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TRANSCRIPT

SPEAKERS:

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HEATHER HEGEDUS: Hello there, everybody. Thank you so much for joining us today for *Market Sense.* We're delighted to have you here today. I'm Heather Hegedus with Fidelity. US hiring last month topped all estimates and the unemployment rate unexpectedly fell, while wage growth accelerated. And some analysts say, that means the Fed is much less likely now to make another big interest rate cut in November. And that sent stocks falling.

So to talk about what this might mean for investors today, we've got Jurrien Timmer with us once again. Of course, he's Fidelity's director of Global Macro. We're also excited to be joined today by Alice Joe. So she works on Fidelity's government relations team, and she is one of our inside sources for all things happening in Washington D.C. And today we've asked her to help us answer some of the questions we've gotten about the election from you, our valued viewers and listeners as we gear up for a very busy month ahead.

And I want to just say right now, off the top, thank you to everybody who wrote in with questions and who participated in this process and in the shaping of this episode, we wanted you to feel like this is your show. And it truly is. So thank you to both of you for joining us today. Alice, thanks for calling in from DC.

ALICE JOE: Yeah. Great to be with you again.

HEATHER: And, Jurrien, you're on the West Coast today. Thank you, as always, for squeezing us into your schedule no matter where you are in the world.

JURRIEN TIMMER: Yes. Greetings from San Diego. Nice to see both of you.

HEATHER: And before we begin, I speak for Jurrien and Alice. I know when I say that our thoughts are with all of the folks down South bracing for yet another hurricane, our hearts go out to you and we are with you in solidarity. And with that, today is Tuesday, October 8. It's hard to believe we're at less than a month away now from election day. It is so close.

But before we talk politics, I want to talk about the market really quickly, Jurrien. So we actually have another milestone to talk about. Another date. We are approaching the two year anniversary of the bull market. It's a good time, I think, to take stock of how far this bull market has come, Jurrien. So I was hoping we could start off by taking us through the highlights of this bull market. And that common question that we always get from investors, which is how much more room do you think there is for this market to keep going?

JURRIEN: Yeah. So I guess I'm—we're stealing the thunder from next week's show where it actually will be the two year birthday of the bull market. But for the stock market, the bottom was October 13, 2022. It was somewhat of an unusual bear market because it was driven entirely by rising interest rates and not by falling earnings. And then basically two years ago, the market started to sense a recovery, that the Fed was going to be done raising rates relatively soon. It ended up taking longer than maybe a lot of people thought.

But when we deconstruct bull markets for in stocks, there tend to be different phases like chapters, if you will. The first phase is always driven by rising P/E ratios, rising valuations because price always anticipates earnings, not always correctly, but the market always goes ahead of where the fundamentals are perceived to be going. So that first phase, which can last six months, a year or longer, tends to be valuation-driven, which is exactly what happened here. And then at some point the baton needs to be passed to earnings, which happened a year ago.

So earnings inflected going from down a very modest 3% in 2023 to now up about 9% to 10% in 2024. At least that's what the estimates are. And the estimates are for another 14% increase next year. We'll see if that's realistic or not. But that baton pass always happens and it happened this time. So we are now in the phase where earnings have to carry the load, and that's exactly what has been happening. The second quarter earnings season was very robust. Third quarter earnings season is right around the corner.

And when we add up what's been going on in the market, we are at the 24 months mark. The S&P has risen 66% to its most recent high. When we contrast that to the average bull market cycle going back hundreds years or so, we see that the median length is 30 months. The median strength, if you will, is 90%. So by that measure, this is still a somewhat immature bull market, or at least maybe we're in the sixth or seventh-inning. Of course, the averages mask of wide disparity of outcomes. So we can't really go by that solely.

But as long as earnings continue to carry the day, I think this market is on reasonable footing. And you mentioned the Fed. Of course, the Fed is now cutting rates. It won't cut them as quickly as the market maybe was expecting a few weeks ago. But that's not a bad thing because if it's cutting less for all the right reasons, which is that the economy remains robust, then that's not a bad outcome. You don't want the Fed cutting for the wrong reasons. And so right now, the stock market is benefiting from both rising earnings and the falling cost of capital. And that's a pretty good backdrop for the market. So that's where we are right now.

HEATHER: Interesting that back in June when we had our June midyear outlook, you were saying seventh inning and you're still saying sixth or seventh inning. And now you're saying maybe sixth, if not seventh. So that's reassuring because that means there's still room for it to run, right?

JURRIEN: Yes.

