Fixed Income Perspectives

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The big story

> "The absence of [any Black Swan event] may just allow the market to deliver what most are predicting: déjà vu."

A recent guest on a financial news program predicted that 2026 would be "déjà vu, all over again": in other words, more of the same. For markets, perhaps they will be proven correct, but the stories influencing the markets will likely be quite different. In 2025, two main themes drove market direction and volatility: the rhetoric and policies from the Trump administration, and the investment, potential revenue and other still-emerging impacts of artificial intelligence (AI). Although it is unlikely we will see another Liberation Day or repeat the scale of the multi-year mega-commitments among the hyperscalers and major AI players, these themes will remain important in 2026. The known-unknowns include the transition to a new chair of the Federal Reserve in the first half of the year, and U.S. politics – including potential policy and stimulus – surrounding the mid-term elections in the second half of the year. The unknown-unknowns are, by definition, unpredictable. That said, as with all Black Swan events, the impact of the catalyst depends as much on market dynamics (leverage, breadth of exposure, contagion, etc.) as on the trigger event itself. The absence of such a surprise may just allow the market to deliver what most are predicting: déjà vu.

U.S. Federal Reserve (the Fed)

Chair Powell appears to be finished guiding the Committee to deliver insurance cuts, as he did in the last quarter of 2025. Now that policy rates are much closer to neutral, the data on inflation and labour will be key for the Fed in assessing which side of their mandate requires more attention. The recently released third-quarter GDP print, which came in at a higher than expected 4.3%, re-opens the question of whether recent labour prints are a lagging indicator, or whether the AI productivity impact is driving a higher level of economic activity without the need for jobs. The 4.6% unemployment rate is within 10 basis points of triggering a response for a cut by the doves. However, this will have to be viewed in the context of the upcoming consumer price index (CPI) prints, which may start to reflect tariff pass-throughs that companies are targeting to start in January.

European Central Bank (ECB)

With the latest ECB projections reinforcing voter expectations that 2% CPI is most likely over the medium term, the message from the December meeting appears to be that the ECB is comfortable holding its policy rate at 2% for a protracted period in 2026.

Bank of Canada (BoC)

The BoC held its policy rate at 2.25%, citing strong third-quarter growth and labour-market improvement while reiterating that current settings are sufficient if conditions evolve as expected. With uncertainty still high, we see rates on hold for an extended period.

Bank of Japan (BoJ)

With real rates still in negative territory, the BoJ has yet to call an end to its hiking cycle. The question is whether the economy and market circumstances (FX and rates) will warrant a faster cadence than the two hikes per year that the BoJ has delivered thus far.

Bank of Mexico

The Bank of Mexico cut its policy rate by 25 basis points to 7.0%, signaling a likely pause in forward guidance while raising near-term inflation forecasts. Markets expect this to be the last cut, but we see scope for one more, potentially in the second quarter.

Central Bank of Brazil

The Central Bank of Brazil's policy committee held its main interest rate at 15% for the fourth straight meeting, maintaining a highly contractionary stance amid persistent inflation and global uncertainty. Softer labour market language and a lower 2027 inflation forecast suggest that easing could start in the first quarter of 2026.

Valuations

- **Leveraged loans:** We are modestly overweight. The floating-rate loan market boasts one of the highest current yields in fixed income and delivered solid total returns last year. However, the sector has lagged others for two reasons: a lack of duration in a falling interest-rate environment, and a large portion of the market is priced at or above par, which limits the upside of spread compression as loans may be called and reissued with lower coupons. Looking forward, as the Fed cuts short-term rates, the yield advantage in this sector may diminish over time, at which point loans could lose their appeal for unlevered portfolios.
- **High yield:** We are modestly overweight. We are not expecting near-term spread-widening given the strength of issuer balance sheets, but the sector is susceptible to exogenous shocks. With spreads once again close to historic lows, valuations do not justify increasing beta at this time. Dislocations at the industry and issuer level focus our attention on idiosyncratic opportunities as we patiently wait for signs that the credit cycle is turning.
- **U.S. investment-grade corporates:** We are underweight. Earnings for large-cap companies are robust, balance sheets remain strong and the appreciation in the equity market has increased the cushion beneath the debt in the capital structure, justifying current valuations. However, if fundamentals unexpectedly deteriorate, the sector may be vulnerable to significant underperformance, particularly if the technical backdrop weakens as the market digests extremely heavy AI- and data-centre-related supply.
- **International credit (hedged):** We are modestly overweight. This sector has underperformed primarily because sovereign base yields have lagged U.S. Treasuries. The spread advantage relative to U.S. credit that we saw earlier in 2025 is mostly gone, though there is still a carry advantage 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 continue to own idiosyncratic risk through selective ownership of names in Brazil, Colombia and Mexico. Broadly speaking, this sector was the best-performing fixed income asset class last year as long-duration investment-grade issuers and distressed/high-yield issuers both contributed. We expect higher-than-normal foreign exchange volatility while trade policies are being negotiated and central banks remain active.
- **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 has been and will continue to be a source of funds when the market gives us an opportunity to buy credit sectors. We still think the curve has potential to steepen further, 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 near 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 30 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, with the total size of the allocation 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 close to 14%.

