Benefits and risks of owning individual bonds, bond funds, and bond ETFs

Richard Carter: Good afternoon, everybody. Thanks for joining us today in this presentation, where we are going to be looking at the current market — the bond market, that is — and then we’ll look through bonds, bond funds, and bond ETFs. As you can see from the agenda, we’ll start with the bond market context and then move into the product-specific elements of the presentation. So let me begin and introduce again Beau Coash. Beau is an institutional portfolio manager. Could I start with you, by asking — you know, we’ve just had a Fed meeting last week; the Fed’s elected to leave things unchanged. So where does this leave us? Is the Fed done, do you think, raising rates this cycle? If so, have they been able to raise rates enough to help the economy, should it need it?

Beau Coash: Yeah, so that’s a great question; a lot of folks are focused on this topic. As everyone remembers, October 3rd, Jerome Powell said, “We are not anywhere near neutral rates.” Neutral rate is the rate at which we have enough interest rate in the marketplace for the economy to do well and not put it under. And so at that point in time the market got really scared that the Fed was going to move rates several times from there and disrupt the — kind
of the rebound that we’ve had since the Great Recession. And I think Jan. 4 came out and said, after a little bit of rough sailing from markets and feedback from around the globe in terms of slowdowns, that “I think rates are high enough.” And so you can see, if we go to the dot plot of said funds target rate, how low those rates were way back in 2013 through ’15, and you can see the Fed started raising rates, and now you’ve got a forward-looking guide here at the right-hand side of the chart, with the dotted blue line showing you that the market is thinking that rates are going to come lower versus where we are today, and you could see the Fed voters in those dots, with the median vote just slightly above. That used to be a bit different, where the Fed votes used to be much higher than the marketplace, but this is telling us that the Fed has got it just about right, and they’re pretty closely aligned with the market. So we think that the Fed is likely not going to raise rates unless we have a robust return to 2.5, 3% — even probably 3% growth to get rates higher from here. So we think we’re pretty much in a lower-rate, lower-return — lower kind of return environment. Typically, end of cycle, you get the 4.5, 5% of Fed funds; today we’re at 2, 2.5, roughly, 2.4%, and we’re going closer to 2, most likely.

**CARTER:** Right. I mean, you know, one of the things we hear a lot about is the Fed trying for that 2% inflation bogey, and it’s proving difficult. So could you just
elaborate on that score? You know, what do you think, for the medium-term, are the chances of that ever being met in this cycle?

COASH: Right, so the Fed has got two mandates. It’s employment, so employment, and also to get inflation to the right level — we get to the right level at 2, 2.3% is really their target — 2.3%; we’re just slightly below that now, and it’s unlikely we have — you know, just so difficult to get wages, that wage is up, and now we’re getting a bit of a rollover in terms of shelter, core — if we look at core inflation, about 40% of that number of core inflation is housing and shelter, which seems to be rolling over a little bit, and that’s due to the higher rates that we saw or the anticipation of higher rates through the fall. And that may change over the next six months or so. So right now the market is not feeling like we’re going to get overheated inflation, so the worry is not around inflation. And then if you look at longer-term, you can see, really, the other thing that drives rates and inflation is GDP. And we’ve broken out two components here, productivity and labor-force growth. And you can see in both of these scores, the economy, or the US, is in not such great shape in terms of productivity. We peaked back in 1969 for that metric, and for labor-force growth in the early ’80s, and those numbers have been coming down with the aging populations. And so you can see that it’s going to be a bit challenging to get the inflation numbers that are going to go much above Fed
target — it looks like we’re going to be maybe slightly below Fed target for a bit here, around 2% — you know, 1.9 to 2% CPIs.

CARTER: Thanks, Beau. So there’s a pretty compelling long-term trend there. What about the — I think in the back of people’s minds there’s always this fear of a shock, some inflation shock or sudden, you know, Fed-inspired shock, even. What would that entail for the bond investor today at such low rates, do you think? I mean, is there a risk there?

COASH: Yeah, so we don’t think there’s a big risk. We’ve actually sold a lot of the TIPS, which would protect you against inflation, in our fixed income portfolios. We’ve sold those down — we have now very small amounts of inflation protection; we just think the Fed’s going to be on the sideline, we think that GDP is contained at roughly 2.5 to 3%, so we’re not overly concerned. But there are many tools you can use, you know, going at the curve for duration, but owning TIPS — there’s lots of things you can do to protect. And we had those on when the Fed was more aggressive, bringing inflation at the lows, and 2016 was as low as 1.2%; Fed got it all the way back to 2.2%, roughly, and now we’re back to 190 to 2% CPI to our inflation-type levels.

