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TRANSCRIPT

SPEAKERS:

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HEATHER HEGEDUS: Hi, everybody. Thank you so much for making the time to join us for another episode of *Market Sense*. I'm Heather Hegedus with Fidelity. It's a week of transition at the Federal Reserve. Jerome Powell's expected successor, Kevin Warsh, has been confirmed as Fed governor. He still has to go through the vote to become chair, although he is anticipated to be in place by the June Fed meeting. All of this as stocks pushed to record highs on the back of a stronger than expected jobs report and some pretty robust corporate earnings.

So to talk about what these latest headlines might mean for investors, we are joined today, as we often are, by Jurrien Timmer. He is Fidelity's Director of Global Macro. We are also thrilled today to be joined by Adam Kramer, who is a Fidelity portfolio manager here. He's the Lead Manager of the Fidelity Multi-Asset Income Fund. We've had Adam on the show before, but it's been a while. And today, he's going to be sharing with us four tangible, income generating ideas that investors might want to consider having on their radar. Thanks to both of you for joining us today. And, Adam, welcome back to the show.

ADAM KRAMER: Thank you. Great to be here, Heather.

JURRIEN TIMMER: Good to be here. And always a pleasure to be on the air with one of my heroes at Fidelity. So welcome, Adam.

HEATHER: All right. With that, Jurrien, I want to start with you. Today is Tuesday, May 12. So Fed leadership is expected to change as soon as tomorrow. And we will, of course, see it play out in financial news headlines over the next couple of days, Jurrien, no doubt. Wondering, first of all, from you, how much of a market impact could this change in Fed leadership have?

JURRIEN: For the short term, not much, because Kevin Warsh, obviously, will be on the Fed. He's taking Stephen Moran's spot and very likely will be the next chair. And, policy wise, there's not much that can really change right away. I mean, he has to get settled in. He needs to have a certain consensus about what needs to be done.

And, of course, recently the headlines have been stolen by the situation in the Middle East—the closure of the Strait of Hormuz and what that has done to oil prices. And we just had the CPI report come out this morning, and it was pretty hot. Core inflation, up 0.4%, headline inflation up 0.6% month-over-month. And so that is stealing the show right now.

Because when we started the year, the market was assuming that the Fed would continue to cut rates and that, especially under the new leadership—and, of course, at the beginning of the year, we didn't know who the new leader was going to be—but whoever it was going to be probably would be a proponent of lowering rates. And that obviously can't happen right now because inflation is not coming down. In fact, it's coming up. And so oil prices, of course, have something to do with that—a lot to do with that.

So there's not some pressing thing that the incoming Fed Chair would do that he now can't do, because, basically, the Fed is beholden to the economic data. And right now, there's not much they can do other than wait this out.

HEATHER: All right, Jurrien. Thanks so much for getting us caught up on the latest market news. I want to move on to Adam, because we have a lot to talk about today with Adam in terms of income investing in a market that is, to your point, Jurrien, moving very quickly.

So, Adam, you're in the trenches here. You and your team are looking for opportunities other investors may have overlooked. You call it items that might be mispriced. Can you talk about that and talk about if this recent volatility has made it harder to find income opportunities?

ADAM: Yeah. Heather, it's actually the opposite. The market tends to, rightly or wrongly, price in risk and rewards only to get adjusted the following year when the actual events occur. And it's really that feature of the market that creates a lot of opportunities for myself as a multi-asset income investor.

Now, if you look at the major US income oriented asset classes over multiple decades, half the time it's something other than investment grade bonds or stocks that's the best performing asset class. And the other half of the time, it's things like high yield bonds, floating rate debt, emerging market debt, real estate income, REITs, preferred stock, and convertible bonds, just to name a few. And what's interesting is that over multiple decades, the difference between the best and the worst performing asset class could be thousands of basis points of return. So this is really a very rich alpha environment.

