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The big story

Throughout much of the year, the market has been squarely focused on policies in Washington DC. These have induced quite a bit of volatility amid surprising, and at times chaotic, shifts. However, while uncertainty remains elevated, a notable development is starting to emerge. The administration is shifting its focus slightly from policies that pose headwinds to the economy (immigration and tariffs) to policies that can be tailwinds (fiscal initiatives and deregulation). As well, it is trying to pressure the U.S.

Federal Reserve into cutting rates, which would provide further stimulus. It should not be surprising to see this gain steam as we get closer to the midterm elections. Much remains to be seen as to how these policies take shape and what impact they have – More lending? Growth in capital expenditure? More demand from banks for U.S. Treasuries? – but generally, these are policies that the equity market should find appealing. When it comes to risk assets in fixed income, however, it is difficult to envision spreads getting any tighter. Could investment-grade corporates trade in line with U.S. Treasuries? In our view, that is very unlikely.

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U.S. Federal Reserve (the Fed)

The Fed left policy rates unchanged at the July FOMC meeting. Governors Christopher Waller and Michelle Bowman dissented, preferring to lower rates at the meeting. The division between the FOMC and the two dissenters seems to have to do with getting ahead of any potential deterioration in labour markets. For now, the FOMC believes that the economy is solid, despite rates being “modestly restrictive.” With unemployment low and potential tariff-driven price increases ahead, the committee will be very data-dependent in determining the need for policy cuts. A rate cut at the September meeting will therefore be dependent on labour markets weakening sharply. The Fed will not be preemptive this time.

European Central Bank (ECB)

In July, ECB President Christine Lagarde threw further doubt on the prospect of the eurozone policy rate settling below 2% later this year. ECB voters feel they are “in a good place” on rates, compared to their 2% CPI target. Presuming the preliminary E.U.-U.S. trade deal settles at a 15% tariff rate on many E.U. exports, the ECB may well have completed its latest easing cycle. For now, we can see one more precautionary rate cut to 1.75% in September, but this is by no means certain, and may require another slight disinflationary catalyst that is not yet obvious.

Bank of Canada (the Bank)

The Bank held its policy rate at 2.75% in July and is now using three tariff scenarios rather than its conventional forecasts. With high uncertainty about both trade policy and the macroeconomic outlook, the Bank is balancing its forecast for higher core inflation with continued downside risks for growth. Markets are no longer fully pricing in one more cut in 2025, due to continued economic resilience despite the ongoing trade uncertainty.

Bank of Japan (BoJ)

As expected, the BoJ left rates unchanged at its two-day Monetary Policy Meeting in July. The policy rate, at 50 basis points, is still far below the core CPI inflation rate of 3.3%. The rate hiking cycle had been put on pause pending a conclusion to the tariff negotiation with the U.S., which weighed on the BoJ's growth and inflation outlook. With clarity on trade and a higher forecast for near-term inflation in the price outlook, the probability that the BoJ will resume policy hikes as early as the October policy meeting has increased.

Valuations

- **Leveraged loans:** We are modestly overweight. The Fed's being on hold provides technical support for floating rate loans, but with spreads having mostly recovered and the majority of loans trading above par, the upside from capital gains is limited. The asset class still boasts one of the highest current yields in fixed income, driving its attractiveness.
- **High yield:** We are modestly overweight. "Liberation Day" volatility provided a short window of opportunity to add exposure before spreads returned to historically tight values. Defaults remain very low, and credit quality is stable, so we are not expecting near-term spread widening (although we recognize susceptibility to exogenous shocks), but valuations no longer justify further increasing beta. Dislocations at the industry and issuer level encourage us to focus on idiosyncratic opportunities.
- **U.S. investment-grade corporates:** We are underweight. Valuations have recouped nearly all of the tariff-related underperformance, which, in hindsight, was relatively modest. Balance sheets for large-cap investment-grade issuers are strong, and the assumed impact of tariffs was modest, given broad-based pricing power and the ability to absorb some margin impact. Dislocation in this sector may require an actual recession, given the strong fundamentals and technical support.
- **International credit (hedged):** We are modestly overweight. This sector has offered a modest spread advantage relative to U.S. investment-grade corporate bonds since "Liberation Day," presenting a small carry opportunity after hedging currency risk. We still value the diversification and security selection benefits of evaluating a larger pool of investment-grade issuers.
- **Emerging markets debt:** We have selective ownership of issues in Brazil, Colombia and Mexico. Changes in U.S. trade policy remain uncertain and could create a headwind. We expect higher-than-normal foreign exchange volatility while trade policies are being negotiated.
- **U.S. Treasuries:** We maintain a long duration position at this historically high level of interest rates. 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 still think the curve will steepen, but in a gradual contrarian trade, we have leaned into the underperformance of the long end of the curve.
- **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 greater than rate volatility (approximately three times higher). We own exposure in Brazil and Japan. Brazilian local currency bonds currently yield approximately 14%.