CARTER: Right, right. But, I mean, when you say would they suddenly find some reason, or some reason for overheating, I think you indicated that, you know, a
A diversified bond portfolio gives you the coupon flow, right, to ameliorate the sort of capital loss that might happen in a short time span.

**COASH:** Yeah, you need a good cushion, and the chart that’s on the page now is bond returns versus interest rates. You can see a couple of these periods, you know, we had a negative 2% in 2013, that was the taper tantrum when the market was really fearful of rates going a lot higher; the market took rates up 100 basis points even though the Fed didn’t take rates up at all, and you can see what happens when there’s fear of inflation. But then again, once things calmed down, the returns came back nicely, a bit over 5% the following year. So there’s ways to protect against inflation, and you’ve got to — you have to have enough carry in your portfolio, enough coupon in your portfolio, to overcome some of the inflation fears. Because you just won’t keep up with inflation if you’re in the front end of the curve.

**CARTER:** Yeah, right. And, I mean, that is a great chart. But I think a lot of the clients and viewers today will be asking themselves — you know, we’ve heard a lot lately about the flattening yield curve, and the fact that it may be hard to find that extra yield from the long end. Is that something you’re concerned about, the yield curve?
COASH: No — yeah, and we — you know, with the Fed moving rates up to 2%, and we have a chart in here around the flattening yield curve — that’s a great setup for this slide. So what we’ve done here is we’ve marked off the recession periods. Back in the early ’90s, you could see 2001 and 2002, and then the Great Recession. We’ve also then subtracted Fed funds from the 10-year yield, and to show that, that’s the blue bar that’s going across. And the market’s been a very knee-jerk reaction to seeing flattening yield curve to inverted, and saying, oh, my gosh, there’s a recession. We look at charts like this and we say, “Hold on a second, it’s got to be very persistent for a long period of time to get us too concerned that we’re going to have a recession.” So in the mid-’90s, you had several years between going flat to inverted before we had a recession in 2001, 2002. So you had a long run there, with, by the way, the 10-year rallied all the way through that. You had the same kind of trade back in the mid-2000s, with a flat 10-year yield all the way through that, but you needed to get — we had about two years of inversion or flattening before we had the Great Recession. So you’ve got plenty of time, and we’re in an economy now where we’ve got much lower all-in rates to start. The rates back in the mid-’90s and 2000s were a couple hundred basis points higher starting levels. You can even go back to 1994, when the Fed moved seven times, and the last three times were two 50 basis point moves and a 75, and still didn’t get a recession off of that move. So we think we’re in a decent
economy right now, we’ve got decent earnings — this past quarter’s earnings came in; they beat expectations that got lowered. We still think that we’re in a relatively good economy for companies, and that the US is probably the best place to be from an investor perspective. So we don’t see an inversion leading to or flattening the yield to a recession, short-term.

CARTER: OK, well, that’s well-said. How about we dive a little bit deeper, maybe, into some of the components of the economy that might flash amber when the recession comes? So the corporate sector, how about — can we look at corporate bonds, Beau? Would you mind just taking a look?

COASH: Not sure you can go a day without reading an article today about the concern around credit and corporate bonds. And here we talk about one of the biggest topics that’s been in the marketplace and the concern around the growth of the corporate bond market and the amount of triple-Bs in the index. You could see, upper-left-hand panel, the growth — we have gone from 1.9 trillion to roughly 5 trillion, and in the right upper panel, the growth of triple-Bs from 34% to just under 50%, so people get concerned. What people aren’t focused on is these are companies that have done a lot of this intentionally, through M&A activities. Also, they’ve got a lot more leverage than they did in ‘07, but they have coverage levels that are very good. So even if our earnings
over interest payments are double what they were, or 40% of what they were, or almost 60% of what they were in ‘07 — so they’re much better than they were in ‘07, because the coupon that companies are paying is half of what it was. The companies have much cheaper access to credit, rates are much lower, so they can take more debt out — that’s the simplest way to say it. And if you look at the bottom right hand of the panel, you can see some of the largest companies — AT&T/Verizon downgraded. InBev, that’s Budweiser, they’ve taken a lot of debt on to do M&A, but they’re now reducing some of that debt. AT&T/Verizon is also reducing their debt. CVS bought Aetna; you can see that’s been a big addition to some of the triple-B growth. GE has had their own problems; we all see that every day in the press. And then GM and Ford have gotten upgraded. You know, just as an aside, Ford’s got something like $23 billion on their balance sheet, getting ready for maybe the next cycle. So they’ve got plenty of capital in it, so if you’re an investor, you might think about where do you want to be on that curve, but they just bought a two-year deal at 5%, which looked very attractive.

