Fixed Income Division

The Impact from Regulatory Reform: A New Era of Cash Management

May 2011

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Agenda

I. Industry Overview

II. The Impact From Regulatory Reform

III. Current Market Conditions

IV. Investment Process Overview

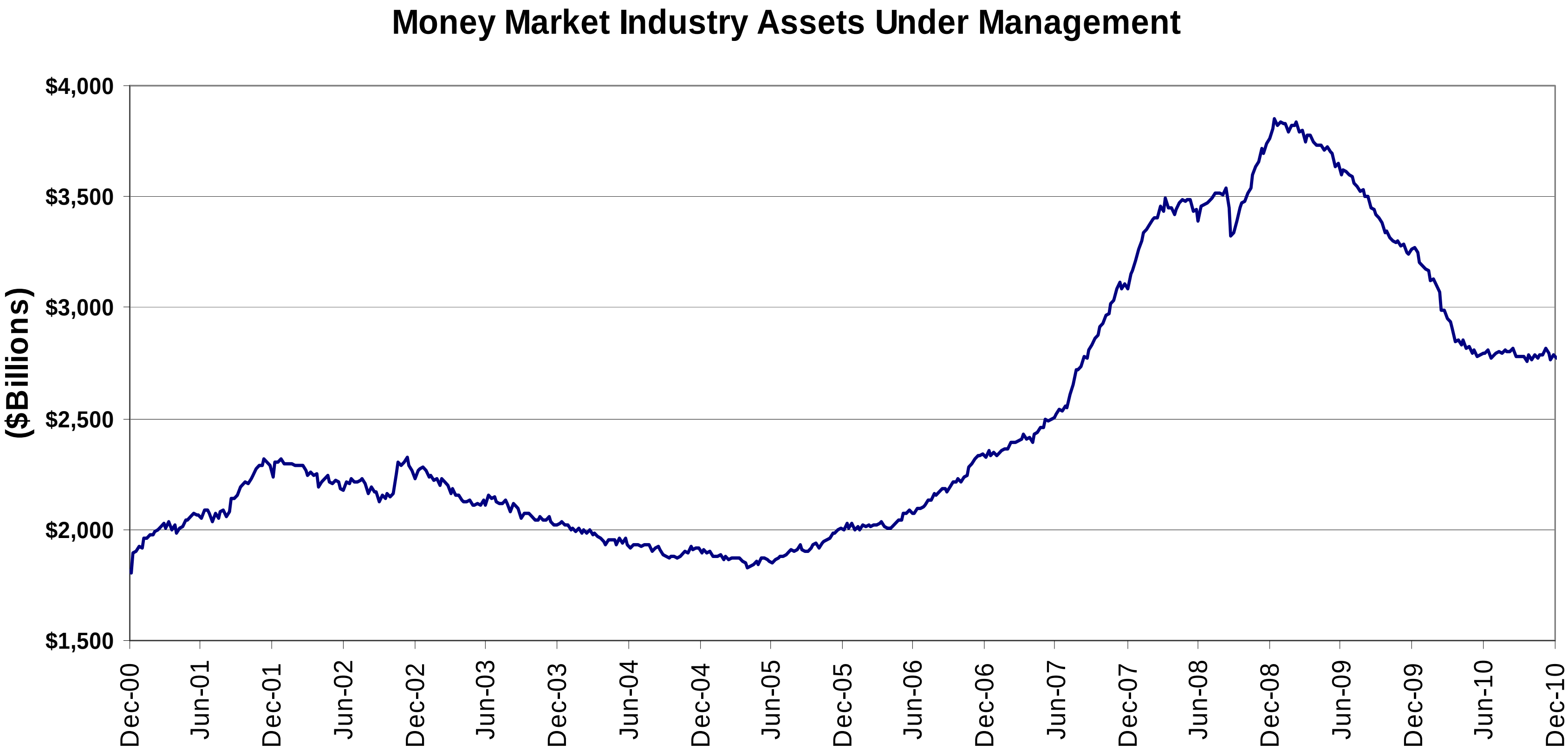
V. Post-Crisis Observations

Industry Overview

Pre-Crisis Observations

- Clients may have become less sensitive to investment risks inherent in cash investments
- Some fund sponsors failed to maintain appropriate client investment objectives and required resources to meet those objectives
- Technology/portals increased “ease of use” for MMF investors
- With decades of virtually loss-free investing, investors were lured to “highest yielding” product offering

