FIXED INCOME MONTHLY APR 2024

Inflation risks nearer term, growth risks longer term

Fidelity International's outlook from the Fixed Income investment team

For investment professionals only

Fidelity INTERNATIONAL

Executive Summary

Yields on US 10-year treasuries rose quickly through March, climbing around 20 basis points from the month low as February's 3.2% CPI posted slightly hotter than expected, rising on January's 3.1%, which itself overshot estimates. The inflation picture is proving stickier than expected, particularly in services, leaving goods inflation to do the work. With growth also showing resilience, the dovish tone from Fed Chair Powell at March's FOMC meeting is somewhat counterintuitive, especially given the Fed raised its growth forecast for this year and its interest rate projection for 2025.

The Fed continues to expect three rate cuts this year and the market is generally aligned, but there is a risk that the last mile of inflation will be stubborn for some months and as a result, markets are probably underpricing this risk.

Beyond that, there is a gradual slowing playing out in the economy that may take more prominence in the latter part of the year. Real time data shows job openings and quit rates are falling significantly. There is also weakness in small business hiring that could hint at future pressure on payrolls. With the market embracing the soft landing narrative (and increasingly the no landing scenario), the risks to growth are higher than the market thinks.

Consumers are facing pressure with pandemic-era excess savings run out for all but the richest and the labour market is incrementally weakening. Despite the current resilience in consumer spending, we could see a squeeze on households later this year or early next year, which would in turn put pressure on companies.

Corporate margins have room to fall given many industries have not yet passed on lower costs to consumers as a result of cheaper commodities and improving supply chains. While corporate leverage looks healthy compared to the past decade, this ignores the presence of higher interest rates. US companies across the ratings spectrum would need to reduce their debt by over 30% to maintain absolute levels of interest expenses.

Despite the risks to corporates, credit spreads are tight. Investors are focusing on all-in yields, which are attractive given high core yields, but spreads are generally expensive. I elaborated on this point more fully last month, but the trend remains in place. As a result, we continue to favour US duration in the longer term. While the market appears to be underpricing the risk of stickier inflation in the near term, the risks over the long term are more around the slowing trajectory of the economy.

Steve Ellis
Global CIO Fixed Income

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Strategy summary

We have raised our probability of a no landing scenario this year to 30%, with a soft landing now at 40%. We continue to be overweight US and EUR duration, and neutral UK duration. We moved to neutral in EM FX given implied volatility is low in EM, making us relatively cautious.

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Macro and rates overview

Given the resilient US economy and sticky inflation data we have raised our probability of a no landing scenario this year to 30%, with a soft landing now at 40%. While a soft landing is most likely in our opinion, the no landing narrative is already starting to drive markets. On balance, given the guidance from central banks and the risks in the market, we continue to be overweight US and EUR duration.

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Inflation linked bonds

We increased real duration exposure slightly and remain long duration versus the index given our view that the inflation data has had an outsized reaction in rates markets. This position is primarily expressed in UK and US real yields. However, we heed longer term structural upside inflationary headwinds, which may warrant a long breakeven inflation position soon, and calls for a somewhat moderate long in duration.

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Investment grade credit

Global IG credit returned 1.2% in March, benefitting from strong technicals and tightening credit spreads. Spreads tightened by 6bps with valuations reaching close to post-GFC tights. Despite the compression, all-in yields remain attractive and we are neutral on the asset class. We prefer European IG with valuations remaining comparatively cheap as spreads price in the greatest risk of recession versus other asset classes.

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High yield

Global high yield (HY) returned 1.1% in March in local currency terms and spreads tightened by 8bps amid strong economic performance, healthy new issue volumes and supportive technical factors. We lean towards rates staying higher for longer, but a stabilisation in the rates market will prompt us to shift up the credit quality ladder.

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Emerging markets

Emerging market bonds posted mixed returns in March, with hard currency sovereigns (2.1%) outperforming hard currency corporates (1.0%) and local currency bonds (0%). In EM FX, we trimmed exposure and moved to neutral. While some currencies have performed well, the implied volatility is low in EM, making us relatively cautious to remain overweight.

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Quant appendix

Important Information

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.

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: The price of bonds 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: Overseas investments will be affected by movements in currency exchange rates. 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: Investing in emerging markets can be more volatile than other more developed markets.

Derivatives: Some fixed income investments 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, and expose investors 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.

Strategy summary

The Fixed Income Monthly provides a forward-looking summary of the medium-term views from Fidelity's 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 and the views presented in this document. 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.

Rates	– –	–	=	+	++
Duration				●	
UST rates				●	
EUR rates - core					●
EUR rates - periphery		●			
GBP rates			●		

Main views

- Remaining overweight UST given market's increasing consensus on no landing scenario.
- Maintain strong overweight on EUR rates (core) given stabilisation in inflation and potential for rate cuts draws nearer.
- Underweight on European peripheral duration with valuations still stretched and risk-reward skewed to the downside given expected supply will lead to significant spread widening.
- Remaining neutral UK duration given market fairly valued.

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

- Despite higher than expected upticks in inflation data, the overall inflation trend is still moving downwards.
- Value is starting to emerge in breakevens, as they are currently priced for a benign inflation outlook. Longer term dynamics such as green transition costs, deglobalisation and geopolitical tensions pose threat to this outlook.

