Fidelity Viewpoints®: Market Sense

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TRANSCRIPT

SPEAKERS:

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Heather Hegedus: Hello, and thanks for joining us for Market Sense. I'm Heather Hededus with Fidelity and I'm your new host of the show, and I'm so thrilled to be here today. If you were watching last week then you saw my predecessor Jim Armstrong hand over the reins here and he introduced me last week but in case you missed it I wanted to share a little bit about myself just briefly before we get into things today. So I'm a former television news anchor and reporter, and I worked in New York, D.C. and Boston for more than two decades. I covered everything from prime to the legal system, the education to the economy, and markets. And the way I see things here is I'm here to help you make sense of investing and what market developments mean for you in your everyday life. Personally, I'm the mom of two kids so I'm navigating that as well. I'm trying to plan for college for one of my children. Our other child has special needs so we're planning in a very different way for him. I'm also the daughter of a financial planner and my parents are dealing with a lot of the same retirement questions that we'll going to be talking about today.

So, let's jump right in today, you know the markets have held their ground in the last weeks, still showing stability after the volatility in the banking sector. So today, as we often do, to get the big markets picture we're going to be speaking with Jurrien Timmer who is Fidelity's Director of Global Macro. We're also going to be talking today about some new, impactful legislation called Secure 2.0. It's going to make it easier for folks to save for retirement despite volatile markets and high inflation. So Leanna Devinney, a Massachusetts based branch leader here at Fidelity is back with us today to help us talk through that. Big hello to both of you guys, thanks for taking the time out of your busy schedules to be part of this conversation today.

Leanna Devinney: Thank you, Heather, big welcome to you and hello.

Jurrien Timmer: Yes, it's the beginning of the Heather era, welcome aboard.

HEATHER: Wow, I'm flattered, thank you so much to both of you. So let's jump right in, today's Tuesday April 11th. It is definitively spring right now. Jurrien, I want to start with you, as we mentioned off the top we are seeing signs of stability in the markets after the volatility around the banking closures. In fact, this point the market is in the green year to date. So if you would please, catch us up on where you see things in the markets right now.

JURRIEN: Yes, so it is April, hard to believe it's already the fourth month of the year but for the markets, it's been an ongoing case of limbo, right? I mean, basically the market, which of course fell a lot last year as the Fed raised rates. Put in its initial bottom in June and then put in a slightly lower low so far in October. But really since June, and this is now 9-10 months later the market has basically gone nowhere. You know, in recent weeks markets has been a little stronger but that's been mostly the result of a few very large cap tech names going up but if you look at, for instance, the S&P 500 Equal Weighted Index where every company has the same weight in the index, basically the market's gone nowhere for 9 to 10 months. And while that can be frustrating for a lot of people, we tend to think in binary terms up or down. I think it's actually a healthy pause that the market has taken after some pretty, you know, extreme moments over the past three years when the pandemic started and then, you know, hopefully ended for good.

But we are still feeling the aftermath of that and you mentioned the bank headlines, you know, those have receded from the scene in the last few weeks and I think a few weeks ago when the headlines started a lot of people were kind of holding on, wondering which next shoe would be that would drop whether this would be the beginning of, you know, a bank run that would affect all banks. And the reason that that's important of course is because banks' lending into the economy, into small businesses, extending mortgages, they are the lifeblood of the US economy. And so if banks stop lending because their deposits are leaving that obviously is a pretty serious thing. And when we look historically about, you know, at recessions that often are singled by what we call an inverted yield curve, so short rates higher than long rates.

That, you know, usually will lead to trouble and we've been trying to sort of figure out what will be the catalyst for a recession, if indeed we get one. And so the bank headlines about a month ago now certainly seemed to be the obvious catalyst and the fact that after those first few tumultuous weeks where we were kind of wondering what the next headline would be and often that would be on a Sunday night like, okay, what does the government have to fix before the markets open? We haven't really seen anything like that in the last couple weeks and that has allowed the market to kind of stabilize here and that's where we are today.