HEATHER: OK. Jurrien, thank you. And let's dive into politics now because we've got a lot to get to today, Alice. Thanks to our viewers who really did give us some really terrific, very intelligent questions. So as I said, we're a month away from election day. And right now the polls are still showing this presidential race to be a statistical dead heat. So I'm wondering, first of all, what are your sources there on the ground in Washington telling you about just how tight this race could be? And what do you think the likelihood is of us not knowing the outcome until well after election day?

ALICE: Yeah. Well, Heather, the polls that we hear a lot about in the news, they tend to be these national polls, where we hear Harris may be up several points. But while that's useful information, I think what's really going to decide the presidential election are the seven swing states that are in play this year. And I like to categorize them into three different groups, if you will. First, we have the Sun Belt, which includes Arizona and Nevada. And then we also have what I call the blue wall, that includes Wisconsin, Michigan, Pennsylvania. And then, of course, the Southeast, which includes North Carolina and Georgia.

I mean, as of the end of September, the polls in each of these states were really, really tight with really small fluctuations each day, all of them within the margin of error. Now sometimes we'll see Trump leading in the polls, sometimes we'll see Harris leading in various states. So it does fluctuate. Interestingly, though, we're on the heels of some major events domestically with Hurricane Helene wreaking some havoc in the Southeast last week. And now we've got Hurricane Milton barreling towards Florida. These weather events could impact voter turnout this year.

And the fact that we're now in October, it's very possible that we're in for some more surprises that could change the trajectory of this election. But right now, I'd say it's too close to call how the presidential race will turn out. And in terms of when we'll actually know the outcome of the election, it's really likely that it's going to take several days, possibly even up to a week to find out who the real winner is, because in a couple of states in Pennsylvania and Wisconsin, state law says that if election officials can't start processing those early votes, those mail in ballots until election day.

And that's going to take some time, especially with the increasing number of votes that are coming in via the mail since the pandemic started. And then we also have Georgia, who just a couple of weeks ago, the Board of Elections there adopted a new rule that requires hand counting of every ballot. And of course, that's definitely going to delay the reporting of election results in that state. But I'll say that Democrats there have filed a lawsuit against the new rule. And so the outcome of that case will be determined before election day. So perhaps they may be on time after all.

HEATHER: It is just so close, Alice, and obviously that has a lot of people wondering if there will be uncertainty after election day. Another question that we got frequently as we were asking people to submit questions for today's show was, which political party will be best for the economy and for your bottom line and my bottom line? So of course, two disclosures that I have to make up front here are, of course, number one, Fidelity is never going to tell you which candidate to vote for.

And number two, that answer is obviously subjective anyway. But having said that, I know what you can do for us, Alice, is walk us through some of the campaign promises and some of the proposed policies to help us all be informed and make up our own minds. So with that in mind, I thought we could go through first with the GOP and then with the Democrats. And start with the GOP, Alice. So first of all, if Republican lawmakers sweep this election, what kinds of proposals are they talking about?

ALICE: As voters, we hear a lot of proposals on the campaign trail, but they don't always pan out because a lot of these proposals require a legislative change that Congress has to approve. So it's tough to really accurately predict policy changes that are going to happen. But until we actually know which party is going to control Congress. But we can definitely look at the different sweep scenarios that you mentioned in which one party would take control of the White House, the House and the Senate.

So if Republicans win and sweep in November, we're likely to see President Trump driving much of the tax policy agenda for Republicans. Now keep in mind, this is going to be one of the main topics for 2025. Former President Trump, he's expressed a desire to extend all of the expiring provisions in the Tax Cuts and Jobs Act, otherwise known as TCJA, because we like acronyms here in Washington, which, as we know was essentially overhauled the Federal Tax Code back in 2017 for individuals, estates, and businesses.

Now all of the individual and estate tax provisions are set to expire at the end of next year, at the end of 2025, if Congress doesn't act before then. So what does that mean? For individuals extending the Tax Cuts and Jobs Act would keep the seven ordinary tax brackets with TCJA thresholds and rates. The top tax rate would be kept at 37% versus the 39.6% where it was before TCJA. And the exemption, exemption phase out threshold from the alternative minimum tax would remain elevated.

Now the standard deduction would remain roughly twice as high as before TCJA, and the personal exemptions would remain eliminated. And for households who itemize use itemized deductions, the cap on mortgage interest deduction would remain at $750,000 in mortgage debt. Now a number of Republicans and former President Trump has called for the elimination of the current $10,000 limit on state and local tax deduction, which, if you remember back in 2017, was unlimited. So that's definitely something that we're watching out for next year.

And on the campaign trail, we've heard former President Trump talk about new tax policies for the middle and lower income individuals as well. Those things that would include no tax on tips, no tax on Social Security, no tax on overtime pay. And he's also proposed to lower the corporate tax rate from 21% to 20% for those companies, and for those companies that produce domestically like manufacture their products in the United States, their tax rate could drop down to 15% there as well.