Investment grade credit	– –	–	=	+	++
Investment grade credit beta			●		
USD IG			●		
EUR IG					●
GBP IG			●		
Asian IG (USD)			●		

- IG spreads continue to grind tighter, with valuations close to post-GFC tights. We are, however, neutral on global IG corporates as they maintain an attractive yield.
- Given tight valuations on a spread basis we remain selective in credit exposure. More broadly, we prefer European IG with spreads still screening as attractive versus other regions.
- Yield curve inversion and expensive valuations at the long end of the credit market means we continue to favour the short end of the credit spectrum, where risk-reward appears most attractive.

Financial and corporate hybrids	– –	–	=	+	++
Financial and corporate hybrids			●		
Contingent convertibles			●		
Investment grade corporate hybrids			●		

- Short call securities look attractive due to yield curve inversions and favourable convexity profile in the event of a call.
- After beta rally we see less scope for significant compression but still like short call AT1 given high propensity to call.
- Neutral in corp hybrids, given relatively resilient performance.

High yield	– –	–	=	+	++
High yield credit beta		●			
US high yield		●			
European high yield		●			
Asian high yield		●			

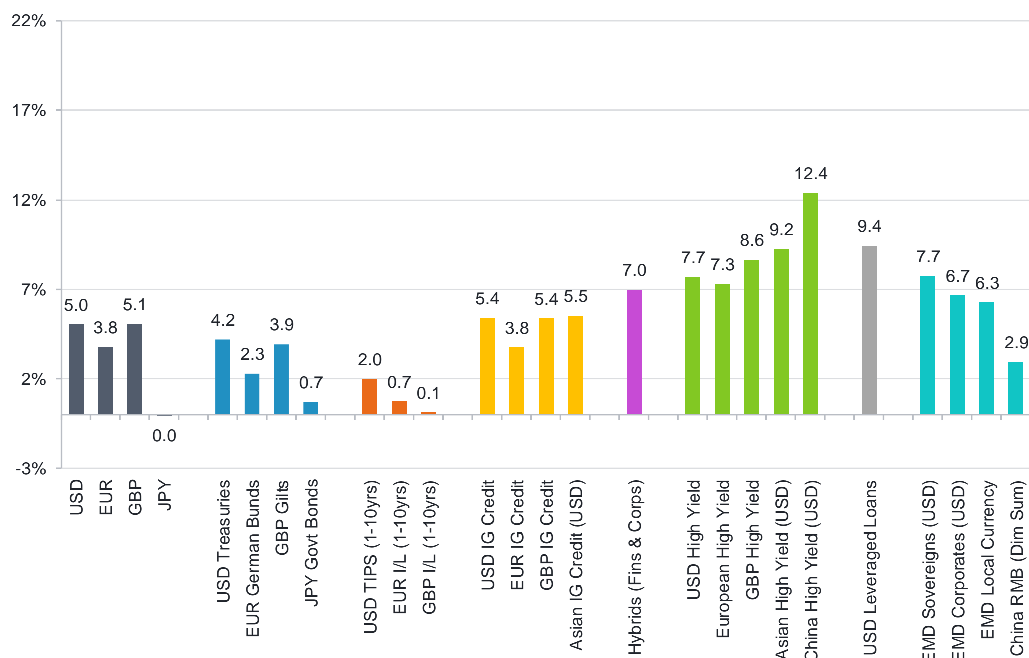
- Amid unappetising spreads and decreasing margin for error, we maintain an underweight position in US HY.
- Maintain an underweight stance in European HY as substantial increase in idiosyncratic risks raises a risk of contagion into the rest of the universe if rates stay higher for longer.
- For Asian HY, we maintain an underweight stance given not-as-compelling valuations. Positioning revolves around capturing yield, while not being overly aggressive in active credit risk.

Emerging markets	– –	–	=	+	++
EM hard currency sovereign debt				●	
EM hard currency corporate debt		●			
EM local currency duration				●	
EM FX			●	←	
China RMB debt			●		

- Slight overweight EM Sovereign credit and moved to a neutral in EMFX.
- Overweight local duration amid weak global inflation momentum and broadening of monetary policy easing cycles within EM .
- Our bullish stance on EM Sovereign is more tactical than on rates.

Yields across fixed income asset classes

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



Source: Fidelity International, Bloomberg, JPM and ICE BofA Merrill Lynch bond indices, 28 March 2023. 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 others. The Yield to Maturity (also known as the Redemption Yield) is the anticipated return on a bond expressed as an annual rate based on price / market value as at date shown, coupon rate and time to maturity. Hybrids universe defined as 50% Corporate Hybrids and 50% Financial Hybrids indices.

