TRANSCRIPT

Selecting your bond portfolio in today's environment

Presenters: Christine Thorpe, Michael Danaher, Pete Stringfellow & Thom Maciula

PETE STRINGFELLOW: All right, well, thank you very much. I got to say I always love facilitating and participating in these sessions, largely because they are so informative, it's reminiscent to me of attending a college course, really listening to a professor or various professors present on their topic of expertise. So this topic in particular is very near and dear to my heart, largely because both sets of my parents, my direct parents and my wife's parents, are either just retiring or about to retire. So they ask a lot of questions related to how to replace their income stream, and fixed income is really one of the key topics that we look at when trying to mitigate volatility within a portfolio. So today what our presenters will be going through is first and foremost an overview of the bond market, so really the bond market in context given the current state of the environment. From there we'll get a little bit deeper into individual bonds, really investing in individual bonds and how one might go about building and maintaining a bond portfolio, maybe just as a sleeve of their portfolio. And then we want to get a little bit deeper into investing in separately managed accounts, which also gives direct exposure to individual

bonds. A lot of folks find that to be a very efficient way of getting exposure and again managing risk.

From there, we'll jump into some questions. So here to kick us off as far as our topic is Mike Danaher, our portfolio manager. So Mike, I'm going to kick it over to you to go through the current environment of the bond market.

MICHAEL DANAHER: Perfect. Thank you very much, Pete, and thank you, everybody, for being here today. I'd like to take a few minutes to provide some background on the current state of the fixed income market and the bond asset class generally so that you can have the information that you need as an investor to choose what type of fixed income strategy may work for you. So before getting to this chart here I'd like to take a little bit of a step back to level-set with everybody. When we think about the bond market so far in 2021, what have some of the major themes been? Many of them are probably things that you're already somewhat aware of. So for one thing there's been a strong global economic recovery coming out of the COVID pandemic. Businesses have been reopening. Vaccine distribution has been prevalent. And corporate profits have been remarkably strong. Additionally another thing that's been strong has been the monetary and fiscal policy support coming out of DC. So on the monetary side the Federal Reserve has kept

interest rates at the zero bound for the past 18 months. And their monthly purchasing of things like mortgage-backed securities and Treasurys has been very strong through their quantitative easing program. And additionally on the fiscal side trillions of dollars of federal aid for individuals and businesses has been doled out from the federal government through vehicles such as the American Rescue Plan and the CARES Act. Now those first two themes that I mentioned are interacting together to lead to the third and final theme that I'd like to present for 2021 so far, and that's the potential for inflation. It's rearing its head once more and it's an open topic of debate in the market in terms of how transitory that inflation may be. There's some pockets of the economy such as the used car market where supply chain difficulties may be temporary and allow inflation to abate over time, but there are other areas of the economy where inflation could potentially be more persistent such as in the housing market. And so those are some of the themes that have been driving us so far as we look at the bond market this year. Now it's time to see how these themes have impacted year-to-date returns, which you see on this great chart.

So generally the potential for higher inflation and normalization of central bank policy has caused interest rates to rise, and absent other factors bonds tend to move in the opposite direction to interest rates. As rates go up bond prices

generally go down. So consequently as you look to the left side of this chart in the olive bar Treasurys have posted a negative 1.4 percent return generally due to higher rates. Directly to its right in the light blue bar the US aggregate bond benchmark, 40 percent of that benchmark is comprised of Treasurys, so that benchmark's performance has been dragged down as well.

Now we still view Treasury's to be a useful component of one's fixed income strategy. They're very tradable. They have superb liquidity. So they allow investors to efficiently manage interest rate risk. Additionally they carry a full faith and credit pledge from the federal government, so they have very strong and high credit quality. But nevertheless they've had a negative absolute return so far this year.

How about on the other side of the ledger or the right side of the chart? Now I'll direct you to the dark green bar on the far right side. So TIPS, Treasury inflation-protected securities, are inflation-linked. Therefore higher inflation expectations in the market have been a real boon for that sector. TIPS have been a top fixed income performer. They're up about 4.3 percent year-to-date.

Other areas of the fixed income market that have performed well so far this year are emerging markets or EM and municipal bonds in the orange and navy blue bars respectively. So like I was mentioning earlier, absent other factors when rates go up prices go down but there's been a significant other factor in both of these markets, namely very strong investor demand. So looking at emerging markets, that tends to be a sector with a little bit lower credit quality, there's been a great reach for yield in 2021, so greater investor appetite for yield has been really supportive for that sector. And then for municipal bonds that's a higher credit quality sector but interest income on municipal bonds can often be exempt from federal income taxes, so investor desire for tax protection has been really prevalent there especially as Congress contemplates higher income tax rates in the ongoing reconciliation bill discussions.

