Fidelity Viewpoints®: Market Sense

Week 115, September 27, 2022

TRANSCRIPT

SPEAKERS:

Jim Armstrong   Naveen Malwal   Leanna Devinney

Jim Armstrong: Hello and thank you for joining us for Market Sense. I'm Jim Armstrong with Fidelity. This continues to be a time of questions and worry for a lot of investors. We've got the Federal Reserve Bank continuing to raise interest rates in an attempt to fight inflation. Which ends up raising our concerns of a lot of things: market volatility, the potential for a future recession, and of course, we're wondering how and what the Fed might do to try to bring inflation under control.

So, today, we want to talk about what the Federal Reserve is doing but also what we can do in response to the volatile market we're all living through. To help guide today's conversation, Naveen Malwal is here. He's an institutional portfolio manager for Fidelity's Strategic Advisers. Today he's going to be sharing insight into the Fed's actions and, again what they mean to us as consumers and to the markets as a whole. We're also thrilled to have Leanna Devinney back again this week. She's going to be talking about the strategies that she and her team offer Fidelity customers who, just like you and I, are trying to figure out personal plans during times like these. Guys, thank you both for being here.

Leanna Devinney: Thank you. Missed you both last week.

Naveen Malwal: It's nice to be back.

JIM: Great to have you back, absolutely. So, Naveen, if we could, we'll start with you. It is September the 27th, Tuesday the 27th, and of course, last week we saw the Fed raise rates for the fifth time this year. Inflation is still running near 40-year highs. You know, what's your sense, we'll start with that, of what you think the Fed is expecting to achieve with these hikes?

NAVEEN: The Fed is following a game plan they've had for decades now, which is when inflation starts to get hot, one of the things that can help is to raise interest rates. What I found interesting about this latest one is they were more explicit about their goals. So, they shared three specific things. One is to try to cool off overall economic growth and when growth is extremely hot, like it has been for some time, that can lead to some inflation. The other two areas they pointed to; one was the housing market. So, perhaps the housing market house price appreciation has been running really warm the last couple of years. Trying to slow down home price appreciation.

And then the third element was the job market, where an overheated job market can cause inflationary pressures in the economy as well. And the Fed believes they have to address all three of those areas to bring inflation back to more reasonable levels.

JIM: You are probably among the many, many people who try to read the tea leaves, I guess, for lack of a better way to say it, about what the Fed decision is after any given meeting to try to figure out what's to come next and what's yet to happen. So what's your sense of whether or not more rate hikes are coming, and how it may affect individual customers?

NAVEEN: The Fed discussed its plans, and its plans are to continue to raise interest rates until they feel that inflation is going to head back toward their long-term target, which is roughly about 2% over the long run. Now, in the near term that impact these higher interest rates, there are numerous on consumers. The more obvious ones I would say on this visual in front of us, which point to consumer loans. The loans that are near the bottom-middle of the page, those are the ones more directly impacted by the Fed's increasing interest rate. The ones higher up on the page are less affected. But you can see, consumer loans, auto loans, mortgages, student loans, they can all be affected by this. So, maybe some higher borrowing costs for consumers.

Now, there's other implications of this as well. So, think about the mortgage rate, right? With higher mortgage rates, the typical consumer is able to afford less home so as a result, we'll likely to see home price appreciation slow down, which I just mentioned is one of the Fed's goals. So, that is something we're likely to see as rates rise.

Another thing that tends to happen as interest rates rise is it does take some edge off of corporate profits. So, if companies are paying more interest costs, there's less profits. And as a result, I can expect maybe two things. One, perhaps stock prices might appreciate at a more modest rate because their profits are not as high. And two, for some companies it might mean either changing hiring plans or putting things on hold, or even doing some layoffs. So that can affect the job market.

Now to end on a bit of a brighter note, one item on this visual is if you are a saver, right? If you have a savings account or looking at investing in something like a CD or bonds, well rates on those areas are now higher than they have been for years. So, as a saver, higher interest rates can be a benefit to help investors either maintain or grow their wealth over time.

JIM: So much to dig into with that answer, Naveen. Thank you for laying that out. I mean you touched on all the different ways going through all of our minds about how our personal wallets could be affected by what's happening.

