Fixed Income: Fundamentals for Investors
Why invest in bonds?

In every phase of an investor’s life, bonds are typically recommended as part of a diversified portfolio,* along with stocks and short-term investments such as cash and money market funds.

Their distinct structure may help investors better tolerate market uncertainty and stay invested over the long term. In general, and in varying degrees, bonds may help them:

**Generate income**

The coupon payments bonds offer can help build an income stream that can be reinvested or used to manage cash-flow needs, by either supplementing existing income or creating a source of income in retirement.

**Preserve capital**

Repayment of the bond’s original investment can help investors protect capital and meet financial needs, such as college tuition or a down payment on a home, with greater certainty.

**Lower portfolio volatility**

Bonds are often less volatile than stocks and can help lower a portfolio’s risk.

Today’s financial markets are full of ups and downs. Many investors, finding it hard to tolerate fluctuations in their portfolios, want investments that can help moderate risk.

Fixed income securities can help address this need.

Bonds are known as fixed income securities because they generally provide fixed periodic payments. The amount of income and the risk vary depending on the type of bond.

* Diversification does not ensure a profit or guarantee against a loss. In general the bond market is volatile, and fixed income securities carry interest rate risk. As interest rates rise, bond prices usually fall, and vice versa. This effect is usually more pronounced for longer-term securities. Fixed income securities also carry inflation, credit and default risks for both issuers and counterparties.
Bonds are fixed income securities that are similar to IOUs. They are issued by governments and corporations around the world to finance new projects, maintain ongoing operations or refinance other debts.

Here’s how they work:

**Issuer (borrower)**

The issuer uses the money from the loan to finance new projects or support ongoing operations. The wide range of issuers includes:

- federal, provincial and municipal governments and their agencies
- private institutions such as hospitals or colleges
- foreign governments of emerging or developed nations
- corporations – start-ups to Fortune 500

**Lender (investor)**

When an investor purchases a bond, he or she is loaning money to a corporation or government body known as the issuer.

Return of principal

At the end of the defined time period, the bond matures and the issuer repays the lender the amount loaned (the principal), assuming no default. The maturity date can range from one to 30 years in the future, depending on the issuer’s needs.

Interest payments

In return for the loan, the issuer promises to pay the lender an interest payment (often twice a year) for a defined period of time, which ends on the bond’s maturity date. The amount of the interest payment is generally set by the issuer and determined by:

- the issuer’s financial strength and its ability to make interest and principal payments
- length of time until the bond’s maturity
- prevailing interest rates

Are all bonds created equal?

Although bonds have some similar features, such as fixed payment rates and maturity dates, they are not all equal in terms of income potential and risk. Two important bond measurements – credit quality and duration – are good indicators of the income an investor may receive and the risk being taken on to pursue that income.

**Credit quality**

A bond’s credit quality indicates the likelihood that its issuer will default on paying interest owed and repaying principal at maturity. It is assigned by credit rating agencies that analyze the security and the financial soundness of the issuing company. Bonds generally fall into one of two credit quality categories:

**Investment-Grade Bonds**

- Have higher credit ratings from major rating agencies (Aaa or AAA to Baa3 or BBB-)
- Are often issued by:
  - more established companies or developed countries
  - companies with fairly healthy balance sheets
  - companies with a positive growth outlook

**Below-Investment-Grade Bonds**

- Have lower credit ratings from major rating agencies (Ba1 or BB+ to C or D)
- Are often issued by:
  - newer companies or developing countries
  - companies in particularly competitive or volatile sectors
  - companies with troubling fundamentals

**Duration**

In general, as interest rates rise, existing bond prices usually fall, and vice versa. But these changes do not affect all bonds equally. Duration measures a bond’s price sensitivity to changes in interest rates. It is influenced greatly by the length of time until the bond’s maturity. Bonds generally fall into one of three duration categories:

**Short-Term Bonds**

- 1 – 3.5 year duration

**Intermediate-Term Bonds**

- 3.5 – 6 year duration

**Long-Term Bonds**

- 6+ year duration

**Lower**

- Default Risk
- Income Potential

**Higher**

- Interest Rate Sensitivity
- Income Potential
Bond funds and ETFs: Making investing easier

There are a vast number of issuers and bond offerings to consider. Mutual funds and exchange-traded funds (ETFs) offer a convenient and affordable way to invest in bonds. An investor's money is pooled with other investors’ and is professionally managed. Bond funds cover each broad market sector and invest in bonds from different issuers, and with different credit ratings, maturities, yields and other features. Each of these offers its own balance of risk and reward.

