

Headwinds weaken the economy - What might this mean for liquidity markets?

Carolinas Cash Adventure

May 23, 2023

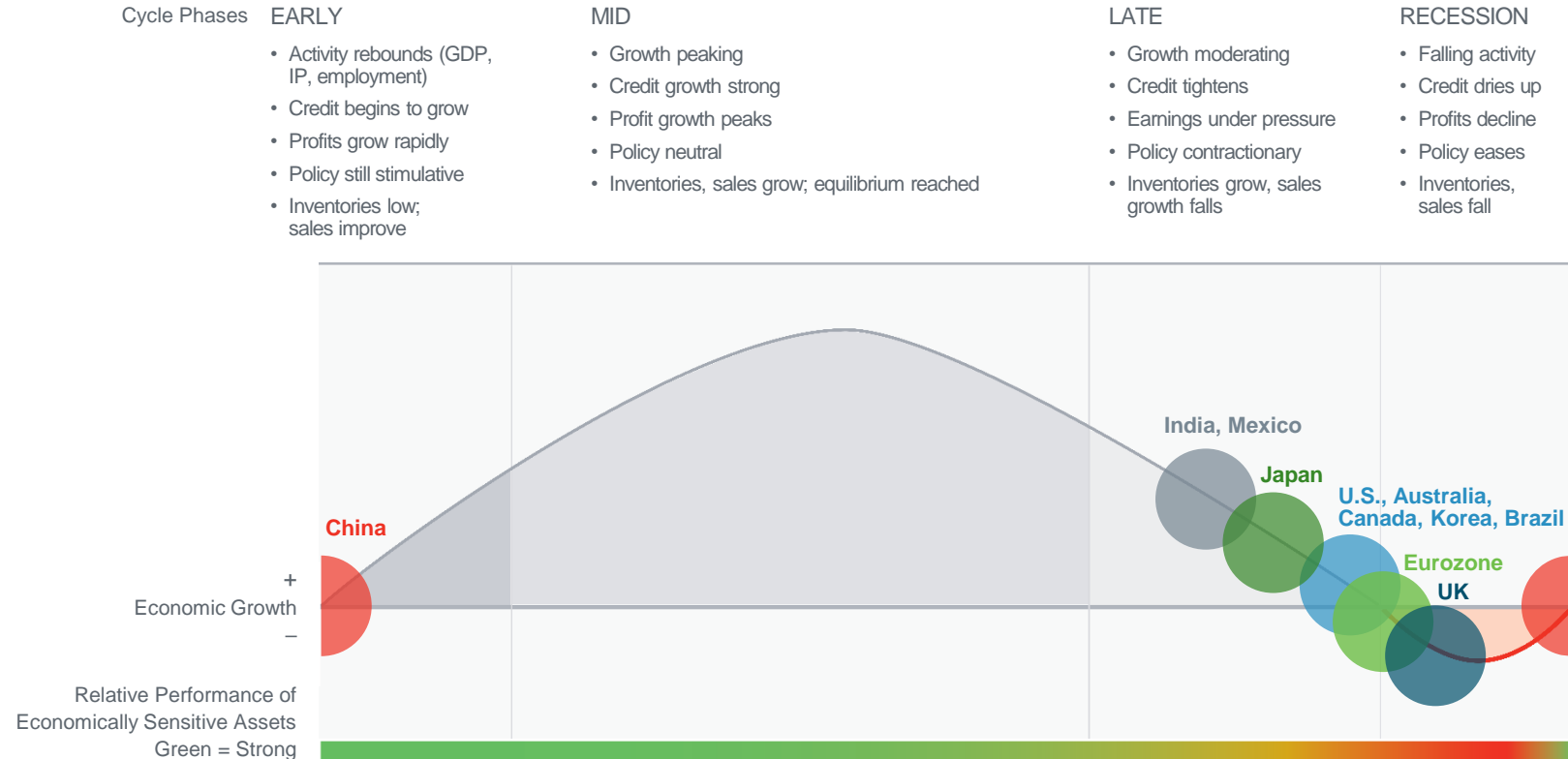
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Elevated Global Recessionary Pressures to Begin 2023

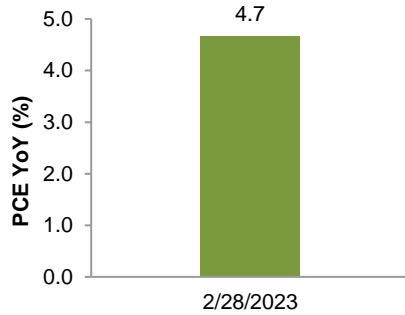
Business Cycle Framework



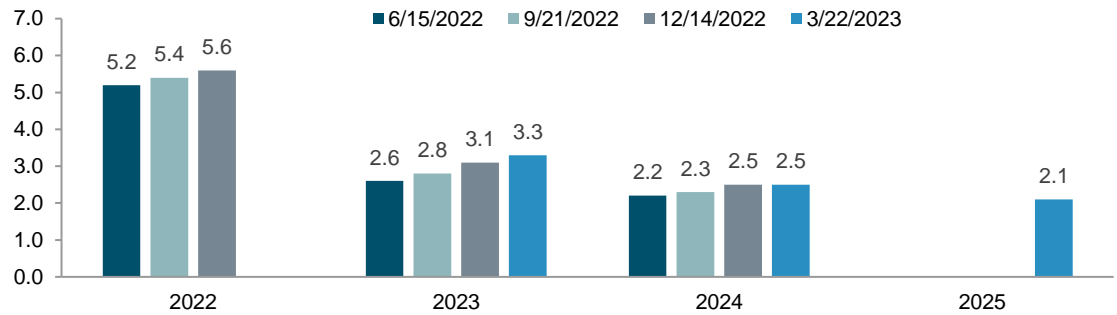
A growth recession is a significant decline in activity relative to a country's long-term economic potential. Note: The diagram above is a hypothetical illustration of the business cycle, the pattern of cyclical fluctuations in an economy over a few years that can influence asset returns over an intermediate-term horizon. 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. Source: Fidelity Investments (AART), as of 3/31/23.

