JULY 2021

Fixed Income **Monthly**

FOR INVESTMENT PROFESSIONALS ONLY

Fidelity INTERNATIONAL

FIXED INCOME **MONTHLY**

FOR INVESTMENT PROFESSIONALS ONLY JULY 2021

Important Information

This information is for Investment Professionals only and should not be relied upon by private investors. It must not be reproduced or circulated without prior permission.

The value of investments and the income from them can go down as well as up so you may get back less than you invest. Past performance is not a reliable indicator of future results.

Bond investments: Fixed income funds invest in bonds whose price is influenced by movements in interest rates, changes in the credit rating of bond issuers, and other factors such as inflation and market dynamics. In general, as interest rates rise the price of a bond will fall. The risk of default is based on the issuer's ability to make interest payments and to repay the loan at maturity. Default risk may, therefore, vary between different government issuers as well as between different corporate issuers.

Corporate bonds: Due to the greater possibility of default an investment in a corporate bond is generally less secure than an investment in government bonds.

High yield bonds: Sub-investment grade bonds are considered riskier bonds. They have an increased risk of default which could affect both income and the capital value of the Fund investing in them.

Overseas Markets: Some fixed income funds may invest in overseas markets. The value of the investment can be affected by changes in currency exchange rates.

Currency Hedging: Currency hedging is used to substantially reduce the risk of losses from unfavourable exchange rate movements on holdings in currencies that differ from the dealing currency. Hedging also has the effect of limiting the potential for currency gains to be made.

Emerging Markets: Fund investing in emerging markets can be more volatile than other more developed markets.

Derivatives: Some fixed income funds may make use of derivatives and this may result in leverage. In such situations performance may rise or fall more than it would have done otherwise. The fund may be exposed to the risk of financial loss if a counterparty used for derivative instruments subsequently defaults.

Hybrid securities: Hybrid securities typically combine both equity and debt sensitivities and exposures. Hybrid bonds are subordinated instruments that have equity like characteristics. Typically, they include long final maturity (or no limitation on maturity) and have a call schedule increasing reinvestment risk. Their subordination typically lies somewhere between equity and other subordinated debt. As such, as well as typical 'bond' risk factors, hybrid securities also convey such risks as the deferral of interest payments, equity market volatility and illiquidity. Contingent convertible securities ("CoCos") are a form of hybrid debt security that are intended to either convert into equity or have their principal written down upon the occurrence of certain 'triggers' linked to regulatory capital thresholds or where the issuing banking institution's regulatory authorities considers this to be necessary. CoCos will have unique equity conversion or principal write-down features which are tailored to the issuing banking institution and its regulatory requirements.

Other: Fidelity Funds do not offer any guarantee or protection with respect to return, capital preservation, stable net asset value or volatility. Reference to specific securities should not be construed as a recommendation to buy or sell these securities and is included for the purposes of illustration only. Investors should note that the views expressed may no longer be current and may have already been acted upon.

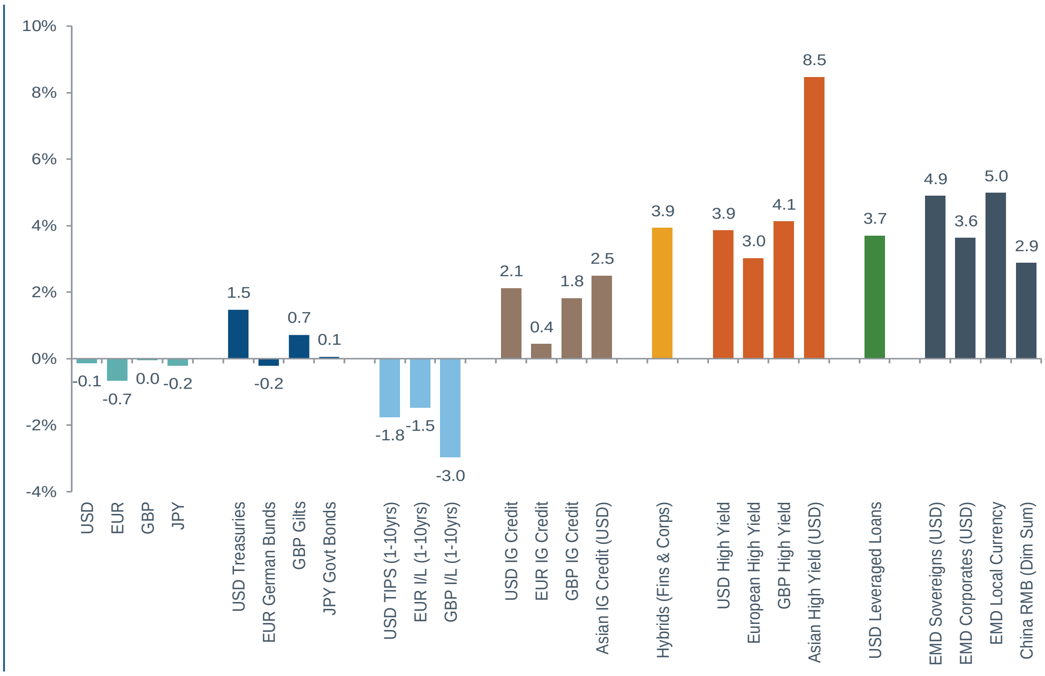
Strategy Summary

The FIXED INCOME MONTHLY provides a forward-looking summary of the medium-term views from the Fidelity Fixed Income team. Our investment approach is multi-strategy, with portfolio managers given clear accountability and fiduciary responsibility for all investment decisions in a portfolio. Given this portfolio manager discretion, there may at times be differences between strategies applied within a fund and the views shared below. We believe in managing portfolios with a mix of active investment strategies, including top-down and bottom-up, such that no single strategy dominates risk in a fund.

