Fidelity Viewpoints®: Market Sense

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TRANSCRIPT

SPEAKERS:

Heather Hegedus   Jurrien Timmer   Heather Knight

HEATHER HEGEDUS: Hi, there. And thank you so much for making the time to join us today for Market Sense. I'm Heather Hegedus with Fidelity. As you can see, we're in the midst of the holiday season. Both Jurrien and I are getting festive today.

And it certainly is feeling jolly on Wall Street, as stocks closed Friday at all-time highs. The S&P achieved its 57th closing record of the year. It is on pace right now for its best annual return since 2019.

So that rally was in reaction to another jobs report that we got on Friday, which increased bets that the Fed may deliver another rate cut next week. So to talk about that and the bigger picture from all of this, too, we've got Jurrien Timmer with us today, our director of global macro—as you can see, in his festive attire, too—to share his insights.

We are also really excited today to welcome Heather Knight, who is a vice president here at Fidelity and a national brokerage coach. And she's here today to talk about ETFs, or Exchange Traded Funds. Thanks so much to both of you for making the time during the busy holiday season to talk about this. I'm excited for this conversation.

HEATHER KNIGHT: Hey, thanks for having me, Heather. And Jurrien, it's great to see you again.

JURRIEN TIMMER: Hello, Heather and Heather.

HEATHER H: H squared. So today is Tuesday, December 10. And Jurrien, we always start off with the headlines. And we have that important jobs data that we got on Friday to talk about, which—this is sort of interesting. It showed more companies are hiring again.

But it also showed that unemployment keeps rising, which I think some people might say sounds like conflicting data. What does this tell us, though, about the state of the economy? And what does it say about the likelihood of a Fed cut? And if there is a cut, how much the Fed might cut in December, Jurrien?

JURRIEN: Yeah, so we did have the jobs report. And just for those who don't know, the jobs report can be a little confusing. Because there's what's called the nonfarm payroll report, which is how they tally up how many people companies are hiring. And then there is the household survey, where they actually survey households about whether people are employed or not. And that's where the jobless rate comes from.

So the jobless rate and the payroll number, the one that gets quoted, 200,000 people added, are coming from different surveys. And of course, this is a very large country with a lot of people in it. And so the establishment survey, as the payroll report is called, is really a statistical formula that takes a small sample and extrapolates it over the entire economy.

So we always look at moving averages. And we look at both. And both of these surveys told a slightly different story. But overall, the sense is that the economy continues to do quite well. It's quite resilient.

Corporate profits are growing. They're expected to grow 10% this year. The unemployment rate at 4.2% remains very, very low. And the jobs market is more or less in balance, in terms of the number of jobs that are available and the number of people looking for jobs.

So the economy is in a nice point of balance, which allows the Fed to bring policy back to a more neutral stance. And as we all know, because we've been talking about it for the last couple of years, the Fed had to raise rates quite aggressively because inflation was a massive problem in the aftermath and during COVID. And so the inflation rate is still elevated above the Fed's target. The Fed's target is 2%.

And again, I'm talking about the rate of inflation, not the price level, which, of course, continues to be very high compared to four years ago. But the rate of increase in those price levels is down to about 2.83% or 3%. And we're getting the CPI report very soon.

And that's close enough to a more steady state level that it allows the Fed to take back a couple of those rate hikes that I did in '23 and in 2022. And the Fed is meeting in December. And that is what is expected from the markets, that the Fed cuts one more time this year. Of course, it's December. And then we have to see how much is in store next year.

HEATHER H: OK, so the economy is relatively in more balance than it had been, relatively strong. Let's talk about the stock market rally now. So I said, the S&P briefly surpassed the 6,000 mark in November following election day.

It's on track to have its best annual record since 2019. That's huge. Are the stars aligning at this point now for a Santa rally to push stocks even higher into 2025, do you think you're in?

JURRIEN: So we are in the seasonally most favorable kind of part of the year. So from, let's say, mid-October until April, those tend to be strong months. And as you point out, the market is up quite a bit. The S&P 500 is up about 28% year to date, 29% the equal weighted S&P, which kind of normalizes for the size of what we call the magnificent seven. These gigantic tech companies still have a very respectable 20% this year.

And the historical average is about 10%, 11%. So this has been a big year. And for all of us invested in the markets, we should be thankful for that. Because that's not how every year goes. And we just saw, a couple of years ago, that it can swing in the other direction, too.

