Fidelity Viewpoints®: Market Sense

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TRANSCRIPT

SPEAKERS:

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HEATHER HEGEDUS: Hey there, everybody. Thank you so much for making the time to join us today for *Market Sense*. I'm Heather Hegedus with Fidelity.

So traders seem to be shaking off the latest tariff news, but the market does remain a little bit uncertain right now. There are a lot of moving parts right now I think is the best way to put it. And some of those moving parts Jurrien will be getting into today.

But last week we did get some mixed jobs data. We also got a report that consumer sentiment has reached a seven month low over inflation concerns. And we do have some more inflation data expected this week, which Jurrien will certainly be watching as well. So to talk about this and all of the big financial headlines from the past week, we are joined by Fidelity's Director of Global Macro, Jurrien Timmer. Also, it was Ben Franklin who said, of course, the only things that are certain in life are death and what, guys?

BOTH JURRIEN AND MAURA: Taxes.

HEATHER: That's right. Taxes, taxes. And tax filing season is officially underway, like it or not. And the reality is, we know taxes are a big part of people's investment and financial picture. So that's why we are especially excited today to be joined for the first time by Maura Clow, who is going to be helping to answer some of your most pressing tax questions that you submitted to us.

And Maura is a financial consultant in our Framingham office that's just west of Boston. She helps create financial plans for clients, but she's also a former tax preparer. She has about a dozen years of experience in the tax world. And fun fact here, Jurrien. Listen to this. She prepared 400 tax returns a year. And I can't even prepare one tax return a year. I don't even attempt to.

But Maura also has a breadth of experience. She is the mother of five children, and one of those children is a son with significant special needs. So a lot of life experience. Thank you so much for both joining us, and Maura, welcome to *Market Sense*.

MAURA CLOW: Thank you so much, Heather. JURRIEN TIMMER: Good to see you both.

HEATHER: Well, it's good to see you, Jurrien, because we didn't see you last week, and it feels like it's been almost a month since we've talked to you, even though it was only a week, because we've just gotten so many market developments since we last spoke. So first of all, I was just hoping you could catch us up on what you're seeing right now.

JURRIEN TIMMER: Yeah, so the news flow really has been almost overwhelming in terms of how much we've had to absorb. And we always have to sort of wonder, try to figure out what the noise to signal ratio is. And so there's been a lot going on, a lot of headlines, of course. The new administration is in full swing.

January actually was a very good month for the market. And all the assets that I track were up for the month of January. So it is a good start for the year. We're about six weeks in now.

HEATHER: And Jurrien, just to interrupt you, isn't there a school of thought that January is a good barometer for how the rest of the year could perform?

JURRIEN: Yes, it's called the January barometer, and it says that as January goes, so goes the year. There's a little bit less than meets the eye there, because it's really true for every month of the year. So if March is up, generally the rest of the year will be up. And really, all it says is that markets tend to trend up or down but mostly up. And so if January is up, it just tells you the trend is up. And therefore, the trend is more likely than not to continue, which is not a prediction. But that's kind of what the what the thinking is.

So the big takeaways here, it always comes down to earnings and interest rates. Earnings are very strong. We're in the fourth quarter earnings season right now. Earnings for the fourth quarter are up 13% year over year. So the economy is strong. The labor market data that you mentioned are relatively constructive. The unemployment rate back down to 4.0%.

We're looking at inflation, of course. Interest rates are for the moment more well-behaved. And so the markets are in a sense of balance. But again, there's a lot of unknowns, a lot of headlines. And we're just always kind of waiting for what happens next, especially when it concerns trade policy with all the tariff announcements.

HEATHER: Right, right. I know that's something you're watching closely. Another big development is after years of focusing on the Fed and whether it's hiking or easing, that focus has now shifted at this point to the long end of the yield curve. So I was hoping, first of all, you can kind of explain to people who maybe don't understand what we're talking about why that is getting so much attention right now. And also, what does this mean for stock valuations and for a stock bond mix in a portfolio?

