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TRANSCRIPT

SPEAKERS:

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HEATHER HEGEDUS: Hello there and thank you so much for joining us for a special in-person edition of *Market Sense*. I'm Heather Hegedus with Fidelity. So we offer these investing outlooks at the beginning and the midway point of the year because we feel these two time periods might be a good time to take a step back and make an assessment of where things stand with the economy, the markets, and what it all might mean for you. It might also be a good time for investors to run what we like to refer to as a portfolio checkup where you make sure your investments still align to your goals, and time horizon, and consider any risks and opportunities that may have surfaced along the way. So right now the economic backdrop includes some mixed signals that investors may have been finding slightly hard to interpret as of late, as well as some ongoing uncertainty primarily because of tariffs. Although for now the worst case scenario seems to have been taken off the table with regards to tariffs after that trade truce was reached with China in May. It's a temporary truce, but the markets did recover very quickly. That doesn't mean though that there's any shortage of events and economic data points to talk about. So we are going to unpack it all for you today with our terrific threesome here, our team of superstar Fidelity professionals, and of course they are first and foremost Jurrien Timmer, of course, *Market Sense*'s unofficial quarterback, and Fidelity's director of Global Macro who's going to be discussing what it could all mean for both stocks and bonds and yes, even alternative investments. We are also so excited to be joined today by Denise Chisholm. She's of course Fidelity's director of Quantitative Market Strategy, and Denise uses a data driven approach to uncover historical patterns, and you're gonna be talking about stock opportunities through that lens today, Denise. And finally, Naveen Malwal. He's a CFA and an institutional portfolio manager here at Fidelity. His team manages millions of clients' accounts. And you're gonna be taking that data today, Naveen, that Jurrien and Denise talk about and unpack that for us and talk about what it might mean for people's portfolios. Um, so thank you to the three of you for making the time, clearing your calendars. I think it is an important time period in the year for investors to be thinking about their portfolios, so I appreciate you guys sitting down with me to do this.

JURRIEN TIMMER: It's a pleasure to be here with the A-team.

DENISE CHISHOLM: Yeah, great to be back.

NAVEEN MALWAL: Yeah, it is. Let's do this.

HEATHER: Let's do it. A-team indeed. I love it. And um let's start with you, Jurrien. Um, just kind of get like a stage scene set for you, if you will, here with a pretty basic question. So it's been an unpredictable year. I don't think there's a better way to put it and that might be an understatement if we think back to January, the last time that some of us sat down together. So much has changed since January. So if you could give us a quick recap, I think that would be really helpful of how we got here and where things stand right now.

JURRIEN: Yes, uh, so I'll start with my predictable statement about the markets always being in price discovery so markets are always trying to figure out what's going to happen next, and that's why price, as Denise always says, tends to lead earnings and so when things don't change a lot, the market just kind of chills out and hangs out there but when things change a lot and fast, the market has to reprice based on whatever the new available information is so we had the election of course last November. It was fairly decisive, right, a Republican sweep. Markets had to reprice from kind of we don't know where things are going to you know animal spirits and I'll define animal spirits. It means like kind of this roaring twenties thing where the the business of America is booming.

HEATHER: Great Gatsby era right.

JURRIEN: And so and so that's what the markets were pricing in and there was a sense what, yeah, there's that whole tariff thing but we're gonna hope that it's a means to an end and not the end. Uh, then as we got into this year in January, markets started to get a little bit more concerned about, well, what if tariffs do happen, uh, and, and it creates some kind of a growth shock. We need to price in for that so the markets that went down 10% we're hanging out there and you know, uh, as Denise knows markets are down 10% half the time like it's very, very common for the markets to be in some sort of corrective mode, uh, but then we had sort of Liberation Day, April 2nd. And that whole list of very, uh, you know, aggressive tariffs were rolled out and the markets had to reprice again for that so we went from like a 10% off sale to a 20% off sale in the markets and then the tariffs were rolled back at least they were, you know, we have this 90 day truce and the markets again had to reprice themselves for now a less bad outcome or a better outcome and that's how the market are just constantly going back and forth and it it's chaotic, but it actually makes sense because the market is very efficient. It's not always right, but it's efficient in pricing in all known information. But when that known information is switching from one day to the next, it creates the volatility that we've seen.

HEATHER: Well, you really described quite a roller-coaster ride that we have been on just in the past 6 months Jurrien. And Denise, I know you've done some specific research in regards to where the market tends to end up when it falls 20% like it did just this past year. So I was wondering if you talk about your research and and what it found.

DENISE: Yeah, you can look at the, I think 15 bear markets since 1957, and technically we weren't in a bear market. I call us bear adjacent because on a closing basis we didn't fall more than 20%.

HEATHER: Jurrien calls it a bear scare.