Carter: Well said.

Coash: So Ford was a cheap deal, and some of these other names have done a nice job getting their debt back into line or reducing some of their debt.
CARTER: All right, Beau. Thank you. Let me — just to summarize, you know, you could just show the audience here, like, how you look at — as we’ll see more from Mike and Lee in a few minutes, the different types of the bond universe — you know, it’s not a homogeneous market; there’s many sub-markets within it. How would you, you know, suggest people can approach the different risks and rewards that are out there today?

COASH: Yes, great. So what we’ve done — we have three slides in here, but I’m just going to focus on the 10-year slide, the last slide. When you get this deck you’ll have access to all three, but the story’s the same. And typically what you’ll see is, when you look at a slide like this — how much risk am I taking? — that’s the standard deviation on the X-axis, and then — how much return am I getting for the risk that I’m taking? — that’s the Y-axis. You can look at the curve and you can see short-duration you’re just not getting a lot of yield; long-duration you’re getting the most yield, but you’re taking the most risk. So you’ve got to figure out, where do you want to take your risk-reward along this food chain? The other thing I’d point out is the passive bonds are below that efficient frontier line. So all different kinds of ways to add value and go along that spectrum, but be prepared, you will have — with the more risk to your
asset classes, you’ll have some short-term draw-downs, so you have to stick with some of those strategies.

**CARTER:** Great. Thank you, Beau. OK, well, that’s terrific. Thank you, and nice note to end on. So with that in mind, let me now turn to Mike Hodapp. Mike is a regional brokerage consultant out in the New Jersey area, and focuses on helping out clients with individual bonds. So let me start with you, Mike, if you’re out there... to what extent would you say, Mike, the retail investor is interested in investing in individual bonds these days?

**Michael Hodapp:** Oh, sure. Thank you very much, Richard. Good afternoon, everyone. When we’re looking — before we really get into the deep dive on individual bonds, how you research, how they’re priced at, what the market looks like, it’s best to really provide the context around bond markets and ownership — who owns them? On the slide on the screen, we have two pie charts that are showing the US treasury market and the muni market. Very different markets. We have the various owners that are listed under each one, from individuals to mutual funds, pension funds, state and local governments, international governments. The treasury market is $15.3 trillion, significantly larger than the muni bond market, which is $3.8 trillion — so three to four times larger, the treasury market is. Now, this webinar is geared for the
individual investor, so I want to focus on that segment. It’s in the dark green of the two pie charts. So if you notice, they’re very similar. On the treasuries it’s 1.90 trillion. On the munis it’s 1.77 trillion — but much different makeup as far as the overall market. Individual owners in the US treasury market make up 12% — that’s a good chunk — versus the muni ownership; they make up a whopping 46%. So very different type of makeup of individual bond holders and how much they own of a particular market. I think it’s important to really look at what’s the growth in these markets over the past decade or so. On the table on the right, this is going to show us our growth. If you notice, in December of ’07, all three markets, treasuries, municipals, and corporates, are relatively the same size — 4.5 trillion, 3.5, 5.3 trillion. The treasuries over a 10-year period have grown 240%. That market’s now 15.3 trillion. The municipals, the supply has stayed relatively the same — it’s 3.8 trillion. That’s only an eight percent increase. And then the corporates, as Beau had talked about earlier, the corporates have really stepped up their issuing. That market’s increased in size to 73%. So you can see, the dynamics for the markets are very different here.

CARTER: Thanks, Mike. And so with that in mind, then, you know, there’s a great — nice deep dive into those two products. Tell us about maybe some other products that individual investors could invest in, and maybe elaborate about
what they should be aware of when stepping into other segments of the bond market.

