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The big story

The dominant narrative in today's fixed income markets isn't inflation or even real growth trends. While we continue to monitor incoming economic data closely, the spotlight has shifted to a more fundamental issue: the independence of the U.S. Federal Reserve (the Fed). The Fed's credibility – and its ability to fulfill its dual mandate of price stability and full employment – rests heavily on its freedom from political influence. Market participants understand that future actions by the Fed will be key drivers of bond valuations, long-term interest rates and even equity performance. An independent Fed is expected to respond rationally to evolving economic conditions, although often with a lag, as it seeks confirmation before acting. Recent political pressure, particularly the administration's push for lower short-term rates, has raised concerns. Beyond rate policy, control over the Fed would extend to bank regulation and its balance sheet, factors that could significantly affect supply-demand dynamics and shape the yield curve. From a bond market perspective, the potential politicization of the Fed introduces a level of uncertainty that arguably surpasses even the risks posed by ongoing trade tensions. How this story unfolds remains to be seen, but its implications for market stability and investor confidence are profound.

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U.S. Federal Reserve

Fed Chair Jerome Powell's speech at Jackson Hole confirmed his inclination to start adjusting monetary policy, possibly as soon as the September FOMC meeting. Unlike last year, when the August Jackson Hole speech laid the groundwork for a 50-basis-point cut the following month, Powell still lacks a committee consensus for a September cut. Accordingly, while we think the likelihood of a 25-basis-point cut is high, it will need to be confirmed by the next nonfarm payrolls and CPI reports. Committee members are divided between those who anticipate the tariff passthrough to be a one-off price level shift that will not prove inflationary and those who expect tariff pricing to have a more nefarious impact on inflation and inflation expectations over time. Meanwhile, there is a growing cohort of committee members, such as Powell, who are becoming concerned by the stagnant labour market. The debate on the appropriate policy is rapidly becoming complicated by the administration's attempts to put its own people on the Fed's board, as seen in Adriana Kugler's recent replacement by Stephen Miran, and the attempted firing of Lisa Cook by President Trump.

European Central Bank (ECB)

Voter members of the ECB continued to report both monetary policy and eurozone inflation as being "in a good place" through August. In aggregate, trade conflict has had little impact so far on eurozone activity or the labour market, despite some obvious pockets of weakness. Such "resilience," as several policymakers characterize the situation, could see the ECB maintain a 2% policy rate at its September meeting, in line with consensus expectations. However, slower-than-expected declines in eurozone labour costs, along with rising political and fiscal malaise in France, should prevent the ECB from seeming too hawkish.

Bank of Canada (BoC)

The balance of risks favours another reduction in the BoC's overnight rate, after real GDP contracted by 1.6% in the second quarter, slightly below the BoC's forecast of a 1.5% decline. Moreover, first-quarter GDP was revised lower, from 2.2% to 2.0%. On balance, there are greater downside risks for the Canadian economy, with growth currently well below potential.

Bank of Mexico

On August 7, the Bank of Mexico lowered its overnight interbank interest rate by 25 basis points, in line with new forward guidance to reduce the magnitude of its cuts. The decision to provide additional monetary accommodation is supported by the prevailing slack in the economy and "important downside risk to activity," with the Mexican economy growing just 0.8% year-over-year in the first quarter. However, upside surprises in inflation warrant a shift in policy direction, after year-end inflation forecasts were raised by 40 basis points and 20 basis points on headline and core inflation measures, respectively. That said, the central bank still expects inflation to converge toward 3% by mid-2026.

Bank of Japan (BoJ)

The timing of the next rate hike by the BoJ is difficult to pin down, given mixed inflation and growth projections. If the October Monetary Policy Meeting passes with no change, the next "live" meeting will be in January, after the BoJ conducts its regional economic survey.