DENISE: That's a good one because there are some approximate ones that we've seen throughout the last 20 years as well. But if you look at all those bear markets, despite the fact that they happened for all kinds of different reasons, right? We haven't experienced anything like tariffs, but we've had these bare scares or bare adjacent markets quite often. And when you look and you analyze them and you say, OK, what if once they happen, if I just closed my eyes, held my nose, bought stocks, and woke up a year later, how often would I be up? And it's 80% of the time. Which is not to say that at that time that you buy, that the lows are usually in, because they're usually not, but it's just the longer your time horizon, the more likely you are to make money. The interesting pattern behind our bear scare was really this was the third most rapid bear market since 1957. And you do see a very specific pattern. The speedier the bear market is, the more likely the bear market is to be higher a year later. So those three big secular bear markets that we're all sort of afraid of, 1973, um, 2001, and then of course, the financial crisis, those were really defined by the fact that it took 300+ days to get into bear market territory, so that's not currently our situation. So it is interesting when you see those patterns that again, despite that it has all different idiosyncratic reasons to have the bear market, but 80% of the time if you just wait, you're up a year later.

JURRIEN: And you raise a really good point that uh bear markets have obviously a price component, you know, generally people think of it as down 20%, but it has a time component, right. So in late 2018 the market fell 20% and like a few weeks later we're back at new all-time highs. No one thinks of that as a bear market even though it was 20%. So there's more to it than just the degree of the drawdown.

HEATHER: The degree of how bad it is, but the duration matters of how long it is as well. So Naveen, I know you've been coaching your clients and your team has been coaching your clients through this period of uncertainty. Um, how have you helped clients sort of weather the storm in the past six months and, you know, how are your clients doing? How are they feeling right now?

NAVEEN: Yeah, I was getting flashbacks as Jurrien was describing the market so far this year, and there were some dark times for our investors, and we, like you said, we helped millions of families, their accounts, and most of our clients invest in a mix of stocks and bonds and other investments which I'll talk about later in the episode. But what they were surprised by is that diversified portfolio did surprisingly well. So as much as volatility was impacting US stocks directly, other investments like international stocks, bonds, um, real estate investments, commodities, they were doing surprisingly well. So while diversified portfolios helped those clients experience less volatility, but emotionally it was still very, very jarring for them. So I imagine a lot of them are catching their breath right now and feeling OK, I'm glad the market has mostly come back, but they must still have a lot of questions as to what's coming next.

HEATHER: Well, understandably so. And speaking of, you know, you had just mentioned Liberation Day, Jurrien, that day, April 2nd, when the president announced a new tariff plan. We saw a lot of recession headlines at that period. Since that time, though, as I said, you know, some of these tariffs have been dialed back a little bit, and the US and China reached that temporary tariff truce. It's a tongue twister, but it's temporary, but we have seen the S&P make up all of the losses since that time. The S&P, yes, is still off the all-time highs from February, but it has rebounded. So what do you think this means for the economy at this point, Jurrien? Are we still sort of in a holding pattern here? And what is the risk that tariffs could re-escalate and trigger a recession?

JURRIEN: I mean, it's certainly a risk, and we know that trade is an important component of um of the current political uh uh you know, landscape.

HEATHER: Backdrop, yea.

JURRIEN: So it's not going to go away and and we just heard very recently about, you know, Europe and 50% and now that's going to be presumably negotiated and there'll probably be a pause there as well, but, you know, the economy, so if we can divide economic data into two categories one is what we call soft data, so surveys, consumer confidence surveys, things like that, those took a hit during that tariff storm or tariff tantrum, um, and some of them have rebounded since the hard data which are actual like, you know, like layoffs, jobless claims, GDP growth, things like that, those have held in pretty well and, and again it's still early days right because tariffs have gone up by 10% and we're seeing we're seeing those numbers, um, you know, play out in the economy but there are many, many variables, right? I mean there's the the currency side, uh, there's unemployment or employment, there's monetary policy, and of course for the stock market ultimately it comes down to earnings and interest rates and we'll talk about this a little bit later but you know earnings are affected by many things, but tariffs would be presumably one of them. Um, but the other elephant in the room, if you will, are interest rates, and that's been a big focus as well, not only at the from the Fed at the short end of the yield curve as we call it, but also long term rates and that and those are kind of the two big components here but so far the economy is holding up well, uh, which makes sense because the tariff hit hasn't been that um that onerous yet, right? Like the economy can manage a 10%

increase in tariffs. It might eat away at profit margins a little bit. It might create some more inflation, but that's a manageable number, I think at least in the eyes of the markets like a 50% tariff would be a different story, but we haven't gotten to that point yet.

HEATHER: OK, and we will get to the point about interest rates in a little bit, so sit tight on that thought for a minute, Jurrien, but you had mentioned earlier that the market is always in price discovery mode, meaning it's always trying to determine what assets are worth, essentially, right? So Denise, when the market was down, how much of that do we now think had already been priced in and what could that mean for what Jurrien was just talking about earnings?

DENISE: Yeah, I think that that's the trick that every investor needs to struggle with because we don't know what's going to happen over the course of the next 3 months, 6 months with tariffs. But we do have to try and struggle with what the market is discounting because that's how you get that climbing the wall of worry when it's bad, but it's just not as bad as what the market is discounting.

HEATHER: And explain what you mean by climbing the wall of worry.