I want to definitely get to you, Leanna, to ask you a follow up on that, too. But before I do, one more for you, Naveen. What would you say the Fed's campaign is doing to fight inflation, how it's affecting people's investments, right? How is that also being affected?

NAVEEN: Yeah, it's been a really tough year for investors. It seems there hasn't been too many places to hide with both stocks and bonds down for the year. So visually looking at showing US stocks and bonds going back the last five years. Over on the right side of the page is essentially the year to date. You can see both those lines kind of heading down. That's been a drag for people, feeling this pressure, both stocks and bonds down. I know folks who are in retirement, in particular, perhaps living off their assets, like my mom and dad, they really feel the pain of this. And it's tough to bear that.

But I'm sharing a five-year visual here intentionally. So, if you've been in the market for some time, in spite of the pullback that's happened this year, there's a pretty good chance you've actually still made some gains in stocks and bonds over the last five years. The second thing this visual highlights, to me, is we've seen pullbacks before, you can see a big drop off in 2020. Or even back in 2018, and in both those instances investors are really stressed out, similar to today. And many of them are tempted to go to the sidelines or maybe avoid the market for a while, but we know how the story ended in those cases.

So, typically, after market pullback there is some stress but since the 1950s, we've seen a lot of pullbacks and every single time, the market eventually recovers and has gone on to make an all-time high somewhere down the road. So if we're patient investors, I think it can payoff to be disciplined, not overreact to this near-term volatility, and just understanding the history of the market, it seems the odds are in favor of an eventual recovery and higher wealth down the road.

JIM: That long-term perspective again, so crucial to keeping calm, right, not reacting to stress. But, Leanna, as we've said so many times on this show. That's almost an academic argument, right? It sounds like something, sure, my brain is telling me I should do, but my gut is telling me something very different. I'm curious what people coming in to talk to you and your team are talking about these days.

LEANNA: So, right now, client sentiment is really low. I think June and July, and just the summer months, we had some strong market months this summer. And we were feeling a bit of a recovery and a bounce back, and I think clients felt that reprieve and also were traveling, spending time with family, warm weather.

So, a little less positive the past couple of weeks in some of the client meetings. I think some—just even COVID cases coming back, so I have felt a little bit more down sentiment from our clients. But they're coming in and asking us to revisit their analysis. And questions along, “Am I still on track, knowing inflation is this high. Knowing my spending, I'm spending more than usual, or what will retirement look like now?” So, I think visually seeing the analysis that we do, to take a look at your spending, your total wealth, has been really helpful.

And then on the positive note, to Naveen's point on savers. You know, with the Fed rate increases, we are seeing that directly in money market accounts, CDs, high yield savings account, so we're having conversations with our clients about their cash, their emergency funds, if they're able to save more making sure that we are getting interest and earnings on that piece of your wealth.

JIM: You know, one thing you have mentioned, Leanna, in the past that people have come to your team with questions about is recessions, right? Are we in one? Has it happened yet? Is it going to happen soon? Naveen, I would love your reaction to that general sentiment as Leanna has described it in the past, right? How are you seeing the Fed's actions, and how do they play into people's fears of recession? How should they, perhaps?

NAVEEN: Yeah, historically, when the Fed raises interest rates, a lot of times a recession has eventually unfolded, but it doesn't happen overnight. It's not that as soon as the Fed starts hiking interest rates, a recession is definitely happening. In fact, normally, rate hike cycles can last for many quarters, if not many years. And again, oftentimes there's a recession but not every time. You know, as of right now what I'm seeing in the economy, it feels like a mix of both some signs of growth, signs of slowing. But just looking at unemployment for example, right?

Unemployment is still extremely low. There's a strong job market out there and in a typical recession, you don't see that. But taking a step back from that, looking to this visual in front of us, what you're seeing here is the history of stock market performance around Fed interest rate hikes. I think for a lot of folks, they might think, “Oh, if rates are going up and recession might be coming. Stocks might just go down on a regular basis.” But the reality is historically, stocks typically do rise through rate hiking cycles. And this year has actually been unusual in the sense where we're seeing stocks come down quite a bit as the rates have been going higher.