Summary of returns as of 29 March 2024 (%)

Government	1 Month	YTD	2023	2022	2021	2020	2019
US Treasuries	0.6	-0.9	3.9	-12.9	-2.4	8.2	7.0
EUR Bunds	0.9	-1.4	5.1	-17.6	-2.6	3.0	3.1
UK Gilts	1.8	-1.9	3.7	-25.1	-5.3	8.8	7.3
Inflation Linked							
USD	0.7	0.0	3.6	-12.6	6.0	11.5	8.8
EUR	0.9	-0.4	5.0	-8.1	6.2	3.1	6.0
GBP	2.6	-2.2	0.7	-34.4	3.9	11.3	6.5
Investment Grade Corporate							
USD	1.2	-0.1	8.4	-15.4	-1.0	9.8	14.2
EUR	1.2	0.4	8.0	-13.9	-1.0	2.6	6.3
GBP	1.8	0.2	9.7	-19.5	-3.0	8.7	10.8
Asian Dollar	0.9	0.2	7.5	-11.0	0.0	7.6	11.5
Financial and Corporate Hybrids							
Contingent Convertibles	2.2	3.6	5.7	-11.4	4.7	6.8	17.6
Investment Grade Corporate Hybrids	1.5	2.3	10.2	-12.9	1.4	3.8	14.2
High Yield							
US	1.2	1.5	13.5	-11.2	5.4	6.2	14.4
European	0.1	1.4	13.1	-13.9	3.3	3.6	13.8
Asia	0.9	6.2	-0.1	-13.3	-6.2	8.4	13.2
Emerging Markets							
EM USD Sovereigns	2.1	2.0	11.1	-17.8	-1.8	5.3	15.0
EM USD Corporates	1.0	2.4	9.1	-12.3	0.9	7.1	13.1
EM Local Currency (USD unhedged)	0.0	-2.3	12.7	-11.7	-8.7	2.7	13.5
China RMB	0.4	1.3	4.8	1.9	3.2	3.7	5.6

Source: Fidelity International, ICE, Datastream, 29 March 2024. Total Returns based off JPM and ICE BofA bond indices as of 29 March 2024. Custom index used for Asia High Yield (ICE BofA Merrill Lynch Q490 Index).

Macro and rates overview

Monthly review

- The Fed maintained rates at its March FOMC meeting but raised its 2024 growth forecast to 2.1% and kept three cuts in its dot plot.
- The ECB kept its policy rates stable but signalled a June cut is possible and lowered its inflation forecast to 2.3% for this year.
- The Bank of England made no change to policy rates and struck an optimistic tone on inflation.

Strategy	– –	–	=	+	++
Duration				●	
UST rates				●	
EUR core					●
EUR periphery		●			
GBP rates			●		

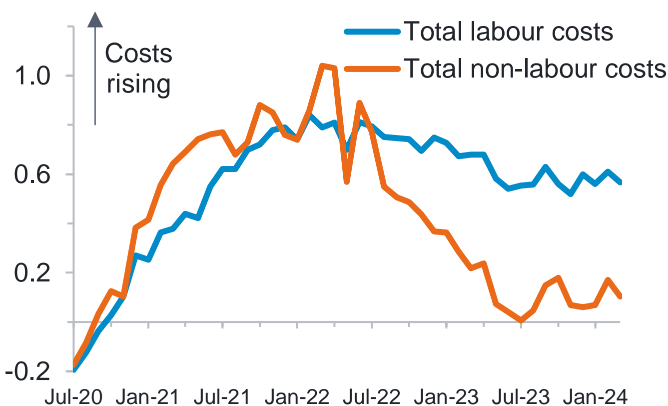
Outlook

Despite no policy rate change at March's FOMC meeting, the Fed was decidedly dovish. Its long-term interest rate forecast ticked up slightly and its growth estimate for this year was also raised, yet the Fed continues to expect three rate cuts this year. That's a relatively dovish signal and together with the Fed's emphasis on forecasting, suggests the Fed is likely to start rate cuts from June.

Almost in synchronised action, the ECB and Bank of England struck similar optimistic tones on inflation moving in the right direction and interest rates approaching. Both these central banks could also start rate cutting in June.

The complication for central banks remains that inflation is above target and, in some cases, surprising to the upside. US core services inflation has not moved since October and is settling above target, putting pressure on goods inflation to do the work to reach target. This means the March CPI figure is significant, and given the still tight labour market, there could be a higher-than-expected probability of an upside surprise.

Labour costs remain sticky



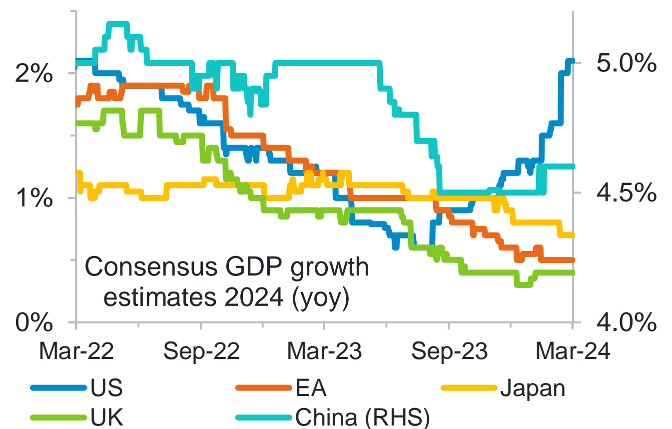
Source: Analyst Survey Fidelity International, March 2024. Note: chart shows proportion of responses reporting costs are increasing minus those reporting costs are decreasing.

