Fidelity Viewpoints®: Market Sense

Week 165 July 15, 2025

TRANSCRIPT

SPEAKERS:

Heather Hegedus   Jurrien Timmer   Naveen Malwal

HEATHER HEGEDUS: Hi there, everybody. Thank you so much for making the time today to join us for another episode of *Market Sense*. I'm Heather Hegedus with Fidelity.

So we got a new inflation report this morning that found inflation is in line with expectations. But it's still hotter right now. It was hotter in June than it was the previous month in May.

Once again though, tariffs continue to dominate the headlines right now. And of course, that is leading to more market uncertainty. Stocks alternated yesterday between small gains and losses as President Trump escalated tariff threats against both the EU and Mexico.

Many are waiting to see, though, what happens on August 1. That's the new date on the calendar now, when the deadline is supposed to happen that was imposed by the administration. Keep in mind, though, the S&P continues to reach new all-time highs. We also have banks kicking off earnings season today. And Bitcoin, the crypto bellwether, reached new highs.

So as usual, no shortage of events to talk about. And we are thrilled as always, to be joined by Jurrien Timmer, who is Fidelity's Director of Global Macro. And also, what we really want to focus on today are some of the biggest takeaways from the second quarter. We're going to talk about what happened, what the learnings were, and how we can use that information to set us up for success in quarter 3 and beyond as we take a look at the back half of the year.

So to give us his team's quarterly report, we are excited today to have Naveen Malwal with us. He is a CFA charterholder and an institutional portfolio manager, and his team manages millions of clients' accounts here at Fidelity. Thanks to both of you for joining us. I always look forward to these quarterly reports,

NAVEEN MALWAL: Great. Good to be here.

JURRIEN TIMMER: Yeah, nice to be back after a couple of weeks of travels.

HEATHER: Good to see you. Hope you had safe travels, Jurrien. You're looking great as always. And today is Tuesday, July 15, and the markets have been relatively quiet, I think you could say, Jurrien, except for the Mag Seven and Bitcoin, what you might expect for July.

But, Jurrien, we haven't seen you for a couple of weeks. As you mentioned, you've been traveling. So I was hoping, first of all, you could just talk about where things stand right now and also talk about that CPI report that I mentioned, the inflation report that I just mentioned at the beginning of the show that showed inflation has picked up again.

Is inflation still above the Fed's comfort level, and what might this mean for finally seeing a rate cut this year from the Fed? Of course, we haven't had any rate cuts this year, Jurrien. So how do we think about interest rates as we prepare for the second half of the year?

JURRIEN: So yeah, I think it's been two weeks since I've been on, and I was in Europe traveling, doing a roadshow for our institutional clients over there. And as you might imagine, the vibe had a lot to do with about tariffs and a potential new world order and things like that. But I'm back, five countries in two weeks with one carry-on. So that should earn me a prize of some sort.

HEATHER: Yeah, that is no small feat there, Jurrien.

JURRIEN: But yeah. So the market has been obviously strong, the stock market. And the One Big Beautiful Bill obviously was passed since we last chatted. And that certainly promised to add some fiscal stimulus again. So we had after COVID or during COVID, we had about a $5 trillion fiscal program. And now we have the second $5 trillion fiscal program. And before you know it, this adds up to a fair amount of money.

And so that fiscal impulse, if you will, is, of course, positive for earnings. The question is, is it also going to impact inflation? And to what degree might it impact interest rates? And so as always, we're very focused on not only the Federal Reserve and which, of course, is very much driven by both inflation and economic growth. That's the twin mandate.

And as you mentioned, the CPI came out this morning. Year over year change is about 2.9, 2.7. So better than it has been. But prices are just rising more slowly than they were before. So they are still rising faster than the Fed would like to see. And at the same time, we have the employment report just a week ago that showed the unemployment rate going back down to 4.1, which is below what is considered the sustainable full employment rate, which is about 4.3.

