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TRANSCRIPT

SPEAKERS:

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Heather Hegedus: Hello, thanks so much for joining us for Market Sense. I am Heather Hegedus with Fidelity. All right, since we last met, we learned consumer inflation continues to improve but we also saw the credit ratings of ten banks here in the United States downgraded. So to talk about it all today, I'm excited to welcome back our very own Jurrien Timmer, our Director of Global Macro here at Fidelity. Also, Ashley Tran is with us once again today, she's a Florida based Vice President and Branch Leader at Fidelity. And she is going to be talking with us today about inflation and how it is or isn't affecting your ability to have some summer fun. All right, good afternoon to both of you on this summer afternoon. Thanks for being with us.

Ashley Tran: Thank you, Heather, happy to be back.

Jurrien Timmer: Great to see you, sorry I missed you guys for a couple of weeks there.

HEATHER: We missed you, Jurrien, for sure. And just a quick note to our viewers before we get started, I just want to remind everybody Market Sense is meant to help you make sense of the market, thus the name, but it's also meant to answer your money questions. So we want to hear from you, so if you watching us live right now, you can submit your questions for Jurrien and Ashley below the video, that's regardless of whether you're watching us on our website or on LinkedIn. And we might actually use your question on future Market Sense episodes. And we're actually going to be featuring one of our viewer's questions today. We want this to be a conversation, and you are part of that so we appreciate you weighing in.

We do have a fun conversation to get to today, I'm really excited about it. I want to start things off talking about inflation and where it's at and do another check here on it. You know on Thursday, the latest inflation report came out showing the Consumer Price Index rose less than expected, so that was good news. But then the PPI, which is a different inflation measure, came in hotter than expected right after that. So Jurrien, I would love to hear from you first about where you think this leaves us and where you think the Fed goes from here now?

JURRIEN: It's a great question. So the CPI is the Consumer Price Index, and the PPI is the Producer Price Index, so the PPI tends to be more commodity sensitive, and of course, oil prices and other commodities have been going up recently, so that's why the PPI is a little hotter right now than the CPI. But, you know, the good news is that inflation has come down; it was 9% a year ago in June, it's 3% now, so that is the CPI, the headline CPI. A lot of that, however, it came from declining commodity prices, which, of course, are an important inflation measure, but also from what we call base effects; right? So we measure inflation as a rate of change from a year ago; right? So as the latest index gets calculated or the rate of change does, you know, you add the latest data and you drop out the data from 12 months ago. And so, when inflation skyrockets, as it did last year to 9%, and then it starts to come off, it's relatively easy for it to moderate because of that base effect. So now we are reporting for July, and so that is now 13 months after the peak, and so that base effect is pretty much gone.

So it's going to be harder to continue to make improvement from here, and also from the perspective of the Fed, you know, the Fed doesn't really look so much at headline inflation just because it is very volatile. It includes, you know, food and energy. So the Fed tends to look at core measures, and its favorite measure is what we call the core PCE, and now even people are talking about the super core PCE that strips out housing cost just because there are very long lag times with housing. You think about signing a lease and then being in that lease for a year, for instance. And you know, so the challenge is that these core measures have come down, but they are only have come down from about 5% to 4%, and of course, the Fed's target is 2%. So I think the Fed is mostly done raising rates, and I think that's generally the conclusion in the markets. But that doesn't mean they are going to be cutting rates anytime soon, especially considering that inflation, even though it has improved, remains well above the Fed's comfort zone.

HEATHER: Okay, all right, I also want to talk to you quickly about on a macro level about the credit downgrade of those ten US banks. You know, this is a topic where we got a lot of viewer questions about last week during our live show. It was happening last week when we were actually recording this show. Jurrien, is there any concern about the downgrades impacting the chances of a soft landing? And for all of our viewers out there like myself who still vividly remember 2008 and the Great Recession, give us a little reassurance, if you would, about why it's so different this time around.