Rates	– –	–	=	+	++	Main views
Duration		●				▪ Discretionary overweights in US and core European duration more than offset by underweight signals from our quant models. ▪ Expect yields to remain in check as inflationary pressures subside; ▪ On a discretionary basis, prefer core European duration to periphery, with the latter more sensitive to changes in ECB purchases.
UST Rates		●				
EUR Rates - Core		→	●			
EUR Rates - Periphery		→	●			
GBP Rates		●				
Inflation	**– –**	**–**	**=**	**+**	**++**	
Breakeven Inflation			●			▪ Moved to neutral in UK breakevens given structurally expensive valuations and less positive momentum. ▪ Remain neutral in US breakevens as valuations are now close to fair value. ▪ Maintain long in Euro real duration, via France, and may look to add to real duration over breakevens looking ahead.
IL – USD			●			
IL – EUR			●			
IL – GBP			●	←		
IL – JPY			●			
Investment Grade Credit	**– –**	**–**	**=**	**+**	**++**	
Investment Grade Credit Beta			●			▪ Retain an underweight in EUR IG, US IG and GBP IG on the back of expensive valuations. ▪ Monitoring the market for a pickup in credit unfriendly activity as corporates take advantage of the low rate environment to increase leverage. ▪ Reduced exposure to Asia IG, taking profit after the strong rally in spreads.
USD IG		●				
EUR IG		●				
GBP IG		●				
Asian IG (USD)			●			
Financial and Corporate Hybrids	**– –**	**–**	**=**	**+**	**++**	
Financial and Corporate Hybrids				●		▪ Continue to be positive on AT1s, as banks continue to benefit from the reflation trade, while spread tightening still remains available. ▪ Corporate Hybrids screen cheap relative to companies' senior debt and issuance remains dominated by strong credit quality, IG companies.
Contingent Convertibles					●	
Investment Grade Corporate Hybrids				●		
High Yield	**– –**	**–**	**=**	**+**	**++**	
High Yield Credit Beta			●			▪ Moving to positive on European HY, as seasonality is expected to be supportive in July. ▪ Neutral on US HY on valuation grounds, potential growth headwinds balanced by further fiscal stimulus. ▪ Asia HY remains attractive on valuation grounds both relative to other regions and on a historical basis.
US High Yield			●			
European High Yield			→	●		
Asian High Yield				●		
Emerging Markets	**– –**	**–**	**=**	**+**	**++**	
EM Hard Currency Sovereign Debt				●		▪ EM debt supported by an easy global monetary policy, ongoing demand for yield and a weaker USD. ▪ EMFX still undervalued, while the USD likely to remain on the backfoot, although reduced exposure after the recent rally. ▪ Reduced further the exposure to Local Currency duration. EM policy rates close to the lower bounds, while closing output gaps and rising commodity prices could push EM inflation higher.
EM Hard Currency Corporate Debt				●		
EM Local Currency Duration		●				
EM FX				●		
China RMB Debt			●			

Yields across fixed income asset classes

- Cash
- Government Bonds
- Inflation Linked
- Investment Grade Credit
- Hybrids
- High Yield
- Loans
- Emerging Market Debt



Past performance is not a reliable indicator of future results. The value of investments and the income from them can go down as well as up so you may get back less than the amount originally invested.

Source: Fidelity International, Bloomberg, JPM and ICE BofA Merrill Lynch bond indices. 30 June 2021. Shows yield to worst for high yield and EM, yield to 3yrs for USD Loans, real yield for inflation-linked bonds, yield to maturity for all other asset classes. The Yield to Maturity (also known as the Redemption Yield) is the anticipated return on a bond / fund expressed as an annual rate based on price / market value as at date shown, coupon rate and time to maturity. The redemption yield is gross of any charges and tax. Yield to Worst: is the lowest potential yield that can be received on a bond considering all potential call dates prior to maturity. Hybrids universe defined as 50% Corporate Hybrids and 50% Financial Hybrids indices.

Summary of returns as at 30 June 2021 (%)

Government	1 Month	YTD	2020	2019	2018	2017
US Treasuries	0.9	-2.7	8.2	7.0	0.8	2.4
EUR Bunds	0.5	-2.8	3.0	3.1	2.4	-1.4
UK Gilts	0.7	-5.8	8.8	7.3	0.5	1.9
Inflation Linked						
USD	0.9	1.7	11.5	8.8	-1.5	3.3
EUR	0.3	1.6	3.1	6.0	-1.4	1.3
GBP	-0.2	-3.0	11.3	6.5	-0.3	2.3
Investment Grade Corporate						
USD	1.7	-1.1	9.8	14.2	-2.3	6.5
EUR	0.4	-0.4	2.6	6.3	-1.1	2.4
GBP	0.9	-2.6	8.7	10.8	-2.0	4.9
Asian Dollar	1.0	-0.5	7.6	11.5	-0.1	5.3
Financial and Corporate Hybrids						
Contingent Convertibles	1.0	4.2	6.8	17.6	-3.7	14.4
Investment Grade Corporate Hybrids	0.7	1.3	3.8	14.2	-4.6	12.1
High Yield						
US	1.4	3.7	6.2	14.4	-2.3	7.5
European	0.7	3.1	3.6	13.8	-3.9	7.4
Asia	-0.2	1.9	8.4	13.2	-3.3	6.1
Emerging Markets						
EM USD Sovereigns	0.7	-0.7	5.3	15.0	-4.3	10.3
EM USD Corporates	0.8	1.3	7.1	13.1	-1.6	8.0
EM Local Currency (USD unhedged)	-1.0	-3.4	2.7	13.5	-6.2	15.2
China RMB	0.1	2.0	3.7	5.6	5.2	5.1

Past performance is not a reliable indicator of future results. The value of investments and the income from them can go down as well as up so you may get back less than the amount originally invested. Source: Fidelity International, ICE, Datastream, 30 June 2021. Total Returns based off JPM and ICE BofA Merrill Lynch bond indices as of 30 June 2021.