But it looks like Santa has brought his animal spirits with him. And of course, we've had an election. And whatever your point of view is on that, the expectation is that the economy should continue to do well as companies spend on capital formation.

And so that is what we're looking at going forward. And again, there's a lot of emphasis on how narrow the market has been. But it really actually hasn't been that narrow, even though a handful of companies are very big.

So the magnificent seven—these are seven stocks that are 30% of the market. And that can lead to some concerns that, if something goes wrong with any of them, it can take the market down. But beneath the service, about 75% to 80% of the stocks in the S&P 500 are in uptrends. And so this really has been a fairly broad rally, even though a couple of stocks are stealing the show.

HEATHER H: OK. And I know we're going to talk about small caps a little bit later. But thank you for getting us caught up on the markets. And I want to switch over to Heather Knight, because we've got a pretty in-depth discussion with Heather today that we're excited to bring to you. So, Heather, first of all, tell us a little bit about what you do, what your role is here at Fidelity, and also the growing role that brokerage accounts are often playing in people's portfolio these days.

HEATHER K: Yeah, absolutely, Heather. As a national brokerage coach, our mission is to educate our associates and our clients about our brokerage offering, especially for those who prefer more of a self-directed approach. When you think about evolving technology and all the people that are really wanting to play a part in managing their portfolios, it's really important for us to stay ahead of that so that we can support these folks ongoing.

HEATHER H: OK. So you're the perfect person to talk about this topic, which is where ETFs might fit into people's portfolios, how they might. We know that ETFs have become popular vehicles with DIY investors who are maybe looking for a mix of generally low-cost and tax-efficient investments. So once an investor has determined that an ETF may be right for them, how can an investor go about determining what allocation may be appropriate for their portfolio, Heather?

HEATHER K: Yeah. Heather, you're absolutely right. When we think about ETFs, low-cost, diversification, even potentially some of the tax efficiencies—those are just a few of the characteristics that make ETFs so attractive. There's so many ways to build portfolios just in general.

But I'd say that one of my favorites is taking on a core or satellite position approach. I'd say that one thing that you want to do, first and foremost, is determine that risk profile and your asset allocation before diving into building a portfolio. So take the time, assess your risk tolerance, know what your financial goals are. And think about things like, if I need money sooner, should I be taking on less risk?

And don't forget to consider the emotional temperament. Ask yourself, do my investments keep me up at night? Can I handle the market ups and downs? And that's also going to help us figure out what that comfort level is when we think about investing. And that's why, a lot of times, you hear all—at least us here at Fidelity—say, focus on those goals first so that we know exactly where you'd land when we think about starting out with your portfolio.

HEATHER H: OK. So I'd love for you to explain a little bit more what you mean by core and satellite. And also, once we figure out what our risk profile is, and an asset allocation, and we start filling out our ETF portfolio, what are some of the other important things to keep in mind, as well?

HEATHER K: Yeah, so once you know that what that risk profile looks like, you can choose what we call the core part of your portfolio. And that's really all going to determine how much you invest in either stocks, versus bonds, or even some other assets. So you might consider finding something like a low-cost or a broad-based diversified ETF, for example, something that tracks like the S&P 500 or even the total bond market.

Luckily, Fidelity offers some really great screeners, especially related to ETFs. And those will help you narrow down those results. And I always suggest to folks to take a look at setting up a watch list so that you can track them easier. Those will really make up that core part of your investments. And sometimes, that can make up or may make up anywhere between 50% to 90% Again, going back to that risk tolerance and your time horizon—of course, those goals.

For the remainder of your portfolio, consider whether a satellite investments might be right for you. These are usually more actively managed. And with active ETFs, their goal is usually to seek to outperform the index that they're tracking. So that's where you can add that personal touch or, I'd say, a tilt to your portfolio.

For example, if you believe small caps have an attractive valuation or they're expected to exceed the growth of larger cap valuation stocks, you might consider looking to add maybe small cap ETFs as part of that satellite. Or maybe you want to add exposure to a specific industry or even a narrow-based ETF. And when I say narrow-based, Heather, I'm talking—really, narrow-based means the ETFs that track maybe a smaller number of those securities rather than broad-based ETFs like that S&P 500 that seek to track those bigger indices, let's say.

