Fidelity Viewpoints®: Market Sense

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TRANSCRIPT

SPEAKERS:

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Jim Armstrong: Hello and thank you for joining us for *Market Sense*. I'm Jim Armstrong with Fidelity. It is America Saves Week which you can think of that as an annual call to action for Americans to commit to saving successfully. So, today we'll talk about ways you can think about prioritizing saving and how paying down debt is actually a form of saving. So to get some insight about how we can think about saving our money most effectively, we've got Leanna Devinney on the webcast today, she's the financial planner and a Massachusetts based branch leader. And as always, we'll get the big picture market overview today as well, and to do that we'll speak with Jurrien Timmer. He is Fidelity's Director of Global Macro, and as he often will, he'll be sharing insights into the latest world news, national news market conditions, and what all of it means to us as investors. Thank you both for being with us today.

Leanna Devinney: Thank you, excited to be here.

Jurrien Timmer: Good to see you all.

JIM: Hey, Jurrien, we'll start with you if that's okay. It is Tuesday, 28th of February, the end of February already. And gosh, it's been a rocky start to the year. Strong January, markets seemed to have been settling, if that's the right word for it. I'm just curious, there are so many different narratives right now, what do you think is the main one or the main ones driving what's happening in the markets as we speak?

JURRIEN: Yes, well the term narrative is certainly a good one to use because every market cycle has a narrative, and in this case, it's actually a series of narratives, almost like chapters in the book, if you will, right? So just to kind of go back a little bit, about 13 months ago the market, you know, formed the top, it was early January of 2022. It fell, you know, 28% from that January high of about 4800 on the S&P to the October low of around 4500. So far that low has held and we're up about, you know, let's say 12–13% from that low.

And if I can sort of dissect that period into chapters. The first chapter, that decline was basically the market dealing with the Fed raising rates very substantially, right? So the Fed raised the cost of capital and that essentially took down the present value of future cash flows. That's just the way the math works. And that effects, of course, all assets, not only stocks but also bonds, crypto, like you name it, everything got effected by that. But at the same time the economy was fine, earnings were growing, people are fully employed. And so the narrative for last year was really all about valuation, rates going up, valuations coming down, they tend to be inversely related, while the economy was fine. Then we had the low in October, since that time earnings have actually started to come down. So the earnings inflexion that we've been talking about for so long, is happening. But at the same time, the market was able to kind of look through that, as the market often does because the markets always discounting the future, not always correctly, but it does always discount the future. And so the market basically said, yeah, earnings are falling but we know this already, and we can look past it because the market felt that there was that promise of inflation coming down hard, allowing the Fed to pivot. That's kind of the current buzzword from higher rates to lower rates and the market historically shows that it can look through an earnings decline as long as that promise is there for easier money, right, through a Fed pivot.

And so from the October low until basically the end of January, when we saw that strong rally and especially January, of course, was very, very strong. I think that was kind of the narrative for the markets. Like yeah, we're looking through the earnings weakness because there's easier liquidity conditions coming down the pike. That has changed now a little bit because with the January employment report, which was released in early February, we see that the economy actually remains really strong, which, of course, is good for most people. But it's a point where sort of good news is now bad new, if you will because it means that the Fed is going to stay higher for longer. So the current narrative is that, you know, the economy is maybe not softening enough or not as much as the Fed would like to see. While at the same time, the inflation data are still generally heading in the right direction but they're kind of turning a little bit stickier, and so this narrative of like it's okay that earnings are declining because we see easier money ahead. That's being put to the test right now and I think that's why February, which will end today, has been more of a two-way market whereas January was a straight up market.

JIM: I want to linger a little bit if we can on inflation which you were just starting to touch on there. You know, and I think it's a great segue into what Leanna is going to be talking about in a couple of minutes because inflation effects all aspects of our lives, saving and spending. But talk a little bit, if you could, about inflation maybe being I think stickier or more persistent than—or were we too optimistic a few weeks or a couple of months ago thinking that it was starting to come down and we would see just that slow, slow steady decline.

