Fidelity Viewpoints®: Market Sense

Week 143, January 14, 2025

TRANSCRIPT

SPEAKERS:

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HEATHER HEGEDUS: Hello there! Thank you so much for taking the time today to join us for *Market Sense*. I'm Heather Hegedus with Fidelity. Before we begin, I want to start by acknowledging the devastation out in California right now. The wildfires there are the most destructive in Los Angeles history. So many people's lives have been forever changed, and it goes without saying that we are thinking of them right now and how we might be able to help.

We want to let you know that we do have a link to help through Fidelity Charitable, which is included in the show slides that are downloadable after the show is over. So as we continue to watch those events, our country is also preparing for a leadership change. In just six days, Donald Trump is going to be sworn in as the 47th President of the United States, and the first confirmation hearing for one of his cabinet picks started this morning. I've been listening all morning long. Perhaps some of you have been too.

We are watching to see which of the proposals the Trump administration have promised to take action on are prioritized when he is sworn in. So to talk about what all of this could mean for the economy, and the markets and investors, we are pleased to be joined today, as we often are, by Jurrien Timmer, Fidelity's Director of Global Macro.

We are also delighted to be joined today by Alice Joe. She's a Vice President on Fidelity's Federal Government Relations Team, and she's here today to share with us what some of her sources are telling her about some of the president-elect's cabinet picks. So I want to say thank you to both of you for making the time today, and I hope you're both well.

ALICE JOE: Thanks for having us.

JURRIEN TIMMER: Good to see you. Welcome, Alice.

HEATHER: Nice to see you in a different backdrop you're in. And today is Tuesday, January 14. We are already two weeks into the new year, and we like to start off with the headlines. And we just had our 2025 Outlook Show last week, Jurrien, where you laid out some of the patterns that you're going to be watching, and that you're seeing in the markets right now, and what you're expecting in this new year. As I said, we're only a few weeks into the new year, but the markets are down right now. I was hoping you could walk us through the reason behind that, and whether investors should be concerned about this.

JURRIEN: Yes. And by the way, greetings from Aruba, where I'm visiting my brother while my parents are visiting from Holland. So that's where I am with the swaying palm trees. So in a nutshell, 2024 was a year where many things went right. Earnings grew 10%, and earnings are the backbone of any bull market. And they certainly have been this time.

But on top of that, valuations increased quite a lot. So when you look at the 25% return last year, 2/3 of that came from a rising PE, and 1/3 came from earnings. That's definitely something that I had not foreseen a year earlier, but that was sort of added fuel to the bull market's momentum.

I think that is sort of changing. I mean, that was kind of as good as it got, and also, the Fed cut rates 100 basis points, so there was a lot of support from the monetary policy side. The economy, of course, has proven to be quite resilient, and it continues to be.

But as we turn the page into 2025, I think the market's having a little bit of a hangover. Sentiment got quite ebullient at the end of last year, sort of the animal spirits rally of the red wave that we're going to talk about today, that after the election, investors started to price in a more active economy, a faster-growing economy.

And so at this point, with some pressure on rates, with the Fed perhaps being closer to being done, and again, the markets really quite expensive here, the bullish outlook is still intact from my point of view. But my sense is that the market's recognizing that it really is going to come down to earnings, and the market may not get a lot of other help after that.

HEATHER: Bullish outlook still intact, but perhaps a bit of a hangover from that red wave in the animal spirits, the red wave trade. Another question for you. Interest rates seem to be playing a big factor right now in the markets mindsets, both in terms of what the Fed might do and also how long-term interest rates have been rising as well. How do you see that impacting, how do you see interest rates impacting where the market goes for the rest of the year?

JURRIEN: Yeah, so I think that this is probably the biggest driver right now. So you have short-term rates, right, the rates that the Fed sets at its FOMC meeting. And of course, the Fed did cut rates last year by 1 percentage point, and at this point with inflation being a little sticky, and we'll get the CPI tomorrow, and the economy being quite strong—we had a very strong jobs report last week—it's less likely that the Fed has a lot more room to cut.