Federal Reserve's Economic Projections

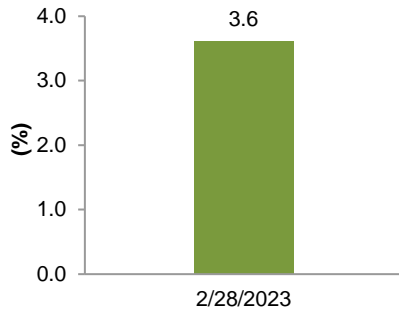
INFLATION



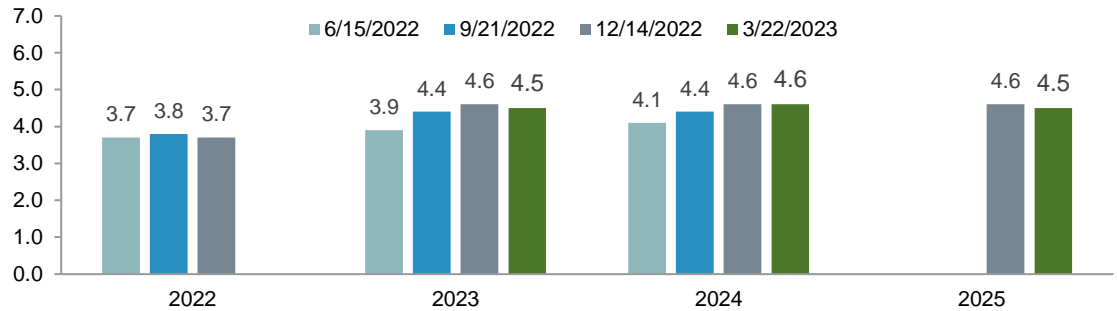
FOMC FORECAST



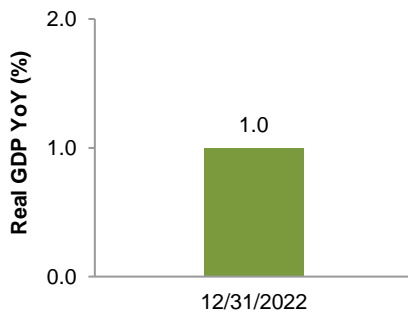
UNEMPLOYMENT RATE



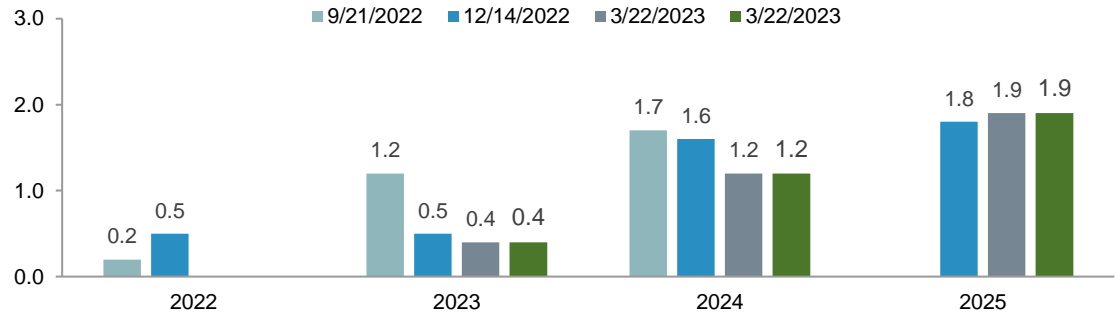
FOMC FORECAST



GDP



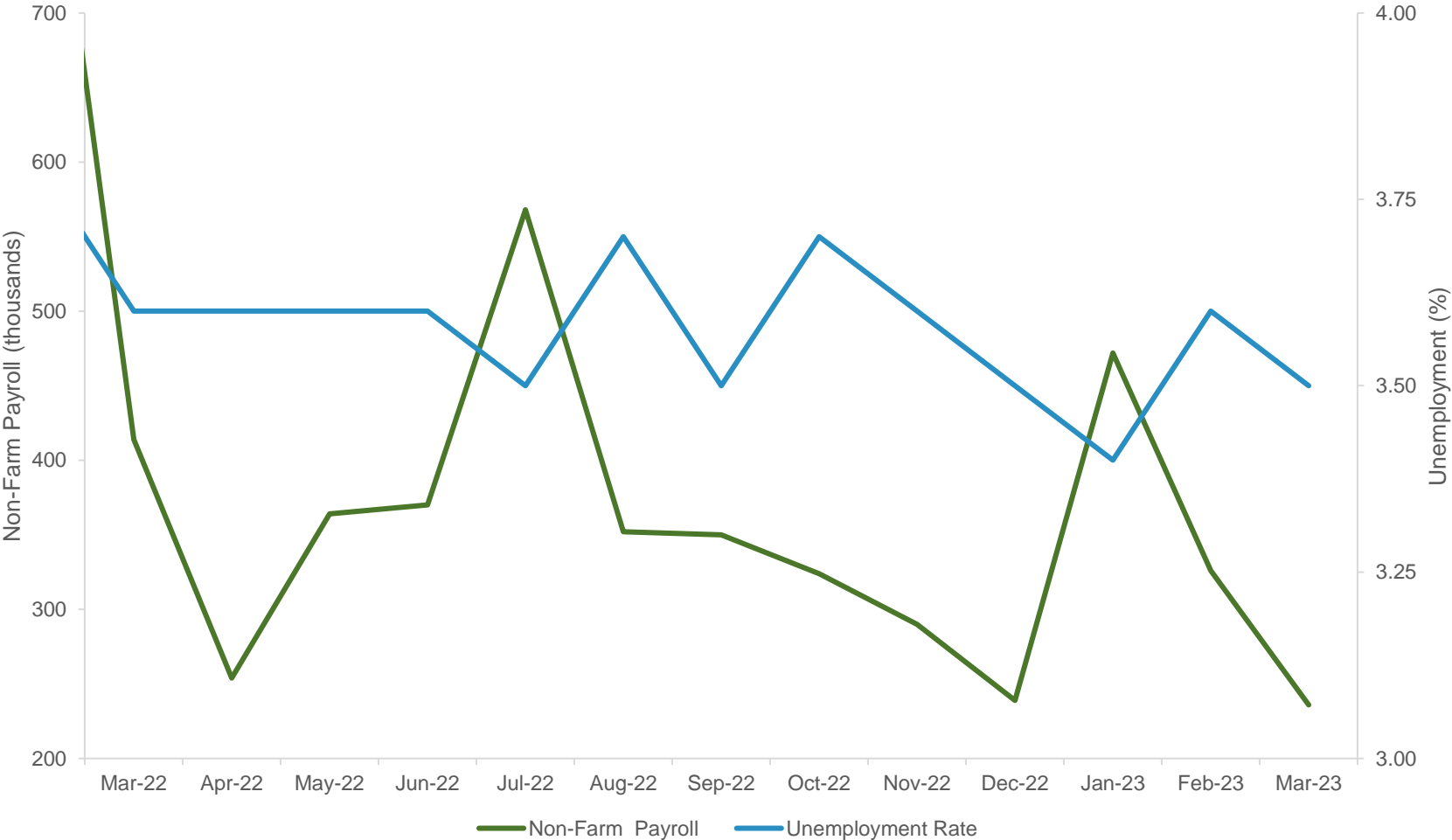
FOMC FORECAST



Source: Bloomberg and Federal Reserve.



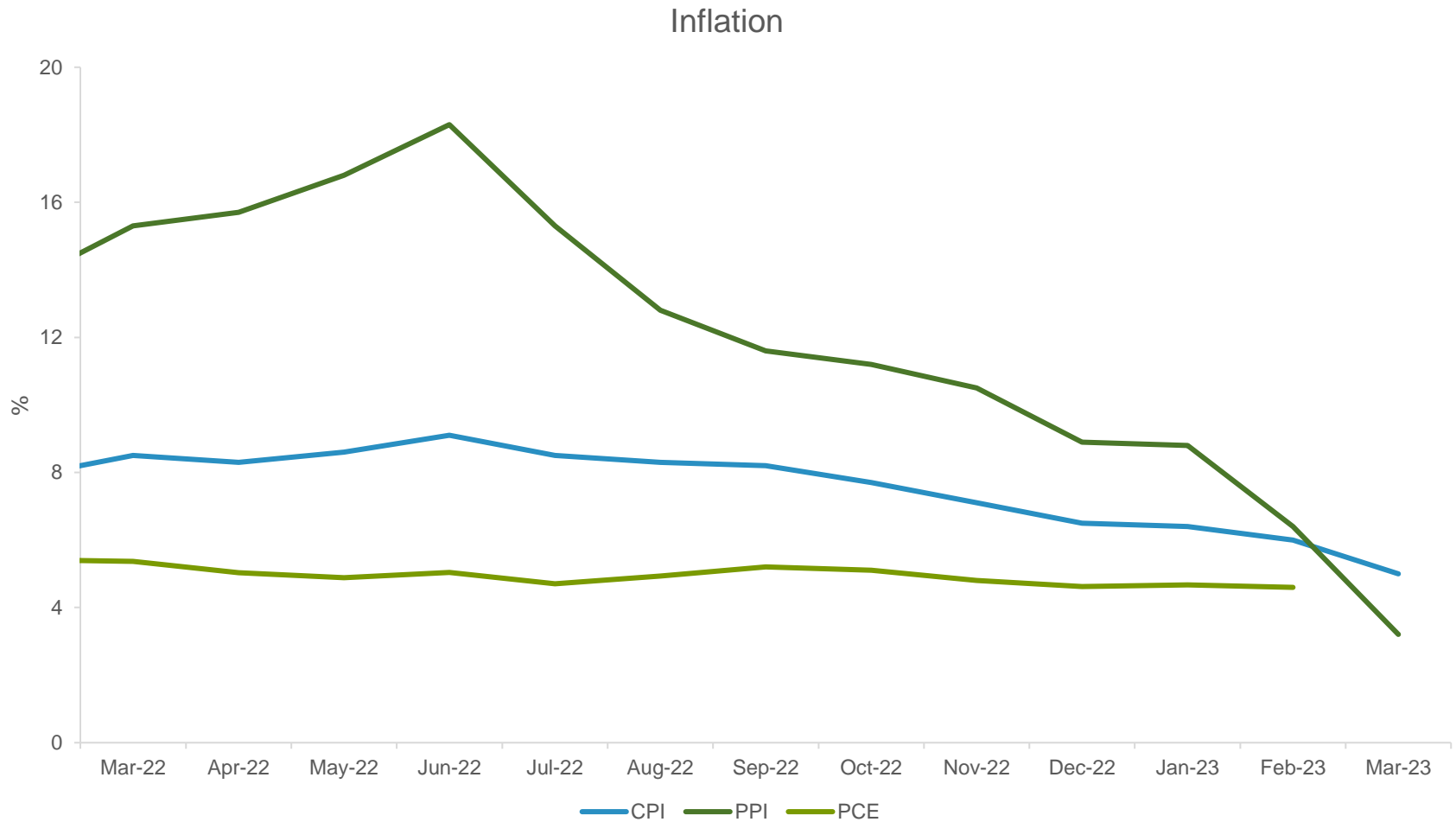
Employment Slows but Remains Resilient



4 Source: Bloomberg and Bureau of Labor Statistics 3.31.2023
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Inflation Trends Lower but Still North of the 2% Target



