Fidelity Viewpoints®: Market Sense

Week 142, January 7, 2025

TRANSCRIPT

SPEAKERS:

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HEATHER HEGEDUS: Hello there, and thank you so much for joining us for a special in-person 2025 investing outlook edition of *Market Sense*. I'm Heather Hegedus with Fidelity. So we do these outlook shows twice a year. We do them in January and June. And we find they're always a good opportunity to reset and restrategize as we begin a new year or back half of the year. And this year, that backdrop also includes a new presidential administration and the Fed-initiated a rate-cutting cycle in the second half of last year.

We're also watching global relations. They seem as uncertain as ever. Having said that, though, we are still starting 2025 off in a pretty good place when it comes to the economy and markets.

So to unpack some of the key learnings from 2024 as we lean into 2025, I'm excited to be joined by three exceptional panelists today—Cait Dourney, CFA and Head of Business Cycle Research on Fidelity's Asset Allocation Research team who's going to be talking about where the US economy is right now and where it might be going, Jurrien Timmer of course *Market Sense's* unofficial quarterback, fearless leader, and also Fidelity's Director of Global Macro who's going to be unpacking what this could all mean for the markets, and of course, Naveen Malwal, a CFA and institutional portfolio manager here at Fidelity, who's going to be breaking down for us the data that Cait and Jurrien are watching and tell us what that might mean for our portfolios.

So, so nice to have all three of you in person here today. Thanks for making the time when I know you're really busy with the beginning of the year. And so great to see you in person.

CAIT DOURNEY: Thanks so much, Heather, and happy 2025.

JURRIEN TIMMER: Yes, great to be here. Thank you.

NAVEEN MALWAL: Good to be here. Thanks for having us.

HEATHER: All right. Well, I think this is a great time to be having this conversation. We are at a bit of a crossroads right now with this new administration coming in. And, Cait, I would love to start with you for a quick level set before we talk about this new administration and what's new for the new year. So as you work on Fidelity's Asset Allocation Research team or AART, you're providing deep dive research into everything related to the economy, for Fidelity and for our clients. So first of all, how is the US economy doing right now?

CAIT: So, Heather, the economy is doing really well. We're well supported by kind of two factors, the corporate sector and the consumer sector, both which are really large parts of the economy. So when we think about what might be different in 2025, in '23 and into 2024, we actually saw an re-acceleration of activity. We saw an acceleration of corporate profitability. And we saw another benefit, which was disinflation, or inflation slowing down closer to the Fed's target. So those are all great things.

As we look into 2025, as I said, we have a strong starting point. What will be a little bit different is that we're already starting from a steady rate of growth, whether it's GDP growth or corporate earnings. And so that's already a steady Eddie, good backdrop. And then we're probably going to see less disinflation than we saw in 2024. And so what that means to us is still a good market backdrop but probably not a re-acceleration of activity the way that we saw over the last 12 months.

HEATHER: Steady, not a re-acceleration. OK, so just a quick follow up question for you on that point. So of course, most business cycles go from late-cycle expansion to a recession. This one, though, went backwards and we had some mid-cycle vibes. And then we also have to take into account the fact that the yield curve inverted, and yet we never had a recession, which typically is a signal that a recession is coming. So, why do you think this time has been so different? And do the old rules still apply anymore? Should we just throw those rules out the window at this point?

CAIT: It's a great question, and one that I get all the time. And I would say that while we spend a lot of time studying history and studying these old rules, it's also really important to look at what's different this cycle. And I think that's where it's been the most interesting.

And so for this cycle, for example, those two parts of the economy that I talked about, the corporate and the consumer sector, they're quite healthy and they didn't really take on a lot of excesses or take on a lot of debt this cycle. And as a result, when the Fed started to raise interest rates, which is usually the thing that causes a recession, it didn't really impact these big parts of the economy and we were able to brush it off and continue into this expansion.

HEATHER: OK. And Jurrien, in building off of what Cait just said, I'd love to get a quick recap from you of what we saw from the market last year. We've been in a strong bull market up until this point, but is there a danger? Is this something to consider? Is there a danger that the market potentially went too far? And what do you think we can expect from stocks this year in 2025?

JURRIEN: Yeah, it's been an unusual year because some parts have been not predictable but logical, so earnings have been growing. They grew about 10% in 2024. And as we all know, stock prices follow earnings. Sometimes they anticipate those earnings. And so by that measure the market should have been up 12%, earnings plus dividends.

