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TRANSCRIPT

SPEAKERS:

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HEATHER HEGEDUS: Hi there, everybody. Thank you so much for making the time today to join us for *Market Sense*. I'm Heather Hegedus with Fidelity. Let's talk about the market headlines. We've got a lot to talk about today. So the S&P rally last week—it crossed into positive territory year to date after that tariff relief news came in the form of that temporary truce between the US and China. Although that rally then was dampened by a downgrade in the US credit rating from Moody's and also from the largest drop in the leading economic index in two years. And that sent 30 year Treasury yields to 5%.

Also, US consumer sentiment has fallen to the second lowest level on record. That's according to the University of Michigan. The main reason cited was tariffs. So plenty of headlines to catch up on today. And to talk about what this might all mean for investors, we are joined as we often are by Jurrien Timmer. Of course, he's Fidelity's Director of Global Macro.

We are also thrilled to be joined today by Ben Kalkert. He's a Fidelity Vice President and an alternative investment strategist, and he's going to help us better understand alternative investments and how they can help diversify your portfolio. Thanks to both of you for making the time. I'm really excited for this conversation, Ben.

BEN KALKERT: Same here. Thank you so much for having me.

JURRIEN TIMMER: Yeah, great to see you both. And, indeed, a very timely conversation to have.

HEATHER: Very timely indeed. And let's get a quick check of the markets before we do get into that conversation, because we have a lot to talk about, as I said. It is Tuesday, May 20, Jurrien. So of course, the big story from the weekend was the US credit downgrade, as I mentioned, from Moody's over continued worries about increased government debt, Jurrien.

So Moody's was the last of the major credit rating agencies, though, to drop the US from its rating. So that announcement probably shouldn't have come as a huge surprise. But let's talk about what this might mean for the bigger picture, Jurrien. And, first of all, what could this mean for the bond market? And could we see further repercussions because of this downgrade down the road from here?

JURRIEN: Yes. Well, as you indicated, the news itself shouldn't have come as a surprise, because S&P and Fitch had already downgraded and Moody's had put the US on a credit watch already, I think, a year ago. And of course, we all know that we're on an unsustainable fiscal path, not only in the US, but around the world with deficit spending as far as the eye can see. So none of that really comes as a surprise.

But it was, I guess, just a rude refresher that with all the drama in the markets about tariffs and are they going to trigger a recession or a trade war, that once that storm seems to have finally passed or receded with that truce with China a few weeks ago—that this kind of reminds us, well, that isn't really the only issue that's out there.

The issue of interest rates and bond yields and deficits and who's going to buy all the treasuries. That is an issue that is not going away, and it has not going away. And it's a reminder that ultimately—and I hate to oversimplify things, but ultimately, the markets come down to earnings and interest rates. And so tariffs, of course, affect earnings. If companies have to eat the tariffs as the president mentioned recently, that comes out of profit margins.

Or they get passed on and they raise consumer prices. And that leads to inflation, which leads to higher interest rates. Deficit spending can also lead to higher interest rates. So at the end of the day, it's earnings and interest rates. And earnings were the main variable in recent weeks with all the tariff stuff going on. And maybe the pivot now comes back to the interest rate side. And I think, in that sense, the Moody's downgrade was a reminder that side of the story has not gone away.

HEATHER: When you mentioned that this is a reminder that tariffs aren't the only story here, does government debt, does fiscal spending have the potential to become an even bigger issue than even tariffs?

JURRIEN: So, where are we in the cycle for the stock market obviously remains a very big question. The market has roared back. So the S&P fell 21.5% to the lows, and is now up 23% from those lows. And, of course, 20% down is not offset by 20% up, because it comes from a lower level. But still, that's a remarkable v-shaped recovery that we have so far seen.

And so that tells you, I think, the power of the markets. So the policy side was pushing the agenda in a pretty aggressive direction. And that got the attention, obviously, of the markets in terms of the tariff story. And now that the policy side has backed off, at least temporarily—all of the relief we're seeing on the tariff side are just temporary truces, if you will, as you mentioned earlier. So who knows in 80 or 90 days whether we're going to have to go through this again.

