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The big story

The U.S. Federal Reserve (the Fed) is cutting short-term interest rates, while the three-month average unemployment rate is just 4.2%, and real growth is almost 3%. If negative trends were starting to emerge, the Fed is hoping to steady them and prolong the cycle with looser monetary policy. Financial conditions are already at the easiest levels in the past 30 months, and if the Fed's Summary of Economic Projections is even close to accurate, conditions may get even easier from here. Equities are making new all-time highs and default rates have been trending lower. With that backdrop, it may be hard for fixed income risk assets to underperform dramatically in the near term, but valuations do reflect all that good news and momentum. We are very modestly long risk, diversified, liquid and being very patient as we wait for new opportunities. While alpha from sector beta is elusive, there are many dislocations among issuers and individual bonds to take advantage of, by following the high-conviction recommendations of our world-class research analysts and traders.

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The U.S. Federal Reserve

The Fed commenced its easing cycle with a 50-basis-point (bp) cut in September, which Fed Chair Jerome Powell characterized as a "strong start." The fresh dots imply an additional 50 bps of cuts this year, with 100 bps more in 2025. The market is pricing in even a bit more.

European Central Bank (ECB)

ECB President Christine Lagarde and the ECB continue cautious cutting, delivering a second 25 bp cut this month and making no commitment on the future path. Even so, the market is pricing in about 25 bps per meeting through mid-2025, and recent macro data in Europe have reinforced these market expectations.

Bank of Japan (BoJ)

The prospect of an ever-so-slight convergence of short-term rates in Japan and in the U.S. has driven the Japanese yen to the strongest level against the U.S. dollar in a year. The stronger yen, a vulnerable Nikkei and the volatility caused by the unwinding of the carry trade may prompt the BoJ to be patient and evaluate the data carefully before hiking again. The new Japanese Prime Minister Shigeru Ishiba's recent prevarication on continued BoJ rate hikes underscores the delicate market environment that the BoJ will have to contend with as it normalizes interest rates.

Bank of Canada

The Bank had 75 bps of cuts under its belt before the Fed got out of the blocks. During the September press conference, Fed Chair Jerome Powell implied that the Fed should have cut in July – perhaps a nod to his neighbours to the north. The market continues to price in an aggressive easing cycle, but we don't expect significant divergence between the Fed and the Bank.

Valuations

- **Leveraged loans:** We maintain a modestly overweight position after meaningfully reducing our position this summer. Leveraged loans gave up their spot as the top-performing fixed income asset class. The asset's floating rate nature, which had been an advantage, started to take a toll as the Fed began its rate cutting cycle, reducing the yield advantage of loans. How much further the Fed goes remains to be seen, but the direction of travel is clear.
- **High yield:** We maintain a modestly overweight position. The duration of high-yield bonds has propelled the asset class ahead of leveraged loans year-to-date.
- **Investment-grade corporates:** We are underweight. This asset class is priced for perfection, because demand for yield has driven spreads to very tight levels despite over \$1.2 trillion in supply year-to-date. If spreads were to return to just the long-term median from their current values, it would erase more than four years of carry. Investors can generally receive 85% of the yield investment-grade credit offers by buying U.S. Treasuries of similar maturity instead.
- **Global credit:** We are modestly overweight. Spreads are close to the 12-month average relative to U.S. investment-grade credit. A small carry advantage remains, and alpha will likely be idiosyncratic in nature. The asset class is less correlated to U.S. Treasuries than domestic credit.
- **Emerging markets:** We have selective ownership of issues from countries such as Mexico, Brazil and the Dominican Republic, in local currencies and in U.S. dollars. This sector has had a tremendous run, to the point that many emerging market debt issues have spreads and yields at or below investment-grade corporate debt with similar credit quality.
- **U.S. Treasuries:** We further reduced duration, given the recent rally in rates. That said, U.S. Treasuries remain a large overweight, with exposure almost as high as it has ever been in our nearly two-decade portfolio history. Most of the yield curve now has a positive slope, but substantial further steepening remains possible as developed market curves continue to normalize. As a result, the intermediate part of the yield curve is our favourite. There are high potential total returns in a number of scenarios (geopolitical risk, deteriorating labour market, growth scare, etc). The U.S. presidential election is not an investable theme, and we do not expect it to be a source of rate volatility.
- **Inflation-protected bonds (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 and have now fallen below the lower bound of that range. We prefer the liquidity of nominal U.S. Treasuries.
- **Mortgage-backed securities (MBS):** We also have a zero weighting in MBS. Spreads against U.S. Treasuries in the area of 40 basis points are not compelling, and we prefer the liquidity and stability of U.S. Treasuries.
- **Structured product:** We are selectively overweight, specifically in franchise bonds and airplane financing. For the most part, holdings in CMBS holdings are very small. We continue to look for well-structured idiosyncratic exposure.
- **Local currency debt:** We only have idiosyncratic exposure, and the total size of the allocation is below 3%. Currency volatility is significantly higher than interest rate volatility (approximately three times higher). We own overweight positions in Mexico, Brazil and Japan. Mexican and Brazilian local currency bonds enjoy high yields. The Japanese yen has had a nice run, but may stall, because a lot of interest rate convergence has already been priced in.

