Fidelity Viewpoints®: Market Sense

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TRANSCRIPT

SPEAKERS:

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JIM ARMSTRONG: Hey there. Thanks for joining us for *Market Sense*. I'm Jim Armstrong with Fidelity. Heather has the week off. It is, incredibly, already August. And traditionally, this is the time of the year when the markets tend to exhale a little bit. Maybe things get slightly calmer than they had been, although that's not necessarily the case this year. Market's having a pretty good few days, as we speak, on the heels of some sustained volatility, which we will, of course, talk about.

We also want to spend a few minutes talking about some of the other things making news. This earnings season certainly is something worth talking about, as well as the 10-year Treasury inching closer to that 5% mark that's got a lot of people concerned, as well as inflation in general.

So, lots to unpack among those many headlines there. And to do that, we are thrilled, as always, to be joined by Fidelity's Jurrien Timmer. As I'm sure you're aware, he is our director of Global Macro. He's going to help us understand what all of those headlines potentially mean to each of us as investors right now.

Also today, we're going to pivot a little bit and start talking specifically about what it can mean to be in or near retirement during times of volatility like this. It can be unsettling, at the very least, to have spent decades of your life saving for and planning for retirement, and then take your hands off the wheel a little bit and feel like macro and market forces are more in control.

So, to help us get a handle on how to think about that, we are also very excited to be joined by Fidelity Vice President and branch leader Kenny Davin. He's going to be sharing his thoughts about exactly that, about how he and his team work with Fidelity clients and customers all the time, helping them navigate this retirement transition. Gentlemen, thank you both for taking time out of your day to be with us.

KENNY DAVIN: Thank you. It's a pleasure to be here.

JURRIEN TIMMER: Great to be here. Nice to see two familiar faces again on the show.

JIM: Same, same. All right, Jurrien, let's get started. It is Tuesday, the 4th of August. Really, I want your take on just about everything that I mentioned off the top of the show, but in particular, maybe we can start with where we are in the current earnings season.

I'd love your sense of what's happened and what's to come, also, maybe through the lens of big tech companies, the Mag Seven, the Magnificent Seven in particular. It feels like they're having a really good time of it. And it feels like investors might be a little bit more—maybe discriminating the right word? They're starting to see the big tech as less of a monolith and more looking at each individual company. Is that your read as well?

JURRIEN: Yes, so there's been a lot of crosscurrents. The S&P 500 is now making a new high for the first time, really, in two months. Until the last two days, it really had been churning sideways since June 2. And during that time, we saw quite a nice rotation out of the big AI, tech, Mag Seven types names, into, basically, everything else—financials, industrials, you name it.

And because of how top-heavy these big tech companies are, if they're getting rotated out of, it's hard for the S&P to really make a lot of progress. And so, most of the activity was really behind the scenes. And at the surface level, the S&P just kind of went sideways.

So that's been the last two months. But now, we have earnings season where we're actually starting to wrap it up a little bit. I think about 300 companies have reported, including some of the really, really big companies. And the earnings results have been very, very good. The growth rate from last year is running at about 30%, so certainly very, very significant. And the Mag Seven have come through with really spectacular earnings numbers. And that is propelling them higher again, taking the S&P with it.

But as you mentioned, investors are asking the right questions, the critical questions about AI, namely, the hyperscalers—so the really big tech companies who are investing a lot of money into the infrastructure, the data centers, the power. There's a question of, how much is too much? Is there going to be a positive return on investment on these things?

And so, those companies are really under the microscope now. And that's good. I would rather see investors ask really difficult questions than not ask any questions, because when we talk about whether this is a bubble or not—and I've been saying it isn't a bubble. During bubbles, nobody's asking critical questions. They're just going along.

So I think this is all very healthy and very good. And it's nice to see when the AI names are not leading, that, basically, everything that's not AI is doing quite well. So, for an investor with a broader approach, an active approach, there really are a lot of fish in the sea right now to get ideas from. And that's what we're seeing.

So, earnings are booming. Valuations are not really driving the bus right now. And the fundamentals remain supportive. Just last week, the profit margin or the operating margin for the S&P 500 made yet a new all-time high at 16.5%. And credit spreads are very low at around 0.75%. And just those two factors alone explain a lot of what's going on in the market, with the third factor being interest rates. And that is the only area where the market has some digesting to do.

JIM: You led me exactly to the next question that I wanted to ask you, thinking specifically about questions on the minds of customers. So, the Fed last week, as we all know, paused and did not take any action with regard to interest rates. But Jurrien, my sense is that a lot of attention was paid and has been paid in the days since then, trying to read the tea leaves about the Fed's messaging, about what might be coming for the rest of '26, and then maybe even into '27. What's your sense about that?

