

MAY 2025

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## The big story

The ongoing trade war and the chaotic implementation of tariffs continue to be the primary drivers of market volatility. Initially framed as the U.S. versus the rest of the world on "Liberation Day," this conflict has evolved into an economic war against China, with both nations seeking allies and urging others to choose sides. While the rhetoric against China has intensified, and tariff rates have increased, the reciprocal tariffs on all other countries announced on Liberation Day were delayed for 90 days, just before they were to take effect. Why? Although the White House appeared willing to accept a sharp decline in the equity market as the price of reshaping global trade, early signs of dysfunction in the bond market prompted Treasury Secretary Scott Bessent to sound the alarm, leading President Trump to relent. Although the equity market welcomed this temporary relief with a dramatic 10% one-day rally, it was the bond market that quietly acknowledged the implied support the administration had provided. Given historically high interest rates, further evidence of the diversification benefits of fixed income and a confirmation that the government put option may be activated by rising yields, bonds remain an attractive component of a balanced portfolio.

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## U.S. Federal Reserve (the Fed)

Caught between the prospect of rising inflation due to tariffs and a still robust job market, the Fed is currently on hold as it awaits concrete data to justify any action. The market is currently pricing in 75–100 basis points of cuts in the second half of the year, beginning in earnest at the September Federal Open Market Committee meeting; that consensus seems plausible to us. The timing of the first cut will largely depend on the labour market. The resolution of the debt ceiling issue, which will accompany the reconciliation bill in early autumn, will present another critical juncture at which money market funding might become tight, potentially unsettling U.S. Treasury markets once more. This could necessitate further intervention by the Fed.

## European Central Bank (ECB)

With interest rates at 2.25%, eurozone monetary policy is now viewed as neutral by ECB officials. However, "insurance" rate cuts are expected throughout the summer, rather than the recently anticipated pause in cuts. The global trade conflict has taken precedence. The ECB perceives an immediate growth shock with an anticipated disinflationary tail as outweighing any short-term upward CPI risk, although it is not forecasting a recession yet. Interest rate markets fully reflect the current ECB thinking.

## Bank of Canada

The Bank of Canada maintained interest rates at 2.75% in April, following seven cuts, the swiftest approach by any G7 central bank. The visibility of the future rate path has been reduced as the Liberals, under the leadership of Mark Carney, secure power. A potential increase in fiscal spending could possibly boost growth; however, the extent of the economic damage from tariff uncertainty remains unclear.

## Bank of Japan (BoJ)

U.S. tariff policy and its subsequent negative impact on global growth are making the BoJ increasingly cautious. BoJ Governor Kazuo Ueda adopted a more dovish stance at the May monetary policy meeting, prioritizing growth concerns over inflationary concerns arising from a labour shortage that has not been so acute in decades. It remains uncertain whether a disinflationary wave of goods from China could disrupt the nascent virtuous wage and inflation cycle. This caution may prevent the BoJ from altering its current quantitative tightening plans at its upcoming June meeting.

## Bank of China

The People's Bank of China remains restricted in its ability to implement further easing, due to concerns about capital outflows triggered by additional foreign exchange weakness. The strategy appears to be to maintain stability. The reserve requirement ratio might be adjusted downward to provide more liquidity to banks, thereby encouraging lending.

## Valuations

- **Leveraged loans:** We are modestly overweight. The portion of the market priced at or above par has declined to less than 10%, compared with nearly 70% before the tariff headlines. Spreads have widened, clearly in anticipation of a weaker economy. However, spreads are still tight from a historical perspective, and far from fully pricing in a recession.
- **High yield:** We are modestly overweight. We leveraged recent volatility to increase exposure. Defaults are still very low and credit quality remains stable, but vigilance is required regarding tariff-related effects. Following the recent sell-off, the sector is no longer at the wealthy end of its historical range. However, spreads are still below the historic median, necessitating opportunism when adding exposure. Preference is given to idiosyncratic opportunities over generic beta.
- **U.S. investment-grade corporates:** We are underweight. Spreads are still well below the historic median and far from pricing in a worst-case scenario. Risk/reward has improved but remains unfavourable: a return in spreads to just the long-term median from current levels would erase over two years of excess carry. (Before the tariff headlines, the math suggested four years of excess carry would be lost.) Investors can earn roughly 75% 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. Spreads have closed the valuation gap and now trade nearly flat in spread terms relative to U.S. investment-grade credit, even in the midst of tariff volatility. A small carry advantage remains, and potential alpha from security selection is available due to spread dispersion, but tariffs have significantly increased uncertainty. 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, 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 negotiated.
- **U.S. Treasuries:** We maintain a long duration position after leaning into the significant rate sell-off over the fourth quarter of 2024. Despite recent technical pressures in the market, U.S. Treasuries are well positioned to provide a diversification benefit. We still view U.S. Treasuries as having the best risk/reward in fixed income, even after posting the best year-to-date performance in the asset class. 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 modestly trimmed to fund an opportunistic addition in high yield.
- **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 to Brazil and Japan. Brazilian local currency bonds currently yield approximately 15%.

