Insights Live℠
Today's markets, the economy, and our 2025 outlook

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TRANSCRIPT

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JIM ARMSTRONG: Hey there. Hello, and welcome to the latest *Insights Live*℠: Today's markets, the economy, and our 2025 outlook. I'm Jim Armstrong, and I work on the webinar team here at Fidelity. Today, we're going to be doing a deep dive on the factors influencing today's markets. We're going to talk about what you might expect in the year ahead. And we'll also hit on some wealth planning strategies to help you make the most out of opportunities.

Before we get started, though, I do want to point out that Fidelity does not give legal or tax advice, so nothing we talk about today should be interpreted as legal or tax advice. The information we provide is really going to be more general in nature, and might not apply to your situation. If you do have any questions about your specific tax or legal situation, we would just advise you to check with your attorney or tax professional.

All right. With that out of the way, we can get started. First, I want to thank our excellent panelists for taking time out of their super busy schedules to be with us today, and I'd love it if you could each just start with a little 30-second introduction. Tell the folks watching a little bit about who you are and what you do at Fidelity. And Lars, if it's OK, we'll start with you.

LARS SCHUSTER: Would be great to. And hello, everyone. Thanks for being here. Thanks for spending time out of your day. My name is Lars Schuster. I'm an Institutional Portfolio Manager with Fidelity's Strategic Advisers. We're actually the lead portfolio manager for most of Fidelity's managed accounts. And as a member of the investment team, I'm really responsible for delivering Strategic Advisers managed account philosophy, our investment process, and our ongoing activities to a wide range of investors.

JIM: Excellent. OK. Welcome, Lars. And Jake, how about you?

JACOB "JAKE" WEINSTEIN: Hi, everyone. I'm Jake Weinstein, Senior Vice President on the Asset Allocation Research Team. Our goal is to provide top-down macroeconomic research to help guide portfolio decisions and asset allocation recommendations to Fidelity's portfolio managers, but also to provide our insights to folks like you and just get a sense of what's going on in the overall economy.

JIM: Sounds great. And Jen.

JEN CURTIS: Hi. Thank you. I'm excited to be here. I am the wealth planner in the Raleigh, North Carolina, office. I work directly with our clients to help create and execute those customized financial plans that we'll talk about today. Specifically, we talk about investment strategies, savings and income strategies, health care, taxes, estate planning, and even asset protection on a daily basis.

JIM: Excellent. All right. Thank you all again for being with us. Jen, we're going to start with you. Let's call where we are right now an interesting time, for sure, in a post-election landscape. There's a lot of people watching right now who feel a sense of relief and calm, believe it or not. Others certainly feel a lot of anxiety, and frustration, and concern, and everybody else is falling somewhere on that spectrum.

So, Jen, as you mentioned, you literally every day sit across from people and help them figure out their plans. What are some of the most common questions or concerns you're hearing from people along that whole spectrum?

JEN: Yes. I can't ever remember a point in my career where there weren't uncertainties, but it does feel like, today, there's a lot going on. I would say the biggest questions are related to the new administration. Clients seem to be curious about if they should be making any changes from both an investment and a planning standpoint. I just met with a couple yesterday, and the very first question was, what is going to change under this administration, and what do we need to do today?

I'm also hearing concerns around inflation increasing. What's going to change with taxes? Should we be concerned about the national debt or the chance of a recession in the near future? Another topic on a lot of clients' minds is around international investing, given all the turmoil we've seen take place outside of the US. So those are a few.

JIM: Yeah. So that's great. Thank you for that. And I'm happy to say those line up almost perfectly with many of the thousands and thousands of questions that viewers sent in when they registered for today's webinar. So, Jake, through that lens—again, a lot of the questions that we got from viewers were about recession, interest rate changes, mortgage rates, overall concerns, I would say, about the new administration. How would you answer that very, very wide lens?

JAKE: So what we do at the very top level is try to just get a sense of what's going on in the overall economy. And our highest conviction view right now is that the US remains in expansion, and the global economy remains in expansion. We actually don't see many recession risks out there. They are pretty low, either here in the US, or abroad across the world.

Policy matters. Administrations do matter. That is clearly the case. We could look at historically and see how different policies matter over time and how they impact markets and the economy. But at a very high level, I would say, let's just start off the bat by saying the US is in good shape. Unemployment rates were going up a little bit last year, but they've seemingly stalled. And we'll talk about a lot of those other things that people asked about, like inflation and other things.

But from a policy standpoint, it's not really something that I think that we're going to advise people need to make grand, huge changes to their portfolio as a result. Things are going to change on a margin, but they're not going to likely impact the overall state of the economy. Because we're likely to think of the near term that the US and the global economy remains in expansionary phase.