JURRIEN: Yes, it is. I mean, we are not in another 2008 financial crisis. There have been some issues with the banks, and of course, we heard about them back in March, actually. This is already almost six months ago, you know, Silicon Valley Bank, First Republic, Signature Bank, but, you know, the banking system is in far better shape now than it was during the financial crisis. Banks were over levered, right, so their balance sheets relative to their capital were enormous. And of course, the financial crisis led to a lot of regulation and, in some people's minds, too much regulation, but that's a conversation for another day. But the banks are much more regulated now, and their balance sheets are much smaller relative to how much capital they have. So you don't have that leverage issue that we had, you know, back then. And we don't really have the credit problems that we had back then. Remember, the housing crisis, you know, too many mortgages being underwritten. So banks are much tighter right now.

But ironically, the one thing that the banks were never really tested for this time around in the aftermath of the financial crisis back in '08 was owning too many long-dated bonds and what happens when interest rates rise. And of course, that's what's actually been going on here. The Fed has been raising rates a lot, bond yields have risen. The ten-year yield has gone from half a percent in 2020–21 to now over 4%. And that is being felt on banks' balance sheets. And that's, you know in part, what led to the troubles we had back in March with a few selected banks.

Now, it is a tale of two banks; right? So you have the smaller, regional banks, the community banks. They are feeling this a little bit more than the very large banks, the mega banks. And these downgrades kind of speak to that. But generally speaking, the banks remain in pretty good shape, but they are feeling the consequences of rising interest rates. And of course, that's completely in the control of—under the control of the Fed. And that's why, you know, all eyes are on a potential ending to the Fed tightening cycle.

HEATHER: All right, well we'll find out in September when the Fed meets again what happens. Ashley, I want to bring you in now, though. I would love to hear from you because you talk with customers every day. And inflation and fears of recession typically affect what we call "consumer discretionary spending," which is spending on nonessential items, things like taking vacations, you know, all the fun stuff in life, but not the necessities; right? So what are you hearing from your clients right now about what they've been up to this summer? Have they been spending money on trips and experiences?

ASHLEY: Yeah, great question, Heather, and you know, some people do think that vacation is a necessity, so it's all perspective there.

HEATHER: Yes, that's right.

ASHLEY: But what we have been hearing from clients is that they are still very interested in taking advantage of the summer to enjoy vacations and experiences, whether that's traveling or having a staycation at home or an experience like entertainment. So we definitely have seen an increase in folks planning or wanting to take a trip this summer now that most COVID restrictions are fully lifted. And there's been a little bit of help this year from lower gas prices, at least compared to what we had about a year ago.[3] And that has made things like road trips or, in some cases, airfare at least slightly cheaper. However, that's not true for everyone. So there are some surveys out there that show that not everyone has been embracing summer spending. In fact, about half of Americans said that at the beginning of the summer anyways, that they are still holding back on taking summer vacations due to financial concerns.[4] And things that we are hearing in the news, like you mentioned, with inflations, it can feel a little scary.

But another trend that we saw that was really interesting this summer was big concerts; right? Post pandemic, the big headliner concerts have been back. I think Taylor Swift has arguably been leading that, having the hottest ticket in town with her Eras tour. And there's been a lot in the news about how her Eras tour has helped stimulate the economy. And it was projected, I don't know if it just passed, to become the first tour to gross $1 billion in ticket sales. And yes, that's a billion with a "B."[5] So some of you might be thinking why do I care? I don't think we have too many 15-year-old Swifties that watch the show.

HEATHER: No, I don't think so, yeah.

ASHLEY: Yeah, but there really is a big economic impact here. And in fact, the Federal Reserve even came out and said that the Taylor Swift tour is helping boost hotel revenue in particular in cities across the US. The Fed's Beige Book, which summarizes how the economy as a whole is doing, mentioned that Philadelphia had particularly been through a slow tourism recovery, but said May was the strongest month for hotel revenue there since the beginning of the pandemic and, in large part of that, it was because of an influx of guests into that city for the Taylor Swift tour. And in addition to Philly, Chicago, Swift's tour stopped there, and that helped set an all-time hotel record. There were more than 44,000 hotel rooms sold each night of her three-night concert there.[6] So we've really seen an influx into the economy due to her.