JURRIEN: Yeah, this has been really interesting, fascinating to watch. I mean, I've been through four decades of cycles. I remember when Alan Greenspan took over from Paul Volcker back in 1987. And then, of course, we had, I guess, Bernanke, then Janet Yellen, then Powell, and now, Mr. Warsh. And I think Kevin Warsh is taking a page from the old Greenspan days where he doesn't want to be too transparent.

His beef, if you will, with how the Fed has been managed over the decades is that the Fed holds the market's hands too much. And when you do that and provide a lot of forward guidance and dot plots and all of that stuff, you're taking away the market's signaling of what the markets are saying, because the markets are just sort of anchoring themselves on what the Fed is saying. And so, I think Kevin Warsh is trying to restore that price signal function back to the Federal Reserve of yesteryear.

And remember that things like forward guidance and the dot plot and quantitative easing, which he is also a critic of, are all byproducts of the financial crisis and the zero interest rate days, because those were tools implemented when rates were at zero and couldn't go down anymore, so they had to go through other means. But we don't have that issue. Rates are at around 4%, 4.5%.

So what's really interesting for us market geeks to watch here is that what is Kevin Warsh actually trying to signal here, or not signal? And to me, the obvious—I mean, nothing is that obvious, but the obvious implication is that long rates go up when the market has less certainty, or more uncertainty. And that uncertainty comes from when the Fed is less transparent.

So what we've seen in recent weeks is that short rates are holding steady because the Fed is not—at least not yet—raising them. But long yields are going up, and they, just two days ago, hit as high as 4.73. They're down a little bit from that. And that is the natural consequence of less information, less transparency, and less certainty. And so, the curve is what we call in a bear steepener where the long end goes up. And that, of course, affects a lot of people. It affects anyone getting a fixed rate mortgage. It affects the government's ability to borrow at low rates.

And just one other point I would make is the irony is that if you read the economics books, you have this thing called crowding out where, at a time of large fiscal deficits, the government borrows so much money that it crowds out the private sector. And ironically, we might be doing the opposite here, that there are so much borrowing for AI that perhaps it's crowding out the interest to buy government bonds. And so, there's a lot of little nuances here to unpeel.

JIM: That is fascinating. So, thank you for that. You have set the table perfectly for us to bring Kenny in. I think, Jurrien, you probably used the word "uncertainty" totally half a dozen times in your answers, which leads me perfectly to Kenny.

So, you and your team talk all the time to people who are in retirement, navigating retirement, or perhaps approaching retirement. The last thing they want to hear about is uncertainty and a lack of signals. They want all the hand-holding they can possibly get their hands on. So, Kenny, high-level, how do you and your team help people navigate that transition and stay focused on the bigger picture, despite the uncertainty?

KENNY: The first thing I want to do is acknowledge what the client's feeling, moving into or living in retirement. It's a huge transition. And it can bring a wide, rich mix of different emotions—excitement, sadness, fear of the unknown, potentially. So, it's important to understand that there's tons of emotions, and they're completely normal. They're reasonable and even healthy.

So, when a client asks, am I going to be OK, or what should I be doing, I really want to thank them for bringing those concerns, instead of making changes on their own, which might have some unintended consequences. I really want to make sure our clients feel heard, understood, supported, and just confident that they're in the right place, and Fidelity can help navigate their concerns. Once we've acknowledged the emotions, then I can shift the conversation from how they're feeling to the planning and guidance that may help them invest, stay invested, and feel more confident about their decisions.

JIM: I love that approach. Jurrien, I think you had an analogy, too, about how to navigate something like this. Is that right?

JURRIEN: Yeah, well, I just, over the weekend, did my annual cycling fundraising called the Pan-Mass Challenge, which many of the viewers might be familiar with. It was my 28th year. But the way I thought about it is kind of like—it's an obstacle course. You've got all these miles to do, and all of a sudden, you've got a hill, or you've got heat or wind. And the investing is kind of like an obstacle course.

The math tells you that more likely than not, you're going to get a prize at the end. But that price has a price—no pun intended. And that is that you have to endure these obstacles, whether it's higher interest rates or a recession or over-exuberant sentiment. And it's like a marathon. And you have to be in it for the long term to get that prize.

JIM: And so, Kenny, let's extend that metaphor as delicately as we possibly can. Jurrien and so many other people ran this race recently. Certainly, at some point, they could have bailed. They could have jumped out and said, this is harder than I thought it was going to be, not going the way I thought it was going to be. I want out. Talk about why that's not an optimal choice for people when it comes to their investments.

KENNY: Yeah, the biggest thing we want to resist is that temptation to sell investments, especially during a challenging market environment. Here's why we typically have these conversations with our clients. First of all, retirement is a new chapter. It's not an endpoint. Some might say I don't have long term. I'm retiring next year.