JURRIEN: Yeah, it's a great question. And as you mentioned, over the last few years, when the Fed started raising rates in 2022 and then lowering them by one percentage point last year, it's been a lot of focus on what does the Fed do? What does that mean for us as investors or people buying homes, et cetera?

And the Fed only controls the overnight lending rate. It's called the Fed funds rate. And it's actually kind of an outdated rate. It's the rate at which banks can borrow from each other. And nobody really uses that anymore. But it's a symbolic starting point, because money market fund yields, T-bill yields, they're all derived from that overnight short rate.

But what is most important right now, I think, is not the short rate, because the economy actually is in pretty good shape. And the Fed went from 0 to 5 and 1/2, and that didn't break the economy. So the economy is pretty resilient here. Unemployment is very low. But what happens at the long end? So the 10 year yield or the 30 year yield is very important. It's important for homeowners, of course, because fixed rate mortgages are mostly derived from long rates.

And so the yield curve that you mentioned is the difference between short rates and long rates. And what has been happening over the past six months is that as short rates have come down, long rates have come up. And that is a reflection of a rising term premium, another buzzword here. But the term premium is like a risk premium that investors demand when they lend money for a very long time.

So there's not really a term premium for a two year treasury note, but there is for a 10 or a 30. And if there is inflation risk or if there's the risk of runaway deficits, which certainly has been a topic recently, investors probably will demand a higher term premium. And that's what we've been seeing.

And the reason why this is important is because treasury bonds are considered the risk free asset. So if you're an investor and you're looking at the menu of investment possibilities, if the risk free asset offers a 4 and 1/2 percent yield, which is what it does right now, and then you look at the stock market and the stock market, if it's trading at a 20 PE, if you turn that around, that is also a 5% yield. And so it's like, OK, which one is better. Stock market tends to have more growth, of course, so many people choose stocks.

But the reason I'm mentioning this is because if the risk free rate is close to the yield on the stock market, the stock market has to kind of pay attention to that and reprice itself as yields go up. So when yields were 1% or 2%, it didn't really matter because stocks were still by far the better asset. But now that bonds are more competitive, as yields go up to 4 and 1/2 or 5%, stock market can have a little bit of a wobble once in a while. And so that's why the long end of the curve right now is so important, especially right now in Washington with the question on deficits and how can they be cut, et cetera.

HEATHER: Terrific explanation there, Jurrien. And we might, if we have time, hit on the deficit question a little bit later on in the show. But we do also want to talk about some tax tips before the April deadline. And I just have to make this quick reminder for our compliance friends that we do not provide tax advice here at Fidelity.

But as we mentioned at the top of the show, before Maura became a financial consultant, she was a licensed tax professional. So she's no longer allowed to give specific tax advice, but she sure knows her stuff. And Maura, I always like to start off a show with a foundational question, just to make sure everybody's on the same page and they can follow along with our conversation, just to level set. So first of all, is there anything that a really basic level that when you are preparing people's taxes you felt your clients didn't really get about the system that they really should understand, that you would like folks at home to understand?

MAURA: Yeah, absolutely, Heather. One of my core business beliefs is that prior planning prevents poor performance. And to understand your taxes, it's really about educating and preparing yourself. Our American tax system is progressive. We don't pay the same rate on every dollar that we own. There's your marginal rate, which is the rate at which your last dollar of income is taxed. And then your effective tax rate, which is your total tax rate you pay. The top rate is 37%. The bottom rate is 10%.

It's helpful to think of these income ranges as falling into buckets rather than brackets. And we have a slide on the screen which illustrates those buckets. But don't worry if you're listening at home. I'll walk you through it. Each bucket holds a different amount of money that's taxed at a different rate. When the first one fills up, your income spills over into the next one, and so on.

So after education, the next most important piece is expectations. If you know you're going to get a refund or if you know you owe, you know what to expect. And that can alleviate any anxiety you may have. Getting money back means you just gave the government an interest free loan for a year. Or if you owe the government a big chunk of money at the end, that could really affect your savings account. Evaluating this in the summer will give you that information on what you've already had deducted. Will it be enough by the end of the year? Or do I need to make an adjustment? That prior planning prevents poor performance sticks through for taxes.