Macro and Rates Overview

Monthly Review

- Global government bond yields fell as the Fed changed its inflation narrative, which brought forward the market's timeline for taper and rate hike cycle.
- Long bond yields fell across the globe, led by US Treasuries and UK gilts, as investors reconsidered reflation expectations and braced for an eventual pullback of central bank stimulus.
- The 5–30-year yield spread on US Treasuries narrowed to the smallest gap since August 2020. German bund yields also tracked their counterparts and declined over the month.

Strategy	– –	–	=	+	++
Duration		●			
UST Rates		●			
EUR Core		→	●		
EUR Periphery		→	●		
GBP Rates		●			

Outlook

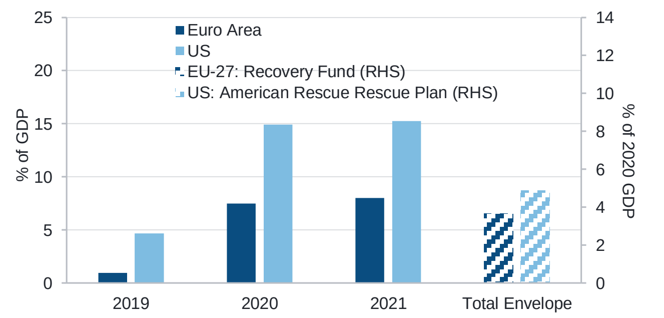
Central banks remain in the driving seat for rates markets and the June Fed meeting was the most recent example of how sensitive markets are to even small changes in the outlook for monetary policy.

June's FOMC meeting saw a revision higher in the "dot plot", with the median now showing two 25bp hikes in 2023 versus the one hike over the same period that the market was pricing in ahead of the meeting. On inflation, core PCE forecasts were revised higher, although Powell went to great lengths to highlight that the Fed sees the inflation spike as temporary, and don't feel they are behind the curve. Nevertheless, the market interpreted the revisions as hawkish, bringing policy normalisation on the cards sooner than expected. The reaction in rates was swift, with a repricing higher of front-end yields followed by lower longer end yields and a flatter US Treasuries curve. Investors quickly had to reassess the Fed's commitment to its still relatively new average inflation targeting framework, and markets likely priced in a risk of a policy mistake should inflation prove indeed transitory, and the Fed remove monetary policy support too early or too quickly.

Our stance on US duration has not changed much throughout the most recent volatility, with discretionary long positions driven by our inflation and growth views offset by short signals from our quant models. We expect the reflation narrative to remain a leading theme for markets in the months ahead. While we acknowledge the strength of H1 releases - largely owing to base effects, supply chain bottle necks and the general reopening of the broader economy - we see little room for further price pressures, given base effects, structural caps in certain sectors, pent-up supply coming to market and the sharp correction in certain commodity prices, which could signal a turning point with potential spill over into asset prices going forward. We are also monitoring the direct impact of recent inflation prints on real earnings. Lower disposable incomes across a range of different countries due to the recent inflation spike will be further set back by the rolling off of government-funded unemployment benefits. How such dynamics play out over the coming months is yet to be seen, with question marks whether the consumer can absorb this reduction of stimulus and disposable income, or whether it will lead to downtrading and substitution of goods and services.

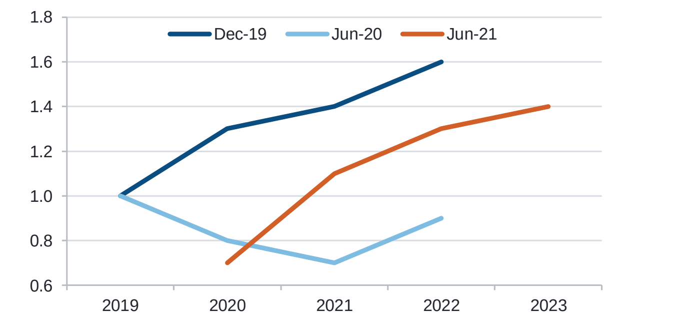
Over in Europe, it is interesting to see how, in the space of a few months the ECB and the Fed's stance seem to have reversed. If now the Fed is seen as the more hawkish of the two central banks, this was certainly not the case earlier in the year. Indeed, until the Fed's meeting in June, taper talk was very much a European affair, with the June meeting that was supposed to be the date where ECB would signal its intention to reduce the pace of purchases. The June meeting came and went with no change, and the tapering decision is now postponed to September in investors' minds. We do not subscribe to the September taper view and in fact we expect the ECB to use the entire PEPP envelop by March 2022, keeping the pace of purchases unchanged at just under €80bn/month. As the PEPP programme comes to an end in 2022, we expect the focus to shift back to the APP as the main policy tool, which the ECB will likely upsize to €60bn/month, for at least a year if not until end of 2023. The European economic recovery remains feeble at best, with the fiscal stimulus deployed or about to be deployed that is insufficient on its own to get growth on track, especially in southern European economies. Monetary stimulus is still badly needed to compensate the shortcomings on the fiscal side. Against this backdrop, the best way for the ECB to support European economic growth is to keep the net government bond supply numbers at least flat during any given year. Lastly, with ~€150bn of NGEU issuance expected to come to market every year for the next 4-5 years, it would not be appropriate for the ECB to step back stimulus at a time when it is needed the most. On balance this leaves us constructive on core European duration, and German Bunds in particular. We acknowledge that the Fed's hawkish turn could spill over into wider European government bond spreads, especially in peripheral markets. However, the more yields rise, and financial conditions tighten on the back of non-EU related factors, such as the Fed and other external drivers, the more likely the ECB will counterbalance the moves with ongoing stimulus and purchases.

Difference in magnitude of EU vs. US fiscal plans



Source: Fidelity International, Goldman Sachs Global Investment Research, June 2021.

Trajectory of ECB core inflation forecasts



Source: Fidelity International, BofA Global Research, June 2021

Inflation-Linked Bonds

Monthly Review

- Global breakevens declined, as the US Fed changed its stance on inflation. Markets looked beyond the structural versus transitory debate on inflation and perceived the change in stance by the Fed as a cause of concern.
- 10yr US breakevens fell and ended the month at 2.34%, after reaching a new high of 2.56% in May.
- US headline CPI continued to rise and jumped to 5% year-on-year in May, the fastest pace since August 2008.