Valuations

- **Leveraged loans:** We are modestly overweight. The sector still boasts one of the highest current yields in fixed income, driving its attractiveness. However, the Fed is starting to adopt a more dovish view, which will soften this advantage over time. Furthermore, with spreads having mostly recovered and the majority of loans trading above par, the upside from capital gains is limited.
- **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 a 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 was relatively modest in hindsight. 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 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 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, 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 approximately 14%.

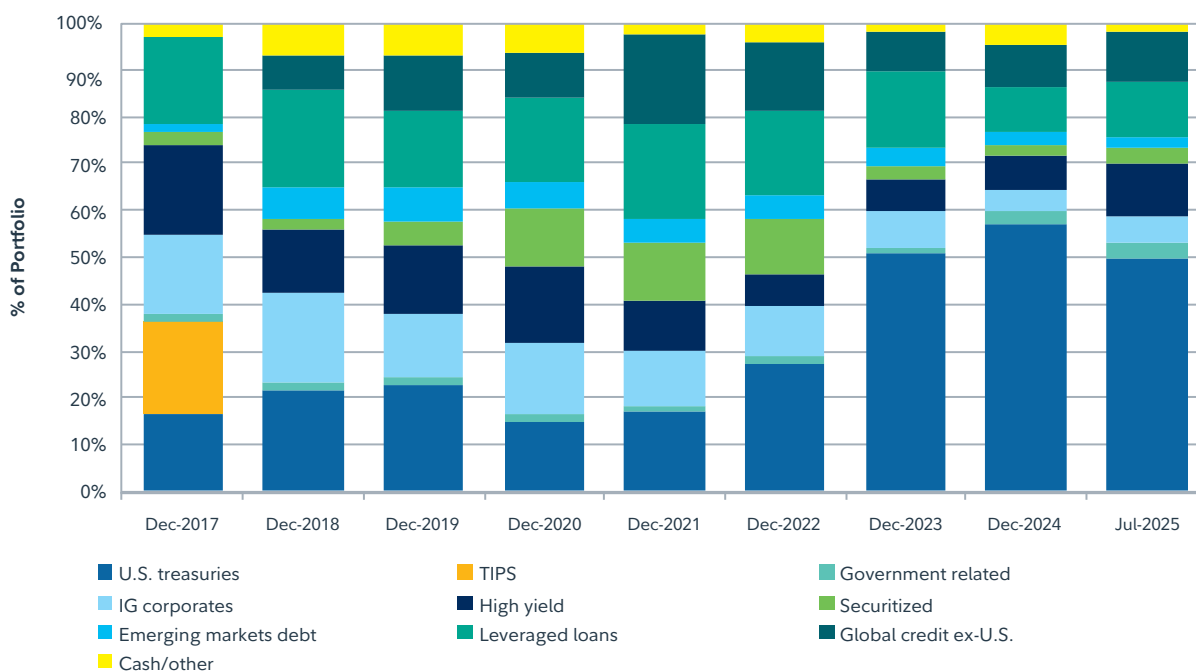
Performance (%)

As at August 31, 2025	3-month	YTD	1-year	2-year	3-year	5-year	Since inception*
Fidelity Multi-Sector Bond CN Fund – Sr. F	2.1	3.9	1.7	4.2	2.9	0.3	2.0
Fidelity Investment Grade Total Bond CN Fund – Sr. F	2.1	3.9	1.7	4.4	2.7	-0.2	1.5
Fidelity Global Core Plus Bond ETF	2.1	4.1	2.0	4.6	3.3	0.7	1.1
Fidelity Global Investment Grade Bond ETF	2.1	4.2	1.8	4.1	2.4	-0.4	0.0
Fidelity Tactical Credit Fund – Sr. F	2.2	3.1	3.9	5.8	5.4	–	3.1

Source: Fidelity Investments Canada ULC. Performance shows annual compounded returns as at August 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 July 31, 2025. Benchmark: Bloomberg U.S. Aggregate Bond Index.

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