JURRIEN: I mean that is the trillion-dollar question right now is, you know the inflation peaked at 9% last year, June. So the rate of change was 9% in the CPI. We're down to about 5ish, give or take, depending which inflation series you're looking at. The Fed wants it to go to 2, right, or maybe 2½, maybe even 3 will be enough for the Fed to declare victory because it now uses sort of

an average inflation targeting protocol.[1] And so the risk always was that going from 9 to 5 would be easy, just because of the way base effects work in calculating a rate of change. And, you know we saw that oil prices are coming down which is a big chunk of inflation. And so the worry always was that the easy—that that part was the easy part, but falling from 5 to 2 will be not impossible, but that it will be harder because then you start dealing with entrenched inflation. And of course, you know, we see this in the wage—on the wage front, right? I mean, the unemployment rate is the lowest since 1969, I think it is about 3.5%. There is still two jobs available for every job opening so the labor market is very strong, which of course, is great for the people who are working or looking for work.

But that is also the stickiest part of the inflation story. And so, you know, so the risk is not that inflation won't continue to come down but that it will take longer to get from the current 5% all the way to the Fed's target. Because remember, it's not enough for inflation just to come down in the eyes of the Fed. It has to come all the way down to its target of around, you know, let's say 2 to 3%. And if that takes longer to happen, then that means that the Fed will keep rates higher for longer, which is great if you're buying T-bills or have money in a money market fund account, but it also suggests a more restrictive liquidity environment which again feeds in the valuation of bonds and stocks. So it really comes down to how quick from here, because the quicker inflation goes back to the Fed's target, the faster the Fed can pivot back to a more neutral rate.

JIM: Thank you for that, perfect. And that gives us a chance to pivot over to Leanna because this is a great example of Jurrien's macro view dovetailing perfectly what you're going to be talking about, Leanna, which is how we make sense of what's happening at the macro level. So first for a bit of background here, America Saves it is a nonprofit organization that helps bring attention to saving successfully. And Fidelity works with them every year during America Saves Week. And a big emphasis for this year, for 2023 is this idea about paying down debt as a form of savings all by itself. And I know debt is no one's favorite topic to talk about, Leanna, but how would you start to help our heads around it.

LEANNA: Yeah, it's certainly not a fan favorite for a topic. But it is a big component on how we help our clients financially plan. And when we can help tackle down debt or at least manage debt, it then allows us to save or invest for our long term goals. So, a lot of times the conversations with investors or our clients, the concern is around how to prioritize balancing debt with the other financial goals that we have. If it is short-term financial goals, if it's long-term financial goals. So I say debt overall, it first starts with having an understanding of your full financial picture, so what are your expenses, you know, what's coming in, what's going out, what type of debt do you have.

I always say that there's bad debt and then there is better debt. No debt is really good debt! But there is certain debt like a mortgage that we'll treat very differently than debts such as high interest credit card debt. So essentially though, reducing your debt, bad debt or better debt, it allows you to not pay interest and some of the things that can creep up on us. So we'll talk today just on

things that you can do to pay off your debt or manage it or make those extra payments to then allow you to save more and invest more.

JIM: And a key part of that discussion as you just mentioned, going back to what Jurrien was talking about, is interest rates. What is the interest right on your student loan look like versus your credit card debt and we know that nearly half of all Americans are carrying a credit card balance. Meaning they don't because they're not able to probably payoff their full debt every month.[2] And just for some people that can feel like an impossible burden to ever get in front of that level of debt. But as you mentioned, if you can prioritize putting some money aside for extra payments, how would you suggest to go about starting that process?