JIM: Lars, similar question to you. Given all of the uncertainty that both Jen and Jake have just mentioned here, and that's certainly on our clients' minds, how do you think investors should be looking—or do you think, I should say, investors should be looking to make any year-end changes to their portfolios?

LARS: Jim, just because it's the year-end, it doesn't mean that I would recommend making big moves, and you're moving into a new year. It's actually one of the reasons why, in the management of our clients' critical assets at Strategic Advisers, we actually tap into this deep network of research that includes folks like Jake and his team. And part of it is really just to understand what is the current economic backdrop, what is the direction of corporate earnings, what are the level of valuations.

And so let's just maybe take that theme that Jake was noting around expansion here in the US, seeing very little recession risk, really, across the globe. And I think back to two years ago, and there was many headlines noting that a recession was just right around the corner. And that didn't arrive. Right?

And I think that if there were individuals that were positioning their portfolios for the uncertainty or the potential for recession, they probably missed out on some pretty nice returns. Because over the last couple of years, we've seen the US continue to expand, as many economies around the world did. Stocks are up considerably since then. And it's those returns that can really help power portfolios to future financial goals.

And it's just one of the reasons why we just so strongly believe that investors should have that financial plan. I work with folks like Jen and her team. Align it to an investment plan that has this broad mix of stocks, bonds, short-term investments.

But to your question, make changes. Look, maybe there are adjustments that you can make over time. And they can be modest, whether it's because of changes in the cycle, which we're not seeing right now. But there are maybe a couple other things that maybe investors might be aware of. One could be rebalancing. We've actually done a tremendous amount of rebalancing in client accounts this year, just given the strength of stocks.

And you look ahead. It puts these portfolios into positions with risk levels that match their situation. Also maybe another thing to keep in mind. I know we brought up inflation once here. But inflation is remaining a little firmer. It's more stable in the last few months. And if that is projected to stay firmer in the new year, there are small exposures that can really help manage that risk.

So for example, in recent months, we've actually elevated positions in things called Treasury Inflation-Protected Securities. It's a mouthful. You usually see it as things called TIPS, also commodities, and to a lesser extent, things like real estate investment trusts. They could actually benefit from some of that inflation that could stay warmer in the coming months.

So those are just some things I might think about in the short run.

JIM: That's great. Jake, would love for you to follow up on this idea of inflation. Certainly, it's cooled considerably over the past year or so, but as Lars points out, it seems to be slowing down a little bit. What's your outlook for inflation in the coming year?

JAKE: Yeah, so a lot of questions on inflation. We've got more questions on inflation in the last three years than probably we've ever really gotten. Yes. Last couple of years, inflation was at very high levels. The year-over-year CPI rate was about 8% or 9%, and it was coming down. And markets loved it. That was a core reason why, over the last two years, that the S&P has been able to return over 20% per year.

But if you look at what's happened recently here in this line here, it's stopped falling. And if you look at going forward, we don't think it's going to massively re-accelerate, but the models that we run do suggest that, in our opinion, there is an upside risk to inflation over the next year.

That could be coming in the form of better growth opportunities, which could lead to more inflation. There's some supply-side dynamics under the hood that can lead to things like lower housing supply or lower labor supply. Other things like immigration and tariffs could impact things. Those aren't even in this model. But there is an upside risk.

And so when you think about inflation overall, the market—that's what this purple line on the bottom is assessing. That's the market's expectations. They think that inflation is going to go down to 2% or stay really low. That may happen. But mathematically, we think it's going to be tough to do. And we actually think, more likely, inflation is going to go sideways or even potentially go up a little bit from here. And it could have implications on the markets, lead to some more volatility, impact the way the Federal Reserve thinks about monetary policy.

So inflation, front and center, is going to be a core development as we look into 2025.

JIM: And so, Jen, with that in mind, we'll look to you to move us from the macro to the micro. People watching right now as individuals, we have no control over inflation. We have no control over recession. What we do have control over is our own choices and our own strategy. So should people be making any moves based on this uncertainty?

JEN: Well, for the most part, we don't make changes based on expectations of the market. In other words, we don't time the markets. We build plans to make sure we have money for unexpected expenses, protection, and growth potential. So I'll dive into that a little bit deeper. We think about this as a three-bucket strategy. Bucket number one, emergency fund. It makes sense for everyone to have some money set aside for the unexpected. And while three to six months' worth of essential expenses is a good starting point, this amount can be much more for some people in order to sleep at night.

