MARCH 2018

Fixed Income **Monthly**

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Fidelity INTERNATIONAL

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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.

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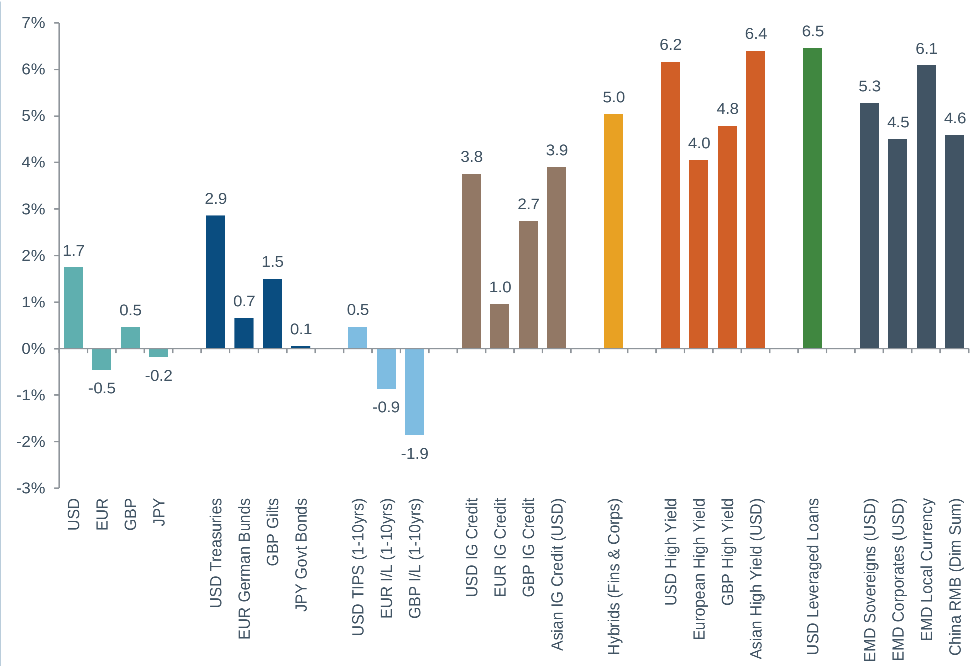
Contents

Strategy Summary – March 2018

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	– –	–	=	+	++
Duration			→	●	
UST Rates			→	●	
EUR Rates - Core				→	●
EUR Rates - Periphery				●	
GBP Rates		●			
Inflation	**– –**	**–**	**=**	**+**	**++**
Developed Markets Inflation			●		
IL – US			●		
IL – EUR			●		
IL – GBP			●		
Investment Grade Credit	**– –**	**–**	**=**	**+**	**++**
Investment Grade Credit Beta			●		
USD IG			●		
EUR IG				●	
GBP IG		●			
Asian IG (USD)			●		
Financial and Corporate Hybrids	**– –**	**–**	**=**	**+**	**++**
Financial and Corporate Hybrids				●	
Contingent Convertibles			●		
Investment Grade Corporate Hybrids				●	
High Yield	**– –**	**–**	**=**	**+**	**++**
High Yield Credit Beta		●			
US High Yield		●			
European High Yield		●			
Asian High Yield		●			
Emerging Markets	**– –**	**–**	**=**	**+**	**++**
EM Hard Currency Sovereign Debt		●			
EM Hard Currency Corporate Debt				●	
EM Local Currency Duration				●	
EM FX		●			
China RMB Debt			●		

Yields across fixed income asset classes



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. 28 February 2018. 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 28 February 2018 (%)