But for now, the markets—they were staring over the abyss a little bit, and now they've retreated. And the earnings numbers are still OK. First quarter earnings season was very strong. The earnings estimates for the coming quarters have been reduced, but still point to positive growth. And so, if all we get is a slowdown in the economic growth trajectory and not a recession, then I think the market can deal with that. And so that seems to be what the market is voting on.

And the tech side, the Mag Seven certainly have come back to life as well. They're trading at a 35 PE, which is high, but it's not crazy high for those companies producing so much free cash flow and profit. So it remains a pretty constructive backdrop for the markets as a whole. And even with my 40 years in the business, I'm still impressed by how quickly the market can lurch from complacency to fear and back to complacency.

And it's a good reminder for the investors and customers watching this that the markets will always reprice faster than we can. And better not to get caught up in that, and just to take a step back, rebalance, make sure you're in the right portfolio, and go from there.

HEATHER: Yeah, there has been a lot of investor whiplash lately with this huge turnaround in the stock market again, last week, Jurrien. And you mentioned tech stocks, Mag Seven, back in the driver's seat again, powering this May rally. Do you think this could be a new bull market for tech?

JURRIEN: I think that if what we just saw was not the beginning of a bear market—and we don't know, but we're only 3% below the all time high. So we've had periods where the market declines 20%. And generally, people will call that a bear market. But in my view, a bear market requires not only a price decline but also a time element. So 2022, for instance—that was a 28% decline that took nine months. That is a bear market. There's no question about it.

A 20% decline in six weeks that is almost immediately fully recovered is like a bear scare. In 2018, we had one of those episodes. So if we end up at new highs from here, and we're not far from those, I would say that we're still in the old bull market, not in the new bull market, and that basically this was just a very close call, but nothing more.

HEATHER: All right. A bear scare. Jurrien, thank you so much. I love that term. Ben, I want to bring you in here because we have a lot to talk about, too, when it comes to alternative investments. So just to set the scene for everybody today—so in the past, these kinds of investments have only been offered to institutional investors or to select ultra high net worth investors who work with an advisor.

So what's different now is that now Fidelity is helping to enable greater access to liquid alts through structures that are available to a wider set of investors. So, first of all, can you explain what we are talking about when we're talking about alternative investments or alts? And how do they differ from traditional asset classes like equities and fixed income, Ben?

BEN: Happy to, Heather. So alts can generally be defined as investments that don't neatly fall in your traditional asset class categories like stocks, bonds, or cash. The term "alternative investments" can cover a broad range of different assets or investments. It can be private equity, private credit, real assets, digital assets, and then, of course, liquid alternatives. And each one of those can have unique characteristics that may allow the investor to one, grow their wealth, diversify their holdings, or manage their risk.

And, Heather, you're absolutely right. Historically, alternatives were available to high net worth investors. Large institutional investors. And they typically were offered in private funds, and they also had high investment minimums. But after the global financial crisis, or throughout the global financial crisis in 2008, there was a lot of demand for diversifying strategies.

And because of that increased demand and, of course, some other factors, we've seen a lot of innovation in that space over the last few years. And so now, more and more investors are able to consider alternatives as part of their portfolio, both in the public and private market. And now we've had many, many years, well over a decade, to see how these strategies act in different market environments, how they perform, and how we can use them.

HEATHER: So, in essence, financial institutions are democratizing this asset class. But could you explain a little bit further about the difference between private market alternatives and liquid alternatives that are now available to a wider range of investors?

BEN: Yes, of course. So private market alternatives can be intermittently liquid or illiquid, meaning that you could be subject to a lockup period where you cannot sell your investment, or you may not have access to your capital for a period of months or years. Now, in exchange for that illiquidity, private market alternatives typically offer an investor the potential for a higher rate of return, and that extra bit of return is known as the illiquidity premium.

And so that's one of the differences is that liquidity. So when you compare and contrast that to liquid alternatives, liquid alternatives invest in securities that trade in the public markets. They price daily, and they can be bought and sold readily by the investor at their discretion. So there's a little bit more flexibility there.

So there are a number of other differences. So one is the eligibility. Liquid alternatives are available to most investors, whereas private market alternatives can have a net worth or an income requirement. Another difference would be tax reporting. Liquid alternatives come with a standard 1099, whereas private market alternatives can trigger a schedule K-1, which comes with a little bit more complex tax filing process.