And also, he has put forward several trade policy proposals to impose new taxes on imported goods and services, including a 10% across the board tariff on all imports and much higher targeted tariffs. And then finally, just to tie it with a bow, we've heard his vice presidential pick, Senator JD Vance, proposed raising the child tax credit up to $5,000, which is more than double where we are today.

HEATHER: OK. That was a lot to get to. How about if Democrats pull off a sweep, Alice?

ALICE: Yeah. Absolutely. We've heard Vice President Kamala Harris talk on the campaign trail about providing support for the middle class. And while the campaign trail phrase they've been using is, "making the wealthy pay their fair share." Now in terms of the middle class and the lower income individuals, she has supported a number of provisions, including also no tax on tips. She also supports a $6,000 one time child tax credit for new babies as well.

She's talked about extending the current tax rates under Tax Cuts and Jobs Act for those making $400,000 or less. But raising them for those making above that threshold. Now in terms of targeting the wealthy, she's endorsed President Biden's fiscal year 2025 budget proposal, which includes a lot of changes there. Now anyone making $1 million or more in taxable income, would be subject to a long term capital gains rate of 28% and an additional 5% for net investment income tax for a total of 33%.

And one other thing I just want to mention that's gotten a lot of attention lately, is the proposal to levy a 25% minimum tax on income and unrealized gains on investments for those with a wealth of over $100 million. And then, of course, last month, she endorsed the American Housing and Economic Mobility Act that's really intended to help address the housing situation here in the US. But it includes a proposal to lower the estate tax exemption down to $3.5 million, which is well below where it would go if TCJA were to expire.

And of course, on the retirement front, there's also support from Democrats to limit large retirement accounts as well as eliminate backdoor Roth conversions that are in place right now. And for corporations and businesses, she's proposing to increase the corporate tax rate from 21% up to 28%. However, if you are a small business or you have a small business, she is proposing to increase the tax deduction for startup expenses from $5,000 where it is today, all the way up to 50,000.

HEATHER: All right. So you laid out a lot of proposals there, Alice, from both sides of the aisle. And many of those proposals also come with high price tags. Of course, the question of how, how are they going to pay for these proposals and these campaign promises? And that leads us to the next question that we got from many viewers and listeners who are worried about the growing national debt. Quite frankly, neither campaign, though, is putting this issue front and center. But we are getting this question from a lot of concern customers.

So lawmakers punted the debt ceiling deadline out to January 3 as the new date. Again, that's going to be next year. So it's going to be the first day of the new Congress. The new president won't have taken office yet, though, so we'll have a lame duck president. I'm curious, Alice, given those things, how do you think this is going to play out? How do you think Congress is going to tackle this issue right out of the gate when they are forced to do that?

ALICE: Yeah. That's a great question. It's definitely a concern. I get a lot of questions about the National debt. This is certainly top of mind for Congress, who of course will need to pass legislation to either suspend or raise the debt ceiling, so that they're able—so the US is able to continue meeting their financial obligations. Now fortunately, the Secretary of the Treasury does have the ability to take action and deploy what we call these quote, extraordinary measures. These measures include things like suspending the daily reinvestment of treasury securities or redeeming existing investment of treasury securities in certain government programs.

So this gives them some more wiggle room before they would hit the debt ceiling there. This could potentially help them keep them afloat for up to four to six months. And it depends really on the inflow of tax revenues that will come in during tax season. So it could last a bit longer than that. But this does put a spotlight on the National debt because right now, as we know it's pretty high. It's at 34 point—$35.4 trillion. And that continues to grow every year with fiscal deficits accumulating.

Now it's a challenge that lawmakers have yet to address. And keep in mind too that this debt ceiling debate will serve as a backdrop for negotiations on extensions of the Tax Cuts and Jobs Act, which, if they were to extend everything as is, that would cost roughly $4.6 trillion. And then when you add on the proposals that we've heard on the campaign trail, it's going to be substantial.

HEATHER: Hey. Jurrien, I want to bring you back here. How concerned should investors be about the growing national debt? And does that impact the economy in the markets?

JURRIEN: It can. It's a highly nuanced answer, and I apologize for that. But in principle, if a person or a business or a government takes on debt and to increase productivity, for instance. So if you or I buy a home and we can lock in a low rate and the home appreciates in value, there's nothing wrong with that because you're essentially investing in the future. But there's a sense that if the debt to GDP ratio, the amount of debt relative to the size of the economy, if that gets to 90 or 100%, and we're already beyond that in the US and many other countries around the world, it becomes unproductive.