Strategy

Strategy	– –	–	=	+	++
Breakeven Inflation			●		
IL – USD			●		
IL – EUR			●		
IL – GBP			●	←	
IL – JPY			●		

Outlook

Breakeven rates fell in June as the Fed's hawkish shift stalled the reflation trade. 10yr breakeven rates across the US, UK and Germany fell to 2.34%, 3.47% and 1.33% respectively. This means 10yr inflation expectations in the US have fallen from 2.56% in mid-May to June-end which is the largest 60-day fall in 2021. Inflation continued to rise through a combination of strong base impacts from the year before and strength in prices associated with the re-opening.

The US consumer price index (CPI) rose by +5.0% YoY in May, beating expectations for the second month in a row and marking the highest jump since 2008. Core US CPI, which excludes the more volatile components like food and energy prices, rose by +3.8% YoY, the largest YoY change since 1992. Used cars and trucks continued to march higher on a month-on-month (MoM) basis, rising +7.3% and accounting for roughly one-third of the seasonally adjusted all items increase. Outside of used cars and trucks, there was a continuation of recovery in categories linked to the re-opening, with household furnishings and operations, new vehicles, airline fares, and apparel all rising. We continue to monitor the shelter component very closely given this accounts for a large part of the US inflation basket and is key to our forward-looking views on US inflation and the services part of the basket. May showed only a modest rise here with the shelter component rising +0.3% MoM.

Looking ahead, we expect to see services inflation supported while the strength in goods inflation to be more temporary. We moved our long US breakeven position to neutral in May which proved to be the right call as breakevens stalled during June. We remain neutral today but are looking for opportunities to move long once again should valuations continue to improve, but at current levels we see US inflation expectations as fairly priced.

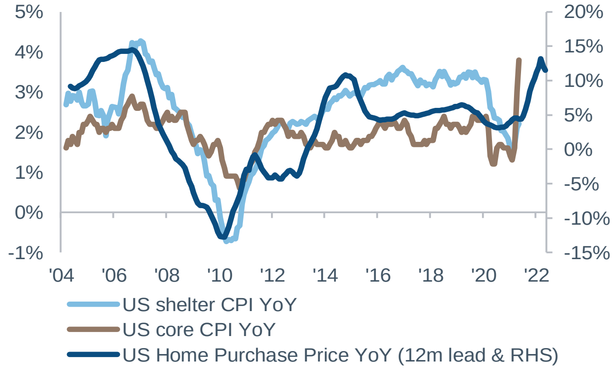
Looking to the UK, the CPI index that includes owner occupiers' housing costs (CPIH) rose by 2.1% YoY to May, up from 1.6% during April. The largest upward contribution came from transport on the YoY change. Similar to the US, on a MoM basis, categories linked to the re-opening saw particular strength, such as; clothing, motor fuel, recreational goods and meals and drinks consumed out. We had noted the difficulty in sourcing price data given COVID-19 restrictions, however, the ONS highlighted this month that because of easing restrictions the number of items which were unavailable to collect fell to 27 accounting for just 3.1% of the basket weight.

We moved our overweight in UK breakevens to neutral in early June. We had been long largely on momentum and given index-linked Gilts benefit from a captive UK buyer base providing technical support for UK breakevens. However, we felt this momentum was shifting away in June and continue to see UK inflation expectations as overpriced, indeed our longer-term stance has been to be underweight. For example, 10yr UK breakevens are 3.47% showing the market expects UK inflation to average 3.47% over the next 10yrs which we think is unlikely.

Looking to the Euro Area, inflation accelerated in May with headline up +2.0% YoY and core inflation up +0.95%. Once again, services inflation was supported by non-essential activities which were allowed to gradually resume in May, such as; restaurants, hotels and shops (which were all allowed to reopen in France, Italy and parts of Germany). We did note some supply-side pressures in semiconductor-impacted areas, however, this looks to be contained to specific items rather than spilling into the broader price index. The flash estimates for June show a mild deceleration in YoY inflation with some base impacts fading from food, energy and services. Package holidays typically post strong seasonal monthly gains in June, however, the re-weighting of the inflation basket saw this item weight reduced by 66% in 2021 and this is likely to mechanically drag down services inflation when we see the full June release.

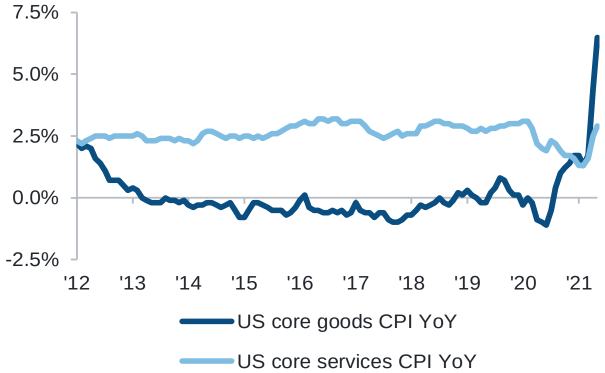
We remain neutral in Euro breakevens but maintain a more constructive stance on real duration, particularly in the 5yr part of the curve via France.

Housing strength will support rental prices



Source: Fidelity International, Bloomberg, June 2021.

US core goods and services CPI YoY



Source: Fidelity International, Bloomberg, June 2021.

Investment Grade Credit

Monthly Review

- Investment Grade (IG) markets posted positive total returns and recorded spread tightening in all regions in June.
- Supportive technicals and a constructive macro picture in most regions have contributed to the performance of IG credit of late.
- The slight recovery in sovereign bond yields has further aided the performance of IG credit in recent weeks.
- Overall, though positive on the fundamental outlook for IG credit, tight valuations warrant a very selective approach.