Another difference could be fee structure. So liquid alternatives tend to have lower fees than private market alternatives, which typically are offered in private funds and can also employ a little bit more complex investment strategies so they can also have higher fees. Of course, all of that very much depends on the type of fund and the type of strategy that we're talking about. And the last one that I'll point to is that private market alternatives tend to have higher minimums than liquid alternatives, which typically have very low minimums or no minimums at all.

HEATHER: So the difference is the access you have to your capital, eligibility, taxes, fee structure, minimum investment requirements. Let's go back to access for a minute though, Ben. Can you talk about how DIY investors can now browse for liquid alts inside their brokerage accounts? How does that work?

BEN: Yeah, absolutely. So liquid alternatives are offered in familiar investment vehicles like ETFs and mutual funds. And they invest in publicly-traded securities like stocks and bonds as well as commodities, currencies, derivatives. But unlike traditional mutual funds, liquid alternative funds can go long or short—the underlying investments. And so they may be able to generate positive returns in up or down markets and allow an investor to one, diversify their holdings. And two, manage their risk.

HEATHER: And we hit on this a little bit already when we were comparing and contrasting liquid alts with private market alts. But could you take a little bit more time now to go a little bit deeper on what some of the potential benefits are of having liquid alts in your portfolio?

BEN: Yes, happy to. So there are a number of benefits. I'll highlight four of them here. So the first one we already talked about a little bit, and that is that flexibility that liquid alternatives have. So they can go long or short an investment. They can use derivatives. They can also deploy leverage. So they can take on a variety of different risk return profiles, and so they can become return enhancers. And they can be complementary to your traditional assets in your portfolio.

Another benefit that I would highlight here is the structure. So as I mentioned, they're typically offered in ETFs and mutual funds. They price daily. It can be easily sold and bought at the investor's discretion. The next one that I would point to is transparency. These funds invest in publicly-traded securities, so they also are able to offer periodic and frequent updates on performance as well as the underlying holdings.

And then the last one that I'll point to is that liquid alternatives tend to be outcome-oriented. So, for example, hedged equity portfolios are portfolios that aim to offer equity exposure, but then seek to manage the volatility by using option overlay strategies. And where that can come in helpful—it may help an investor or give extra confidence to an investor to get invested or stay invested in equities to meet their objectives during those more volatile times.

I think successful investing is not about timing the market. I think successful investing is about building durable portfolios that can weather many different market and economic environments. And liquid alternative strategies like hedged equity may be able to help with that.

HEATHER: And we talk about that all the time here on *Market Sense,* so I'm glad you pointed that out, Ben. So it sounds like liquid alts can be more flexible. They can be bought and sold as you wish, at an investor's discretion. But we do want to, of course, always talk about the risks of any potential investment as well. So on the flip side, what are some of the risks when it comes to liquid alts?

BEN: Yeah, definitely want to talk about the considerations and the risks. And I'll highlight four here as well to keep it balanced. So the first one I'll touch on is investment risk. So like traditional investments, liquid alternatives are exposed to economic risk. They are exposed to price volatility as well. But because, unlike your traditional mutual funds, these funds can invest in—they can go long or short. They can invest in derivatives. They can use leverage. They may be more speculative.

Another consideration that I would point out here is the complexity. So some of these liquid alt funds employ pretty sophisticated investment strategies. And so it may just be a little bit more challenging to understand exactly how they work and how they may impact the overall portfolio.

The next one I would say is performance. Like any investment, any asset class, liquid alternatives can go through periods of under-performance. I think it's also important to keep in mind that investing does come with risk, and that the value of your position will fluctuate over time. And it's certainly possible to make money in liquid alternatives. But you can also lose money in liquid alternatives as well.

The last one that I'll highlight is the use of leverage. So leverage can enhance returns, but it can also amplify losses. But I think the bottom line is that you want to be aware and familiar with the individual risk characteristics of the fund that you're investing in. So I would say, review the prospectus carefully and then weigh those risks with your overall financial goals.

HEATHER: Yes, Sounds really sound judgment there, Ben. Jurrien, let's bring you back in here for a minute, because I always like to ask you how different kinds of asset classes might fit into somebody's portfolio. How in this current market environment do you see liquid alts fitting into an investor's portfolio?

