

Fidelity Viewpoints[®]: Market Sense

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TRANSCRIPT

SPEAKERS:

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HEATHER HEGEDUS: Hi there, everybody. Thank you so much for making the time today to join us for another episode of *Market Sense*. I'm Heather Hegedus with Fidelity. Right now, we're in the midst of quarter 2 earnings season. And so far, the ongoing uncertainty surrounding tariffs and criticism of the Fed is not affecting the markets.

In fact, the S&P just posted another record close. It is up nearly 25% in just 16 weeks. It is a remarkable recovery, to say the least. And that's also according to my brilliant friend and one of today's guests, who I'll be introducing in a moment, Denise Chisholm, who says there have only been a handful of times in history that the market has rallied this sharply over such a short time span.

Also here with me today to talk about what this might all mean for your investments, we are grateful to be joined by Fidelity's Director of Global Macro, Jurrien Timmer. But the conversation today is really going to be focused on the strength of tech stocks and whether they're still a good buy. Despite a rocky start to the year, the tech-heavy NASDAQ staged a remarkable comeback this year.

And Denise, who is Fidelity's Director of Quantitative Market Strategy, is here with us today to tell us why she is so bullish about this sector and its future, despite what might look like high valuations. Well, thank you both for joining us today. I really love the combination of you two. And I'm super excited for this conversation.

DENISE CHISHOLM: Hey. It's great to be back, Heather.

JURRIEN TIMMER: Nice to see you both.

HEATHER: Wonderful to see you on this 22nd of July. Boy, summer is flying by. Jurrien, I want to start with you. You look very summery today, I might add. As I mentioned off the top, quarter 2 earnings season off to a terrific start, a very strong start. And we are expecting to hear from over 100 more companies in the S&P 500 throughout this week.

But it's been such an impressive performance because of the tariff uncertainty. So I'm wondering if we could start with you, just talking about what you're seeing right now, what you make of it. And when do you think we will start seeing a tariff impact, if we haven't already?

JURRIEN: Yeah, so 225 companies have reported so far, so about half of the S&P. Typical story, about 80% are outperforming by about 8 percentage points. But it's especially important now because at the beginning of the year, analysts were expecting about 12% earnings growth through 2025. Then, of course, we had the tariff tantrum in April. And those estimates were cut by Wall Street analysts down to about 7%.

And then it was like the dog that didn't bite, the tariff story. I mean, there are obviously some tariffs in place, and there may well be more as we go along. But the worst case scenario so far has not panned out. And at the same time, the dollar is down, which tends to be supportive for earnings because a lot of companies get a lot of sales for overseas.

And so that haircut or markdown, if you will, on earnings estimates may have been premature. And so what we're seeing now is that second quarter earnings season is now underway. And that growth rate has started to come back up. And of course, we've had the One Big Beautiful Bill as well, which, certainly, is fiscally stimulative, should be good for earnings. And at the same time, profit margins are actually making a new high of 13.1%.

So long story short, at this point, it's hard to see too much evidence that the tariffs that are in place so far are either shrinking profit margins, which would be one way that the tariffs could play out. Remember, tariffs are like an import tax, right? Someone's going to pay for it. We just don't know who it could be—consumers through higher prices or producers or importers.

So the CPI data has been OK. The margin and earnings data have been quite good. So at this point, we're waiting for that shoe to drop, and it's not dropping. And maybe it won't. Who knows?

HEATHER: That CPI data coming in last week, showing inflation is up a little bit from May to June, but still could be worse. Let's talk a little bit more about—you said the dog that didn't bite, and the S&P shrugging off the tariff news so far and shrugging off Fed criticism. We should talk about that, too. Why do you think this is happening, Jurrien? Is the market just being complacent here? Is it also a combination of the fact that it's that—it's the summer months, when things tend to be slower. Is it the time of year? Or what do you think is going on here?

JURRIEN: I think it's likely a combination. I mean, it is July. And the market has recovered quite dramatically from that 20% decline back in early April. And investors—that there is a cycle of sentiment. I mean, investors are fearful at the bottom. Then they get less fearful. And then they get more comfortable, and then they get confident. And maybe then they get overconfident. And that's what you tend to see at peaks.

And there's not a lot of evidence to suggest that investors are overconfident, if you look at the sentiment surveys. They obviously have improved from the lows in April, but they're not at levels that would give me pause, that says, OK, people are really getting cheerful here.