HEATHER: Calling it a healthy pause, we'll take that, Jurrien. You know, last week we got the most recent jobs report numbers which gave us a little bit more information into the picture here. It showed unemployment falling yet again to another multi decade low of 3.5%. So that certainly makes it sound like the economy is in strong shape yet as you have been noting investors are currently expecting the Fed to actually start cutting rates soon and that's an action, of course, the Fed would typically take only if the economy is weak. So if you would, unpack that discrepancy for us here?

JURRIEN: Yeah, so the markets are sort of expecting two diametrically opposing things. You know, they expect earnings to continue to grow after the next few quarters, those are expected to show modest declines. While at the same time—but then continue to grow after that into 2024 and beyond while at the same time the Fed is expected to be pretty much done raising rates or maybe it does one more. If you look at this chart, the gray line is what we call the Fed funds target rate so that is the official policy rate of the Federal Reserve. And the dotted black line is the forward curve. So that's what the market is expecting the Fed to do. And as you can see, the market is expecting the Fed to basically be done here and to start cutting rates.

And it's interesting historically the Fed during a tightening cycle, will take rates up to the inflation rate or above. And that's usually what it needs to do to kind of tame the inflation dragon, if you will, and you can see that that purple line is what we call the core PCE which is a little technical but it's the preferred inflation gauge that the Fed uses to set policy. And you can see that the expected Fed funds rate is now at or above the actual trailing inflation rate. So there is reason to expect that the Fed should be done soon. And I don't know that the Fed would basically disagree with that but the question is will the Fed pivot, as we call it, to much lower rates after that?

And I think that is very much, you know, the jury is very much out on that. The Fed has been trying to walk back the market's narrative of this imminent pivot because the market was expecting this three months ago and six months ago, and the Fed's been reminding everyone that inflation, even though as you can see in the chart it has been coming down, it is still very high. And actually, the CPI report which is the inflation rate—inflation gauge that most people think of, the Consumer Price Index, that is being released tomorrow and that will be an important piece of the puzzle that will help guide the Fed as to whether they need to push back on the market's expectation. But right now, rising earnings, falling interest rates, the market can get one or the other but not necessarily both at the same time.

HEATHER: Can't have them both, all right, well thanks for laying that all out for us, Jurrien. As we've been saying, we've been through a lot of uncertainty lately. It has been hard on investors—on all investors but the good news is this new legislation that we mentioned at the top of the show that we want to take the opportunity to talk about right now, Secure 2.0 is going to provide some relief even if your portfolio is rocky, even if you're worried about things like losing your job. So I want to bring Leanna in now. And Leanna, all of the details of this law are not complete yet, there's

a lot we still don't know about it but what do we know big picture about what this new piece of legislation does? What is Secure 2.0?

LEANNA: So, the Secure 2.0 Act, so it's a bill and it was hundreds of pages long. It took years to be finalized but it was passed in December and it was really crafted in an attempt to strengthen retirement opportunities for most Americans. So while the bulk of it focuses on retirement, it's also important to underscore the law isn't just for people who are near or approaching retirement but also helps younger people try to save for the future.

HEATHER: Yeah, and we'll get into that about how it helps younger people in a moment but I did want to start Leanna, with the population that you talked about. People who are in or are nearing retirement. So one of the big pieces of this law is it builds on earlier legislation that increased the age at which retirees must take required minimum distribution or RMDs, you may have heard of RMDs. So Leanna, what do we know about RMDs changing and what are the considerations for when we might want to take our first RMD?