Protection. This is bucket number two, very critical. It includes things like life insurance, maybe even protecting part of your money from market risk. So we talk a lot about principal protection and income protection strategies here.

And then the third bucket, the growth portion of your plan. This is your diversified investment strategy. It's designed to help your money keep pace with inflation and help you accumulate wealth. The key is to be comfortable with the amounts that you have in each of these buckets to ensure that you stay invested through the ups and downs of the market, especially for those who are more risk sensitive.

I know right now there is some attraction to cash because yields are higher than they've been in a long time. But we do need to be careful not to have too much in the cash protection bucket, as it's not going to outpace inflation.

LARS: Jim, if I could just maybe piggyback on Jen's comments there. Because as I've traveled around the country over the last few months talking to investors, I've heard this sentiment, just like Jen has noted. It's kind of, why take the risk when you can receive these very appealing yields? 4.5%, maybe 5%. And I get it. It's been a long time since we've seen yields this high. However, just remember, it's the real returns, which is after the effects of inflation. That is what matters. And they are much lower than that.

And in my mind, it's all about just trying to ensure that you maintain a healthy level of future purchasing power over time. And this is why stocks have that key role in longer term focused portfolios. Because historically, they have outpaced inflation, and it allows you to potentially spend on things and experiences well into the future.

JIM: Now, before we go any further, I do want to reflect one more time on the client question that Jen mentioned she got just yesterday from that couple wondering what's to come with this new administration starting next year. Lots of questions we received before this webinar about potential regulatory changes. One of them centered on—one bucket of questions, I should say, centered around tariffs.

So, Jake, I want to shoot three customer questions that came in from viewers who registered today before I hand it over to you. General questions—"What impact will tariffs have?" "Where do we see the markets going if tariffs are increased in 2025?" And a third person says, "Which industries and sectors could be most affected by the Trump tariffs?" So wide lens there again, Jake.

JAKE: Oh yeah. So tariffs are a very popular question that we're getting. And I would say, from a research perspective, it's so complicated we're still actually in the midst of doing it all. So we don't actually have firm numbers to say what it's going to do and how it's going to impact the economy, by how much. Because it's too early right now to tell because we don't know what's actually going to happen. We don't know if these tariffs are just the starting point for negotiation. We don't know if the negotiations are going to go well. They're going to go poorly. We don't know if they're going to go well with a certain country versus another.

I just want to start off by saying that the tariffs that are proposed, the 60% tariff on China, that seems like a very big number. But just keep in mind that people may not know this, but we don't actually do that much trade on a relative basis with China compared to the rest of the world. So that actually may not have as much of a big impact, despite that number looking so big. But a 10% tariff across the board, across every single country. It can be very impactful. There could be retaliatory tariffs. You don't really know.

So I would just say that directionally, from an economic standpoint, tariffs are likely to cause goods inflation and overall inflation to be a bit higher. And they could have a negative impact on growth. So will they come? Will they not come? When will they come? That is very uncertain. I don't think they're going to be implemented in a way that's going to completely disrupt the entire economy. That's our base case. That may not be right. It may. Who knows?

But I think that the overall point is, directionally, if they are ultimately implemented, the market will interpret them as probably higher inflation and perhaps a bit slower growth.

JIM: OK, good context there and a lot to keep our eyes on. And I know I'm going to ask for—I'm asking you to say things that are more uncertain. But what other potential policy changes out there on the horizon potentially do you see that might disrupt economic growth?

JAKE: Yeah, so disruption. It's hard to see. Lower tax rates would be beneficial to corporate earnings. Fewer regulation could kind of open up lending within the financial system. And so there's no one out there that could, like, major disruptions. But tariffs and immigrations could ultimately impact the labor supply and, ultimately, reduce growth.

I wouldn't call it necessarily likely to actually be huge disruptors, but they will be in the news flow. They could impact the psyche of things. They could impact market volatility. And that's kind of a reason why we always, at Fidelity, think about diversification and risk management. And I'm always thinking, what could go wrong because the market right now thinks almost everything can go right.

But ultimately, we've seen this in the past, and sometimes things can be a little bit shaky as different policies get implemented throughout the year.

JIM: Sure thing. A lot to keep our eyes on there. Another thing to keep our eyes on is the potential for changes when it comes to taxes. The 2017 tax cuts significantly increased exemption limits for gift taxes, for estate taxes, and a host of other changes as well. Now those changes, those cuts, are set to expire at the end of next year, at the end of '25. But they also could be extended. So Jen, viewers sent us questions like, how should I adjust my retirement plans based upon potential changes to existing tax laws? And what's the future outlook for estate taxes?

