# Fixed Income Perspectives

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## The big story

The economic environment has changed. Since Inauguration Day, we have been evaluating the U.S. administration's expected policies on trade, immigration, fiscal policy and regulation and their aggregate impact on the economy. After some early actions on immigration (the border and public deportations) and fiscal activity (Department of Government Efficiency and tax cut rhetoric), trade and tariffs have taken centre stage, for good reason. The reciprocal tariffs announced on "Liberation Day," in addition to previously implemented tariffs on specific industries and countries, exceeded even the most draconian estimates. If these tariffs are maintained in perpetuity, econometric models will break down, and recession, or worse, is thought to be inevitable.

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Few people believe the opening gambit will persist, but there is an incredibly wide range of outcomes given the base case. The level of tariffs ultimately imposed by the U.S. – and tariffs imposed by trading partners on the U.S. – and the duration of negotiations are uncertain and critically important. In a protracted trade war, irreversible damage may be done to relationships cultivated over decades or longer, slowing domestic growth for an extended period. At this point, uncertainty is extraordinarily high, as expressed by elevated volatility in the markets. Risk assets should perform – and are performing – poorly, while flight-to-quality assets like U.S. Treasuries are generally doing well. In our funds, we are maintaining a conservative positioning until we have more clarity on the future of trade relations, or until valuations reflect a worst-case scenario.

## U.S. Federal Reserve (the Fed)

The Fed has a dual economic mandate: to seek full employment and stable prices through monetary policy. Fed Chair Jerome Powell acknowledges the Fed may, at some point, have to weigh the impact of tariffs on prices against slower growth and a weaker labour market. They will wait to see the "hard data" and will not react to policy alone. For now, the Fed deems the current Fed funds rate to be appropriate, although the market has priced in approximately 100 basis points of cuts by the end of the year.

## European Central Bank (ECB)

Prior to "Liberation Day," the ECB continued to expect on-target 2% CPI in the medium term. We still expect some rate cuts in the summer, but we also note that the voting "doves" have proven sympathetic to ECB hawks in recent weeks. At the April 17 ECB meeting, voters somewhere in between will be weighing the near-term inflationary impact of tariffs against any longer-term disinflationary threat. A pause in cuts is possible this month, and macroeconomic uncertainty is very high.

## Bank of Canada

Trade tensions with the U.S. have escalated quickly for Canada, complicating the central bank's mandate. The removal of forward guidance by the Bank of Canada indicates that it intends to react to inflation and labour data rather than try to forecast them, given the heightened level of uncertainty. The market expectation is for 75 basis points of cuts through the end of the year.