But of course, markets were up much more than that. And that's because the PE side, the valuation side, did a lot of the heavy lifting. And that's fairly unusual. It happens, but it generally only happens in soft landings, which of course, is, looks like, what we've gotten.

So the valuation side, in part driven by what we call the Magnificent Seven, these multi-trillion dollar tech stocks, greatly amplified what would have been a good year anyway because earnings grew above average. So it's an unusual market in that sense. And in some ways, it shows an advancing bull market—valuations going higher—and they are getting to levels that certainly concern some people. And on the other hand, the market cycle seems to be getting a little younger because more stocks are participating.

HEATHER: It would be understandable, though, Jurrien, if it didn't feel like a bull market to every investor because you just mentioned the Mag Seven. Really, that group of mega-cap stocks was leading the way for a really long time. That changed in the end of 2024. We saw that shift. Can you talk about that shift and what we saw in 2024, and what you think that might mean for market leadership in 2025 as well?

JURRIEN: So certainly, the market remains somewhat bifurcated. The Magnificent Seven, these mega-cap growers, led the way out of the bear market. So the bear market ended in October of 2022. So we're now in the third year of a cyclical bull market. And those stocks are trading at substantially higher PEs than the rest of the market.

So the Mag Seven are trading at about 40 times earnings. The other 493 stocks are trading at about 22 times. And that pulls the PE for the whole market up because those seven stocks are a third of the market. So the way we look at markets, the S&P 500 is a capitalization-weighted index. So those stocks will drive the performance of the market up.

The good news is that the other stocks are participating—those 493—and that actually has started since late 2023, when the Fed started to signal that the end of the tightening cycle was near. So those stocks are participating, but they are just not going up as much as the Magnificent Seven.

And that's why maybe to a typical investor who does not have exposure to those Mag Seven, it doesn't really feel like they're participating. But any investor in an index strategy or an ETF or an active fund that has those stocks should be reaping the benefit in 2024 and hopefully in 2025.

HEATHER: All right. And Naveen, we'll turn to you. How has your team been managing clients' portfolios throughout this period and how are you positioning them for success now in 2025?

NAVEEN: Well, our team generally helps our clients invest their money in diversified portfolios, which is a mix of stocks and bonds. And given the backdrop you just heard about from Cait and Jurrien, we agree. It's a relatively positive backdrop.

So how does that come across in our portfolios? If you look at, say, a client who typically would have 70% of their account in stocks and 30% in bonds, we're leaning a bit more towards stocks so more like 73% stocks and something like 27% bonds. And the benefit of this is if the market continues to rise, the economy continues to expand. These investors may benefit from a rising market, both stocks and bonds.

Yet at the same time, we've heard about higher valuations, a more mature expansion. So there are going to be, possibly, opportunities where there's going to be volatility in the market. So in that case, we don't want to have too much exposure to stocks where the risk might spook an investor from their long term plan. So this balance of optimism with some sense of caution is how we're approaching investing in this new year.

HEATHER: OK. So a little bit more towards stocks.

NAVEEN: That's right.

HEATHER: So if history is a guide, some volatility is still a possibility to be aware of at this point. And we did see a little bit of brief volatility in the third quarter of 2024. The other big story, though, in the second half of 2024 was we saw rate cuts for the first time in years. So Jurrien, I'd love for you to talk about those rate cuts and what you think we might see from the Fed this year.

JURRIEN: Yes. So starting in 2022, the Fed raised rates by over five percentage points, going all the way into the middle of 2023. And then at the end of '23, it started to signal, saying maybe we're done here. Maybe we can start giving back some of those rate hikes. Because if you think about the dual mandate of the Fed, it's price stability, 2% inflation, and full employment.

And of course, we had COVID. We had all the stimulus and all of the dislocations in the economy that created, of course, a massive inflation wave. That wave has since crested, and even though price levels are still obviously much higher than they were before COVID, the rate of change, which is how economists think about these things, has come down from 9% to 3%. And that obviously is an improvement.

And the labor market has found its balance as well. Those labor shortages that happened in 2021, when the economy reopened fairly quickly but people hadn't reentered the labor force yet, that has been rebalanced as well. And so the Fed is now at a point where it can get off of the very restrictive side and get closer to neutral. And that's, in 2024, what the Fed started to do.