HODAPP: Sure, yeah. Great point, Richard. The bond markets are not homogeneous. When you look at whether it’s high-quality, low-quality, corporates, munis, or treasuries... much different markets. And when doing research, it’s really important to kind of take a look at how these different asset classes perform. On this slide we see a nice bar chart that’s going to be segmented by the types of bonds, and it’s going to show various performance over seven different select years — these are not seven years in a row, but we picked seven years over the past decade, and how they look. HY-Corp, that’s high-yield corporate bonds. High-yield is the nice way to say junk bonds. These are bonds rated on the S&P scale double-B-plus or below. You can see there’s some pretty wild swings here, from ’08, which posted a huge negative loss, to ’09, which was a huge positive gain. IG Corporates, those are investment-grade — those are triple-B-minus or better on the S&P scale. And you can see, it posted the same type of results, but the swings were not quite as large. A loss in ’08 and a nice gain in ’09. The muni market was even a little bit tighter as far as the volatility goes, and as we’re moving from left to right you can see the volatility, the swings in performance, have actually — are much tighter. The muni market posted a slight negative loss in ’08, and it
posted a nice healthy gain in ’09. The US Agg, that’s the — what is the aggregate market? That’s the taxable US market. So it’s everything from treasuries to corporates. This is the entire market. You can see that was even tighter. If you notice, the aggregate is actually positive in ’08, and that’s due basically to the treasury outperformance in ’08. So you can see the treasuries performed significantly well in ’08, and that basically has to do with flight to quality. So those annual returns in ’08 was really a nice shiny spot within the market. As we are considering individual bonds, there’s a few things to consider here. Addressing the bond sectors and features, this is just what we talked about — the difference between a junk bond and investment-grade; should I be in munis or corporates or treasuries? How do you feel about risk and reward? And that’s really what we need to put this in the context of. How you’re assessing credit ratings — there can be multiple ratings across different agencies, and it’s important to know the history of ratings. Has a particular company or municipality, do they have a history of upgrades or downgrades? And assessing liquidity. If you buy a bond today, if you need to sell it tomorrow, what’s that liquidity look like? And then also assessing diversification at that standpoint.

**CARTER:** Thanks, Mike. Well, certainly a lot of great considerations that you put out. I mean, we don’t really have quite the time today to do them justice as topics
in themselves, but maybe you could walk us through some of the experiences that customers can enjoy themselves by going onto one of the Fidelity.com sites, and, you know, keeping these things in mind, these factors in mind, as they do their bond research.

**HODAPP:** Yes, great, so how to get started. I’ll talk to our landing page. Our landing page, you’d go up to News and Research in the top green portion of Fidelity.com. Hover over it with your mouse and you click on Fixed Income Bonds and CDs. That brings us to this page, our landing page. We have sub-tabs on the landing page, as highlighted by the gray box #2. Finding Bonds and CDs, that’s the page that’s listed — Research and Markets, which we’ll explore a little bit. But we also have Bond Tools, Services and Solutions, and Understanding Bonds, which brings us to the Learning Center on a whole slew of subjects. Numeral 3 here, this brings us to the yield table. The yield table is a searchable table; each one of those blue percentage returns is actually a link that you can click on and see the bonds that make up that segment. It’s organized by maturities across the top, three months to 30 years, and the various types of bonds on the left-hand column. CDs, Treasuries, Agencies, Corporates; below that, we didn’t have the real estate to show it, we also have Municipalities on there. And on the right we have a news carousel showing
current events, third-party research, a list of webinars and recent viewpoints that have come out from Fidelity.

CARTER: Great, Mike. So let’s imagine, right, that you click in one of those cells, it’s one of the ways to do a bond search, right, and you get a return. Let’s say now you imagine you’re diving into a particular issue — maybe you could just take us through some of the things to look out for.