JURRIEN: Again, as I said at the beginning, this is a very timely conversation to have because questions looming over the markets, again, with that interplay of tariffs and earnings and interest rates is—does the old 60/40 model still deliver the goods? So growing up in the markets, as probably most of us did in the '90s and 2000s, really, all you had to do was own some 60%, the S&P 500, and own some 40%, the US investment-grade benchmark. And that was all you needed. You got a 9% return with a 9% volatility, and that was the sweet spot.

Now with bonds having become positively correlated in recent years with stocks, they still are a viable asset class. They deliver a positive real yield. But if that correlation is no longer there, then maybe we have to paint this with a broader brush in terms of what goes in the 60/40. And again, alternatives—liquid alts and real assets—those might be a very nice complement to what otherwise would just be a bucket of bonds because they are generally uncorrelated. They're not necessarily negatively correlated, but they don't have strong positive correlations. And with cash—

HEATHER: Can you talk about what you mean by that, Jurrien, when you say they don't have negative or positive correlations?

JURRIEN: Yeah, so one of the benefits for bonds in recent years until 2022 was that bonds are like an insurance policy so that if there was a recession and earnings go down and that pushes the stock market down, the bond market would go up. So bond prices would go up, and that 40% would be a good buffer against the 60%.

But what we saw in 2022 was that bonds and stocks went down at the same time. Now, that doesn't mean that's going to happen again. And bonds did OK recently when stocks went down 20%. But still, having more assets in that bucket of insurance policies, if you will, is probably a good thing to consider. And these alts, again, they're not negatively correlated. They don't necessarily go up when the market goes down, but their movements are somewhat independent of the overall market. And that's a nice feature to have in a portfolio so that not everything is moving in the same direction at all times.

HEATHER: So liquid alts can provide some nice diversification. Also, Ben, what are some other ways that you find investors using these kinds of funds?

BEN: I think, Heather, in summary, I would say that liquid alternatives can help investors in three ways. So one, build your wealth. Two, diversify your holdings. And three, manage your risk. And there are many different liquid alternative funds out there, and each one of them may be able to help in one or more of those three areas.

And some funds are focused more on delivering an attractive absolute rate of return, while others are more focused on delivering that defensiveness that we highlighted here today. And it's important to understand what the objective is of the funds before you invest, and then align that objective with your objective, with your time horizon, and of course, with your risk tolerance.

HEATHER: Hey, Ben, thank you so much for taking the time to educate us on liquid alts today. We have a lot of DIY investors who watch and listen to our show, and I'm sure they were listening and taking notes and intrigued a little bit by this new offering. So thank you for that.

We're at the 20 minute mark. But, Jurrien, we have time for a quick "Timmer's Take," which is when Jurrien gives us his take on what he's watching that we might want to watch alongside him. And we had a lot of data points coming in already this past week, as we mentioned, Jurrien. But what are you watching going forward from here now?

JURRIEN: I would say the main thing is the 10-year Treasury yield. It's around 4.5%. 30 year yield is at 5%. Interest rates matter, and I suspect they're going to be driving the bus here for a little bit while the tariff stuff has been put on hold.

HEATHER: Watch those interest rates now. All right, thank you so much, Jurrien. And thank you again, Ben. As always, we like to leave our audience with a further resource to help you further your education on this week's topic. So right now, you can scan over the QR code on your screen right there. Take you to a page with more information about Fidelity's liquid alts offering. Or if you're listening to us as a podcast, just write this down. Fidelity.com/liquidalternatives.

Great conversation today, gentlemen. Again, thank you for making the time. Quick programming note. We're off next week because of Memorial Day weekend. However, we'll be coming back to you two weeks today with our midyear outlook episode. We are really excited about this. We only do these in-person sit down episodes twice a year. Jurrien's going to be there. I hope you'll be there, too. That's coming up on June 3 at our regular time of Tuesdays at 2:00 Eastern. Until then, take care, everybody.

[1]Bloomberg, May 19, 2025: www.bloomberg.com/news/articles/2025-05-19/long-dated-treasuries-fall-as-moody-s-sharpens-focus-on-us-debt?srnd=homepage-americas

[2]https://www.conference-board.org/topics/us-leading-indicators

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