Government	YTD	Feb'17 - Feb'18	Feb'16 - Feb'17	Feb'15 - Feb'16	Feb'14 - Feb'15	Feb'13 - Feb'14
US Treasuries	-2.2	-0.5	-1.3	2.9	5.2	-1.1
EUR Bunds	-0.9	-2.5	0.1	1.9	10.2	0.5
UK Gilts	-1.8	-1.2	6.4	4.2	12.3	-0.9
Inflation Linked						
USD	-1.9	-0.1	3.4	-0.9	3.8	-6.2
EUR	-0.1	2.3	2.8	-1.9	10.2	2.4
GBP	-2.3	-1.3	20.8	2.9	16.1	-1.6
Investment Grade Corporate						
USD	-2.4	2.3	6.4	-1.5	6.4	1.4
EUR	-0.3	1.5	4.3	-1.1	7.8	4.2
GBP	-1.9	1.2	13.4	-2.1	12.1	4.1
Asian Dollar	-1.7	1.4	4.5	2.4	8.1	0.0
Financial and Corporate Hybrids						
Contingent Convertibles	0.4	10.9	19.1	-3.5	6.1	N/A
Investment Grade Corporate Hybrids	-0.9	8.5	13.0	-6.9	11.2	10.9
High Yield						
US	-0.3	4.1	22.3	-9.0	2.8	8.4
European	-0.4	4.7	13.8	0.0	4.8	10.2
Asia	0.2	3.0	19.6	-1.5	5.1	2.2
Emerging Markets						
EM USD Sovereigns	-2.0	4.4	12.1	1.1	6.9	-1.4
EM USD Corporates	-0.9	4.2	11.8	0.1	4.7	0.6
EM Local Currency (USD unhedged)	3.4	14.4	12.4	-12.5	-5.8	-10.1
China RMB	0.9	5.1	5.6	3.2	2.5	3.1

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, Datastream, 28 February 2018. Total Returns based off JPM and ICE BofA Merrill Lynch bond indices.

Macro and Rates Overview

Monthly Review

- US government bonds posted negative returns in February, due to concerns around a widening twin deficit and higher inflation.
- European government bonds posted positive returns, supported by dovish comments by ECB President Mario Draghi and worse than expected macro data.
- Gilts rallied over the month, with Brexit that remains the main driver for the asset class.

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

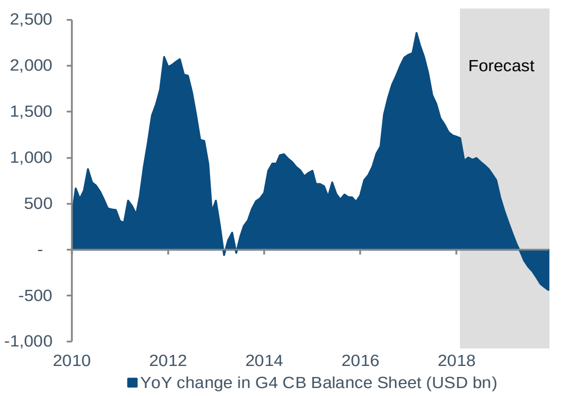
Outlook

US Treasuries lost some further ground in February, with strong momentum favouring higher yields and weighing on returns. After two challenging months, 10yr US Treasuries are now registering a 3.6% negative total return year to date. Looking ahead, while risks of still higher yields remain, we see current valuations as attractive, favouring a longer nominal duration exposure. CFTC data suggests that speculators are running very short positions in US Treasuries futures and while the US economic backdrop remains solid, downside risks to macro data are on the rise. The latest poor set of results by traditional US retailers, while mostly due to disruption from online competitors, could also be a canary in the coalmine that US consumption is not that strong afterall. Fiscal stimulus has been delivered by Trump over the last two months and while the benefits of tax cuts and other initiatives are largely still to come, these are for the most part already reflected in market prices. On the monetary policy front, Powell's testimony to Congress portrayed confidence in the US growth story, with the Fed firmly on a path to tighten policy further. Three rate hikes in 2018 are the base case scenario for the market, leaving little room for any additional repricing that could push yields higher still.

