Towards the Balanced Fund of the Future

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We are incorporating a number of alternative investments in our multi asset class funds. Specifically, we are initiating positions in three liquid alternatives (Fidelity Global Value Long/Short, Fidelity Market Neutral Alternative and Fidelity Long/Short Alternative) within our Fidelity Managed Portfolios, and approaching the beginning of the funding of our previously-announced Brookfield direct real estate capability in our Private Investment Pools. Below we summarize the rationale for these investments and our expectations for their contributions to portfolio performance.

Why alternatives?

The principal goal in allocating to alternatives is to enhance returns, manage risk and/or improve diversification beyond what traditional asset classes offer. There are broadly two types of alternatives. Liquid alternatives cover a wide range of hedge-fund-like strategies, often using derivatives and/or leverage. Less liquid alternatives primarily cover investments in private real estate, private equity and private credit. In both cases, the goal is to harness a return stream differentiated from that offered by public equity and debt markets. Institutional investors have long taken advantage of the diversification opportunities in alternative asset classes, and we are pleased to now be able to bring these benefits to the multi asset class funds for which we're responsible.

Why now?

There are two main reasons we are taking this step. The first is access. Fidelity has developed a number of innovative investment vehicle structures in Canada to expand access to alternatives beyond the traditional set of institutions. For us, as managers of Fidelity's multi asset class funds, we are always deliberate about introducing capabilities into our strategies, and this is particularly true of new asset classes. This is in order to gather confidence that we will get the behaviour we desire, as well as allowing us to calibrate the appropriate allocations in the appropriate funds. The three liquid alternatives in which we are investing have recently passed their three-year mark, and we have much longer experience and history with the managers and their investment processes. Our private real estate capability is a new fund (probably not a bad thing in this commercial real estate environment), but we are guided in our allocations by the long history of the behaviour of commercial real estate returns in Canada and elsewhere, and Brookfield is an established top asset manager in the sector.

The second reason is that alternatives now look to be more valuable in portfolio construction, as the diversification offered by traditional asset classes appears to have waned. For decades, bonds have generally been good diversifiers to equity risk, tending to rally when stocks sold off, thus mitigating overall portfolio volatility. That's been the magic of 60/40. As we have discussed in previous papers, however, the stocks-bonds correlation has flipped positive over the past couple of years, reflecting the return of inflation volatility after a long period of dormancy. With inflation likely to remain an issue, the diversification offered by bonds may be less reliable, requiring us to look further afield for diversification. We have long been addressing this challenge in our funds by diversifying into differentiated asset classes such as emerging market local currency debt and commodities, as well as using our active asset allocation tools, for example taking positions in currencies with more reliable negative correlations to equities. We now have the opportunity to further enhance diversification with the introduction of alternatives.

What are we doing?

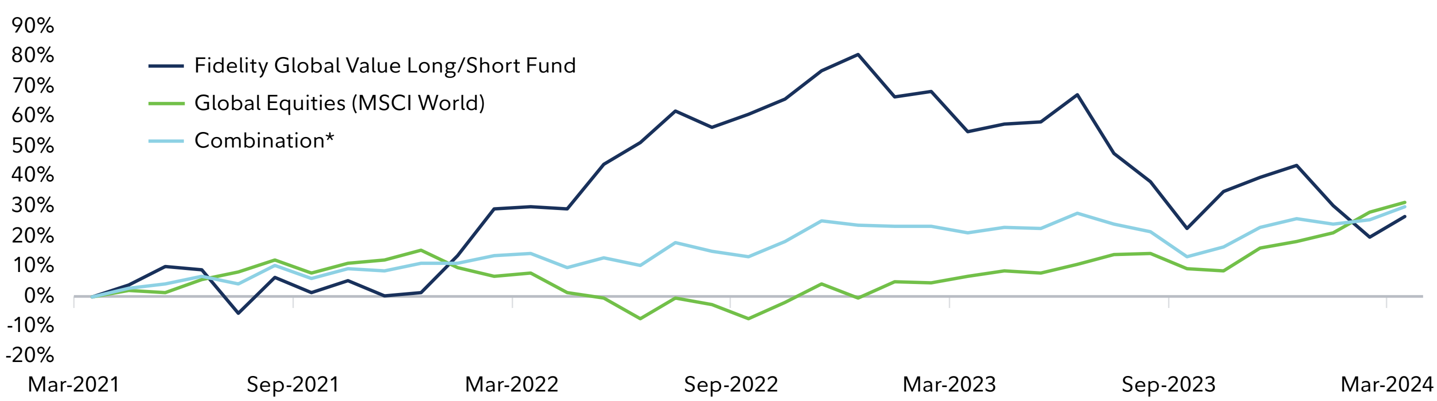
Liquid alternatives

We are incorporating three liquid alternatives strategies – Global Value Long/Short (GVLS), Market Neutral Alternative (MNA) and Long/Short Alternative (LSA) – into our Fidelity Managed Portfolios (FMP's).