And now the question of course is, how many more rate cuts are coming? And of course, nobody knows the answer to that. But I think after this conversation, maybe we'll a good sense of what's in store from the Fed.

HEATHER: Yeah, and I know that Cait will touch a little bit more on the labor market in a minute. But I also want to dig into some of the potential policies and potential impacts of the Trump administration. But I'd love to level set as we start this part of the conversation, Cait. First of all, how much do changes in policy really impact the broader economy? In other words, can presidential administrations change where we are in the business cycle? Can they impact that? Is that within the realm of possibility?

CAIT: So as much as we hear a lot about different policies coming out of the government, traditionally, they can't really wholesale change where we are in the business cycle. That's because we have such a large and diversified private sector in the US that really drives the overall cycle. So policy makers can enact policies that can either amplify certain business cycle dynamics or work against them. So a tax cut for companies could boost company earnings, or more government spending could boost growth or boost inflation a little bit. But in general, these things are kind of on the margin.

And the same goes, really, for trade policy in the US. So the US is a very large closed economy. In other words, meaning that we're not reliant on external demand for our growth. We don't have to export or sell a lot of things to the rest of the world. So even something like trade policy, which can have an impact on the margin, is not going to wholesale impact the business cycle. It's actually been more monetary policy, historically, that's contributed or changed where we are in the business cycle. That's because the Federal Reserve or the central bank can change the cost of credit for basically all parts of the economy. It's much more broad-based.

HEATHER: That makes sense. Thank you for explaining that. And Naveen, I know we heard from so many of our customers, from so many investors that they were holding off, maybe on making really big decisions until the election shook out, until we knew what the results were. And so now, we're getting ready for the inauguration. How is your team managing clients' portfolios now with this new administration coming in?

NAVEEN: Yeah. So to your point, I know Jurrien and I both spoke about this and wrote about this at length that don't try to time these elections. I think the last year was a good example where people were waiting, and yet we had a very strong market that many investors might have missed out on. So I think the lesson from that is try not to get too hung up on the election cycle—different cabinet appointments, potential policy actions.

HEATHER: Headlines.

NAVEEN: Exactly. It's headlines. It's interesting to follow, but to make investment decisions based off of that is, in my opinion, relatively risky. But our team tends to do instead is be patient and wait to see what the actual policies are. There's always time for these things to develop and play out. And things can change considerably between what was promised on the campaign trail to what actually goes into law.

So rather than guess and speculate, we believe it makes more sense to just wait and see what is the policy shift going to be. And once we're aware of that, we can decide we need to do something here or not. And usually, the answer is no. You just keep your long term perspective, focus on your goal, and keep your investments intact. On occasion, you can tweak things, but generally speaking, we don't find this generally prudent to make big changes to an investment account just based on election results or policy speculation.

HEATHER: Yeah, and with the market events the day after the election, like you said, many of those investors missed out. OK. Let's dig into some of the actual policy proposals, shall we now?

So let's talk about what is most likely to come first, and that's tax cuts. We've heard about those being a huge priority for this administration. So Cait, I was hoping you could tell us what tax cuts might look like and what kind of impact they can have both on corporations but also on individual investors. What do you think?

CAIT: Definitely. So there are two big policies that we think are going to be priorities—our tax cuts, as you said, and also tariffs. So if we start with tax policy, a lot has been said and announced and a lot is still uncertain at this time. But what we've done is tried to analyze and understand what the most likely are, as you said.

So on the corporate tax side, a lot has been said, and this is where there's more uncertainty. Basically, it's important to remember that a couple of years ago in 2017, we already had a pretty meaningful corporate tax cut. So from here, while there have been more corporate tax cuts floated, it's a little bit less likely that we would get another across the board cut. We may get things like individual tax cuts for companies that operate a lot in the US. They have a big US presence or smaller businesses. These are things to look out for that could boost company earnings for those types of companies.

On the individual income side, this is where we have a little bit more clarity. So again in 2017, we had tax cuts for individuals. And it does appear to be a strong priority for the administration to extend these tax cuts. So they're set to expire at the end of this year in 2025. It does appear to be a high priority to make sure that those get extended from here.

And basically, when we think about the economic outcome of these two things, an extension of existing tax cuts or smaller tweaks to individual company rates, not as impactful from a growth perspective as what we saw back in 2017, when lots of folks across the economy got pretty sizable tax cuts. So not as much of an economic boost.