Economic indicators may seemingly have peaked in Europe as well. The latest Eurozone PMI and IFO surveys, for example, were both soft, and the Citi Eurozone Economic Surprises index dropped into negative territory for the first time since 2016. On the inflation front, we received some positive news from the latest wage negotiation rounds in Germany, where significant pay rises were achieved. However, these are unlikely to have a major read-across for the rest of Europe. In an environment where growth indicators could slow, inflation is still lacking and further currency strength may be unwelcome, the ECB will follow a very slow approach in removing monetary policy stimulus. Against this backdrop, European government bonds should remain well supported and continue to outperform their US and UK peers on a risk-adjusted basis. European government bond curves are still very steep. As an example, the 2yr-10yr yield differential is nearly 120bp in Bunds and 220bp in Italy. This compares to just over 60bp in US Treasuries, with EGBs providing good carry and roll down for investors. Italian elections resulted in a hung parliament, but delivered a strong result for populist parties at the expense of the more orthodox political class. The outcome, while relevant, is not a surprise and confirms known trends among the Italian electorate. Looking ahead, BTPs will remain volatile, but it's unclear whether this will spill over into other peripheral European markets.

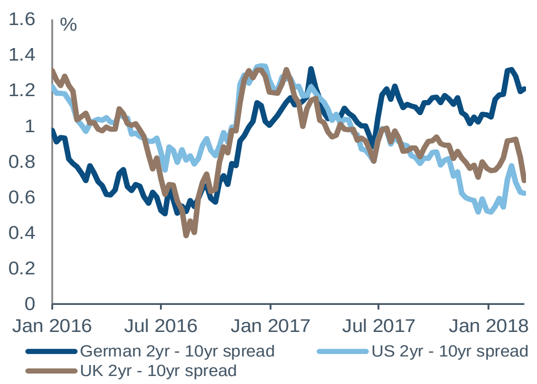
Lastly in the UK, Gilts remain a difficult call. Brexit and domestic politics remain the main drivers, where a lack of transparency and an uncertainty of outlook continue to cloud the picture. On the macro front, data has been mixed of late. The latest GDP release shows sluggish consumption, possibly due to falling real incomes, and still little sign of a rebound in capex, most likely due to Brexit uncertainty. The BoE, meanwhile, has recently shifted their tone, and taken a more hawkish stance. With potential GDP growth set at 1.5%, the Bank sees little slack left in the UK economy, which may be at risk of a supply-side inflationary shock. The MPC is therefore indicating that they may hike rates three times in 2018 and 2019, with the first rate hike likely in May. Investors have now largely priced this path into rates curves, with the immediate risk perhaps that slower global growth pushes the next expected hike out to the second half of 2018. Gilts have outperformed US Treasuries in the recent selloff, but may trail their US counterparts should US Treasuries recover.

Policy support fading in 2018



Source: Fidelity International, Bloomberg, December 2017. ECB: 30bn pcm of PSPP purchases from Jan-Sep18 and EUR 15bn/m from Oct-Dec18. Fed: bs shrinking at 10bn USD pcm from October 2017, pace of reduction increases by 10bn USD per quarter, to a max pace of 50bn USD. BoJ YoY purchases slow at a rate of 0.25% yoy. Constant FX rates.

European curves are still very steep



Source: Fidelity International, Bloomberg, 2 March 2018.

Inflation-Linked Bonds

Monthly Review

- US inflation breakevens were unchanged over the month despite a higher than expected US CPI print.
- German inflation breakevens tightened over the month as German inflation slowed more than expected to hit a 15-month low in February.

Strategy	– –	–	=	+	++
Developed Market Inflation			●		
IL – US			●		
IL – EUR			●		
IL – GBP			●		

Outlook

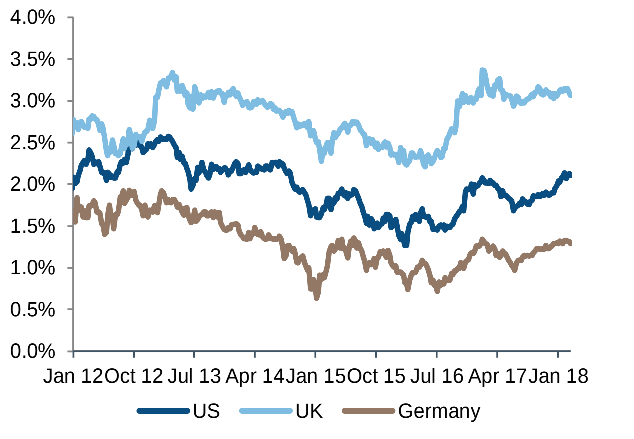
US headline CPI for January came in higher than expected at 2.09%, helped by the strongest month-on-month reading in a decade of 35bp. There was a particularly strong contribution from clothing, but also robust rises in a wide variety of service prices from rents over medical services to car leases, insurance and personal and household services. Despite the data release, the outlook for US inflation is more benign compared to a month ago, largely in part to the recent weakness in oil markets, as prices have moderated below USD 65 bbl. Our forecasts now see headline US CPI peaking at around 2.7% in Q3 2018 before coming down towards 2%-2.5% by the end of 2018. Core inflation, however, is about to start increasing on a more sustainable basis. We expect core CPI to hold steadily above 2% for the rest of the year. Against this backdrop, the Fed should feel comfortable with their hiking path, and should be able to increase Fed Funds three times in 2018, as the market currently prices in.