Given the resilient economy and sticky inflation data we have raised our probability of a no landing scenario this year to 30%, with a soft landing now at 40% (cyclical recession 25% and balance sheet recession 5%). Data this year indicates strong momentum in the US economy and some moderate improvement in the Eurozone and UK, largely driven by services.

While a soft landing is most likely in our opinion, the no landing narrative is already starting to drive markets, which we expect to continue until more clarity on the direction of the cycle and central banks' reaction functions emerges in the coming months.

However, a no landing is unlikely to be a sustainable into year-end as high-for-longer rates – or even further rate hikes – drive the economy into recession or the labour market rebalances towards a soft landing outcome.

US no landing scenario gaining traction



Source: Fidelity International, Bloomberg, March 2024.

This cloudy outlook means there are arguments to be both long and short government bonds. Unemployment, while still low, is gradually rising and with rate cuts approaching, historically bonds tend to perform. On the bearish side, a resilient US economy means monetary policy could end up being tighter than expected. On balance, we continue to be overweight US duration on a discretionary basis.

In the Eurozone, March inflation was 2.4% and below the consensus 2.5%. The ECB is first in line for rate cuts out of the major central banks and we remain strong overweight EUR duration.

The UK is currently pricing in three rate cuts this year inline with the US. The UK had seemed it would be a laggard to the other major central banks in tightening policy rates given its stubborn inflation prints, but recent data points have brought it more into line with the US and Eurozone. As a result, we remain neutral UK duration.

Inflation linked bonds

Monthly review

- Although March saw mixed data, the overall trend in inflation is lower.
- Owner's equivalent rent remains elevated compared to pre-Covid.
- We see value in breakevens as they are currently priced for a benign inflation outlook.

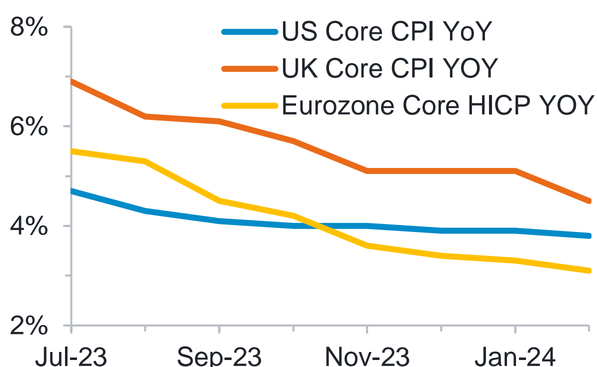
Strategy	– –	–	=	+	++
Breakeven inflation			●		
IL – USD				●	
IL – EUR		●			
IL – GBP			●		
IL – JPY			●		

Outlook

March was a mixed in terms of inflation data. US inflation surprised to the upside once more, leading investors to delay their expectations of rate cuts again. Services inflation continued to be sticky, affirming our view that the final path for inflation from current levels to the target 2% is going to be challenging.

We increased real duration exposure slightly and remain long duration versus the index given our view that the inflation data has had an outsized reaction in rates markets. This position is primarily expressed in UK and US real yields. However, we heed longer term structural upside inflationary headwinds, which may warrant a long breakeven inflation position soon, and calls for a somewhat moderate long in duration.

The broader inflation trend continues downward

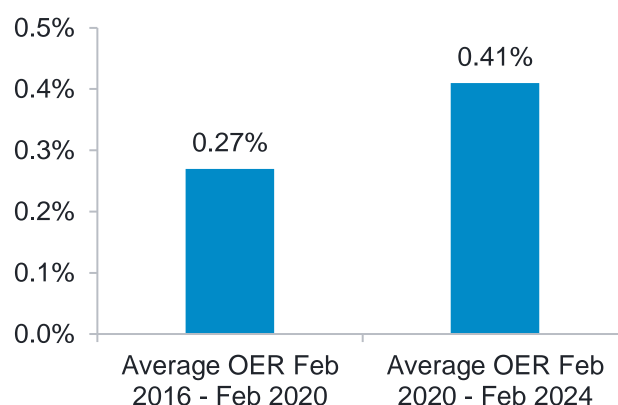


Source: Fidelity International, Bloomberg, April 2024.

US headline CPI edged up to 3.2% yoy in February from 3.1% in January. Markets expected 3.1% and the surprise led to uncertainty around the timing of the first Fed rate cut. The inflation increase was driven primarily by a rise in gasoline prices from 1.3% yoy in January to 12.1% in February. Core inflation edged lower from 3.9% in January to 3.8% in February.

Last month, we flagged the unexpectedly strong 0.6% month-on-month reading in January's owner's equivalent rent (OER) data. February's OER print of 0.4% showed a relative normalisation in this important component of the basket. However, this is still elevated compared to pre-Covid levels. This reinforces our caution around longer term upside inflationary risks.

Owner's equivalent rent is elevated (MoM)



Source: Fidelity International, Bloomberg, April 2024.

In the UK, draught stout such as Guinness, have been removed from the UK inflation basket in the Office for National Statistic's annual rebalancing. Air fryers were added to the basket among many other changes. This exercise is conducted to reflect the typical UK consumer's spending habits to form the basket weights for the inflation data.