But in reality, you might spend just as many years in retirement as you did working. You may not need an alarm clock anymore, but your money still needs to work and hopefully grow and support a long retirement. Secondly, it's really impossible to predict consistently when these short-term movements are going to come and go. So investors who sell during a downturn, they often miss the good portions of the market's recovery.

As shown on the chart for the viewers watching, historically, missing just the 10 best days over several decades, it can have a dramatic impact on wealth accumulated. Interestingly enough, some of the best days can happen right after what might be considered some of the worst times to invest. So, just to summarize, we recognize this conversation isn't just about money when it comes to the volatility. It's really about the lifestyle that our clients have built and the legacy that they want to leave behind.

Part of my role is acknowledging those emotions that the uncertainty could create, but we also want to let the planning process, not the emotions, really guide the discussion and the decisions. So if the client doesn't have a plan, they have the opportunity to create one, but also being mindful that planning is a process. It's not a one-time event.

Regardless, we want the next steps to be really guided by strategy and not emotion, because that's what really provides clients the confidence that they need to stay the course. We want them spending less time worrying about the markets and more time focusing and enjoying the retirement that they've worked hard to achieve.

JIM: So, tactically speaking, though, Kenny, how does somebody in or near retirement begin that process of figuring out income and withdrawals to both take into account market volatility, but still meet their needs and their goals?

KENNY: Everyone's needs are different. So for one person, it might be being able to travel every year, crossing a destination off their bucket list. For another, it's the ability to give generously to their children, their grandchildren, or charities that they support. For some people, it's simply just being able to pay the bills every month without having to worry about what the markets are doing.

I've seen clients feel more confident and at ease when they have these three components that exist in their plan—first, having an adequate emergency fund. Unexpected expenses, they will arise. It's a part of life. So it's really important to have access to funds that are considered safe, readily accessible to handle those surprises with confidence.

When it comes to structuring income, the second component is identifying essential expenses and making sure that those are covered by reliable sources of income. This can provide clients with the confidence that the expenses that they simply cannot or do not want to live without, they're covered regardless of the market conditions.

And then the last thing, the third thing is really structuring a retirement investment portfolio in a way that supports all the different jobs that the portfolio needs to do in the next chapter. So when you think about retirement investing, it's no longer just about seeking growth. It's pursuing and just pursuing returns. It's almost also positioning the portfolio to generate income, manage risk, and potentially leave a legacy. So, that's very important to consider how the portfolio is positioned.

And equally important, it's really taking the withdrawals in a sustainable fashion. Avoid the risk of taking too much too soon, and also maintaining a strategy at the risk level that you're comfortable with and that you're going to be able to stick with through various market conditions. So, it's all about having a plan. Having a plan is going to help you stay committed through the challenging and strong markets. These three components, they typically help create the confidence needed to stay the course as well.

JIM: I'm actually really excited about the way you laid out essential expenses there, because I think about that all the time. My essential expenses, what I consider to be top of the list in my retirement, is definitely not going to be what's on yours, or what's on Jurrien's, or so it goes.

KENNY: Absolutely. I'll give you an example. I had a client in South Florida who loves golf. OK, I have a lot of clients in South Florida—

JIM: Just one?

KENNY: —who love golf, OK? But there was a conversation with one that really resonated with me when we talk about essential expenses. On paper, golf may appear as a discretionary expense to some, but for this client, that was really essential to her happiness. It wasn't just a hobby. It was her exercise, her social circle, and her community. And because it brought her so much joy and purpose, she told me if she can't pay those club dues and if she can't golf regularly, I'm not ready to retire. That was a really remarkable statement, because it just really reminded me that we're not here trying to replace just a paycheck. We're replacing a lifestyle.

So, to bring it home, identifying which expenses are truly non-negotiable and having those essential expenses covered by guaranteed sources of income, like Social Security, pensions, certain types of annuities, that can provide some comfort and reassurance. It's really knowing the ability to cover those things that matter most are not dependent on what the markets are doing.

JIM: And so, knowing that everybody's essential expenses, their goals, their hopes, their dreams are all so unique and different, I think sometimes that can be a barrier that stops somebody from making that first step. What would you say is a really good first step to somebody starting to conceptualize all of this, trying to come up with a way to create a plan that seeks to grow their wealth through retirement?

KENNY: The first step is determining the appropriate mix of stocks, bonds, and cash. That's also known as your asset allocation. That should reflect your goals, your income needs, your time horizon, and just your overall comfort with risk. I've said this on previous episodes, but I'll say it again, because it's worth mentioning, that there's a risk in being overly aggressive, but there's also a risk in being too conservative.