We are tactically neutral US breakeven inflation after reaching our 2.1% local target. After a strong start to the year, momentum stalled slightly in February, and breakevens were flat to lower over the month. Flows into the asset class have remained robust, however, as investors eye stronger core data and loose US fiscal policy in an economy at full employment. With risks tilted to the upside, we stay tactical and look for better entry points to reload our long US breakeven position.

The outlook for European inflation has not changed much in the past few weeks, with the EUR TWI broadly unchanged year to date, and the higher wage settlements in Germany that are unlikely to spill over into higher wage pressures across the Eurozone. Our forecast for European inflation sees both headline and core converging towards 1.5% by the end of 2018, still far from the ECB's "below 2%" target. Spare capacity in the region remains high, and a strong Euro will eventually become a headwind for Eurozone inflation. Euro breakevens offer little value at current levels, and we keep a neutral stance, waiting for better opportunities to emerge.

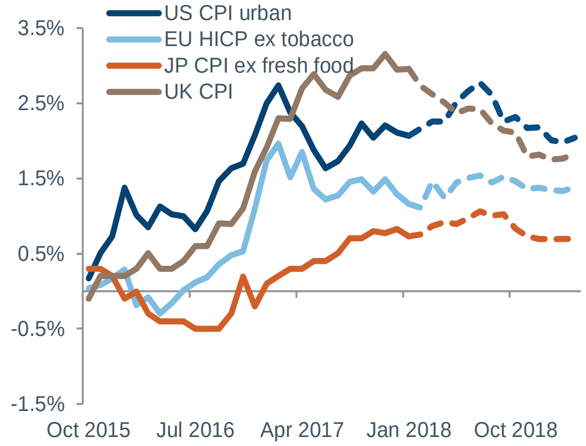
In the UK, headline and core CPI were slightly stronger than consensus in January, driven mostly by higher prices in recreational goods and services. December's positive surprise in air fares reverted down as expected. We are beyond the peak in CPI and we see drops in the annual inflation numbers nearly every month, to roughly 2% CPI by the end of the year. Fading currency base effects will be the biggest drag on inflation, but the decline in real wages last year is beginning to weigh on consumers' ability to spend. With the market pricing inflation that looks too high compared to our forecasts, we could look to go short the UK in the near term.

10yr inflation breakeven rates



Source: Fidelity International, Bloomberg, 28 February 2018

Fidelity inflation forecasts



Source: Fidelity International, February 2018

Investment Grade Credit

Monthly Review

- Investment grade (IG) credit posted negative returns in February as government yields rose and credit spreads widened.
- Outflows weighed on the asset class but were partially offset by underwhelming supply.
- European names fared better than their US counterparts. The former continues to benefit from the ongoing support of the CSPP programme, while the latter suffered from the volatility in the US Treasuries market.

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

Outlook

After an initial period of spread tightening in January, credit markets showed some sign of stress in the face of rising government bond yields. Investment Grade (IG) credit spreads widened in the second half of February, but did so in a rather orderly fashion, with no sign of panic among investors. As the dust settles, IG credit spreads are now back to the levels where they started the year, and have so far recorded marginally positive excess returns versus government bonds.