Lastly, in the middle of the charts, investment-grade corporates and mortgage-backed securities have been in the middle of the year-to-date performance spectrum with muted returns. So for corporates, earnings, again they've been excellent, but valuations have been historically expensive. So for many of the strategies that I help to comanage, we're being very selective in terms of where we're adding corporate exposure at the present time. And for mortgage-backed securities the Federal Reserve again has been a really active

participant there. We're very closely paying attention to the Fed's anticipated tapering of monthly mortgage-backed security purchases which we expect could be announced in the November or December Fed meeting. So that's a recap of where we've been so far in 2021. What are we monitoring going forward?

Well, the last thing that I just mentioned is a critically important piece. Potential monetary policy tightening is going to be a huge catalyst for markets going forward and that again could come in the form of tapering in the near term and/or interest rate hikes as we look out later in 2022 or potentially early 2023. And so how will these tightening actions potentially impact financial conditions? And again another open question is will these actions begin to slow inflation in any way or is the Fed going to be a little bit late to the party and will have to take further tightening actions to rein that in. Additionally we continue to closely watch developments on the Delta variant and whether that will impact the job market or economic activity in any adverse way. And lastly as always we're analyzing political risk in DC, specifically infrastructure bill negotiations and debt ceiling brinksmanship. So we can go to the next slide, please.

Perfect. So that's the state of the bond market in 2021. I'd like to take the latter half of my remarks and address two main reasons why we believe fixed income should continue to remain a valuable trusted component of your portfolio during these turbulent times. So the first reason we want to cover in this chart, and that is that we continue to believe at Fidelity that bonds help to effectively diversify your asset allocation. And so over the past month you've probably noticed a little bit more stock market volatility. It's definitely been a while but it appears to be back. And so one great question is how do bonds perform during these periods of volatility. At Fidelity we believe that history can be a guide, and we think that this chart accurately reflects that. So we've taken a look at this in-house, and we've looked since the mid-1920s, so around the previous 100 years or so, and we've seen broken out on this chart that there are several yearlong periods where stocks have fallen. That's shown in the blue bars for each year. And what I'd point you to is the green bars here. What you'll see is for the majority of these times where stocks had negative full year performance, investment-grade bonds actually had positive returns. And what you'll see in every single bar is during these years of stock market underperformance bonds did better than stocks. Historically bonds generally have been a less volatile asset class than stocks. Another data point supporting this. Since the 1920s, again looking over the past 100 years, the worst three-year holding period return that you would have gotten in the stock

market is negative 42 percent. So it's without a doubt that stocks have been a strongly performing asset class but there are certain periods of time where you would have done quite badly. In the bond market your worst three-year holding period return over the past 100 years would have just been negative 1 percent, almost flat. So in our minds the old adage of not putting all of one's eggs into one basket continues to ring true. When combined with more volatile assets we continue to believe that bonds can help smooth out investment performance over the long run.

And with that we can go to my final slide. So the second virtue of bonds that I'd like to close with addressing is that they have a history of providing resilient returns across a variety of market cycles. So many of you have seen in the financial media concerns about rising rates. Very understandable. Let's talk about it. Let's bring that elephant in the room so to speak. So it's certainly true as we saw earlier with strongly rising rates this year certain pockets of fixed income have had negative year-to-date returns thus far in 2021. But at Fidelity whatever fixed income strategy you choose to work for you, we strongly advocate that you do so with a longer-term approach in mind. And so again this chart does exactly that. We've analyzed 150 years of bond market returns. And as a proxy for that you see Treasury rates in the green line shown on this chart. So certainly on the far right side the darker rectangle, that's the

fixed income bull market of late. That's gotten a ton of attention. Obviously interest rates have gone to generational and even historic lows. And bonds have performed well as a result. But I'd humbly ask you to consider the lighter rectangle or the middle of the chart as well. We experienced a four-decade period of rising rates from the post-World War II period to the early stagflationary years of the 1980s. And what you'll surprisingly see there is that annualized nominal investment-grade bond returns were still comfortably positive. And so how can this be? We thought that when rates go up bond prices always go down. Well, what's happening is that over the long run once again other factors can be at play. And in this particular case going through the data we found that increasing coupon income more than offsets the negative impact of price declines. So as yields go up coupons can tend to follow. And with higher coupons investors receive more cash flow on an annual basis to reinvest and capture these higher yields over time for the benefit of their portfolios.