And also, for those folks that like to have just a handful of stocks, maybe you're looking at that as part of your satellite, but you don't feel comfortable buying the individual securities. You can also search for ETFs by stock exposure on fidelity.com. And you can put up to about five stock symbols. And you'll be able to get the results of ETFs that have the highest exposure to those stocks, as well.

And finally, another option that I have to highlight to you, because it's really popular with a lot of the folks that we have here—and they use it to help create that core portfolio and in choosing some of their ETFs. And what it is it's called the ETF Portfolio Builder. So taking a look at that might be something that might help you along the way, as well.

And by the way, rebalancing always seems to be the stuff that folks forget all the time. So you may want to review the intended asset allocation versus simply reviewing your ETF performance, as each ETF should have a clear purpose. And if it doesn't perform as expected, consider replacing it, of course.

HEATHER H: OK. And think of satellite as giving you some exposure but not the core. It's out there but not at the center of your portfolio.

HEATHER K: Absolutely. Absolutely.

HEATHER H: All right, nice visual there. I like the way that you're just kind of helping us to think about it. And you just mentioned several free ETF tools, as well, for Fidelity customers. And at the end of the show, if everybody could please stay tuned till the end, we will share a link to all of those tools, as well, that can help you just start this process.

So Heather, you mentioned small caps. And Jurrien, this year has particularly had us paying attention to this bullish broadening happening in the markets, which is the rest of the market catching up to the so-called mag seven, the tech stocks that have been leading the way for so long. We did get a viewer question.

A viewer wrote to us at our email, marketsense@fidelity.com, and wanted to know whether this is a good time to head into small caps. And if so, what's a good ETF for that? So Heather, I'll let you answer that viewer question. What do you think?

HEATHER K: Absolutely. So while we can't recommend what ETF is right for everyone, because it's going to be different, of course, depending on your strategy, what I can say is that small caps offer a really great option for portfolio allocation. So if you're looking for more of a growth opportunity, that might be something that you lean towards. But they generally come with a higher risk compared to large cap stocks.

So I would say that, look to the market sentiment. And ask yourself, am I properly diversified? Volatility and time horizon, like we mentioned before, they're going to come into play and how that fits into your overall portfolio, as well.

JURRIEN: Yeah, and just on that note, it is a very good time to be having this conversation. Because we all know about the leaders—I call them the generals. And then the rest of the market are the soldiers.

And actually, it was 11 months ago that the S&P 500 made its first new all-time high after that correction that we all experienced in 2022. It took a good year for the market to crawl back up. And when that happens, history shows that the market tends to gain momentum, which, of course, is exactly what has happened.

And again, underneath the surface, many stocks are participating, some slower than others. But one of the challenges, I think, going forward is, in a market that is so dominated by a handful of multi-trillion dollar stocks, if those stocks ever stop working—and that's not a prediction, by any means. But if that ever happens and they're so big, how do gain access or get the benefit from this broadening, where all these other smaller stocks are doing well, but they're kind of taking a back seat to the leader? So having other ETFs, or index funds, or active funds that speak to the broader market is one way that could work.

HEATHER H: And Jurrien, remember back as early as last May and June during our midyear outlook, you were talking about, generally speaking, history shows that, where the generals go, the soldiers will follow. And like you said, that is indeed exactly how it has played out, as you told us it might. Heather, just back a little bit to our discussion of ETFs—and let's talk about crypto funds.

Because Bitcoin just reached a new all-time high last week. It was a massive week for Bitcoin. The price of one bitcoin hit $100,000 for the first time ever.

Demand for the digital currency has been surging ever since the outcome of the election was announced, the presidential election and the congressional election, as well. Crypto funds can be one popular way to get some digital currency exposure without actually holding that digital asset directly. So I was hoping you could talk a little bit about the different kinds of crypto ETPs, and how they work, and why they are so popular.

HEATHER K: Yeah, as you said, crypto funds, they can provide an easier access to digital assets or even the digital asset ecosystem, eliminating the need for those wallets and direct interaction with crypto exchanges. And some of them even offer the ability to invest in multiple blockchain-related companies. That said, it's really important to note that there are different things to consider when you're looking at these exchange-traded products.

First, there are crypto-related ETFs that can provide exposure to companies in the crypto industry or futures based, which can provide exposure to the futures or a specific currency, maybe even or a basket of those. And then also, considering there's spot crypto ETPs that actually hold cryptocurrency and offer direct exposure to cryptocurrencies' value. Although, you don't necessarily own that digital asset directly.

