Fixed Income Perspectives

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The big story

"We expect these opposing forces to continue to keep rate volatility elevated for now."

The bond vigilantes seem content for now. Yields on U.S. Treasuries have been falling for several weeks, resulting in a nice return for the bond market in June. However, the three-month pause in reciprocal tariffs is expiring, and the administration has completed very few trade deals. And the debt/GDP and deficit spending narrative is still active as the "One Big Beautiful Bill" continues to be debated in Congress. Meanwhile, pressure on the U.S. Federal Reserve (the Fed) to lower rates sooner rather than later is building, and some Fed officials – perhaps posturing for the Fed Chair nomination – have voiced support for cuts. Treasury Secretary Scott Bessent is also using positive trade rhetoric to try to constrain (or lower) longer-term rates. We expect these opposing forces to continue to keep rate volatility elevated for now, although our base case is that yields will remain inside the well-established three-year range. Uncertainty persists.

U.S. Federal Reserve

We maintain our view that a policy cut could be delivered, at the earliest, at the September FOMC meeting. In recent weeks, Fed Governors Christopher Waller and Michelle Bowman have strengthened the case for a July cut, but there isn't sufficient data to make an overwhelming case – especially given the potential for tariff-driven price increases – at such an early juncture. While Fed Chair Jerome Powell is sympathetic to the case for cuts as labour markets deteriorate, it will take hard data to make a convincing case to the hawks on the FOMC who are focused first and foremost on inflation.

European Central Bank (ECB)

The market still expects the ECB to terminate its cutting cycle at a policy rate of about 1.50%. Through June, the ECB consensus signalled comfort with today's 2% policy rate overall, with some voters in favour of no further action and others seeing a little more easing as necessary. This should result in an "on hold" vote at the July meeting, before another rate cut in September that the market is expecting. U.S. trade conflicts with the E.U. may add to more dovish ECB bets if both sides fail to compromise by July 9; otherwise, the ECB seems confident in its approximately 2% CPI outlook for the next few years.

Bank of Canada

The Bank held its policy rate at 2.75% on June 4 and is "less forward-looking than normal" due to continued uncertainties that include U.S. trade policy, economic growth following a period of high-activity, front-running tariffs, and resilience in core inflation. The Bank is weighing downward pressures from lower activity against upward pressures from higher tariff costs. Sectors exposed to U.S. trade were negatively affected in April, with exports to the U.S. down 15.7% and monthly activity contracting by 0.1% due to manufacturing and wholesale trade. Inflation uncertainty is high due to numerous distortions created by tariffs, Canadian tax changes and oil price volatility. Markets continue to price in one more rate cut in 2025.

Bank of Japan (BoJ)

The BoJ is no longer expected to hike policy rates at its previously much-anticipated July monetary policy meeting. Since "Liberation Day," growth concerns have overshadowed the still-robust domestic inflation narrative for Governor Kazuo Ueda. The BoJ's view is that near-term growth and inflation will take a hit, whereas the demographically driven labour shortage will come back to underpin a reacceleration in inflation by 2027. The BoJ is conscious of the considerably negative real policy rate setting and will likely seek to re-embark on its hiking cycle once the trade and tariff coast is clear. The BoJ discussed the pace of its asset purchase program (QE) at its June meeting, and decided to slow the decline of JGB purchases starting in April 2026.

Valuations

- **Leveraged loans:** We are modestly overweight. The Fed's being on hold provides technical support for floating rate loans, but with spreads having mostly recovered and prices once again approaching par, the upside from capital gains is limited. The sector still boasts one of the highest current yields in fixed income, supporting its attractiveness.
- **High yield:** We are modestly overweight. "Liberation Day" volatility provided a short window of opportunity to add exposure before spreads returned to historically tight values. Defaults remain very low and credit quality is stable, so we are not expecting near-term spread-widening, but valuations no longer justify further increasing beta. Dislocations at the industry and issuer level encourage us to focus on idiosyncratic opportunities.
- **U.S. investment-grade corporates:** We are underweight. Valuations have recouped nearly all of the tariff-related underperformance, which in hindsight was relatively modest. Balance sheets for large-cap investment-grade issuers are strong, and the assumed impact of tariffs was modest, given broad-based pricing power and the ability to absorb some margin impact. Dislocation in this sector may require an actual recession, given the strong fundamentals and technical support.
- **International credit (hedged):** We are modestly overweight. This sector has offered a modest spread advantage compared with to U.S. investment-grade corporate bonds since "Liberation Day," presenting a small carry opportunity. We still value the diversification and security selection benefits of evaluating a larger pool of investment-grade issuers.
- **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 being negotiated.
- **U.S. Treasuries:** We maintain a long duration position at this historically high level of interest rates. 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. We still think the curve will steepen, but in a gradual contrarian trade, we have leaned into the underperformance of the long end of the curve.
- **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 short 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 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%.