Looking ahead, our relative preference is little changed from last month, with neutral exposure to US and Asia IG, a more constructive view on EUR IG and a cautious stance towards GBP IG.

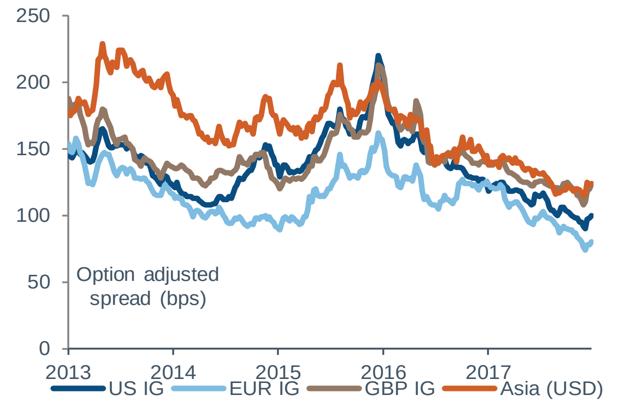
Corporate fundamentals are still better in Europe than elsewhere, where the market is at earlier stage of the credit cycle. The steepness in European sovereign yield curves also applies to the corporate bond space, with the asset class offering a good level of carry and roll down to investors, while the ECB’s cautious approach should keep spreads and volatility in check relative to other markets.

The US IG market has seen a dearth of supply and net issuance is down 20% year-to-date. The positive technical backdrop is likely to persist, but is offset by weaker corporate fundamentals and a long duration exposure, in an environment where risks of higher sovereign yields and higher volatility in US Treasuries persist. US IG spreads should hold steady, but are likely to provide lower risk-adjusted returns than European IG, particularly to Euro-based investors who face rising currency hedging costs. A similar pattern applies to Asia IG, and in both markets a neutral stance is warranted.

Lastly, GBP IG spreads, while wider than other IG markets, will continue to trade on the back of Brexit-related headlines, and uncertainty remains high. While a recovery could be prompt if we see an improvement on the political front, it remains a very difficult call to make, and timing a rebound can be particularly challenging.

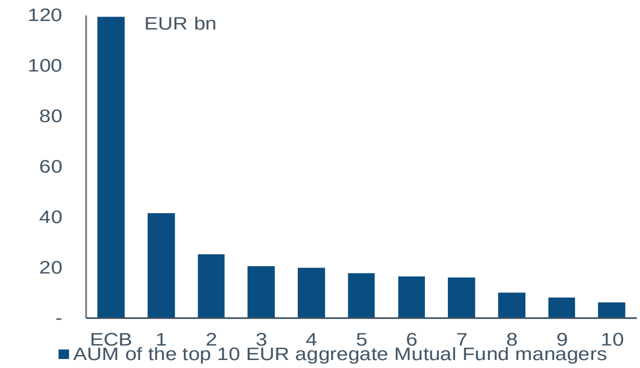
The main risks for the asset class come from government bond yields more than credit spreads, and any contagion from volatility seen in risk assets in general. While excess returns matter, and credit spreads may cushion some of the blow from higher government bond yields, investors will ultimately keep a close eye on total returns. Should the momentum in the sovereign space persist, it will eventually begin to impact flows and returns in credit markets.

IG credit spreads



Source: Fidelity International, ICE BofA Merrill Lynch indices, Bloomberg, 28 February 2018

The ECB is now the largest holder of EUR credit



Source: Fidelity International, Evestment, Q3 2017. Largest EUR aggregate managers

High Yield

Monthly review

- High yield (HY) credit posted negative returns and reversed most of the January gains.
- The global risk-off and some key political events ahead led investors to book profits in the HY space, weighing on the asset class' total returns.

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

Outlook

High Yield (HY) credit experienced a turbulent month following the pickup in volatility within rates and equity markets. However, on a relative basis, the asset class outperformed other risk assets. February also saw a further unwind of the global compression trade between IG and HY markets, a valuation-driven theme reinforced by the implications of US tax reform for more highly levered entities. Corporate fundamentals remain strong, though leverage metrics are at cyclically elevated levels and EBITDA growth has outstripped debt growth over the last few quarters. HY outflows, which accelerated at the start of the month in conjunction with Treasuries selling off, initially pushed spreads wider, although there was a partial retracement in the second half of the month.