HODAPP: Sure. Whenever you see an individual name of a bond, you click on the name of the bond, and this is going to bring us to the Bond Details page. There are two tabs here, the Overview and the Price and Performance tab. In the red box that’s highlighted here, you’re going to see material events. It — when you click on “yes,” it’s going to pull up the popup window, it’s going to show recent material events, if they’ve filed financials, or if they’ve not filed, it’ll actually be listed here for Municipalities. Any credit rating changes, whether they’re upgrades or downgrades, are going to show. Always important to check material events, because that can affect positively and negatively the future value of your bond. So this is very important; always look at material events on this page. And moving on to the next slide, but we’re going to stay on the Overview tab, it’s highlighted right in that orange box. Right above that, you can click on the offering statement to see the original
offering statement for that bond, but in the red box, as you click on this, Latest Municipal Reports, this is an example of a St. Clair County school district S&P report, and it’s going to show ratings of the various issues of St. Clair County that are out there. It’s going to affirm S&P’s rating, and it’s going to tell you why it rated the bond the way it did. There’s a section called “This Is a Reflection Of,” and it’s going to list the various strengths or weaknesses of that particular entity. And this allows the retail investor to really understand how a professional credit analyst is actually going to research a bond. So we give you all of those tools here at Fidelity to be able to do that in-depth research. And we’re staying on the Bond Details page, but we’re going to advance that subtab from the overview to Price and Performance. And there’s two boxes that are highlighted here: one is Depth of Book and the other is View Recent Trades. The Depth of Book, that tells me as an investor, I want to know where the bids and the offers are on this particular bond. And when you click on it, the popup window on the right comes up; it’s multiple bids and offers, and it’s going to show you the size of each of those bids and offers. These are not all Fidelity bids and offers. In fact, most of them are broker dealers that are on our platform. We have over 200 bond dealers listing bonds on our platform; these bonds are held in Availability. So it’s going to show where their best bids and offers are for this particular issues. Now, as an investor, I would like to know, where has the bond traded recently? And when I click on View
Recent Trades, marked in box 2, this is all the trace and MSRB data — that's lingo, jargon, for where has the bond traded? — and this can go back several years. And it’s not Fidelity’s pricing. This is everywhere on the Street. And it’s going to show broker dealers, and where the dealer bought the bonds. And it’s actually going to tell you where the customer bought the bond from the dealer. The difference between those two is actually called a mark-up, and that's commission to the firm that’s making that market in that bond. So this kind of segues into what our value prop is here. And really, what is a markup? When a broker dealer buys a bond on the Street, they will push up, or mark up, that price higher and sell it to a client. That differential is basically a commission, a concession, a markup. That’s actually going to come out of your pocket, and that’s going as commission to that broker dealer. And we can see a wide variety of the difference between “what does Fidelity charge,” and “what does the rest of the Street charge?” And we charge one dollar per bond on secondary bonds. Each bond’s $1,000 — so if you’re buying $100,000 worth of a bond, face value, we’re going to charge $100. Well, here’s the important thing to know — that sounds like a good number, but what do others charge? In 2015 we commissioned a third-party research firm called Corporate Insight to study all of this trace and MSRB data. And they compiled a list, and we looked at various brokers, they’re listed there. And you can see from the rates listed below each broker, there is a significant
difference. It’s very important, when you have a high-cost commission markup concession that’s going to eat in your return, and pricing does matter, because that will eat on your return. And just to review —

**CARTER:** (overlapping dialogue; inaudible) Oh, sorry. Yeah, I was going to say, I think that is — has been one area that’s been overlooked, hasn’t it, when thinking about, you know, engaging in the bond market, is really pushing for that clarity and that transparency and what you’re being charged. Maybe I can just shift quickly, as we head towards the end of your section here — tell us about some of the resources you should be attentive to, if you like, once you own the bond, right? So it’s not just the trading of it, is it, but we like to stress that there’s ongoing vigilance.

**HODAPP:** Absolutely. So within our website, many facets, not a lot of time to go through them all. But under our landing page, clicking on Research and Markets, which is the second subtab, you’re able to see benchmarks over time, yield curve comparisons. You’re able to also look at the economic calendar, because that’s going to affect the value of bonds. On the economic calendar you’re going to see all the releases of big and small numbers, whether it’s unemployment, CPI, all the way down to Consumer Sentiment. You also see when the treasury auctions are, just by clicking on the View All Events. It’s
really imperative to conduct this research on any investment before you actually invest, and after you buy it, to continue to monitor that investment. So this brings us to the summary page on the individual bonds section. You know, we showed you how to use Fidelity’s proprietary tools to plan and monitoring, but what are the key advantages of individual bonds? Well, bonds mature. You can help plan for future expenses, whether it’s taxes that are owed, a grandkid’s graduation from college, what have you, a wedding to pay for. The cash flow planning — borrowing an issuer default, you can actually know when those coupons are going to arrive and what the maturity dates are when your principal, your face value, comes back. We really stress that it’s important to research before you invest. And at Fidelity, it’s about researching the investment, choosing the investment, and then monitoring that investment. That’s exactly what our pages are designed to help you do with our specialists, whether they’re at the phone sites or in the branches like myself, to talk about fixed income.

CARTER: Excellent, Mike. Well, thank you so much. That’s a really nice job, and I think you, again, did an admirable job here covering a lot of ground. But well said, and let me now transition, if I may, to Lee Sterne. Welcome, Lee. Lee is an ETF strategist at Fidelity, and Lee, as you’re going to try and take on two products here in a nice compare-and-contrast, let’s begin. And maybe you
could start us off with some context and show us something about the size and the growth of these two markets, rather like Mike did with the bond markets earlier.