## Valuations

- **Leveraged loans:** We are modestly overweight. The portion of the market priced at or above par has declined to less than 10% as of March 31, 2025, compared with nearly 70% a month ago, amid tariff concerns. Spreads have widened and are clearly anticipating a weaker economy. However, spreads are still tight from a historical perspective, and far from fully pricing in a recession.
- **High yield:** We are modestly overweight. Defaults remain very low, and credit quality is stable, but we need to be vigilant regarding tariff-related effects. After the recent sell-off, the sector is no longer at the rich end of the asset class's history. However, spreads are still below the historic median, and we don't see a need to rush to add further exposure. We prefer idiosyncratic opportunities to generic beta.
- **U.S. investment-grade corporates:** We are underweight. The sector has widened on tariff-associated risk but is outperforming other risk sectors. Spreads are still well below the historic median and far from pricing in a worst-case scenario. Risk/reward has improved but remains unfavourable: a return in spreads to just the long-term median from current levels would erase over two years of excess carry. Investors can earn roughly 75% of the yield on investment-grade credit – with zero credit risk – by buying U.S. Treasuries of similar maturity. While we remain patient, we are finding some idiosyncratic opportunities.
- **International credit (hedged):** We are modestly overweight. Spreads have closed the valuation gap and how trade nearly flat in spread terms relative to U.S. investment-grade credit, even in the midst of tariff volatility. A small carry advantage remains, and potential alpha from security selection is available due to spread dispersion. This sector is less correlated to U.S. Treasuries than domestic credit, but European government bonds are also compelling, with central banks easing.
- **Emerging markets debt:** We have selective ownership of issues in Brazil, Colombia and Mexico. Changes in U.S. trade policy could create a headwind. We expect higher-than-normal foreign exchange volatility while trade policies are negotiated.
- **U.S. Treasuries:** We maintain a long duration position after leaning into the significant rate sell-off over the fourth quarter of 2024. U.S. Treasuries are demonstrating their diversification value amid the tariff volatility. It's no surprise that this remains one of the best-performing asset classes year-to-date. U.S. Treasury exposure remains close to the highest level in the history of the strategy; it will be a source of funds when the market gives us an opportunity to buy credit sectors.
- **U.S. Treasury Inflation-Protected Securities (TIPS):** We have a zero weighting in TIPs. Inflation break-evens have been 2.2% to 2.4% for the better part of two years, despite the expectation that tariffs will increase price levels in the near term. We prefer the liquidity of nominal U.S. Treasuries.
- **Mortgage-backed securities (MBS):** We have a zero weighting in MBS. Spreads against U.S. Treasuries in the area of 40 basis points are not compelling for this strategy, and we prefer the liquidity and stability of U.S. Treasuries.
- **Structured product:** We are selectively overweight, specifically in franchise bonds and airplane financing. We have a very small allocation to commercial mortgage-backed securities (CMBS) due to valuations. We continue to look for well-structured idiosyncratic exposure, using our research edge.
- **Local currency debt:** We only own idiosyncratic exposure, and the total size of the allocation is below 2%. Currency volatility is significantly higher than rate volatility – approximately three times higher. We own exposure in Brazil and Japan. Brazilian local currency bonds currently yield approximately 15% as of March 31, 2025.

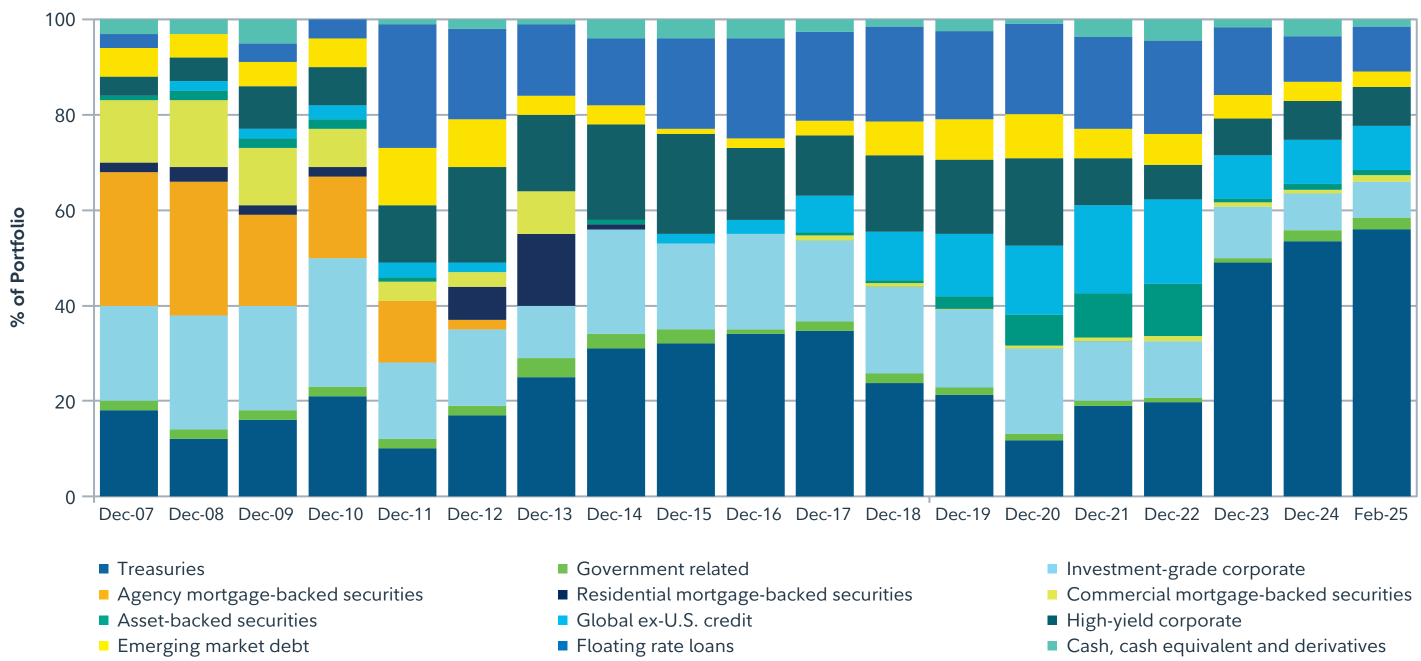
## Performance (%)