So lots of tax questions came our way.

JEN: Yes, this conversation came up a lot in 2024. Although not every household will be affected by estate taxes, the Tax Cuts and Jobs Act has had significant effects on both individuals and corporations. So for example, the Act did shift millions of Americans to the standard deduction category versus itemizing. It reduced both individual and corporate tax rates. And just like you said, it doubled the lifetime estate and gift tax exemption.

So for 2024, the exemption stands at $13.6 million per person. And that's $27.2 million for a married couple. This means far fewer households are now subject to the estate tax upon their passing. And keep in mind, the estate tax rate can be as high as 40%. If nothing changes, at the end of 2025, the limits will revert back to 2017 levels, which could be around $7, $7.5 million for an individual, about $14, $15 million for a married couple. It all depends on inflation.

But this now means more households are going to be subject to estate taxes. So there's several ways to tax-efficiently transfer assets while still accomplishing your financial goals. The simplest way is to leverage the annual gift tax exclusion, which for 2024 is $18,000 per individual. So this means you can give away $18,000 per person to an unlimited number of people without eating into your lifetime estate and gift tax exemption amount. So this isn't going to reduce your taxable income, but it will allow you to strategically transfer wealth to your heirs tax-free.

Another strategy we talk about a lot is to transfer a portion of your assets today into an irrevocable trust, again, for the benefit of your heirs. But all the money in irrevocable trust will be out of your estate. You can also leave assets to charity upon your death, which reduces your taxable estate as well and allows you to potentially leave a charitable legacy.

So even with the talks of the Tax Cuts and Jobs Act being extended, I still encourage clients to continue with these strategies I just mentioned, mainly because there's no guarantee of the extension, and we don't know how long that extension will last. So we could be talking about this again in just a few years.

LARS: Jen, if I could—I certainly hope not. But I think you're probably right that we very well could. I might just want to add on to this comments you were just talking about, and it even goes back to some of Jake's comments, that you look at the post-election here, and investors have seemingly kind of looked at everything and said, boy, there's this high expectation that because the Republicans have control of the White House, and of the Senate, and of the House, that all these facets of the 2017 tax bill that you just went through, Jen, are going to be or may be extended at the end of 2025.

And maybe that's true, but maybe it's just not going to be as easy as some presume. And that could lead to a little volatility throughout the year. So think about the fact that we have a very different starting point today than back in 2017 when that tax bill was first passed. The first, I might just highlight, is just the fact that the Republican majority in the House today isn't nearly as big as it was back then. And there are already some indications here in just the last week or so that Congress is looking to shore up support for border and defense issues, and they're going to tackle taxes and other issues later in the year.

And maybe the last thing I might just say is that the fiscal debt situation has become way more of a constraint. And that's even maybe further amplified by higher interest rates we have today. So to Jen's point, it may make sense to really continue to consider long-term estate and tax planning strategies in 2025, because we just don't know what the future will hold in later next year or beyond.

JIM: Hey, Lars, while I have you, I have some future-related questions that came in from viewers who registered for today's show that I wanted to run past you. The general theme of them, I will say, is concern that the market's been doing too well for too long. So one person wrote in and

said, "after a banner year like 2024 in the US stock market, what does history tell us about the market's performance in the next 12 months?" A second person says, "are we in the late stage of a business cycle" and a third person says or asks, "with the market continuing to rise, I've heard a lot about a crash. What are your thoughts?"

So, Lars, high level. Can the markets keep going up?

LARS: Jim, those future questions are always my favorite questions. I wish I could answer them all with great certainty. But look, can stocks continue to power forward? Sure. But exactly how that's going to play out over a long period of time is very, very difficult to nail down. And I think, in my view, just because the market has done well the last year or two doesn't necessarily mean it will keep going up forever.

But the key driver for stocks over time are factors like the pace of economic growth, the direction of corporate earnings. And as we've already discussed today, and Jake mentioned earlier, the economy is still growing, and corporate earnings are projected to rise. So that's a positive backdrop.

But I would acknowledge—and I think one of the questions we're kind of getting at it is that the expectations for stocks to continue to do well are pretty high. So I think maybe the investment way of saying this is that valuations for stocks, or the price that an investor is willing to pay for future earnings, are on the more expensive side. But there's this possibility that, look, US stocks will keep doing well. It's just a higher hurdle.

But that story does have a flip side. So these higher valuations for US stocks have largely been driven, in my view, from very large tech companies that have done pretty well over the last few years. So the flip side of this is that smaller-sized companies and maybe companies associated with areas of the market, like banks, they've been more underappreciated in recent years. So we are seeing some signs that company earnings are broadening out beyond just very large stocks. And should that continue and maybe some benefits here of less regulation in 2025, that could actually continue to help stocks in the new year.