LEANNA: So there is really two ways that you can go about managing your debt, prioritizing more, or paying it off in full would be the big goal. So I would say, you're right it's for those that are carrying one month to month, it can be hard to see how to get from having this every month to being completely debt free. So it is not possible for everyone right now to make more than their minimums. But if you can, if you can make those extra payments, there is really two strategies, the avalanche strategy and the snowball strategy. So starting with the avalanche, this one mathematically gives you the opportunity to save more on your interest payments over time. So particularly if you have loans that have a wide range of interest rates or if you have multiple debts or if you have high interest rate type of debt, this is putting all of your money first to those high interest rate debts, pay those off and then you do the next one in line. So by the end, you're again putting money toward your whole debt but you've now, you know essentially had this avalanche, you pay the heavy ones first.

The snowball is more emotionally kind of gratifying because you get the small wins. So you start by listing your debts by balance size and then with the smallest at the top actually and the largest at the bottom. So the snowball method again, you're paying off the smaller debts, you feel the like energy and success of paying down debt. And why I say there is the mathematical one and emotional, there is not one that's necessarily right or wrong. It has to be, you know custom for you of what's going to work. I would say where I've seen the snowball work is again, you're getting those wins and then you're kind of bought in, and you're into the system of managing and paying down debt. But mathematically, the avalanche one is saying let me get out of the interest rates, let me pay you less interest over the long run.

JIM: Got it, I want to talk a little bit about student loans as well next. I think the numbers are just staggering when you think about them. Some 45 million borrowers in the US today owe something like a combined 1.7 trillion—with a T, trillion dollar, in educational loan debt.[3] And I think it's important to remember, it's certainly is former students but it is also moms and dads and grandparents and other people that have taken on debt to support those students who also have student loan debt. It is not just, you know, people just starting out in the workforce right now.

LEANNA: No, it's not. I mean, I see it everywhere you're right, parents, grandparents, students, you know, people in their 40s and 50s. Like still taking on and paying off their student loan debt. So it's certainly prevalent. I'd say overall, there is many options like any debt, it can be overwhelming on how do you prioritize and change. So just a couple areas that we would help, we start with putting extra payments to your loan. So you don't have to change a loan agreement, you don't have to refinance, but a way to pay down debt sooner, is just putting the extra payments down.

Those that do have multiple student loans, it could be an opportunity to consolidate those loans. It is also an opportunity to look back at that avalanche method, so paying off the one with the higher interest rate first to help, and then refinance would be another one that we do. So tougher rate environment right now, but if you have had loans for a long time and you haven't taken a look at refinancing, that's always an option for you, to pay less interest on the loans that you have.

JIM: I used to just round up with my student loans, talk about an emotional victory rather than maybe a mathematical one but I would just round up to the next 100. And so in my head I was always putting a little bit more on. I mean, it made it end faster but not dramatically so.

LEANNA: It is a great way to do it though, absolutely.

JIM: One last thing for you before we turn to Jurrien, as well Leanna. I'd love to get your sense about saving, right? We know that the interest rates are probably not getting cut any time soon, in fact they are probably going to be higher than previously expected. But talk a little bit, if you could, about the idea of consistently saving a little bit more over time. Kind of the inverse of my slowing chipping away at debt, how about slowly adding to a savings.

LEANNA: Yeah, so back to the main concern that I will hear is how do we prioritize saving for short term goals, how do we prioritize paying down debt, but also not neglecting longer term goals if it is, you know, college for a loved one, educational expenses, if it is retirement goals for you and your family. So I would say for those that have debt or don't even have an emergency fund, it can be hard to think that I can even balance multiple goals. So I'd say, if you're listening you certainly can. It comes with, again, first understanding what your whole financial picture looks like, what's coming in, going out, and then getting a plan in place to be able to have multiple savings goals. So I would say, it certainly is possible.

One of the first things that we want to do, aside from paying your minimum debt, you don't want to not do that or have late payments, is you want to set up an emergency fund or that rainy day fund. We recommend certified financial planner, 3 to 6 months of your expenses in a rainy day fund. But if that's too much, even just having a $1,000 buffer or your full month's rent buffer is a great place to start.