What we would say is that if for example, the individual income tax cuts were not extended and they were allowed to expire, that would be a negative because it would be a hit to disposable incomes for individuals. So that would be of a risk to look out for. Not our base case, but important to look out for.

On the tariff side, we think that this is going to be, again, another priority. Probably, fairly soon we'll start to get announcements or headlines about tariffs for countries like China or Europe or Mexico. It's probably going to be a little while before we have certainty, but it's important, again, to remember here that those tariffs actually impact us less here in the US than they can impact the other business cycles or other markets in other parts of the world.

HEATHER: Because we have a closed economy, as you were explaining before.

CAIT: Exactly.

HEATHER: And I want to talk about tariffs a little bit further, Jurrien. Can you talk about what kind of an impact tariffs have on US markets and the economy? We just heard Cait say maybe less of an impact on the US than other countries.

Also, how could they impact individual investors and consumers whose wallets have already been hit pretty hard by inflation? When I talk to my friends about the incoming administration, one question that they have been asking is, will we be paying more for items now? Are those companies going to be passing on their costs to consumers? And we've already been hit hard by inflation. What do you think?

JURRIEN: Yeah. So there's I think more questions than answers at this point. We don't know if the tariffs to what degree they are a negotiating tactic and an incentive for companies to build onshore supply chains, which I think would be good in many ways. But it might also be inflationary because you're now replicating supply chains, perhaps in a more expensive part of the world.

And even if we knew all the answers, whether the tariffs were coming and how much they are, it's nuanced. So in theory, if a company has to pay more to import something via tariff, either the company passes that cost along to the consumer, in which case the consumer would pay, or it might reduce the profit margin of the company if it can't pass it along.

But even then, there's offsets. So for instance, the dollar has been very strong. If the dollar continues to strengthen because the US economy is more dynamic and animal spirits have returned, you could argue that a stronger dollar or a weaker currency on the other side of that dollar would mitigate the cost of tariffs to some degree. So it's not a cut and dry thing where it's like, if this happens, that happens. There's a lot of different variables.

HEATHER: A lot of variables, OK. And Cait, I know you were just in Europe meeting with government leaders, which is a tremendous opportunity and great timing here. So I'm curious, what do they say to you about the ways that they might be anticipating potential US tariffs impacting their economies and impacting their markets? What were your takeaways from meeting with those leaders?

CAIT: Yeah. So it was a really productive trip. We were in five countries. So we were in Italy, Spain, Germany, France, and the UK, and we were meeting with monetary policymakers, fiscal policy companies, and other investors.

And because of what we talked about, that actually US trade policy can impact other countries and markets even more than the US, we were getting a lot of questions about what the administration's trade goals are, what the objectives are. And a lot of nervousness around that, and basically an expectation that these other countries may have to prepare for US tariffs and may even put on retaliatory tariffs.

In other words, start tariffing our goods that we export to these parts of the world. But again that, too, doesn't really impact us nearly as much as it could impact these other countries.

So a lot of nervousness, a lot of questions. But as Jurrien said, really still more questions than answers from our side as well.

HEATHER: OK. And also to that point a little bit, I know there is some nervousness and investors might be wondering if tariffs could be headwinds for international markets. What's your team's thinking on that, Naveen?

NAVEEN: I think what Jurrien said applies here. He said, it's not just, hey, tariffs are happening so this is the end result. I think it's hard to predict these things. It's hard to know in advance, one, what are the tariffs going to be. Which countries do they apply to? Which goods do they apply to? Are they here temporarily? Do they go away after a while?

So markets internationally, at the end of the year, they softened a bit. So to some degree investors are looking at a market that maybe, to some degree, priced in this effect of tariffs coming on board. And some of the managers that we invest with in international, some of them have said that they moved their stock allocations away from companies that were more exposed to US exports to other parts of the market. So there's things that an investor can do to maybe get around some of these challenges coming up.

But I think the big takeaway here is that it is unpredictable and you can't just presume that every international company now is going to struggle. So let's take, for example, an Australian business that doesn't export a lot of things to the US. They'll probably be fine through a tariff regime. And if you think back to 2018, we've already been through some tariff back and forth between the US and China, for example.

And one surprising outcome of that was soybean farmers in the US struggled because China imposed tariffs on soybeans coming from the US. But Brazilian soybean farmers saw a tremendous growth in sales because they didn't have that tariff. So Brazilian investments wound up being a good bet that year. So it's similar. Looking ahead, let's not presume that all international markets, all international stocks will struggle. It's hard to know in advance who the winners and the losers might be.

