Fixed Income Perspectives

Fidelity Investments

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The big story

> "With bond yields at current levels, we have many ways that we can win."

The interest rate volatility that we have mentioned over the last couple of months has continued. The conflict in Iran remains at the centre of this volatility, as the potential inflationary pressures from higher oil prices have reduced optimism that the U.S. Federal Reserve (the Fed) will ease policy or remain on hold. In addition, signs of a more resilient economy, including firmer labour markets and strong corporate earnings, have added to some of the upward pressure on Treasury yields. The market is now pricing in a full Fed interest rate hike over the course of the next year. We have continued taking advantage of the interest rate volatility and are modestly long duration. With bond yields at current levels, we have many ways that we can win. One way is if we get a conclusive resolution to the conflict in Iran with a path to normalizing the oil market. This would start to ease inflation expectations and should lead to some reversal of the increase in Treasury yields since the conflict started. Another way we win is if the economy stumbles or the Fed becomes overly aggressive in trying to respond to inflation and, in doing so, slows down the economy. Our duration position should help us as recession risk rises, and we would likely get an opportunity to deploy our dry powder into risk assets. Until then, we earn an attractive income stream with the elevated level of yields.

U.S. Federal Reserve (the Fed)

The Fed is likely to remain on hold for the foreseeable future as most policymakers see upside risks to inflation and acknowledge the stability in labour markets. Chair Warsh has proposed "regime change" at the Fed, but this will likely be constrained by the current composition of the FOMC.

Bank of Japan (BoJ)

Government measures capping energy costs and other utilities are, for now, limiting major inflationary pressures in Japan. Still, BoJ voting members are demonstrating comfort with consensus expectations for roughly two rate hikes per year, with the next policy tightening expected on June 16.

European Central Bank (ECB)

With the consumer price index (CPI) around 3% in May and markets expecting a first rate hike at the June 11 meeting, consensus ECB voter rhetoric has for some time reflected a desire to tighten policy. Meanwhile, growth across the European Monetary Union (EMU) has softened, suggesting that any rate-hiking cycle may prove short-lived.

Bank of Canada (BoC)

The BoC held its overnight rate at 2.25% in April with a hawkish tilt. Since then, data has been weaker than expected. First-quarter GDP was flat, and the economy appears to have slipped into a mild recession.

Bank of Mexico

The Bank of Mexico cut its policy rate by 25 basis points in May to 6.50% and signaled a likely end to the monetary easing cycle. Policymakers expect to hold rates from here, with still-elevated inflation and a slower disinflation path limiting scope for further interest rate cuts despite soft growth.

Central Bank of Brazil (BCB)

The BCB has been on hold since its late April 25-basis-point cut to 14.50%, with the next decision due in June. The easing cycle remains cautious and conditional while softer growth supports further cuts. Sticky core inflation, fragile expectations, and tighter global conditions argue for a gradual pace of rate reductions with pauses.

People's Bank of China (PBoC)

The PBoC stayed on hold in May, keeping policy accommodative as growth remains uneven. It is not rushing to cut interest rates, preferring yuan stability while keeping reserve requirement ratio (RRR) cuts and targeted easing measures in reserve.

Valuations

- **Leveraged loans:** We are modestly overweight. The asset class has recovered a bit in the past couple months, but it has not fully recouped earlier underperformance due to idiosyncratic credit issues and a broader fear that artificial intelligence (AI) will supplant the software sector, which represents a significant portion of the broadly syndicated loan market. Active management can be important during periods of dislocation within the asset class; unlike direct lending, broadly syndicated loans trade in the secondary market. Floating rate coupons have helped sector total returns as Treasury rates have moved higher and the potential for Fed rate hikes is being considered.
- **High yield:** We are modestly overweight. High yield spreads are now tighter than they were at the start of the year, having recovered from the Iran-related volatility. The increase in Treasury yields is putting downward pressure on prices, but not enough to offset a high level of income and tighter spreads year-to-date. Dislocations at the industry and issuer level focus our attention on idiosyncratic opportunities as we patiently wait for signs that the credit cycle is turning. We are also watching supply and demand dynamics as data centre funding has ramped up significantly.
- **U.S. investment-grade corporates:** We are underweight. Earnings for large-cap companies are robust, balance sheets remain strong, and the appreciation in the equity market has increased the cushion beneath the debt in the capital structure, justifying current valuations. However, if fundamentals unexpectedly deteriorate, the sector may be vulnerable to significant underperformance, particularly if the technical backdrop weakens as the market digests extremely heavy AI- and data-centre-related supply. As such, we are patiently waiting for better entry points.
- **International credit (hedged):** We are modestly overweight. The spread advantage relative to U.S. credit that we saw earlier in 2025 is mostly gone, though there is still a carry advantage after hedging currency risk. In addition, the shorter duration and higher quality of the European benchmarks could justify further spread tightening. We continue to value the diversification and security selection benefits of evaluating a larger pool of investment-grade issuers.
- **Emerging markets debt:** We continue to own idiosyncratic risk through selective ownership of names in Brazil, Colombia and Mexico. Emerging markets continue to perform well, with riskier credits (below investment grade) leading the way. More aggressive U.S. foreign policy decisions (e.g., Venezuela and Iran) may lead to higher-than-recent spreads and foreign exchange volatility, perhaps compounded by elevated starting valuations.
- **U.S. Treasuries:** We maintain a long-duration position. Amid increased U.S. Treasury volatility, we added duration as nominal interest rates have moved up to the high end of the three-year range. Furthermore, we have used episodes of yield curve flattening to shift some exposure from long bonds to the belly of the curve (e.g., 7-year bonds). U.S. Treasury exposure remains close to the highest level in the history of the strategy; it has been and will continue to 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. Longer-term inflation break-evens have been 2.2% to 2.4% for the better part of three years. The Iran conflict has pushed oil prices higher, leading to an increase in inflation expectations in the very short end of the yield curve (e.g., less than two years). We prefer the liquidity of nominal U.S. Treasuries, with volumes 10-20 times greater than those of TIPS.
- **Mortgage-backed securities (MBS):** We have a zero weighting in MBS. Despite recent spread widening, spreads against U.S. Treasuries in the area of 20 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 aircraft financing. We have a very small allocation to commercial mortgage-backed securities due to valuations. We continue to look for well-structured, idiosyncratic exposure, using our research edge.
- **Local currency debt:** We only own idiosyncratic exposure, with the total size of the allocation near 1%. Currency volatility is significantly higher than rate volatility, approximately three times higher. We own exposure in Brazil, with Brazilian local currency bonds currently yielding over 14%.