HEATHER: Prior planning prevents poor performance. That's a mouthful.

MAURA CLOW: It's a military term.

HEATHER: I love it, but you're right. You don't want to give the government an interest free loan. That doesn't seem very fair. So I know another possible source of confusion for filers that might lead to errors is knowing which tax forms to use. And this sounds like a simple task, and we understand that a lot of folks out there are not at the beginner level here. But you say this can actually get very tricky for DIY investors. Why is that?

MAURA: It really can get tricky because there are so many forms. So I do like to kind of simplify it. I like to think of your tax return as your financial photo album of the year. All the forms are pictures from the past year, snapshots of the income you've made from jobs, investments, interests, along with photos that are unique to what happened to you that year or what stage of life you're in.

So the majority of Americans report their working income on a W-2 form or on a 1099 if you're self-employed. The 1099 is not just one form. It's the beginning code of how income is received outside of permanent salaried job. There's over 20 types of 1099 forms. Your brokerage form will prepare for you a consolidated 1099. The most common parts of 1099s are the 1099-DIV, which reports dividends, the 1099-INT, which reports interest. But there are, like I said, some forms that are unique to your stage in life. The 1099-R reports retirement income that could come from IRAs or pensions or any other types of retirement income.

By the end of February, you should have all of your forms from your financial institutions. They may not mail them to you, so go online to check. One tip, financial institutions are only required to send you a form if you've earned over $10 in interest. So if you have an account at a bank where you've earned $5 in interest, and at another bank where you've earned $8, you as the taxpayer have earned more than $10 in interest and you need to report that. But the banks don't know what other accounts you have. So you need to check with every institution where you have an interest bearing account to make sure that you have a form, because you are still required to report that.

HEATHER: OK. Check with institutions and then you-- financial institutions. And then you say, once you have the forms, you don't want to sit on them. So what are the reasons to not procrastinate, to resist that temptation, to procrastinate and file your taxes before the April deadline? And also, you mentioned you might not have all your forms until the end of February, and we're only on February 11th right now. So what do you do if you don't have all of your forms yet?

MAURA: Sure, sure. Well, procrastination is the thief of time, and what we all want is more time. So getting started ahead of time gives you plenty of time to look for opportunities to reduce that taxable income. So go online, find out what forms are available for you now. The sooner you get started, the sooner you can get money back if you're owed.

One thing a lot of people don't realize is that when you file is not when you have to pay. You could file today and not pay till April 15th or 17th, depending on what state you're in. So if you owe, starting early can help you soften some of that sticker shock since you'll have time to plan how to make that payment. So say, if you found out on March 1 that you owed $2,000. You now have six weeks to save and plan how you're going to pay by April 15th or 17th. Versus if you wait till March 30th, then you only have two weeks to plan it out.

One thing that's really important that I wanted all of my clients to know was filing for an extension won't help you avoid paying taxes. You may not know this, but you still have to pay what you owe by the April filing deadline or face penalty and interest. All the extension does is give you time to file, but the payment is still due in April.

HEATHER: So it gives you time to gather that paperwork, but you still have to write that check or send in your money. I also know filing early can reduce your exposure to identity theft, so another reason to file early. Maura, at the end of 2024, we also had a *Market Sense* episode about some last minute tax strategies that had to be completed by the end of 2024. It's too late to implement some of those strategies this year, but are there a couple of strategies that people can still implement right now before the April filing tax deadline?

MAURA: Yes, Heather, there are still a couple of moves that we can make. The next thing we want you to do is to make sure that you're taking advantage of any debits or credits that you're entitled to. A debit or a deduction reduces your taxable income, bringing down the effective rate, like contributing to your IRA or HSA. And you can still do that prior to the April filing deadline.

