Fidelity Viewpoints®: Market Sense

Week 109, August 9, 2022

TRANSCRIPT

SPEAKERS:

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Jim Armstrong: Hello and thanks for joining us for Market Sense. I'm Jim Armstrong from Fidelity. Summer of 2022 is putting us through paces for sure of market volatility, inflation, talk of recession, still looming large in a lot of conversations. So today we wanted to talk about possible strategies that you might consider in a down market. To help guide our conversation, Naveen Malwal is here. He is an Institutional Portfolio Manager for Fidelity Strategic Advisors, he is going to share his insights in the world's latest news and national news, market conditions and what they mean to each of us as investors. And as always Leanna Devinney is joining us, sharing what's on our customers' minds. She'll be talking about how she and her team are really helping people this summer and always, figure out how to adjust strategies in a down market. Guys thanks again for making time today.

Leanna Devinney: Thank you, it's great to be here.

Naveen Malwal: Yeah, good to be here.

JIM: Naveen, welcome back to the show, great to have you back again. It is Tuesday, August the 9th. I would love just your take to start us off today on what you see happening in the markets and maybe for a change of pace start us off with what could be some potential bright spots on the horizon.

NAVEEN: Bright spots would be a nice change to talk about. So, you, Jim, outlined the concerns that out there, right? We've seen the last few weeks, the headlines around negative GDP growth, risk of recession, inflation is till high, rates are still going up, and yet to all of that we've had a small rally in stocks and bonds. So, since the end of June, we've seen stocks go up about 10% and bonds are up about 4% since that time, and it's interesting to think about what led to the rally starting off. Initially it seemed to be actually commentary from the Fed. So even as the Fed raised rates in June, their comments seemed to suggest they may be getting closer to the end of their rate hike cycles, so that pointed some investors to think maybe the Fed is more optimistic about inflation and perhaps that could be good for the economy. And that in turn seems to have led to a nice recovery in stocks and bonds. Now we're still not back to where we were at the start of the year, so still some ways to go there but it's nice to have some come back from the bottoms we saw at the middle of June.

JIM: Always, always fascinating to me, Naveen, how much our own collective impressions and thoughts shape what actually happens, right? So much is happening in our heads and then we make some decisions based on that collectively as a group. What would you point out, what other things do people look for when they're sort of forming those opinions? I know you mentioned it's Fed, people really read those tea leaves and dissect Fed opinions to within an inch of their lives sometimes. What else do we or should we be looking at?

NAVEEN: The Fed meeting was back in the middle of June and what I think what has helped the rally sustain itself though July and early August has been second quarter earnings with some of the more gloomy news so far this year. A lot of folks were bracing themselves for a tough second quarter earnings seasons, S&P companies were expected to grow earnings by 5%, and people thought they would miss or see either flat or negative earnings. Well, the good news is over 400 companies reported earnings out of the 500 in the S&P 100 Index and nearly 80% of them have met or exceeded earning expectations. And so far, on average earnings growth has been around 9 or 10% versus a year ago, so very strong earnings results and over time we've seen here at Fidelity from our research that when earnings, when they are strong, that can help carry stocks over several quarters or years.

JIM: So, Leanna, I would love for you—I'd love to hear your thoughts and what you and your team are hearing based on what Naveen was just describing there. I'm curious if people coming to talk to advisers are perking up a little bit, seem a little more optimistic or are they still worried about what they're seeing at that macro level.

LEANNA: We are. I think thankfully to Naveen's point, we have felt some reprieve this past month so we're hearing that in our client conversations. Clients are also sharing they're traveling, they're enjoying summer, they're going on trips, so that paired with some of the positive swings in the market has been good.

I do think overall that it has been a long—it feels long for volatility, since January 4th to now, so we're still certainly still hearing some of that investor fatigue. So, we really make sure to help our clients have that strategy align to the goals that they have, and also make sure that their risk tolerance is still comfortable for them.

JIM: Perfect. I do want to talk to you a bit more in a moment Leanna, about specific strategies for a down market like we mentioned moment ago. But first, Naveen, I would love to circle back to you and ask you to talk a little bit more about the Fed, right? About what their mission is, we know that they want to sort of keep inflation under control, threading this very fine needle, moving interest rates up to a point that doesn't tip us into a recession or, you know, talk more about how they do that balancing act, and how you think they've done so far and what's to come?