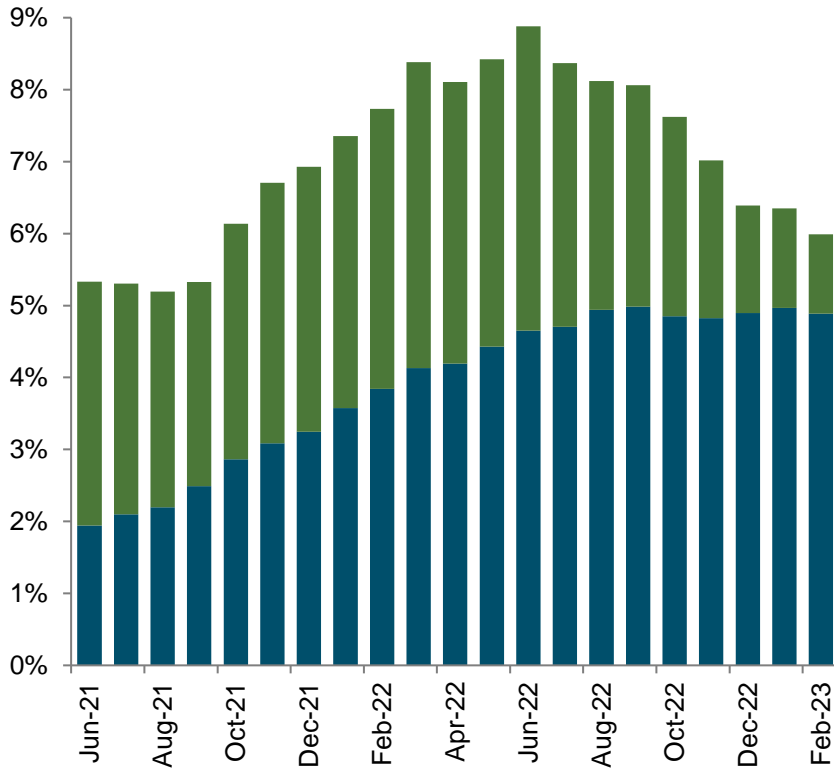
Source: Bloomberg as of 3.31.2023

Persistent Factors Drove Recent Inflation Pressures

Persistent vs. Transitory Inflation

■ Persistent Inflation ■ Transitory Inflation

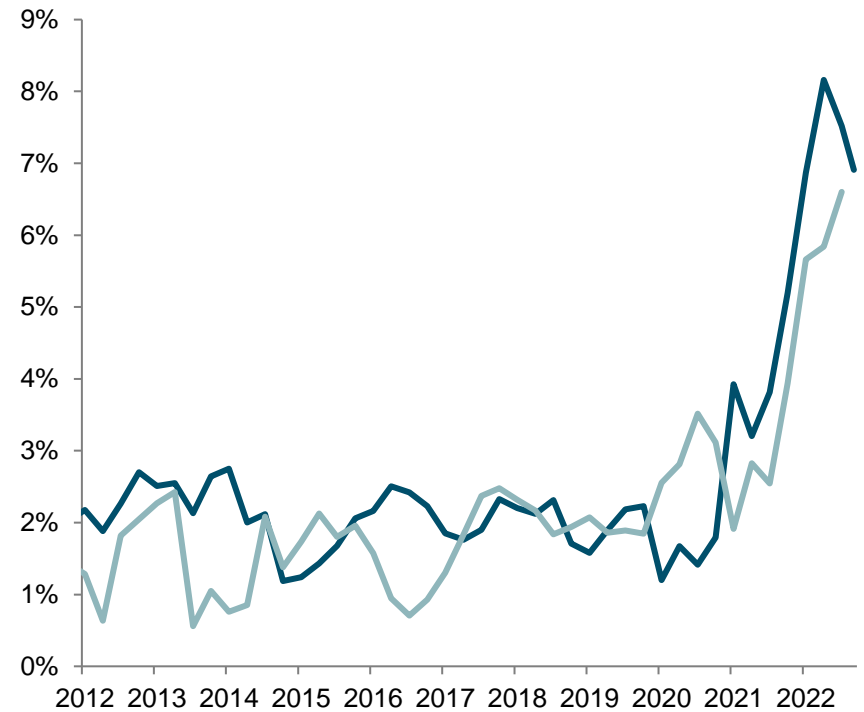
Year-over-Year CPI



Services Inflation vs. Labor Costs

— CPI Services ex Shelter — Unit Labor Costs

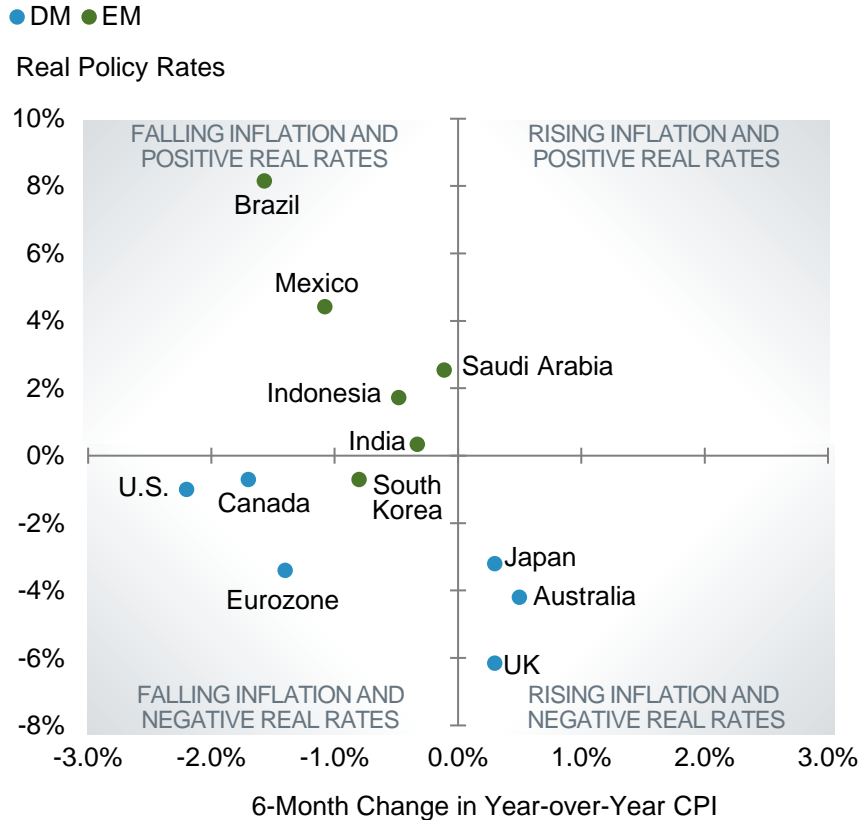
Year-over-Year



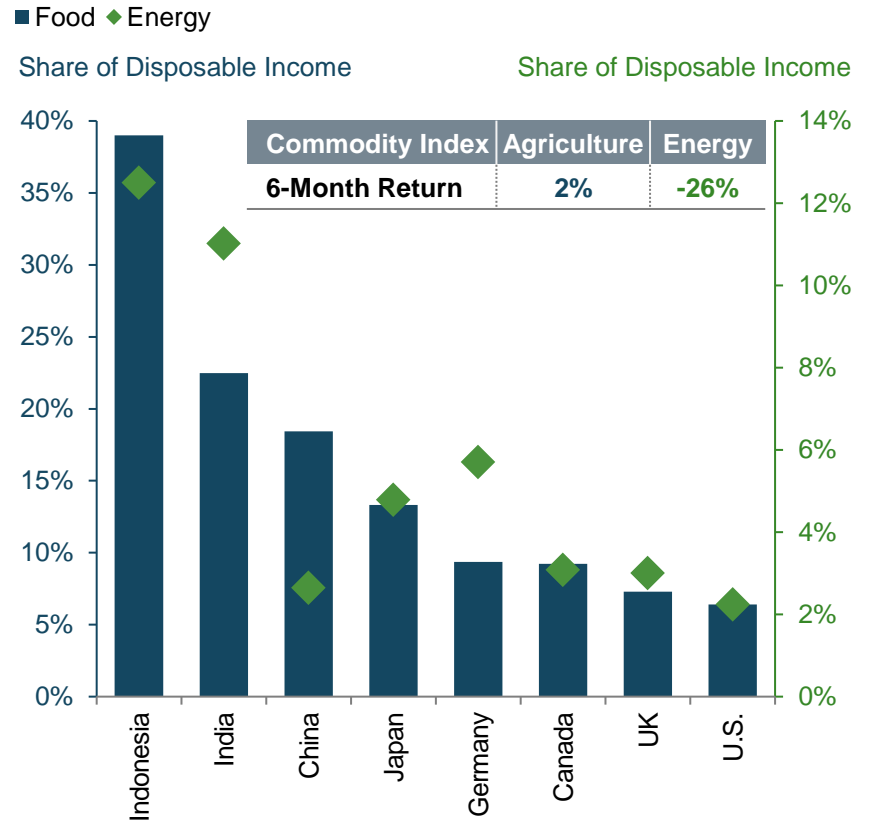
CPI: Consumer Price Index. **LEFT:** Indicates the contribution to Year-over-Year CPI over the past 12 months. Persistent Categories include areas where, historically, inflation has taken longer to dissipate, such as Housing and Food & Beverages. Source: Bureau of Labor Statistics, Haver Analytics, Fidelity Investments (AART), as of 2/28/23. **RIGHT:** Unit Labor Costs measured as 4-quarter moving average. Source: Bureau of Labor Statistics, Haver Analytics, Bloomberg, Fidelity Investments (AART), as of 2/28/23.