Now look, over short-term periods, as I noted, you're going to potentially have to deal with moments of choppiness, whether new news events, or whatever is happening that is kind of getting the markets to pause for a moment. But that's really normal. It happens all the time. And it's one reason why we just encourage our investors to consider a broad mix of stocks, bonds, and other investments, like what Jake was saying earlier. Because it provides some shock absorbers for those short-term moments when markets just have that tendency to churn.

JIM: So then through that lens, Jen, a more tactical question for you. Does it make sense to be buying stocks right now in this moment when the market's so high?

JEN: I heard someone say early in my career—and I think it was Peter Lynch—that more money is lost by investors waiting on the sidelines than is actually lost in the market. So let's say a client comes to me today and says, I have $100,000 to invest. My question to them is, what is the money for? What is the goal, and what is the time frame? If it's a short term goal, let's say less than two years that you want to buy a house, you probably want to stay away from the stock market right now. If it's intermediate term, you have a child going to college in five, maybe seven years, maybe I would add some percentage to stocks. And if it's long term, like retirement is more than 10 years away, I wouldn't hesitate at all to invest in the stock market today.

Now, if you're holding stocks and are worried about things getting worse, I would say that's natural. I hear from a lot of clients. They tend to get that same nervous feeling when stocks hit an all-time high that they get when stocks start to fall. But we have to remember, as Lars said, stocks are going to continue to hit new highs. They're going to continue to have pullbacks. And since we can't time it, we have to plan around it, remembering that all investment strategies start with a goal and a time horizon for that goal.

I did hear Lars say in a different webinar one time that kind of stuck with me—and I apologize, Lars, if you are planning to repeat it—but he said, since 1950, average total returns one year after an all-time high stood at 12.7% So my advice is, stay invested and revisit the plan often.

JIM: Always allowed to quote Lars back to Lars. I think that's always allowed. Jake, I have a question for you, broadening the lens out a little bit to look at the international landscape. Lots of client questions come in, largely saying, given how well the US stock market has done, is there even still a reason or a justification to include international in a portfolio?

One customer summed it up nicely when they registered for today's show. They asked, "Why diversify my stock portfolio with international allocation since international has significantly underperformed the US for years?" How do you answer that?

JAKE: Well, it's a valid question because I've been asked that question every year for the last several years as international has continued to underperform the US. There's a few things. One, from a medium-term perspective, over the next five years, I'd say, is that the US exceptionalism story, I think, still has legs. The US is a great place to invest. It's got great companies, better earnings power. It's lowered its tax rate in recent years. It's competitive. It's got a great workforce. It's highly educated. So the US is still probably a place that's going to have better growth opportunities compared to other developed markets.

However, like we talked about—Lars mentioned it—a lot of that is already baked into the price, which has led to high valuations. And so the actual price that you're paying for those earnings, a lot of it's already been appreciated because the market expects that US exceptionalism to continue, not only for the next five years, but almost indefinitely.

And so if you think about places, where the other question was about, the market's done so well over the last year, over the last two years, how is it going to have another third year in a row? If the economy stays in expansion, there are other opportunities in other areas in the world where non-US stocks, I think, are one that could surprise to the upside.

I've seen a little shaky performance recently after the election, concerns about tariffs—and those are not to be ignored, and they have absolute validity behind those concerns. But as we do research, and we look at, say, historical episodes when we see new elections, and new policies, and anticipation of certain things happening, there are movements in, say, currencies or valuations in the first couple of, say, months or quarters that do ultimately reverse, because, again, there could be unexpected outcomes that occur that you are not looking at, that we are kind of paying attention to but can't really pinpoint.

And I think non-US equities, considering their attractive valuation and considering how weaker their currencies are, are a good area to add diversification and potential capital appreciation in an overall portfolio. So that's an area where I get interested and my team gets interested is when our research shows constructive views, which it is right now, on some of the non-US segments of the market, and when the rest of the market is out of consensus and out of favor, and that's the areas where we could potentially add value to portfolios.

LARS: Jim, if I could, I'd just love to add on to this topic that Jake was going through, and especially on that point about valuations. There is a stark difference between non-US and US right now. And sometimes when expectations are low, you don't need a lot of great news to see meaningful investment appreciation. It sometimes just needs to get less bad.