But when you look in underneath the hood of the market and what's moving, you can definitely tell that there's a little bit more of a momentum play out there, despite the fact that the tariff story hasn't yet gone away and, as you pointed out, that there is some pretty open criticism of the Fed, which I think is, in my view, is kind of a dangerous game to play because an independent Fed is a very nice thing to have over the long term because it helps ensure price stability, and price stability is obviously near and dear to all of us.

But at this point, the markets are either ignoring it or seeing it as the glass half-full or so much negotiation that may or may not lead to anything. So I think the markets are in a mode where they'll believe it when they see it. But they've been down this road a few months ago, where they believe something, and then things were unsaid. And all of a sudden, they went from bracing for a 20% decline and possibly a recession to now a Big, Beautiful Bill and ongoing expansion.

HEATHER: So you don't think investors are getting carried away. You don't think they're too overly confident. But you said when you look under the hood, you do see some momentum at play here.

JURRIEN: Yeah.

HEATHER: OK. So Denise, your research focuses on analyzing market history to try to uncover patterns and probabilities that can help us understand and inform the current outlook. Over the past two years, we have watched as America's high-growth tech stocks have taken a leadership role. And their success contributed to most of the double-digit returns investors enjoyed last year.

2025 has been a little bit of a different story. The tech-heavy NASDAQ actually did enter correction territory back in March. It's since recovered all of those losses. But I was hoping you could recap for us what happened in the tech space this year and explain why the tech sector has been the subject of so much volatility this year.

DENISE: Yeah, coming into the year, technology's expensive valuation really made it vulnerable to a correction. So when your starting point is expensive, whether you judge it based on relative forward PE or relative trailing PE versus the overall market, that doesn't mean that the

sector or the stocks within it need to lag the market. But it does make you very dependent on fundamentals continuing to improve, whether that's operating margins or profitability or earnings growth or earnings beating expectations.

And what we saw in April was that tariff tantrum was a signal that fundamentals might actually be declining. Now, we'll see if that ends up happening. But in that low, technology stocks, again, being vulnerable because of their starting point on valuation, underperform the overall market by more than 1,000 basis points. Now, in that underperformance, you had a very sharp valuation reset.

So all of a sudden, instead of hanging out in the top what I call two quintiles of valuation, which is just if you divide up the history that we look at into quartiles or quintiles or sections of data from cheapest to expensive, does that change your odds of a market advance or technology outperformance. And it does. When you're in those top two quintiles, you have a more negative or a more nuanced risk-reward.

But that very sharp valuation reset, that we actually saw technology stocks come all the way back down to median levels relative to the market, relative to their history, which sets you up in a much better position for technology leadership going forward. So I do think that this really changed the risk-reward for the sector on a go-forward basis and has made it likely sustainable and durable leadership in the equity markets.

HEATHER: You're so brilliant, Denise. Jurrien was talking a little bit earlier about the uncertainty around US trade policy and whether tariffs could hurt profits. And that seemed to be one of the main drivers of volatility this year. I'd love to get your take on all of this. How do you think tech sector investors should be thinking about these kind of risks right now, Denise?

DENISE: It's complicated because tariffs aren't going away. I think that the issue for any investor as they think through tariffs are, really, we want to be struggling with two kind of intrinsic data points, which is, one, is it going to be worse than we thought it was at the bottom? Remember we talked about on the midyear outlook that a 20% decline in stocks, and we were pretty much there, is equated to a 15% contraction in earnings growth.

So that's at the low, what the market expected. To the extent that we turn around after all of the tariffs are implemented and say, well, it wasn't quite as bad as we thought at that low—meaning earnings didn't end up contracting by 15%—well, then, that's actually good news for the market.

The other thing—the other way to consider it is not only if it just wasn't as bad as what we discounted at the low in terms of market history, but maybe we're beyond peak uncertainty as it relates to tariffs, which isn't to say that tariffs won't still be uncertain. They will. But if we are past that point of peak uncertainty that we potentially saw in April, that's good news for the market as well.

Always remember, the market moves in second derivatives. So if it's just less uncertainty, or it's less bad than we thought, that's actually good news for the market. And that's the math we talked about behind what you call the "wall of worry," which is a way to say that the news isn't going to get any better, but it's not as bad as the market once thought.

HEATHER: It's like talking superlatives—

JURRIEN: And I'd just—

HEATHER: —right? Superlatives, it's not as bad as it could be. Jurrien, sorry to interrupt you.

JURRIEN: Yeah, I would just add—I mean, Denise makes a great point. But it's also, what happened in April is that the markets shouted back and said, look, don't forget about us when—if we reprice harshly enough, policymakers will listen. And that's exactly what ended up happening.