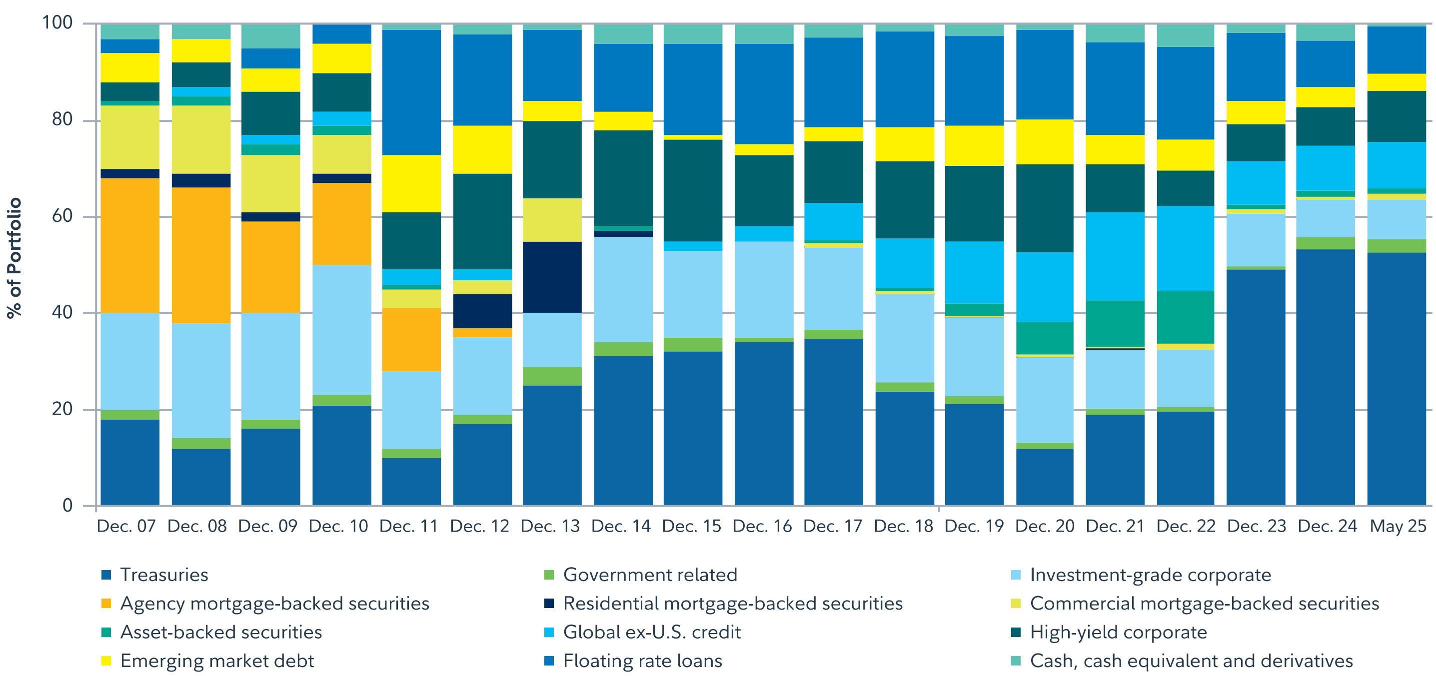
Performance

As at June 30, 2025	3-month	YTD	1-year	2-year	3-year	5-year	Since inception*
Fidelity Multi-Sector Bond CN Fund – Sr. F	1.0	3.4	4.6	3.6	3.2	0.7	2.0
Fidelity Investment Grade Total Bond CN Fund – Sr. F	0.9	3.3	4.6	3.8	3.0	0.0	1.4
Fidelity Global Core Plus Bond ETF	1.3	3.5	5.1	4.0	3.8	1.0	1.0
Fidelity Global Investment Grade Bond ETF	1.2	3.6	5.0	3.5	2.5	-0.2	-0.1
Fidelity Tactical Credit Fund – Sr. F	1.8	2.4	5.3	5.9	5.9	–	3.1

Source: Fidelity Investments Canada ULC. Performance shows annual compounded returns as at June 30, 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 May 31, 2025. The historical exposures shown are those of Tactical Bond Composite (the U.S. Fund) as at May 31, 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.

Fidelity INVESTMENTS

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