Fixed Income Perspectives

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The big story

The second quarter starts as a carbon copy of the last six months. The bond market continues to offer compelling yields, permitting us to build a diversified portfolio with yields in the 6% range and a maturity profile between five- and ten-year key rates. Even more, our bond products may offer a important tail risk hedge should negative economic and/or market surprises occur.

For now, economic data in the U.S. support the notion that this is the "anti-08," despite the rise in interest rates over the past few years. Consumers seem strong, buoyed by consistent employment and wage growth, as well as a wealth surge in home equity and stocks that is unparalleled in recent history. Corporate profits and revenues are likewise showing solid growth, as evidenced by recent national accounts data. Government debt is somewhat of a concern, albeit a long-tailed one, in our view.

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What is the big worry, then? Our guess is non-U.S. factors: more specifically, tepid economic growth in China and Japan. There might be evidence of risk in the foreign exchange (FX) market. The Chinese renminbi (yuan) and the Japanese yen are at – or flirting with – multi-decade weakness, in part due to low interest rates, terrible demographics (including a population decline) and a proclivity to favour exports and trade (and weak FX) when pressed for growth.

U.S. Federal Reserve (the Fed)

Fed Chair Jerome Powell continues to beat the drum, saying that rate cuts are possible this year. Unfortunately, the most recent economic data suggest he may need to keep the focus on inflation and tight financial conditions.

European Central Bank (ECB)

Both hawkish and dovish ECB voters are publicly coming to a consensus on June as the most probable month for a first rate cut, although our analyst Tom Nolan cautions that further rate cuts will be data-dependent.

Bank of Japan (BoJ)

Confusion and indecision reign. Economic growth is better than in the past, but very low compared with global peers.

The People's Bank of China

A trade-oriented FX decline is the country's best idea now that many of the recent regulatory and sector-specific rate cuts seem not to have worked. Slow growth may be the new baseline.

Valuations

- **Leveraged loans:** We are overweight. Continuing the trend at the end of last year, loans were the best-performing fixed income asset class in the first quarter. A very high starting yield, short-term rates that look like they may stay higher for longer, earnings that support a low default rate, and robust CLO demand are supporting the sector.
- **High yield:** We are modestly overweight. Following very strong fourth-quarter returns in 2023, high-yield bonds generated positive returns in the first quarter, even while Treasury yields rose. As with loans, positive fundamentals and a maturity wall that has been pushed out are leading to a low expected default rate. With spreads priced for perfection, valuation has become less compelling, and we are not adding to holdings at this time.
- **U.S. investment-grade corporates:** We are underweight in longer-maturity, higher-quality corporate bonds. Spreads are nearly as narrow as they have been in the past 25 years. The opportunity cost of an underweight position is now very low. We prefer to capture 85% of the yield of investment-grade credit, with no credit risk, by owning U.S. Treasury securities instead. New issuance has been massive, as for loans and high yield, so far this year.
- **International credit (hedged):** We are modestly overweight. Spreads are relatively wide and have lagged the recent rally in U.S. credit. As in U.S. investment-grade corporates, we prefer short- and intermediate-duration bonds. There are lots of interesting idiosyncratic opportunities. Like the Fed, the ECB appears to be at the end of its hiking cycle, and sovereign rates are rallying as a result. New issuance has been significant year-to-date.
- **Emerging markets debt:** Our preferred strategy with this asset class is to focus on idiosyncratic stories, rather than allocate to sector beta. Our top idea is to own local-currency issues from Brazil and Mexico. Both countries have yields at or near double digits, credible central banks that have demonstrated success in fighting inflation and current account surpluses, making them net creditors to other countries. We have a few U.S. dollar names, such as the Dominican Republic, and a few emerging market corporate names.
- **U.S. Treasuries:** Our current allocation is our highest weighting in Treasuries ever. Yields are at 20-year highs, the Fed is credible on inflation, and Treasuries now provide the potential to offer diversification for stocks. Our focus is seven- to ten-year key rates, but we will own longer duration when paired with floating rate sectors.
- **U.S. TIPS (Treasury Inflation-Protected Securities):** We have no exposure. Inflation break-evens were in the 2.2%–2.4% range for almost two years. The market is confident the Fed has won the inflation battle. We prefer nominal Treasuries.
- **Mortgage-backed securities:** We have no exposure. Spreads of 50 bps are not compelling, and we still prefer U.S. Treasuries, for diversification and yield curve management.
- **Structured product:** We have selective exposure. We are overweight in franchise bonds and airplane financing. We have very modest exposure to real estate. AAA-rated CLOs are interesting, but we do not own any at this time.
- **Local-currency debt:** We are modestly overweight in a few currencies, but holdings total less than 5% of the portfolio in aggregate. Almost all our local-currency trade is described in the "Emerging markets debt" section above. Currency volatility, even for developed debt, can be double or triple that of the volatility of the Bloomberg U.S. Aggregate Bond Index.