You're spending your resources just on paying interest. And the US is already paying over $1 trillion in interest. And a lot of this debt is not really discretionary. You add up defense, Social Security, Medicare, Medicaid, debt service, there really isn't that much left. And that, I think, is one of the reasons why it's not really a campaign issue. I think neither side or both sides are not that afraid of debt. So then it becomes a question: Does it affect the markets?

And in the extreme case where you have a lot of debt that you can no longer afford to service, you'll have an instance where the central bank might become subordinated behind the fiscal side. And Japan has been a perfect example of that. And the central bank will keep rates low. Now that could lead to inflation, for instance. So that is not a really great outcome, we want the Fed to be independent. But in the US we have a big AI boom going on.

If that leads to productivity gains, and it allows the US to outgrow other countries around the world Europe, Japan, China, especially China, which of course, has an adversarial relationship, then maybe we can stay the cleanest dirty shirt and muddle our way through. We also have the reserve currency of course. And currencies tend to be the ultimate price that a country might have to pay if the debt is unsustainable. So an eye on the dollar would be helpful as well. But right now the markets seem to be OK with this.

And again, if we were the only country in the world that had a lot of debt and our debt was funded by international investors, like if you think about an emerging market like Brazil or Argentina, then it very quickly gets to the breaking point because once those investors walk away, your currency collapses. But the US is in a unique position in that it does have still the reserve currency of the world.

HEATHER: OK. Could be a watch out. We could be the cleanest dirty shirt. I'm going to try to keep you guys moving here, so we can get in a couple more questions since we're really tight on time here. Now we got a lot of viewer questions here in about tariff proposals and how that could impact inflation. So what are your views on tariffs? Can they impact the markets on the economy?

JURRIEN: They can as they lead to deglobalization. As we know former President Trump started the tariffs, but President Biden continued them. So that has not been a partisan topic, just like the debt has not been a partisan topic. And I think the overriding issue is we're going from a world of globalization where we kind of there's labor arbitrage between China and the US or Mexico to deglobalization. And I think tariffs are a sign along the way that that's where we're heading. And that's why we see things like the CHIPS Act where companies are incentivized to produce locally. And I think we'll see more of that.

HEATHER: OK. Great, Jurrien. Thank you. Alice, I think I have time for like maybe one more question from you, and we'll go a little bit over today. But we don't want to go too far over on time here. So one of the top few questions we also got was with the new president and a new Congress taking over in just a few weeks. What could that mean for the future of Social Security? What do you think?

ALICE: Yeah. So that's a great question. As we all know Social Security trustees are projecting that that program is going to deplete funds in 2035. So Congress is going to need to step up and make some changes. We've heard some hearings happening in the House and a few members of Congress talking about that. But there's really been no real action taken on here, especially that this is a presidential election year.

I think in order to see some real change here, we're going to have to see members of Congress on both the Republican and the Democratic side come together, lock arms, and make some policy decisions that perhaps aren't politically palatable. But it's going to take a bipartisan effort to get this going definitely before 2035.

HEATHER: All right, Alice. Hard to hear, but important. Great job covering so much ground. Jurrien, really quickly. We've talked about this in the past, but let's talk really quickly about the impact of the market on elections, because we keep getting this question. And I know you say, there might be some initial volatility. We talked with Alice about how the election outcome might not be decided on election day, but in general, the markets tend to do their own thing regardless of election outcomes. Is that fair to say, Jurrien?

JURRIEN: Yes. If we wait long enough as investors, the markets will do their thing. That's not to say that the election will not impact different sectors, different policies, but the stock market is worth $50 trillion. And so if you wait long enough, the markets will do what they do. It's a very big economy. It's a very efficient economy, and it's going to do what it does. And so far as the chart shows, we've been following the presidential cycle very, very well. And I'm going to keep my eye on that.

HEATHER: I know you will be, Jurrien. Thank you. Before we go. Timur's take Q3 earnings this week.

JURRIEN: Earnings season starts next week, and we'll see if the robust rate of change or growth continues into the third quarter.

HEATHER: All right. We've got to leave it at that. But thank you so much again, Alice. Terrific information and insights. And , Jurrien, always appreciate having you on. And to everybody who sent us those fantastic questions, we really appreciate it. And remember, you can always reach out to us at market sense @fidelity.com. We truly do use your feedback to shape every show, not just today's show.

So on behalf of Jurrien Timmer and Alice Joe, I'm Heather Hegedus. Thank you so much. Don't forget to get out there and vote next month. Meantime, we'll see you back here next Tuesday at our regular time of 2 o'clock Eastern. Take care.

[1]Bloomberg, October 4, 2024: US Jobs Report September 2024: Live News on Employment, Payrolls – Bloomberg

2Fidelity Viewpoints, October 1, 2024: https://www.fidelity.com/learning-center/trading-investing/US-national-debt

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