ADVISER INVESTMENTS

ADVISER FUND UPDATE

Market Summary and Commentary for Individual Investors from Adviser Investments

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Fidelity's Bond Blast

Keeping the world's largest mutual fund company going is one thing. Keeping it growing is another. Yet, on both counts, Fidelity continues to exceed its competitors.

As evidence, consider Global High Income, Conservative Income Bond and the four "defined maturity" municipal income funds launched in recent weeks. These six funds add to Fidelity's ever-growing bond fund roster, which now consists of over 50 funds (not including money markets and additional share classes).

It's no secret that bond funds have been enjoying huge inflows over the past couple of years, and Fidelity has never been shy about satisfying—or profiting from—investors' demands. With millions of Baby Boomers beginning to enter their retirement years, we expect Fidelity will continue to roll out more bond funds to meet the growing demand for income-producing products.

While there's no question of Fidelity's ambition to garner assets for these new funds, the question we ask at Adviser Investments every time a new fund opens is if it's worthy of any of our clients' assets. Let's take a look.

Going Global With Global High Income

Fidelity's assessment of the world in which we invest is this: The global marketplace is here to stay. That's not exactly news, as most Fidelity managers are already running globalized portfolios. They will invest wherever they can find the best opportunities, whether that's in the U.S., a developed foreign country or in emerging markets. Fidelity applies that same approach to its bond funds.

What is news is Fidelity's approach to creating standalone global funds. Global High Income is a perfect case in point. While the global marketplace for bonds provides ample long-term investment opportunities, it's also rife with risks, especially in the high yield (junk bond) market.

It wasn't too long ago when the market for high yield bonds was limited primarily to the U.S. But the need to finance economic growth overseas has created a high yield bond market in established foreign and emerging markets that makes our own junk bond risks look tame.

Global High Income presents a way to manage those risks while delivering a product that can play a role within most growth and income investors' portfolios. The fund also provides an opportunity for higher yields in what is likely going to be a lackluster yield environment. Fidelity's size and reach (geographical and analytical) provide additional risk management capabilities and return potential.

As its name suggests, Global High Income's mandate is to deliver high current income, along with the potential for capital appreciation. The fund invests in a mix of high yield bonds, preferred stocks and convertible securities from four regions:

- 40% to 80% U.S. high yield (60% neutral weighting)
- 5% to 35% emerging markets high yield (20% neutral weighting)
- 0% to 30% European high yield (15% neutral weighting)
- 0%-10% Asian high yield (5% neutral weighting)

Global High Income began trading this month, carries an expense ratio of 1.31% and a back-end load of 1.00% for shares sold within 90 days of purchase.

The fund is run by a team of four managers: John Carlson, Bryan Collins, Harley Lank and Ian Spreadbury. Lead manager Carlson is an experienced foreign bond market hand and he's responsible for Global High Income's emerging markets subportfolio. He'll continue managing New Markets Income, a standout in the emerging markets debt space (and a fund that we currently invest in on behalf of our clients), which he's run since 1995. He's also managed Strategic Income and Emerging Markets in the past. Co-manager Lank runs the fund's U.S. high-yield segment. Lank has been with Fidelity since 1996 and will continue to manage Advisor High Income Advantage. Spreadbury, located in Fidelity's London office, handles the fund's European high-yield investments. He has over 30 years of experience in the field, joined Fidelity in 1996 and has been managing a European high-yield fund for non-U.S. investors since 2002. Collins, who's based in Fidelity's Hong Kong branch, has been with the firm since 2006 and has been managing fixed income assets since 2008.

Given lead manager Carlson's pedigree and the increasing opportunities we're seeing in developed and emerging markets bonds, we'll be keeping a close eye on Global High Income. Our initial impression, as mentioned above, is that it could function as a good diversifier and source of income in a growth and income portfolio.

Conservative Income Bond Stays Closer to Home
Fidelity's Conservative Income Bond is a decidedly tamer domestic fund targeted at investors with an investment time horizon of six to 12 months. The fund appears to have been designed to hold up better during an unexpected crisis than Fidelity's Ultra Short Bond managed to do in 2008, when it caught many investors off guard by losing nearly 8%.

Conservative Income Bond invests at least 80% of its assets in U.S. money market and high quality investment-grade securities, with a maximum maturity of two years on fixed rate funds, and three years on floating rate investments. The fund typically maintains an average-weighted maturity of 0.75 years or less (versus two years or less for Ultra Short Bond).

Manager James K. “Kim” Miller joined Fidelity in 1991 as a municipal bond credit analyst. Previously, Miller managed a number of institutional money market portfolios, several state-specific municipal money market funds, as well as several of the Asset Manager funds. Conservative Income Bond began trading in March and so far has pulled in about $200 million in assets. It carries an expense ratio of 0.40%.

Like Ultra Short Bond, Conservative Income Bond could be used in a portfolio as a higher-risk, higher-yielding money market substitute. However, with yields remaining near rock bottom, Conservative Income Bond does not look particularly attractive to us right now.

Defining a New Type of Bond Fund

The launch of the aforementioned defined-maturity municipal bond funds last week is Fidelity’s attempt to cash in on recent fears of instability in the municipal bond market. These funds are the first to offer municipal bond investors a diversified portfolio of bonds that are tasked with providing federal tax-exempt income (the funds can invest up to 100% of assets in issues subject to the Alternate Minimum Tax, however) and a return of investment principal at a specific date. The four funds are: Municipal Income 2015, Municipal Income 2017, Municipal Income 2019 and Municipal Income 2021, each named for the year in which assets will be liquidated and returned to shareholders. These funds carry expense ratios of 0.40% each and all also charge a 0.50% back-end load for shares sold within 30 days of purchase.

Mark Sommer is the lead manager on three of the four funds (2015, 2017 and 2019) and co-manages the fourth (2021). He has a long track record managing a slew of Fidelity’s muni bond funds, including Municipal Income, Short-Intermediate Municipal Income and Tax-Free Bond (all of which he continues to manage), as well as a handful of state-specific muni bond funds. Kevin Ramundo is the lead manager on Municipal Income 2021 and co-manages the other three new funds. Like Sommer, he can also count a long list of Fidelity’s muni bond funds on his management tally. Sommer and Ramundo are joined by co-manager Jamie Pagliocco, another of Fidelity’s experienced muni bond fund managers, on all four funds.

The investment strategy for these funds, while unique on the bond side of the mutual fund market, seems comparable to target date mutual funds. Target date or lifecycle funds bank on the desire of some investors to oversimplify the portfolio construction process by allowing them to pick a retirement date in the future and sink their assets into a single fund based on that single criterion. Of course, these bond funds have an even tighter focus—instead of providing a mix of asset classes (as can be found in lifecycle or target funds), they will be locked into a narrow universe of bonds with similar maturities (each fund is mandated to pick among bonds maturing within a one-year timeframe coinciding with the year in the fund's name). For this reason, we think most investors would be better suited taking a more diversified approach to the bond market portion of their portfolios and avoiding these four funds.

About Adviser Investments

Adviser Investments and its subsidiaries operate as an independent, professional money management firm specializing in Fidelity and Vanguard mutual funds. With 2,400 clients and over $2 billion dollars under management, Adviser Investments is one of the nation's largest mutual fund research and money management firms. Our staff of 50 investment professionals focuses on helping individual investors, trusts, foundations, and institutions meet their investment goals. Our minimum account size is $350,000.

For more information, please visit www.adviserinvestments.com or call 800-492-6868.