Strategy

Strategy	– –	–	=	+	++
IG Credit Beta		●			
USD IG		●			
EUR IG		●			
GBP IG		●			
Asian IG (USD)			●		

Outlook

Investment Grade (IG) credit ended the first half of 2021 on a positive note across all regions. The drift lower in sovereign bond yields has helped to alleviate some of the pressure on IG credit performance in recent weeks, while other factors such as the improving economic environment, very strong technicals, and lower supply expectations for 2H21, have also supported the performance of the asset class of late.

Year-to-date, IG spreads are now on average 15bps tighter at index level across Asia, Europe, UK, and US, and are mostly below their historical OAS averages. Although fundamentally we remain constructive on the near-term outlook for IG credit, the latest bout of spread tightening observed in June has pushed valuations even further into what we deem to be 'expensive' territory. In our view, it is difficult to see how much tighter spreads can go from here and so, we maintain a cautious stance on IG credit across all regions except Asia IG where we maintain a neutral stance, given its relative attractiveness compared to other regions.

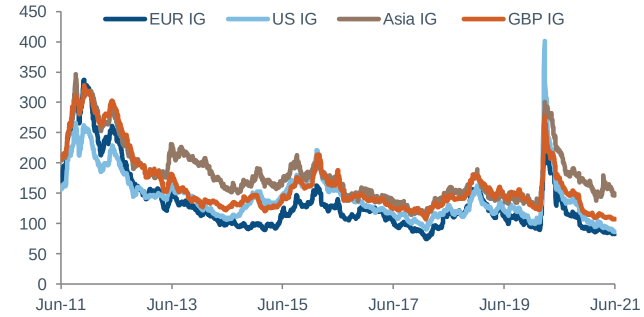
June was a particularly strong month for US IG, with total returns for the asset class coming in at 1.7% and spreads closing 5bps tighter on the month. After a challenging start to the year, US IG has benefitted from the partial recovery of Treasury yields in recent weeks, recouping a significant portion of the losses it suffered in Q1. Looking ahead, we expect economic growth in the US to remain supportive of corporate earnings, and expect this to be reflected in improving credit metric trends for the asset class. On technicals, despite its more hawkish tone of late, the Fed remains firmly committed on policy support in the US, while H2 supply dynamics for US IG (widely expected to be lower than H1) should also help to keep spreads in check. On balance, albeit difficult to find fault in the fundamental outlook for US IG, we maintain a cautious stance on the asset class at this juncture given unattractive valuations and very low levels of dispersion across sectors and ratings. We note a rise in M&A activity and associated risks this year, however we have seen almost no impact of such creditor-unfriendly activity on corporate valuations to date. We continue to monitor this trend as a potential trigger for short-term market volatility, which would be ideal for a name selection approach, and the tactical, nimble style we employ across our portfolios.

GBP IG spreads displayed similar resilience in June, with the index tightening 3bps over the month and total returns positive at 0.9%. Following a move to a more cautious stance on GBP IG credit in H1, our view remains that IG spreads in the UK are through their fair value and, despite a modest rise in idiosyncratic risks of late, we are unlikely to see significant widening pressures over the coming months. Much like in the US, the technical backdrop in the UK is robust, while the fundamental outlook shows little sign of slowing down. Overall, we continue to err on the side of caution in GBP IG given that a lot of good news is already reflected in asset prices. We maintain some selective exposure to covid-impacted IG names where we believe there is room for further recovery, and maintain some exposure to the UK ABS market.

In Asia IG, index level spreads tightened 12bps in June while total returns came in just shy of 1% over the month. Relative to other regions, valuations in Asia IG continue to look optically attractive at current levels, though a lot of value has been restored across the asset class when compared to earlier this year. One of the biggest risk factors for us in Asia IG is a potential slowdown in the recovery momentum of China in the second half of the year. Though still constructive on the region's technical backdrop and corporate fundamentals, we maintain a cautiously neutral stance on the asset class for the time being, given the potential for a rise in volatility in 2H and the contagion effect that might result from this.

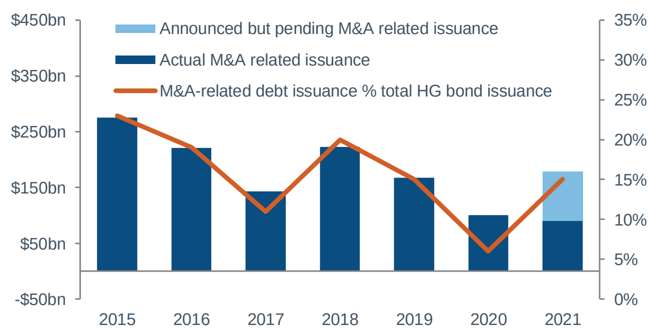
Lastly in EUR IG, spreads tightened 2bps in June and posted positive total returns of 0.4% over the month. Overall, economic conditions in Europe remain constructive, and the strong technical support of the ECB is likely to keep EUR IG spreads in check throughout H2. For this reason, and considering we are now through historic tights across EUR IG, we are comfortable to maintain a defensive positioning until we see a pick-up in volatility and more attractive levels at which to reengage.

Asia IG offers most value relative to other regions



Source: Fidelity International, Bloomberg, June 30th, 2021.

Low yields and better growth have elevated M&A activity so far in 2021



Source: Fidelity International, J.P. Morgan, June 2021.

High Yield

Monthly review

- High yield markets, except Asia high yield, posted positive returns.
- Credit spreads of US and European high yield markets tightened amid strong economic data and upbeat corporate earnings.
- A sell-off in Chinese property sector amid concerns around Evergrande Group spilled over to weaker single B developers and weighed on sentiments in Asia.