Let us take the example of the GVLS strategy to illustrate how we are approaching the incorporation of these liquid alternatives into the multi asset class funds. Dan Dupont, manager of GVLS, has a well-established defensive and value-oriented process. For many years, we've had Dan's long-only Canadian Large Cap Fund in the FMP's. We view GVLS as an expression of Dan's approach in more concentrated form, employing leverage to focus the portfolio on names consistent with his process and short names at odds with it. This approach will naturally result in more volatile returns, but importantly, it also produces a much lower (in fact empirically negative) beta to equity markets. So while that volatility may be challenging to investors on a stand-alone basis, it is quite valuable to us in a multi asset class context, helping to hedge the equity risk we have elsewhere in the funds. Exhibit 1 shows how this works in practice. GVLS has generally been up when equities have been down and vice versa; putting the two together in a well-calibrated manner has translated into strong returns that have been broadly similar to each asset class individually, but with vastly reduced volatility and minimal drawdowns.

EXHIBIT 1: A Smoother Ride

Cumulative Return %



Source: Bloomberg, FMR Calculations. Data as of March 29, 2024.

* Blend of 70% MSCI World Index and 30% Fidelity Global Value Long/Short Fund. All returns in CAD.

Our investments in MNA and LSA are guided by the same set of principles, allocating to these strategies in order to enhance return, manage risk and/or improve diversification for a given multi asset fund as a whole. We see MNA, managed by Brett Dley, as an attractive cash substitute, with our investments calibrated to potentially enhance returns with limited additional risk in the zero-beta elements of our portfolios. We see LSA, managed by David Way, as an attractive source of diversification within the equity portion of our portfolios, being a 130/30 fund with a foundation in a proven research process and employing a differentiated approach.

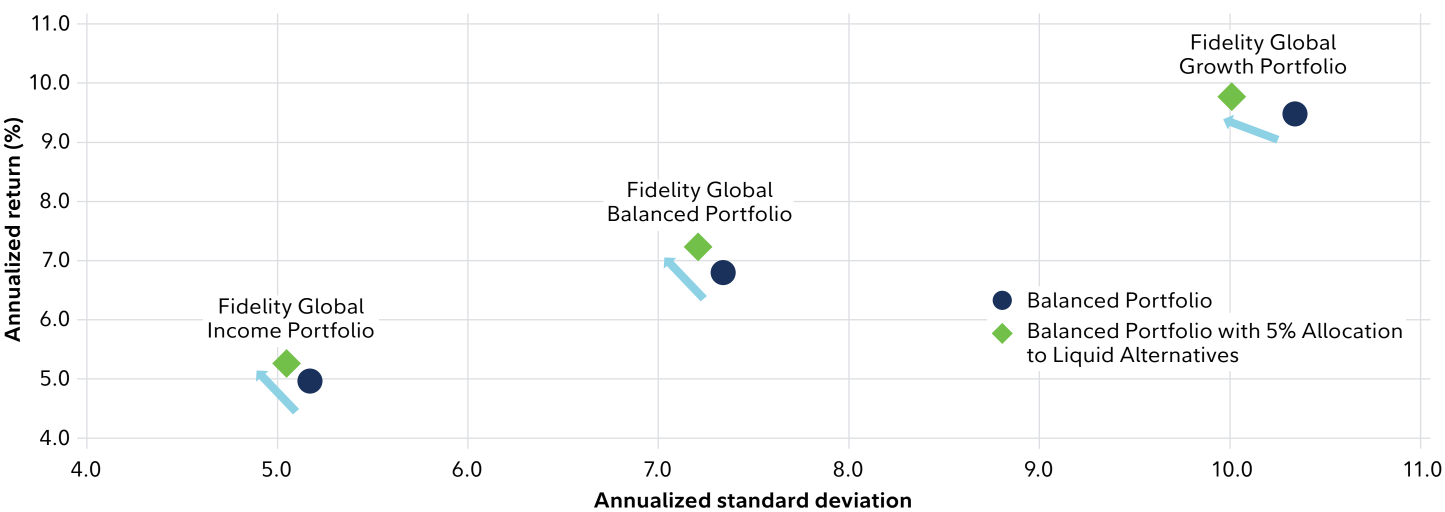
Exhibit 2 shows the simulated impact over the past three years of a collective allocation to these three strategies in the Global Income, Global Balanced and Global Growth FMP's. On this return/risk scatterplot, the incorporation of the alternatives shifts the funds' results up and to the left, ie more return and less risk – obviously the desired outcome. Importantly, though, the dots don't shift much, even with a material allocation. That's fine with us. We are not seeking to change the broad contours of performance that investors have come to rely on in the FMP's. We are seeking to make incremental improvements in risk-adjusted returns. We expect that the inclusion of these liquid alternatives will contribute to that.