And what's often worked for investors is to always be cognizant of what's happening in the world but to avoid making predictions. And by simply waiting for those opportunities to be created by the markets, a repeatable and duplicable process exists. And we could say that that's no matter what part of the economic cycle we're in. So, like you said, the past few months have offered a reminder that the markets often act first and ask questions later. But for nimble investors with deep research capabilities, that really isn't necessarily a problem. And with the flexibility to invest across the full spectrum of income-oriented asset classes, an investor can, essentially, do more with less, I like to say—in other words, try to achieve an equity like return with fewer equities, less volatility, better downside protection, and a premium yield.

HEATHER: OK. So you've set the stage for us here, Adam. And I'm sure you've certainly piqued folks' interest here, and my interest, personally. Can you talk about the four specific investing ideas you have for us today? And let's go through them one by one. Where have you seen value and income opportunities in this market right now?

ADAM: Yeah, I'd love to. So, first, I really like convertible bonds. And this is a market I've been involved with for my 26 years at Fidelity. In fact, it's been the secret sauce in my thinking, because it's allowed me to toggle the equity exposure in a very effective manner.

But let me take a moment to explain what a convertible bond is. It's a bond that pays interest quarterly. And it promises to pay you back at par at maturity. But where it's different from any other fixed income security is that the bond participates with the underlying stock of the company in varying degrees.

And what I mean by that is that when a convertible comes to the market, it will have the downside protection of a bond. But you get that additional principal return provided that the underlying stock moves higher. And that's the key feature, because it makes convertible bonds the only fixed income security in the world where you can double, triple, quintuple, or, as was the case in the past with a few handfuls of companies that used to issue convertible bonds, 10 to 15 times your money.

Now, I think we're in the golden age, I like to say, of the convertible bond market, meaning that we're going to continue to see a stream of new deals come to the markets. So you might ask, why is that? Well, close to one-third of the markets is going to mature in the next two years, which will likely create pent up demand for new deals to come to the markets. And when that happens, we've historically seen new companies, and industries, and themes that we otherwise wouldn't have predicted. Think about themes like space, and artificial intelligence, and adjacent robotic industries.

And, lastly, another reason why I like the market is that, unlike other fixed income asset classes, it's not trading at historically high valuations. That's a key point.

HEATHER: And I think also when you said, close to a third of the market is going to mature in the next two years, that's really exciting to see what new deals do come to the markets out of that. All right, number two on your list is preferred stocks.

So, like convertible bonds, like you just talked about, preferred stocks are also a hybrid security. They blend characteristics of both stocks and bonds. Can you talk about that and what you like about them?

ADAM: Yeah, let me define what a preferred stock is. It's like a bond in that it pays income quarterly. But, unlike bonds, the income is taxed advantageously as a dividend. And, now, preferred stocks are also junior in the capital structure to bonds. So they're not obligations of the company, which means that they have fewer protections than bonds under periods of stress.

Now, in the US, if you look at the preferred stock market, it's mostly limited to three industries—the US banks, utilities, and REITs. And they're longer dated securities. So there's more sensitivity to interest rates. And they generally trade at a more attractive yield than investment grade bonds. Today, while the preferred stocks are more attractive than investment grade corporates on the absolutes, the lower yield isn't high enough relative to the risk.

But—and this is the key "but"—if you dig a little deeper, I think there's a potential opportunity in preferred stock backed by Bitcoin, which is one of the biggest innovations in the fixed income markets over the last 26 years that I've been in the markets. And these type of preferred shares, which is also known as digital credits, have attractive yield levels in the low teen range, like 10% to 13%.

And generically, for every $1 of preferred, there might be $5 to $7 of Bitcoin on the balance sheet, which can offer strong downside protection. So you might also be surprised when I say that those low teen yields, they're tax deferred, because they're considered return on capital dividends or ROC dividends. And that's important, because to get an equivalent pre-tax yield, you'd need to search for distressed credits with bankruptcy risk.

So this is a great example, again, of that doing more with less that I was talking about, meaning doing more equity-like returns with fewer equities and with, potentially, big premium yields. And one last point, Heather—as we head into the second half of 2026 and 2027, the combination of headline inflation, exceeding short term rates, combined with a pragmatic Federal Reserve that isn't raising rates so far, has historically always been a good setup for Bitcoin. So, with that change at the Federal Reserve coming, it will be interesting to see what actually happens.