JIM: Yeah, I love that, small, obtainable goal that you can get to and then feel confident that there is cash on the sidelines you can deploy when an emergency happens. After you have done that though, what comes next maybe?

LEANNA: So then you want to prioritize your longer term goals, so like retirement. So I always say you can take a loan for education, you can't really take a loan for wanting a retirement of the lifestyle you want in the future. So a next step after that rainy day fund would be taking a look at your workplace plan. So think if you have a 401(k) or a 403(b), you want to put an amount away to that. That's pretax and if your company matches, you want to at least try to hit that match.

For those that don't have a 401(k), 403(b), or an employee sponsored plans. There are retirement accounts, tax advantaged accounts, individual retirement accounts that you're able to contribute to. So these are again, ways that you can plan for the long term, a great aiming goal would be to save 15% of your income towards retirement. If that's a lofty goal, I certainly encourage you to at least increase once a year, you can do by 1%, even annually, and you don't miss it. Kind of out of sight, out of mind, and it's a great way to save and get the power of compounding on your side.

JIM: Great, let's segue with that long term mindset back over to Jurrien for the last question, if we could. Maybe I got irrationally exuberant in January when I saw the markets were performing so well. And I tried to be more mindful of what you had said late last year, Jurrien, that your expectation for '23 was that there wouldn't be gigantic swings up or down, kind of a choppy, you know bumping along for the duration of the year. Is that still what you're seeing?

JURRIEN: Yes, and it's, you know may be a very unsatisfying forecast. But, you know again, if we take a step back, you know, 13 months ago, the S&P was at 4800, that was the top. Three-four months ago in October, October 13th, S&P was around 3500. And right now, we're at around 4,000. So we're more or less in the middle of the range between the high and the low. And, you know, I can see very easily that the lows in October could be the lows that we don't have to go any lower, even if earnings, you know, continue to start—continue to fall as they're doing now. But at the same time, I don't really see the narrative for a new bull market yet. You know, the Fed is still raising rates, and the terminable point, the level to which the Fed is expected to raise rates keeps rising, it's now 5.3%. You know, it was 4⅞ths just maybe two months ago or even one month ago.

And the market has been hoping that the Fed would get there but then very quickly started cutting rates again back towards 3%. And I think what the last inflation report show, which kind of were a little bit stickier than I think all of us would have hoped, is that maybe the Fed will kind of stay higher for longer before it gets back to a more neutral policy. And so it creates a tail wind, it is not an unsurmountable tail wind, but it just kind of pushes out the story line that we would want to see for anticipating that next bull market that will take us to new all-time highs. So I think 2023 is a year where we need to have patience, doesn't mean there is nothing to do, there is always an opportunity to rebound and you know who to see if you need to do that.

You know, bond yields are back up towards 4%, shorter term yields are in some cases above 5%. So there is opportunity but, you know, I think the days of 20% up markets, certainly January being an up 7% market, I think those are the exceptions rather than the rule. And I think for this year into next, it's just basically a time of limbo for the market while we wait for the puzzle pieces to fall, to come together.

JIM: Excellent, excellent context and perspective there. We always cram a lot into about 20 minutes, but today feels like we did an especially good job of that. So thank you both for being a part of this great conversation.

For folks in the audience, just a reminder to you, if you have questions about, of course, making or updating a financial plan, maybe staying on track with the one that you have had for a while, Fidelity can help. Give us a call, go online, visit our website, download our app, and check out what we have to offer on your mobile device. Tons of ways to continue to get in contact with us and to learn more about your plans. Again, huge thanks to Fidelity's Jurrien Timmer and Leanna Devinney. Have a great week, we'll see you all back here next Tuesday.

[1]Consumer Price Index as of 2/14/2023.

[2]AJ Horch. "Almost half of America is now carrying credit card debt, and more of it". CNBC.com. May 4, 2020.

[3]Zack Friedman. "Student Loan Debt Statistics in 2022: A record $1.7 Trillion". Forbes.com. May 16, 2022.

[4]IRS.gov. Dec 21, 2022.

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