Adjustments to Higher Inflation Vary Across the World

Global Monetary Policy and Inflation Trend



Household Spending on Food and Energy



LEFT: CPI: Consumer Price Index. Real policy rates is the policy rate of each central bank minus YoY CPI. 6-Month difference in YoY CPI.
RIGHT: Food: at home; Energy: utilities, gasoline, gas, oil, water. Share of disposable income calculated from 2019 values. **TABLE:** It is not possible to invest directly in an index. All indexes are unmanaged. See Appendix for important index information. Returns represented by Bloomberg commodity total return sub-indexes. Source: World Bank, Haver Analytics, Bloomberg Finance L.P., National statistical agencies,

Regional Bank Failures May Exacerbate Credit Tightening

U.S. Banks Lending Standards by Loan Type

— Commercial & Industrial — Commercial Real Estate — Multi-Family Residential

Share of Banks Tightening

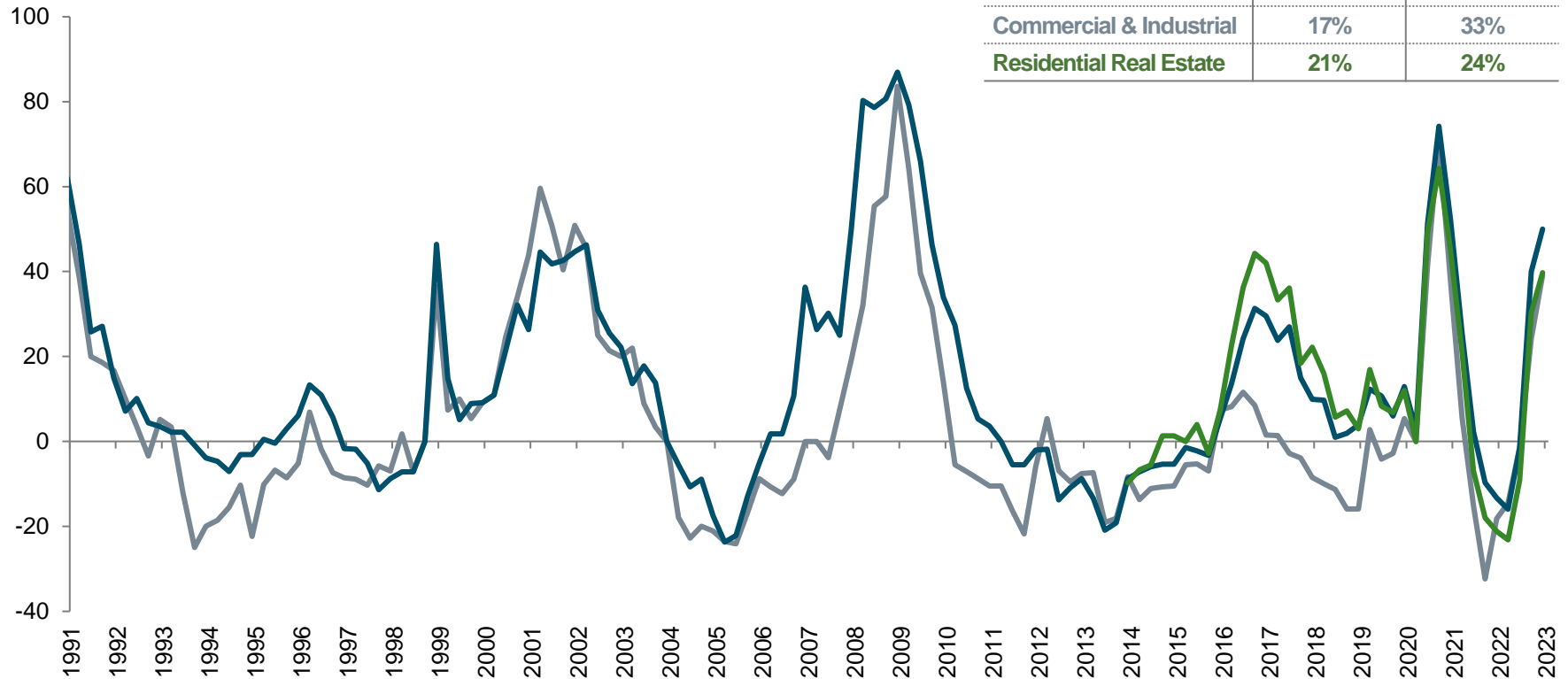
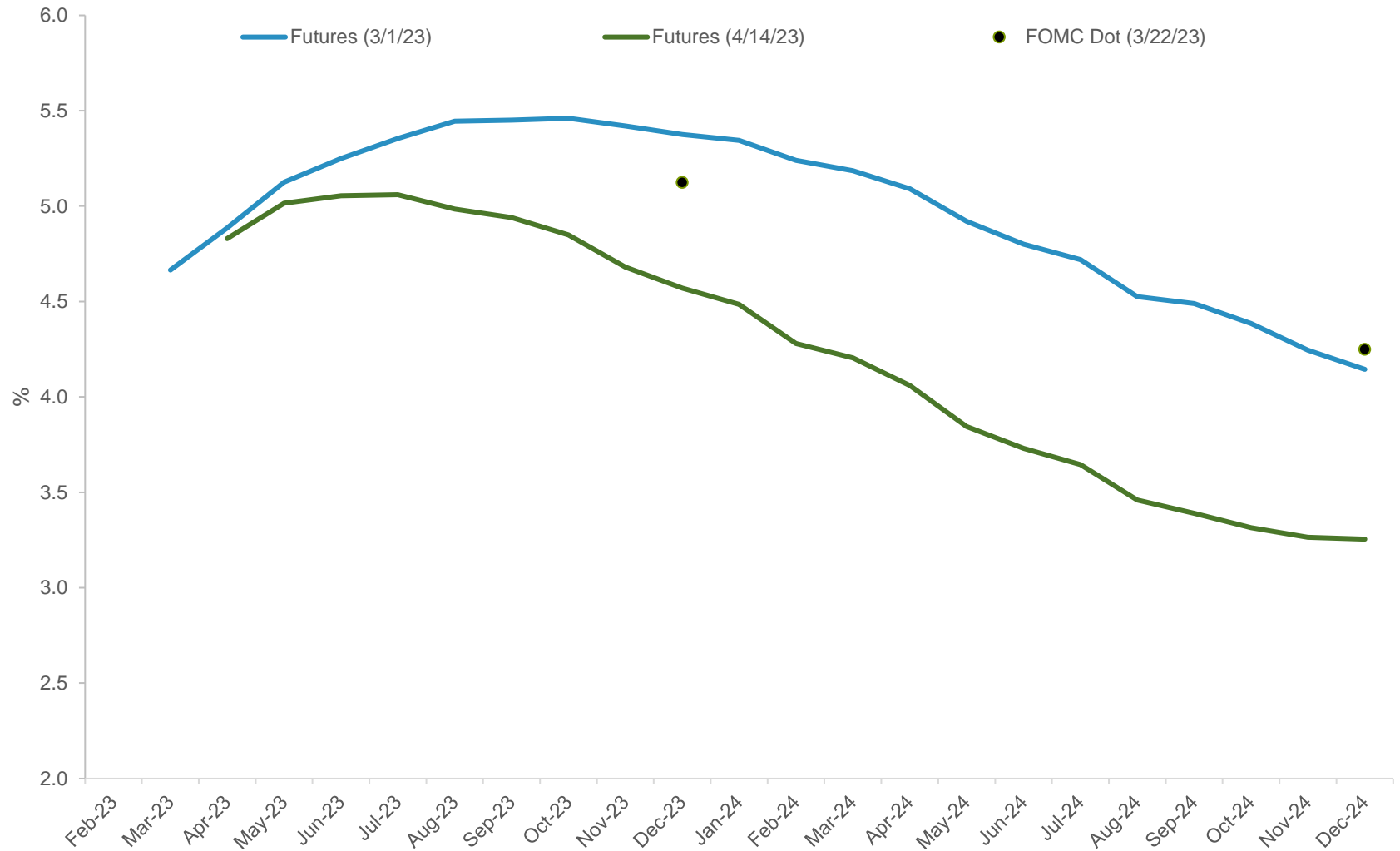