DENISE: Climbing the wall of worry is stocks going up even though the news isn't any better on a meaningful basis. And that's because stocks might have discounted the worst case option. So the way you can sort of approximate it is if you look at all the times, those 15 bear markets that I was talking about when stocks are down 20%, you can scatter plot them and say, Well, what is that in terms of the hit to earnings growth? And you'll find that it's usually a linear line in terms of 15% earnings growth. So that is at the low what stocks were discounting. Well, you know, rewind to a couple of months ago, we thought that earnings were gonna grow, let's call it 10 to 15% ish. Now a little less, right? 7% ish around that area, but it's not negative 15%. So you start to end up in this situation where we're probably not going to get a whole lot of good news, and it's probably true that earnings numbers are going to come down, but if they're not cut as much as the market thought at that low, then you get this situation where the market already discounted bad news that turned out to be less bad than expected.

HEATHER: So it's relative.

DENISE: Correct.

JURRIEN: And that's always a caution against trying to time the market, right, because the price action is always ahead of the the fundamental, the fundamentals and so oftentimes when the price is moving it makes no sense to the if you just to the casual observer and and so you have to have that in context.

HEATHER: And that's why you just keep, keep the money in there and don't try to time the market and then you also have to figure out when to put your money back in which is the other problem, um, so slow down or recession. How are you positioning clients' portfolios throughout this period right now?

NAVEEN: Yeah, it's a lot of questions, right? People are wondering where do we go from here? I think the points Denise and Jun made so far are so important to keep in mind. I think a lot of folks hear the word slow and start to imagine really bad things happening, but think back to the earnings numbers Denise is shared, right? So instead of like 10 to 15% earnings growth, maybe it's 7 or 8%, that's still positive earnings growth. That still might be a good outcome for the markets. Now we closely followed research from Fidelity and other places and the research at Fidelity from the Asset Allocation Research Team is suggesting that we're still expecting to see moderate economic growth. So there is a risk of recession, but it's relatively low. And so if you're expecting moderate economic growth, you don't have to make any drastic changes to the way your portfolio is being managed. It may be helpful to think about are you in the right level of risk for your goal, and then try to diversify around that, right? So rather than just hanging on to stocks, which are very volatile, think about adding other elements like non-US stocks or bonds or commodities or real estate that can all help smooth out the ride. The other consideration here, of course, is thinking about what's gonna happen with inflation, which I'll talk about a bit later, but the view from the same research team is inflation may start to take up later in the year due to tariffs and other concerns, even with that, just having some other parts of the portfolio that focus on inflation like inflation protected bonds or commodities or real estate investments, those might be helpful ways of not drastically changing what we're trying to do here, but just adding some inflation protection to the portfolio.

HEATHER: OK, I want to drill down a little bit even further on how we position for this, what Naveen was just talking about and and Jurrien, I was hoping you could talk a little bit about how you think about a balanced portfolio in a changing world. You know, I, I've heard you say that for a long time it was sort of like a portfolio with stocks, bonds, call it a day, right? Do you think that is shifting?

JURRIEN: I, I think so, and, and this is just my, my own uh personal view, but for a long, long time, let's say from the late 90s until uh COVID or, or the, the bear market in 2022, uh the 60/40 portfolio and it could be different, it could be 50/50.

HEATHER: 70/30.

JURRIEN: but, but that's just a a broad brush, um. Really for that period all you really had to own was the S&P 500 and investment grade bonds and anything you did to kind of be clever about it didn't really help you that much um and so you just had had to have two, two assets in your portfolio but that period in time is really the exception rather than the rule we we call it the great moderation, right? Inflation was falling, the volatility of inflation was falling. And it was just a very peaceful period in the markets and an investor in that 60/40 earned 9% per year um with a 9% volatility which is like really in the sweet spot when you think about the efficient frontier. But before then we had many, many decades where bonds and stocks were positively correlated, meaning when stocks go up, bond prices go up and vice versa so that period that I just described was a period of negative correlation. So when stocks go down, bonds go up and you have a buffer in the portfolio, uh. So in an era where correlations maybe are more positive, which I suspect they have been since 2022, and I suspect that they may continue to be that.

HEATHER: So again, more positive, meaning that stocks and bonds are sort of going up at the same time and not really one offsetting the other.

JURRIEN: Exactly because we have a big fiscal story, right? It's not just tariffs, it's we have a large deficit that's been running now year after year, about 6-7% of GDP that has to be financed. Somehow, um, and so there's some pressure on rates and the risk premium in long term rates and so in that sense, um, a 60/40 there obviously the 60 is always gonna be the anchor right that's the growth side, uh, and the, the compounding effects are proven over time even though stocks are very volatile and that's kind of the price of admission if you will to get those returns. But the 40, you know, there's obviously a strong case to be made to own bonds because they're yielding 4.5, 5% long bonds and inflation is around 2, 2.5, 3% so you're getting a positive, uh, real yield, but if they don't provide that insurance in down markets like what happened in 2022, I, I would paint the 60/40 with a broader brush and maybe call it like a 60/20/20 or 60/30/10 and take some of the bonds and put it in what we call alternatives and those some could be liquid alts and uh Naveen will talk about that. They could be gold or bitcoin or real estate, uh, other things that maybe are not negatively correlated to stocks but they're also not positively correlated and so that's kind of how I think of a modern era 60/40 and again just personal view, uh, but I, I think that's kind of where we're at because bonds may not be playing the same role that they used to play over the last three decades.