Strategy	– –	–	=	+	++
High Yield Credit Beta			●		
US High Yield			●		
European High Yield			→	●	
Asian High Yield				●	

Outlook

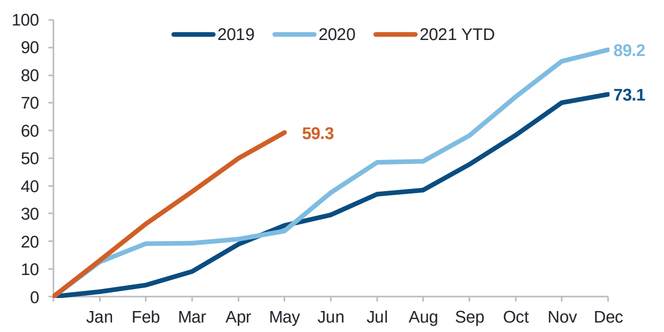
June saw a strong month for global HY, with a total return of 0.9% and spreads tightening by 14bps. Despite high headline return levels, there was significant disparity within HY, with US HY returning 1.4% and Asian HY returning -1.6% due to a surge in idiosyncratic risk. New issuance remained high over the month, but this is expected to die down as we progress into the summer months. Looking forward, all eyes are on Q2 earning figures and 2H 2021 forecasts. Robust GDP growth translating into revenue growth is well anticipated, but it is more important to observe whether sectors subject to input cost pressures and bottlenecks can navigate these challenges without lasting damage to margins. Overall, our stance is broadly neutral on the asset class, we do however think Asia and European High Yield are set to benefit from certain tailwinds over the coming months as described below.

US HY returned 1.4% in June in local currency terms, with spreads tightening by 30 bps. Robust June returns for risky assets were due to diminishing volatility and despite the hawkish shift in the Fed’s stance. High yield clearly benefits from quasi safe-haven status within the fixed income universe, thanks to its historically positive correlation with inflation. While there are few obvious catalysts for material drawdown over the next few weeks, asymmetric risk is quietly building for the high yield asset class. Summertime liquidity conditions provide an environment conducive to material price swings for event-driven credits. Aside from that, fundamental credit quality continues to improve with economies reopening and the earnings recovery is driving an upgrade cycle. Borrowing conditions are still very favourable, with almost $35bn of issuance printed in June, but supply should diminish over the next few months. As spreads ripped tighter for the month, it is becoming precariously close to a catalytic point for shifting to a defensive stance, but our outlook remains neutral for now.

European HY returned 0.6% in June in local currency terms, with spreads tightening by 7 bps. We are moving back to a positive stance on Euro HY. While risk markets overall have been in good shape and credit derivative indices have performed well, HY cash markets have been a touch heavy of late due to very robust supply. In addition to some indigestion of the calendar there has been some weakness in the reopening names across travel and leisure, due to concerns about the Delta variant. Despite this, the current backdrop continues to be one that favours this particular asset class, for the following reasons - robust liquidity conditions, improving macro, strong but not excessive animal spirits, becalmed volatility, and still very good value in some areas of the market considering the ultra-low default environment we’re in. Inflation risk is topical, but European projections still fall short of ECB’s objective; hence the taper risk in Europe is more distant whereas the ECB purchases remain high. We’d expect the calendar to die down materially over the summer months and, as seasonality is also typically supportive, are moving back to an overweight position.

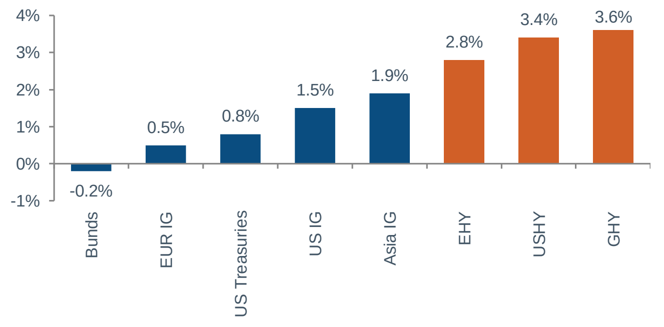
Asia HY returned -1.6% in June in local currency terms, with spreads widening by 100 bps. June was not a strong month for the asset class, characterized by a few idiosyncratic outliers’ moves. Earlier this month, the FOMC delivered a hawkish surprise to market. After half a US session of relative calmness, price action of two ensuing sessions were surprising: an aggressive rates rally, curve flattening and breakevens dropping, and inflationary vehicles selling off heavily. Asia HY is a lower-duration asset classes, but the importance lies in the big picture. Beyond rate hike and inflation, the most relevant aspect is that the positive incremental liquidity creation has almost certainly peaked. The Treasury General Account program has helped soften the blow of China’s rein-in, but upon a Fed pivot it would be hard to argue that the change in liquidity provision would be as supportive. At the same time, we have most likely seen peak positive economic surprises for quite a few economies - notably China and perhaps US. Purely on these two things, it would be intuitive to turn to a more defensive stance. However, we are conscious of cheap valuations and high income in Asia HY, and pockets of value emerging in this space, for these reasons we remain positive on the asset class.

European HY 2021 supply has by far eclipsed previous years



Source: Fidelity International, Credit Suisse, June 2021

Yields are attractive relative to other fixed income asset classes



Source: Fidelity International, ICE BofA Indices, June 2021 (EUR hedged)

Emerging Markets

Monthly review

- Emerging market debt posted mixed returns with local currency bonds underperforming hard currency bonds.
- Most emerging market currencies weakened against a stronger US dollar as the US Federal Reserve moved up its timeline for interest rate hikes.
- Within hard currency, sovereign spreads widened over the month while corporate spread levels were largely flat.

Strategy	– –	–	=	+	++
Hard Currency Sovereign				●	
Hard Currency Corporates				●	
Local Currency Duration		●	←		
EM FX				●	←
China RMB			●		

Outlook

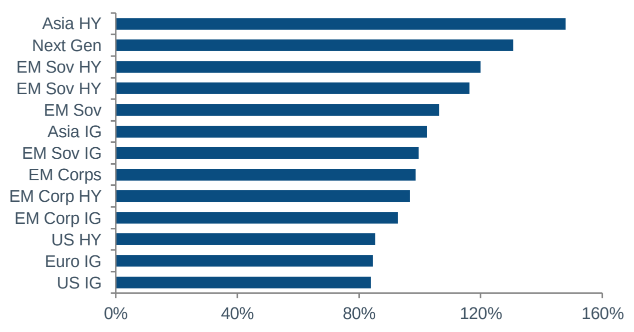
Emerging market debt posted mixed returns in June with hard currency bonds outperforming local currency bonds. In the hard currency space, sovereign debt posted total returns of 0.7%, while corporate debt returned 0.8%, both boosted by falling US treasury yields. Spreads widened modestly in the sovereign space, while spreads were largely flat in corporate debt. Local currency bonds posted negative returns of -1.2%, driven mainly by FX depreciation. After the first quarter of the year which proved challenging for EM risk assets, the second quarter saw better returns. This was driven in part by the stronger than expected recovery in global growth, continued dovish rhetoric from key central banks and a grind higher in commodity prices.