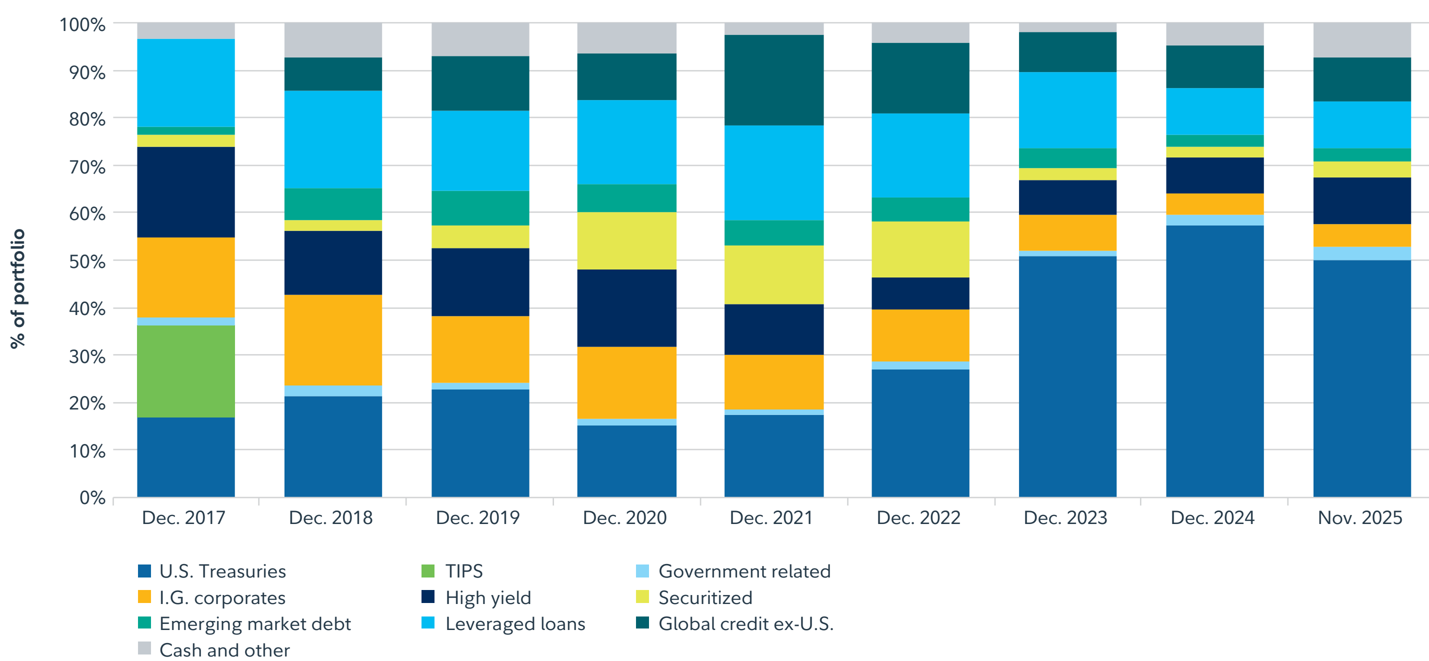
Performance (%)

As at December 31, 2025	3-month	YTD	1-year	2-year	3-year	5-year	Since inception*
Fidelity Multi-Sector Bond CN Fund – Sr. F	0.2	5.4	5.4	3.0	4.1	0.1	2.1
Fidelity Investment Grade Total Bond CN Fund – Sr. F	0.2	5.2	5.2	3.1	3.9	-0.4	1.6
Fidelity Global Core Plus Bond ETF	0.1	5.4	5.4	3.2	4.2	0.4	1.2
Fidelity Global Investment Grade Bond ETF	0.0	5.4	5.4	2.9	3.5	-0.6	0.2
Fidelity Tactical Credit Fund – Sr. F	0.6	4.7	4.7	4.8	6.4	–	3.3

Source: Fidelity Investments Canada ULC. Performance shows annual compounded returns as at December 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 November 30, 2025. Benchmark: Bloomberg U.S. Aggregate Bond Index.

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