HEATHER: Yes, serious stuff. I mean this really is, you know, macroeconomics. There is a real part of this discussion that fits in with what Jurrien talks a lot about. So to your point, I read an article last week in The Wall Street Journal about all of this, about the Taylor Swift impact called "the summer of women flex their spending power," and it talked about, to your point, you know, this is not just limited to hotel rooms that a concert impacts. It also means consumers are spending money on merchandise and clothes for these concerts and all sorts of side expenses. So that's a huge, you know, factor that can't be discounted. And it's not just concerts too; right? Going to the movies is back this summer too; right, Ashley?

ASHLEY: Yeah, right, and we had seen a decline in that because of the pandemic and streaming. But the phrase Barbenheimer has recently become a pretty commonly recognized term in our vocabulary. And yes, when I say Barbenheimer, I am referencing the releases of the big box office pictures Barbie and the Oppenheimer movie. And if you have seen Barbie and Oppenheimer and you're watching us live, shoot us a line in the comment section below this line. But Barbie, which I went and saw on opening night, alone raked in $1 billion at the box office, sparking some hopes that a post-pandemic, and despite streaming services, going to the movies is back. In fact, Bank of America research report tracked a significant spike in cardholder spending money on entertainment the week that those two movies came out. And overall, Bank of America says it's card holders spent more money on entertainment compared to a year ago than any other category that was tracked.[7]

HEATHER: You see either of them, Ashley?

ASHLEY: I saw Barbie. Oppenheimer is on the list so I hope to see that soon.

HEATHER: Me too, they're both on my list. But we know that the consumer drives 70% of economic growth.[8] So we're not trying to say that Taylor Swift can single handedly, you know, be the reason that we avoid a recession, but maybe collectively when we talk about all of these factors, could that help—could that be enough, Jurrien, to execute a soft landing? What do you think about that? And by the way, have you seen either of those movies, too, Jurrien?

JURRIEN: I saw Oppenheimer. Barbie is high on the list; I think we are actually going to go see it tonight. And I do have one gripe with Barbie, and that is that I have a long tradition with my partner to wear matching outfits, which are often hot pink. And so now when we go and do—go out to dinner wearing what we've been wearing for years, people are calling us Ken & Barbie. And I'm like wait, we were way before that movie. And so anyways.

HEATHER: You are so ahead of the trend, you're so ahead of the curve, Jurrien. Just be flattered by it. But yeah, what do you think? Do you think that all these factors, you know could Taylor swift and Barbenheimer, and some of these other somewhat fluffy or softer spending items be enough to pull us out of a recession or avoid a recession, I should say?

JURRIEN: Well, as you mentioned, 70% of the economy is consumer spending, and the consumers are spending. And what the stats that Ashley mentioned show is that the consumer still has money to spend; right? So inflation has come down, so real wages are actually improving. So that means that people have more money in their pockets, and clearly, I think there maybe is a cultural trend here where people are starting to favor experiences over stuff, which I completely agree with. But ultimately, you know the soft landing scenario continues to play out even though we have this kind of, you know, harbinger of doom from the yield curve, which a lot of people are starting to wonder if that still has a signal.

But, you know, ultimately when you get a recession, and I am not calling for that, but I mean it's always a risk down the road, maybe in the next year or so. It comes from a few places, right, either the banks stop lending money because their balance sheets are at risk or what have you, and you mentioned the downgrades earlier, but I don't think that's a systemic problem for the banks yet, at least. And the other reason, the more likely reason, is that companies are laying off people. And then, you know, if people don't have jobs they're not going to spend money. And we are not seeing that either. So there really are no signs yet, other than at the margin, where things are maybe slowing, that the consumer is going to be less able to spend money. Because if you have a job and your wages are keeping track with inflation, as they are now, and you don't feel like you have a large risk of getting laid off, then probably you are going to keep spending money, and that's exactly what we are seeing this summer between Taylor Swift and Barbenheimer.

