NCCMT Government & Term Overview
NCLGIA Summer Conference

July 2017
Agenda

1. Regulatory Reform Recap
2. Global Macroeconomic Update
4. Federal Reserve Interest Rate Policy
5. Government & Term Portfolio Overview
6. Question & Answer

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Regulatory Reform Recap
Institutional Prime & Government Yield Spreads

Source: iMoneyNet as of 5/31/2017

Notes: May Assets Under Management is preliminary and may be subject to change. MMF yields shown are average month end net 7-day annualized yields reported by iMoneyNet for institutional prime and institutional government money market funds. In the chart, spread refers to the difference between prime and government money market yields. Past performance is no guarantee of future results.

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Global Macroeconomic Update
Note: The diagram above is a hypothetical illustration of the business cycle. There is not always a chronological, linear progression among the phases of the business cycle, and there have been cycles when the economy has skipped a phase or retraced an earlier one. A growth recession is a significant decline in activity relative to a country’s long-term economic potential. We have adopted the “growth cycle” definition for most developing economies, such as China, because they tend to exhibit strong trend performance driven by rapid factor accumulation and increases in productivity, and the deviation from the trend tends to matter the most for asset returns. We use the classic definition of recession, involving an outright contraction in economic activity, for developed economies. Source: Fidelity Investments (AART), as of 6/26/17.
China’s Credit Impulse

Sources: Bloomberg as of 5/17/2017.

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Europe Expansion Intact, though Political Risks Abound

**Manufacturing Bullwhip**

- **France**
- **Germany**
- **U.K.**

New orders PMI less inventories PMI (3-Month Average)

2017 European Political Events

<table>
<thead>
<tr>
<th>Event</th>
<th>Date</th>
<th>Result</th>
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<tbody>
<tr>
<td>Netherlands National Elections</td>
<td>March</td>
<td>Anti-Euro party defeated</td>
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<tr>
<td>Brexit Notification</td>
<td>March</td>
<td></td>
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<tr>
<td>France Presidential Election</td>
<td>April/May</td>
<td>Anti-Euro party defeated</td>
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<td>Germany National Elections</td>
<td>October</td>
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<td>Possible Italian Parliamentary Elections</td>
<td>?</td>
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**LEFT:** Source: Markit, Haver Analytics, Fidelity Investments (AART), as of 5/31/17. **RIGHT:** Fidelity Investments (AART), as of 3/31/17

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Easy Monetary Policies Act as Anchor on Global Rates

Sovereign Bond Yields and Policy Rates

Yield

-1.00% -0.50% 0.00% 0.50% 1.00% 1.50% 2.00% 2.50%

U.S. Italy Canada U.K. France Germany Japan Switzerland

10-Year Yield Policy Rate

Sources: Bloomberg Finance LP, Fidelity Investments, as of 6/30/2017.

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Many Reasons Yields So Low, Some May Not Last Forever

<table>
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<th>Why rates are low</th>
<th>What might push them up</th>
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<td><strong>Fundamentals</strong></td>
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<tr>
<td>Slow growth</td>
<td>Better than expected growth</td>
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<tr>
<td>Low inflation</td>
<td>Higher than expected inflation</td>
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<tr>
<td>Monetary easing</td>
<td>Less easy monetary policies</td>
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<td><strong>Technicals</strong></td>
<td></td>
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<tr>
<td>Reduced supply</td>
<td></td>
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<tr>
<td>Quantitative easing</td>
<td>Less QE than expected</td>
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<tr>
<td>Fiscal tightening</td>
<td>Fiscal easing</td>
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<td>Increased demand</td>
<td></td>
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<tr>
<td>Regulatory backdrop</td>
<td>(Very low probability of change)</td>
</tr>
<tr>
<td>Demographics</td>
<td>(Very low probability of change)</td>
</tr>
</tbody>
</table>

Source: Fidelity Investments (AART).

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The Impact of Potential Public Policies in 2017
Various policies are likely to have different implications for U.S. growth and inflation.

Source: Fidelity Investments as of 12/12/2016
### Updating the Trump Policy Continuum

**Blue Dot = Current Market Expectation; Gray Dot=Market Expectation as of Dec**

<table>
<thead>
<tr>
<th>Establishment</th>
<th>Compromise</th>
<th>Populist</th>
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<td><strong>Taxes</strong></td>
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<td>Corporate &amp; Individual Tax Cuts</td>
<td>Tax Reform</td>
<td>Progressive Tax Cuts</td>
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<td><strong>Spending</strong></td>
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<td>Defense Spending, Fiscal Restraint</td>
<td>Pub/Pvt Infra, Balanced Spending Plans</td>
<td>Pub Infra Program, Protect Entitlements</td>
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<td><strong>Trade/Immigration</strong></td>
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<td>Free Trade, Immigration Reform</td>
<td>Targeted Trade Renegotiations</td>
<td>Trade Wars, Deportations, Building Wall</td>
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<td><strong>Monetary Policy</strong></td>
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<td><strong>Regulation</strong></td>
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<td>Deregulation &amp; Limited Government</td>
<td>Deregulation + Bully Pulpit (Twitter)</td>
<td>Outright State Intervention</td>
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<td><strong>Implications</strong></td>
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**Implications**
- Small Growth Pickup
- Stable Inflation
- Rates Higher Led by the 5yr
- Neutral for TIPS
- Strong Dollar
- Global Risks Rise via FX
- Moderate Growth Pickup
- Moderately Higher Inflation
- Rates Higher Across the Curve
- Modestly Positive for TIPS
- Sweet Spot for Risk Assets
- Large Growth Pickup
- Significantly Higher Inflation
- Rates Higher Led by the 30yr
- Very Positive for TIPS
- Weak Dollar
- Global Risks Rise via Trade
Much Higher 4% GDP Growth Not Likely over the Long Run

Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, Haver Analytics, Fidelity Investments (AART), as of 12/31/16.