HEATHER: You can't make a blanket judgment like that—that all international stocks will struggle. And a lot of variables, which you both pointed out, gentlemen. All right. Well, thank you.

Let's talk about immigration policy now, another top priority for the administration. And viewers might be surprised to know that there could be economic impacts from immigration policy. So I turn to you for that question, Cait. Can you walk us through what that might look like?

CAIT: Definitely. So I think in thinking about the impact of changing immigration policy, it's important to think about the impact of the immigration policy we've had over the last couple of years of more open immigration. I would say, in addition to having negative impacts, it can also have positive impacts.

And so one thing that immigration tends to do is that when people come into the country, they are looking for a job. And so it increases the availability of workers, especially in the US at lower-skilled jobs. And so what that did is in parts of the labor market that were very tight, where companies maybe couldn't find as many workers as they wanted or they were having to pay higher wages to workers, that helped alleviate some of that pressure.

And by alleviating some of that wage pressure, it actually helped overall inflation start to slow down. So that was kind of a good impact that we saw come out of immigration, in addition to the fact that when people come here, then they start spending money on stuff like that. And it tends to be a bit of a demand impact as well.

HEATHER: Rent, food—they need to spend money.

CAIT: Exactly. And so when we look ahead from here, it's going to depend a lot on the scale or scope of the immigration policy. So are we talking about doing deportation policy, actually removing workers and immigrants from the US? Or are we just talking about slowing down the flow or the number of people that we're letting in every year? Where we end up on that spectrum is going to matter the most.

But the impacts that we would expect to have are lower availability of workers. So probably some more pressure on wages as companies have to pay people a little bit more. It's harder to find workers, which can put some upward pressure on immigration. Although it'll have the benefit for folks that are eligible to work here in the US, they'll probably get to see a little bit more wage growth and a little bit better discretionary income. So a mixed bag, and it's going to depend. But that's kind of our best guess going forward.

HEATHER: Yeah. Again, it's going to depend on these variables, again, that still need to shake out. I know another topic of concern for investors is with conflicts in Ukraine and the Middle East. The world might seem to be a scarier place than it was once before, a more dangerous place. So we talk about geopolitical risks sometimes. And Jurrien, should investors be considering geopolitical risk? What do you think?

JURRIEN: Yeah. I've gotten this question so many times and it does seem like things are more scary and uncertain today, with all the hotspots around the world. But then I think back to a conversation I might have had five years ago or 10 years ago and there were equally bad things to worry about. And so I think there are always things to worry about.

And I think if you think about it from a behavioral perspective, we have money invested. Our life savings are invested in the market, and we're scared to lose it. And so when you worry, it's tempting to say, well, let me take a few chips off the table. But that's always a very risky thing to do because then your market timing on the basis of something that may or may not happen, or even if it happens, it may not affect the US economy.

Ultimately, it comes down to earnings, interest rates, and not every hotspot in the world affects us here. And it's hard to say, but compartmentalizing the human aspect of geopolitical events and just—

HEATHER: We have to recognize that.

JURRIEN: —the market aspect, it sounds coldhearted, but as investors, we need to be unemotional about those things and we just need to look at the numbers. And the market is very efficient at discounting what is systemic and what is not. And the market, and Naveen knows this, the market will always reprice itself faster than you can adjust your portfolio. So trying to outsmart these things is generally not a winning strategy.

HEATHER: You need to think about facts, not emotions, when it comes to these things. Naveen, how does your team manage clients' portfolios around these potential conflicts?

NAVEEN: Yeah. It's challenging, as Jurrien said. I think for me, emotions are a good input. They're part of the process that helps us in many ways. It gives us a warning that we should probably pay attention to something, but it doesn't always mean we need to act because of the emotional impulse that we're having. So to me, the international challenges around conflicts and tensions, it's similar to the tariff situation. Let's not presume that suddenly all international stocks are not a good investment.

Just as an example, let's say there's a conflict happening somewhere in the Middle East. Well, that may not impact Latin American businesses or Australian businesses as much. So there's plenty of companies around the world that are not close to the hotspots, not involved with the tensions that are taking place. So lots of opportunities for investors that are beyond where the trouble zones might be. So that's one way to think about it.