And I think that's generally OK with the markets. The economy is strong enough that the Fed doesn't really need to cut a lot more, and the Fed is closer to what I would say is a neutral rate, around 4%, than it certainly was last year. But I think the real action is at the long end of the yield curve.

So long-term yields are rising. The 10-year Treasury is around 4.79 right now, and that's important because if you look at the PE on treasuries, so the price, if you invert the yield and you take the price that investors need to pay to get their bond coupons, the Treasury market is very competitive with the stock market in terms of their respective valuations.

And the Treasury market is considered the risk-free asset because it's backed by the full faith and credit of the US government. And you would think that the risk-free asset would be a little bit more expensive than the risky asset, which are stocks. And so—

HEATHER: Risky relatively speaking to bonds.

JURRIEN: Relatively speaking, because there should be a premium that stock investors get over and above the risk-free asset. And as the risk-free yield, so the Treasury yield, pushes closer to 5, the yields are so similar that the stock market kind of needs to respond by raising its yield or lowering its PE in order to remain competitive.

And I think that is a tension that we've seen like since 2022. We saw it in '23, and I think we're likely to continue to see that in 2025. And again, it doesn't mean that the bull market for stocks is over, but it's a cross-current that will eat into the returns a little bit while the earnings keep doing the heavy lifting.

HEATHER: OK. So what I'm hearing from you is that's a tension we're going to be watching. We're also going to be watching to see if the Fed does make another cut or if it's done. All right, let's switch gears and turn to you now, Alice. So since we last had you on the show, the Federal government narrowly avoided that Christmas shutdown. Right before Christmas, it avoided it. However, that issue is going to be coming up again in March, which is just around the corner.

President-elect Trump has endorsed abolishing the national debt altogether. He did that during that debt ceiling debate. Yet, he also created DOGE, of course, the Department of Government Efficiency. And the intent of this is supposedly to help make the Federal government more lean.

And those two things might be a little bit confusing for investors and for anybody. You know, it just seems like those two things might kind of count each other out or contradict one another. So I'm curious from you, what do you think we can expect from this administration when it comes to government spending and getting debt in check?

ALICE: Yeah, well, Heather, I mean, I think the fact that national debt continues to rise and Congress has to pass legislation every few years to raise the debt ceiling, It highlights a real and growing problem in the US. In fact, as you mentioned, the negotiations of the stopgap government funding bill last December, it actually included a handshake agreement amongst House Republicans to target about $2.5 trillion of spending cuts paired with any increase in the debt ceiling, which we'll see later this year.

Obviously, that deal lends more support and momentum for the Department of Government Efficiency, which is supposed to serve as a resource over the next 18 months to find about $2 trillion of inefficiencies in the Federal government. I think a couple of the key areas that they'll be focusing on will be on regulation and personnel.

And the idea is that by reducing potentially thousands of regulations, there's going to be a lot less need for government workers to handle compliance assistance and enforcement, thereby reducing the government workforce. Now, DOGE has also been taking input from stakeholders on where to find some efficiencies, things like eliminating ineffective or unnecessary regulations, as well as cutting certain programs that aren't working and beefing up enforcement in areas where there's been a lot of fraud, waste, and abuse.

HEATHER: I think it's worth pointing out too, Alice, that DOGE is actually just an informal advisory panel. It's a commission. Even though "Department" is in the title, it's actually not a title. So I know a big part of the Trump administration's first 100 days is going to be focusing on the federal budget. That needs to get done.

And it's proposing a multi-trillion dollar reconciliation bill that will include provisions on everything from border security to energy to tax policy. In other words, this is a pretty jam-packed bill, Alice. So I'm curious, given how much is in it, how much of a challenge do you think that could pose to getting it done?

ALICE: Yeah, that's a great question. Even with total Republican control in Washington, inter-party negotiations, I think, are going to be really, really challenging. One huge priority is going to be the expiring provisions of the Tax Cuts and Jobs Act. I mean, every American's taxes are potentially going to go up if those provisions expire at the end of the year.