Lee Sterne: Great, thanks, Richard. I really appreciate the opportunity to come and speak in this forum. So good afternoon, everyone on the call. So I’m going to quickly talk about mutual funds and ETFs, and go over their attributes and the size of the market and some of the tools that are available to investors to actually do a lot of research on these types of investments, as well as, you know, what type of offering we have on the platform. So looking at the mutual fund market, for fixed income mutual funds, last year, year-over-year, the growth was pretty flat. So the flows into the fixed income mutual funds were fairly flat, and so we ended up the year right at about $4 trillion worth of assets under management. Over the last 10 years, though, you have seen some very substantial growth in fixed income mutual funds; assets have more than doubled over that period. So it’s a very robust part of the marketplace, a lot of money flowing in from a lot of different sources, and it remains robust. Moving on to the fixed income ETF market, it’s a slightly different story. Fixed income ETFs have only been around for about 17 years; they were first launched in 2002. And the growth trajectory of fixed income ETFs has been quite steep, especially over the last 10 years. And you’ve seen over five times
— 5X growth since — in assets under management since 2009 — actually, more like seven times the growth. Last year we saw about $45 billion flow into fixed income ETFs. Assets under management stand at about $705 billion. So it’s not nearly as big as the mutual fund market; it’s approaching a quarter of the size or a fifth of the size. But we are seeing substantial growth and adoption in the marketplace. And there is belief that ETFs, on the whole, will continue to grow, potentially doubling in assets over the next five years. And there’s also a belief from market participants that the sector that’s going to see the most growth will be fixed income ETFs.

CARTER: Thank you, Lee. Interesting background there, and as you say it’s almost like a contrasting market there, between the established player and the young upstart at its high growth stage. Maybe you could — I could ask you to dive a bit deeper into the different characteristics of each type of product, maybe? I think a lot of people often get confused between the two, or just see them as very, very similar; maybe you could help us look under the hood of it?

STERNE: Great, well, thank you, Richard. Yes. So first of all, let’s just make a point that, you know, I think that there’s no — this isn’t an either/or proposition. We’re not suggesting that investors need to pick either individual bonds, mutual funds, or ETFs exclusively in their portfolios. I think there is definitely a
place in investor portfolios for all three types, or a subset of the three. In my
particular portfolio, I actually own all three types of investments in the
individual bonds. But let’s just focus on ETFs and mutual funds, and kind of
look at the similarities and differences between the two products from a cost-
trading as well as transparency and tax perspective. So just looking at ETFs
and mutual funds, they’re both investment products, they’re both co-mingled
investment products registered under one of the FCC’s regulatory acts,
whether it be the 33 Act or the 40 Act. So both of these products are
professionally managed by an asset management company, and as a result
they tend to have an expense ratio, meaning that the sponsor of the product is
going to be charging a fee to manage those products. In general, passively
managed products tend to have lower fees than actively managed products,
and that’s usually around the amount of resources that are required to manage
both types of products. Aside from that, there are some pretty significant
differences between ETFs and — a lot of ETFs and mutual funds. And most of
it has to do with how individuals buy and sell their exposures in those types of
products, whereas with the ETFs, it’s an exchange-traded product, so
individual investors need to trade on the exchange through their brokerage
accounts, whereas with the mutual fund, you tend to transact usually through
your mutual fund or directly with the fund, and there’s no need to place a
trade order on the exchange. So as a result, ETFs tend to have potential
exposure to things like costs like commissions, as well as bid offer spreads and premium and discount. The bid offer spread will basically be the difference between the bid price and the offer price on the exchange, and that can eat into your returns if that spread is excessively large. And because ETFs don’t necessarily trade at its net asset value, throughout the day it can be changing — it won’t necessarily trade at its exact net asset value, so it can trade at either a premium or a discount to its net asset value. And we’ll go over how to actually look at that later on in the presentation, but it’s something to keep in mind, because that can affect your return too and can be a cost. On the mutual fund side, you want to make sure that you understand whether or not your mutual fund is subject to loads or no loads. And because mutual funds aren’t exchange-driven, you actually transact at the end of day net asset value, or NAV. But there could be redemption fees that are associated with the mutual fund if you don’t hold it for the minimum holding period. Moving on to the next slide, so let’s talk about trading, right? So I alluded to trading for ETFs — so ETFs are exchange-traded, so you need to transact on the secondary market as an individual investor throughout the day. So ETFs trade during the market hours, so 9:30 to 4:00 Eastern Time and you trade those at the prevailing price in the marketplace. Because they are exchange-traded, it gives you a lot of the same flexibility that you would get from trading an equity. So you can use things like limit orders, stop orders, or conditional
orders. And there’s also potentially the ability to buy shares on margin or short shares of an ETF. So depending on how your account’s set up and the individual product, you may have the ability to use that. Mutual funds, on the other hand, are only transacted at one price per day, as I said earlier, and that’s the net asset value that’s calculated every day at the close of business. So there is no ability to use things like conditional orders or stop orders or limit orders, and you’re unable to short the shares of a mutual fund. You may be able to buy it on margin, but it really depends on how long you’ve held the product and the type of account you have. And then moving ahead, about the transparency and tax considerations of a product — so the interesting thing about ETFs is that they disclose their holdings daily, on a daily basis, so you can get a sense of exactly how an ETF is structured on a daily basis. You know, you could also — whereas with a mutual fund, you tend to have a holdings disclosure usually on a monthly basis, and sometimes that can be delayed by 30 to 60 days. ETFs are offered across a number of different industry sectors and sub-sectors; there tends to be a lot of differentiation within the fixed income ETF marketplace. Mutual funds tend to be focused on more... broader segments of the market, such as covering the Barclays aggregate index or something like that. And then from a tax-efficiency point of view, ETFs may be more tax-efficient due to some of the underlying mechanics of the ETF. They tend to be able to mitigate some of the capital gains distributions that
investors may be subject to. Mutual funds don’t have the same degree of flexibility that ETFs have, so you may be more subject to receiving taxable, capital gain distributions, on an annual basis.