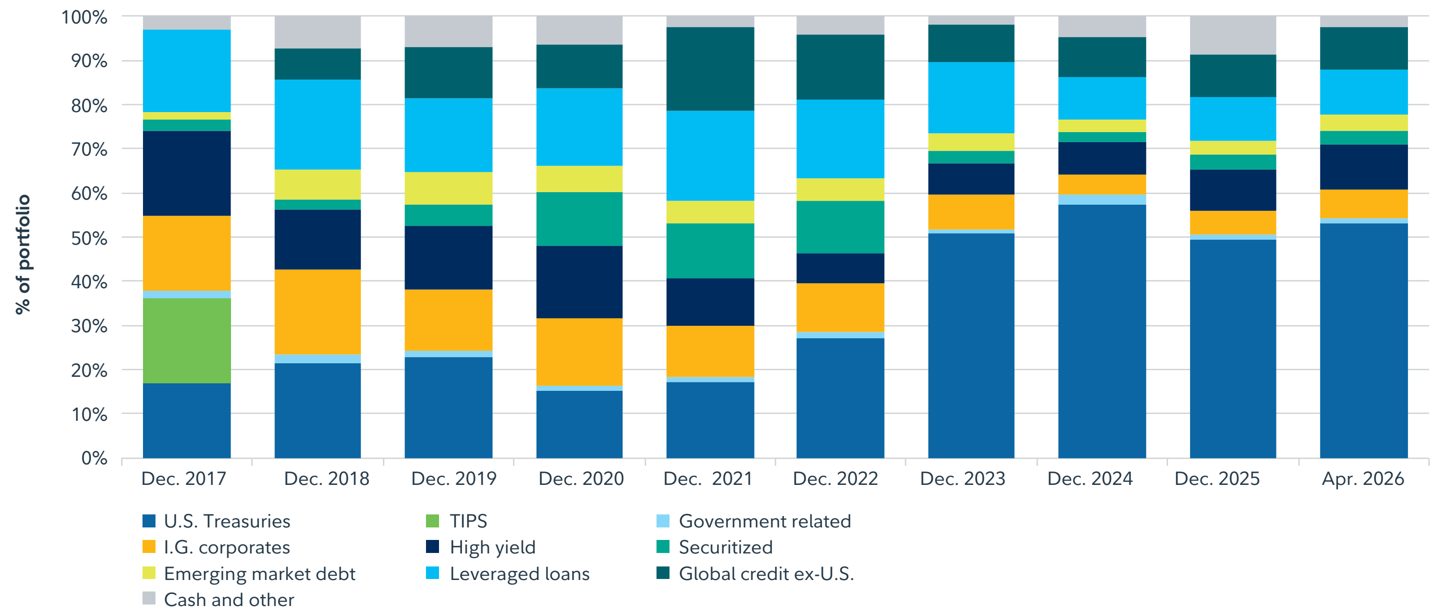
Performance (%)

As at May 31, 2026	3-month	YTD	1-year	2-year	3-year	5-year	Since inception*
Fidelity Multi-Sector Bond CN Fund – Sr. F	-1.6	0.0	3.5	3.6	3.2	0.4	2.0
Fidelity Investment Grade Total Bond CN Fund – Sr. F	-1.6	0.1	3.6	3.7	3.2	0.0	1.5
Fidelity Global Core Plus Bond ETF	-1.6	0.2	3.5	3.9	3.4	0.7	1.2
Fidelity Global Investment Grade Bond ETF	-1.5	0.3	3.6	3.9	2.8	-0.1	0.3
Fidelity Tactical Credit Fund – Sr. F	0.4	1.0	4.9	4.6	5.5	–	3.2

Source: Fidelity Investments Canada ULC. Performance shows annual compounded returns as at May 31, 2026, 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 Multi-Sector Bond Fund historical exposure



Source: Fidelity Investments Canada ULC. As at April 30, 2026. Benchmark: Bloomberg U.S. Aggregate Bond Index.

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