Fidelity Viewpoints®: Market Sense

Week 131, February 14, 2023

TRANSCRIPT

SPEAKERS:

Jim Armstrong Jurrien Timmer Leanna Devinney

Jim Armstrong: Hey, there; thanks for joining us for *Market Sense*. I'm Jim Armstrong with Fidelity. It is Valentine's Day. This year Americans were expected to spend nearly $26 billion[1], that's billion with a B, on Valentine's gifts for their special someone. Here at *Market Sense*, however, we feel there is no better way to say I love you than with getting on the same financial page. So that's our goal today, of course, not just to bring you the latest insights on the markets and the economy, but we also want to help you navigate what could be lasting ways to show somebody you care with financial acts of love.

I should point out, of course, the strategies we'll review and things we talk about today will be every bit as relevant to single people, of course, as well. To get our big markets picture, we'll speak with Jurrien Timmer as we often do, he is Fidelity's Director of Global Macro. And to get insight on how couples can build their finances together with insights for single people as well, we'll talk to Leanna Devinney, she is a financial planner and a Massachusetts branch based leader. Welcome to both of you.

Leanna Devinney: Thank you, happy Valentine's Day.

Jurrien Timmer: Yeah, happy V-day.

JIM: Is there a little bit of red in Jurrien's shirt? I think that the closest any of the three of came.

LEANNA: I have a love cup here.

JIM: That counts, that definitely counts. Jurrien, let's start with you. It is, of course, the 14th of February, Valentine's Day. At the start of the year, you mentioned your thought for 2023 could be that the markets would move sideways, kind of in a choppy fashion. However, you know, six or so weeks in, today notwithstanding, the markets have been sort of a steady march upward. Has your outlook for the year changed at all based on the last handful of weeks?

JURRIEN: It has not. But certainly, January was very strong and it was in many ways the polar opposite of last year. So everything that went down a lot last year went up a lot in January. And so, the markets I think are maybe somewhat declaring victory that the worst is over and I would agree with that. You know, it wouldn't surprise me at all that the lows that were created last October, you know, will be the lows for the cycle and, of course, a lot of bad news was priced in last year. You know, the market went down 28% from its best point to its worst point, the PE ratio, which I think is actually a better metric, went down about a third which is about what the average bear market produces. You know, with the caveat there is no such thing as an average bear market.

But, you know, we're not completely out of the woods yet because now we're starting to see that earnings are starting to fall and we'll talk about that a little bit later. But at the same time, you know, inflation certainly has rolled over. We have the CPI report, you know, this morning, and it was okay, but it was not – the inflation rate is not falling at the same rate that it was over the last, you know, six to nine months or so, but still, the inflation outlook is improving. But I think that the big head scratcher is that, you know, the Fed has now raised rates by 4.5% in just a span of a year, and by many accounts the economy is still chugging along pretty well. You look at the labor market, right, so two Fridays ago we had the employment report, which was of course a very important gage of how the economy is doing. And the jobs market is still very strong which, of course, is great news, right? I mean we want people to have jobs, and good jobs, and there are still two job openings for every job seeker. But I think it concerns the Fed a little bit because there is still a lot of tightness in the labor market, and wage inflation is a component that has the risk of becoming more sticky in terms of the overall inflation dynamic.

So in the span of the last couple of weeks, the expectation for how high the Fed will go with interest rates has risen from 4 and 7/8th to about, you know, 5.2. And it is not a huge difference, but it is a difference, and the speed at which the Fed is expected to lower rates after it is done raising them, is getting kind of pushed out. So the Fed has been saying this all along, it has been saying listen, you people in the market, you have been way too optimistic on how quickly we're going to drop rates once we are finished raising them. And the Fed is kind of winning this battle a little bit in terms of saying, look, we're going to stay higher for longer and that's something that needs to be, you know, discounted into the market.

So my sense remains that after a very big down year last year that, you know, 2023 is not going to be a terrible year, I don't think we'll go to new lows or anything like that. But I do think it is a year where we're going to churn, where, you know, the bulls had the upper hand in January, the bears may have the upper hand in March or something like that. But overall, it is a year where we kind of try to find a base and then from there we can go back up.

JIM: It feels like what's behind a lot of the questions we get is, you know, to visualize it, it's a hill to climb. Have we reached the top of the hill yet? Can we see the light at the end of the tunnel? Whatever your analogy sort of is or are we at the place where things can only get better or do they still have to get a little bit worse before they improve?

JURRIEN: That's the $64,000 question. So the market thinks that we're that we can at least see the top of the hill, right? So the market always anticipates these things, so the market doesn't wait until we get to the top of the hill, but it starts to turn when we can see the top of the hill. And the market thinks we have seen the top of the hill. So the market thinks the Fed is almost done, whether it is another quarter point or another half point, you know, it doesn't matter so much. And the market at the same time thinks that there's visibility on the economy that the Fed will achieve the so called soft landing and that earnings are, you know they have inflected, they are starting to come down, but they won't come down a lot.