Credits are better than debits because a tax credit will reduce the tax you owe dollar for dollar. So if you have a child, there are multiple credits and deductions that you may be able to take advantage of. So imagine if you have a five-year-old and before claiming the $2,000 child tax credit, your tax bill was $5,000. After the credit, you'll only owe $3,000. There's also the child and dependent care credit. Credits can be really complicated, so I would always consider consulting with a tax professional when filing with those.

HEATHER: I also know the new standard deduction is higher this year. So most Americans don't file, or rather, don't itemize anymore, rather. But I know that some things could be worth it, could push people over that threshold and make it worth it to itemize. So can you share a couple of those circumstances that people might not be aware of?

JURRIEN: Sure. Yeah, you're right. With the new tax laws, the deduction is higher. So most people don't file exemptions or use deductions. But since many of them were eliminated in 2017. So like we say, most people do end up taking the standard deduction.

The first thing that comes to mind is what's going on in California. And we're keeping those people in our thoughts and still finding out ways we can help them. But if you were impacted by a federally declared disaster area, such as the fires in California or floods in North Carolina, you will have a special tax provision to help you.

In an extraordinary circumstance, medical bills can be itemized. But if you have medical insurance, you probably won't meet the minimum to write it off unless you had an extraordinary medical year, which we always hope that no one does. If you have a special needs child or adult, and Heather, I know this applies to both you and I, legal bills that you may have obtained during trying to get services for your child from your school district may count often as a medical expense. And daycare expenses for an adult dependent parent who may be physically or mentally unable to care for themselves can also often be deducted.

At Fidelity, one of our favorite itemizing things is to bunch your charitable deductions. Make all your contributions in one year is another way we can find a strategy to meet that threshold.

HEATHER: Super smart. And then what else do you want our viewers to be thinking about? Not just at tax time, but year round, Maura, to help reduce their taxes?

MAURA: Yeah, absolutely. Like I said, prior planning prevents poor performance. So this year when you meet with your tax preparer or on your own, think about ask for some constructive criticism. What can I do to make things better? Verify with them using your W-4 that you're taking the correct amount of exemptions. You probably completed that W-4 when you were hired. It's an IRS form that helps your employer know how much taxes to withhold from your paycheck.

As your financial photo album changes, so should your W-4. Reviewing this form any time you have any major life event can help avoid an unexpectedly large refund or tax bill. Last year, I discovered my husband hadn't changed his W-4 after two of our children were no longer our dependents. So even someone like me, who is a tax professional has places we can find to improve.

Because if you typically receive a refund, you may be giving the government that interest free loan for the year and withholding too much. But if you typically owe, you're not withholding enough. So lowering your withholdings can mean more to spend or save for emergencies and contribute maybe to your tax advantaged accounts like the 401(k) or HSA. Just remember, prior planning prevents poor performance.

HEATHER: Well, that makes me feel a little better to hear that the husband of a former tax preparer even made a mistake, because I certainly have left money on the table in the past, and that's not a good feeling. Let's talk about tax loss harvesting, too, Maura. It's something that's specific to investors like our viewers here on *Market Sense*. So can you walk us through what that looks like?

MAURA: Oh, absolutely. I'm a total nerd for tax loss harvesting. I love it. So what tax loss harvesting is, is when you sell an investment at a loss to offset the gains in your portfolio to reduce your tax liability. You should not wait until the end of the year to do this. Very rarely is December the best time to tax loss harvest, and it's too late to do it for this year's April filing deadline. But it's something to consider.

I tell my clients if they love their stock and you don't want to part with it, but you want to leverage a loss, you could have the option to sell it and rebuy it. You just have to wait 30 days. Keep in mind when you're buying it back, you're likely buying it at a different price and the clock will start over with respect to long term versus short term gains, if applicable. If that sounds a little complicated, that's also something an investment professional like myself can help you with.

HEATHER: It kind of blows my mind. I've never thought of that before, Maura. Honestly, if you really are really emotionally tied to a stock, sell it, buy it back if it makes sense from a tax loss harvesting perspective. All right. Last question for you. With the new administration in office, are there any tax changes that may be coming down the pike in 2025 that we might want to keep on our radar or that might be affecting us this year or next year?