The other one is, what Jurrien said, it doesn't impact US earnings. It's similar for international. A lot of these conflicts, they don't directly affect every company that is maybe closer geographically to where the challenge might be as well. And in some cases, you get surprising winners, and the commodity prices go up or there's demand for, say, defense manufacturing. You can have investments that can pay off because of some of the conflicts, which is sad to think about. But again, if you look at it a coldhearted kind of way, think about your long-term goal. It's all part of how the market ebbs and flows over time. So I wouldn't expect, or I would hope investors would overly react to these headlines by de-risking their portfolios. Over the long run, things tend to work out OK based more on earnings and economic growth.

HEATHER: I think investors need to give themselves a break. It's not being cold hearted. It's just separating the emotions from financial decisions. And that's just sound judgment.

All right. Let's switch gears and talk about long-term rates. Because we talked about the Fed. We talked about the Fed controls short-term rates. But it might be a little bit confusing for investors that the Fed is cutting rates, and yet 10-year treasuries are actually up. We've also got the fact that bond portfolios didn't perform as well as bond investors probably had hoped they would in 2024. So what is the outlook for longer-term rates in 2025? And Cait, I'll pose that question to you.

CAIT: Yeah. So as you said, Heather, the Fed controls short-term rates. But actually, long-term rates are usually influenced by growth and inflation. And when we look into 2025, we're expecting resilient growth and still sticky inflation. And this is actually a pretty similar backdrop to what we saw last year in 2024. And so both of these things would suggest that longer-term rates should really stay elevated.

The other thing that can impact longer-term rates is the government borrowing needs or funding themselves by issuing treasury bonds. And here, too, with deficits expected to stay on the larger side relative to what they've been in the past, here, too, this probably means upward pressure for these longer-term interest rates going forward.

HEATHER: Given what Cait just touched on, Jurrien, how should investors be thinking about bonds these days?

JURRIEN: So bonds can play several roles in a portfolio. So the good news for bonds is that, as our bond colleagues like to say, the income is back into fixed income. So in other words, if you buy a bond and you hold it to maturity, the yield you're getting is your return. So if you can buy an investment-grade bond portfolio at 5% or 5.5% and you don't sell it, that's what you will get. And then it's a matter of what does inflation do relative to that 5%. And inflation is below it, so the real yield that investors get is substantially positive. It's a couple of percentage points, which is good. So bonds, have become a viable competitive asset class again. A few years ago they were kind of impaired because yields were so low. Rates were so low and investors would have to eat a negative yield on those bonds—a negative real yield, I should say. OK.

So they would lose purchasing power. So that's all in the rear view mirror right now. But then the question is, do bonds still play that role as an insurance policy?

HEATHER: As a port in the storm.

JURRIEN: In a 60/40 portfolio.

HEATHER: For volatility. Yeah.

JURRIEN: And since 2022, they have not. So the correlation of bonds and stocks is now positive. We don't know if it's going to stay that way. So that could change. But the good news is there is a real income in those bonds. And maybe bond yields will stay under some pressure because we do have a lot of fiscal deficits.

The Federal debt is up $12 trillion just since COVID, which is only four years ago, five years ago. And so they're challenged in that sense, and I think an occasional rate flare up could affect the stock market like it did in the '80s and the '70s. But generally speaking, there is value in the bonds, even if they don't zig when the stock market zags, basically.

HEATHER: What do you mean by the zig and zagging? I hear you talk about that a lot.

JURRIEN: So for the last several decades, a lot of investors—probably a lot watching today—grew up world where if the stock market has a correction, bond prices go up so yields go down, and it mitigates the loss that you otherwise would have. And so that's what I mean by zigging and zagging. Right now, they're kind of zigging in the same direction or zagging in the same direction, but at least bond yields are now 4.5 instead of 1, which is what they were in 2020.

HEATHER: OK. Thank you for explaining that, Jurrien. And I know you already talked a little bit about the role of bonds and portfolios that you manage, Naveen, but can you elaborate a little bit more on putting together what Cait and Jurrien just said, what that means for your clients' portfolios?

NAVEEN: Yeah. So if you take everything that Cait and Jurrien just shared, looks like bond yields are more attractive than they have been for a while. When I talk to my bond managers and my team, they're smiling more than they did a few years ago when the yields were very low and it was very hard to make money in the bond market. So we're looking now at investment-grade bonds, a yield around 5%, where we were sitting closer to 2% or 3% for a very long time. It's a very challenging period.