So the question is, is the market right at thinking that, and, you know the market, of course, is – tends to be more right than wrong because it's trillions of dollars of investment, wealth, trying to anticipate the future. So it's – the market is much smarter than all of us are. But that doesn't mean that the market is always right, and the market seems to be kind of priced for a perfection year. And that's why I don't think this is yet the start of a whole new bull market cycle that will take us to new highs, you know, in this year. I think that scenario is still out there. So I think right now the market may have more disappointments than positives to prices in the months ahead.

JIM: Okay, thank you for that. And we will follow up in just a couple of minutes on earning season which you referenced in that earlier answer. But first, Leanna, let's talk about Valentine's Day, or at least money and relationships. Which we talked a little bit before the *Market Sense* show started, and mentioning that a lot of what Leanna will talk about are about the tensions that can arise. It is Valentine's Day but like if we're honest: money, finances, budget, spending, those can be the source of a lot of arguments inside a relationship.

LEANNA: Yes, it can. So not totally a loving Valentine's Day theme, but according to Fidelity's most recent study that we do on couples and money, it came back that 44% of partners say that they argue or disagree about money, at least occasionally.[3] So we were joking saying, like, we kind of feel it must be more than that but you can see on the screen here, these are the related disagreements about money, where they stem from. So it could be when you plan to retire, how much savings is needed, if you're a saver or spender, so a lot of different themes out there.

But I will also attest, just from working with one on one with clients for a good amount of time and hearing the conversations my team has with couples and families, these are very normal and common conversations that you may disagree on. So if you're up on the screen, you're not alone. What's not up here though, that I do see very often, is that a lot of times one party in a partnership will take a backseat to financial planning. And this is something I'm very passionate about because we often learn that we need to now take the reins of finances and money when something tragic may happen, if it is death, if it is sickness or, you know, if well may be a divorce may happen. So it's really important that you have both parties involved in the finances.

JIM: At the risk of having you put on a couple's therapist hat, you must still have to – and your team – when you sit and talk with people, who maybe are not communicating super well about finances. It's certainly within your lane, right, to offer some tips and strategies to be better communicators. What do you tell folks if there is that mismatch?

LEANNA: Yes, so I'd say communication is key. It is really important to make sure that you're both on the same page. You may not agree on everything, but you want to get aligned out there, like what your goals are, what your concerns are. So I often see and hear that many times when couples and families, they get on the same page, it's when they're sitting down with a financial planner. It is an even playing field or having that third party there. So it is a great time to hear out loud, you know, what are our goals, what are our concerns, what is our whole financial picture look like? And so often financial advisors become more facilitators of the conversation. I'd say in the beginning meetings, your financial advisor should do a lot of listening and so that you're doing the talking and getting on the same page, understanding things like what's coming in, what's going out.

Many have goals to pay down debt so we have to understand what your essential expenses are, and if you're not talking about it and all of a sudden coming home saying stop the spending here, obviously it could be a tense conversation. So just getting everything out there, it then allows you to plan for other goals. You know, talking about be debt is never fun, but you can talk about things like retirement, what are our long term goals look like, maybe it is sending a kid to college, buying that second home. So these conversations are really key, and then they become fruitful and it actually can be less stressful when you have the goals and plan in place.

JIM: So those feel like some really good examples about long-term planning, right? Leanna, you mentioned retirement or long-term goals. But I've got to imagine you need that same level of cooperation when you are thinking about more immediate term planning. Say you've got a brokerage account or something like that, a portfolio that, you know you might be struggling to figure out how to diversify within it. There's some collaboration that needs to happen there too.

LEANNA: Absolutely, so same advice, communication is key but it's also really helpful to get to know yourself and your partner, as an investor, so that's really important. It doesn't mean that you'll always agree on each other as an investor, things like risk tolerance or your comfort in the markets may be different. But the communication around what your goals are and then building an investment plan to reach those goals is really important. So we do an exercise with clients where we collaborate and we take a look after going through analysis, viewing your holistic wealth. We assign different roles and responsibilities for the wealth that you have so you'll have an emergency fund but maybe a part of it is having protection in your plan, maybe it's market protection or protection against income. Then there may be another category for growth, diversified portfolio to help keep pace with inflation. But we split up those in different buckets and majority of the time, spouses will give polar opposite answers or they disagree completely on what should be in those buckets. And again, it's okay, it's a great way to either get on the same page, maybe need a compromise, or really just open up the conversation around risk and reward. So it's really helpful and again I know we are catering to couples but this is also really important exercise if your single or even just looking at families as well. Understanding you as in investor then allows you to build that customized diversified portfolio for the goals that you have.