Despite the rally in spreads over the last quarter, we still believe there are areas of the market that still offer some value, but overall, the de-risking theme continues. We moved even closer to neutral in credit beta terms, given that EM spreads in most places are back at pre-crisis levels. The only hurdle to that was several attractively priced new issues, but even those were not frequent enough to stop us from increasing cash and bringing credit risk down overall. Looking at credit valuations, EM lower rated bonds (B/CCC) as well as Chinese IG and HY are still wide vs pre-crisis and are still attractive where considering the lack of upside elsewhere in fixed income. However, there are good reasons for wideness ranging from sanctions over ESG issues to wide fiscal deficits and exposure to the Chinese property slowdown. On fundamental support, the still sizeable short to medium-term positives seem to be in the price. There has been positive vaccine news in China, where 1bn doses have been administered and much of the elderly part of EM is likely to get their shots by end of this year. Also, we've seen positive news on the commodity price boost for exporters, and the ongoing lenience of the IMF and other multilaterals on debt sustainability criteria. On technicals, the positive technical of flows exceeding issuance is over for now, EM flows are only just positive thanks to taper fears, and even weak issuers are using the window of opportunity before further US yield curve increases to issue quickly.

We are getting closer to neutral on EM FX. Post the Federal reserve meeting in June, we are watching real rates and the US dollar very closely, as some crowded trades in market may continue to suffer. We have discretionary long positions in the Peruvian sol, Chilean peso, Colombian peso, Turkish lira, Thai baht, and Korean won. We dipped our toes back into a couple of regional laggards after the post-Fed blow-out and unwound our short EUR/USD hedge, as seasonals are about to tactically turn more positive for risk markets going into Q3. We still hold some exposure in selected frontier market currencies but took off positions in some outperformers to lock in gains. The EM FX recovery has been lagging commodity terms of trade, but at current valuations we are not quite convinced enough to re-enter the Russian ruble or Brazilian real.

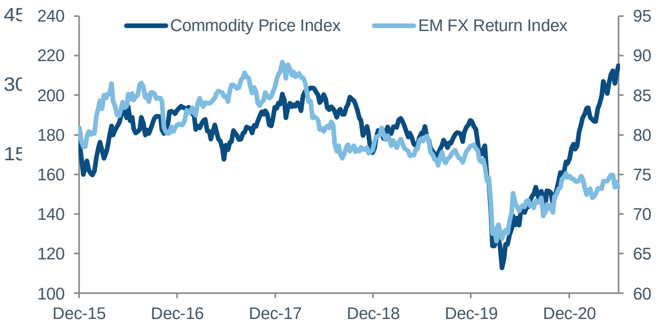
We are marginally underweight local currency duration. With inflation shocks continuing in emerging markets, central banks have turned hawkish in order to address inflation and related credibility concerns. We have already seen some central banks moving toward policy normalisation with rate hikes in Brazil, Hungary, and Mexico among others. Hence, we have been avoiding this part of the market and waiting for better levels to re-enter. We have some discretionary long positions in selected frontier markets as they offer a decent yield cushion and hold an underweight duration position in Poland.

Spread levels relative to pre-crisis*



Source: Bloomberg, 30 June 2021. * Pre-crisis date 2nd January 2020.

FX has lagged the commodity index recovery this year



Source: Bloomberg, 30 June 2021.

Quant Appendix

Fidelity Fixed Income Quantitative Scorecard

6th July 2021

Credit Beta & Asset Allocation

Credit Beta	TOTAL	Macro-economics	Momentum	Liquidity	Reversion	Seasonality
USD Investment Grade Credit	0.53	0.4	1.0	0.4	0.0	1.0
EUR Investment Grade Credit	0.49	0.4	1.0	0.4	0.0	0.7
USD High Yield	0.24	0.4	1.0	0.4	-0.5	0.3
EUR High Yield	0.36	0.4	1.0	0.4	0.0	0.3
EMD Sovereigns (USD)	0.36	1.0	0.1	0.4	0.0	0.0

Comments:

The credit beta models have been adding risk over the last month as the seasonality signals have been moving long and the mean reversion signals have been moving less short. This has been offset to some extent by a less supportive liquidity signal.

Asset Allocation	TOTAL	Macro-economics	Fundamentals	Sentiment and Liquidity	Valuation and Reversion
Investment Grade Credit	+0.81	+1.0	+1.0	+0.4	+1.0
High Yield	+0.65	+1.0	+1.0	+0.5	+0.3
US Loans	+0.65	+1.0	+1.0	+0.5	+0.3
EM Sovereign Debt (USD)	+0.72	+1.0	0.0	+0.4	+1.0
EM Local Currency Debt	-0.01	+1.0	0.0	-0.0	-1.0
EM Corporate Debt (USD)	+0.67	+1.0	+1.0	+0.6	+0.3

Comments:

The asset allocation model has been trimming risk across the board as the sentiment and liquidity signals have moved less long. Generally, the model remains overweight in all asset classes, with the exception of EM local currency debt, where unattractive valuations lead to an overall neutral allocation.