HEATHER: OK, let's talk about stocks too in your portfolio and what that might look like Denise. How about opportunities within stocks? You know, when the market moves, sometimes different opportunities become apparent and sometimes there's dislocation, meaning some sectors are impacted more than other sectors. So what have you seen over the past 6 months about dislocation and, and what are you feeling really excited about at this point right now?

DENISE: Yeah, I'd say the answer is technology stocks. And for me that's a little bit new because over the last 3 years, technology has clearly been leadership. But over the last 18 months or so other sectors looked a lot more interesting.

HEATHER: For a while the market was really broadening, right?

DENISE: We did see that and we saw that a little bit in the drawdown where, you know, unique sectors outperformed like financials, but in the downdraft, what you saw was technology repriced to really interesting valuation levels. So technology stocks were hanging out like from a data perspective in the top two quintiles of valuation, so they were expensive. So we have the data going back to the 60s, and that doesn't mean they have to underperform. But it does mean that you're completely dependent on really strong fundamentals. So operating margins expanding, earnings continue to grow. When you get repriced and at the bottom, technology stocks underperformed the S&P by almost 1000 basis points, it repriced back down to median valuation levels. So all of a sudden these stocks that have grown very fast don't look expensive at all. So from that vertical you can actually measure it from a probability perspective. Usually that's the sweet spot for technology outperformance, and you usually get outperformance even if earnings growth slows, even if earnings growth contracts, or even if profitability actually declines. Why? Because it's already priced in. So what the data shows you is that technology has this really rich history of pricing in bad news before it actually happens. And meanwhile, relative earnings, earnings have fallen in terms of estimates have fallen for the entire S&P, but they didn't fall as much in technology. So even with the outperformance that we've seen, we've still seen that valuation compression, which I think is very different from anything that we've seen in my data for the past 5 years, which means that technology is now in my data an opportunity.

HEATHER: So a newer, uh, thought from you. OK, Denise, thank you. How about you, Naveen? What are you and your team excited about right now?

NAVEEN: So a couple of areas I can think about. One has been international stocks, and that's an area we started adding more towards even in last year, which is surprising because US stocks have been doing so much better than international for years into that. So clients said asks like, why are you doing that? Then you fast forward to 2025 and so far international stocks have vastly outpaced US stocks. Part of it is the tariff story, but beyond that, those stocks are much cheaper than the US stocks whether you're looking at their own histories or just on broad numbers like price earnings ratios and the earnings story seems to be better overseas too. Here we talk about earnings expectations have come down for US stocks, whereas they're actually improving internationally. So that kind of tailwind we think has been very helpful and maybe a nice thing to consider again if you've been ignoring that part of the market for a long time. And the other thing I've harped on a couple of times is just I'll kind of agree with Jurrien's point earlier. The 40% of the portfolio that's meant to kind of help offset in a 60/40 portfolio, some of the stock market risk, doesn't just have to be bonds. I think we've been for years now using things like commodities, real estate, stock investments, and inflation protected bonds when we feel the environment is suited to allow them to provide further protection from volatility. So that's another space that maybe takes more research, more learning for many of our viewers, but I think it's an area that's rife for opportunity for many investors.

HEATHER: OK, um, sticking with this topic of balanced portfolio, you mentioned gold and um also bitcoin as well Jurrien. Can you talk a little bit more about what role you see those playing in portfolios and also can you talk about the leadership of gold that we have seen this year and what that might be telling us about the future?

JURRIEN: Yes, I, I'll do the, the, the second question first. Um, during that big sell-off, um, you know, back in, in April, uh, it was very interesting because bonds, stocks were down, bonds were down, the dollar was down all at the same time. That that does not happen very often. Usually when there's some kind of stress in the system, in the financial system, the dollar goes up because it's the world's funding currency. That did not happen, so it was like uh everything US was on sale for those few weeks uh and the and the and gold soared and, and so that was a hint hopefully uh fortunately it was temporary, uh, but it was a hint of like if this went. To the worst case scenario of a trade war and maybe leading to a capital war where foreign investors or countries repatriate their dollars that are invested in our stock and bond markets, uh, gold would be the very clear winner because it would replace or supplement the US dollar as reserve currency with gold being kind of a hard currency. So that's your second question, you know, the first one is um. So we think about the 60/40 and we think about how to hedge against the 60. But what if we really need to hedge against the 40? Like what is the hedge against the 40? It's not necessarily the 60 because it can be rising rates that actually put pressure on the stock market, so the 40 could actually cause the 60 to go down rather than, you know, the other way around and so gold to me comes in as uh. You know it's a tricky asset. It doesn't have a yield, right, so you can't compound yield you can't clip coupons from gold, uh, and bonds certainly have that advantage. But when you go back 100 years and you look at the performance of long-term government bonds, the times when they do the worst are the times when gold does the best. So I see gold as a hedge against the 40 and that's why I'm thinking 60/30/10 or 60/20/20. And then it's a question of OK, so that's gold, of course it's a proven store of value over thousands of years. It doesn't have to prove itself, right? Uh, and then we have sort of bitcoin and not to make a comparison between the two because they are different assets, but bitcoin is is trying to be in my view, a player on that team that store of value team. Uh, the problem with bitcoin is that it's, it's a young asset, uh, it's only 16 years old, uh, and young assets generally are, are prone to speculation, so you get these boom bust cycles, and we know about bitcoin's volatility. So Bitcoin to me has kind of like a little split personality like a Doctor Jekyll/Mr. Hyde. Uh, some days it it kind of tries to be like gold. Other days it looks more like the Nasdaq and you, you don't really know which which Bitcoin is gonna show up at the party but but I see them as different players maybe on on the same team and they generally are not playing on the field at the same time so it's interesting that uh the, the, the most negative correlation of any asset to gold is bitcoin even though, in theory, they're trying to do the same thing. They're trying to be a hard currency or hard money, I should say, but so it's very fascinating. A little goes a long way, but that's how I think of gold and bitcoin and other hard assets as a hedge really against paper assets, which is what bonds ultimately are.