MAURA: Sure. 2025 is going to be an interesting year, as we all know. And for taxes, many of the provisions of the Tax Cuts and Jobs Act, or the TJCA that impact individuals and families, not businesses, will sunset at the end of 2025. That means in 2026, more than $4 trillion in tax cuts may no longer be available unless Congress and the new administration act.

It's expected that they will act, and they will be extended, because it does have bipartisan support. But the general consensus is it might not happen until the second half of 2025. So while an extension is likely, a new tax deal probably won't emerge until later in the year. So it might be a good idea to stick with the plan you have or build an all weather plan for 2025.

HEATHER: Jurrien, one of the concerns about the TCJA is the price tag and the potential impact that it could have on our nation's debt. As an economist, are you watching this and how much of an impact do you think the TCJA could have?

JURRIEN: Yeah, no, it's an important consideration, because I'm not an economist, but through the lens of economics, if you extend a tax cut that's already in place, it's not really seen as a stimulus to the economy because economists deal with rates of change. So if the tax cuts were to expire, and that means taxes would go back up to their previous levels, in the economy, that would be seen as a tax hike, even though technically it's just you're just taking back the tax cut.

So probably the extension of the tax cuts, and I agree with Maura that it's likely to happen, it's not going to really boost the economy, but it is going to have what many people think is about a $5 trillion price tag in terms of more deficits. And that brings us back to our previous conversation about the long end of the yield curve. And so how the bond market reacts to potentially $5 trillion more of treasury issuance and what that does to yields is probably the most important consideration in this conversation.

HEATHER: Well, this conversation came full circle. So that tied it all together very nicely, Jurrien. Quickly, can you do a quick Timmer's Take of what you're watching right now?

JURRIEN: Yeah, so we're in the final throes of earnings season. That's been very good so far. And we get the CPI, which even though it's a look back to the last year, it's very important because it helps the Fed and the market understand what else is likely to happen from the Fed. Right now, the Fed is sitting on its hands, which I think is exactly the right thing to do.

HEATHER: So the CPI, the Consumer Price Index, coming out Wednesday, the Producer Price Index coming out Thursday. And we've got to leave it at that. But terrific job to both of you. Maura, you did fantastic. Will you come back on *Market Sense* I hope?

MAURA: Absolutely, I loved it.

HEATHER: We enjoyed it too. And before we go, we do like to leave everybody with a resource to further their education on the topic that we discussed today. So we want to leave you today with our tax education page, where you'll find articles and information about some of the topics that Maura hit on today, including tax pitfalls to avoid and even a retirement strategies tax estimator.

So to get to that page on our website, just hover over the QR code on your screen right now. Or you might be listening to us as a podcast, because we are a podcast. You can get us wherever you catch your podcasts. Just go to fidelity.com/managingtaxes.

So on behalf of Jurrien Timmer and Maura Clow, thanks so much for the pleasure of your time. We're off next week because it's a holiday on Monday, but we'll be back the following week. We are on live every week, Tuesdays at 2:00 Eastern.

[1]Fidelity Viewpoints, January 8, 2024: https://www.fidelity.com/learning- center/personal-finance/how-do-tax-brackets-work

[2]Fidelity Viewpoints, January 30, 2024: https://www.fidelity.com/learning- center/personal-finance/getting-started-on-tax-returns

[3]Fidelity Viewpoints, December 18, 2024: www.fidelity.com/learning-center/personal- finance/tax-pitfalls

[4]Fidelity Viewpoints, January 22, 2025: https://www.fidelity.com/learning- center/personal-finance/guide-to-the-w-4

[5]Fidelity Wealth Management, January 2, 2025: https://www.fidelity.com/learning- center/wealth-management-insights/tax-smart-investing

[6]TCJA: https://tax.thomsonreuters.com/blog/experts-discuss-tax-reform-landscape-in- 2025/

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