UK core CPI was 4.5% for February, and below market expectations of 4.6%. This downward trend in inflationary data has been met by increasingly dovish rhetoric from the Bank of England, with Governor Bailey signalling that the prospect of June cuts is still "in play". This has supported our slight long duration position in UK real yields as 10-year index linked Gilt yields fell over March.

Amid this broader backdrop, we are closely tracking inflation breakevens, a proxy for the market expectations of future inflation. Given broader structural headwinds and continued geopolitical pressure, inflationary risks remain to the upside and the market's benign pricing of US CPI at 2.4% over a 10-year period (represented by the 10-year US breakeven rate) may underappreciate these longer-term upside risks.

We continue to see 1-10 year inflation linked bonds as an efficient way to gain exposure to inflation protection by balancing inflation and duration risks associated with the asset class.

Investment grade credit

Monthly review

- Global investment grade credit posted positive total returns in March, with Sterling IG outperforming other regions.
- Credit spreads tightened over the period, with EUR IG and Asia IG outperforming as spreads tightened by 8bps in both regions.
- While valuations are becoming expensive, the high yields on offer continue to drive demand in the franchise.

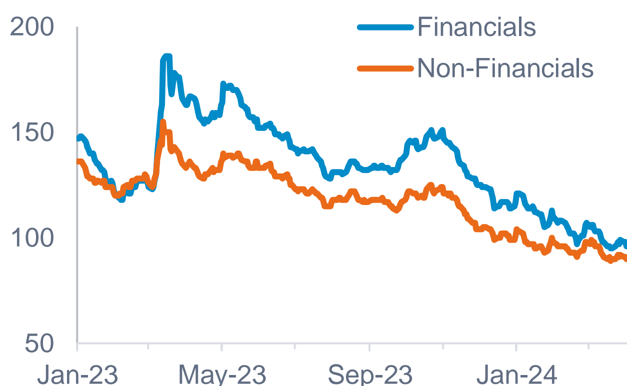
Strategy	– –	–	=	+	++
IG credit beta			●		
USD IG			●		
EUR IG					●
GBP IG			●		
Asian IG (USD)			●		

Outlook

Global IG credit returned 1.2% in March, benefitting from strong technicals and tightening credit spreads. Spreads tightened by 6bps with valuations reaching close to post-GFC tights. Despite the compression, all-in yields remain attractive and we are neutral on the asset class.

As the economic backdrop deteriorates somewhat, corporates are working to protect their profit margins. There has been a rise in M&A activity in certain sectors and we are also noticing a deterioration in the health of small businesses, which are cutting jobs to protect profitability - if price wars occur this will exacerbate the pressure. This trend is yet to materially translate to larger businesses and consequently have a significant impact on the labour market. However, small businesses are often a leading indicator for the overall direction of corporate hiring and firing.

US financials have compressed versus non-financials



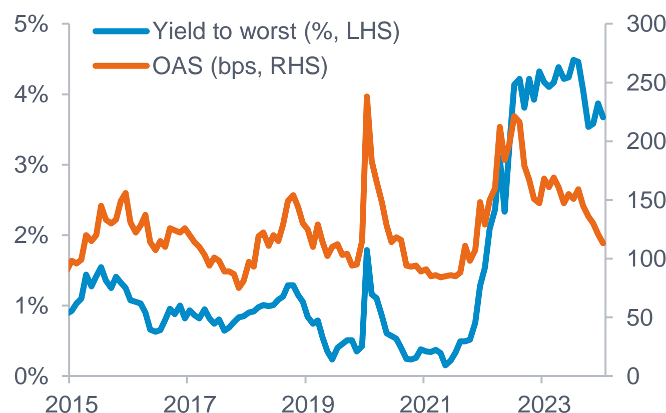
Source: Fidelity International, Bloomberg, 3 April 2024. ICE BofA indices.

We remain neutral on US IG, which returned 1.2% in March, and we are staying selective in credit exposure. Fundamentals remain healthy at an index level but disparity between issuers is appearing. We continue to favour less cyclical names with lower leverage that are better placed to weather declines in profitability. Despite continued fundamental strength in financials, we have been taking some profits given tightening in the sector (US financials spreads are only about 6bps wider than non-financials).

MBS screens as attractive on a historical basis and the consensus is to be overweight. However, our contrarian approach leads us to prefer to be neutral.

Euro IG returned 1.2% and spreads tightened by 8bps in March, despite stronger-than-expected supply from non-financial corporates. Technicals were supported by a dovish message from the ECB, helping to re-accelerate inflows and providing further scope for tightening. Valuations remain comparatively cheap in Euro credit as spreads are still pricing in the greatest risk of a recession versus other asset classes.

Euro IG valuations remain attractive



Source: Fidelity International, Bloomberg, 31 March 2024.

Sterling IG returned 1.9% in March, with spreads tightening by 7bps. The risk-reward at the front end of the curve looks symmetrical, while valuations are expensive at the back end. Overall, we are cautious on credit and are biased towards defensive sectors like ABS and utilities (especially water utilities). We have been de-risking by trimming exposure to long-dated credits, although we have a slightly long beta position to take advantage of the continued compression trade.