HEATHER: So gold a hedge against bonds, and bitcoin, a sprinkle of it, as you said, right? Because it's doing different things at different times. How about you, Naveen? How about, how does your team think about alts and how does your team approach exposure to alts for clients?

NAVEEN: Yeah, so our team tends to take a more conservative approach to managing assets. We still believe that the core of a client's growth over the long term and risk management will come from traditional stocks, both US and international, and bond holdings. At the same time, if you look at our current positioning for say a 60/40 portfolio, it is roughly 60% stocks between the US, international, and real estate stocks. It is about 35% of bonds in short term. The last 5% is a mix of different things and in there we do have some commodity exposure. How we typically get there, though, rather than looking at gold specifically, we'll tend to invest in a fund that'll get us more diverse exposure to not just gold but perhaps other precious metals or industrial metals or even some rare earths, right? Things that were in the news right now about potentially having a lot of value, um, agricultural products, those can all help provide some diversification over the long run and then with alternatives specifically, we tend to think of them as, um, some, some strategies that include investing in managers who tend to follow the markets and can potentially gain from rising and falling markets or rising and falling interest rates. There's other strategies that focus on mergers and acquisitions, for example. So a lot of this stuff can feel kind of technical, but we're trying to do is just find other ways of providing protection from stock market volatility and to Jurrien's point, if both stocks and bonds are struggling these other asset classes have moments where they can shine and that can provide some further buffer from seeing that up and down the market in the portfolio in the client's account day to day. So they're small moves, but we do find they can add some value over the long run historically.

HEATHER: Your team is always keeping their eye out and always looking for a different strategy. I love that. All right, so we talked about tariffs, we talked about the risk of recession. Um, but let's talk a little bit more about this administration's agenda because we know that there are other things on their agenda that we might be talking about in the next 6 months from here. They've talked about prioritizing deregulation. They've talked about tax cuts, and we saw just recently when the House passed the administration's tax plan, the price tag of that bill caused bond yields to rise. Of course it still needs to, you know, go through Congress. It's only passed in the House right now, but I think it might have sort of brought up the question or begged the question for investors, Jurrien, about how much power policymakers might be able to wield over the markets just generally speaking. I know this could be a whole discussion. We could do a whole 45 minutes on this, but what is the relationship of policy to the markets in your mind?

JURRIEN: I think it's, it's like a dance, like the tango, right? So policymakers, some of them are kind of in do-no-harm mode. It's like, OK, things are fine, we just kind of chug along. And then other times you have uh an election where a new administration comes in and really wants to change things, of course, which is what we're having now um and um the markets can survive that but again changes can be disruptive. The price action has to discount those changes and without a clear outcome right and with tariffs is there's so many nuances, right? It's like how how substitutable are the products that are being tariffed? To what degree is their currency offset? There's all these questions. It's not linear like, OK, it means this for earnings, it means that for rates. There's many other dimensions going on and the markets have to figure that out and the markets are very deep and efficient, especially in this country, and so I trust that the markets will figure it out, but, but it is a dance because the bolder the policy movements are, the more the markets will react and if it's a bad reaction instead of a good reaction, the reaction can become bad enough that it forces policymakers to then retreat and that's exactly what we've seen not only for the stock market falling but also for interest rates rising. Uh, it's caused, you know, kind of the, the government to sort of take a step back and say, OK, well we'll give it 90 days and some deals will happen and the market's like that, but it's, it's, it's a dance, but we, we tend to be, I tend to be more cynical about markets that the market will always win in the end. Because you know this is this the S&P 500 is over $40 trillion, right? It is a very large pool and the bond market is near $30 trillion when, when the markets speak, you know, generally policymakers have to listen.