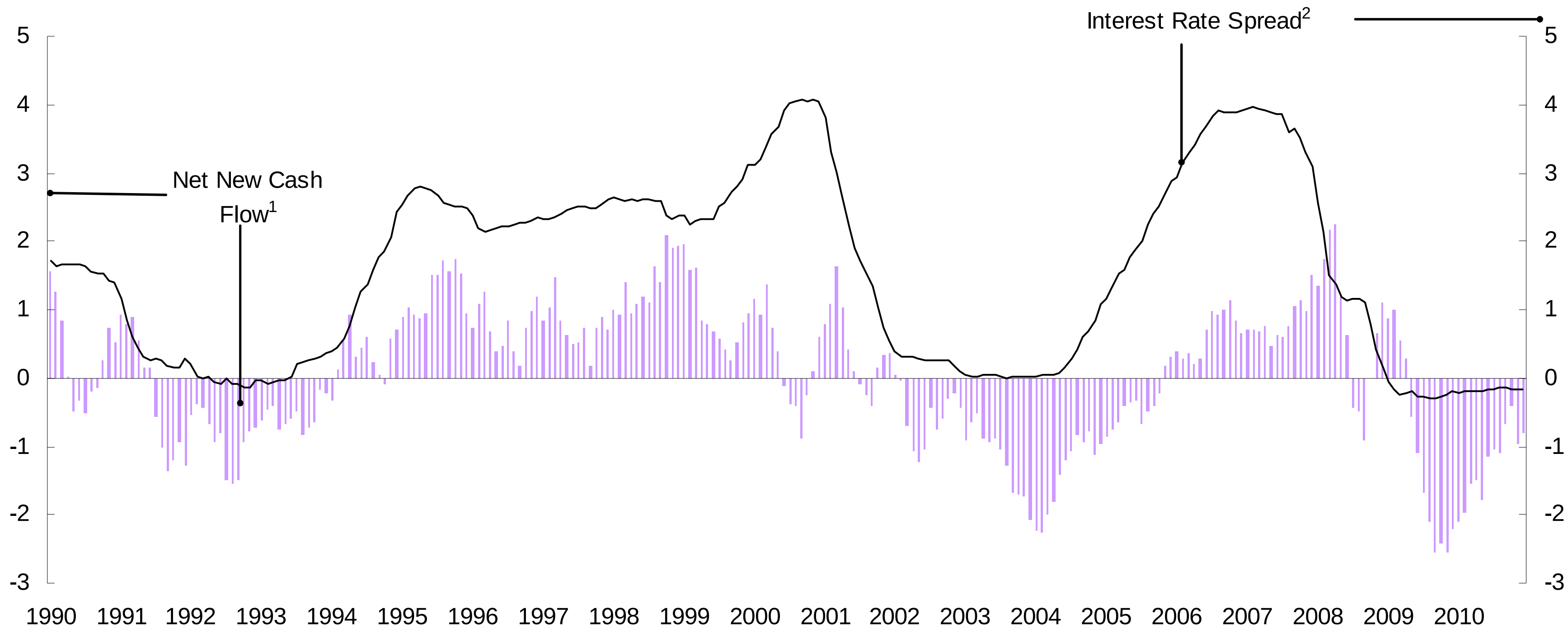
Money Market Fund Assets Stabilize, Remain Historically High



Source: iMoneyNet and FMR as of 12/31/2010

Yield Differentials Drive Flows

Money Market Fund Flows Versus Interest Rate Spread to Banks

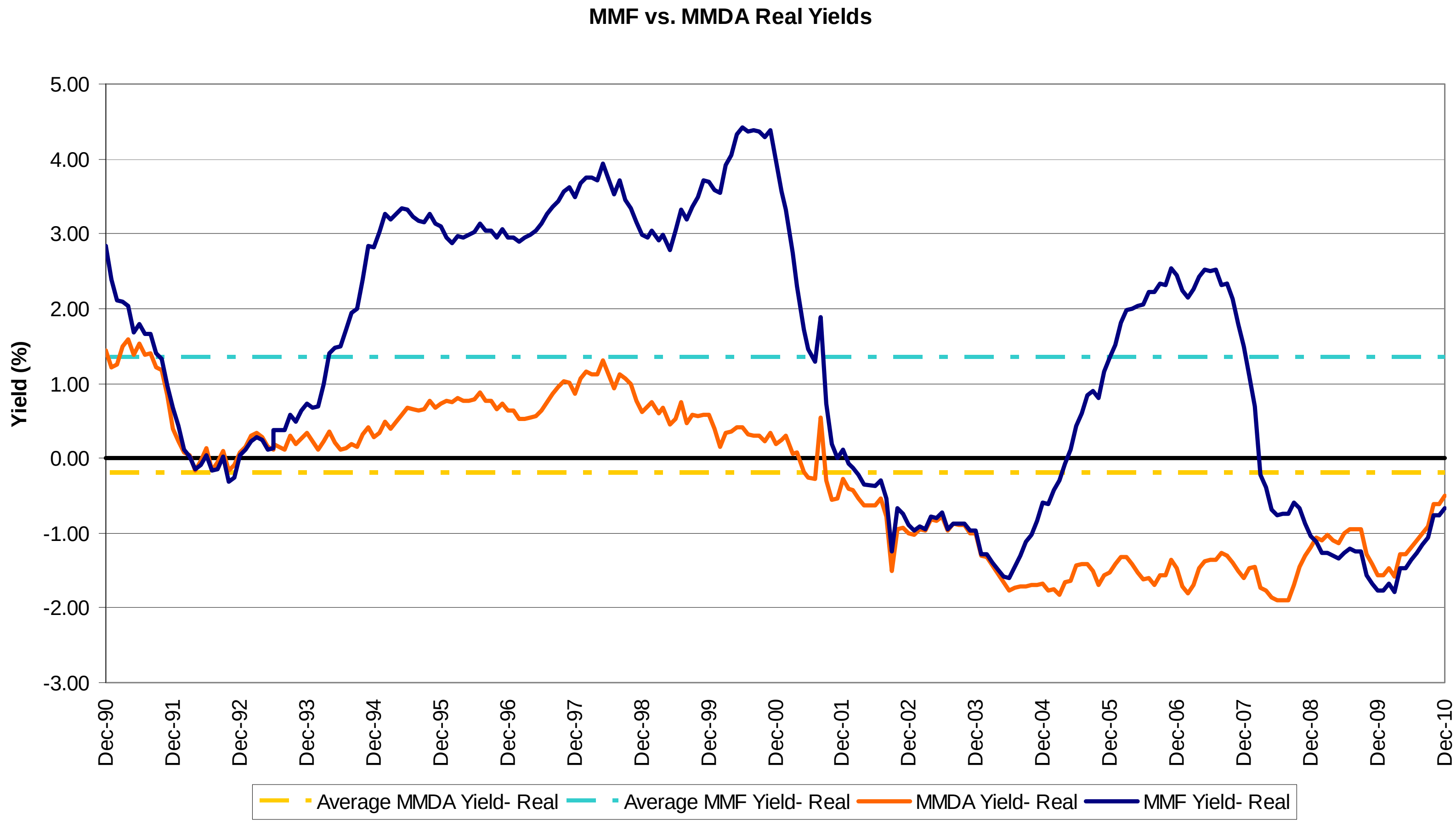


1 Net new cash flow is a percent of previous month-end taxable retail money market fund assets and is shown as a six-month moving average