JURRIEN: And you know, the conversation, it can be a uniting conversation, right? It doesn't have to be something that divides because you're solving for your future together. And yeah, I would just add that obviously we're talking about couples and Valentine's Day but it can be to other members of the family as well, right? I mean I'm having conversations with my 26 year old daughter who is a nurse and she is saving for retirement and she is doing the travel nursing right now which means she'll make a lot of money for three months and then she'll be off for a month or two. And so there is a whole cash flow management, you know, side to that. And so, you know, it can be a family wide conversation even though we're having this talk on Valentine's Day.

JIM: No, that's definitely true. And Leanna, one quick follow up for you, another thing that we were talking about before this show went live today, this idea that you and your team will often when working with a couple, no matter the dynamic of the couple, somebody is the driver, right? Whether it is two men, two women, a man and a woman, when somebody sort of takes the lead? That doesn't necessarily have to be a bad thing in and of itself as long as there is that communication. Someone may like it more than someone else, but the other person can't be left in the dark.

LEANNA: Yes, someone typically takes more of the reins but it doesn't mean that we either turn a blind eye, or we don't want to be involved or we say they do that.

JIM: Yeah.

LEANNA: Again, like I said in the beginning, unfortunately what we can see like life happens and you don't want to be left alone to your own devices when you haven't ever been part of it before. And when you're planning together you both have skin in the game or again, family conversation, like you're both vested in the goals that you have and that comes with a sense of ownership, pride, and then again, the want to get to the goals that you have. So I would say absolutely, someone always may take the reins but it is really important to be involved and ask those questions and be part of it.

JIM: Yeah, love Jurrien's idea of it as a relationship builder, that's pretty cool.

JURRIEN: I was going to add, we all know that financial planning can be to a lot of people so overwhelming.

JIM: Yeah.

JURRIEN: That we kind of stick our head in the sand and we don't want to deal with it until often it is too late. In a relationship where one person is more interested in the topic or more versed in the topic than the other. You must play a big role, Leanna, in terms of facilitating the educational parts so that the person who is less involved will become more engaged and not kind of say I'm just going to, like, let you do it all because I don't – it is too intimidating for me.

LEANNA: Yeah, exactly, it can be stressful. And naturally in our industry we can speak a lot of jargon and a great financial advisor is spending time educating on the options you have and making sure that you're feeling well informed in the decisions that you make. So education is a key part of that.

JIM: So speaking of which, let's get a little bit smarter when it comes to education about what's happening in the markets right now because Jurrien always talks about the health of corporate earnings, right? When companies tell us how they did the previous three months, it's a great sense or can be a great sense of the future. So what do we know about this current earning season, Jurrien?

JURRIEN: Yeah, and just to back up a moment, so 2021 was the year where valuations kind of went too high, right? So the PE on the stock market went too high, the yield on the bond market went too low, and that had to do with all the monetary stimulus that came after COVID. You know, what the Fed did with zero rates and all of the balance sheet expansion they did, it created a little bit of an asset bubble across all assets. 2022 was the year where that bubble got deflated basically, right, valuations went way down on both the 60 side, the stock side; the 40 side, the bond side. And 2023 for me has always been the year where the question is do the earnings hold up, right? So 2022 was about rates when the Fed raises rates, if you think about it this way, the Fed raises rates, it lowers the present value of cash flows, whether it is on bonds or on stocks and that's what happened in '22.

The market seems to be priced for a soft landing in earnings and they may very well be right. And the market, you know, always looks ahead, right? So price doesn't always do what we think it should do based on what we're seeing on the ground in terms of the economy, earnings. We saw that during COVID very much, market's always a step ahead. And it can do that, it can rally while earnings are falling, which is essentially what's happening right now, as long as the liquidity environment becomes more supportive which means the Fed is easing. What we're seeing right now though, it is that earnings, you know, they're okay, like first quarter earnings season is now about three quarters along. About 350 companies have reported, 70% have beaten estimates, which is fairly typical by about an average of 1.5%,[4] which is good, right? It is positive, but it is not as positive as we have seen in past quarters.

And when you look at the guidance for the coming quarters, you can see that it's coming down. So my guess is based on historical trends of how earnings estimates evolve over time is that earnings will be down this year by 5 to 10%. And you know, the market can move past that, like, that's not a huge earnings decline. But it can only move past it if the monetary side becomes more supportive, and that would require the Fed to go, like, we know the Fed will go to 5% or so, but it would need to then reverse course and go back down. And all of that is priced into the market, and I don't know if the market is going to get everything it wants in the timeframe that it wants. So I think that is kind of the big variable for 2023 and that's why I don't think we're in the start of a new bull market. We may have seen the lows, but that doesn't mean that the next bull market has begun. That's why my view that we're going to have a trading range, I think basically makes sense.