| As at March 31, 2025 | 3-month | YTD | 1-year | 2-year | 3-year | 5-year | Since inception* |
|---|---|---|---|---|---|---|---|
| Fidelity Multi-Sector Bond CN Fund – Sr. F | 2.3 | 2.3 | 3.3 | 2.9 | 0.4 | 2.0 | 1.9 |
| Fidelity Investment Grade Total Bond CN Fund – Sr. F | 2.4 | 2.4 | 3.6 | 3.0 | 0.2 | 1.3 | 1.4 |
| Fidelity Global Core Plus Bond ETF | 2.2 | 2.2 | 3.5 | 3.1 | 0.8 | 2.2 | 0.8 |
| Fidelity Global Investment Grade Bond ETF | 2.4 | 2.4 | 3.4 | 2.3 | -0.4 | – | -0.3 |
| Fidelity Tactical Credit Fund – Sr. F | 0.6 | 0.6 | 4.2 | 5.5 | 3.4 | – | 2.7 |

Source: Fidelity Investments Canada ULC. Performance shows annual compounded returns as at March 31, 2025, net of fees, in Canadian dollars.

* Since-inception date for Fidelity Multi-Sector Bond Currency Neutral Fund is May 10, 2017. Since-inception date for Fidelity Investment Grade Total Bond Currency Neutral Fund is January 24, 2018. Since-inception date for Fidelity Global Core Plus Bond ETF is September 20, 2019. Since-inception date for Fidelity Global Investment Grade Bond ETF is June 5, 2020. Since-inception date for Fidelity Tactical Credit Fund is January 25, 2022.

## A flexible approach to fixed income: Fidelity Tactical Bond Composite (the U.S. Fund) historical exposure




Source: Fidelity Investments Canada ULC. As at February 28, 2025. The historical exposures shown are those of Tactical Bond Composite (the U.S. Fund) as at February 28, 2025. The U.S. Fund is not available to Canadian investors. The exposures of the U.S. Fund should not be interpreted as those of Fidelity Multi-Sector Bond (the CDN Fund), which is available to Canadian investors. The exposures shown above are used to illustrate the historical allocation changes to the portfolio over the period shown above. It is not meant to illustrate allocation or exposures within the CDN Fund, which follows a substantially similar investment approach. While the CDN Fund follows a substantially similar investment approach to the U.S. Fund, the CDN Fund may hold different investments and have different geographic exposures. In addition, the U.S. Fund and CDN Fund are subject to, among other things, different regulatory and tax rules, fee structures, timing of trades and investment restrictions. These and other factors will cause the U.S. Fund and the CDN Fund to have different returns. **Benchmark: Bloomberg U.S. Aggregate Bond Index.**

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