Fidelity INVESTMENTS

Fixed Income Perspectives

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

The big story

Just last month we highlighted the market's dramatic shift to a "higher for longer" narrative and a material move up in rates. How quickly the market can pivot! Since then, we have seen a roughly 50-basis-point drop in the 10-year U.S. Treasury yield. Overall, bond market yields are still very attractive, and remain near the highs of the last 20 years, but the recent drop is notable. Part of the move was driven by economic uncertainty regarding potential policies from Washington, D.C. (in a reversal of the market's reaction to potential policies a month ago).

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The broader point, however, is that after a prolonged period of extraordinarily low rate volatility induced by the U.S. Federal Reserve (the Fed), rate volatility is now closer to its longer-term historic average. This bodes well for active management, as we can position portfolios to take advantage of market short-sightedness. That said, spread volatility remains nowhere to be seen. It's prudent to be cautious about complacency in the credit markets given the current spreads. While it's hard to predict what the catalyst will be, we do expect to see a bout of volatility at some point, and we have plenty of dry powder to take advantage of it. In March 2020, the catalyst was a global pandemic; in March 2022, it was war in Europe; in March 2023, it was a regional bank crisis. That all these occurred in March may simply be an odd coincidence – but still a good reminder to stay vigilant this month (and every month).

U.S. Federal Reserve

For now, the Fed remains comfortable with the view that current monetary policy is appropriate, and it expects to continue to see inflation trending down over time without hurting the labour market. The market, however, has recently priced in additional easing by the Fed later this year. This indicates a shift in focus from the view that economic policies from the administration may have an inflationary impact to one that might include slower growth.

European Central Bank (ECB)

Broadly, the ECB's expectations of CPI at approximately 2% will be reaffirmed at its March meeting, when our analyst expects another quarter-point cut. Beyond that, the majority in favour of rate cuts should dwindle with each new meeting, given a bottoming of disinflation and increasing voter confidence that policy is reaching a neutral point. Still, rate cuts remain likely into the summer.

Bank of Canada

Absent permanent tariffs, the Bank is getting close to the limit of its policy divergence from the Fed. A stronger-than-expected economy, solid job growth and inflation under control provide the Bank additional flexibility at its March and April meetings.

Bank of Mexico

Given the current data, it is likely that Mexico's central bank would ordinarily be preparing to lower its overnight rate, due to slowing inflation and moderate growth. However, U.S. policy uncertainty could instead lead the central bank to be more cautious, and to cut less than the macro conditions themselves warrant.

Valuations

- **Leveraged loans:** We are modestly overweight. The majority of the broadly syndicated loan market is priced at or above par, leaving little to no capital gain opportunity, given structural callability. Nearly 70% of the broadly syndicated loan market has been refinanced or repriced at tighter spreads over the past year, leaving less income for investors in the future (so we can expect lower total returns). The Fed's being on hold has attracted inflows to the asset class, as the base rate (SOFR) may keep yields elevated for a while. Demand from the collateralized loan obligations (CLO) machine remains strong; AAA CLO ETFs have seen significant growth.
- **High yield:** We are modestly overweight. As with leveraged loans, the decline in spreads over the last 18 months has reduced the appeal. Defaults remain very low and credit quality is stable, but valuations at the rich end of the asset class' history are keeping us cautious. The modest sell-off in February was not enough to create a buying opportunity. We prefer idiosyncratic opportunities to generic beta.
- **U.S. investment-grade corporates:** We are underweight. The sector is priced for perfection, with spreads as tight as they have been for the last 20 years, and it has run out of room to compress further, despite positive fundamentals and technicals. Risk/reward is unfavourable: a return in spreads to just the long-term median from current levels would erase over four years of excess carry. Investors can earn roughly 85% 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. Global credit spreads have closed the valuation gap and how trade nearly flat in spread terms relative to U.S. investment-grade credit. 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 and Colombia. Changes in U.S. trade policy could create a headwind, which keeps us cautious regarding foreign exchange volatility.
- **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 have been the best-performing asset class year-to-date as yields have fallen, demonstrating the diversification benefits of the sector. U.S. Treasury exposure remains close to the highest level in the history of the strategy; it will be the 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. 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%