### CHOICES AROUND

<table>
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<tr>
<th>GOVERNMENT BOND FUNDS</th>
<th>INVESTMENT-GRADE CORPORATE BOND FUNDS</th>
<th>HIGH-YIELD BOND FUNDS</th>
<th>GLOBAL BOND FUNDS</th>
<th>EMERGING MARKETS BOND FUNDS</th>
<th>MULTI-SECTOR BOND FUNDS</th>
<th>FLOATING RATE LOAN FUNDS</th>
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<tr>
<td>Invest primarily in bonds issued or guaranteed by governments, such as Canadian government bonds, U.S. Treasury bonds and bills, and bonds issued by provinces, cities, states and other local government entities, as well as mortgage- and other asset-backed bonds issued by government agencies.</td>
<td>Invest primarily in investment-grade bonds issued by corporations to expand, modernize, cover their expenses and finance other activities.</td>
<td>Invest primarily in bonds that are issued by corporations facing adverse or uncertain business, financial or economic conditions. Might include some emerging markets government bonds.</td>
<td>Invest in a range of bonds issued by foreign governments and corporations. Global funds may also include domestic issuers.</td>
<td>Invest in government and corporate bonds from developing countries around the world.</td>
<td>Invest in a mix of bonds, including both high-yield and investment-grade securities issued by domestic and foreign governments and corporations.</td>
<td>Invest in investment- and non-investment-grade variable-rate bonds issued by corporations.</td>
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</table>

### CREDIT QUALITY OPTIONS

| High-quality investment-grade | x | x |
| Investment-grade and below-investment-grade | x | x |
| Primarily below-investment-grade | x | x |

### DURATION OPTIONS

| Short-term | x | x | x |
| Intermediate-term | x | x | x |
| Long-term | x | x | x |

### INCOME POTENTIAL

Income potential tends to be lower than other funds and varies depending on the fund’s duration and the quality of its bonds. Funds with more exposure to bonds issued by lower levels of government typically provide greater potential income than funds with more bonds issued by federal governments.

Income potential will typically be higher than investment-grade bonds to offset the high level of default risk.

Income potential will be higher than domestic bond funds, given the additional risks, and varies depending on the fund’s duration.

Income potential on high-yield bonds will typically be higher than developed market bond funds, given the additional risks and longer durations.

Income potential ranges from low to significantly higher, depending on the type and amount of bonds purchased.

Income potential will typically be higher than government bonds to account for increased credit risk. Funds with more exposure to lower-quality bonds typically provide greater potential income than funds with greater emphasis on investment-grade bonds.

### PRIMARY RISKS

Lowest credit risk relative to other issuers/markets, but interest rate risk depends on the fund’s duration. Funds with more exposure to bonds issued by lower levels of government are generally riskier than those with more exposure to federal government bonds.

Although many have moderate credit risk, there are high-yield options that increase default risk (see high-yield bond funds). Interest rate risk depends on the fund’s duration. May also invest in other fixed income securities, such as bank loans, preferred securities and convertible bonds.

High credit risk but lower interest rate risk, as the fund’s pricing tends to move in the same direction as stocks. May also invest in other high-yield assets, such as bank loans, preferred securities and convertible bonds.

Cary similar risks as domestic bond funds, and additional risks, such as currency risk and country/political instability.

Are more likely to experience greater volatility due to sharp economic swings, political upheaval and other disruptions not typically found in countries with more established financial markets.

Range of fund risks depends on bonds in fund; fund’s diverse holdings can help spread risk across a large mix of bonds, lowering volatility.

High credit risk but lower interest rate risk, as floating rate coupons tend to move in tandem with short-term interest rates, reducing the impact of rising interest rates on floating rate bond prices.

### Unlike individual bonds, most bond funds do not have a maturity date, so holding them until maturity to avoid losses caused by price volatility is not possible.