LEANNA: Sure, so just taking a step back, the RMD, required minimum distribution, that's the amount the IRS requires you to withdraw each year from an eligible deferred savings account so thinking IRA, your 401(k). All that money that you may have in there has been tax deferred that you've contributed to and hopefully it's grown and you've seen that tax deferred growth but the IRS says, okay, now it's time to start withdrawing and paying taxes on it. That's the required minimum distribution. And the real purpose is to make sure that those are spending their money in their lifetime and not deferring it too far down the road. So the age at which owners of retirement accounts must start taking their RMDs increased with the Secure Act 2.0. It went from 72 to 73 this year, so that gives folks an additional year to delay taking those mandatory required distributions.1

So two important things to know, if you turned 72 last year, so 2022 or earlier, you do still need to continue taking the required minimum distribution as scheduled. But if you're turning 72 this year and you may have already scheduled your withdrawal you can consider changing that or updating your withdrawal plan.1 And for those that are farther out from retirement just keep in mind that's starting in 2033, so some years away. The RMD will actually go to age 75.1 So when we partner with clients though we spend time talking about your income plan. You know, often we're talking about investment strategy and how your portfolio is invested catered to your goals, but taking income in retirement is a big part of that. So when you have a required minimum distribution, it can for some, turn into a large tax event. So we can help discuss strategies and also advise to partner with your tax advisor on how we can help mitigate or have that customized income plan for you.

HEATHER: Okay, and Jurrien, you know, bringing back into the conversation for a sec too. I imagine that having that extra year to have your money sort of sit there, given the market volatility and the high inflation that is still in the picture now, that extra year or that extra three years as

Leanna was saying eventually where you don't have to touch your retirement savings might be able to help.

JURRIEN: Yes, indeed, I mean, we know that the magic of compounding, tends to work, you know, to our favor over the long term. And so, if we have another year to let that compounding work then I think that is generally a good thing of course. And it's funny, I was just talking to my 26-year-old daughter who is a nurse about, you know, investing in her 403(b) and you know, what kind of time horizonand of course at 26, she has a very long way to go. And so this just adds another year of compounding, and as you point out, it also adds more of an opportunity that if the portfolio is at a loss of course, and we did see a very large correction last year not just in stocks but in bonds as well, it gives you another year to recover. Because remember the value proposition of investing in stocks and of course portfolios should not be entirely invested in stocks but it should be a diversified portfolio but the value proposition is that you can get a good return over the very long term. But you do have to stomach some, you know, stomach churning volatility from time to time like we saw last year and like we see typically every five years or so. And so this gives you just a little bit more time if you are nearing that window to have some recovery or to have more compounding.

HEATHER: Okay, all right, well I wanted to talk about another aspect of the law too. Another big part of it is something called catchup contributions for folks over 50 years old. Leanna, how do those work and what do we need to know about how this law will change them?

LEANNA: Sure, so catchup contributions, think of those that may feel they need to play catch up. So, it's a retirement savings contribution that allows people age 50 or older to make an additional contribution to your 401(k) account. And that is going up overall so in 2025 that's going to increase but it is optional for all plans. So the Secure 2.0 is adding a special catchup contribution limit for employees specifically ages 60–63. That's starting in 2025 you will be able to do a special catchup of the greater of 10,000 or 150% of the standard catchup contribution. And that will be adjusted for inflation. So today, the catchup amount for people age 50 and older is $7500. So if we just use today's limit, $7500 that means a participant can potentially contribute $11,250 which is 150% of that regular amount. So a special catchup contribution.[1]

HEATHER: And an extra opportunity to put money into certain plans, okay, Leanna. So we talked a little bit about what the law means for people who are nearing retirement or are in retirement. But I wanted to also to get into how the law also includes provisions, Leanna, for younger people to help with things like paying off student debt and also emergency savings. Walk us through that if you would?

LEANNA: Sure, so Fidelity does a lot of research on this and we find year after year—and I have conversations with clients as well. But those that are tackling student debt will typically delay contributing to their retirement account because they can't afford to do both. You know, I often get questions on how do I prioritize these multiple goals like student debt, other debts,

contributing to retirement accounts. So under the Secure 2.0, employers will be able to essentially match an employee student loan payment with matching contributions to a retirement account. So those workers don't have to choose whether they should pay off student loan debt or save for retirement. So just to reiterate, this is an optional provision for employers that starts in 2024.