Private real estate

We are approaching the beginning of the funding of the previously-announced Brookfield-managed direct real estate capability within a number of our Private Investment Pools (PIP's).

EXHIBIT 2: Liquid Alternatives can improve a traditional portfolio

Fidelity Managed Portfolios with a 5% total allocation to liquid alternatives



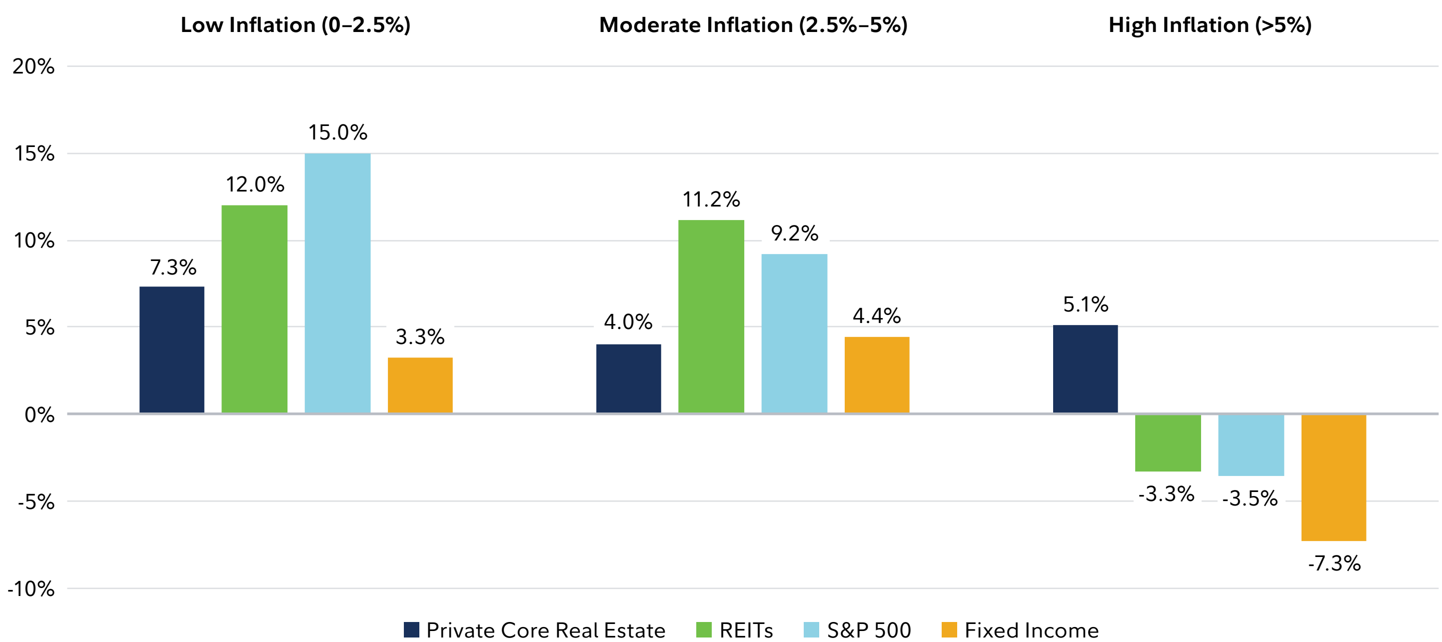
For illustrative purposes only. Source: Fidelity Investments Canada ULC. Data shown for Series F, net of fees, and in Canadian dollars. As at March 29, 2024. Analysis is done on a daily basis, from April 1, 2021 to March 29, 2024. The hypothetical 5 percent allocation for all of the portfolios shown in the chart above consist of 1.5% Fidelity Market Neutral Alternative Fund, 1.5% Fidelity Long/Short Alternative Fund and 2% Fidelity Global Value Long/Short Fund, funded as appropriate from sources within each of the three balanced funds depicted above. The performance shown above is for illustrative purposes only and does not reflect the actual or hypothetical performance of any Fidelity product. Past performance is not indicative of future returns.