- The provincial and municipal market is volatile and can be significantly affected by adverse tax, legislative or political changes, and the financial condition of the issuers of these securities.
- Lower-quality bonds can be more volatile and have greater risk of default than higher-quality bonds. Floating rate loans generally are subject to restrictions on resale and sometimes trade infrequently in the secondary market; as a result, they may be more difficult to value, buy or sell. A floating rate loan may not be fully collateralized and therefore may decline significantly in value.
- Foreign securities are subject to interest rate, currency exchange rate, economic and political risks, all of which are magnified in emerging markets.
**What is best for my investment needs?**

With so many types of bonds available, many investors choose to invest in mutual funds or exchange-traded funds (ETFs). Financial advisors can help investors make these decisions, factoring in specific investment goals, time horizon and tolerance for risk.

**If your primary goal is to:**

<table>
<thead>
<tr>
<th>Help protect against stock market volatility</th>
<th>Balance steady income with potential for growth</th>
<th>Achieve higher yield and total return potential</th>
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<tr>
<td><strong>CONSIDER</strong></td>
<td><strong>WHY</strong></td>
<td>** WHY**</td>
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<tr>
<td>Investment-grade funds</td>
<td><strong>May help reduce overall portfolio volatility – and an investor’s concerns during periods of high stock market volatility.</strong> Leverage in-depth research to select undervalued securities with potential higher returns.</td>
<td><strong>May help investors generate income through tactical asset allocation among various fixed income sectors. Take advantage of changing economic and interest rate environments in a single solution.</strong></td>
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<tr>
<td>Multi-sector funds</td>
<td><strong>May help investors generate income through tactical asset allocation among various fixed income sectors. Take advantage of changing economic and interest rate environments in a single solution.</strong></td>
<td><strong>May provide gain-focused exposure to issuers and asset classes that are typically more difficult for individual investors to access. Allow expert portfolio managers to select securities they believe are mispriced and at lower risk of default.</strong></td>
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<td>High-yield funds</td>
<td><strong>May provide</strong></td>
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<td>• Lower volatility than stocks and high-yield bond funds, due to more reliable income sources and lower default risk.</td>
<td>• Income from a broader investment universe while diversifying fixed income exposure across various sectors.</td>
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<td></td>
<td>• Downside protection; high-quality bonds tend to outperform the stock market during periods of high volatility, as investors prefer their relative safety.</td>
<td>• Higher returns through both asset allocation and security selection decisions made by experts in each fixed income asset class.</td>
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</table>

**Achieve higher yield and total return potential**

- **May provide**
  - Diversification within a focused fixed income portfolio, as high-yield bonds may react differently to economic and interest rate changes.
  - Income and increased returns through exposure to the high-risk, high-return end of the credit spectrum.

Fixed income securities are not limited to bonds; they also include money market instruments, loans and annuities. For the purpose of this document, we are focusing on bonds and fixed income funds.

**Invest with an experienced fixed income manager.**

Fidelity offers a comprehensive lineup of products designed to meet investor needs for diversification* and income. Our investment capabilities extend globally, connecting hundreds of fixed income professionals with hundreds of equity professionals analyzing the same companies.

**A complete product lineup with a full view of the capital structure**

Fidelity’s fixed income and equity research analysts work together to develop a 360-degree view by hearing a company’s pitch to both bond holders and shareholders – not just one or the other – and exchanging their insights.

Our product development and asset allocation teams are constantly reacting to changing market and credit conditions to offer investment solutions for today and the future.

Our fixed income funds cover each broad market sector and invest in bonds from different issuers, and with different credit ratings, maturities, yields and other features. Each fund offers its own balance of risk and reward.

**Why Fidelity for fixed income?**

**A global network**

A wide investment reach through Fidelity’s extensive global network of fixed income specialists, equity analysts and asset allocation professionals.

**Integrated perspective**

Connecting fixed income investment professionals with equity investment professionals to gain a 360-degree view of a company’s capital structure.

**Systematic approach**

A team-based approach to fixed income investing that is clearly defined, repeatable and fosters deep levels of collaboration.

**Why does it matter?**

Through Fidelity’s extensive global network, we gain access to a wide array of products, tools and insights. With investment professionals worldwide, Fidelity takes unique local market knowledge, identifies real investment opportunities and makes them available to you here at home.