Asia IG returned 0.9% with spreads tightening by 8bps. New issuance was skewed towards higher quality names due to prevailing market sentiment and technical factors. Yields are at the high end of the historical range, while spreads continue to ricochet around historical tights due to limited supply and a benign macro backdrop. Despite attractive valuations, we maintain a neutral credit beta and a bias towards high quality countries.

High yield

Monthly review

- High yield bonds posted positive returns in March.
- Global and US high yield credit spreads tightened amid stable corporate fundamentals and a relatively positive economic outlook.
- European HY spreads widened due to significant increase in single name volatility as three issuers announced to have appointed advisors to look for proactive debt extensions and haircuts.

Strategy	– –	–	=	+	++
HY credit beta		●			
US high yield		●			
European high yield		●			
Asian high yield		●			

Outlook

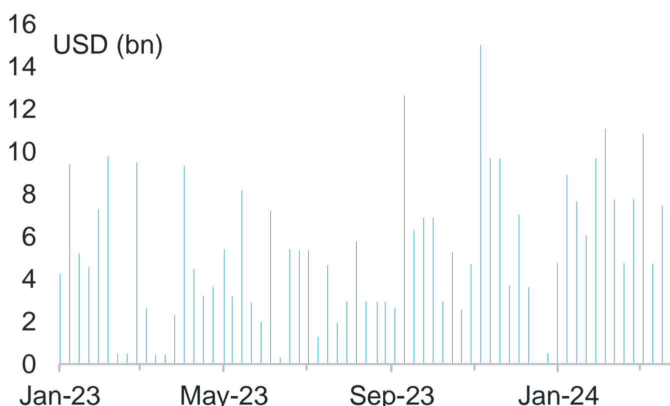
Global high yield (HY) returned 1.1% in March in local currency terms and spreads tightened by 8bps amid strong macro data, healthy new issue volumes and supportive technical factors. We lean towards rates staying higher for longer, but a stabilisation in the rates market will prompt us to shift up the credit quality ladder. A shift in the rates environment, resumption in residential sector transactions and clearance of troubled commercial real estate assets are pre-requisites for a sustainable recovery.

Maintaining conviction in riskier credits will depend on risk management sensitivity, embedded spread compensation and issuer alignment with creditor interests. That said, we are tactically underweight global HY as most of the good news is reflected in spreads and yields are healthy but no longer robust.

US HY returned 1.2% in local currency terms and spreads tightened by 14bps. The fundamental dilemma is unchanged - yields are healthy historically but spreads across leave limited margin for error. We retain an overweight in Bs and underweight in BBs and CCCs.

Capital market activity is positive in a backdrop of spread compression, strengthening equity markets and real economic activity. New issue volume ended the first quarter at over $87 billion, the highest since mid-2021, with the bulk earmarked for refinancing. We maintain an underweight in US HY amid unappetising spreads and decreasing margin for error. Sensible income capture and avoiding tail risks are key.

Healthy new issue volumes in US HY



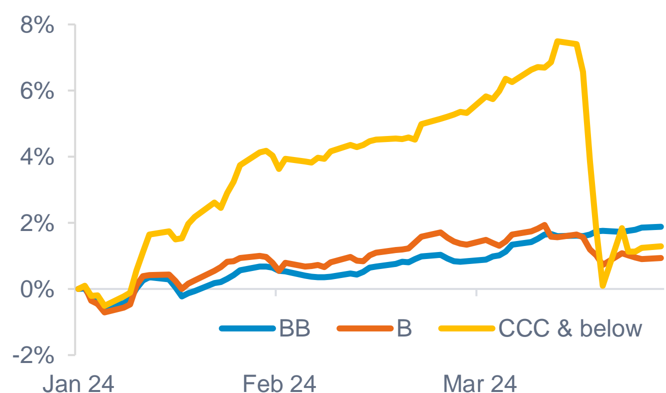
Source: Fidelity International, 31 March 2024.

European HY returned 0.1% in euro terms and spreads widened by 22bps. Idiosyncratic single name volatility emerged over the month. There was covenant deterioration in leveraged borrowers, which often means companies are taking forceful moves to deleverage.

While this may cause some discomfort for existing creditors, it will be positive if bondholders can elevate their claims and/or receive take-back equity in the business. It will help de-risk the asset class towards a lower leverage.

We maintained a tactical underweight in EHY as we think spreads do not compensate for the substantial increase in idiosyncratic risks. The majority of the universe is heavy in BBs with solid fundamentals, but more aggressive treatment of bondholders in the challenged capital structures of several large issuers raises contagion risks if rates stay higher for longer.

European HY cumulative returns by ratings



Source: Fidelity International 31 March 2024; ICE BofA Indices.

Asia HY returned 0.9% in March in local currency terms and spreads widened by 6bps. Fundamentals are supportive as earnings should remain robust as a number of issuers are exposed to stronger countries such as India or are in sectors with tailwinds such as Macau gaming.

China property is an outlier with weak earnings likely to persist. Primary activity has ramped up and new issue premium has increased. With reasonable earnings/funding access mix and technical support, and less compelling valuations we maintain an underweight stance.