**CARTER:** Thank you, Lee. Well, that’s great. Quite a lot of things there to bear in mind; a lot of similarities, a lot of differences. Maybe, as with Mike, I could ask you to transition now to some of the practicalities, if you like, and if you imagine yourself to be an investor in either of these products, what should you be looking out for and how do we help people screen from quite a big universe, these days, of bond ETFs and bond mutual funds to find the right ones that they are looking for that would suit them?

**STERNE:** Sure, thanks, Richard. Yes, so first of all, I just want to point out that anybody who’s a client of Fidelity has a lot of very robust functionality that they can access on the Fidelity.com website. So if we could advance to the next slide — if you want to do research, there’s a very robust research function under the Research tab on the website. So if you go into the mutual fund Research page and tab into a particular mutual fund that you’re looking at, you get a lot of information that can really give you the basics and the fundamental understanding of exactly what type of exposure you can expect, as well as the track record, the cost, and so forth of the underlying — of the mutual fund.
you’re thinking about. So on the Summary page, you get all the details — what category the fund is in, what type of expense ratio it has, its rating stratification as well as its underlying investment objective. You can also access things like portfolio composition; you can look at the underlying holdings to see what it owns, or at least what it owned as of its last portfolio holdings disclosure; and you also have the ability to compare a particular mutual fund across five different other types of funds, and see exactly how they connect — how the one that you’re viewing compares to a number of its different competitors. As far as mutual fund research is concerned, moving ahead to the next slide... I mean, ETF research is concerned... we also have a very robust ETF research capability. So if you type in a ticker, let’s say, for, let’s say, the Fidelity Total Bond ETF, the ticker FBND, you would pull up this screen, which basically gives you a detailed understanding of exactly how the mutual fund is structured, and gives you a lot of other information around trading and so forth. So for instance, you get a detailed quote, and I’m going to go through all the attributes of the detailed quote in a second. But you also can look at the profile of the particular product, you know, how — what types of holdings it has, how its performance has been versus its index and peers and so forth. You can also look at things like analyst ratings, so Morningstar ratings or FactSet ratings — we have a number of different ratings agencies that we subscribe to. You can look at fund characteristics, things like the
average duration, which shows the interest rate sensitivity of the particular product, its average maturity, and its SEC yield. And finally, you can compare — this screen actually pulls up five comparable ETFs, and it shows you how the one that you’re looking at compares to other five comparable ETFs in the marketplace. So the next thing I’d like to talk about is the detailed quote screen, because I just wanted to drill down into this particular aspect because of the fact that ETFs are exchange-traded, and the trading is really important when it comes to what return experience you have. So when you look at a detailed quote, it’s going to give you most of the relevant information that will help an investor to effectively trade an ETF, so enter and exit and do it in a way that they get the best experience. So for instance, I was talking about bid offer spreads — you can see, in real time, exactly what the bid offer spread, what the bid is, what the ask is, how much is being bid for, and how much is on the ask side. You can also see how much volume has traded today, as well as what the average daily volume is on the product, and that’s important to understand exactly how the liquid the product is. You can also see the range of prices, as well as things like the expense ratio, what the income distribution is, its price and performance on a particular period. And then finally, when you drill down into this screen, you can look at things like where it last traded, its intraday value, which is basically a measurement of — a prediction of the current net asset value of the fund that’s updated every 15 seconds. You can
look at its net asset value or how — where it closed the night before, and compare that to where it’s trading currently in the marketplace. You can also get a sense of those premium and discount and its distribution dates and amounts. So moving ahead to the next screen, so just to quickly talk about how — other things, so we do have two very robust screeners available to investors. First, the mutual fund screener, and that’s accessed through the Research tab — punch in the mutual funds, and it will take you right to this particular screen. And here you can search for mutual funds, giving that number of different criteria — commission-free, I mean, no transaction, Fidelity Picks, a particular asset class, whether or not — you know, what star rating’s doing, and so forth. On the ETF side, same way, you go into the Research tab on the website, tab down into ETFs — it’ll put you into the ETF screener. We offer a number of different ways of screening, either, you know, self-directed by the investor, they can create their own screens, or we’ve created screens, one-stop buttons to give you a particular view into the types of ETFs that are available in their marketplace.