DENISE: Yeah, we've seen some offsets like Jurrien said with the rollback of the tariffs, but we've also seen an offset in energy prices, and I think, look, it is tricky to put some math around tariffs. I think that with the initial Liberation Day tariffs, we were talking about maybe $1 trillion worth of tariffs. Tariffs are like a tax. You just don't know where they land exactly. So some could go to the foreign producer, some could get absorbed by currency. Some hits the US consumer. What the US consumer doesn't want to pay for goes to corporate profits. So, but if you assume, at that point of $1 trillion in tariffs and half was absorbed by the US consumer and half by US businesses, that would be a 2% shock to income. So that's been a recessionary hit in the past, never from tariffs, most likely from crude oil when you look in the past. But the interesting part is with this rollback, we're starting to talk about only a 1% headwind. Only a $500 billion hit that shared potentially a $250 billion hit to the US consumer. Now you say, well, that's a big hit, that's a really strong headwind, but could there be any offsets? And when you look back in history, we've seen 1% headwinds before in tax hikes in 1968, 1982, and I think 1993. And one of the reasons why it wasn't as strong of a headwind to be recessionary is because there are all these lurking offsets that you're not examining. And I think one of them comes from oil prices right now. So that declined. So now I think oil, energy goods and services is only 3% of income, not the 7% that it was in the 70s, but it's down 30%, so 30% times 30%, 90 basis point tailwind almost rounded up to 100 basis points, almost fully offsetting the tariffs.

HEATHER: So we're spending less money on filling up our tanks, but we're spending a little bit more money on the prices that might be passed on from tariffs.

DENISE: Exactly.

HEATHER: Um, let's, let's stay on the topic of the federal government for a moment and let's talk about the Fed. Um, you know, you guys talked about interest rates a little bit. Jurrien, you hit on it a little bit. So the Fed cut 3 times in 2024. We haven't seen a rate cut since then. The Fed has been on hold this whole year so far, but the Fed's economic projections did suggest that there were going to be several rate cuts this year. So I'm wondering. You know, Jurrien, do you have a position on why you think they have decided to wait? What are they waiting for and when might we be able to expect those cuts are coming?

JURRIEN: Uh, I'll make two comments. One is that what the Fed does has become a little bit less important. It's still very important, of course, but we're in an era where fiscal policy is kind of dominating. Um, and that affects long-term interest rates which affects, you know, our mortgage rates, it affects the cost of funding for the government for the debt that is out there, and that becomes a very important thing, whereas what the overnight rate, the short-term rate that the Fed directly controls, it doesn't really control any other rates, although it can try to impact them. Um, is a little bit less important right now, and I think the Fed is doing exactly the right thing by holding off right, because the Fed has a dual mandate—full employment, um, and price stability at 2, 2.5% right now uh the CPI is at about 2.5%, so above the Fed's target, uh, but you know, moving in the right direction. But, but, uh, but not to the point where the Fed can declare a victory and at the same time unemployment's very low but again with the tariff question we don't know what if that causes a recession or what have you and so for the first time in decades, the Fed has to kind of balance these two mandates very equally. I mean, it always balances them equally, but for the last couple of decades inflation was always low. It was below the Fed's target, so we didn't really have to worry about the inflation side when there was a growth shock it could just go in and cut rates. Now it's a little bit more nuanced, um, and I think the Fed is is correctly holding off and keeping its powder dry rather than giving the markets a rate cut that maybe it has to take back if tariffs do end up being inflationary and again the economy isn't hanging on by a thread waiting for those rate cuts to happen, right? So the Fed has the has kind of a free option here to hold off and I think it's doing the right thing.

HEATHER: All right, well we talked about the Fed and inflation. A lot of people are concerned though that tariffs could reignite inflation. We've heard that a lot this year, but I know Denise, you sort of have a more glass is half full approach to this than some investors might be approaching this at. So can you talk about what your research has found in terms of tariffs and inflation?

DENISE: Yes. Glass is half full in terms of maybe the inflation part, but I'm not sure in terms of the tax part. So to me, when you look, we don't, we don't have a lot of instances of tariffs in the past, but all 5 that we do have, never this magnitude, but all 5 that we do have, if you look at a year, inflation wasn't accelerating, it was decelerating. So I do think that there's like a historical red flag waving saying, hey, hey, hey, be careful, tariffs almost act more like a deflationary tax than they do as a permanent rise in the price level, which is not to say that over the short term there won't be many prices and certainly some, if not many prices that rise, but if no one gives you more money to purchase those rising prices, then you have to offset that somewhere else, so your marginal propensity to consume declines in other areas, and that means those corporations don't have pricing power. So back to the overall offsets is sort of my first comment. The second comment, I do think that the general level of prices matters a lot here. And when you look at the core CPI ex shelter, the last data point was 1.77%. So we're starting at a level of the generalized, you know, core prices again excluding shelter, which marches to its own drum a little bit. We're looking at something below 2%. So even if there is a boost from there, always remember that from an equity perspective, the sweet spot for equity investors is 3 to 4%. So as long as there is growth, equity markets usually don't have a problem with inflation. So it might not be as inflationary as we think. And the other side of that coin is it might not be as bad for equities as you think.