Emerging markets

Monthly review

- Emerging market debt generated mixed returns in March, with hard currency sovereigns outperforming hard currency corporates.
- Within hard currency sovereign, tightening credit spreads along with lower US treasury yields buoyed returns.
- Local currency bonds posted muted returns, primarily due to rise in local yields while positive FX moves supported performance.

Strategy	– –	–	=	+	++
HC sovereign				●	
HC corporates		●			
LC duration				●	
EM FX			●	←	
China RMB			●		

Outlook

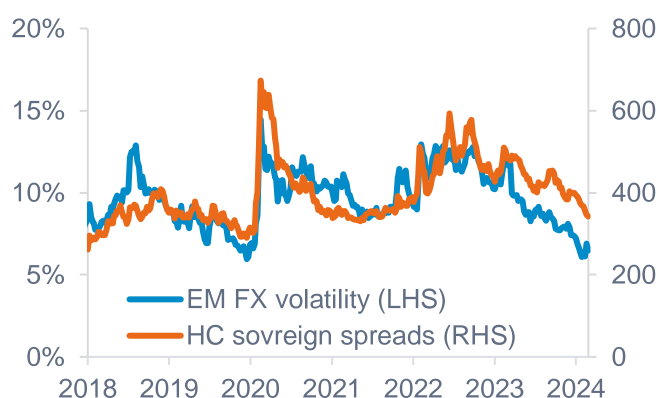
Emerging market bonds posted mixed returns in March, with hard currency sovereigns (2.1%) outperforming hard currency corporates (1.0%) and local currency bonds (0%). Hard currency sovereign credit spreads tightened over the month, supported by a positive global risk environment. Local currency bonds performance remains subdued driven by rise in local yields while positive FX moves supported performance.

We maintain an overweight in EM local duration, which is our highest conviction area. EM central banks that started rate hikes early in the inflation cycle are reaping the benefits of their credible policy. The EM easing cycle has been ongoing for several months, with Mexico the latest to join.

We favour local government bonds in Mexico, which is our largest position in terms of duration, followed by Peru, Brazil, and South Africa. Overall, it remains attractive to stay overweight rates for the medium-term, even as rate cuts become priced in, especially in counties with high real yields.

In EM FX, we trimmed exposure and moved to neutral. While some currencies have performed well, the implied volatility is low in EM, making us relatively cautious to remain overweight. We added some short positions in Euro and CNH and increased our long position in the US dollar.

EMFX volatility has fallen considerably since 2023



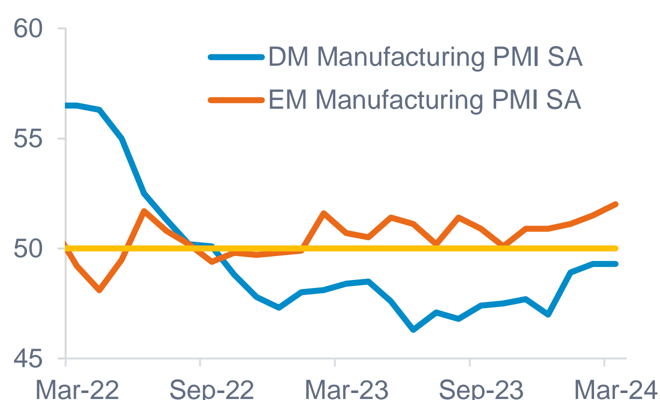
Source: Fidelity International, J.P. Morgan, Bloomberg, 31 March 2024.

However, we are still overweight in carry markets such as Nigeria, Egypt and Turkey. These are uncorrelated positions where central banks have turned orthodox after FX devaluations. Overall, we remain tactical in positioning and nimble.

In credit, we have a positive view on EM sovereigns and are running an overweight credit beta position. This is based on supportive fundamentals, positive technicals and favourable idiosyncratic developments in several HY countries including Pakistan, Egypt and Ukraine, which secured IMF support. This is helping the risk premium compression trade to continue with some alpha opportunities in lower rated cohorts of the market.

We remain overweight in Sub-Saharan Africa (SAA) and distressed sovereigns such as Ukraine. At the same time, we started reducing our credit beta as EM spreads elsewhere have tightened significantly. We moderated our exposure and booked gains in Ecuador and Zambia.

Manufacturing PMIs point to broadening recovery



Source: Fidelity International , Bloomberg, Indices used: MPMIDMMA Index and MPMIEMMA Index, 31 March 2024.

In EM corporates, we continue to remain bearish given that spreads have compressed significantly both in IG and HY names. We are cautious on the more levered parts of the universe, which has resulted in an underweight in credit beta. We are moving up in quality, continuing to reduce exposure following resilient performance in the last couple of months and valuations appear to be less attractive.