So that rounds out my remarks. It's certainly true in 2021 that it's been a turbulent market. And various sectors of fixed income have been impacted in various ways. Sometimes to the negative. But in our opinion turbulence brings opportunity for astute investors. And over the long run we continue to strongly believe that bonds provide diversification, cash flow, and return

benefits to many client portfolios. And so now equipped with that market knowledge, it's time to dig into some of the ways that you can potentially go about crafting your bond portfolio and for that I'll turn it back to Pete.

STRINGFELLOW: All right. Well, thank you, Mike. That was very informative. Personally as I get questions from parents, family members, especially as market volatility comes into play, I always tell them, "Look, you have to have a good base foundation of knowledge and understanding around what's happening in the market." And from there, to your point, Mike, we look at how to find opportunities within the market. And largely that should align with your plan. Your timeframes, your risk tolerance, your goals. But when you really start to get into identifying opportunities oftentimes you start to focus on the individual bonds. So I'd like to welcome Thom Maciula to the virtual stage here to talk a little bit about building and maintaining an individual bond portfolio. And in particular through the resources and the tools that are available right within Fidelity.com. So with that, Thom, the floor is yours.

THOM MACIULA: Great, Pete, thanks very much. So following up on some of Mike's comments, when you talk about an individual bond or bonds in general, the real goal or the real objective that a bond investor is seeking is to reduce volatility in the portfolio and preservation of capital. And I think it's significant to note that if you were to buy a conventional bond, meaning a

fixed income with a set maturity, or fixed coupon I should say with a set maturity, you know the day you bought that bond exactly what your yield is going to be if you hold it to maturity and it's a good credit. Unlike a stock or a bond fund or stock fund for that matter. You really don't know what you're going to make on that investment until you completely exit. But with the individual bond you lock in your yield on the day you buy it. As long as you hold it to maturity and it's a good credit. So that's a lot different than some of the other alternatives that you buy at Fidelity.

Now Fidelity has a lot of online tools that make it really helpful when searching for individual bonds. And this slide touches on some of the steps that you can use. And I'll go into these in more detail to show you how to use the Fidelity platform online when selecting individual bonds.

Go ahead, and move to the next one. So one thing that's really significant about the fixed income landing page on Fidelity.com that makes us very unique when compared to a full-service bond house for example is Fidelity unlike that type of broker who's a primary dealer, we don't own and offer very many bonds. Most of the bonds that you get to buy in the secondary at Fidelity.com come to us through aggregators that are showing dealer-to-dealer offerings that our dealer desk sees from all the other dealers that we

talk to. So during the day you're likely to be able to view offers from over 100 different dealers, some of them are depicted on this slide. And we average currently approximately 75,000 unique bonds offered on Fidelity.com and 120,000 offerings. Now I think that relationship is particularly significant. And it relates to how messy the bond market is compared to the stock market.

Now you can go out and buy a share of Apple today. Everybody pretty well knows what the bid-ask spread is on one share of Apple. And it trades pretty efficiently at that rate. Bonds are a little different than that. And that's why Fidelity designed a really great platform for us to use to analyze the cost, the markup, and the fair pricing. So the ratio of 120,000 offerings but only 75,000 bonds reflects the fact that occasionally you'll find a big issue or new issue on Fidelity.com and there may be three or four different dealers showing that exact same bond to the Street and the Fidelity client base. And in all likelihood you're going to see three or four different prices. And those prices could range, could be different from $5 to $10, even $20 apart in some instances. Now the neat thing about Fidelity.com is we always default to the cheapest price for obvious reasons but you as an investor will be able to view online what those other dealers are offering bonds for, and what else is available in the Street at that point in time.

So really great platform. When you go online to search for individual bonds you can do a search engine. And this slide depicts that model where you can go in and you can create a very specific search for what you're looking for. And you can search for the maturity range that you're interested in. You can narrow the search to a specific credit rating that you're tolerant of for obvious reasons. You can narrow your search by coupon. By dollar price. By yield. Any number of different factors that become part of the process when selecting bonds. You can narrow your search online at Fidelity.com and then name that search and save it to your personal account. And the nice thing about that is once you put in a little effort and design that search based on your criteria as you accumulate cash or as the bond matures and you want to reinvest it, you can log in to your Fidelity.com account, refresh those same searches, and see what's currently available that meet those criteria. And you can do a number of different searches. There's eight people at Fidelity who do what I do, and we have a demonstration account we use to show clients how to set up those searches.