TABLE: Large Banks: Top 25 U.S. Domestically Chartered ranked by domestic assets. Source: Federal Reserve Board, Haver Analytics, Fidelity Investments (AART), as of 3/31/23.

FF Futures are Priced below the Fed's Terminal Rate



Central Bank Tightening Implies Elevated Volatility

Central Bank Balance Sheets

U.S. Eurozone Japan Total

Billions (12-Month Change)

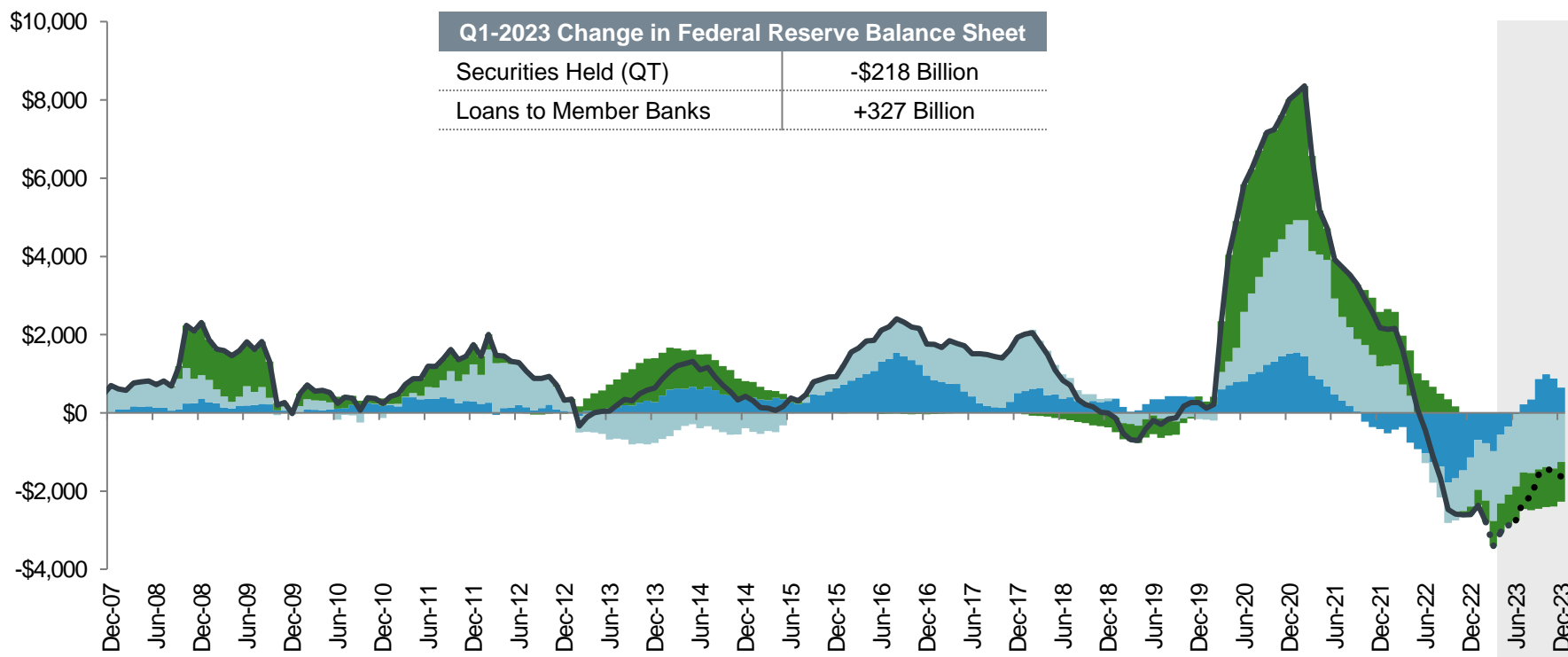


CHART: Gray bar to the right represents projected balances. QT: Quantitative Tightening. Dashed line and shaded area represent estimates based on the U.S. Federal Reserve conducting \$80 billion of Quantitative Tightening per month, the European Central Bank conducting 15 billion euro of quantitative tightening per month and redeeming Targeted Long-Term Refinancing Operations throughout 2023 based on expected loan maturities, and the Bank of Japan purchasing assets at an average of the prior six months. Source: Federal Reserve, Bank of Japan, European Central Bank, Haver Analytics, Fidelity Investments (AART), as of 11/30/22.