HEATHER: Okay, so it is possible, the "summer of spending" really is a thing. We coined that term ourselves here at Market Sense, but maybe it will catch on. We'd also love to hear from our viewers in the comments section right now about whether you have treated yourself to concerts or other experiences this summer, and if so, which ones. And I did ask Jurrien and Ashley before the show what they have been up to this summer, and Jurrien, you have been to a concert this summer. Actually, a couple, the same one; right?

JURRIEN: Well, yes, I don't go to Taylor Swift. It's perfectly fine, I like the music, but—

HEATHER: I am not surprised by that, Jurrien.

JURRIEN:—my musical tastes tend to lean a little more obscure, let's put it that way. And The Flaming Lips is my favorite band, and they put on an incredible show. Lots of pink, as you can see in the picture there, lots of neon. And I have already seen them twice this year. This was at the Kings Theatre in Brooklyn on June 8th. I saw them here in Santa Barbara in March, and I actually met the front man, Wayne Coyne, I met him on the street, and we ended up talking for like an hour.

HEATHER: What did you talk about? Did you talk about the economy?

JURRIEN: We had a little bit of a bromance going on, but I was on my bike and I saw him. I was like Wayne! I had to tell him the story about how important his music was at a pivotal time in my life about ten years ago. And we ended up having this great conversation, and that night in the show, he mentioned the conversation live in the show and then dedicated the next song to me. So it was like—

HEATHER: No! Did he say Jurrien Timmer? Did he say that on stage?

JURRIEN: No, but because I was on my bike, completely head to toe in Pink Floyd Dark Side of the Moon kit, so he said "Mr. Bicycle guy, it was great talking to you today." So anyway, but I am going to see them again in a few days on Friday in LA because I am picking up my son there who is flying in from Dublin so we can both go to Burning Man next week. So we're going to see—it will be a trifecta of Flaming Lips this year.

HEATHER: So yeah, you gone to The Flaming Lips three times, you've spent your hard earned money there. Ashley, I know that you've gone to a concert this summer too. But I am assuming you didn't get mentioned by name or by, you know, bicycle, on stage.

ASHLEY: I did not. My story is not as cool as yours, Jurrien. You were cool before cool was cool. But I did go to DC to go to the Beyonce concert and that was my first time in DC. So when we've been talking about discretionary spending, I have not been to Taylor Swift. I am a Swiftie but I haven't actually been able to get tickets. The demand for all of these concerts is so high that for concerts like Taylor Swift and Beyonce, the way that you get tickets initially is you are put in this lottery to be able to buy the tickets, and if you are lucky enough to be selected, then you are limited on what city you get to try and get them in, what tickets are even available. So my best friend was actually selected for the lottery and got DC, and we said hey, we were lucky enough to get tickets, we're going to DC. Let's make a weekend trip out of it, explore the city and the monuments at night. We got to see the capitol, the White House, and the concert, which was phenomenal. And for both Barbie and Beyonce, I went all out buying themed outfits, getting my hair done, so I am happy to help stimulate the economy and do my part when it comes to that.

HEATHER: You certainly were stimulating the economy. You flew there, you paid for a hotel room, you had to get your hair done.

ASHLEY: Oh yeah, it was packed too, everyone goes all out.

HEATHER: I'll bet, and the fact that these concerts are so expensive, you know, shows you the demand for them is so high and people are willing to pay whatever it takes to get a ticket, you know that's the huge part of this conversation too.

I wanted to get to a viewer question, though from last week's show, thanks again to everybody who sent in questions. Just a reminder, you can do that right now as we are talking, in the comments section under where you are watching us. Our viewer, John, wrote into us through LinkedIn and said—probably right asking Jurrien or Ashley this but saying: What is your projection of how inflation of Main Street impacts Wall Street across the second half of this year and next year given real inflation across food, gas, travel, et cetera?

Jurrien, can you take that? In other words, I think what John is saying is what does inflation mean for the stock market moving forward now?