I noticed the other day on that demo account that there's over 80 saved searches right now on the demo account. Now I mention that just so you know you can save a number of searches online. But I also say if you're doing 80 searches you're probably overthinking it a little bit. Just know the capacity

there and the abilities there on Fidelity.com to save those searches is really helpful.

Whenever you find a bond online, typically once you click on that bond, there's a description page. And the slide currently shows a description page on a Toyota corporate bond that was offered on Fidelity.com. Now the nice thing about the description page is you're going to be able to see what the coupon is, if there's a call date you'll see that call date on the description page. If there's any material event that might affect the credit quality of the bond it'll be depicted on the right-hand side of the description page. If there's an something that's been in the media. There's a link to that article that you can read that may affect the quality of the credit.

Another thing that's really neat about the pricing page which is the second page of the description page is it will show you the third party pricing number that we put on every bond that's on Fidelity.com. It's a ballpark estimate of where that bond should trade based on what the market is doing, based on the credit quality of the issuer, based on the bond coupon, and the maturity date. But then another thing that is really helpful on the description page is you can view recent trades. So there's actually a link on there where you can click on recent trades and see what other customers have been paying for that

exact same bond recently, and see where it's even been trading in dealer-to-dealer transactions. It gives you a real good feel of what probably is a fair price for that particular security.

The bond ladder tool is -- oh, I'm sorry. I'm going to talk real quickly about alerts that are available to Fidelity clients. There's really two types of alerts that I recommend bond buyers consider that are available to them on their Fidelity account. The first is -- an alert is an e-mail that you can sign up for. And it'll send you one if there's a material event or an occurrence that affects a bond that you saved at Fidelity. So it's real helpful if you have a bond that got called unexpectedly. If you're signed up for that alert you'll get that alert. If that bond gets upgraded or downgraded you'll also get an alert to that effect, which is good to know. It helps you monitor the credit quality of your existing portfolio.

The second type of alert that you can sign up for and is what's depicted here on the screen is an alert for a new issue that Fidelity might be offering to clients. So I'm headquartered in Texas. I like to buy municipals. So I would probably want to be signed up for new issue Texas alerts. And the nice thing about that e-mail is when Fidelity participates in one of these sales, typically our clients have exclusive retail rights to those issues. The alert will come with

a preliminary scale, meaning it'll show the maturities that are going to be offered on the particular issue. A preliminary coupon that's set up on each maturity. And the pricing which also equates to give you what the yield is going to be on each bond. So if you're signed up for those alerts, you get an e-mail that advises you of a bond being sold on Fidelity.com and you're interested in it, then you can turn around and log in to your account and put in an expression of interest for one of those new issues. So I strongly recommend if you're a bond buyer to sign up for those two alerts.

The other advantage of getting the new issues too is it gives you a feel for what interest rates are doing in the market overall, and what direction they're going hopefully.

The bond ladder tool is a neat tool available on Fidelity.com. I'm going to back up a little bit and talk about what's a ladder. And a ladder portfolio is a basket of a variety of bonds that have a scheduled maturity at regular intervals, so that you could have a 10-year ladder, you could have a quarterly ladder. But basically what it gives you is regularly scheduled maturities when bonds roll out of the portfolio. And then ideally you reinvest at the end of your ladder every time you have a bond roll off. The beauty of the ladder is it provides some liquidity to the investor, to you. Because you've got a bond regularly

rolling off at regular intervals. The other thing it does is it kind of mitigates your interest rate investment risk. So over time as you continue to add to that ladder and extend out over time, hopefully you'll be able to ride the yield curve or capture most of the curve when doing so. Nobody ever gets to get all the highs. But hopefully if you're sticking with the ladder you have a good way of not always hitting all the lows too, or repricing your portfolio all at once at record low rates.

One thing about this tool I should mention. So it's great to use. Say you have $500,000 and you want to build a 10-year ladder, you can go in here, plug in that data, plug in the search criteria that you want, and then the model will go into Fidelity.com and specify specific bonds that meet your criteria that can fit into that ladder bucket. It takes a little bit of effort but at the end you'll get a recap of what it would look like, what the projected cash flows would be, what your yield would be on the entire portfolio, and your yield on each individual bond.

The other thing I want to mention that's good to know is if you start working with this and it becomes a little clunky, a little cumbersome, know that on the fixed income landing page on Fidelity.com there's an 800 number on the top right-hand corner as is depicted on this slide today that goes to the fixed income specialty desk. So if you ever need some assistance trying to put

something like this together, know that you can call the fixed income specialty desk and they'll be happy to help you at no additional expense.