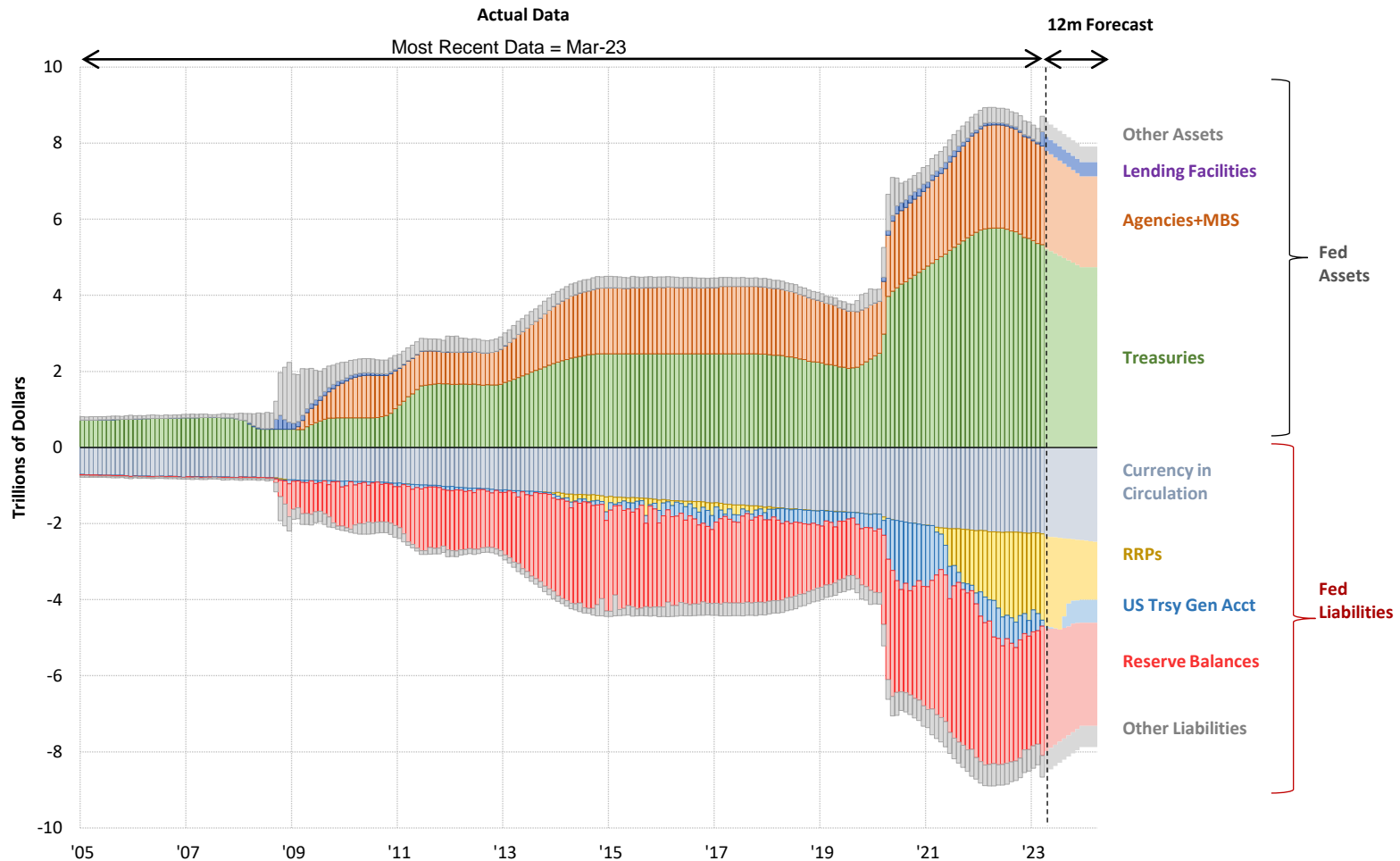
10 TABLE: Loans include discount window and FDIC-related borrowing. Source: U.S. Federal Reserve Board, Fidelity Investments (AART), as of 3/31/23.



Quantitative Tightening Slowly Draining Excess Liquidity

T-bill valuations will improve as liquidity conditions normalize

Federal Reserve Balance Sheet



Source: Monthly, Federal Reserve, FMR Calcs

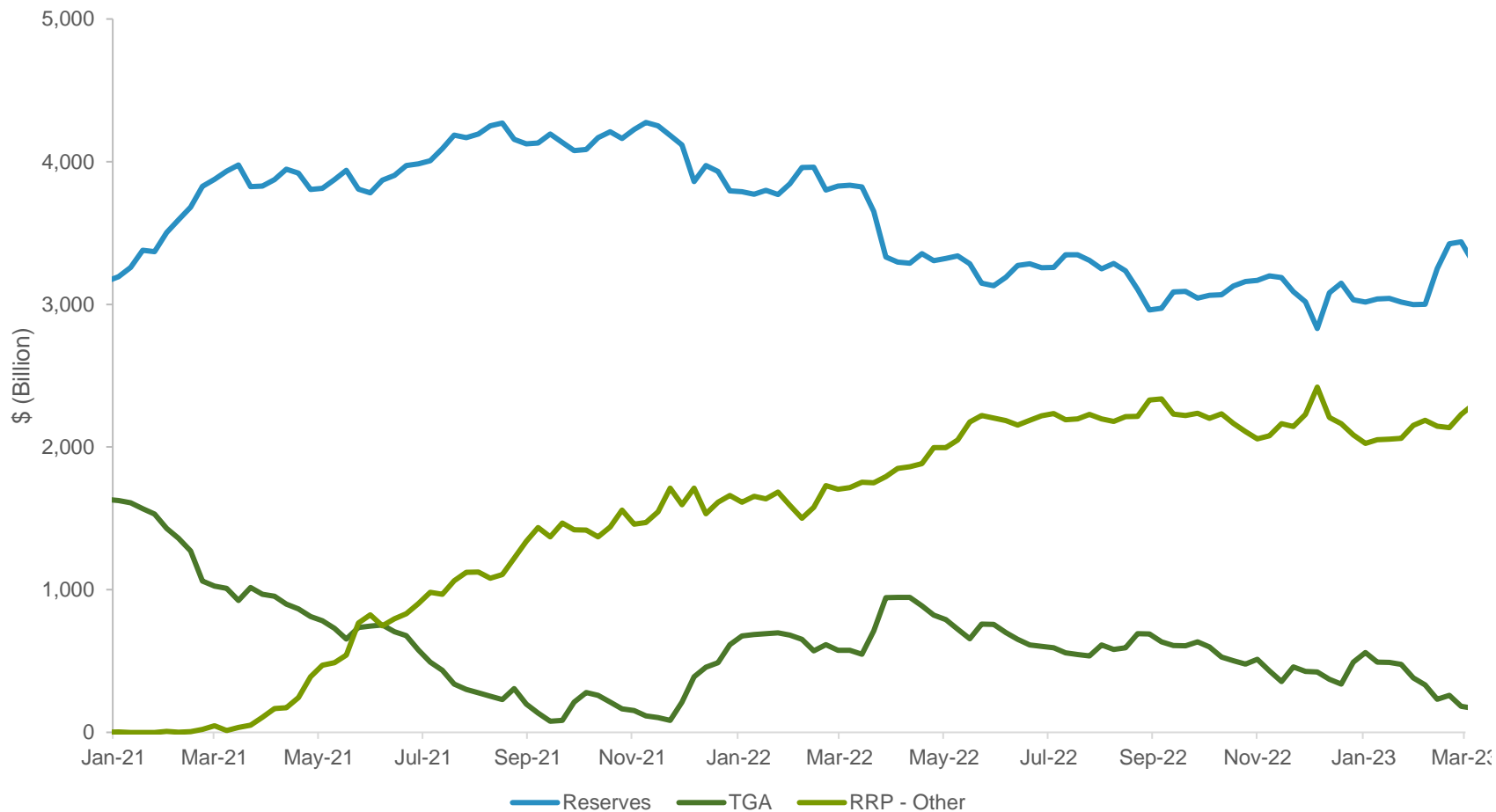
Data as of 3/31/2023.