HEATHER: Yeah. On that point about the Fed, Adam, Jurrien just talked about the change of leadership at the Fed too. And for most bond investors, the Fed's actions certainly play a major role in investors' moves, right? So could you talk a little bit more about how much weight a Fed regime change could carry for the bond market? Could it be a disrupter?

ADAM: Yeah. Heather, I mentioned at the start of the interview, but I'll mention it again just because it's such a key point—the market tends to rightly or wrongly price in risk and rewards only to get adjusted the following year when the actual events occur. So, rather than making predictions about what the Fed policy might mean, I'm just going to wait for the market to react. And I'll assess if new investment opportunities get created. And this is how I do that more with less. But it also emphasizes that I really believe there's always an opportunity, no matter where we are in the business cycle.

HEATHER: Always an opportunity. OK, well, then, let's move on to your third income investing opportunity then, Adam—dividend stocks. So you have a very specific idea within this category, I know—oil tankers. You've said this was on your radar even before the conflict in the Middle East, and I imagine they are even more so now. Just to be totally candid, it does feel a little bit niche here. So what makes this a potentially attractive area for investors?

ADAM: Yeah. That's right. I've been following the industry since I started as an analyst nearly three decades ago. Now, an oil or product tanker is a ship to transport oil or refined products from point A to point B. And it used to be a boom bust industry, but now a few of these publicly traded companies are net debt free, they're free cash flow break below the cycle trough, and they also pay out 80% to 100% of their net income as dividends.

The industry has tailwinds that I think are going to continue to play out over the next one to two years also, and here they are. First, the recent developments in the world have made it clear that oil and refined product inventory levels are going to have to be rebuilt from depleted levels. In other words, it's possible for an inventory rebuild cycle to begin, the likes of which we haven't seen in a few decades.

Second, tankers are both traveling longer distances, and they're going to eventually have to be scrapped due to their age and environmental safety profile. So this means that there's momentum for supply to be taken out of the system over the next few years. And, of course, a peaceful outcome to many of these world conflicts could also be a catalyst for better supply dynamics. And on top of that, because of the better environment that I just described, the companies are starting to sign multi-year contracts, so their cash flows are becoming more predictable, which, in and of itself, could result in multiple expansion on the underlying stocks.

HEATHER: Really interesting idea. We'll certainly be watching that now that you've put that on my radar, Adam. OK, last but not least, your final idea is a newer one. These are all new ideas, but this one just came into focus just over the last few weeks. You say clipping coupons from Treasury bills in this current economic environment could be beneficial. What is the idea behind that?

ADAM: Yeah. So I've already spoken about three examples that are attractive. But, for the most part, two asset classes I find less attractive are high yield bonds and investment grade corporate bonds. They're trading quite rich relative to their history. So a lot of good news about the economy is already priced into those.

Now, it is possible that spreads can continue to improve or interest rates could drop. But at this point in the cycle, the risk reward trade off isn't there. So investors could benefit from sitting on the sidelines with a combination of cash, short term Treasury bills, and even longer dated US Treasury bonds. And this type of positioning allows investors like me to track the investment grade and high yield bond markets with less capital deployed in order to take advantage of the other investing ideas I talked about today.

Now, in a worst case scenario, where we experience a true liquidity driven sell-off, I think money would flow to the long bond, which could help to preserve capital in any portfolio. It's not that I think anything bad's going to happen, but the way I look at it, and I'm talking about high yield bonds and investment grade corporates here, they're basically coupon clippers plus or minus interest rate and credit spread moves. But, of course, if there was more bad news priced into these markets, I'd be able to pivot very quickly.

HEATHER: So, basically, that strategy is to keep the money on the sidelines, and then you are ready to go. You're ready to pivot quickly as things change.

ADAM: Right.

JURRIEN: Can I just interject here? Adam makes a good point. And we were talking earlier about what the Fed can or can't do. One thing we're kind of seeing right now, actually, in light of the conflict in Iran, but also just the CPI report, is that the market—not the Fed, but the market—is actually starting to price in, maybe, a rate hike.