And the hurdle for that is pretty low. So when you look at US and international all together from a stock perspective, it, in my mind, isn't an all or nothing proposition. In fact, if you look at the market capitalization of the globe and all publicly traded companies, today it's about 65% US, 35% non-US. And that's up quite a bit over the last 10 years.

At Strategic Advisers and management of our client accounts, our starting point is actually 70% US, 30% non-US. So we have a little home bias effect there for the US. Some of the things that Jake was actually mentioning about that longer-term profile for US companies. But when you look at that 30%, the non-US component, there could be some helpful diversification benefits there. So one that I might just highlight is, we've seen a lot of deglobalization trends emerge in recent years. We're seeing that today here in the US. We're talking about it. We've mentioned tariffs quite a few times. Many economies around the world are really seeking to protect key industries.

So if that trend really does continue over time, it could actually mean that global economies shift through their market cycles at different times from one another. And so that really highlights the benefits of diversification as markets, whether here in the US versus overseas, just go up and down at different times.

JIM: That's really interesting. And I want to tie that back to a question that I wanted to ask Jen as well, because you talk about clients building their portfolios. I think it's pretty common, Jen, for someone to look at their portfolio's performance and feel like it's underperformed relative to some other benchmark, and then be disappointed, and second-guess themselves, and feel like they made mistakes.

How, in your opinion, can someone really effectively evaluate how well their investments are doing?

JEN: Yeah, this is what I refer to as S&P 500 envy. The S&P 500 is a popular benchmark. We see it everywhere. So it is natural to think that this is how all investments perform. But it's not. If you're in a 70% stock portfolio, 30% in bonds, you're not going to get the same returns as the S&P 500, because remember, the S&P 500 is 100% stocks, no bonds. So while I do think performance is important, I'm not typically concerned so much with the performance, as I am concerned about how much you're saving toward a goal, or even if you are retired, how much you're spending.

JIM: And so I do have a quick follow up based on what you were just saying there than the idea of a 70/30 stock/bond mix. 60/40 is spoken about a lot as well. Lots of different ways to slice that up. How should somebody try to think about their asset allocation in a market like today?

JEN: So the allocation shouldn't come from current market conditions, but rather, we would encourage building a solid investment strategy to help realize your goals, no matter what the market does. So your asset mix, stocks, bonds, and cash, should be aligned to your investment time frame, the financial need, and the comfort with volatility.

And diversify within these different types of investments, such as different market capitalizations and sectors for your stocks. We want to have large-, mid-, and small-cap stocks. We want to have all the different sectors, not just tech. When it comes to your bonds, we want to make sure we have different maturities, credit qualities, and durations. And although diversification isn't going to guarantee against losses, it does have the potential to improve returns.

JIM: Got it. I want to turn to Jake now and hit you with some customer questions, viewer questions that were sent in during registration around bonds, which Jen just started to mention. We know bonds certainly saw some volatility around November's election. Clients asked us questions to the extent of, "Is 2025 likely to be more favorable to bonds or stocks?" A second person asks, "Is it the right time to invest in bonds, and if so, what types?" And a third person says, "Please discuss your outlook for bonds. Thank you."

So you got a please and a thank you with that one, Jake.

JAKE: I appreciate the please and thank you all day long. I should probably answer that one first. No, but they all tie together, and people do want to have the view about bonds. Put it this way. Three years ago, 10-year Treasury yield, end of the year 2021, at 1.5%. If you asked me the question then, I would have said, that's not a very attractive yield to get on bonds. They could provide some diversification if there's a downturn in the economy. And there were higher recession risks at the time. So from a portfolio construction standpoint, that made sense. But you weren't getting much yield. And on an inflation-adjusted basis, you're actually getting a negative yield.

All right. Three years later, 10-year Treasury yield at 4.2% right now. Positive yield on an inflation-adjusted basis. And if something does wobble in the market, it is very highly likely that those bonds are going to give you capital appreciation. Because if interest rates fall in a wobbling market, the bonds actually rise, and that could provide additional correlation benefits to stocks. So still makes sense to hold bonds.

Now, 2025 outlook, it's a little murky about what's going to happen to interest rates. Are they going to go up because we have higher growth or higher inflation? Potentially. I don't think they can go significantly higher than they are today. But there is a risk of bond yields rising. But at the end of the day, if bond yields do rise, that's good because that means then the yield on them will be higher and people will be collecting more income from them.

So I think the outlook for bonds is relatively neutral. There could be some upside risk to yields. But overall, nothing that would make me say, avoid bonds and fixed income at all costs.

JIM: OK. I don't want to move on from this topic without checking in with Lars as well. Lars, you mentioned that your team manages portfolios for Fidelity clients. In light of everything that we've discussed so far, I'm curious how you and your team position the bond portion of well-diversified portfolios that you manage.