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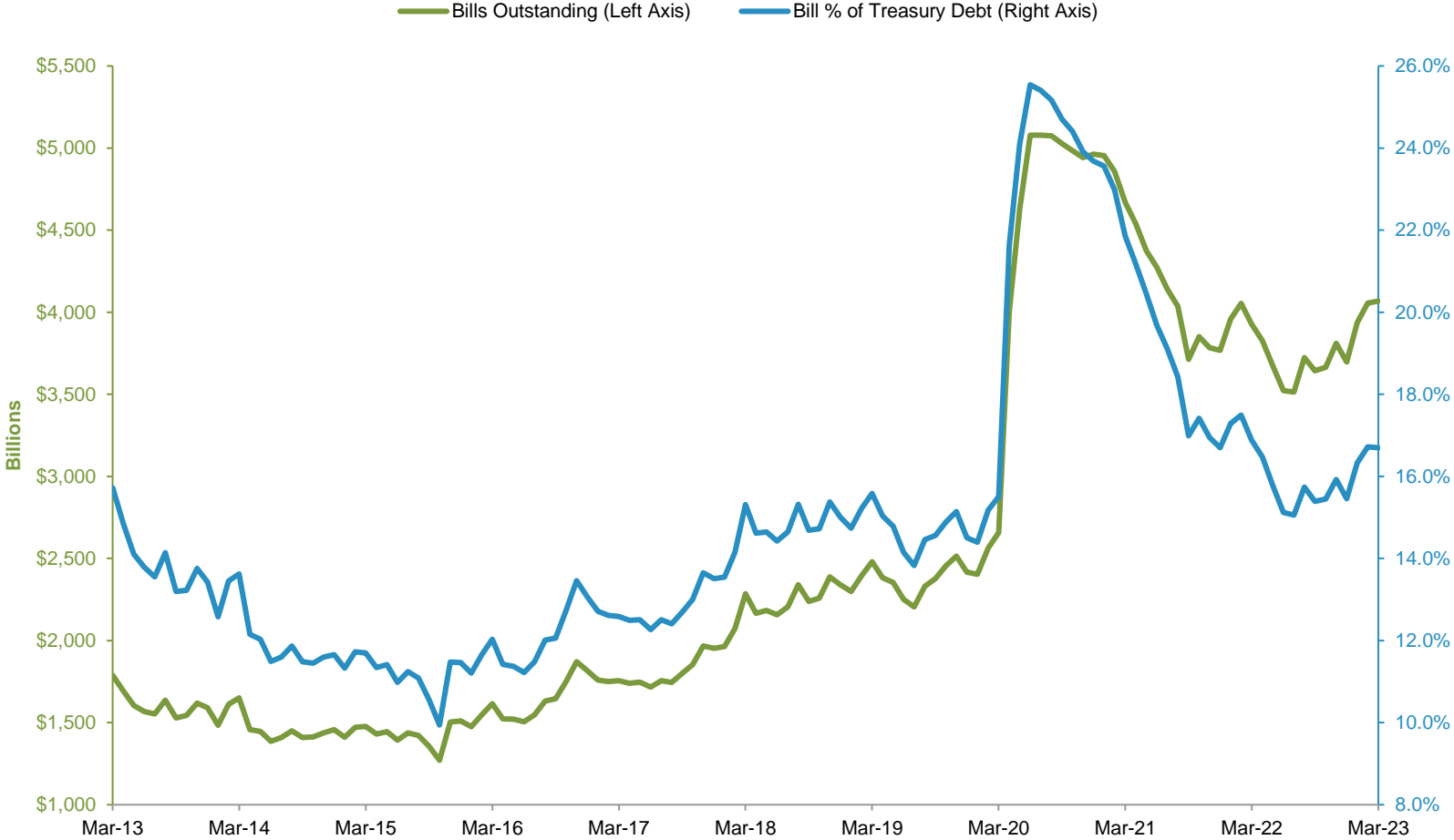


Select Federal Reserve Liabilities Impacted by Debt Ceiling

Liabilities of the Federal Reserve



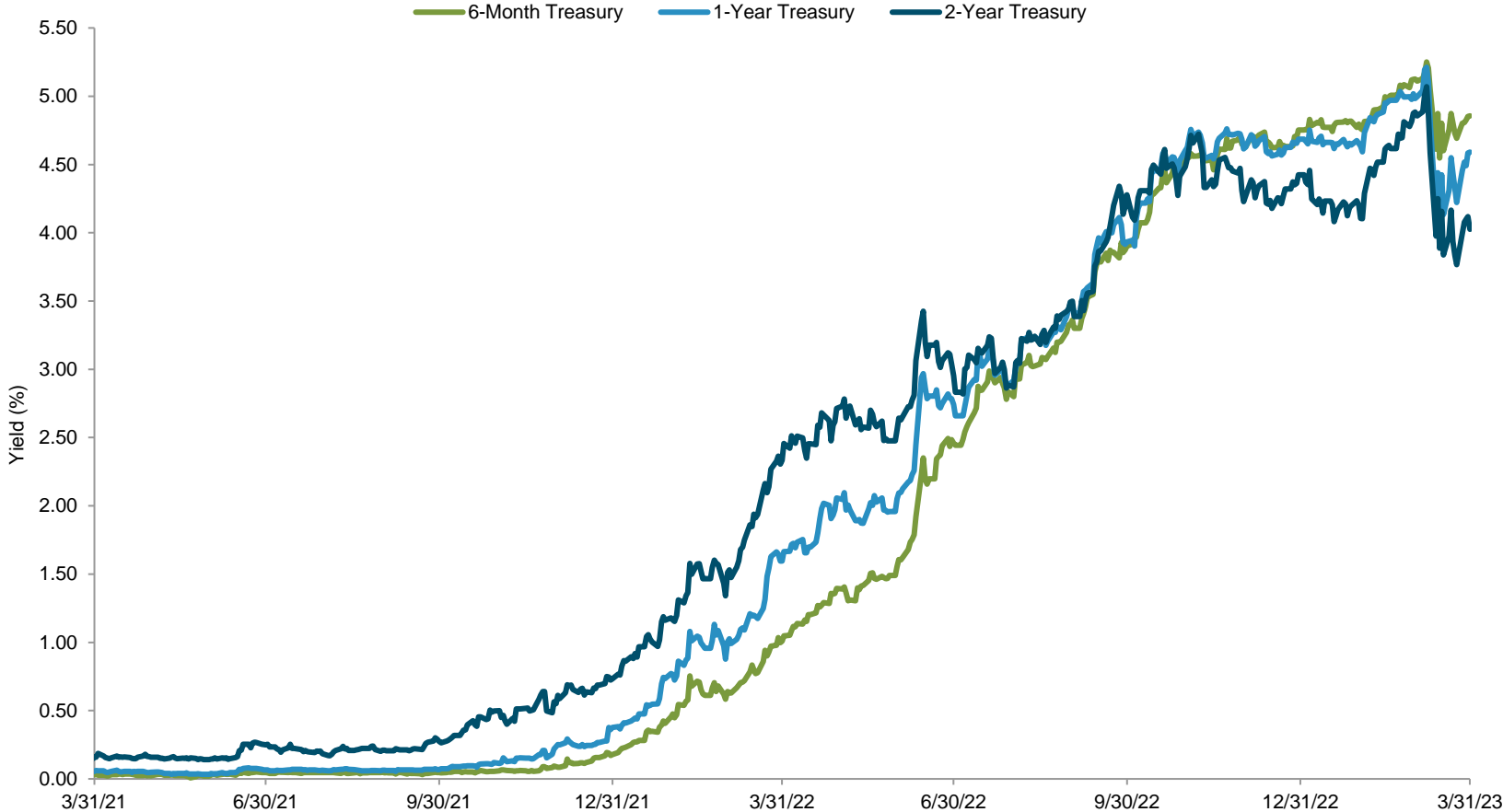
Treasury Bills Outstanding



Source: U.S. Treasury and Bloomberg as of 3/31/2023.



Short-Term Treasury Yields

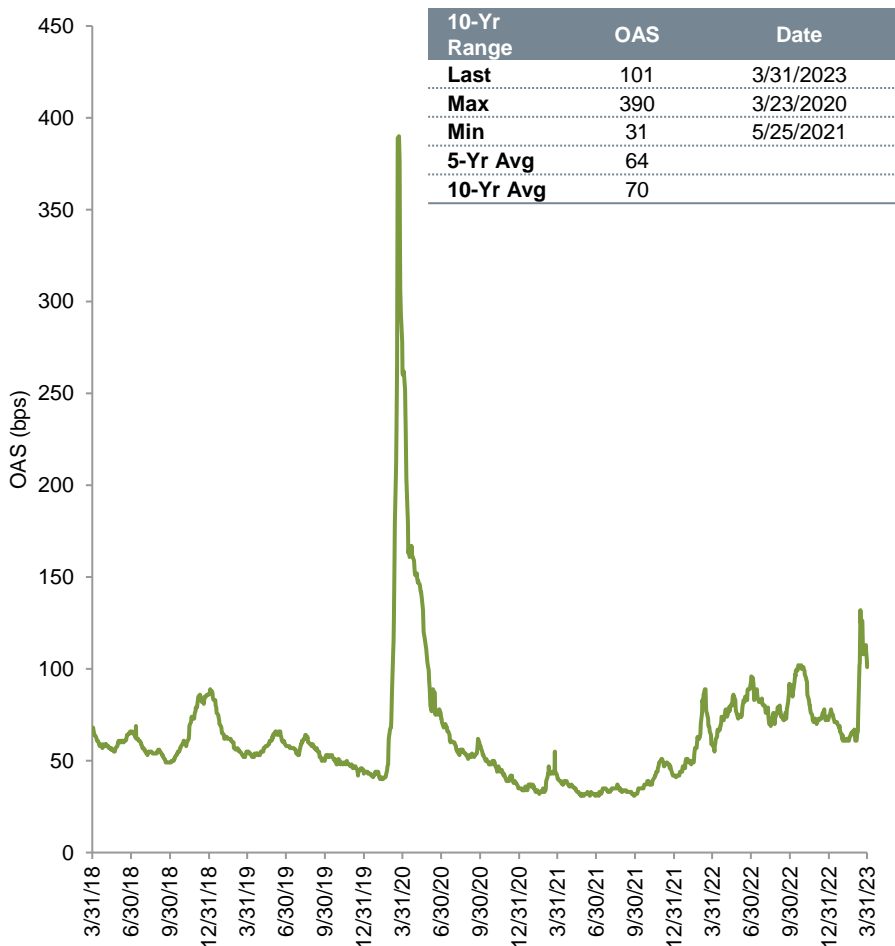


Source: Bloomberg as of 3/31/2023.