The fixed income analysis tool online is one of my favorite Fidelity tools. If you have an existing portfolio at Fidelity this is really really helpful for you as an investor to stay on top of your bond portfolio. It's a three-page report. The first page lists each of your bonds by maturity. The second page is projected cash flow. And that is really one that all of our clients find most helpful. It's depicted here on the slide in the dark blue, light blue bars. The dark blue bars represent maturities rolling off in what looks like a fairly laddered portfolio each year. The light blue is the projected interest income anticipated on existing holdings for each year going forward. Know that you can change this to a monthly projection. You can also change it to a table which breaks it down in dollars and cents if you like. The other thing on the cash flow page that you can do is you can click on the events button. And if you have some callable risk in your portfolio, it would show that call risk when you click on the event button. And it'll help you to better maintain or spread out your call risk so you don't have the entire portfolio callable all at once.

And then finally the third page of the fixed income analysis tool is what I refer to as your bond portfolio from 30,000 feet. If you have taxable and tax-exempt

bonds in your accounts it'll break those down for you. It'll break down all the bonds by credit rating so you get a feel for what your average credit risk is. If you have a municipal portfolio it'll break it down by state so you can monitor and see that's diversified. If you have corporate bonds it'll break it down by sector. Again you try to maintain a little diversity by reviewing that exposure there. And if you have a CD portfolio, it'll break it down by bank. So you can see how much exposure you have to each bank that you're buying CDs. It also does an estimate on the duration of the portfolio which might be helpful as well. So again if you have an existing portfolio, fixed income analysis tool is a great resource to take advantage of.

Then finally I want to talk a little bit about cost transparency. Fidelity takes a lot of pride in being a high quality purveyor of financial services at low cost, and when you buy bonds in the secondary market like I've talked about today from those other dealers, we charge you $1 bond* or $1 per $1,000 to cover our cost to move that bond from that dealer inventory into your account at Fidelity. If you buy more than 250 bonds on any one trade, we cap the fee at $250. So if you bought 500 of one bond for example, we'd only charge you 50 cents a bond at that. Because again we're really just trying to cover our cost. As you execute a trade online at Fidelity.com we'll show you that $1 that's added into your total expenses. You'll be able to see that. If you're buying

*Minimum markup or markdown of $19.95 applies if traded with a Fidelity representative. For U.S. Treasury purchases traded with a Fidelity representative, a flat charge of $19.95 per trade applies. A $250 maximum applies to all trades, reduced to a $50 maximum for bonds maturing in one year or less. Rates are for U.S. dollar-denominated bonds; additional fees and minimums apply for non-dollar bond trades. Other conditions may apply; see Fidelity.com/commissions for details. Please note that markups and markdowns may affect the total cost of the transaction and the total, or "effective," yield of your investment. The offering broker, which may be our affiliate, National Financial Services LLC, may separately mark up or mark down the price of the security and may realize a trading profit or loss on the transaction.

real short bonds that $1 could move your yield slightly. But it'll be disclosed when you pull up that sales ticket before you execute the trade. So you can decide not to if you feel like the $1 bond is too much. But we display all that right up front being transparent.

This slide depicts the fact that in most full-service bond houses that I talked about earlier that own and offer mostly their own inventory, they tend to mark up bonds, but they don't disclose to you the investor what that markup could be. And in some instances we see $5, $10, $15, and even $25 a bond or $25 per $1,000 that you're paying for and kind of adversely affects the yield on your bond portfolio. So know that at Fidelity we want to be transparent in our cost and help our clients get the best price they can find in the market.

Now Pete, I touched on a lot of really neat tools here today. I'm real proud of what Fidelity provides its bond investors because it really is dynamic. There's a lot of things you can do online if you like. But I also know there's going to be clients in our audience today who are going to say, "Gee, that's really neat, it's neat that Fidelity does that, but I'm not sure I want to put that much time into my bond portfolio, or I'm not sure I want to get my hands that dirty." If that's the case what would you suggest at that point?

STRINGFELLOW: Well, Thom, I think that if we think about human psychology we tend to go with the basic security that makes sense and that's low-cost, looking at individual bonds. So as you just showed, it's really really easy and very simple to do research and find all these great opportunities right across the marketplace within Fidelity.com. For some it might be a little overwhelming, but they want to maintain that exposure to individual bonds for whatever reason. Folks will oftentimes look at funds for exposure. But in particular in a rising rate environment there seems to be concern that a lot of clients have with funds. Now Mike hit on the fact that as rates go up coupons tend to follow and typically offset any sort of price decrease or depreciation within the individual bond space. But again oftentimes there's concern that folks have in the fund space. So one option that a lot of folks like to look at but don't have a lot of education on is investing in a separately managed account. So I'd like to welcome Christine Thorpe, one of our institutional portfolio managers, to the virtual stage here to talk a little bit about investing in individual bonds through separately managed accounts. So with that, Christine, the floor is yours here.