CARTER: Thank you, Lee. I think you can see there, like, we adopted the same approach with our individual bond offering, wanting to show the investors — or give access to our investors, the broad marketplace. Maybe I could just allow you a few moments of product promotion, and I know you’ll be very
interested to tell our audience about Fidelity’s own ETFs, and maybe we could just go there immediately, and just give us a quick overview. We don’t have a huge number of ETFs in the bond world at Fidelity, but I know you’ve taken great care in crafting the offering that we do have. Do you want to just quickly do the overview there?

**STERNE:** Yeah, sure. So first of all, real quick, we do have a number — over 1,000 transaction free — transaction-fee-free mutual funds on the platform. We have 83 transaction-free ETFs on the platform, 78 of which are iShares products and five of which are Fidelity fixed income ETFs. From a Fidelity perspective, we offer five different products across the credit spectrum. So basically from the highest quality on the investment-grade side, on the left there on the side, all the way over to the high-yield segment. We have two products that were recently launched, which are factor products, so kind of the bookend on this slide — the FLDR product, which is an ultra-short-duration product that’s a passive product that’s using a Fidelity-developed methodology to offer ultra-short exposure that targets floating-rate investment-grade corporate bonds and US treasuries, to offer an exposure — a duration exposure of 0.9 every year. Because it is passive, it’s priced at 15 basis points. On the other end of the spectrum, offering factor exposure in the high-yield segment, offering investors exposure to high-yield bonds with the greatest amount of quality and
value in the marketplace, this is a model-driven product, an actively-managed model-driven product, so it’s really following a model significantly differentiated from our fundamental research-based high-yield, high-income mutual funds. And this product is basically trying to offer kind of a smart beta type of exposure to the high-yield market and is priced at 45 basis points, so very competitive pricing. And then the three products in the middle are basically three of our flagship fixed income strategies offered in the ETF. These products were our first foray in the market, so they’ve been around for almost five years now. I’d say the middle product is our flagship, core fixed income allocation, our Fidelity Total Bond ETF, ticker FBND. That product is managed by the same team that managed the mutual fund, so it is currently a five-star Morningstar product, and it’s managed by the same team that manages the mutual fund that won Morningstar Portfolio Management Team of the Year back in 2016. The other two offer slightly different exposures — FLTB, the limited-term bond ETF, offers exposure to kind of the five-year and in fixed-rate part of the market — targets durations of about two and a half to three years, and it’s going to be primarily credit and treasury bonds. And finally, our corporate bond is the actively managed corporate bond strategy, trying to outperform the credit market and offer a superior exposure to the credit market than you would get in a passively managed product.
CARTER: OK, Lee, thank you so much. That was really interesting, and a great area of new product development you’ve been leading here. Let’s just conclude, if I may, with a quick summary of next steps. How about I turn it to, Mike, you, first of all, and just in a few seconds, if you wouldn’t mind, just tell us — why bonds at Fidelity? Why would you consider buying individual bonds at Fidelity, do you think?

HODAPP: Sure, Richard. Very simple. Two reasons: $1 per bond — we have a couple of competitors who have tried to match us on this; we are the best on the Street when it comes to availability. So it’s price and availability. On our website today, as of 12:45, there’s 120,000 offerings, 67,000 unique CUSIPs on our website. The price matters — that’s your return, and you want a wide availability. Also, we don’t lead with bonds and just sell you a bond with a large mark-up and charge commission; we start with planning guidance, the asset allocation, the look at what you’re trying to accomplish, and then end up with a solution after a conversation.

CARTER: Well said, thank you, OK. And how about I turn it back to Beau, actually, here. Do you want to tell us just some of the attributes about our management on the fixed income side, Beau?
COASH: Yeah, so we have a well-resourced team. We are a team-based approach — that is, everyone’s compensated for the performance of the fund, versus a star system. We know what happens with star systems: when your portfolio manager leaves, it’s not usually good news. Committee-based approach tends to have a long lead time of getting ideas into portfolio. We have transparency — very transparent portfolio, very straightforward, you know what you’re rooting for, and we have very consistent risk-adjusted returns over long periods of time.

END OF AUDIO FILE