I think that’s a reflection of higher inflation and just a fear of recession that’s out there, right? People are pointing to things happening overseas, things happening in this country and are just wondering. And I think a lot of that is feeding into the volatility this year. But this, to me, is another example, right? Of thinking about “Hey, do higher rates necessarily mean the market is going to go down?” Turns out, historically no. So, it could be another case for I understand the near-term volatility but history suggested even 12-24 months after the Fed has started hiking interest rates, stocks can, and often have, wound up being higher.

JIM: To be able to look 12–24 months into the future, that would be amazing. Leanna, I'm just reflecting on what you were saying a moment ago, this idea of folks coming in and asking to revisit their plans, right, just to sort of check in. I didn't know you were going to say that right now, and this morning—I am not kidding—I went in and looked at my plan, again, online. I've shared with this show before, I have my annual review with my advisor every June, so we met this summer. I felt good, but these last 10–12–14 or so weeks, since that meeting have really gotten me a little bit worried. So I went in, nothing has changed fundamentally for me, my wife and I are still on target with all of our goals and plan to retire at the right time, and everything. But I really did want to go in and try to figure out if I was headed in the right direction. That's got to be something that it sounds like you are hearing quite a lot?

LEANNA: We are. And it's a stressful time as we mentioned. And we do want to urge our clients to keep perspective, downturns like this are normal. But the first thing we want to do is make sure that your investments, so Jim, you and your wife's investment strategies, is it still aligned to the goals you have? And is it aligned to your risk tolerance, your timeframe, your whole financial picture? When we get that right, it can be, while hard, it gives us that confidence to stay invested and keep that perspective. So, that part is really important.

On this slide here it's showing the different mixes, just a few examples of how you may be allocated. But the past couple weeks we've met with a lot of clients who are either in retirement, like Naveen's parents or a few years away, and recently we had some who said I was always in more aggressive growth. So further to the right, growth and aggressive growth, and I just had my paycheck coming in, it went to my 401(k), it felt set it and forget it. Really out of sight, out of mind. But now needing to take income, or being close to taking income, you're feeling more panicked.

So, we really help our clients really make sure that we're keeping those investments aligned, but how are we going to plan for taking income while still having that diversified growth. Because even when we're close to retirement, we're planning for a long, healthy retirement, that's hopefully 30 plus years long. My grandfather turned 93 yesterday. He's been in retirement for 30 years.

JIM: Awesome.

LEANNA: So, we still need our portfolios and wealth to grow. That part is important. But, for the most part, having that dedicated plan in place that's well diversified, aligned to you, that's how we can really keep perspective during these times.

JIM: Wish him a belated happy birthday for us please when you talk to him again.

LEANNA: I will. I agree.

JIM: If we're being honest, though, even if the market were gangbusters right now and I was someone entering retirement, I would still be nervous about starting to draw down because it's the money that I've been saving for decades. Like you said, 30 or 40 years, no matter the circumstances, it's nerve racking to start to draw that money down. When you need to make adjustments, Leanna, how should you go about doing that when you're still in that accumulation phase?

LEANNA: So, that time to when you're going to be making changes is really important. It also could be if you've had a big change in your life. So, maybe there's a loss of income. We saw this a lot in the pandemic, even kids home, spending changes, needing to tap into emergency fund, unexpected expenses; these could be reasons to make adjustments outside of that goal coming up. Another one would be that true risk tolerance that really comes out in these periods of time. We never want you to go from, you know, a growth portfolio, as an example, all to a cash on the side lines.

And if you feel like you're going to, well, maybe we make subtle tweaks and kind of move over to the left to keep you invested but staying more comfortable, or maybe it's looking at defensive approaches. These are just options that we have. I would recommend, sit down with a planner, use our resources, and we can really help you navigate times like this.

JIM: We'd love to also talk if we could about investments in terms of loss. Because investors certainly want to protect and preserve what they've built and no one among us likes taxes. So, help us understand, if you could, how sometimes those losses—don't want to be too rosy about it, let's be realistic. The losses maybe don't have to do some good but at least don't have to feel so badly.