Because the Fed I think will be done when we get to 5%, you know, give or take. But I think that the Fed may end up staying there longer than what the market expects. And so, if the market is going to look past an earnings decline, it needs to have that liquidity side supporting it and we may have a period this year where we have neither. Where earnings are falling, not a lot but falling, while the Fed is still remaining in a restrictive mode. I think that is the dynamic that the market is not entirely ready for but that may come. So, you know, for the average investor, it doesn't mean sell everything or it doesn't mean you buy everything, but I think patience, just like we need in relationships, could be the order of the day for 2023.

JIM: Oh, how do I follow that, that was perfect. That was great, that you, Jurrien. Thank you for setting us up for what I feel is probably several months of *Market Sense* discussions as we watch that delicate dynamic play out. And as always, if you've got questions about making you personal financial plan, figuring out how it works with somebody else, a partner or someone else in your family, staying on track with plans you've created a while ago, what ever the situation, give us a call. Fidelity can help, go online, visit our website, download our app, figure things out on a mobile device. Lots of way for you to continue to learn more and to get your question answered.

Jurrien and Leanna, thank you again for making time to be with us today and for everybody watching, thank you as well. Happy Valentine's Day and we'll see you next week.

[1] Jessica Dickler. "Valentine's Day spending is set to jump, even if it means more credit card debt". CNBC.com. February 7, 2023.
[2] Jeff Cox. "Jobs report shows increase of 517,000 in January, crushing estimates, as unemployment rate hit 53-year low." CNBC.com. February 3, 2023.
[3] "2021 Couples & Money Study". Fidelity Investments. 2021.
[4] Jurrien Timmer's WAAR Report, Earnings & Valuation section.

The 2021 Fidelity Investments Couples & Money Study analyzes retirement and financial expectations and preparedness among 1,713 couples (3,426 individuals).

Information presented herein is for discussion and illustrative purposes only and is not a recommendation or an offer or solicitation to buy or sell any securities. Views expressed are as of the date indicated, based on the information available at that time, and may change based on market and other conditions. Unless otherwise noted, the opinions provided are those of the speakers and not necessarily those of Fidelity Investments or its affiliates. Fidelity does not assume any duty to update any of the information.

This podcast is intended for U.S. persons only and is not a solicitation for any Fidelity product or service.

To the extent any investment information in this material is deemed to be a recommendation, it is not meant to be impartial investment advice or advice in a fiduciary capacity and is not intended to be used as a primary basis for you or your clients' investment decisions. Fidelity and its representatives may have a conflict of interest in the products or services mentioned in this material because they have a financial interest in them and receive compensation, directly or indirectly, in connection with the management, distribution, or servicing of these products or services, including Fidelity funds, certain third-party funds and products, and certain investment services.

Investing involves risk, including risk of loss.

You cannot invest directly in an index.

Diversification and/or asset allocation do not ensure a profit or protect against loss.

Stock markets are volatile and can fluctuate significantly in response to company, industry, political, regulatory, market, or economic developments. Investing in stock involves risks, including the loss of principal.

In general, the bond market is volatile, and fixed income securities carry interest rate risk. (As interest rates rise, bond prices usually fall, and vice versa. This effect is usually more pronounced for longer-term securities). Any fixed-income security sold or redeemed prior to maturity may be subject to loss.

Dollar-cost averaging does not assure a profit or protect against loss in declining markets. For the strategy to be effective, you must continue to purchase shares in both market ups and downs.

Fidelity Wealth Services provides non-discretionary financial planning and discretionary investment management through one or more Portfolio Advisory Services accounts for a fee.

Advisory services offered by Fidelity Personal and Workplace Advisors LLC (FPWA), a registered investment adviser. Discretionary portfolio management services provided by Strategic Advisers LLC (Strategic Advisers), a registered investment adviser. Brokerage services provided by Fidelity Brokerage Services LLC (FBS), and custodial and related services provided by National Financial Services LLC (NFS), each a member NYSE and SIPC. FPWA, FBS, and NFS are Fidelity Investments companies.

Fidelity does not provide legal or tax advice. The information herein is general and educational in nature and should not be considered legal or tax advice. Tax laws and regulations are complex and subject to change, which can materially impact investment results. Fidelity cannot guarantee that the information herein is accurate, complete, or timely. Fidelity makes no warranties with regard to such information or results obtained by its use and disclaims any liability arising out of your use of, or any tax position taken in reliance on, such information. Consult an attorney or tax professional regarding your specific situation.

Personal and workplace investment products are provided by Fidelity Brokerage Services LLC, Member NYSE, SIPC, 900 Salem Street, Smithfield, RI 02917

923295.210.0