HEATHER: OK. All right. So, Naveen, you heard sort of both sides of the coin when it comes to inflation. You know, Denise's view is slightly different than what we've heard in the headlines. Um, and we've also heard the term stagflation tossed around a lot in the headlines this, uh, first half of the year. Uh, regardless of whether we are headed towards a period of stagflation or not, how are you positioning investors to be able to protect their money through a period like that?

NAVEEN: Yeah, so let's let's talk about stagflation, not for too long because I think it's, it can get really hairy, but it's generally speaking, a situation where you have high inflation with stagnating growth. That's how it gets its name, and we haven't seen that in the US for over 40 years now. You have to go back to the 1970s and early 1980s, last time we experienced it, and it's typically caused by a very specific set of events. Back then it was caused by several oil shocks that hit the US economy just as a bunch of other stuff was happening at the same time. So I don't feel that stagflation is a base case scenario here in the US. I, I appreciate the risks are out there and there's in the headlines, but I don't really necessarily presume it's bound to happen. So I wouldn't, for one, take it for granted that it's definitely coming. If it does wind up being a stagflationary environment, what tends to happen is what the Fed learned back in the late 70s, early 80s is you have to attack the inflation part of it. It can be painful, but you attack the inflation part of it aggressively and as that inflation number comes down, that's when you come out of the stagflation environment. For what does it mean for investors? Nothing drastically different. So if you're already in a well-diversified mix of investments, you don't have to make big changes around that. And actually this goes back to some of the points I was making earlier around inflation protection. So with stagflation, inflation is high. So there again, look to your commodities, look to your inflation protected bonds. They're called TIPS very commonly. Look at real estate investments, alternatives. These are all strategies we've intentionally added on the off chance we do get some near term price increases and in the very, very off chance we do get some sort of stagflationary environment. But again, that is not the base case that me or my team have right now.

HEATHER: OK, all right. Uh, we have about 5 minutes left, so I'd like to do a lightning round. That doesn't mean you need to talk like the Micro Machines guy or talk really fast. It just means that, um, I want to try to leave people with some takeaways, um, and just sort of take it up a notch and have a little bit of fun with this too. So we're gonna go right down the line, Jurrien, Denise, and Naveen, um, and we're just gonna ask you five questions to try to help people kind of have some, some talking points to go home with today. Uh, so first up, biggest surprise for the first half of the year.

JURRIEN: Well, it shouldn't have been a surprise because I've been in the business 40 years and I've lived through 12 bear markets. But still the speed at which the market can reprice itself down or up, uh, still leaves me a little breathless sometimes like wow, especially when you're used to kind of things being orderly so that that surprise will never go away.

HEATHER: All right. Denise.

DENISE: Yeah, the size of the original reciprocal tariffs. I think the expectations for the market going in were 10 to 15% tariffs on imports, and it came in more around 30, 35%, so that was certainly a surprise.

NAVEEN: I'll point to the performance of international stocks so far this year coming into the year. I don't think too many investors in the US were expecting that gap in favor of international even after the tariffs were announced. I think people presume that might be worse for other countries, yet here we are, international stocks are doing much better than US stocks so far in the early part of this year.

HEATHER: All right. Biggest takeaway from what we experienced with the markets and what how the markets reacted so far this year. What do you think, Jurrien?

JURRIEN: Uh, I think like I said earlier, the, the markets always win in the end. Um, and if you push them too far they will push back and it will get people's attention and that certainly has been true again, uh, this time.

HEATHER: And policymakers' attention. Denise.

DENISE: Yeah, in that same vein, I think when you know during bear markets you sometimes get paid not to react. Like once a market's down 20, sometimes it just pays to sit and wait.

HEATHER: OK. Sit tight.

NAVEEN: And I think the takeaway for me so far is that the power of diversification. For those investors who are working with our team and have diversified portfolios, they haven't experienced nearly as much volatility as just straight out US stock investors. So the value of that can sometimes feel like, what am I paying for with diversification? But in a year like this, where a lot of people feel tempted to abandon their plan, it can help give people the courage to stick it out.

HEATHER: Diversification pays off.

NAVEEN: Yes.

HEATHER: OK, what is the main thing that you will be looking at to kind of get a feel for what direction the market is going in next or the markets, I should probably say markets, bond and stock markets are going in next?

JURRIEN: Uh, like I said earlier, the market comes down to three things: earnings, interest rates, and the, the risk premium on those assets. And, uh, so obviously what happens with the tariff stuff, uh, is going to affect earnings growth. But to me, actually, the big one is the, the yield on long term government bonds. Um, that, that reminds me of kind of the 80s and 90s and 70s and 60s, um, in terms of their power to to affect uh the valuations on the stock market and I think that might be the next chapter in this market story is not the earning side from tariffs but the rate side.

HEATHER: The rate side. All right, Denise.