And in addition to the current tax rate, other expiring provisions would include a higher standard deduction. It would include a higher gift and estate tax exemption, as well as limits on state and local tax deductions, as well as favorable charitable deductions there as well.

Now, President-elect Trump, he's called for no tax on tips. A lot of people have heard that. And that proposal is actually being taken seriously by relevant committee members. Tax, as I mentioned, is going to be an incredibly complex bill to negotiate, because one of the other sticking points that is out there right now that they're trying to work through is what the state and local tax deduction limit will be, because it's not going to stay where it is right now. And of course, that along with other things, are going to drive up the cost.

Another piece of the reconciliation potentially could be on immigration and border, which of course, is not an easy task. It's an issue that Congress has been trying to work out for over 20 years, but then have yielded no results so far. And then there's also talks about raising the debt ceiling and doing deficit reduction within the reconciliation bill. And of course, that just complicates the negotiations even more. Now, obviously, there's lots of moving parts here in the next few months, so we'll have to wait and see how the dynamics play out.

HEATHER: So the budget's going to be one of the big priorities in the first 100 days. You know, for investors who might have been watching and waiting to see what else happens in the first 100 days, whether that's the right thing to do or not, do we have a clearer picture yet about what else the administration might be focused on right out of the gate?

ALICE: Yeah, out of the gate, we're going to be expecting to see executive action, right. And some of the top ones that might affect the market and economy are trade, energy and deregulation. So obviously, with trade, President Trump favors balancing out some of the trade deficits by having more goods being made in the US. It's sort of the "made in America" mantra that he said, and also using tariffs as a stick to negotiate geopolitical priorities as well.

And in line with that, he's announced last November that one of his first acts as president would be to impose an additional 10% tariff on goods from China, as well as a 25% tariff on imports from Mexico and Canada. Now, in terms of energy, he's promised to make America much more energy-independent by increasing some of the production that we see here in the US, and so by allowing more permitting out there. That potentially could help lower the cost of energy.

And then finally deregulation, that's something that he's going to likely prioritize government wide, a big deregulatory reform which will make the regulatory environment for a lot of businesses much more friendly. Now, the one thing I'll say is, obviously, it's important to recognize that not everything is going to happen on day 1, or even on day 100, for that matter, because the administration is limited in some of the actions that they can take. So in some matters, they're going to have to get Congress to weigh in with legislation to make that happen.

HEATHER: We always talk about the first 100 days, but that doesn't mean that it's all going to happen in those first 100 days, to your point. Let's talk about the potential cabinet members now, Alice. So the appointee for the Securities and Exchange Commission is Paul Atkins.

What can you tell us about how he might approach the role of being Wall Street's major regulator? And let's also talk about what this could mean for the crypto industry or for crypto regulations, because crypto spent tens of millions of dollars on this election, reportedly. The president reportedly asked members of the crypto industry to weigh in on this appointment. So what do we know about Atkins?

ALICE: So Paul Atkins is a very seasoned and well respected securities lawyer here in Washington who also served as an SEC commissioner from 2002 to 2008, so very seasoned there. He's known to favor principles-based regulations that really provide the necessary guardrails to ensure investor protection. But at the same time, the rules that he wants to see are not so rigid that it stifles growth.

Now, it's expected that he would apply the same approach to crypto, so much less prescriptive rules and more principle-based regulations that would help foster innovation. But at the same time, one thing we've been missing here in Washington is regulatory clarity. So that would address a lot of the questions that people have on how to apply securities law to cryptocurrency.

Now, I will say the one thing about prior leadership at the SEC and the CFTC was that they were really unwilling and reluctant to issue regulations without Congress commenting or passing a bill on crypto first. But I think under this leadership that's coming in, financial regulators are much, much more likely to take action via new regulations without the need for congressional action. So stay tuned on that.

HEATHER: OK, really interesting. Jurrien, I'd love to bring you back in here for a moment because you follow crypto closely, of course. And we saw the price of Bitcoin surge since the election. What do you think the industry is expecting from this new administration?