2 The interest rate spread is the difference between the taxable retail money market fund yield and the average interest rate on money market deposit accounts

Sources: Investment Company Institute, iMoneyNet, and Bank Rate Monitor

Bank Deposits Offer Negative Real Yield in Long Run



Source: iMoneyNet, BankRateMonitor, Bloomberg as of 12/31/09

The Impact from Regulatory Reform

Regulatory Changes Impacting Portfolio Management

	Old Rule 2a-7	Current Rule 2a-7	Estimated Yield Impact (bp)[1]	Implementation Date
Daily Liquidity – Taxable	**None**	**10%**	0	**May 28, 2010**
Daily Liquidity – Municipal	**None**	**None**	None	**None**
Weekly Liquidity – Taxable	**None**	**30%**	(9 – 12)	**May 28, 2010**
Weekly Liquidity – Municipal	**None**	**30%**	0	**May 28, 2010**
Weighted Average Maturity (WAM)	**90-days**	**60-days**	(0 – 8)	**June 30, 2010**
Weighted Average Life (WAL)	**None**	**120-days**	(1 – 3)	**June 30, 2010**
Illiquid Securities	**10%**	**5%**	(1 – 3)	**May 28, 2010**
Second Tier Securities	**5% 1% per issuer 397-day limit**	**3% 0.5% per issuer 45-day limit**	(0 – 3)	**May 28, 2010**
Total			(11 – 29)	

[1]Estimated yield impacts represent annual reductions in annual fund yield in a normalized rate environment over time. Reductions show impact to fund that is running at or near current Rule 2a-7 limits. Yield impacts differ among rated, institutional, and retail funds.
Sources: FMR and Securities and Exchange Commission

Presidents' Working Group Report-
Potential Options for Money Fund Reform

- Floating the NAV of money market funds
- Mandatory redemptions-in-kind
- Private liquidity facilities
- Insuring money market funds
- Two-tiered system of money market funds of stable NAV and floating NAV funds
- Regulating stable NAV funds as special purpose banks
- Regulating non-2a-7 cash management products

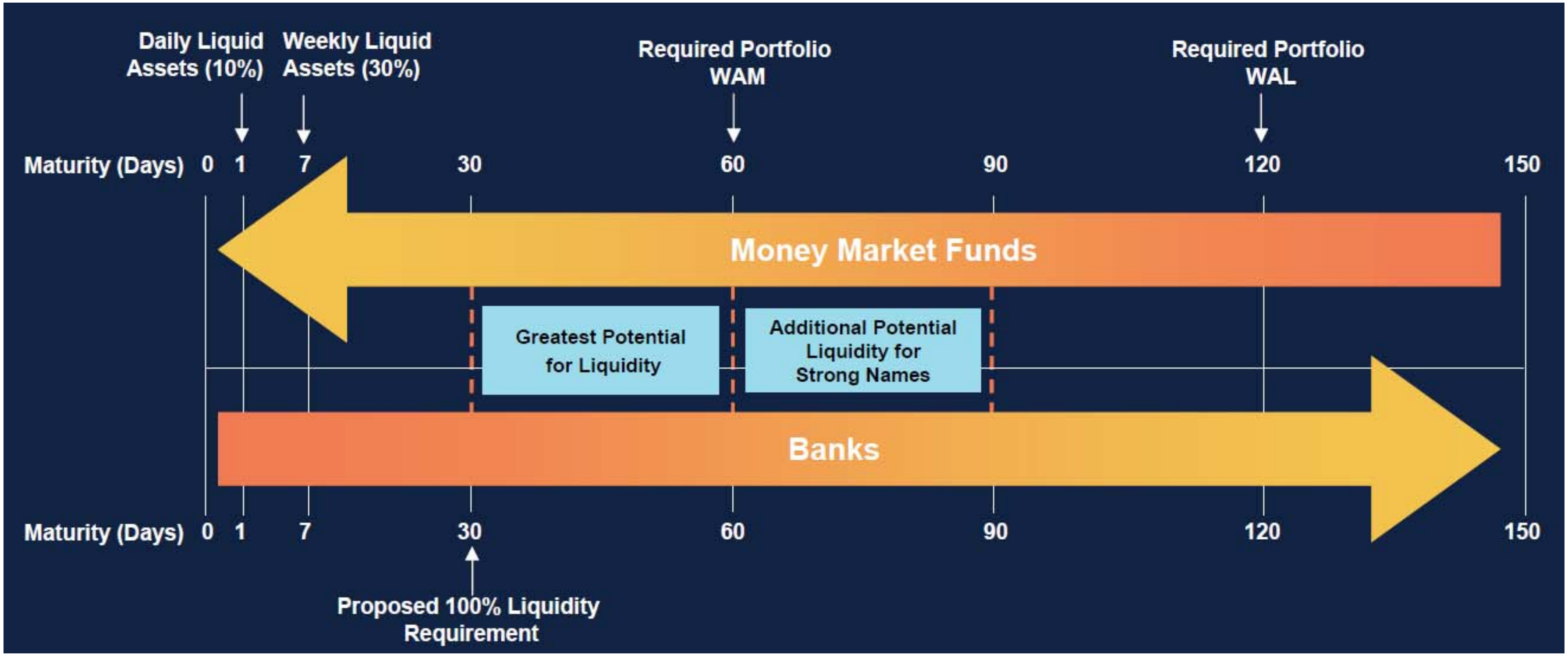
Basel III – Additional Consideration for 2a-7 funds