Interest Rates

Duration	TOTAL	Global Growth	CFTC	CBAI HY	Commods	Cyc Vs Def	Reversion	Global Momentum	Slope	Seasonality
EUR	-0.12	-0.16	-1.52	-1.20	0.02	0.05	0.75	0.72	0.23	0.04
USD	-0.20	-0.16	-1.52	-1.20	0.02	0.05	0.55	0.72	0.20	-0.46
GBP	-0.07	-0.16	-1.52	-1.20	0.02	0.05	0.65	0.72	0.30	0.52

Comments:

This month, the duration model has maintained a small short duration across the board but had reduced the short in GBP. The model short position has been driven by our positioning and high yield risk proxies. On the other side the signals are picking up on strong momentum and steep curves, limiting the short position

Cross-Market Duration	TOTAL (beta-neutral)	TOTAL	Slope	Real yield	Forward yield	Growth	Inflation	Unemployment
AUD	0.39	0.08	0.48	0.38	-0.10	-0.44	-0.13	-0.55
CAD	0.20	0.02	0.25	-0.52	0.25	-0.04	-0.36	0.25
CHF	0.19	0.20	-0.08	0.43	0.28	0.56	0.53	-0.08
EUR	-0.60	-0.12	-0.11	-0.52	-0.06	0.46	-0.34	-0.03
GBP	0.17	0.11	0.05	0.13	0.30	-0.21	0.17	0.23
JPY	-0.27	-0.16	-0.94	0.65	-0.02	-0.02	0.21	0.27
NZD	-0.32	-0.05	-0.18	0.34	-0.25	0.77	-0.41	-0.44
SEK	0.15	0.04	-0.12	0.42	-0.11	-0.40	0.25	0.41
USD	-0.19	-0.13	0.64	-1.31	-0.29	-0.69	0.08	-0.06

Comments:

Over the month the DM cross-market model reduced some of the long in CAD v USD rates. This reflected the model taking some profits on the outperformance of Canadian rates over the month. The model also paid some JPY rates. In general, the model remain long CAD, AUD, GBP against USD and EUR. Some of the EUR short is hedged with longs in CHF and SEK rates.

Quant Appendix explained

Fidelity Fixed Income Quantitative Scorecard

Credit Beta & Asset Allocation

Credit beta:
1. Global macroeconomic surprises compared to consensus expectations
2. Momentum: large one-way moves in either cross-asset-class volatility or credit spreads
3. Liquidity: trends in bond market bid-offer-spreads
4. Reversion: deviation of spreads from their recent average value, expecting reversion to the mean
5. Seasonality: technical indicator driven by historic returns in the corresponding period

TOTAL	1 Macro-economics	2 Momentum	3 Liquidity	4 Reversion	5 Seasonality
0.20	0.1	1.0	0.7	0.0	-0.7
0.08	0.1	-0.6	0.7	0.5	-1.0
0.12	0.1	1.0	0.7	-0.5	-0.3
0.37	0.1	1.0	0.7	0.5	-0.3
-0.18	-0.8	0.0	0.7	0.7	0.0

Credit Asset Allocation:
1. Macro: Global leading indicators plus qualitative growth and rates/inflation assessment
2. Fundamentals: Aggregated trend of single-company forecasts for leverage, margins and indebtedness
3. Sentiment and Liquidity: trend in bid-offer-spreads, cross-asset-class volatility and spread volatility
4. Valuation and Reversion: deviation of spreads from their historic averages, and risk premium above expected losses given long term average default rates

TOTAL	1 Macro-economics	2 Fundamentals	3 Sentiment and Liquidity	4 Valuation and Reversion
0.08	0.8	0.0	0.0	0.0
0.64	-1.6	0.5	1.5	0.5
0.75	-1.1	1.5	1.6	0.0
0.58	-0.9	1.5	1.6	-0.5
-0.34	-1.5	-1.5	-0.7	1.0
-0.07	-1.5	-0.3	-0.1	0.5
-0.09	-1.3	-0.5	-0.1	0.5

Directional Duration:
1. Growth forecast momentum: lower forecasts are dovish, lead to lower rates
2. Fair value: signal comparing the difference between 5y5y forwards
3. Commodities momentum: a proxy for state of the economic cycle
4. Gold momentum: a proxy for risk sentiment and flight to quality
5. Cyclical stocks outperformance: a proxy for economic optimism
6. Reversion: deviation of yields from their average historic value, expecting reversion to the mean
7. Momentum: measures large moves in a single direction, taking advantage of autocorrelation of flows and returns
8. Slope of the yield curve: steep curves earn a higher risk premium
9. Seasonality: technical indicator driven by historic returns in the corresponding period

1 Global Growth	2 5y5y FV	3 Commods	4 Gold	5 Cyc Vs Def	6 Reversion	7 Global Momentum	8 Slope	9 Seasonality
-0.06	0.00	-0.00	-0.01	-0.01	-0.22	-0.15	-0.00	0.21
-0.02	0.00	-0.02	-0.00	-0.06	-0.08	-0.10	0.54	-0.00
-0.02	0.00	-0.01	-0.00	-0.04	0.14	0.01	0.02	0.18

Cross Market Duration:
1. Slope of the yield curve: steep curves earn a higher risk premium
2. Real yield: yields adjusted for inflation, tend to revert to the mean
3. Forward yield: forward yields adjusted for GDP trend, tend to revert to the mean
4. Growth forecast momentum: lower forecasts are dovish, lead to lower rates
5. Inflation forecast momentum: lower forecasts are dovish, lead to lower rates
6. Unemployment forecast momentum: lower forecasts are hawkish, lead to higher rates

1 Slope	2 Real yield	3 Forward yield	4 Growth	5 Inflation	6 Unemployment
-0.2	-0.1	-0.4	-1.1	-0.4	0.0
-1.3	0.5	0.4	0.4	-0.3	-0.2
1.0	0.1	0.5	0.4	-0.1	-0.5
0.8	-0.3	-0.1	0.6	-0.3	0.0
-0.6	0.4	0.3	-0.7	1.1	0.2
0.8	0.1	-0.2	0.3	-0.4	0.0
0.6	-0.6	-1.1	0.1	-0.1	0.1
0.3	-0.5	-0.4	0.5	0.5	0.1
-1.3	0.4	1.1	-0.6	0.0	0.2

Important Information