JURRIEN: Yeah, it's a great question because it highlights kind of a divergence, if you will, between the inflation that we all see in our daily activity, you know, try to get a concert ticket, see how much that costs; right? And so between real life inflation and what the financial markets are predicting inflation will be; right? So if you think about the bond market, you have what we call nominal bonds, the 10 year treasury at 4.2%, for instance. But you also have inflation protected bonds that are priced in real yields. And when you subtract the real yield from the nominal yield in the treasury market, you get what is an implied inflation expectation from Wall Street. And Wall Street has been, throughout this whole inflation cycle, saying that inflation will come back down to about 2.25–2.5%, and it's going to stay there. And, you know, wouldn't that be great if that was actually true? And we don't know that it's not going to be true. But the market is saying inflation is a temporary phenomenon that's going to come back down, it's going to stay down, and that will allow the Fed to pivot and stop raising rates and then eventually start cutting them. And so—but that is definitely a different, I think, vibe than most of us will see when we go to the grocery store or a concert or on a trip or book a hotel room.

And so it's definitely a disconnect. And obviously, I think we can all hope for the markets to be right here, but you know, that inflation protected bond market has only been around for two decades, and those two decades have been a period of low and falling inflation. So it is an untested market in that sense, and it's something that I am sure we will be talking about, you know, in the coming months because we don't really know the answer yet.

HEATHER: Yeah, it is a huge disconnect. That's a really good way to put it, Jurrien, that real feel temperature I've talked about before, that sticker shock you are still feeling. But hopefully the market is right, as you said.

All right, fun conversation today. I appreciate, by the way, both of you sharing what you have been up to this summer. I am glad you are having a good one. Speaking of summer excursions, Jurrien, I know you are heading out to Burning Man next week in the Nevada desert. Have a safe trip. For those of who you don't know what Burning Man is, well, you'll have to tune in in September when Jurrien, I know you will be giving us a full report and low down of what happened there in the desert. So we're excited for you.

Good, all right, to our audience, one last call to reach out with questions. That feature is going to be turned off in a moment. I also want to let you know Fidelity has a lot of resources for you. So just scan the QR code on your screen or you can type in the URL there to be taken to Fidelity Viewpoints, where we have a team of financial professionals answering your personal financial and economic questions. You can sign up there to get our free weekly subscription sent straight to your inbox. It is a terrific educational resource, and it is free, which is the best part of it. As always, if you have questions about making a financial plan or staying on track, also keep in mind that Fidelity can help you. You can always call us or go online or download Fidelity's app to learn more.

I am Heather Hegedus, I hope you are having as great of a summer as we are, and we'll see you back here next week.

[1]CNBC 8/10/23 https://www.msn.com/en-us/money/markets/july-cpi-report-shows-inflation-gauge-rose-32-less-than-expected/ar-AA1f5wIb how's inflation gauge rose 3.2%, less than expected (msn.com)

[2]Fidelity 8/1/23 https://wwwxq1.fidelity.com/learning-center/trading-investing/how-long-will-the-next-recession-last

[3]AAA: https://gasprices.aaa.com/ Gas Prices and Table 1. Consumer Price Index for All Urban Consumers (CPI-U): U. S. city average, by expenditure category - 2023 M07 Results (bls.gov)

[4]Deloitte May 2023 Survey: https://www2.deloitte.com/us/en/insights/focus/transportation/2023-summer-travel-predictions.html

[5]Fortune via MSN 8/10/23 https://www.msn.com/en-us/music/news/taylor-swift-s-eras-tour-will-be-the-first-to-shatter-1-billion-in-ticket-sales-making-a-lot-of-people-richer-the-dollar-bill-should-have-her-face-on-it/ar-AA1f5ucO

[6]IUSA Today 7/14/23 https://www.usatoday.com/story/money/economy/2023/07/14/federal-reserve-taylor-swift-eras-tour-boosting-economy-hotels/70413533007/?trk=public_post_comment-text

[7]CNBC 8/10/23 https://www.cnn.com/2023/07/27/business/barbie-oppenheimer-movies-economy/index.html

[8]https://www.thebalancemoney.com/personal-consumption-expenditures-3306107#:~:text=Personal%20consumption%20drives%20almost%2070%25%20of%20economic%20output.,growth%2C%20making%20it%20a%20key%20component%20of%20GDP

[9]CNBC 8/10/23 https://www.cnbc.com/2023/08/10/cpi-inflation-july-2023-.html

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