- On September 12th, the Basel committee reached agreement on key elements of the capital reform process
- Capital
  - Minimum Tier 1 common ratio of 4.5%
  - Capital conservation buffer of 2.5%, yielding 7% effective T1 common floor
  - Additional countercyclical buffer of 0-2.5%
  - Minimum Tier 1 leverage ratio of 3% effective 2018
  - Capital requirement phase-in period from 2013 - 2018
  - Hybrids phased out over 10yrs beginning 2013
- Liquidity
  - Liquidity coverage ratio effective 2015
  - Net stable funding ratio effective 2018

Source: FMR

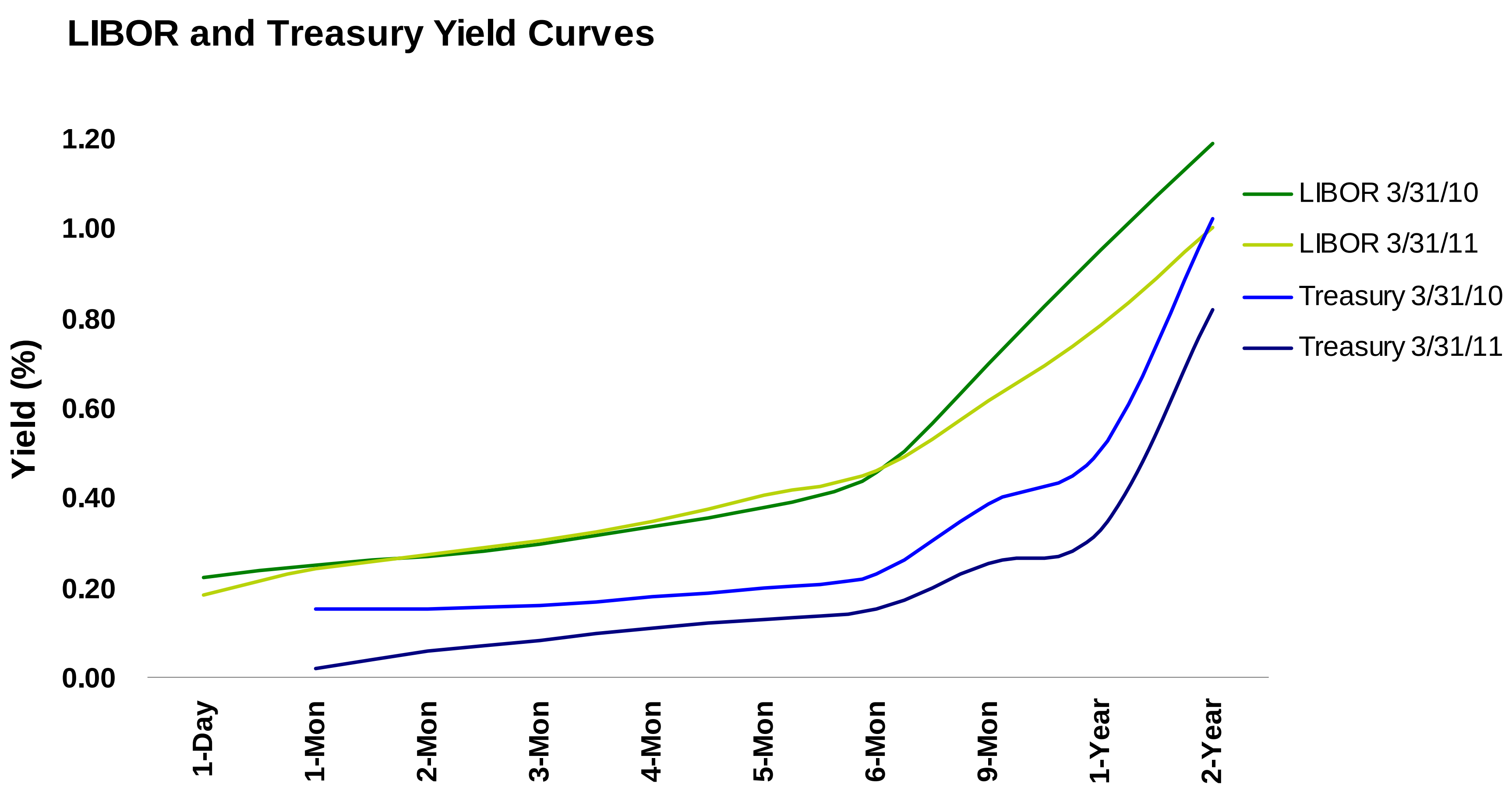
Regulation Creates Opportunity

Money Market Fund and Bank Regulations



Source: Morgan Stanley

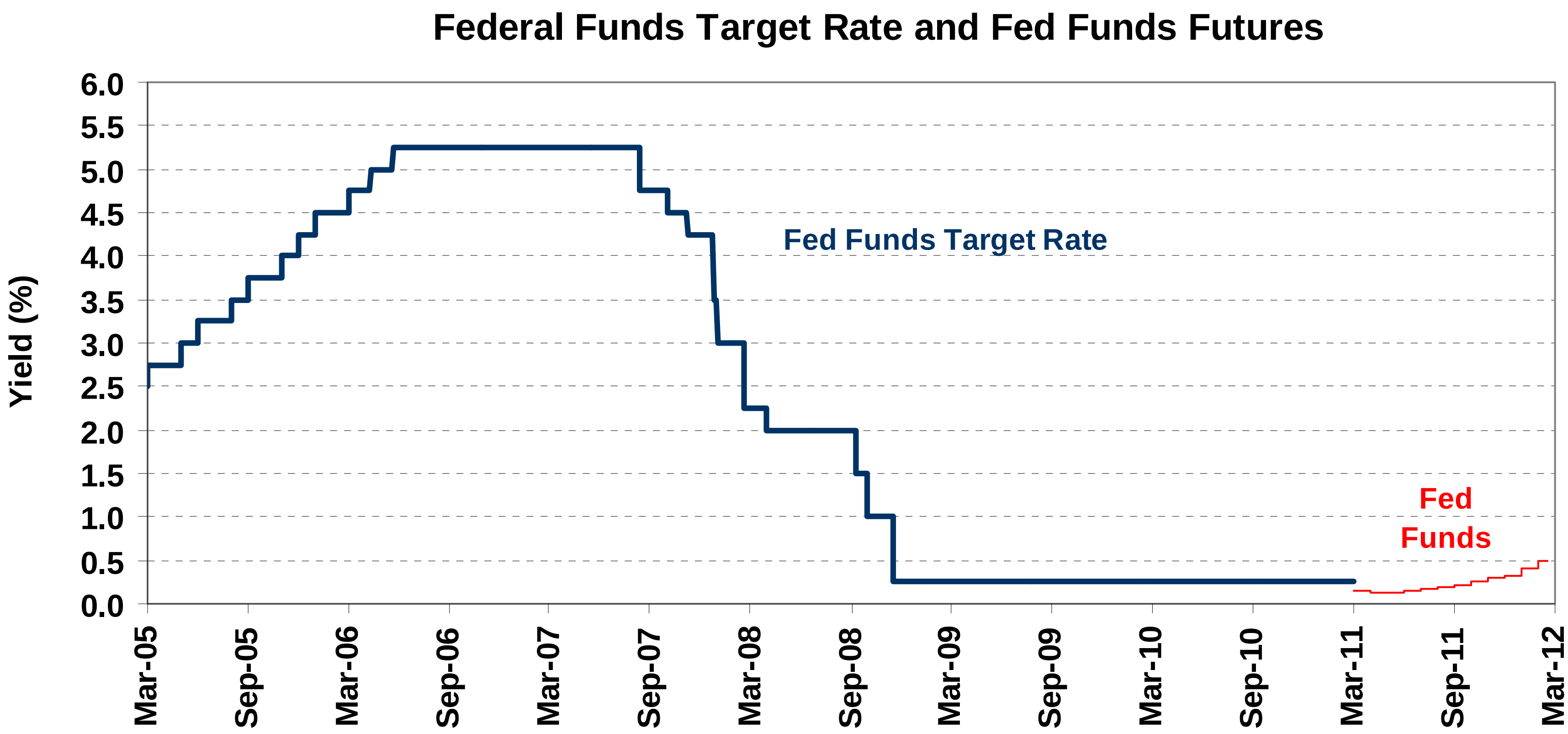
Yield Curve Steep Beyond Six Months



Source: Bloomberg as of 3/31/11