Private real estate exposure has long been a mainstay of institutional investors' portfolios. Real estate shares a number of the properties of both equities (capital appreciation) and bonds (stable income), but with a return stream differentiated from each. In particular, real (physical) assets should hold up better against inflation and have indeed tended to do so historically (see Exhibit 3). This looks to be a particularly valuable characteristic in the higher volatility inflation regime that we may now have entered.

The private real estate capability we are deploying in the PIP's is a dedicated Brookfield-managed portfolio of Canadian commercial properties, such as office buildings, retail, industrial and multi-unit housing. Our intention is to build the capability to a strategic allocation of 5% in the Balanced, Balanced Income, Conservative Income and Asset Allocation PIP's (and related funds), funded equally from Canadian stocks and bonds. These are portfolios which we believe are particularly well suited to direct real estate investment, given their more institutional approach to asset management. At this level of allocation, historical patterns of performance suggest that the diversification benefits of private real estate result in a meaningful improvement in risk-adjusted returns in these PIP's (Exhibit 4).

EXHIBIT 3: Private real estate has been an effective hedge against inflation

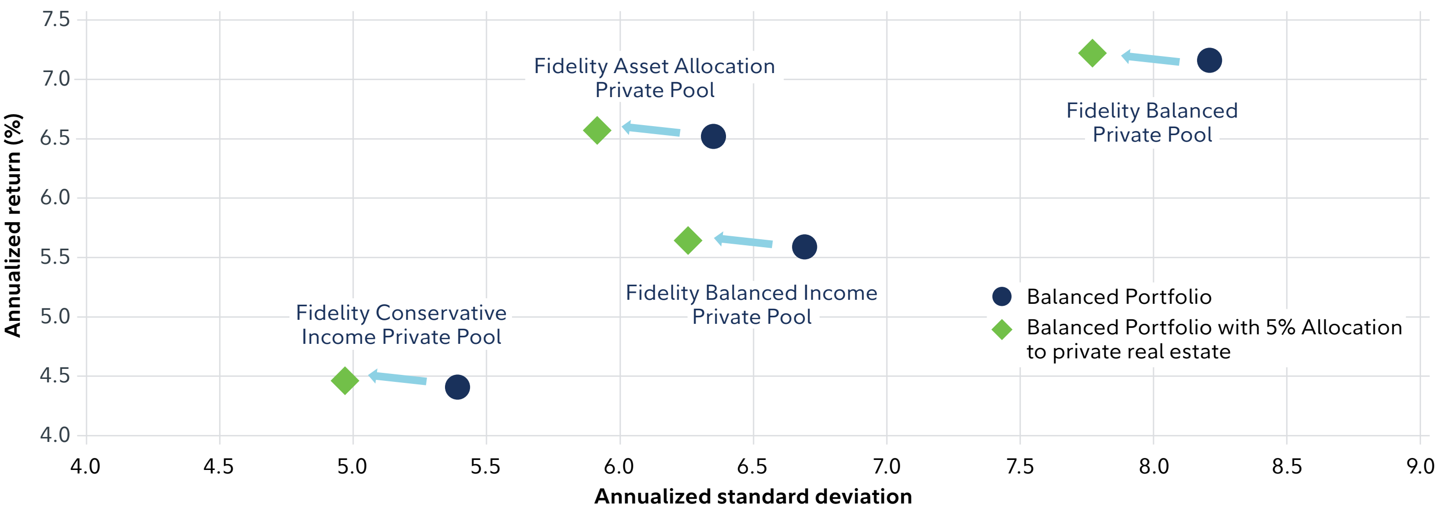
Inflation-Adjusted Annualized U.S. returns by inflationary period 1978–2023



Annualized returns as of December 31, 2023. All data is for the U.S. Sources: Private Real Estate: U.S. National Council of Real Estate Investment Fiduciaries ODCE-NFI Index (NCREIF), Public REITs: FTSE NAREIT All Equity REIT Index, Equities: S&P 500 SPX Index, Fixed Income: Bloomberg US Aggregate Bond Index. Inflation categorization by Fidelity based on data from the Bureau of Labor Statistics.