DENISE: I always watch the same thing and it's credit spreads, and that's just the yield on risky or high-yield bonds versus the risk-free rate of the 10-year Treasury. And I always say that the credit market is often the smarter market when there's less fear in the credit market than there is in the stock market, you can measure it by the VIX, uh, that's usually a good setup for that's one mathematical expression of climbing the wall of worry. And we're seeing actually the credit market come back down to very narrow levels, which means that the credit market's not particularly concerned about a lot of bankruptcies or insolvencies. This is different than even what we experienced in 2022 during that peak-to-trough contraction of 30%, and even during 2018 when we saw the first tariff tantrum. So this at least using the credit market as a proxy, is a better setup.

HEATHER: OK, credit spreads. And Naveen, how about you?

NAVEEN: I'll be following the consumer. So consumer spending makes up about 70% of economic growth here in the US, and we've talked a lot about the inflation impact, potential offsets from lower oil prices. Where does the consumer wind up? Confidence has come down quite a bit this year, recovered a bit more recently after the tariff detente, but the next few months will be really telling to see does the economy hang in there or not.

HEATHER: And summer is traditionally a time when people tend to spend money, right?

NAVEEN: And back-to-school season is coming up too, and the holidays, so a lot of good things to measure for the next 6 months.

HEATHER: OK, I'm sure you'll be watching that closely. Um, we talked a lot about opportunities today. What do you all see as the biggest opportunity just for the next 6 to 12 months, just short term? What do you think, Jurrien?

JURRIEN: I'm gonna flip the question on you.

HEATHER: Oh. OK, here we go.

JURRIEN: There are times when you get very excited about things and you want to make a big bold move and there's a big opportunity and then there are times when I think you just play defense and for me, you know, we've had two very strong years in the market uh since that bear market in 2022 where the market was up more than 20% driven by a lot of multiple expansion. And I think 2025 is gonna be more of a defense year where uh it's less about shooting for for the fences and more about am I invested in the right way if there's volatility I should use that to rebalance back to where I should be invested. You could talk to Naveen. Um, and to me that's sort of—the opportunity is actually to do less and to just ride out this hopefully not a storm but this this squall, uh, both on the earnings and on the interest rate side.

HEATHER: All right, just a squall. Denise.

DENISE: I'm saying somewhat the opposite in terms of from a sector perspective. I do think technology is an opportunity. I think that we've seen really strong growth for a sector on a secular basis and you're finally able to get it repriced to more normalized levels and I think that that creates an opportunity over the next 6 to 12 months.

HEATHER: You're bullish on technology.

DENISE: Bullish on technology.

HEATHER: All right, Naveen.

NAVEEN: And our team, I think, is following more Jurrien's mindset. We're trying to not be heroes right now. There's a lot of uncertainty out there, but it's kind of stay the course, stay close to the middle, don't take big risks. But the one area we're leaning a bit more into is international stocks for the reasons outlined earlier. I think that can continue for the next few months.

HEATHER: All right. Last question. This is really flown by. You know, it feels like this was a long time ago, but think back to last year and all we were talking about was inflation. We talked about it today, but we were really talking about inflation. Then this year came tariffs. I'm wondering, you know, we're still talking about tariffs, to be sure, but what is the next big thing that we're all going to be talking about in the next 6 months that we should be watching? What do you think, Jurrien?

JURRIEN: Long-term interest rates.

HEATHER: Yeah, you said that. You say that again. All right. Denise.

DENISE: I'd say maybe the return to a bull market. I mean, not that we ever had an official bear market, but remember when the market discounts a recession that doesn't ultimately happen, sometimes there's a lot of upside risk.

HEATHER: And Naveen?

NAVEEN: Well, I hope Denise is right. Um, earnings is a big one. I think that's gonna be the one to follow clearly that's an obvious one to point out to you. The other thing I, I'd point to is just thinking about what actually happens with inflation. You heard both sides of the story today, right? The obvious story seems to be prices are going up, but to Denise's point, consumers react. If they don't buy as much, then companies may have to pull back prices and maybe a few months from now prices haven't changed all that much.

HEATHER: Well, I like leaving it with Denise's uh optimistic note, positive thoughts there. So thank you so much. This was such a thorough discussion. We covered a lot of ground here. This was a great halftime report, and I can't think of a team that I would rather be sitting, watching everything unfold alongside than the three of you. So great insights today. Thanks for putting so much thought into your answers. And just a reminder that Fidelity is always here to help. If you have questions, you can always call us, you can download our app. Or you can visit our website to reach out to us if you need us. Also, if you'd like to hear more from Jurrien, Denise and Naveen and our other thought leaders about what they're watching in 2025, please take a look at Fidelity's 2025 investing outlook. You can go to www.fidelity.com/outlook, and there you'll find free insights, analysis, and guidance on the year ahead. And just a reminder too, *Market Sense* is a weekly show. You can catch all of us every Tuesday at 2 Eastern. We do rotate it up, but you'll see, uh, Jurrien and Naveen and Denise making appearances all the time and replays are available on YouTube as well and on our website and wherever you get your podcasts as well. Our website is fidelity.com/marketsense. So on behalf of Jurrien Timmer, Denise Chisholm and Naveen Malwal, thank you so much for the pleasure of your time today, and we hope that everybody has a great second half of the year.

JURRIEN: Thank you.

HEATHER: Great job, team.

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