On top of that, a few years ago, bonds had a very down year. So a lot of investors, if they look at the long-term performance, looking back three or five years, they might look at bonds and wonder, why would I invest in this? It's got a near zero or slightly negative return.

Why invest in this going forward?

Well, over the last couple of years, we've seen good positive bond performance. So the recovery can happen even if the long-term number doesn't look all that great. If you take together the nicer yield, the recovery we've seen, there are opportunities in the bond market.

The other thing about the bond market, you maybe already noticed, it's complicated. It's not as easy as saying, the Fed is cutting rates so I should just do this in my bond portfolio. And I think that makes it a little bit confusing for investors.

HEATHER: It can potentially be very confusing. When I run into people, they say, I don't really get bonds.

NAVEEN: Half the time, I don't understand bonds myself, it seems like. I'm more of a stock guy historically, but I've learned quite a bit over the last few years. What I've learned is that, hey, these things are more complicated than just what the Fed is doing or just what's happening with inflation or just what's happening in the US. Sometimes, it's a global story, too.

The takeaway, though, is that there's a lot of different types of bonds out there. And I look at our portfolios. Diversity is a big part of the solution to how to invest in bonds. So by diversifying across short-term, medium-term, long-term bonds, that can help reduce maybe volatility in some parts of the bond market.

Looking outside of the US borders, looking at international bonds could be a nice way of bringing in income without being as closely tied to just the US economy as well. And beyond that, are you investing in bonds from the government, bonds from corporations, mortgage bonds or high-yield bonds? All of that can be all of those can be factors in what the bond portfolio looks like. The goal for a portfolio manager, like myself and my team, is to put together a mix of bonds that can provide nice income and at the same time help mitigate risk from stock market volatility or other concerns investors might have. And it seems to me, at the start of this year, the opportunity is better than it has been for quite some time.

HEATHER: So many great takeaways there from all three of you. Thank you.

All right. It is time now for the lightning round. So we're going to have a little fun. You're going to all answer the same question. We're going to go down the line. So Cait, first of all, what do you think has been the biggest surprise of 2024?

CAIT: I was surprised by just how much international markets lagged the US. We expected the US to perform the best cycle backdrop. But we thought that maybe international parts of the market could benefit from the rate cutting cycle and, after a few years of underperformance, could do a little bit better. And in turn, they actually lagged by even more than we would have expected.

JURRIEN: I was not surprised by the direction of the stock market, which was up, but by the magnitude of how much it went up. I thought 2024 would be kind of a baton pass from the PE side of the equation to the E side. And we got both.

NAVEEN: I think even starting in 2023, my team was getting so many questions on the election and people were so concerned about how that was going to go this year, how the market might respond. So I think the positives for this year, the positive surprise has been we had a relatively smooth election and the market, like it typically does, ignored all that and responded more to earnings and economic growth and delivered very positive performance last year.

HEATHER: All right. We talked about the market broadening in 2024. So along those lines, what do you think will be the biggest, or what is the biggest question mark in your minds this year for 2025?

CAIT: So for me, as both of these guys said, stocks follow earnings. Fundamentals matter. And so I'll be watching earnings revisions very closely. Our fundamentals getting better, because that can really support different markets, I think will drive a lot of the relative and absolute performance going forward.

JURRIEN: Yeah. I think on that broadening. We had a bullish broadening in 2024. Can that continue? So many stocks are participating. about 75% of the stocks in the S&P are in uptrend, so it's not just the Mag Seven. But one question that loomed in '24 and I think will continue to loom in '25 is, if those Mag Seven ever lose their shine, what does it do to the overall index?

Not those 75% of the stocks going up, they might still go up or even go up more. But those seven stocks are over 30% of the index. And would that knock the index down, even though most stocks are going up? And again, it's not my expectation, but that's certainly a mathematical thing that I think about for 2025.

HEATHER: Consideration. Yeah. OK. Naveen?

NAVEEN: And then for me it's thinking about, similar to Jurrien, is what parts of the market that are unloved might start to do better this year. So I think a lot of investors right now, if they look at the performance the last few years, they think US stocks, big tech growers. But leadership tends to shift over time in the marketplace and it can come from surprising places. Just last year, for example, utilities is not typically an exciting sector of the US stock market, but they have tremendous performance related, ironically, to artificial intelligence investing. And the energy demands that is driving up for utilities.

So for me, it's thinking about what are the unloved parts of the market. Is it international stocks? Is it bonds? What part of the market that people don't feel that excited about that might surprise investors with a nice result at the end of the year.