CHRISTINE THORPE: Great. Thanks, Pete, and feel free to go to my first slide. First, let me just say I'm thrilled to be here to speak with you about our fixed income separately managed accounts or SMAs, and I want to use this time to explain what the product is and give you some insights into our portfolio

management process. First, an SMA is an account that is comprised of individual securities that are owned directly by a client. The key distinction is that those bonds or securities are professionally managed and overseen by a portfolio manager such as Mike Danaher, who you heard from at the top of the presentation. Now there's a couple of advantages to using an SMA for your fixed income exposure. First, the portfolio managers use their investment expertise to pick out bonds for each portfolio and to ensure that they are diversified across sectors, maturities, and credit quality. But our process does not stop there. For our SMAs we also make sure we monitor the accounts daily to determine if we need to rebalance or reinvest coupon payments or maturities.

We're also working with our fundamental and quantitative research analysts and trading teams to monitor the names we've bought to determine when we should liquidate a position and find better opportunities in the market. In addition to the portfolio construction and the oversight we provide, the other advantages of an SMA can include transparency into your account holdings and trades, as well as some ability to customize across certain parameters for our taxable and tax-exempt strategies. And with that, Pete, could you go to the next slide, please?

Now the two SMA products that are managed by Fidelity's fixed income investment team are our intermediate municipal and core bond strategies. I'll share more about them in a bit. But first, while they focus on different fixed income sectors, it's important to understand that our investment philosophy for both is the same. We're trying to strike a balance between the opportunity to generate income and deliver capital appreciation while prudently managing risk over the long term.

There's two components to how we do this. First, we're focused on making decisions that are based on fundamental research rather than trying to place bets on which way interest rates will move. I want to emphasize that fixed income is a complex asset class, particularly given its size. The US bond market is estimated to be over $50 trillion, and that is spanning a wide variety of sectors and security types. To support our ability to parse through all of this, we have a large fixed income research team comprised of over 100 research professionals who provide our portfolio managers with critical and thorough credit analysis and sector perspectives. Often our research analysts are calling the issuers directly or combing through lengthy offering statements or prospectuses to ensure we have the full picture beyond what summary statistics can provide. Our analysts also take advantage of the broader Fidelity resources which can include conferring with equity analysts to understand

what's going on with a corporate issuer or getting updates from our asset allocation research team to better understand the impacts of monetary and fiscal policy or inflation on the broader economy.

Through this we're able to be nimble and react quickly to market opportunities. For example in our core bond strategies we often participate in new corporate issues that come to market, which can offer significant value for investors. We also work to maximize yield in a way that takes into consideration various risks such as changes in interest rates, rating downgrades, and liquidity. This approach allows us to find other opportunities that some may want to shy away from or not have access to. As you may know, credit rating agencies such as Moody's and S&P rate bonds on their creditworthiness and this rating is an important price driver. Because of all of our investment in our proprietary tools and our significant research capabilities we're oftentimes comfortable buying names that may carry a lower credit rating, but where we think the issuer is on solid financial footing. As a result of this we can find opportunities that are undervalued by the broader market. Although investment-grade bonds, as we've talked about today, typically do not carry the same volatility as stocks, their value may fluctuate up and down, particularly as interest rates change. We've seen some of that this year as Mike spoke to earlier. So it can be hard not to react to this. However, that's

where we try to add value as an active manager. Our approach is to provide a steady hand and not trade based on every instance of volatility, but to stay focused on managing risk and looking for opportunities to create value for our clients over a longer time horizon. And with that, Pete, if you could go to the next slide, please.

Our investment process is really how we put this philosophy into action. I spoke earlier about the complexity of the bond market. And one of the best examples of this is when you compare the major equity indices with those that are used for fixed income. Now the S&P 500 not surprisingly covers 500 publicly traded companies. For comparison the Bloomberg Aggregate Bond index has close to over 7,000 bonds issued by corporations alone, and that's not even the full index composition. Other sectors in the index include US Treasurys and government-related bonds and mortgage-backed securities to name just a few. Similarly the muni bond index has over 50,000 bonds and that covers a multitude of state and local entities that issue debt along with public transportation systems, utilities, and nonprofit hospitals or higher education entities.