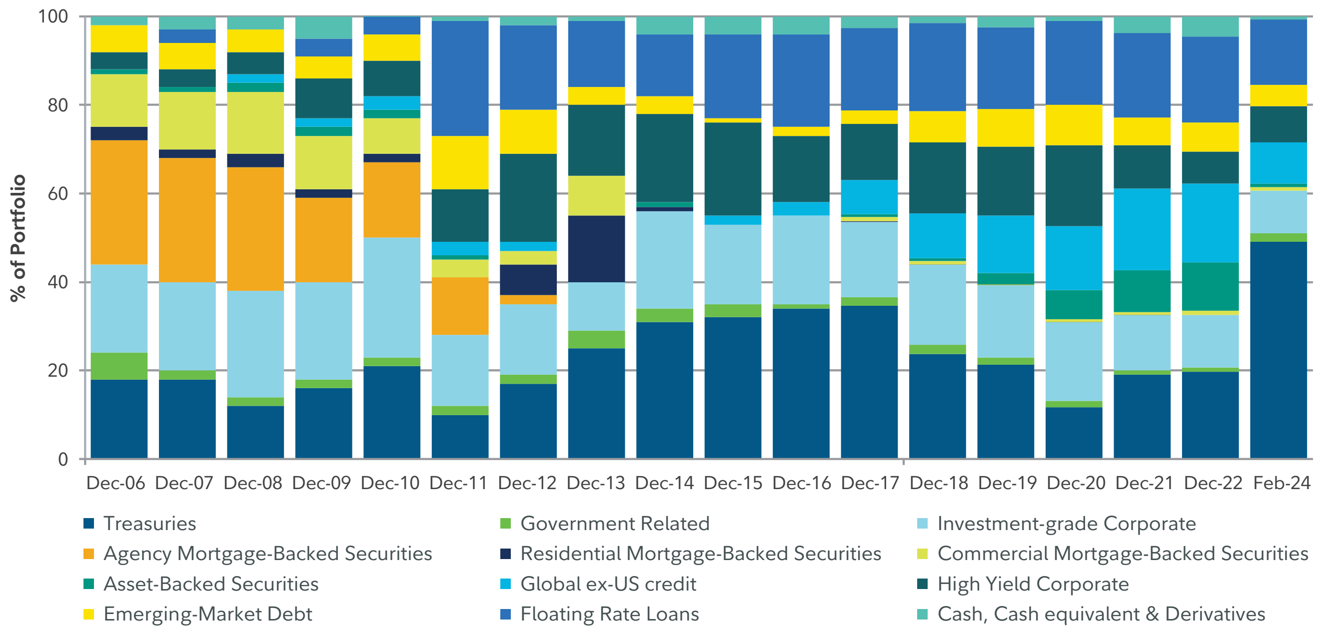
Performance

As at March 31, 2024	3-month	YTD	1-year	2-year	3-year	5-year	Since inception*
Fidelity Multi-Sector Bond CN Fund – Sr. F	-0.2	-0.2	2.6	-1.0	-1.0	1.4	1.7
Fidelity Investment Grade Total Bond CN Fund – Sr. F	-0.2	-0.2	2.4	-1.4	-1.7	0.8	1.0
Fidelity Global Core Plus Bond ETF	-0.2	-0.2	2.7	-0.6	-0.6	–	0.3
Fidelity Global Investment Grade Bond ETF	-0.5	-0.5	1.2	-2.3	-1.9	–	-1.3
Fidelity Tactical Credit Fund – Sr. F	1.2	1.2	6.9	3.0	–	–	2.1

Source: Fidelity Investments Canada ULC. Performance shows annual compounded returns as at March 31, 2024, 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 29, 2024. The historical exposures shown are those of Tactical Bond Composite (the U.S. Fund) as at February 29, 2024. 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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