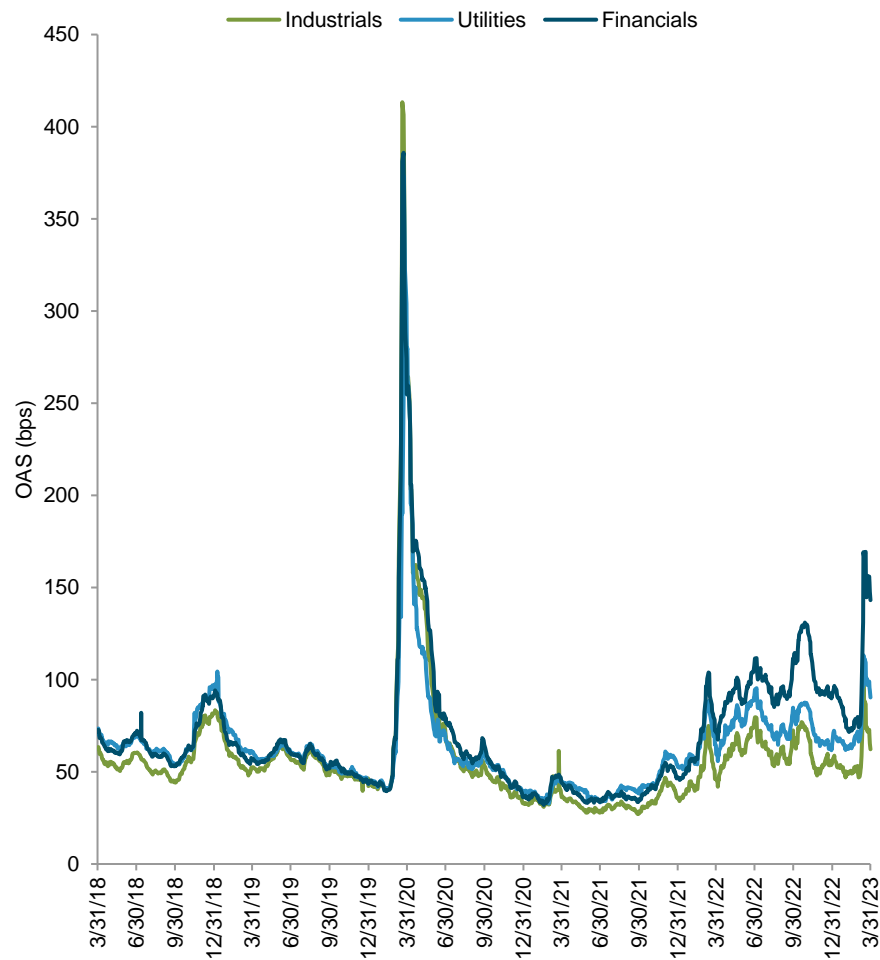


Short-Term Credit Spreads

BLOOMBERG US INVESTMENT GRADE CORPORATE 1-3 YR INDEX

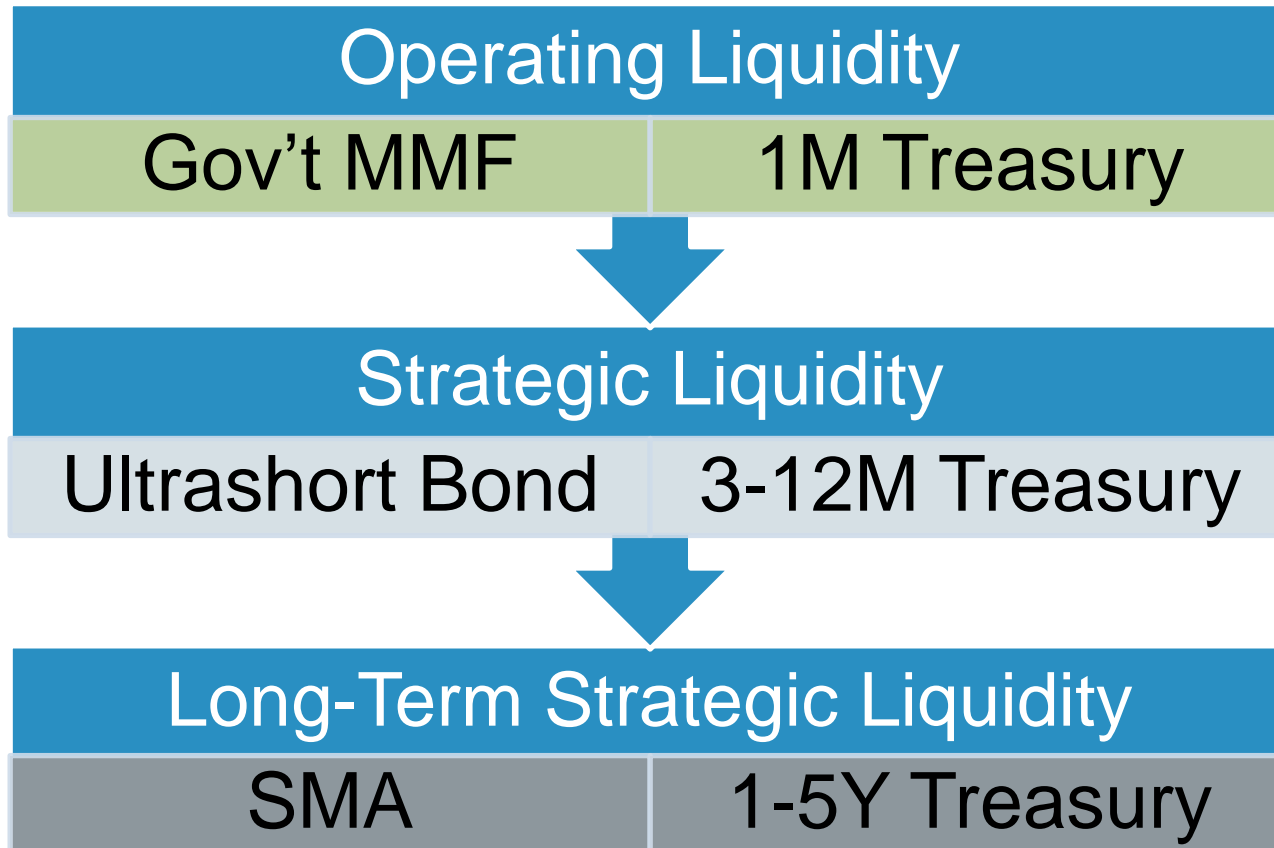


BLOOMBERG US INVESTMENT GRADE CORPORATE 1-3 YR INDEX SECTORS



Source: Bloomberg as of 3/31/2023.

Investment Alternatives and Considerations



Second Quarter Investment Outlook

Outlook

- Fed policy remains hawkish to reduce employment-based inflation
 - The U.S. is in a maturing late-cycle phase with increasing recession risk.
 - Inflation rates should moderate from high levels, but inflation risks remain on the upside.
 - Monetary policy is a growing headwind to economic growth as the Fed remains hawkish.
- The pace of rate hikes moderate as the Fed nears its terminal rate of 5.1%
 - The Fed increased rates by 25 bps in March and may seek to increase rates another 25 bps in May if warranted with incoming data.
 - Federal Reserve Governors suggest that higher rates for a longer period may be required to combat inflationary pressures.
 - The Federal Reserves QT and rate hikes continue to slow economic growth and increase unemployment.

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