And remember, crypto, they're trading 24 hours. And our ETFs aren't doing that. So in general, what I would say in closing is this—is that crypto is a highly volatile. And for all those products, it's really important to understand what you're investing in, and the fund's objective, and the associated risk.

I tell clients all the time, it's really important to review the prospectus. I know it seems daunting. But that's the best thing that you can do to truly know what you're investing in. And you can do all of that on fidelity.com.

HEATHER H: OK. Really important considerations there. And yeah, I think, often, we just kind of put that perspective aside. So that's good to know that that is important information. Another one of the questions that we get a lot from Market Sense viewers and listeners, Heather, is how to build a portfolio from dividend stocks. Can you talk about how dividends work inside an ETF?

HEATHER K: Yeah, usually ETFs that hold stocks that pay dividends, they aggregate those and pay them out quarterly. It's typical. Some pay on different schedules. But ETFs can offer that option to reinvest those dividends into new shares. Sometimes those are going to be—usually, you're going to see those commission free through brokers like Fidelity.

But what I'd say is that, again, check the ETF prospectus for the specific dividend policies and the payout schedules. And also, really important to remember that dividends are variable. So we don't want to really look at those as guaranteed income, for sure.

HEATHER H: OK. All right, thank you, Heather. And I'm glad we got to answer some of our Market Sense community's most commonly asked questions here. We are almost at the 20-minute mark. We do like to wrap things up with a Timmer's take.

And Jurrien, of course, we've got the Fed meeting next week, which we've been talking about for a while now. What is on your mind when it comes to next week? And what's on your radar?

JURRIEN: Well, so we've got the inflation report. Last week, we had the jobs report support. And the labor market and inflation are essentially the Fed's two mandates. So it's price stability at 2% and full employment.

And those things don't always agree with each other. But right now, they are generally in agreement. So I think the Fed can take some solace that it is doing the right thing bringing rates slightly closer to a neutral policy, which, in my view, is around 4%. And then we'll see what kind of tea leaves the Fed will leave for us to read in terms of the dot plot and the summary of economic projections. And after that, it'll be almost the end of the year.

HEATHER H: So you think the neutral rate is about 4% in the Fed.

JURRIEN: Yeah. So if inflation is around 2.83%—looking at the core inflation numbers—and they've been on the stickier side. So they're not really going down anymore. So maybe 3 is the new 2. And then in a expanding economy, a neutral rate, which is after inflation, would be about 1%—so 3 plus 1 equals 4. So that's, for me, the baseline.

HEATHER H: That makes sense. Yeah. That sticky inflation that doesn't really seem to be budging down to the targeted 2% that the Fed would like. And like you said, so perhaps 3 is the new 2.

All right, I think that's a good place to leave it. I want to thank both of you, Jurrien and Heather, for really great information today. This was a packed show. And you guys still made it just so easy to understand. And I really appreciate that.

And something else that helps walk you through the process and makes things a little bit easier to understand are some of the free ETF tools that Heather mentioned that, if you are a Fidelity customer, have access to. So you can find them by scanning the QR code that's on your screen right now. Just hover your phone over that code. And it will take you directly to the tools once you log into your Fidelity account. You do have to be a Fidelity customer, as I said.

You can also find those links to those tools by downloading the slides that you find below the video player of this webinar. And ETFs is such a broad topic. We couldn't possibly have covered this all today in 20 minutes.

Although, Heather, you did a great job of talking about the highlights. But Heather has graciously agreed to come back for an ETF part 2 at some point here on Market Sense. So we're excited about that. And we'd love it if you would email us at marketsense@fidelity.com with more of your ETF questions that we can use for that follow-up episode next year.

So on behalf of Jurrien Timmer and Heather Knight, I'm Heather Hegedus. Happy holidays, everybody. And we will see you back here next Tuesday. We're not taking a break just yet for the holidays. We'll be back Tuesday at our regular time of 2 o'clock Eastern.

[1]Bloomberg, December 6, 2024: https://www.bloomberg.com/news/articles/2024- 12-05/stock-market-today-dow-s-p-live-updates?srnd=homepage-americas

[2]Fidelity Viewpoints, September 16, 2024: www.fidelity.com/learning-center/trading-investing/how-to-build-ETF-portfolio

[3]Fidelity Viewpoints, September 5, 2024: www.fidelity.com/viewpoints/active-investor/etf-myths

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