JURRIEN: I think, you know—by the way, markets are always in a state of price discovery, and sometimes that price discovery happens quickly. And that causes very powerful trends, like we've seen in the stock market with AI, and like we saw in just in the last few months after the election with crypto. And then other times, just the market sits around waiting for new information. And I think Bitcoin has sort of gotten into that mode.

But I think that the general sense is, as Alice said, a little bit more clarity, and the sense that it's more friendly from a regulatory point of view. And for instance, one aspect of crypto are the stablecoins. And it's pretty low-hanging fruit in terms of regulating that, and we've been waiting for years for even that to happen.

So I think just getting some clarity. Investors want to know where the guardrails are. They don't want to get into trouble. And so I think there's just a sense that we'll get closer to that now. And there's one other element to this, which is that some folks in the crypto space think that Bitcoin might be included in as a reserve asset in the Treasuries Exchange Stability Fund. I'm a little bit more skeptical on that, But. Certainly, that is another part of the narrative playing out here.

HEATHER: OK. Something else to watch. Thanks, Jurrien. Let's talk about the Treasury nominee, Scott Bessent. He seems to have a little bit of a smoother path to confirmation, it would seem, than some of the president elect's nominations who have drawn criticism.

The Treasury Secretary has a wide range of influence over things that are financial and economic matters, including taxes and also tariff policies. So, Alice, can you talk about what we know about Bessent's positions so far?

ALICE: Yeah, absolutely. I mean, he obviously is one of the less controversial nominations, given his extensive experience and expertise in global financial markets and the economy. But he's really viewed as a fiscal hawk who supports reducing government spending and trying to bring deficits under control.

From a tax perspective, he supports an extension of the Tax Cuts and Jobs Act, arguing that tax revenues have been pretty consistent with historical levels, while government spending has grown and been very inefficient, suggesting that spending cuts and economic growth rather than revenue raisers are the way to balance the budget here.

Now, he also supports President-elect Trump's strategy to increase government energy production within the US to help spur economic growth. Now, in terms of tariffs, which I know there's been a lot talk about, he believes that they won't necessarily be inflationary if they're implemented on a phased-in approach while coupled with deregulation, because he's made the argument that President Trump's first-term tariffs didn't actually raise prices of affected goods, despite predictions back then that they would have an inflationary effect.

HEATHER: Yeah. Well, there is still so much uncertainty with tariffs right now. And of course, our job here is certainly not to speculate and discuss this topic too much until actual policy goes into effect. But Jurrien, just broadly speaking, can you talk about what you think investors should know about tariffs' potential to impact the economy? And what about those concerns that Alice just touched on that they could exacerbate inflation?

JURRIEN: Yeah, I mean, in theory, all else being equal—and of course, all else is never equal—tarrifs, it's pretty simple, right? If you raise the price of an imported good and you're a US company, you either have to let that increase cut into your profit margin, which would be bad for earnings, or you pass it along to consumers, which would be inflationary. And so that's where that narrative comes from.

But you know, there are a lot of nuances, right. So the dollar has been getting a lot stronger. So if you're an importer and the dollar is gaining strength against the currency of the country that you're importing from, maybe the tariff is offset by that. So it's not a linear, binary thing. And again how they're phased in, whether it's the art of the deal, there's too many unknowns. They're known unknowns, but they are unknowns.

HEATHER: There are plenty of nuances that would have to just work themselves out. One final appointee who could impact people's finances is the labor nominee. That's Republican Congresswoman Lori Chavez-DeRemer from Oregon.

She's considered to be one of the most labor-friendly Republicans in Washington, actually, which makes her sort of an unusual pick for the Trump administration, according to some, anyway. What can you tell us about her, Alice?

ALICE: That's right, Heather. I mean, she's an interesting pick, as a freshman member of Congress with a very limited legislative record. But what record she does have supports policies that make it easier for unions to organize, and that's how she's sort of gotten the support of labor unions, some of whom are still skeptical of incoming President-elect Trump.