As an example, an overly aggressive portfolio may expose you to more risk and volatility that you're comfortable with. And then overly conservative portfolio may not keep up with inflation or retirement that can go on for decades. There's a chart on your screen if you're watching us and not listening to us as a podcast, and it really illustrates the costs, on average, that grow almost 3% due to inflation. So, your investments really need to be able to keep up with that.

The other thing is your portfolio needs to be adjusted, as markets change, the economic environment shifts, tax opportunities arise, and even when your own personal circumstances change. Some people choose to do that themselves and manage those responsibilities themselves, but it really becomes important to be honest with yourself about whether you have the will, the skill, or the time. Can you do that work? Otherwise, that's why some people prefer to partner with a professional.

JIM: Yeah, it makes a ton of sense. Jurrien, I want to bring you back in here. Kenny mentioned inflation. It is, of course, at the top of most people's list when it comes to thinking about retirement or any other long-term plans, or just their savings in general. What's your sense today of inflation's power to still potentially derail the current bull market?

JURRIEN: So, inflation, of course, is the boogeyman. It reduces or—well, it reduces purchasing power. And it will reduce valuations, both for bonds, for stocks, you name it. And so, nobody wants inflation. And the Fed, of course, is included in that list. And the Fed has struck a pretty hawkish tone lately, saying, we will get back to 2% inflation.

Having said that, for the last five years, really, since COVID, of course, we all remember that big inflation spike from 2% to 9%. It's down to 3%, but that's not 2%. And it's been above 2%, now, for the last five years. So it is a persistent challenge. 3% is not high enough to destroy stock market valuations. The history shows that the stock market does just fine at 3% versus 2%. But it does erode people's purchasing power. And of course, nobody wants to see that, especially when you're living off of some sort of fixed income.

And the other thing to remember is that when inflation is high, stocks generally are positively correlated to bonds. So that makes you rethink, OK, what is actually in a 60/40 type portfolio? Should there be fewer bonds and more cash or more other types of uncorrelated investments? And these are all really good questions and conversations to have with people like Kenny and his colleagues.

JIM: And Kenny, I do want to squeeze in another question. Regardless of inflation or whatever's happening in the markets, retirees will eventually find themselves in a position where they have to take Required Minimum Distributions, RMDs. What's the thinking about doing that when the market is down or when it doesn't feel like you want to, but the clock says you have to?

KENNY: Most people who ask about RMDs, they aren't the ones that are using the RMD strategy to cover their essential expenses. If the funds are not immediately needed, there is some flexibility, though, in how and when the distributions are taken. For example, you can delay the RMD until later in the year, as long as you meet the deadlines. You can also spend it and spread it across several months—so taking regular small payments versus a lump sum.

You can also be thoughtful about which investments you liquidate and satisfy your required minimum distribution. For example, RMDs from cash or assets that have held up better, especially those—that will help you avoid like locking in losses. And it gives the underperforming assets some time to recover, rather than liquidating them when they're down.

Finally, just because the money is required to leave the workplace plan or the IRA in RMD, it doesn't mean that it has to be spent. Any proceeds from the distribution doesn't have to go to the mall. You can reinvest it. You can put it back in the market in a taxable account. There's tons more strategies. Again, because of time, we can't discuss today, but I'd really encourage you to speak with a financial professional who can give you guidance depending on your situation.

JIM: Yeah, that's the best call out, Kenny. Thank you for saying that, because everyone's situation is, by definition, unique to them. Before we go, though, Jurrien, I did want to leave a minute or two for you to give us Timmer's Take about what's got your attention over the next week or so until we speak again.

JURRIEN: So the main thing, really, is to watch the bond market here. Earnings season has been a success. It's not quite wrapped up, but it's getting there. The big companies have mostly reported. And it's really that relationship between yields possibly going up and how they affect equity valuations. And then evaluations are under pressure because of rising rates. To what degree is that offset by higher earnings? Because remember, the price, the stock price is always just a residual of earnings on one hand and valuations on the other.

JIM: Got it. All right. We'll have to leave it at that. Jurrien, Kenny, thank you both for taking time out of your day to be with us. Really appreciate it.

KENNY: Pleasure.

JIM: For more information about how to build an investment plan that can potentially support you through retirement, including understanding how different asset classes and guaranteed income might impact your plan, check out our investing, and retirement page for a lot of excellent, excellent resources that you can take your time with and read and reread, and really peruse at your leisure. It's at the website on your screen, Fidelity.com/InvestingInRetirement.

On behalf of Jurrien and Kenny, again, thank you for taking time out of your day to be with us. Heather will be back here next week, next Tuesday at 2:00 PM Eastern. So be sure to join her then. Until then, you can always catch replays of *Market Sense* on Fidelity.com/MarketSense, as well as on YouTube or wherever you get your favorite podcasts. Take care, and we'll see you soon.

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