HEATHER: All right. We do have to consider risks, too. So third question, what do you see as the biggest risk for 2025?

CAIT: For me, it's inflation. So we made a lot of good progress on inflation coming down closer to 3% or even below on some measures. But when you study history, when inflation goes above, say, 5%, typically you then see a second wave or inflation is basically not totally gone. And so it's not our base case, but studying history and seeing that happen makes us a little bit nervous. And we would peg that as the number one risk for 2025.

JURRIEN: Yeah. I agree with Cait. So the first one is what I just mentioned that you could theoretically see a down market because of the Mag Seven, even though most stocks are going up. And so if you're in a passive indexing strategy or an ETF, you may not see the benefits of most stocks going up. So that's one.

And the other one is, is the economy going to re-accelerate after the slowdown in '23 and '24 before the inflation genie has been put back in the bottle? And if that's the case, we could see maybe another wave. Maybe not a huge wave, but a wave but coming off of 3% instead of 1%.

And that would put the Fed on its hind heels and saying, OK, we can't cut it all. Maybe we even have to raise. So it's not my expectation, but I would agree with Cait that that's definitely a risk.

HEATHER: And Naveen?

NAVEEN: And the one I'm thinking about is Cait used the term steady Eddie earlier this year.

HEATHER: I love that.

NAVEEN: Last year's market was relatively smooth and despite all the concerns investors had. Going into this year with some potential policy changes, especially it's the tariff situation, that may cause bumpiness in the market. If I think back to the tariff situation in 2018, for instance, we did see market choppiness. And at the end of the year we saw a pretty big sell off as well before markets eventually did recover.

So I don't think stocks are going to necessarily enter a prolonged downturn because of tariffs, but we may see just headlines causing just movements in the market that are unexpected. I do expect the economy to grow and stocks should be OK in the long run, but it might be harder for investors to bear through those ups and downs this year.

HEATHER: And from risks to opportunities. Let's end things on a positive note here. What do you think could be the biggest potential opportunities for 2025?

CAIT: So mine would be one that Jurrien had mentioned earlier, this broadening out of market leadership, especially in the US, to maybe more mid- or smaller-sized companies that could benefit from better earnings revisions, from better policy, a little bit more favorable to these parts of the market that have been lagging in the last couple of years.

HEATHER: OK.

JURRIEN: Yeah. And so it's the animal spirits. And you look at gold and Bitcoin even, they are telling us something about growth in the money supply, fiscal deficits, which are not great things, generally. But there are assets that are at play on that—real assets, stores of value—that I think are an opportunity to form some part in a portfolio. Maybe a small part, but some part.

HEATHER: OK.

NAVEEN: And similar to what Jurrien said, I think diversification is an opportunity coming up this year. So after the way stocks have gone in the US in the last few years, tempting to keep riding that one trade. But I think looking beyond that, investors have a chance to help insulate the portfolio from potential market choppiness by investing in areas like international bonds, short-term investments, alternative investments. These are areas we're incorporating on behalf of our clients. I think many investors may benefit by doing similar kind of research for their own purposes as well.

HEATHER: All right. Well, I hope that we've inspired people, maybe provided them some reassurance as well. And I think that's a good place to leave it. So thank you to the three of you for lending your brilliant minds today.

And we've certainly covered a lot of ground today. And we just want to let you know that Fidelity is here to help. If you have any questions, you can always call us, download our app, or visit our website to reach out to us.

Also, if you'd like to hear more from Jurrien and our other thought leaders about what they're watching in 2025, please visit Fidelity's 2025 investing outlook. You can go to fidelity.com/outlook or you can hover over the QR code that's on your screen right now, and there you'll find free insights, analysis and guidance on the year ahead.

Also, before we go, just a reminder that *Market Sense* is a weekly show. We're on live every Tuesday at 2:00 Eastern. Also, replays are available on YouTube and on our website, and also wherever you get your podcasts. We are a podcast.

So on behalf of Jurrien Timmer and Naveen Malwal and Cait Dourney thank you so much for the pleasure of your time today. I'm Heather Hegedus. We hope you have a healthy and prosperous 2025.

[1]Slide: Fidelity AART: The Business Cycle Approach to Asset Allocation"

[2]MSF Agriculture: November 21, 2019: Brazil Is the Winner of the US-China Trade War–MSFAgriculture

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