So I think part of the lack or the decreasing discomfort or the increasing comfort in the market is also the sense that there is a limit to what can happen before the markets need to be listened to. And so maybe that adds a little bit of a buffer as well to the conversation.

DENISE: Structural put, yeah.

HEATHER: Let's talk about valuations as well in this conversation. Because I think when a lot of people think of tech stocks, the biggest concern always seems to be high valuations. With that sell-off earlier this year, though, there was a little bit of a price reset in this space. So, Denise, if you could start—and Jurrien, feel free to chime in here, too, if you have any thoughts. But Denise, where are you seeing value these days?

DENISE: Yeah, it's interesting—in the riskiest stocks. I mean, that's where you saw the sharpest repricing. And by risk here, I just mean stocks that move more than the market moves on a daily basis. And what you saw was when risky stocks get cheap, that usually shows you that, yes, times are uncertain, but the market has much discounted a lot of the bad news that is to come.

And when risky stocks become cheap, that usually provides an opportunity to actually propel the sector—which, in this case, technology—forward to an outperformance. So for each quartile that risky stocks are cheap—again, dividing up that history—you have higher odds of outperformance of the sector going forward. So usually, when you see that, that might mean that all the bad news that you are afraid of as an investor might actually be priced in to create an opportunity.

Now, in technology, I think we know we equate risky stocks to semiconductors from an industry perspective. And that's definitely true in terms of what we've seen in the last couple of years. And that was really where the pricing, the repricing took hold the greatest. And in some ways, that

was really the—we saw top quartile relative valuation all the way back down to almost bottom quartile levels.

And that reset has still taken hold because even after the bounceback in stocks, earnings really haven't been disrupted. So the stocks are still maintaining their relative valuation position that sets them up better historically. When you look at where we are in terms of median levels of valuation, you have really strong odds of outperformance—and by strong, I mean above 70% odds—when you see fundamentals improving, like operating margins, or fundamentals going the other way, meaning that the stocks, in some ways, have already discounted some bad news.

Another way to think about it is, semiconductors within it—and technology on a broader basis—has this very rich history of discounting bad news in advance by being cheap enough to continue to outperform and not being dependent on fundamentals. This is the risk-reward that I'm really looking for from a quant perspective. And I think you're really finding it in semiconductors. You're certainly finding it in software. And you're finding it in broader technology overall.

HEATHER: So you're saying that semis have been priced in the expensive zone, and there was little room for error. And that made stock picking a game of getting the fundamentals right. But things changed after April. Is that right? That changed the math a little bit, and the performance has stabilized a little bit?

DENISE: That's exactly right. The math has changed on the valuation reset. We really haven't seen, certainly, semiconductors, to a lesser extent, software, and broader technology be this cheap relative to the market, relative to their history, in, really, the last 2 and 1/2 years. So this is a much better setup when you look at durability of leadership on a go-forward basis.

HEATHER: Hey, Jurrien, I want to bring you back in here again as well. Because if the Mag Seven is back in charge of US stocks, what does that mean for the bull market and the rest of the S&P 500? I guess, in other words, you and I spent a lot of time last year talking about waiting for the market to broaden. And then it did a bit. But now, the Mag Seven is back in charge of market leadership. So is that surprising to you? And also, do you think other sectors could still come in here and take the lead?

JURRIEN: Well, so let's differentiate between absolute return and relative return. So as you point out, a year ago, or, really, two years ago, the first year of this bull market after the 2022 low, if you were not in the Mag Seven, you were not feeling the—you were not getting the goosebumps of a bull market because most stocks really didn't do anything that year.

And then, in 2024, the market did broaden somewhat. It was a respectable bull market, with about 2/3 of stocks going up. But still, the Mag Seven were going up more. And even now—so the Mag Seven is definitely leading. It's the tech sector, is all the way at the top. But it's not the

only game in town. They're just going up more than other stocks. But industrials, financials, consumer discretionary, communication services—there are quite a few economic sectors that are participating. But they're just not going up as much.

So if you're an investor, and you're not exclusively in the Mag Seven, you're still enjoying the fruits of a bull market. And we can extend that beyond the border, actually, because global markets are participating. The MSCI All Country World Index, ex the US, is also making new highs, both in local currency terms, as well as US dollar terms. Emerging markets are really catching a bid here.

So it's actually a very good story because, as Denise knows, you want to be able to fish in the biggest possible pond, so you have a chance of catching a lot of fish and not trying to get those seven fish that are always so elusive and that are very binary, that if you don't catch them, you are really on the sidelines. So it's a good story, and it's what we want to see. And so there's new life yet in this cyclical bull market.