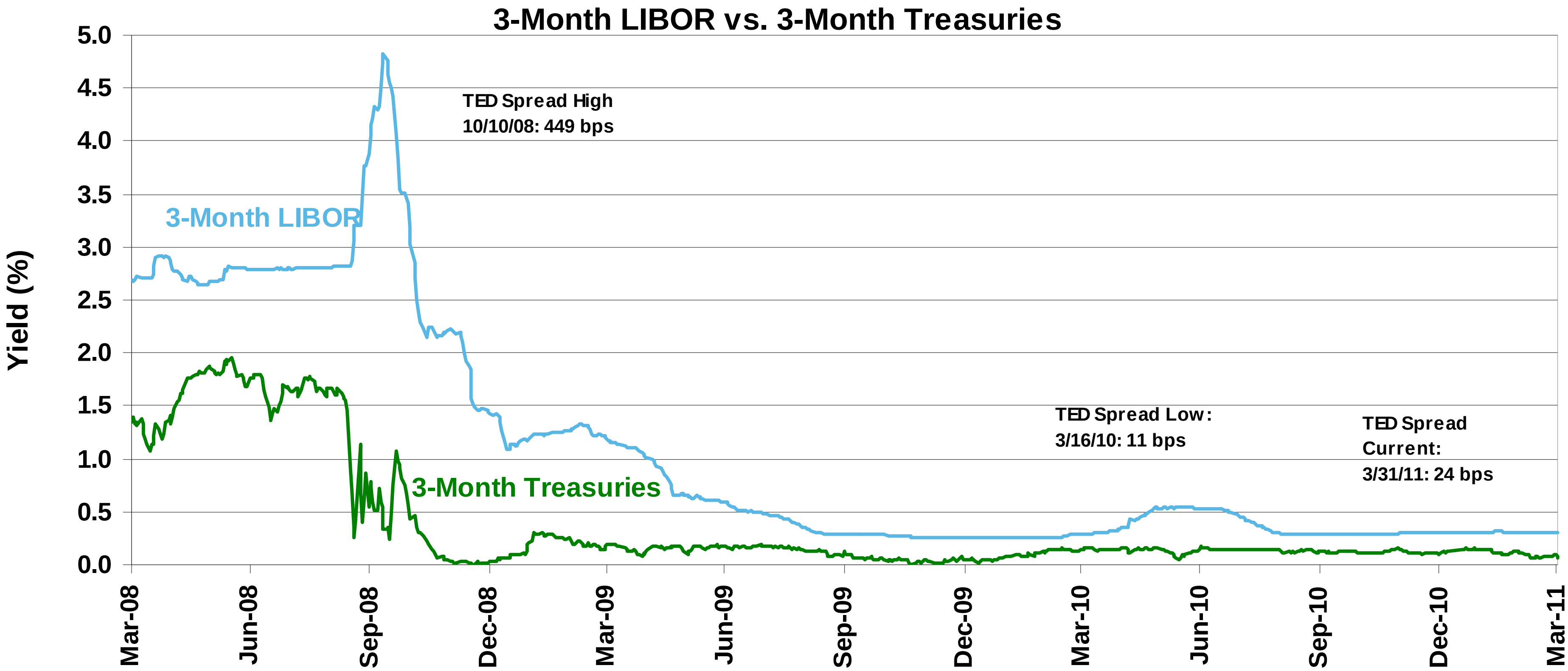
Current Market Conditions

Recovery Underway, Fed Tightening Unlikely in 2011



Source: Bloomberg as of 3/31/11

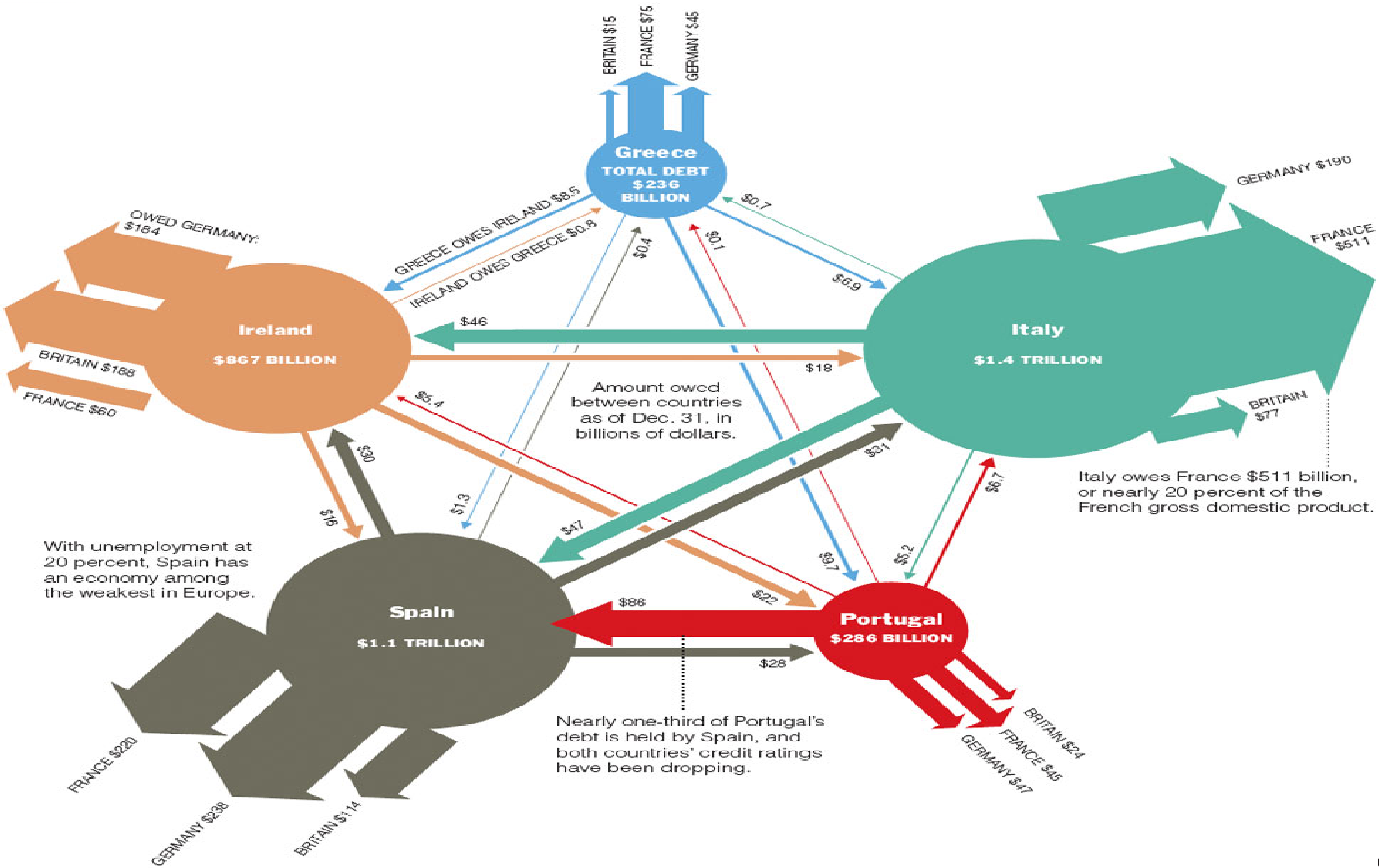
Short-Term Credit Spreads Remain Narrow



Past performance is no guarantee of future results. It is not possible to invest directly in an index.
Index performance is not meant to represent that of any Fidelity mutual fund.