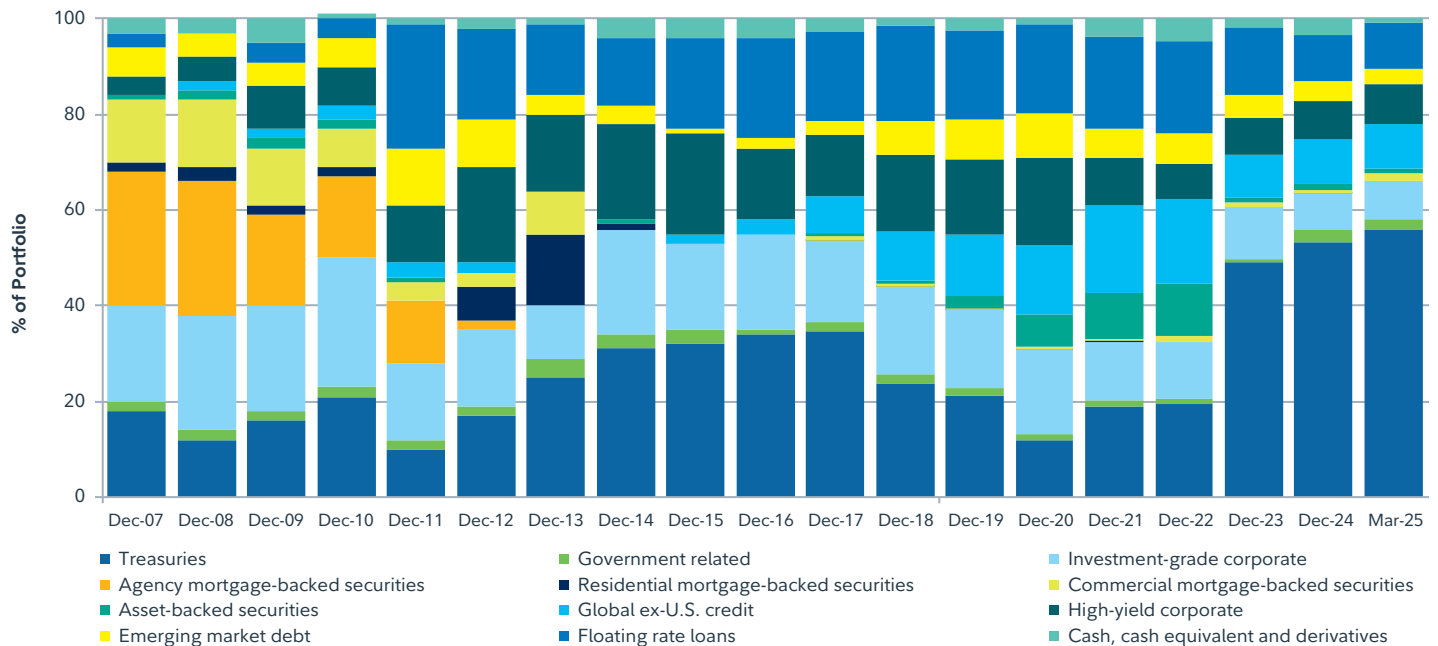
## Performance

As at April 30, 2025	3-month	YTD	1-year	2-year	3-year	5-year	Since inception*
Fidelity Multi-Sector Bond CN Fund – Sr. F	1.8	2.4	5.9	2.7	1.5	1.3	1.9
Fidelity Investment Grade Total Bond CN Fund – Sr. F	1.8	2.4	6.2	2.7	1.4	0.7	1.3
Fidelity Global Core Plus Bond ETF	1.9	2.5	6.4	3.0	1.9	1.6	0.9
Fidelity Global Investment Grade Bond ETF	2.1	2.7	6.5	2.2	0.8	–	-0.3
Fidelity Tactical Credit Fund – Sr. F	(0.4)	0.2	4.6	5.0	3.7	–	2.5

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