Fixed Income Perspectives

JUNE 2025

Michael Plage, Portfolio Manager | **Celso Muñoz**, Portfolio Manager | **Stacie Ware**, Portfolio Manager | **Brian Day**, Portfolio Manager

The big story

We've seen a market of extremes over the course of the last month (and year-to-date, for that matter), with the market struggling to interpret tariff consequences, as well as starting to consider other tax and spending initiatives. This is a market where simple narratives easily take hold and drive price action. To be fair, uncertainty is elevated, and even the U.S. Federal Reserve (the Fed) has changed its tune. A year ago, Fed Chair Jerome Powell said he didn't see either the "stag" or the "flation" when asked about stagflation. This is a view he maintained until recently. Now he sees potential tension between the two sides of the Fed's dual mandate. That said, even with heightened uncertainty, most scenarios we consider result in a potential positive return for the bond market. Our view remains that over the longer term, economic growth will be the main driver of the direction of bond yields. The impact of tariffs, while potentially disruptive to prices in the near term, should be limited on inflation in the longer term. In addition, the government put we mentioned last month seems alive and well. Current yields present an attractive entry point, with intermediate U.S. Treasuries looking particularly compelling. Spreads on risk assets, on the other hand, generally leave little room for capital gains.

> "This is a market where simple narratives easily take hold and drive price action."

U.S. Federal Reserve

The timeline for the start of a Fed cutting cycle continues to get pushed out as tariff negotiations drag on and economic uncertainty remains high. We do not expect a rate cut at the upcoming June FOMC or at the July meeting, and the odds of a September cut are shrinking as labour markets continue to hold up (for now at least), and signs of inflation emerge. Unlike in September of last year, the Fed is not likely to be pre-emptive in cutting ahead of labour market deterioration.

European Central Bank (ECB)

The market has priced in the ECB cutting one or two more times this cycle, if quite slowly. We see a terminal policy rate pricing of ~1.50% as consistent with the ECB's leaning slightly easy, in its view, while still providing a degree of monetary insurance with which the majority of voters will be comfortable while a trade conflict looms large. The ECB's inflation projections continue to flag close to 2% CPI in the medium term.

Bank of Canada

The Bank of Canada held rates at 2.75% again in June after stopping its rate-cutting cycle in April. Officials are signalling that more rates cuts may be necessary in 2025, because the economy is expected to weaken in the second quarter as tariff-associated front-loading behaviour is reversed. However, with average core inflation now above 3%, the Bank is currently prioritizing price stability.

Bank of Japan (BoJ)

BoJ Governor Kazuo Ueda pushed out the much-anticipated July hike at the May monetary policy meeting, citing growth concerns created by U.S. tariff policy. Domestic wage and inflation pressures have been relegated to a secondary concern; they could be backwards-looking indicators if growth is indeed overwhelmed by a global slowdown. The market consensus is that the BoJ will not change the pace of decreasing purchases into 2026, despite the recent backup in the long end of the Japanese government bond curve.

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, driving 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 was relatively modest in hindsight. 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. Unlike equities, corporate bonds in Europe have recently underperformed their U.S. equivalents. A modest spread advantage has reappeared, 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 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%.

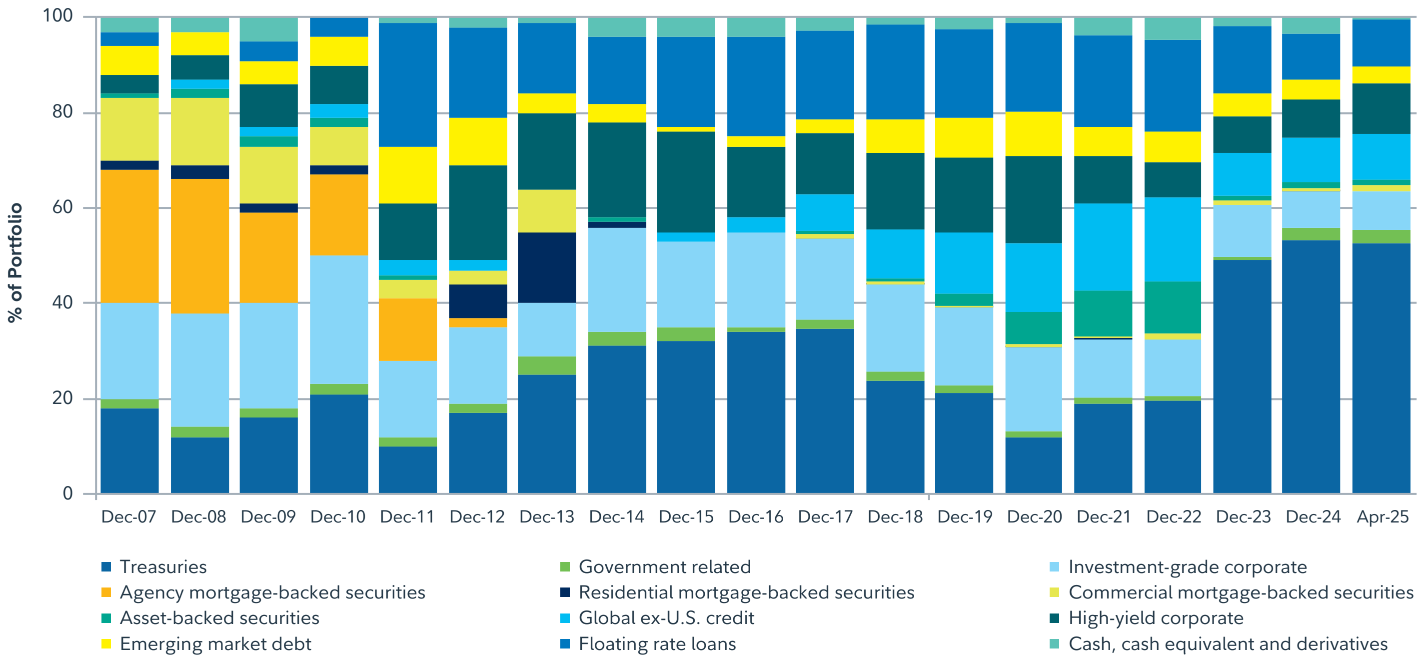
Performance (%)

As at May 31, 2025	3-month	YTD	1-year	2-year	3-year	5-year	Since inception*
Fidelity Multi-Sector Bond CN Fund – Sr. F	(0.9)	1.8	3.7	3.0	1.7	0.6	1.8
Fidelity Investment Grade Total Bond CN Fund – Sr. F	(0.9)	1.8	3.9	3.0	1.4	0.1	1.3
Fidelity Global Core Plus Bond ETF	(0.8)	2.0	4.2	3.3	2.1	1.0	0.8
Fidelity Global Investment Grade Bond ETF	(0.6)	2.1	4.2	2.5	0.9	–	(0.4)
Fidelity Tactical Credit Fund – Sr. F	(0.5)	0.9	4.2	5.9	4.3	–	2.7

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

FIC-2751554 06/25 797351-v2025623