LARS: Sure, right. And, Jim, here you need to really step back and just recognize what the role bonds play in a diversified portfolio. And generally speaking, we use bonds to really just help diversify these portfolios that have lots of different asset classes, because they can potentially just smooth out the investment experience than just owning stocks alone.

To go back and use Jake's time frame here, I know a lot of investors like to look in the rearview mirror. And right now, if you look at three-year returns of bonds, they just don't look very appealing. But again, that was largely driven from that 2022 period—very challenging time for bonds as interest rates rose at their fastest pace in 40 years to battle inflation.

But we need to look ahead. And here I'm actually pretty excited because—and Jake noted it—those higher yields—and today, bond yields are at or near their highest levels in over a decade.

They can help boost future returns. And also just note that not all bonds are the same. They all serve different purposes. So we use a wide array of different bonds to gain certain exposures, defend against certain risks.

So one risk we talked about today here already—and I've already mentioned around inflation and inflation-protected securities, those TIPS. Again, bonds, just like a standard US Treasury bond, so fairly high quality, but they have this unique feature that increases the value of the bond when inflation rises. So that can help maybe protect about the impact of higher inflation if that's a concern.

Another area that we have actually favored over the last year or so is mortgage-backed bonds. They're a relatively safe bond investment, and they give you those yields that we've been talking about. But these bonds are issued by government-sponsored enterprises. So they have a strong creditworthiness. And mortgage-backed bonds are just like what the name says they are. They are these pools of thousands of different mortgages, residential mortgages, that effectively pass through mortgage payments to bondholders.

So when interest rates are high, like they are now, they can be attractive because refinancing mortgages becomes a little bit more challenging. So bondholders get to keep collecting the coupons of those mortgages. And that's pretty attractive right now that interest rates are at levels and stabilizing.

JIM: Got it. Jake, another question for you. Another big topic that came in from viewers today, the national debt. What's your sense of how the ever-growing national debt will impact economic growth in the year to come?

JAKE: Yeah, so debt questions. I've been asked—I've been doing this job for over 10 years, and I've been asked about the national debt every year. It was one of the first questions I probably ever got when I started doing these type of presentations. People concerned about the $17 trillion in debt then, and now it's almost double that, nearly $30 [trillion].

So the answer back then was it wasn't too concerning because the deficits weren't as high. They were like 2% or 3%. Now they're about double that. They're at 6% and expected to continue to rise over time. I'm showing you here a chart. The Congressional Budget Office expects those to increase over time, those deficits to increase the debt over time, because—Lars mentioned this before—there's going to be higher interest rates or higher interest cost as a share that's going to continue to push that up unless something is done. And it's very unlikely some things get done.

Now, to get the debt to stop rising, put this in perspective, interest rates would have to be 1%. And that's what this dark line dashed line here is at the bottom. But our view going forward that, if nothing is sort of done and kind of ignored, there actually could be an upside risk here. And

this is our light blue line we show as the upside scenario, which puts some context around aging economies, which tend to demand more spending from their governments to fund the aging demographic lifestyle.

And that, if this starts to occur, and the market, at some point, starts to pay attention to this, it may force the government's hand. It hasn't yet. But I just want to remind folks that this has impacted—markets have impacted governments before. We had the bond vigilantes of the '80s, way back when. It's impacted France. You see a whole new government there. Impacted UK with the Liz Truss debacle of the last couple of years.

So this could be, 2025, this fiscal debate, could be pretty significant. And if bond yields do rise as a result of the view that these deficits may not fall, that could force the government's hand. If it doesn't, then the government continues to have these large deficits, as far as I can see. So the market is going to be a very interesting push and pull with the government in terms of how this thing plays out. But I would say that I don't see any major catastrophic event occurring. I don't see a massive bond buyer strike.

Because again, if the markets respond negatively and bond yields go up, guess what? They're more attractive. Price is more attractive, the yield is higher. And people like myself and Lars will be like, ooh, that's a pretty attractive yield given what the opportunity set is out there. So volatility is the key name in the game. There could be some wobbles. But don't expect this to completely unravel and destroy anything that's kind of set in terms of the macroeconomic cyclical backdrop.

JIM: And so Jen, we'll look to you again to bring us from the macro to the micro. I feel like what Lars and Jake were just describing there sets up a perfect planning question for you, given what we've been talking about when it comes to bonds and interest rates. How does someone watching today think about an income strategy in retirement?