So another big one, beneficiaries of 529 accounts will have the option to roll up to $35,000 over the course of your lifetime to a Roth IRA account. So every year those rollovers will be subject to the Roth IRA contribution limits. And the 529 account has to have been opened for a minimum of fifteen years2 but that's a really attractive option for those because it removes some of the barriers around saving for higher education knowing that unused educational savings can go toward a Roth IRA account. And a final one is provisions in emergency savings for emergency withdraws. Right now, if you were to take out from your 401(k) you might have to do a hardship withdrawal, show proof of needing that money, and Secure 2.0 they're changing that with potentially reduced penalties, you can self-certify the need for emergency savings. So it just gives choices and for those that don't have an emergency fund, this came up a lot during the pandemic, this would be a great additional step for those to be able to take from their 401(k) as an emergency provision.

HEATHER: Yeah, sounds like a potential safety net for a lot of people. Thanks so much, Leanna for that and you hit on so many of the major changes that this law makes that's going to affect so many of us, so great job with that.

Before we go, I wanted to circle back to Jurrien once again now as we often do. I'd like to talk to you, Jurrien, about what the next indicators on the market or economy that you're looking ahead to that we should all be paying attention to. And you had mentioned in the middle of the show, the CPI report coming out later this week. So tell us what you're going to be watching for here?

JURRIEN: Yes, so the Consumer Price Index report comes out tomorrow. That, you know, the inflation data are really the most important economic releases right now as well as the jobs figures and you mentioned those earlier. Those came out last Friday and showed an ongoing expansion in the labor market which, of course, is great. More people with jobs is good. But for the Fed, you know, the Fed will lower rates only in my view when the inflation data kind of point in that direction. And so the degree to which inflation, the rate of change of inflation keeps going down as it has been, over the last year, will be an important marker in that direction. So if the CPI comes in, you know, better than expected, the markets are going to really like that because it's going to feed into this narrative that the Fed can pivot. So that's a big one.

The other one is that earnings season starts next week for the first quarter and the first companies that generally report earnings are the major banks. And of course, the major banks are very interesting right now because we have all the headlines about a month ago with a few banks going under because they have deposit flights and they had invested in bonds which

were now at a loss. So it's not so much whether the earnings of these big banks come in at or below or above expectations because the big banks are the big banks for a reason. But it'll be interesting to see what they say about their willingness to make loans and what they are seeing happening with their deposits. And so, that will be an interesting data point to take a look at next week.

HEATHER: All right, I'll have to keep tabs on them. We know you're going to be watching it all for us, Jurrien, as you always do. So thanks so much to both of you, this has been a great conversation. And to our audience, we know we covered a lot of ground today. There's a lot to digest here with this law so we want you to know that Viewpoints has a great in-depth article on so many of the areas that we covered today. I encourage you at this point to pull out your cellphones and scan the QR code that you see on your screen there. That's going to take you right to the Viewpoints Secure 2.0 article and also within that same article you can sign up for the Viewpoint's weekly newsletter if you're not signed up already.

So again, use your phone to scan that QR code or you see that URL on your screen you can manually type that in as well. As always if you have questions about making a financial plan or staying on track, Fidelity can help. And I just want to say before we go, a huge thanks to Leanna and Jurrien for making my first episode here so special. Such a great episode, I really did learn a lot today thanks to both of you. And I love it if we can keep this dialogue going together.

JURRIEN: Great job, Heather.

HEATHER: Thank you. For now though, I'm Heather Hegedus, I hope you guys have a week out there and we will see you back here next week. Same time, same place.

[1]Secure Act 2.0 | What the new legislation could mean for you

[2]The SECURE Act 2.0's impact on 529s, Roths, and more

The change in the RMDs age requirement from 72 to 73 applies only to individuals who turn 72 on or after January 1, 2023. After you reach age 73, the IRS generally requires you to withdraw an RMD annually from your tax-advantaged retirement accounts (excluding Roth IRAs, and Roth accounts in employer retirement plan accounts starting in 2024). Please speak with your tax advisor regarding the impact of this change on future RMDs.

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