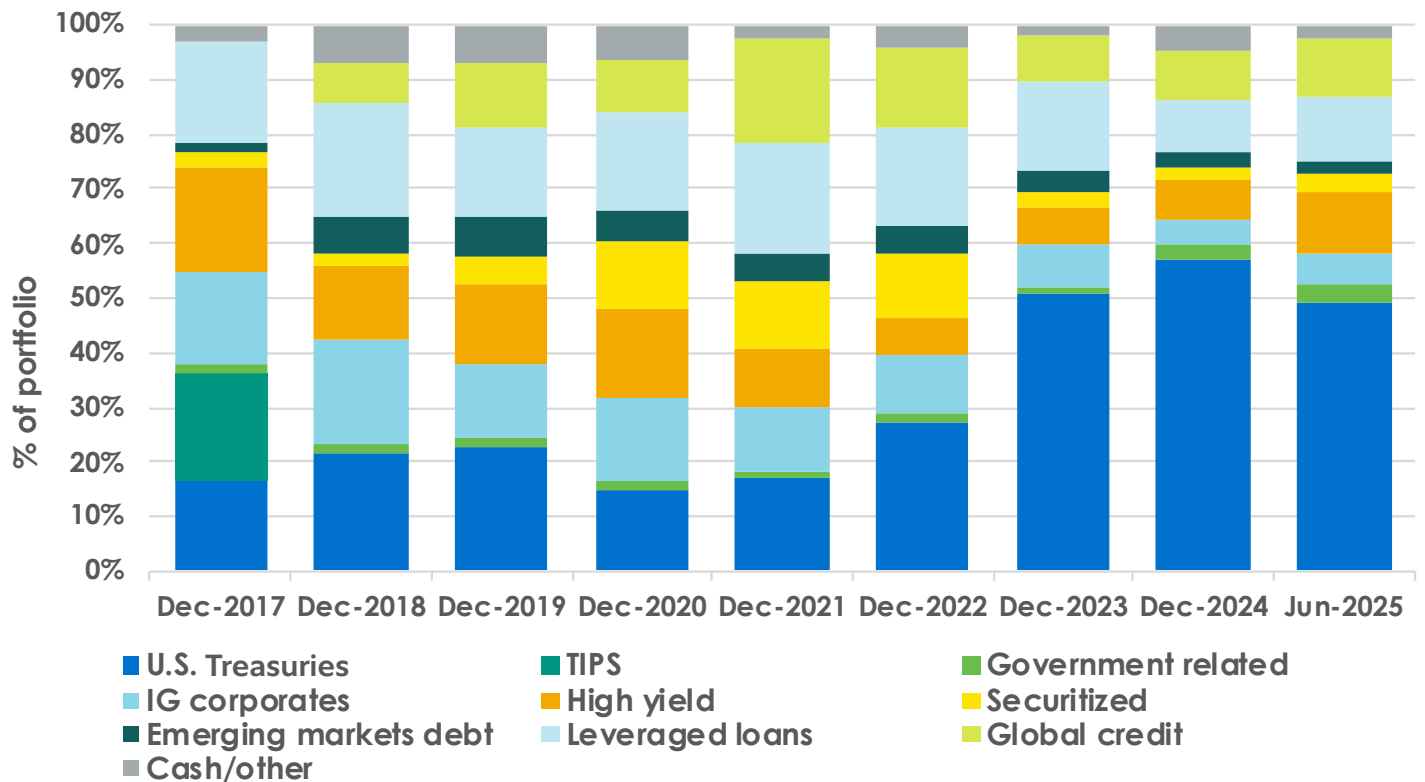
Performance

As at July 31, 2025	3-month	YTD	1-year	2-year	3-year	5-year	Since inception*
Fidelity Multi-Sector Bond CN Fund – Sr. F	0.7	3.1	2.1	3.4	2.1	0.1	1.9
Fidelity Investment Grade Total Bond CN Fund – Sr. F	0.6	3.0	2.1	3.6	1.9	(0.5)	1.4
Fidelity Global Core Plus Bond ETF	0.8	3.3	2.4	3.9	2.6	0.5	1.0
Fidelity Global Investment Grade Bond ETF	0.6	3.3	2.1	3.4	1.5	(0.7)	(0.1)
Fidelity Tactical Credit Fund – Sr. F	2.4	2.5	4.2	5.6	5.1	–	3.0

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



Source: Fidelity Investments Canada ULC. As at June 30, 2025. Benchmark: Bloomberg U.S. Aggregate Bond Index.

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