EXHIBIT 4: Real estate can improve a traditional portfolio

Private Investment Pools with a 5% allocation to private real estate



For illustrative purposes only. Source: Fidelity Investments Canada ULC. Data shown for Series F, net of fees, and in Canadian dollars. As at December 31, 2023. Analysis done on a quarterly basis, over the past 10-years, where the Pool has at least 10-years of performance. The hypothetical 5 percent allocation for all of the portfolios shown in the chart above consist of 5.0% MSCI/REALPAC Canada Quarterly Property Index, funded as appropriate from sources within each of the four private pools depicted above. The performance shown above is for illustrative purposes only and does not reflect the actual or hypothetical performance of any Fidelity product. Past performance is not indicative of future returns.

As always, past performance does not guarantee future results. It is well known that the current environment is a challenging one for commercial real estate. In that context, we believe it is advantageous that our capability is brand new and thus unencumbered by legacy assets. This allows us to be discriminating with respect to the sectors to which we gain exposure and opportunistic with respect to the specific assets we buy. It is why we have been patient in funding this capability and will continue to be deliberate in building the position in private real estate. Our approach is to ensure we're getting the right assets at the right prices, and will invest when and only when those opportunities arise as the cycle plays out.

Where to from here?

We are not done with alternatives. Earlier this year, Fidelity launched a Canadian Long/Short Alternative fund, which holds promise as a differentiated vehicle to harness the firm's strong domestic research capabilities; we anticipate that further liquid alternatives will be made available over time, as well as potential capabilities in private assets beyond real estate. We will, as always, run a deliberate process in evaluating these strategies and their suitability, deploying them in our multi asset funds if and only if we are confident that they will improve risk-adjusted returns. To be clear, stocks and bonds will still have pride of place in the portfolios, but if alternatives allow us to further enhance performance and diversification for our investors, we as managers will take those opportunities.

David Wolf, David Tulk and Ilan Kolet, May 15, 2024

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David Wolf is a Portfolio Manager for Fidelity Investments. He is the co–manager of Fidelity Managed Portfolios, Fidelity Canadian Asset Allocation Fund, Fidelity Canadian Balanced Fund, Fidelity Monthly Income Fund, Fidelity U.S. Monthly Income Fund, Fidelity U.S. Monthly Income Currency Neutral Fund, Fidelity Global Monthly Income Fund, Fidelity Global Dividend Fund, Fidelity Income Allocation Fund, Fidelity Balanced Managed Risk Portfolio, Fidelity Conservative Managed Risk Portfolio, Fidelity American Balanced Fund, Fidelity Conservative Income Fund, Fidelity NorthStar®, Fidelity NorthStar® Balanced Fund, Fidelity Tactical Strategies Fund, Fidelity CanAm Opportunities Class, Fidelity Inflation-Focused Fund, Fidelity Canadian Monthly High Income ETF Fund, Fidelity Global Monthly High Income ETF Fund and Fidelity Tactical Global Dividend ETF Fund. He is also portfolio co-manager of Fidelity Conservative Income Private Pool, Fidelity Asset Allocation Private Pool, Fidelity Asset Allocation Currency Neutral Private Pool, Fidelity Balanced Private Pool, Fidelity Balanced Currency Neutral Private Pool, Fidelity Balanced Income Private Pool, Fidelity Balanced Income Currency Neutral Private Pool, Fidelity U.S. Growth and Income Private Pool, Fidelity Global Asset Allocation Private Pool and Fidelity Global Asset Allocation Currency Neutral Private Pool.

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Ilan Kolet is an Institutional Portfolio Manager for Fidelity Investments. In this role, Mr. Kolet serves as a member of the investment management team, maintaining a deep knowledge of portfolio philosophy, process and construction. He assists portfolio managers and their CIOs in ensuring portfolios are managed in accordance with client expectations.

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