As we construct our portfolios, our active management team navigates all of this through a few key steps. First, our quantitative team screens out

unsuitable bonds and narrows potential names to purchase based on our fundamental views and our risk parameters. From there we consider the inputs of our research analysts and we're often hopping on quick calls to get their latest views on a name we're considering taking action on.

In addition to this we're layering on our trading team's insights and getting their perspective on relative valuations and the most effective way to execute our transactions. Ultimately our portfolio managers are evaluating all of this information and utilizing their investment expertise and macro perspectives to make the final decisions on what is traded in each account. A big part of this process is of course deciding what to buy, but we also spend a lot of time and effort evaluating if we need to rebalance an account to manage risk, or whether we should sell a bond prior to maturity, or if we want to exit a position because our investment thesis has changed.

A perfect example of this is a decision we recently faced for some of our muni bond accounts. A few weeks ago one of our research analysts alerted us to a regulatory issue they were monitoring for a Midwest coal-fired power plant. There were discussions in the state legislature about decommissioning the plant, which would have really impacted the credit profile of the bonds we held. We also learned that due to some of the regulatory concerns the entity

was going to pull back from issuing new bonds. Given this backdrop we were not comfortable continuing to hold these positions and we worked with our traders on a liquidation strategy to take advantage of strong demand in the market for similar bonds. As a result of our team's quick work, we were able to exit the positions before the broader market surfaced the same concerns, which would have had a negative impact on pricing. This type of collaboration across the team and our ability to move quickly lets us keep the focus on delivering strong risk-adjusted returns over the longer term and across a variety of market cycles. Next slide, please.

As I mentioned there's two major types of fixed income SMA strategies we manage here at Fidelity. The first is our intermediate muni strategy, which provides the opportunity to earn some tax-exempt income. Within this bucket you can opt for our national offering, which is buying muni bonds across the country, or California and New York residents can opt for our state-specific strategies. We also provide the option to exclude bonds subject to the alternative minimum tax.

Our second strategy is for our core bond portfolios. Now we work to diversify these accounts across the various investment-grade sectors and we also offer the ability to do some customization such as excluding certain issuers or

sectors. Since these are both intermediate strategies, we run them with a duration band of four to six years to help us manage risk. Duration is a measure of how sensitive bond prices are to changes in interest rates. Although an intermediate strategy may be more sensitive to changes in rates than one with a shorter duration, the upside is typically the ability to earn higher coupons.

We also seek to obtain this income from investing primarily in high quality bonds with low default risk to protect principal. The portfolio managers spend a lot of time analyzing the opportunities and the risks associated with each bond that goes into clients' accounts but they also give the same consideration when evaluating a portfolio as a whole. This means the investment team spends a lot of effort again working to ensure broad diversification so that declines in one sector can be offset by another. Our goal is to provide investors with a total return that takes into account yield and price appreciation while managing risk in a transparent way so that clients can understand their portfolios. We believe strongly as I think you've heard several times today that it is really important to have an allocation to fixed income in your account in order to provide stability and diversification. And our SMAs may be the right fit if you prefer professional management to navigate all these challenges and nuances of the bond market that we've

discussed. Pete, now that we've walked through our approach to fixed income SMAs, can you show everyone where they can find information if they'd like to learn more?

STRINGFELLOW: Absolutely. Thanks, Christine, for going through that. I think that oftentimes when we start to consider exposure to any asset class, in this case we're talking fixed income, we want to just jump in. We want to jump in and find opportunities that hit the bill or hit the mark and would work for us based on our approach or our process. Now one of the things that I really loved about Christine's piece there was seeing the process that a professional management team will take to make decisions. I also love the fact that we can combine that with some of the content that Thom showed, for example alerts, in being able to stay up-to-date on what's happening within the holdings that we own or that we're thinking about owning. So when you go into the news and research tab within Fidelity.com and down about halfway you'll see fixed income, bonds, and CDs, this is the fixed income, bond, and CD landing page here at Fidelity. So really everything that Thom went through aside from the fixed income analysis tool is located within this landing page. There are actually some really great insights you can glean continually from the research and markets section of the landing page, which is a great way of staying on top of what's happening within the current environment, really staying on top of

what really Mike showed us earlier. When you get into finding bonds and CDs, the first link in really the section of the page you're taken to upon clicking on fixed income, bonds, and CDs, that's where you'll see really a yield table. Think like the yield curve in tabular form based on the highest-yielding opportunities across the sub-asset-classes of the market in varying maturities. But if you want to explore your options within the SMA space for example or other managed solution space to get that lower volatility exposure within your portfolio, take a look at the managed accounts tab. So you'll notice here that you've got the yields. That's the table I mentioned a moment ago. Go into bonds just broadly. You can look at new issues, you can look at CDs and ladders, annuities, funds, ETFs, and then managed accounts. So you can get the details.