NAVEEN: So pretty early on in this process, and Jim, you described it pretty well. So, with inflation high, the Federal Reserve is seeking to bring that level of inflation down. And one of its mechanisms for doing that is by raising interest rates that can hopefully lead to slower spending, less frothiness in perhaps in housing markets and that could take some of the gusto out of the inflation number. Now, at the same time, the Fed's second mandate along with managing inflation is also to keep growth going in the economy. So that's the fine balance you've said they're trying to strike and that's exactly right. We're pretty early on in the process so, so far, we've seen some rate hikes. We've seen parts of the economy—I'd point to the housing market for example, as having responded to that pretty quickly. So, already the housing market not nearly as robust or frothy as it was at start of the year. But on the other side of the equation, folks are wondering, "Hey, is the recession already here or is it coming?"

And the two quarters of the GDP felt that was confirmation that the recession is here. I think the debate is more open than that. So, look at a visual like this. This is the unemployment rate over the last 20 or so years and right now, the unemployment level we see in the U.S. is closer to its all time low, closer to 3.5% as opposed to what happens in a recession when we see unemployment tick up to 5%, 6%, 7%, or even 8% or higher. So just by that measure alone, it feels like a bit of a disconnect between GDP and something like unemployment. So, in our view, I think we're seeing much more is more of a slowing growth story and that can be good, that can be good in terms of taking inflation a bit lower, but we're not seeing strong signs of a recession just yet.

JIM: Love that perspective, too, because it's easy to look at a list of two or three things and see, "Oh, that box has been checked, that box hasn't been checked," but it's absolutely not that simple. There is a lot of nuance, a lot of other factors to be weighing in to make that ultimate decision. Where else, in addition to jobless claims, and I love the point that you just made, where else do you think we might want to be looking?

NAVEEN: So, we look at dozens of indicators around the economy and health of corporate America to measure where things are, but two more I'll point you to. So, one we touched on earlier is the earning's story. Typically, we don't see earning's growth in a recession. Historically, we have seen earning's declining during recessions and that hasn't happened yet. So, people were bracing themselves for that, and yet as we talked about, earnings have still been positive for the second quarter and the expectation is they might remain positive for a few quarters to come.

Another area that we can point to is within GDP, there is actually some moving parts there, and the biggest moving part is consumer spending, that's about 70% of the GDP number. In spite of the fact, we see negative, modest negative GDP the first couple of quarters, consumer spending is positive in both of those quarters so far this year, so that's a good sign for the overall health of the economy. If that number starts to fade and get closer to zero or tip negative. That to me would feel like a greater confirmation that we are seeing a true slowing of the economy and perhaps something that feels look more like a classic recession. But, again, we're not just there yet.

JIM: And that's something that sort of, I guess, that plays into my earlier observation about our own sentiment, right? I mean consumer spending has a lot to do with, frankly, how much money you have available and then how much goes to your necessities, but it also, I think, and tell me if I'm wrong, has a little to do with how you feel about expectations for the future. If you're bullish, if you're optimistic you're more likely to spend more freely. Is that fair to say?

NAVEEN: That is fair to say, Jim. And it's interesting you point to consumer sentiment. Some of the surveys that are out there seem pretty dire, right? Folks are nervous about the economy, they're feeling nervous about inflation, nervous about where things might be headed, yet through all of that, they're still finding a way to spend. I think folks are making up for lost time, the last couple of years has not been easy to travel or see people or have certain experiences so we're seeing that spending carry through. A little less spending on goods now, a bit more on services like travel, but the spending is still going at a healthy clip in the U.S.

JIM: Yeah, perfect segue back to Leanna. You just mentioned clients coming in and saying this is their summer to travel, they have put it off a couple of years now maybe or at least that long. So, talk to us, if you can Leanna, about strategies for a down market. We did talk about some bright spots, Naveen shared but I also know people are well aware of how quickly things can turn, and your job and job of your team is to help them figure out how to position themselves for when things do get rocky again.