We are research focused, with comprehensive global coverage of credit and equity markets. Our investment professionals gain insight into companies by combining views from both equity and credit research when making investment decisions for our clients.

Having a disciplined, repeatable investment process is a key element in navigating broad and diverse market conditions. At Fidelity, hundreds of investment professionals, including analysts, traders, lawyers, policy experts and asset allocators, collaborate to identify attractive investment opportunities that others may have overlooked.

360°
A world of opportunity
Fidelity Canada products draw on expertise from around the world.

In an ever-changing and complex financial services world, we’re committed to developing quality products that provide long-term value. As a privately owned firm, we have been providing investment solutions and innovations to our clients in Canada for more than 30 years. We’re invested in proprietary research, bottom-up fundamental analysis, product innovation and our people. With investment professionals worldwide, Fidelity takes local market knowledge, identifies real opportunities and makes them available to you here at home.

Fidelity Investments Canada ULC brings a global network of investment expertise to Canadian investors. Our products are subadvised by a variety of companies, including Fidelity Management & Research Company (FMR Co., Inc.), Fidelity Institutional Asset Management (FIAM LLC), Fidelity Management & Research (Canada) ULC (FMR-Canada), Fidelity International (FIL Limited) and Geode Capital Management LLC. Investment professional counts include portfolio managers, research analysts and associates and traders.

Investment professional count of subadvisors

<table>
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<th>Fidelity Management &amp; Research Company</th>
<th>Fidelity Institutional Asset Management</th>
<th>Fidelity Management &amp; Research (Canada) ULC</th>
<th>Geode Capital Management LLC</th>
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<tr>
<td>37</td>
<td>342</td>
<td>645</td>
<td>39</td>
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</table>

Founded in:

- Fidelity Management & Research Company: 1987
- Fidelity Institutional Asset Management: 1969
- Fidelity Management & Research (Canada) ULC: 1946
- Geode Capital Management LLC: 2001

Source: FMR Co., Inc., FIAM LLC, Fidelity International, Fidelity Canada and Geode Capital Management LLC as at December 31, 2018. Data are unaudited. Figures for investment professionals do not include Division Management and Other Investment. Fidelity Canada means those individuals employed by FCAM.
For more information, ask your advisor or visit fidelity.ca/fixedincome

*Diversification does not ensure a profit or guarantee against a loss.

1. There are credit rating agencies that analyze the creditworthiness of a company or security and indicate that credit quality by means of a grade, or credit rating. In the U.S., major rating agencies include three Nationally Recognized Statistical Rating Organizations (NRSROs): Moody's Investors Service (Moody’s), Standard & Poor's Ratings Services (S&P) and Fitch, Inc.

2. Each agency has its own rating hierarchy, creating differences in ratings scale shown for each credit quality category.

3. Duration is a measure of a security's price sensitivity to changes in interest rates. Duration differs from maturity in that it considers a security's interest payments in addition to the amount of time until the security reaches maturity, and also takes into account certain maturity-shortening features (e.g., demand features, interest rate resets and call options) when applicable. Securities with longer durations generally tend to be more sensitive to interest rate changes than securities with shorter durations. A fund with a longer average duration generally can be expected to be more sensitive to interest rate changes than a fund with a shorter average duration.

Commissions, trailing commissions, management fees, brokerage fees and expenses may be associated with investments in mutual funds and ETFs. Please read the mutual fund’s or ETF’s prospectus, which contains detailed investment information, before investing. Mutual funds and ETFs are not guaranteed. Their values change frequently. Past performance may not be repeated.

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- Foreign securities are subject to interest rate, currency exchange rate, economic and political risks, all of which are magnified in emerging markets.
- Lower-quality bonds can be more volatile and have greater risk of default than higher-quality bonds.
- The municipal market is volatile and can be significantly affected by adverse tax, legislative or political changes, and the financial condition of the issuers of municipal securities.
- A fund can invest in securities that may have a leveraging effect (such as derivatives and forward-settling securities) that may increase market exposure, magnify investment risks and cause losses to be realized more quickly.

This information is for general knowledge only and should not be interpreted as tax advice or recommendations. Every individual’s situation is unique and should be reviewed by his or her own personal legal and tax consultants.

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