Source: Bloomberg as of 3/31/11

First Dimension of Contagion



Source: NY Times as of June 2010

European Response was Significant

- Permanent Liquidity Measures from the European Central Bank (ECB)
  - Main Refinancing Operation (MRO)
  - Long-Term Refinancing Operation (LTRO)

- Recent Measures by European Authorities
  - Expanded collateral eligibility
  - Reinstituted central bank swap lines
  - ECB targeted bond purchases

- Sovereign Support Programs
  - Initial Greek package of EUR110 billion
    - Financed 2/3 from EMU and 1/3 from IMF
  - European Financial Stabilization Fund – EUR 750 billion
    - EU/EC Balance of Payments Facility – Increased to EUR110 billion
    - Eurozone Loan Guarantees of EUR440 billion
    - IMF Loan Facility up to EUR250 billion

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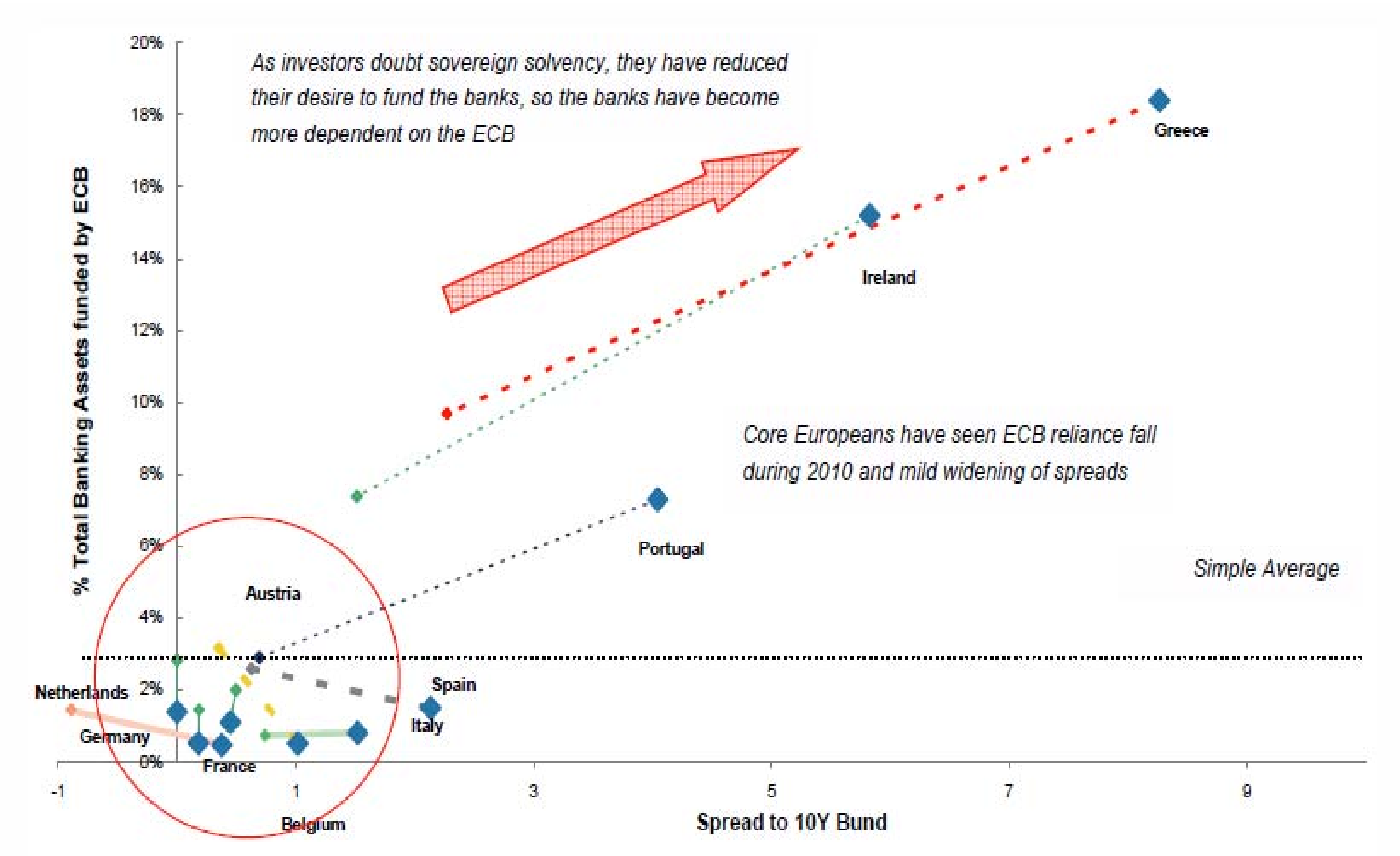
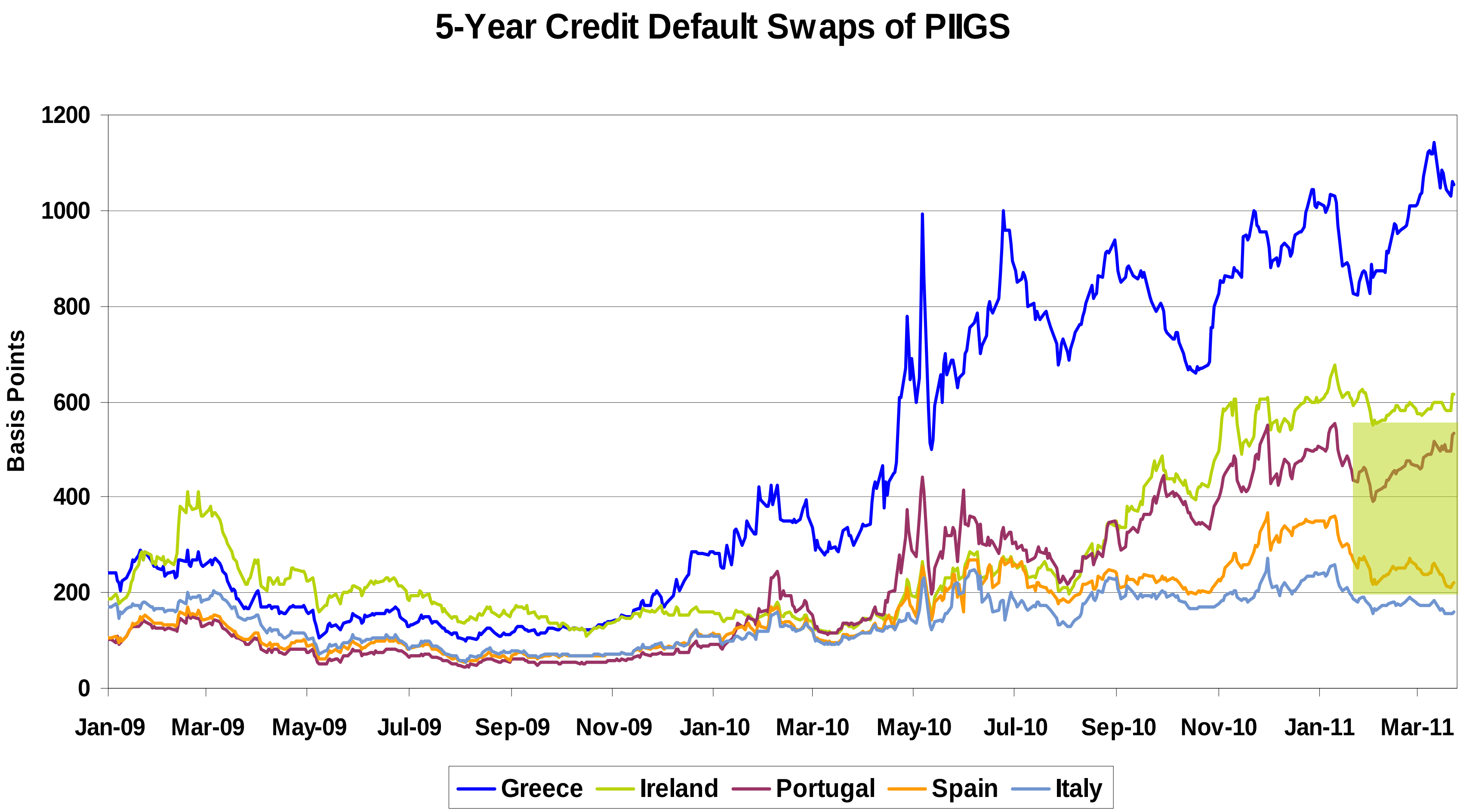
Peripherals Highly Dependent on ECB Funding