LEANNA: Yeah, so many clients will ask like how can we be proactive during these times? And for our nonretirement accounts. Our brokerage accounts, as an example, we can do something called tax loss harvesting. So, that's a mechanism where you take some of your realized losses, and you can use that to offset the gains you've had over time so you net them against each other to then really mitigate or potentially reduce that tax liability that you've had. These losses can also offset $3,000 of your income annually for individual and joint filers, and it could also be carried forward for the life of an investor. So, again, it allows you to be proactive, net those losses and gains together to potentially reduce that tax liability.

JIM: Got it. Anything else?

LEANNA: Another one, and this has been coming up a lot. If you're holding investments in a traditional IRA account, or 401(k) so think your tax advantage accounts, and you think you may be in a lower tax bracket this year than you might in the future, this is an opportunity to convert a portion of that money into a Roth IRA. So, you would be paying taxes on that income that you convert, but the tax benefits would then give you potential tax-free growth, and then tax-free withdrawals in retirement. And that's a really big benefit because Roth money is not subject to the required minimum distribution, so it gives you the opportunity to have tax-free income. Just a couple strategies that we can help with.

JIM: Great. Definitely good questions to have in our mind so that we can ask our tax professional. Because I do want to also say, of course, Fidelity doesn't give tax advice. We can talk about things like this but when it comes down to it, you really want to sit with your accountant, or your personal tax professional and have them run your numbers because it's going to be so specific to your needs.

LEANNA: Yes, you do.

JIM: Hey, Naveen, let's end on kind of a more positive note, or more optimistic forward-looking note with a chart that Leanna was saying can be a pretty popular one because it talks a little bit about that macro view, right? That high lens that we want to keep as we're looking at what's happening today, trying to look forward.

NAVEEN: Yeah, Jim, this visual to me is one of the strongest ones I've seen that just shows you the power of long-term investing. So, it starts in 1950, and goes through I think roughly this year in the summer. And on this visual, you can see the number of expansions that have taken place, the tremendous amount of growth that stock investors have experienced through decades and decades. Now, at the same time, this chart also shows the 11 recessions we've already been through, and numerous other bear markets in correction. So a big correction in 2018, big correction in 2011, and 1987. Who had 15 pull backs of 20% or more for, the U.S. stock market since 1950.

And every one of those cases that are all on this chart, everyone of those cases, the market eventually starts recovery and goes on to make new all-time highs in the long run. And this is another reminder, for me and for the investors I speak to, the long-term perspective really seems to be the thing that pays off for investors. Trying to second guess whether it's a recession, or one is starting or when it's ending, you know that can take a lot of work and effort, and it's extremely hard to time those things perfectly. I find sometimes investors can kind of stay on the sidelines at the right time, when things are kind of choppy. What's extremely hard though, is buying in just before the recovery.

So very few people, for example, started buying the market at the end of March in 2020, or on Christmas Eve in 2018, or in March 2009. Most investors are very cautious and leery after a correction. They don't want to get back in. But I've found the most successful investors tend to do is just be patient. Try not to pull thing out, keep your money coming in, right? Doing that dollar cost averaging over time, adding to the markets as they go up and down, that tends to payoff for investors more often than not. And this visual, to me is a great reminder of the power of that compounding investing over time, despite crises and recessions.

JIM: I promise you that I do keep this conversation and conversations like this every week, in my mind when I go in and check my balances. And I think, "Okay, we're going to get through it, we're going to get through it, Naveen and Leanna told me so."

Thank you, guys, so much for your perspective as always, today. For folks in the audience, if you've got questions about your specific financial plan, how to stay on track, how to revaluate it like Leanna was discussing, Fidelity can help. Of course, you're always welcome to give us a call. You can go online, visit our website, check out our app if you haven't already downloaded that, to learn more. And as a reminder, as well, Market Sense, the show you're watching right now, is also a podcast. So, you can listen to it on your commute, on a walk, at the gym, really anywhere you want. Just search for Market Sense wherever you get your podcasts right now, and you'll be able to follow us, hopefully add us to your personal library and then never miss a moment of our conversation. Again, a huge thanks to Leanna and Naveen, and we hope to see everybody back here again next week.

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