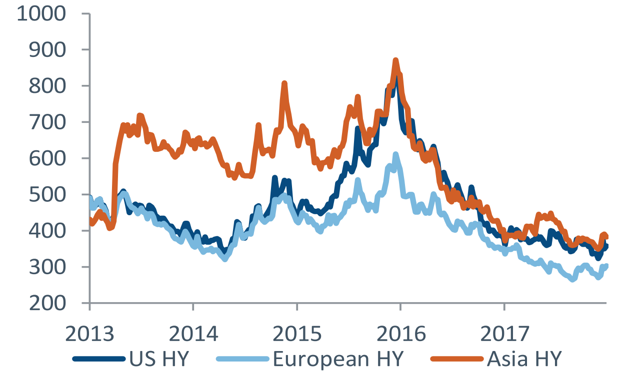
There has been increased differentiation and dispersion within the asset class. In the selloff, market focus shifted towards issuers with lower rate sensitivity and securities outperforming in accordance with reflationary trends. In both the US and Europe, on a total return basis, single B's outperformed the higher quality but longer duration BB segment of the market. The latter are likely to remain under pressure in our base case of rising risk-free rates. With limited margin for error in spreads, still relatively low levels of dispersion and reasonable liquidity, the case to increase average portfolio quality remains valid. At a regional level, we remain cautious towards all HY markets. As spreads remain close to quality-adjusted cyclical tights.

In Europe, economic conditions remain supportive but the key driver for both flows and spreads will be the ECB, and the monetary policy tightening path that they have embarked on. Despite shrinking ECB support to European fixed income markets, the technical backdrop for European HY remains constructive. The latest moves in both yields and FX make the asset class particularly attractive to offshore investors, and should support inflows. For Japanese investors, for example, the yield available in European HY, after accounting for currency hedging, is now at the highest level of the past 2 years. The improvement in the average quality of European HY issuers has been a recurring theme for the asset class, with over 70% of the universe now rated BB, and a growing number of companies that are now a potential candidate to become rising stars, and receive an IG rating. As a result, as large capital structures move out of European HY indices, the demand and supply imbalance in the market should add an additional tailwind, keeping spreads in check. Valuations, however, are not cheap, spreads offer little cushion to protect total returns from rising volatility in yields and spreads, and the correlation of the asset class to government bond yields has increased in the past few quarters. A cautious stance is therefore warranted.

A similar stance applies to the US HY market. After the latest higher than expected inflation prints and potential for a more hawkish Fed, we are likely to see rising dispersion across the various rating buckets within the asset class. Corporates should be able to absorb the rise in rates, given the interest coverage levels, limited net supply and increased issuance of floating rate notes. Nonetheless, we maintain our stance that caution is still warranted, given where we are in the US credit cycle and potential for further volatility in the months ahead.

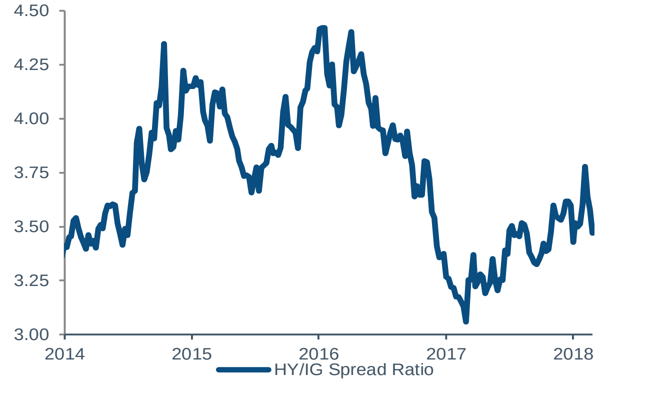
In Asian HY, corporate fundamentals remain stable so the preference for high quality names remains. In aggregate, however, valuations are unattractive. In particular, the lower quality, non-property or maiden issuers, where we expect a rise in supply, look expensive compared to their US equivalents.