HEATHER: New life in the sea. Jurrien always has the best analogies, by the way, Denise. So tangible, and visual analogies. Last week, we were talking about laundry.

But let's talk about taxes, actually. I have no segue between laundry and taxes, but we talked about tariffs. And I did want to quickly hit on the president's new tax and budget bill, Denise, that was passed earlier this month, which, of course, extends those 2017 tax cuts to both businesses and individuals. That bill also restores favorable tax treatment to many types of business expenses. So I was wondering if, from a historical perspective, you could tell us about tax cuts and earnings and what history tells us about how that might impact things.

DENISE: Yeah, this isn't a reduction in the statutory rate. This is probably only a reduction in the effective rate. But it might be as much as 700 basis points, or 7%. So it is very meaningful to corporate America. And you can study history. And either effective rate changes in terms of drops, ex recessions because they always drop in recessions, or changes in the statutory rate have been a good thing for stocks and earnings and multiples.

And that's really the interesting story because when you look at the year that you receive a corporate tax cut—so earnings growth is good and strong, which is no real surprise. But it's also durable into the next year. So there is a framework of persistence around corporate tax cuts as it relates to earnings durability. And because of that, the market usually sees it in advance and doesn't wait for the earnings growth to deliver. It anticipates it with multiple expansion.

And if you're concerned that, well, our starting point is already expensive and priced for perfection, when you look at history, it hasn't really mattered. So even despite the fact that your starting point is expensive, and by expensive, I mean in the top quartile—so, again, dividing up history, the most expensive quarter of history—you still get multiple appreciation because of that durability of earnings growth.

So in some ways, when we talk about higher for longer, we talk about inflation, we talk about the Fed, we talk about deficit spending, to consider maybe higher for longer around tax policy might be expensive stocks.

HEATHER: OK, speaking of higher for longer, we can't forget we have another Fed meeting next week, Denise. Of course, investors should the Fed has not cut rates at all this year. So after that inflation report that came out last week, a lot of analysts are now saying the Fed is probably not going to cut this month either. We're only midway through the year, though. If we were to have some rate cuts later in the year, how could a rate cut affect these high-growth tech stocks?

DENISE: Always with the Fed, it matters why the Fed is cutting. So if the Fed is cutting because they can—meaning that inflation came in lower than expected, and they can start to rebase the rate on the path to normal—then that's been a good thing for growth stocks historically. But if they cut because they have to because the economy is slowing precipitously or if unemployment is rising, that's never been a good situation.

So it's really you have to choose your own adventure as it relates to an investor. I think that the base case is that the economy is going to be good enough. And they'll be cutting because they can, not because they have to. And that is likely pretty good for growth stocks and stocks overall.

HEATHER: Choose your own adventure. Did you read those books as a kid, Denise?

DENISE: I did.

HEATHER: I did, too. Great reference there. I forgot about those. All right, we're right up against the clock. We do like to keep this show to roughly 20 minutes. But before we go, Jurrien, let's do a quick Timmer's Take. A lot to watch over the next couple of weeks, right?

JURRIEN: Yeah. So earnings season, obviously, off to a good start. We're about halfway through. And I keep coming back to the 10-year yield. It was at 4 and 1/2 almost last week. We're down to 4.3. But that, to me, is a very important bellwether because above 4 and 1/2, it tells you that fiscally, maybe things are heating up too much. And below 4 and 1/2, it's calm, calm and quiet as it goes. So certainly, a number of things to watch here.

HEATHER: Yeah, you said during the midyear outlook, that was going to be your number one thing to watch, would be bond yields, the 10-year. So continue to please monitor and report back to us, Jurrien, on your thoughts on that, but we do have to leave it at that.

Big thank you to everybody out there for watching and listening and sending us your questions. We read all of them, and we always try to incorporate them into our shows. So I hope some of the questions that you asked us, you felt were answered in today's show. Also, if you're interested in researching tech stocks and other sectors as well that might fit some of your investing objectives, bookmark the page on your screen, [Fidelity.com/SectorSearch](https://www.fidelity.com/SectorSearch).

Fantastic. Fantastic show, guys. Denise and Jurrien, I think you are two of the brightest minds at Fidelity. And I'm not just saying that so that you'll come back, Denise. But really love having the two of you together. I'm Heather Hegedus. Hope to see you back here next week when we're going to be talking about international stocks. And remember, we are on live Tuesdays at 2:00 Eastern. Hope to catch you next time.

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