Quant appendix

Fidelity Fixed Income Quantitative Scorecard

29 March 2024

Credit beta and asset allocation

	TOTAL	Macro-economics*	Sentiment	Valuation	Seasonality
USD investment grade credit	0.28		0.5	-0.7	0.7
EUR investment grade credit	0.10		0.0	-0.0	0.7
USD high yield	0.68		0.7	0.1	1.0
EUR high yield	0.67		0.6	0.1	1.0
EMD sovereigns (USD)	0.21	1.0	0.2	-0.5	0.7

Comments: The model is turning more bullish on credit this month. Seasonality is acting as a tail wind for being long risk and the macro backdrop has improved for EMD hard currency sovereigns.
*The developed markets do not follow the macro signal in this model

Asset allocation	TOTAL	Macro-economics	Fundamentals	Sentiment and liquidity	Valuation and reversion
Investment grade credit	0.70	1.0	1.0	0.6	0.7
High yield	0.38	1.0	0.3	0.6	0.0
US loans	0.68	1.0	0.3	0.7	0.7
EM sovereign debt (USD)	0.27	1.0	0.0	0.4	0.0
EM local currency debt	0.60	1.0	0.0	0.2	1.0
EM corporate debt (USD)	0.42	1.0	1.0	0.9	-0.3

Comments: The model remains positive on taking credit risk with the signal drivers being broadly unchanged vs last month.

Interest rates

Duration	TOTAL	Global Growth	CFTC	Commodity	Cyc vs. Def	Reversion (return)	Reversion (yield)	Global momentum	Slope	Seasonality
EUR	-0.55	-1.00	0.29	-1.20	-0.11	-1.00	0.09	0.24	-0.37	-1.90
USD	-0.30	-1.00	0.29	-1.20	-0.11	-1.00	0.26	0.24	-0.07	0.10
GBP	-0.32	-1.00	0.29	-1.20	-0.11	1.00	-0.09	0.24	-0.02	-0.99

Comments: The model added to its bearish rates view this month. A strong commodity rally in March added to inflation concerns, whist seasonality is turning against Bund and Gilt.

Cross-market duration	TOTAL (beta-neutral)	`TOTAL	Slope	Real yield	Fair value	Growth	Inflation	Unemployment
AUD	0.00	0.10	0.10	0.40	0.19	-0.06	0.07	-0.12
CAD	0.00	0.12	-0.02	0.29	0.40	0.06	-0.28	0.24
CHF	-0.22	-0.31	-0.35	-0.78	-0.58	0.04	0.17	-0.35
EUR	0.07	-0.16	-0.33	0.21	-0.48	0.18	0.05	-0.56
GBP	0.13	0.22	0.35	0.51	0.33	0.06	0.14	-0.08
JPY	-0.24	-0.25	0.08	-1.32	-0.18	0.68	-0.32	-0.44
NZD	0.00	0.21	0.30	0.34	0.28	-0.33	0.12	0.57
SEK	0.10	0.16	-0.06	0.20	-0.35	-0.13	0.38	0.93
USD	-0.06	-0.09	-0.07	0.15	0.41	-0.49	-0.32	-0.20

Comments: The model was broadly unchanged over the month and continues to be long in EUR/GBP and is short CHF/CAD/JPY. The model also bought SEK vs EUR on the real yield signal as Swedish rates underperformed.

Quant appendix explained

Fidelity Fixed Income Quantitative Scorecard

Credit beta and asset allocation

Credit beta:
1. Sentiment: Technical indicators including trends in credit spreads
2. Valuation: Levels of spreads relative to history, expecting reversion to the mean
3. Seasonality: Indicator driven by historic returns in the corresponding period

Credit asset allocation:
1. Macro: Leading indicators including economic survey data
2. Fundamentals: Aggregated trend of single company forecasts for credit fundamentals
3. Sentiment and Liquidity: Technical indicators including trends in credit spreads
4. Valuation and Reversion: Deviation of spreads from their historic averages including adjustments for potential default losses and credit fundamentals

Directional duration:
1. Macro Future Activity Tracker: worsening economic outlooks are dovish, lead to lower rates.
2. CFTC: signal tracking the Treasury futures contract holdings of institutional investors.
3. Commodities momentum: a proxy for state of the economic cycle
4. Cyclical stocks outperformance: a proxy for economic optimism
5. Reversion (Return): deviation of price from their average historic value, expecting reversion to the mean
6. Reversion (Yield): deviation of yield 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

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. Fair value: forward yields adjusted for GDP trend, tend to revert to the mean
4. Growth forecast momentum: lower forecasts dovish, lead to lower rates
5. Inflation forecast momentum: lower forecasts dovish, lead to lower rates
6. Unemployment forecast momentum: lower forecasts are hawkish, lead to higher rates

TOTAL	Sentiment (1)	Valuation (2)	Seasonality (3)
0.35	0.5	0.1	-0.7
0.17	0.4	0.1	-1.0
0.01	0.1	0.1	-0.7
0.17	0.2	0.1	0.0
0.17	0.5	0.1	-0.7

TOTAL	Macro-economics (1)	Fundamentals (2)	Sentiment and liquidity (3)	Valuation and reversion (4)
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

Global growth (1)	CFT C (2)	Commodity (3)	Cyc vs. def (4)	Reversion (return) (5)	Reversion (yield) (6)	Global momentum (7)	Slope (8)	Seasonality (9)
0.46	1.42	-0.10	0.17	2.00	1.79	-1.84	-0.95	0.51
0.46	1.42	-0.10	0.17	2.00	1.28	-1.84	-0.69	0.14
0.46	1.42	-0.10	0.17	2.00	1.67	-1.84	0.09	0.07

Slope (1)	Real yield (2)	Forward yield (3)	Growth (4)	Inflation (5)	Unemployment (6)
-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

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