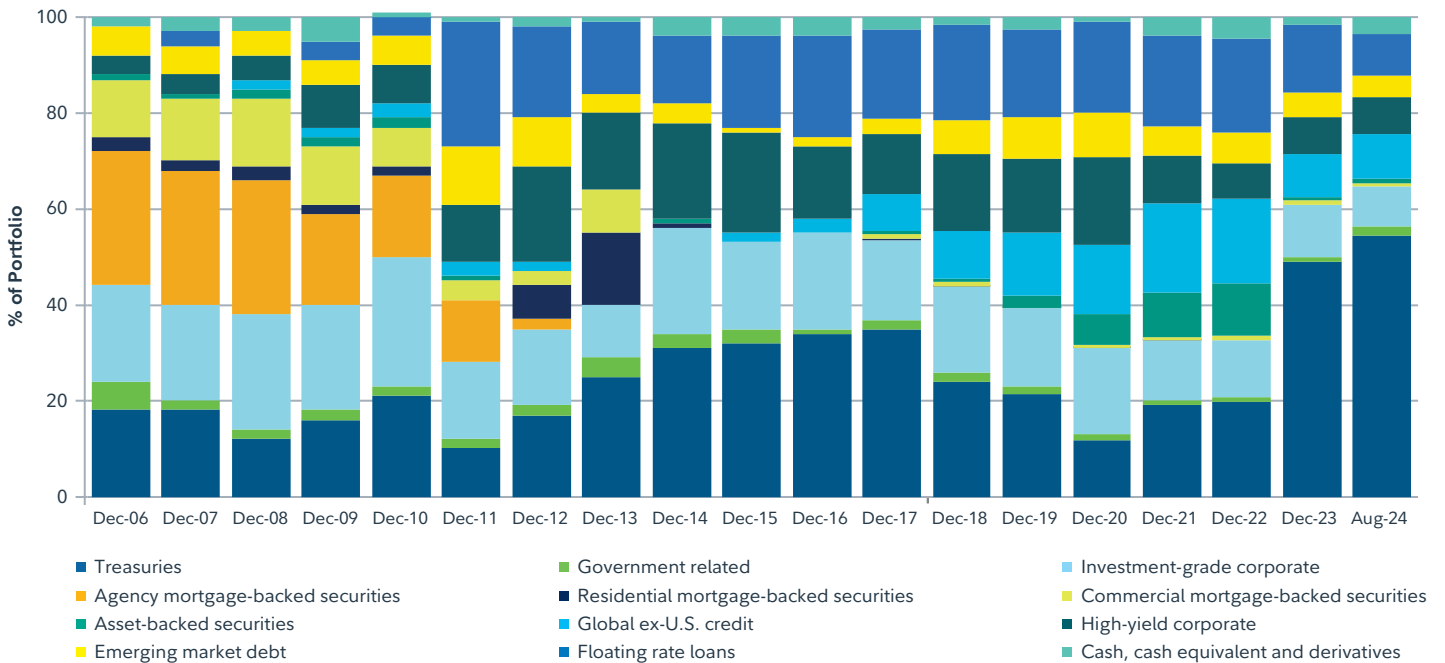
Performance

As at September 30, 2024	3-month	YTD	1-year	2-year	3-year	5-year	Since inception*
Fidelity Multi-Sector Bond CN Fund – Sr. F	4.7	4.3	11.1	6.3	-0.4	1.3	2.2
Fidelity Investment Grade Total Bond CN Fund – Sr. F	4.8	4.4	11.5	6.2	-1.1	0.8	1.6
Fidelity Global Core Plus Bond ETF	5.1	4.6	11.6	6.8	0.0	1.2	1.2
Fidelity Global Investment Grade Bond ETF	5.1	4.2	10.8	5.3	-1.3	–	-0.1
Fidelity Tactical Credit Fund – Sr. F	3.1	5.2	10.0	8.4	–	–	3.1

Source: Fidelity Investments Canada ULC. Performance shows annual compounded returns as at September 30, 2024, 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 August 31, 2024. The historical exposures shown are those of Tactical Bond Composite (the U.S. Fund) as at August 31, 2024. 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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