LEANNA: It is. And it can be stressful, so we first want to educate our clients on where we are in the economy, why downturns are normal, and to keep perspective. But when we build plans for our clients, we really want to make sure that that plan is aligned to the goals that you have, your timeframe, your risk tolerance, and your whole financial picture. It's really important to build a plan that you're able to stick with, so that's our foundation. Pictured here are four different allocation mixes that are showing a diversified portfolio of stocks, bonds, and short-term investments. So, typically, let's say you're in retirement or entering retirement and you need to live off—you need income stream and living off your portfolio to pay your expenses, you may see yourself more to the left, a conservative or balanced portfolio. For those just starting out or accumulating for retirement or have a higher risk tolerance or further away from your goal, you probably will see yourself more to the right. We build this custom for you.

I just sat down with a family a couple of weeks ago. It was a husband and wife. They had the same goal that they were planning for but a different risk tolerance. So, we looked at these four investment mixes to educate on what that investment experience may feel like, and in talking about risk and reward, and then again building that plan appropriate for them. So, I'd say it starts with the foundation and then we can talk through some of the ways we may adjust.

JIM: So many factors, too, Leanna. I'm thinking you might work with couples in retirement who feel like they can take on more risk, or even a single person certainly in retirement—just their age and asset level may be one thing but they might feel more aggressive and then it's your job to figure out sort of how to navigate that, I take it?

LEANNA: It is. Sometimes we hear I need to play catch up. I need to take on more risk, because even though I don't have time, I feel like I may not have started out investing as early as I could have. So, we talk again about risk and reward and why we build these portfolios. But we might make adjustments for a few different reasons. So, again that foundation: risk tolerance, timeframe, whole financial picture, may be life events, if any of those items change, we may have to adjust. So, market volatility like we've witnessed, we have learned, "Okay, this is my true risk tolerance. I actually don't have an appetite for that." So, I might go for a growth-oriented portfolio pictured here and maybe take a step to the left, that's far better than going all to cash or sitting on the sideline. Or life events happen, kids are out of the house, so your expenses change. So, maybe you could take on more risk, or maybe there has been a loss of income and you need to reassess your financial picture. These may be reasons why we would adjust.

JIM: Just curious, does the opposite ever happen where someone in the 20s or 30s comes in and is maybe more conservative than you expect them to be?

LEANNA: We do get that too and we talk about why we invest and really the power of compounding and that we need to grow to keep up with cost of goods being more expensive later on, so if we don't need to touch that money. Let's say it's our retirement for 20-30 years, we talk about why, yes, risk tolerance is important but we also need to keep pace with inflation and grow our money. So it is that healthy balance.

JIM: For sure. I want to also talk to you for a moment if we could about investments just in terms of loss, right? No matter how old you are, no matter how much you've accumulated, you want to protect and preserve what you've built and certainly nobody likes to give more than they have to for taxes so help us understand how to navigate that.

LEANNA: So, clients will often ask how can we be proactive during times, in volatility and just proactive with our portfolio, So, talking about tax loss harvesting. This is in regards to your taxable non retirement account, so think your brokerage accounts. Tax loss harvesting is really a way that may help reduce your tax burden on your investments over time. So, it allows you to sell investments that are down, and then you replace those investments with reasonably similar investments to offset the gains with losses. So those losses can offset $3,000 of income on a joint tax return in a year, and the unused losses that you've harvested can be carried forward indefinitely. So, the end result is really less money is going to taxes and more stay invested working for you.

So, if you have a financial advisor, they may already be doing tax loss harvesting. If you're doing it yourself, it's a great idea to consult with a tax professional. Fidelity, if you have professional wealth management, Fidelity does this all year round, so for many that might be doing it on their own. Typically, we see they wait until the end of the year, but even just looking at this year, you've missed a substantial opportunity, eight months of tax loss harvesting with the volatility we've had.

JIM: And we always like to remind folks that Fidelity, of course doesn't give tax advice. You want to check with a tax professional for something you need to learn—something unique about your specific circumstances. That said, however, we know people do come to talk to you and your team about questions regarding tax strategies. What else would you say to lighten the load potentially?