Source: Morgan Stanley, Bloomberg, ECB and Central Bank of Ireland as of 2/15/2011

Spain Decouples from Portugal



Source: Bloomberg as of 3/31/2011

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Two Rounds of Bank Stress Tests

- The Committee of European Banking Supervisors (CEBS) conducted the first European Bank Stress Test in July 2010
- Only seven banks failed with a €3.5bn total capital shortfall
  - Failed banks included one German, one Greek and five Spanish banks
- The market blamed the low number of failures due to a lack of rigor in macroeconomic stresses and that sovereign haircuts were applied only to trading books and not to accrual books
- Hence, another stress test is scheduled with CEBS expected to be published in June
  - Similar to 2010, the banks tested will cover 65% of EU banking system total assets and at least 50% of the national banking sectors in each EU member state
  - Haircuts for sovereign debt will still not be taken in the accrual book, but there will be better disclosure (e.g. the sovereign holdings by maturity buckets)
  - The test will include a baseline and adverse scenario for the periods of 2011-12
  - The methodology incorporates a core tier 1 level of 5%

Risks Lie Ahead

- Sovereign crises are likely to be with us for some time
- They could expand into other, larger and more systemic countries including Spain, UK, Japan and even the United States
- The rescue packages to date do not address solvency issues and only buys some time
- Large sovereign crises are likely to have major systemic implications, especially given the close linkages between sovereigns and their banking systems
- Austerity and higher funding costs could undermine economic growth and increase the risk of double dip into recession

Investment Process

Identify and Measure Relevant Risk Parameters

Investment Risks	Significance of Risk Exposure	Benefits of a Multi-Dimensional Research Process
Credit Risk	Principal depreciation through price volatility or default	Non-reliance on Nationally Recognized Statistical Rating Organizations
Interest Rate Risk	Principal depreciation through rising interest rates and widening spreads	Quantitative Risk Management Framework
Liquidity Risk	Lost access to cash holdings	Thorough analysis of underlying liquidity provisions
Structural Risk	Complex documentation contains embedded risks	Dedicated legal team with specialized securities knowledge

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Multi-Dimensional Investment Approach

Bottom Up Foundation

- » Fundamental Analysis
  - Fundamental foundation
  - Relative value assessment
- » Quantitative Analysis
  - Proprietary risk modeling
  - Security and portfolio level
- » Structured Analysis
  - Capital structure analysis
  - Complements fundamentals
- » Value Added Trading
  - Relative value assessment
  - Across curve and structure
  - Macro trends/technicals

Top Down Perspectives

- » Macroeconomic Inputs
  - Federal Reserve expectations
  - Sovereign landscape
  - Tail risk/scenario modeling
- » Sector
  - Basis call: transparency
  - Fundamental and relative value
- » Yield Curve
  - Breakeven analysis
  - Slope and volatility
  - Relative value opportunities
- » Interest Rate
  - Duration views
  - Volatility perspectives

Bottom-up, fundamental Investment platform complemented by top-down inputs, results in a robust and durable process

Conclusion: Post-Crisis Observations

- The recent and future regulatory environment have given rise to a new era of cash and liquidity management
- Investment goals and objectives are independent of current market conditions
  - Capital Preservation
  - Liquidity
  - Returns
- Cash Management is a time consuming, resource intensive multi-dimensional process
  - Develop a Risk vs. Return profile
  - Understand all aspects of the investible universe
- The guiding principle of credit research is minimal credit risk
- Money market funds are more resilient than ever before

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