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GDP and 10-Year U.S. Treasury
Highly correlated

GDP data represents annualized 20-quarter percent change.

Past performance is no guarantee of future results.
Inflation Impulse Is Typically a Key to Late-Cycle Transition

U.S. Inflation: The Base Effect

- Headline CPI
- Core CPI

Change (Year-over-Year)

Mid- vs. Late-Cycle Inflation, 1966–2010

- Mid
- Late

Average Annualized Inflation

Two Broad Scenarios for Growth, Both toward Late Cycle

Overheating boom
- Material acceleration in GDP
- Better for stocks, worse for bonds

Constraints on Upside
- Stronger $:
  - Tightens global liquidity
  - Hurts foreign growth, earnings
- Less capacity later in cycle
  - Labor markets tight/inflationary
  - Lower multiplier effect for fiscal
- Higher rates break ZIRP malaise
- Higher rates increase debt service
- Protectionism/trade tensions

Muddle through
- Similar GDP growth as 2016
- Less magnitude of relative performance

Upside Potential
- Animal spirits
  - Deregulation
  - Corporate tax reform/cuts
  - Bank lending
  - Business investment
- Higher rates break ZIRP malaise
- Infrastructure spending

Which factors dominate will determine flavor of expansion

Source: Fidelity Investments (AART). For institutional use only.
Federal Reserve Interest Rate Policy
Markets are Expecting a Faster Pace of Fed Hikes Post-Election

Market Pricing of Short Rates in 1 Year (Constant-maturity Eurodollar Future)

Federal Funds Target Rate

June 2017 Federal Reserve Fed Funds Projections

Median Fed Funds Projection

Post-Election Market Expectations As of June 30, 2017

Pre-Election Market Expectations As of Nov 8, 2016


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Federal Reserve’s Economic Projections

Source: Bloomberg and Federal Reserve
Actual Inflation as of 5/31/2017, Actual Unemployment Rate as of 5/31/2017, and Actual GDP as of 3/31/2017
FOMC Forecast based on the central tendency (excludes the three highest and three lowest projections for each variable in each year) as of 6/14/2017

For institutional use only.
Fed Rate Hike Probabilities

Source: Bloomberg as of 6/30/2017

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Government & Term Portfolio Overview
Portfolio diversification is presented to illustrate examples of the securities that each fund has bought and may not be representative of a fund’s current or future investments. Each fund’s investments may change at any time. Percentages may not add up to 100 due to rounding.

*Net Other Assets may include cash and receivables and payables related to open security or capital stock trades.

Source: Fidelity Investments as of 6/30/2017

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Source: Fidelity Investments; Sector Composition and Fund Characteristics as of 6/30/2017

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Third Quarter Investment Strategy and Outlook

**Investment Strategy**

- Seeking to preserve principal, maintain liquidity and achieve superior risk-adjusted performance
  - Emphasize fundamental and macro research in formulating portfolio structures
  - Manage weighted average maturities (WAM) and weighted average life (WAL) constraints to enhance NAV stability, liquidity and performance
  - Position portfolios based on our assessment of relative value across the money market yield curve within the context of our approved credits

**Outlook**

- Less regulation, lower taxes, and more assertive foreign policy are policy shifts that boost growth
  - With potential exceptions, Trump policies should be supportive of business profits and growth
  - Strengthening economic activity may be associated with higher rates of inflation in the second half of the year
  - Fiscal stimulus may be limited and unfold over years
  - Uncertainty around policy has increased the variability of potential outcomes

- The Fed is still on a path of gradual tightening, given their optimistic outlook
  - FOMC’s forward guidance is still on a gradual path even as growth and inflation trend below targets
  - The market is pricing in less than a 60% probability of third hike by year end
  - The Fed announced it plans to reduce its security holdings in a gradual and predictable manner
    - Run-off caps start at $6 billion - growing to $30 billion/month for Treasury securities
    - Run-off caps start at $4 billion – growing to $20 billion for agency securities
  - Higher predicted growth and inflation enable the BOE, ECB and BOC opportunities to reduce monetary accommodation
Important Information

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Diversification does not ensure a profit or guarantee against a loss.

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, credit and default risks for both issuers and counterparties. Unlike individual bonds, most bond funds do not have a maturity date, so avoiding losses caused by price volatility by holding them until maturity is not possible. Foreign securities can be more volatile than U.S. markets due to increased risks of adverse issuer, political, regulatory, market or economic developments. Changes in government regulation, interest rates and economic downturns can have a significant effect on issuers in the financial services sector, including the price of their securities or their ability to meet their payment obligations. Prepayment of principal prior to a security's maturity can cause greater price volatility if interest rates change. The fund can invest in securities that may have a leveraging effect (such as derivatives and forward-settling securities) that may increase market exposure, magnify investment risks, and cause losses to be realized more quickly. Conservative Ultrashort Bond Funds are not money market funds and will have a fluctuating NAV.

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Fidelity Institutional Prime

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