JEN: Yeah, so this is probably my favorite planning conversation to have with clients. I think it's because there's a lot of excitement. And there could be a lot of stress. So I think we can alleviate some of that stress by being very intentional with the income plan. The core component of creating an income strategy in retirement is taking a realistic look at how much you will spend, or in other words, what your lifestyle will cost.

So when building an income strategy, it's important to understand it's no size fits all. Each client has different spending goals. They have different amounts they've saved, and different types of accounts. For example, I have some clients that have the majority, if not all, of their savings in tax-deferred retirement accounts, like IRAs or 401(k)s. Some have IRAs and some in taxable accounts, and Roth IRAs, which are tax-free.

If there is a significant taxable investment, we might start with an interest and dividend strategy for part of the income need. The interest and dividend strategy means we're taking the interest

from our bond portfolio and the dividends from our stock holdings and putting them into our pocket versus reinvesting them. It's important to keep in mind that this cash flow is going to vary from month to month, and it's not guaranteed to stay the same. So we talked a lot about interest rates going up and down. That could change. The dividends could get cut. And we may have to be flexible and change some things as that happens.

I'm seeing right now, well, actually, 2024, the rates were actually coming down. So people were buying new bonds, and they did have lower yields, which meant we had to find some income somewhere else.

JIM: And so those are the retirement and investment accounts. How about other sources of income to consider?

JEN: Yeah, we're also going to look at sources of guaranteed income, Social Security, pensions, or annuities. And we're going to need to determine if that's enough to cover all your essential expenses. So I think of essential expenses as health care, housing, transportation, and food. And if it's not enough, we're going to explore ways to increase the amount of guaranteed income. Maybe that means we wait a little bit longer to take Social Security or purchase an income annuity to fill that gap.

And then lastly, we're going to determine how much we need to systematically withdraw from our investments. The key to this is to not take too much. We like to limit this to 4% of our account value. And this is generally going to cover the discretionary spending, like travel, entertainment, dining out, et cetera. And then we put this all together in the most tax-efficient way possible.

JIM: This has been the fastest 45 minutes of my career. I think this is. I just looked at the clock and realized, we got to wrap this up. This has been a really, really fantastic conversation. So thank you for taking the time to be with us. Before we go, though, I would like it if each of you could just share your top two or three takeaways that you'd like to leave our viewers with. And Jake, we can start with you.

JAKE: Yeah, sure. So it's been a great year for stocks in 2023 and 2024. In 2025, we're just looking for potential surprises. It would not surprise us if stocks don't do as well as they did the prior two years. But other stocks, like non-US or smaller-cap companies, can keep pace or even surpass those which have done so well over the last couple of years, being those large-cap growth tech companies. That's one thing that we're focusing on.

Do not ignore the implication of stickier inflation and how the monetary kind of situation, how the Fed can impact markets. And so those two kind of things together, I think, there is likely to be volatility. Policy responses and policy may not go as planned. But overall, I'd say, big picture, the US is in a pretty firm expansion right now and looking ahead to some exciting news for the markets for 2025.

JIM: Excellent. And Jen.

JEN: Well, I feel it's important to work with a financial advisor, someone like myself. It is important to create customized investment plans that articulate long-term goals, short-term needs, risk tolerance, and personal values. An advisor is going to help with all this. They're also going to help prioritize new goals or manage life events. They're going to help manage risk and consider opportunities as markets and tax laws change.

So having that documented investment plan can be a big help in staying the course in times of uncertainty or volatility. And an advisor is going to help provide the guidance and encouragement needed to stay on track.

JIM: Got it. All right, Lars. Bring us on home.

LARS: Jim, we're all human. So don't let recency bias and other biases really drive your investment decisions. I've continued to hear it. We heard it in the questions. There are investors out there. They're looking to shun bonds. They're looking to shun international stocks, just given that recent strong performance of US stocks. But as Jake noted, look, there are going to be some surprises in the future. There always are, and things that investors just aren't considering.

So having that diversified mix of US stocks, non-US stocks, bonds, short-term investments aligned to your various goals can really help ensure that you don't miss the upside surprises that could occur while still managing risk for those potentially choppy markets.

JIM: Thank you. On behalf of everyone who took time out of their days to watch today, I want to thank you again for being with us and answering all of these questions and offering these tremendous insights. For everybody watching, if you do have additional questions on how the latest markets and economic news might impact your financial plan, then please reach out to your Fidelity representative. Or you can visit Fidelity.com/Wealth.

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Sources:
S&P 500 Index, MSCI ACWI ex-USA Index, MSCI World ex USA Index, MSCI Emerging Markets Index, and Fidelity AART as of 11/30/24

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