So we've gone through a lot today from the state of the bond market to identifying individual bonds that might make sense within your portfolio and really looking at maybe managed solutions that give you exposure to those individual bonds. But there are a few key takeaways that we want to leave with you all. And first and foremost it's that fixed income can contribute and does continue to contribute to mitigating portfolio volatility relative to just the broad equity market in particular.

You also have a lot of transparency within the resources that Fidelity provides you. Which is in my opinion critical if you're going to make decisions on your own, is to ensure that you have a transparent ability to see what things cost you, what is happening with different issues that you might be considering, and then making decisions based on your process. If you don't have a process it makes sense to consider or at least research and become educated on managed solutions for fixed income exposure. And from there really thinking through what managed solution might make sense if you are abandoning the approach of running things on your own. So Christine did a phenomenal job of introducing us to SMAs, separately managed accounts, and how we can get exposure through those separately managed accounts.

END OF AUDIO FILE

In general, the bond market is volatile, and fixed income securities carry interest rate risk. (As interest rates rise, bond prices usually fall, and vice versa. This effect is usually more pronounced for longer-term securities.) Fixed income securities also carry inflation risk, liquidity risk, call risk, and credit and default risks for both issuers and counterparties. Any fixed income security sold or redeemed prior to maturity may be

subject to loss. The municipal market can be affected by adverse tax, legislative, or political changes, and by the financial condition of the issuers of municipal securities.

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A bond ladder, depending on the types and amount of securities within it, may not ensure adequate diversification of your investment portfolio. While diversification does not ensure a profit or guarantee against loss, a lack of diversification may result in heightened volatility of your portfolio value. You must perform your own evaluation as to whether a bond ladder and the securities held within it are consistent with your investment objectives, risk tolerance, and financial circumstances. To learn more about diversification and its effects on your portfolio, contact a representative.

The Fixed Income Analysis tool, and Bond Ladder tool are designed for educational purposes only and you should not rely on them as the primary basis for your investment, financial or tax planning decisions

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All indexes are unmanaged, and performance of the indexes includes reinvestment of dividends and interest income, unless otherwise noted. Indexes are not illustrative of any particular investment, and it is not possible to invest directly in an index.

Bloomberg U.S. High Yield Index is a market value–weighted index that covers the universe of dollar-denominated, fixed-rate, non-investment grade debt.

Bloomberg Emerging Market Bond Index is an unmanaged index that tracks total returns for external-currency-denominated debt instruments of the emerging markets.

Bloomberg U.S. Corporate Investment Grade Index is a market value–weighted index of investment-grade corporate fixed-rate debt issues with maturities of one year or more.

Bloomberg U.S. TIPS Index is an unmanaged index that consists of inflation-protected securities issued by the U.S. Treasury.

Bloomberg Municipal Bond Index is an unmanaged index that includes investment-grade, tax-exempt, and fixed-rate bonds with at least one year until final maturity selected from issues larger than $75 million.

Bloomberg U.S. Aggregate Index is an unmanaged index that tracks domestic investment-grade bonds, including corporate, government, and mortgage-backed securities.

The Bloomberg U.S. Mortgage-Backed Securities (MBS) Index tracks agency mortgage-backed pass-through securities (both fixed-rate and hybrid ARM) guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). The index is constructed by grouping individual TBA-deliverable MBS pools into aggregates or generics based on program, coupon and vintage. Introduced in 1985, the GNMA, FHLMC and FNMA fixed-rate indices for 30-and 15-year securities were backdated to January 1976, May 1977, and November 1982, respectively. In April 2007, agency hybrid adjustable-rate mortgage (ARM) pass-through securities were added to the index.

Bloomberg U.S. Treasury Index is a market value–weighted index of public obligations of the U.S. Treasury with maturities of one year or more.

The IA SBBI U.S. Intermediate-Term Government Bond Index is a custom index designed to measure the performance of intermediate-term U.S. Government bonds.

IA SBBI U.S. Long-Term Corporate Bond Index is a custom index designed to measure the performance of long-term U.S. corporate bonds.

Standard & Poor's 500 Index (S&P 500 Index) is an index of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.

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