhu Car, a car servicing company that is arguably a consumer discretionary company; while another top bet Hesai Group, a leader in lidar sensors used in vehicle autonomy, is categorised as a consumer discretionary stock despite having a strong industrial bias.

By contrast, while Dale likes the dynamics of the technology sector, he remains selective in stock picks under the current valuation. One area of interest is business management software, which is a nascent market in China but offers considerable growth potential that Kingdee International Software, a leading ERP software firm, has been capturing market share of thanks to its innovation and incorporation of AI across their suite.

We've already covered **other positive parts of the story in China**, such as fiscal stimulus, stabilisation in property prices and the country's ability to weather tariffs. Despite this, as well as the fact that China is well into a new bull market, it's clear that investors remain sceptical, with discounts in the AIC: China/Greater China sector remaining wide.

Yet, we see two key elements to the investment case for FCSS: a considerably improved outlook for the Chinese market and Dale's ability to capture this through the many facets of his process and FCSS's flexible, all-encompassing strategy.

To put the cherry on top, despite sector-topping net asset value and share price total returns over one, three, five



and ten years, FCSS's discount remains in line with peers, adding to FCSS's upside potential.

If sentiment continues to improve and Dale's track record start to be recognised, flying cars won't be the only thing taking off in China.

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