HY spreads continue to grind tighter



Source: Fidelity International, ICE BofA Merrill Lynch, Bloomberg, February 2018

The compression trade has stalled



Source: Fidelity International, Bloomberg, ICE BofA Merrill Lynch indices, February 2018.

Emerging Markets

Monthly review

- Emerging market bonds posted negative returns over the month amid a risk-off environment. Both hard currency and local currency bonds came under pressure.
- A rise in US Treasury yields coupled with wider spreads hampered hard currency returns. Concerns over policy normalisation by the US Federal Reserve and the European Central Bank and speculations around a revival of inflation in developed markets weighed on investor sentiments.
- Emerging market currencies posted mixed returns against the US dollar with the Chilean peso being one of the top performers while the Hungarian forint underperforming.

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

Outlook

The long duration profile of EM hard currency debt did not help the asset class in February, as the yield on US Treasuries pushed higher and weighed on EMD returns. While spreads did provide some support, they widened on the month from what were very tight levels. Moreover, the greenback gained ground over the month against most EM currencies, despite the more general trend of USD weakness that we continue to see in the market. The South African Rand and the Chilean Peso were two notable exceptions to this trend, as they appreciated against the USD in February.

Flows into the asset class reacted swiftly, and Emerging Market bond ETFs suffered their worst one-day outflow in the midst of the rout at the beginning of February. This did not last long, however. As the dust settled and risk sentiment quickly rebounded, flows reversed course and have come back to EM debt. The asset class remains relatively attractive thanks to the strong global growth dynamics and the improvements in EM balance of payments. Local duration is an area where we see the attractive risk-adjusted returns going forward. But some care is warranted towards EMFX, which could come under pressure against the USD should risk sentiment abruptly deteriorate.

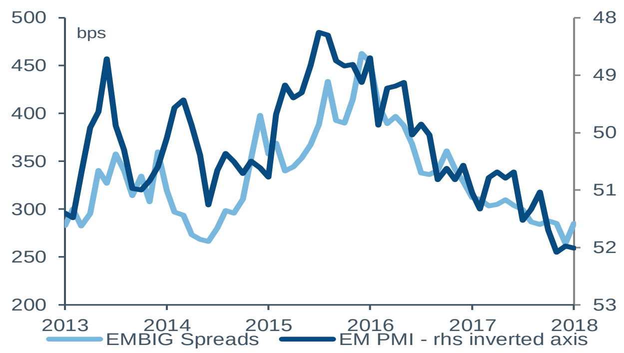
Our five main themes for the asset class remain. A rebound in EM inflation is our strongest conviction and the latest data releases show that it remains on track, supporting our overweight stance in EM inflation-linked bonds. This is particularly evident in LatAm, where we expect a normalisation of food inflation, and higher inflation prints ahead, as base effects from last year's benign inflation prints gradually fade.

In local politics, South Africa's president Jacob Zuma finally resigned from office. This now paves the way for former Deputy President Cyril Ramaphosa to take over and undertake much needed structural reforms to support higher economic growth, lower unemployment and improving wealth equality. The positive development supported South African assets and the Rand was one of the best performing emerging market currencies over the last month. Despite the positive momentum for South Africa, we are wary of a possible ratings downgrade to HY from Moody's which could raise financing costs for the economy. In addition, valuations look tight now and future economic prosperity will depend on how effectively the country can perform structural changes.

Russia received its first ratings upgrade in over 10 years as S&P lifted their rating into the IG category. This upgrade will place them within the IG global bond indices. Russian assets have reacted positively to the news, but there is potential for further outperformance and spread compression in the weeks ahead, as most passive investors are still to rebalance their portfolios and add the country to their holdings.

China's manufacturing PMI came in weaker than expected, in contrast to the strength of development market releases. While seasonal factors related to the Lunar New Year played a role, there are early signs that tighter global monetary policy and the country's focus on reducing leverage are beginning to weigh on economic growth.

EM PMIs versus EM Spreads



Source: Fidelity International, Bloomberg, JP Morgan bond indices, February 2018

EM real yields are attractive

Source: Fidelity International, Bloomberg. As of February 2018

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