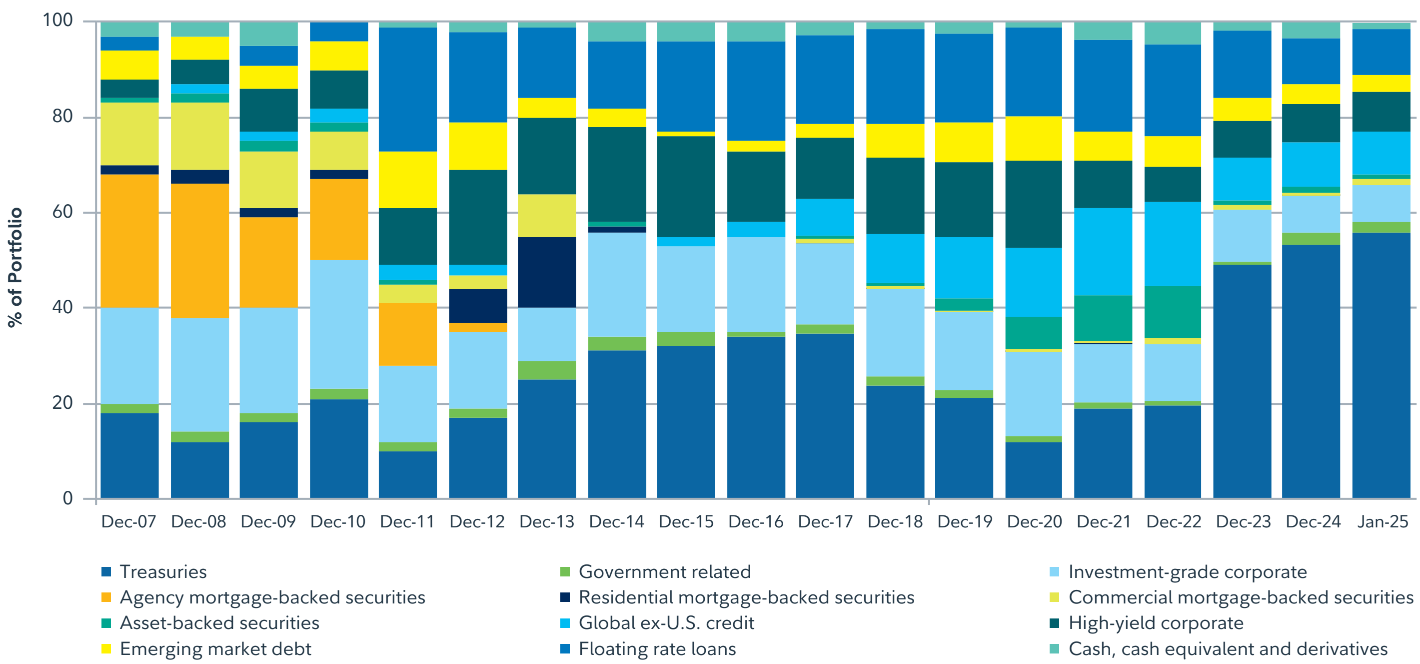
Performance (%)

As at February 28, 2025	3-month	YTD	1-year	2-year	3-year	5-year	Since inception*
Fidelity Multi-Sector Bond CN Fund – Sr. F	0.5	2.7	4.5	3.8	0.0	0.6	2.0
Fidelity Investment Grade Total Bond CN Fund – Sr. F	0.6	2.7	4.9	3.9	-0.3	0.1	1.4
Fidelity Global Core Plus Bond ETF	0.6	2.8	5.0	4.1	0.4	0.5	1.0
Fidelity Global Investment Grade Bond ETF	0.6	2.8	4.7	3.4	-0.8	–	-0.3
Fidelity Tactical Credit Fund – Sr. F	0.5	1.4	5.9	6.7	3.5	–	3.1

Source: Fidelity Investments Canada ULC. Performance shows annual compounded returns as at February 28, 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 January 31, 2025. The historical exposures shown are those of Tactical Bond Composite (the U.S. Fund) as at January 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.**

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