Now, looking at the rest of her voting record, though, she does support many Republican policies, things like expanding HSAs and 529s and extending telehealth as an option for doctor's visits for certain specialties. Now, the one thing that a lot of people probably don't know is that the Department of Labor's largest agency is the Employment Training Administration, otherwise known as ETA, that has a number of programs available to help dislocated workers and to help others develop new skills.

And that's an area that she's really knowledgeable on, is job training and apprenticeships, helping people get back into the workforce. The one thing I'll note that DOL also has is an agency that oversees pensions, 401(k) plans, and other employer-related benefits. So she'll have quite a say in those policies if she's confirmed.

OK. And now speaking of labor, Jurrien, you know, one question that's looming is, how could the president-elect's proposed immigration policy impact the labor market, and also impact part of the Fed's dual mandate of maximum employment? You know, again, we don't want to speculate, but what are your initial thoughts on this?

JURRIEN: Yeah, I mean, with immigration being obviously a very divisive issue, the most non-political way to explain the potential impact of, let's say, deportations, is that when you look at the labor market, it was out of balance during COVID because people left the labor force. The borders were closed.

So the economy reopened faster than people could return to the workforce, and that created a very tight labor market. It created some wage inflation. And then those people did return. The borders did open, and the labor market is now in balance.

If you start removing people, whether they're here legally or illegally, presumably, it would create more tightness in the labor market and would be inflationary. So regardless of where you are on the spectrum, a very large-scale impact on immigration would find its way into the economy.

HEATHER: OK. And we've covered a lot of ground today, but finally, I just wanted to wrap the conversation with you, Alice, by asking you, what is the one top pocketbook issue that you're going to be watching for these first 100 days?

ALICE: Yeah, that's a great question. I think how quickly the Republican conference can come together to pass a budget will be a really good indicator of how likely we are to see the extension of the Tax Cuts and Jobs Act this year. There's a handful of fiscal hawks on the right, and it's all about government spending and deficits in 119th Congress, and getting that under control. So if they can come to an agreement quickly, then I think the sooner Americans can rest assured their tax rates won't go up next year.

HEATHER: Thank you, Alice. You covered so much ground today. We've got to wrap, but quickly, let's do our first Timmer's Take of 2025. Jurrien, what are you watching right now?

JURRIEN: We got CPI tomorrow. Very important, because inflation has not made a lot of progress, even though it's certainly better than it was a few years ago. And fourth-quarter earnings season starts literally right now.

HEATHER: OK, Yeah. It's been a week of inflation data. All right, we've got to leave it at that. But if you are looking for more insights into what the pros just like Alice and Yuri and are watching both in Washington and on Wall Street, be sure to check out Fidelity's 2025 investing outlook. And you can hover over the QR code that's on your screen right now.

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So on behalf of Jurrien Timmer and Alice Joe, I'm Heather Hegedus. We're going to be off next week for Martin Luther King Jr. Day. But we will see you back here the following week at our regular time. We're on Tuesdays at 2:00 Eastern. Take care, everybody.

[1]UPI, January 9, 2025: https://www.upi.com/Top_News/US/2025/01/09/fires-California-Los-Angeles/7271736441127/

[2]AP, December 4, 2024: https://apnews.com/article/sec-chair-atkins-gensler-investors-financial-markets-d1c544f1846071b33c75b9f2d d0c1ba4

[3]Bloomberg, December 6, 2024: https://www.bloomberg.com/features/2024-trump-cabinet-appointments/

[4]CNN, November 22, 2024: https://www.cnn.com/2024/11/22/politics/lori-chavez-deremer-labor-secretary-trump/index.html

[5]Paul Atkins Image: https://www.sec.gov/about/sec-commissioners/sec-historical-summary-chairmen-commissioners/paul-s-atkins

[6]Lori Chavez-Deremer Image: http://chavez-deremer.house.gov/media/photos/chavez-deremer-official-portrait

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