LEANNA: So, another approach to save on taxes is doing a Roth IRA conversion and I'll also highlight why it can be an opportunity in market volatility. But if you're holding investments in a traditional IRA account, or 401K, and you think you might be in a lower tax bracket this year than you may be in the future you could be in a position to convert a portion of that wealth to Roth IRA. The tax benefits are potential tax-free growth and tax-free withdrawals in retirement. Because unlike traditional IRAs, Roth IRAs are not subject to required minimum distributions over a lifetime, IRAs are. One of the benefits now is with the markets down, your value of the account may be a little less than it was last year or at the beginning of the year, so what you're converting a portion now to Roth is a bit lower now, so lower taxable income, but then has that potential to grow tax free over time. So, you pay income tax on the money you convert, but again you have those tax-free withdrawals from the Roth account for many years to come. These are areas that we help our clients and can talk through the different scenarios, but it's a great opportunity.

JIM: Yeah, thank you for that. Really good, Leanna. Hey Naveen, just with the few minutes left. I wanted to ask, I know Leanna gets questions a ton about are we in a recession, is this a recession yet, are we there yet, how bad is it going to be. We would love your perspective, certainly as you look back at history, what can you tell us about where we are and, maybe what's to come?

NAVEEN: Yeah, Jim. Like Leanna, I'm getting very similar questions around when is it coming, how bad will it get, what should I do? So, I find this visual up right now is very helpful just to put everything into perspective. This is going back to 1950, and looking at stock market expansions along with the sessions. If you squint you can see the recession, they're actually pretty small on this chart. And I don't want to minimize them, right. When a recession is here, it's stressful, the markets are volatile, people's careers might be at risk, their jobs at risk, and in some cases, it can have consequences to the family in terms of housing or where to live or even just getting by for a while, so this is not to minimize it. But from an investment perspective, focusing on just what the stock market does, we can see on the visual recessions are relatively short in the grand scheme of things. In fact, the typical recession doesn't even last a full year.

And the market volatility itself, it can be sharp; you'll typically see stocks sell off by 20% or 30% in a recession, and then the recovery typically begins just a few months into a recession. And as you can see on this visual, the recoveries are pretty fast and they can last for years after that. So, the biggest risk I find in this environment is actually investors talking themselves out of the market, whether it's going to the sidelines in an existing portfolio, or if they have money that's ready to invest, maybe hesitating and waiting for a better time or better environment. But I think the last few weeks are a classic case study on what can happen with this kind of thinking, right? Let's say we had clients saying to Naveen or Leanna, "Hey, wait for a market pullback before I invest." Okay. We've had a 20% plus market pullback this year. Then the client says, "Well, I'm kind of concerned about the headlines, I'll wait for the market to recover a little bit and then I'll get back in." Okay, the market has recovered now 10%, what about now? "Well, I don't know. I'm still concerned about the headlines or midterms?" There is always something, right? There's always some reason to stay and wait and time perfectly.

But if you look at this visual, an investor that stayed invested and tried not to get cute about timing things perfectly or picking the bottoms, they would have enjoyed tremendous success over this timeframe, in spite of living through over 10 recessions in this lifetime. So, that's the biggest takeaway for me from investors is I think with recessions, it can be helpful to review our financial plans and maybe even make some small steps within an account or a portfolio to manage risk. Perhaps we lean a bit more into defensive areas of the stock market or bonds and away from growth stocks for a little while, but I think wholesale achievements aren't usually needed and the patient investors, the disciplined investor, the one who didn't panic in 2020 or in 2018 or in 2011 or in 2008. Those are the last four bear markets we had and that investor actually saw recovery and saw all time highs work in their favor. And that, I think is the biggest take away for me in my 20 plus years of investing, the biggest mistake I've seen from investors is I should have gotten out before the recession, it's once they're in the recession they decide to go on the sideline and they miss out on the recovery that follows.

JIM: I see Leanna nodding along, too. It's something that you've said as well. I think, both of your perspectives are so much appreciated. Because in the moment, right, in the moment today, in the moment in 2020, 2018, 2008, and 2009, it's very, very hard to zoom out and take the literal macro look that you're sharing today back 50, 60, 70 years, but that perspective really can help you navigate times like this. So, thank you both for the taking time to share with that with us today. For folks in the audience, just a reminder if you've got questions about making a financial plan or staying on track with the one that you have, Fidelity can help. You can call us or go online, visit our website, download our app, tons of ways to continue to learn and interact with us to help you feel like you're making better decisions.

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