Bob Brown
Fixed Income Market Update- Retail Script
1st Quarter 2013

Hello, I am Bob Brown, president of the bond group at Fidelity Investments. I would like to take a few moments to share our current thoughts on the fixed income markets.

The first quarter brought a strong rally for risk assets. Major stock indices such as the S&P 500 ended the quarter at or near all-time highs. High yield bonds also continued to perform strongly. On the investment grade side, the Barclays U.S. Aggregate Bond Index fell just a few basis points as interest rates rose modestly while spreads tightened. All in all, bond markets held up well considering the magnitude of the equity rally.

In terms of fundamentals, corporate balance sheets remain healthy with manageable debt levels and over $1.4 trillion of cash on balance sheets. Following the crisis there was a universal focus on deleveraging across major global industries. Firms in areas such as banking remain the most dedicated to taking leverage off their balance sheets. The impetus behind the deleveraging is the intense regulatory environment that banks are now operating in. This is a positive for bank bondholders.

Conversely, we have witnessed a change in focus in the industrials sectors. Rather than focusing on balance sheet strength, many firms are now seeking ways to unlock shareholder value, often at the expense of bondholders. We are witnessing increases in dividend payouts, share buybacks, asset spin-offs, mergers, acquisitions and buyouts. Each trend has a negative impact on creditors.

The high profile buyout deals of Heinz and Dell demonstrate the negative financial impact these deals can have on bondholders. Upon the announcement of the Heinz MBO deal, the company's bond prices fell dramatically. This type of event risk is always a priority for us. We have consistently applied the necessary quantitative and credit resources to screen for potential M&A activity.

There are many reasons that firms are undertaking more merger and buyout deals. A slowdown in revenue growth is forcing companies to add value by other means.
The significant improvement in equity market sentiment and lower price volatility has allowed for more efficient capital raising for these deals. The decline in high yield spreads has lowered the cost of LBO financing both pre and post downgrade.

The Federal Reserve's accommodative monetary policy has also allowed rates to stay at attractive levels when financing these deals. However, improving economic data this quarter has many speculating if QE will end sooner than expected.

In our view, economic conditions still appear challenged and far removed from the sustainable gains the Fed has targeted in order to shift policy. Taking a broader look at rates, the yield curve steepened this quarter. The rise in long rates in January and February was due in part to supportive economic data in the U.S as well as fewer concerns about global macro risks.

Headline fatigue may have contributed to this after two years of non-stop European drama. But, Cyprus served as a stark reminder in March that macro risk flares remain, causing rates to fall in the final weeks of the quarter. Frankly, the market response was fairly contained given the potential implications of future depositor bail-ins across the Euro-zone.

The events in Cyprus, as well as the failed elections in Italy, showed that the European crisis is far from over. There remains no cohesive plan to solve near-term local financial headwinds or the long-term underlying structural issues. Consequently, in the bond markets, European sovereign debt has started to show signs of weakening once again.

Across the globe we see many causes of concern that seem to be underappreciated in the markets recently. Sovereign concerns in Europe, the Chinese real estate market, threats from North Korea and the volatile currency markets underscore the risks in the global economy. Bond investors should remember that global macro factors will have an influence on the direction of U.S. interest rates. This will remain true as long as Treasuries are the predominant safe haven asset class. The strength of the dollar this quarter was further evidence that it remains the world's reserve currency. This means Treasuries still offer diversification and an investment option.

In conclusion, we remain concerned about the foundation for sustainable global economic growth given the revenue challenges we see across the globe in industries and structural hurdles in high profile sovereign nations.

Thank you for your time

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