And that's going to be an interesting dynamic. First of all, It supports what Adam said about just parking money on the short end. If the Fed can't cut rates, and maybe even there is some pressure to raise rates if the inflation stickiness continues, having some cash is not a bad place to be. And it would certainly provide a challenge, I think, for the incoming Fed leadership to not only not be able to execute on the game plan of cutting rates, but then have to fight market expectations that maybe they'd have to raise rates. And, politically, that might be a challenging situation to be in.

HEATHER: Something to certainly think about when it comes to, yeah, seeing what is next. So much right now, it feels like, is at a crossroads. Really fantastic point there, Jurrien. So, before we wrap up, Jurrien, we talked last week about how you're in your, what, 41st year here at Fidelity?

JURRIEN: Yeah. 31st. 41st in the industry.

HEATHER: OK. 41st in the industry. And Adam's been doing this for almost 30 years. Both of you have seen many market cycles. So, Adam, I'd love to get your thoughts right now on what Jurrien was just talking about. The market is reaching new highs, yet it's also volatile right now.

Can you put into context for us where you think we are because you have this wonderful historical perspective to share with us, and what kind of guidance you would also give to investors, similar to Jurrien saying, perhaps, cash isn't a bad place to be right now? So what guidance would you give to investors for navigating the current period that we find ourselves in?

ADAM: Yeah, that's a great question. And it best addresses the merits of a flexible approach to multi-asset income investing. I really want your viewers to walk away with the key point that I've addressed, which is that no matter where we are in the cycle, it's usually a great time to be a multi-asset income investor. Having a high enough level of current income to help dampen the down markets also helps. And, most importantly, having the proper matching of income relative to the amount of risk one is taking on in the bond and the equity markets is also so important.

Lastly, by having that flexibility to step into asset classes after they sold off and to avoid those that don't offer attractive risk rewards also helps through full cycles. And I'll leave you with one parting thought. There's always an opportunity, no matter where we are in the business cycle, because we're not wedded to any one asset class. And we're able to find those areas that are mispriced no matter what the market's doing. In other words, a good strategy for investors is to aim for where the puck is.

HEATHER: Aim for where the puck is. I love the hockey analogy there from one of our Canadian fund managers here. Thank you so much for really thoughtful and tactical ideas today for navigating today's market, Adam. Before we go, we have time for a quick Timmer's Take.

We talked about the Fed. We talked about inflation. Anything else on your mind? What are you going to be watching the rest of this week?

JURRIEN: Well, so earnings season has wrapped up. And it was a really good one. We have the summit with President Trump and Xi Jinping. That's going to be very important to watch. And then I'm looking, really, at, obviously, the Strait of Hormuz and how many ships are or aren't passing.

And then, probably most importantly right now, is the 10-year yield, which is, again, knocking on that door of 4.5%. And it's been doing that for a while. That's part of the left tail scenario. The right tail is the AI boom, exploding earnings, a bull market making new highs, but the left tail, the risk side is that the longer this oil shortage continues, the more it can feed into inflation. And we're seeing that with the CPI release today.

HEATHER: Right. Yeah. At the beginning of the year during our 2026 outlook, I had to think about it for a second, what year—the 2026 outlook, you said that geopolitics was one risk that you were going to be watching. And that was before the conflict in Iran started. And, certainly, we are now seeing this play out as we are also watching this market that is excited and continuing to reach these new highs.

Jurrien, Adam, thank you so much for this timely discussion today. Really appreciate your time during a very busy period for you. And if you want more investing insights from fantastic Fidelity portfolio managers just like Adam, we wanted to recommend that you bookmark this page that's on your screen—Fidelity.com/PMInsights. On behalf of Jurrien and Adam, I'm Heather Hegedus. We hope to see you back here next Tuesday right here at 2:00. Have a great rest of your week, everybody.

[1]Fidelity Viewpoints; March 31. 2026: www.fidelity.com/learning-center/trading-investing/income-investing-ideas

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