So on both metrics, there isn't really that much justification for the Fed to cut, maybe a little bit, maybe a couple of times. It's maybe moderately or modestly restrictive. But there certainly is no room to do more than maybe two or three rate cuts in the coming 12 months or so.

So I think the Fed is on hold. I think the Fed is basically doing the right thing. And at the same time—so we're looking at the tariffs, of course, which could depress earnings juxtaposed against the Big Beautiful Bill, which could lift earnings.

So you can see how the crosscurrents there could be fighting each other. And earnings season is now underway. And so we're going to learn more in the next couple of weeks about what the impact has been so far.

HEATHER: Well, Naveen, let's jump into our discussion about the outlook for the third quarter. Now as Jurrien said, so far, markets seem to be shrugging off tariff uncertainty for the most part. We haven't seen the level of volatility that we saw in April certainly when the tariffs were first announced.

So how do you see this all playing out? Do you think the S&P can continue to reach new all-time highs as we finish out the back half of the year?

NAVEEN: It's been an eventful year, for sure. You think about going back to April when we had the first tariff announcements. We saw a big spike in market volatility and news headlines, and policy uncertainty was a buzzword.

So we're not sure what's going to happen with policy, tariff policy, other policies. And those tend to go hand in hand. We typically see the market become more volatile when people are less sure that the government might do on certain fronts that could have direct economic impact.

So we're sharing right now, for those of you watching, a visual, which I'll describe. We have two lines here. One line is showing you the VIX, which is a measure of market volatility. It tends to spike when the market is going through some ups and downs in a short order. And the other line on the chart is showing you policy uncertainty, which is question marks around the government, actions they might take that could impact the economy.

So we saw them both spike in 2020, for example, around the COVID pandemic. And we see them spike again in April of this year around the tariff announcement. So that did happen. We did see the market sell off by nearly 20% in April. Yet since then, the market has recovered over 25%.

And for the year, the market is sitting around a 6% or 7% gain year to date, depending on which minute you're looking at the market. That's a pretty stupendous recovery and a nice return for the first half of the year. If you double that roughly, you get to about 12%, 13%, 14%, a very solid year for the market.

So despite all the question marks on tariffs, on earnings, we have seen the economy growing. We have seen positive earnings results. And that trend could continue. What I've seen so far from tariff impacts, one area of this is a lot of earnings estimate revisions have come down.

Coming into the year, the expectation broadly was earnings for the US stock market might grow by 12%, maybe more. And now the earnings estimates for the rest of the year are perhaps in that 6%, 7%, 8% range. So lower but still positive. And historically, over the long run, as long as earnings have been rising, as long as the expectation has been positive, stock markets generally have moved up.

So if the economy continues to chug along and the earnings story still develops, we could see a continuing of a rising market. I wouldn't discount the possibility of further volatility, of course, given some of the question marks out there still around August 1, certain geopolitical considerations as well.

So I think staying invested has been challenging. But we've learned early in the year, trying to time the market is almost impossible around news headlines. Better, I think, to just have a plan and stick with it and then follow the economy and the earnings stories.

HEATHER: So a rising market could continue, but there might be some extra waves.

NAVEEN: Mm-hmm.

HEATHER: Might not be a completely smooth sail.

NAVEEN: That's right.

HEATHER: So a question that we get from viewers in terms of tariffs is when could we start seeing an impact from tariffs? So far, we haven't seen a huge impact to consumer prices given the tariff pause and other developments. Could this start showing up though in the coming quarters, Naveen? What do you think?

NAVEEN: It certainly could. So to your point, the tariffs announced in April were paused, and there are some additional tariffs here and there. But they haven't largely made their way to the consumer just yet. Many companies have been holding off on price hikes, or they've been able to take things out of the warehouse they bought before the tariffs and put those back on the shelf.

But over the coming months, as we get more clarity on tariffs, it does seem like most investors are expecting some level of tariffs to come in. And once that does come into place, you could expect to see a situation where prices do start to rise for consumer goods, maybe starting around the back-to-school season or even heading later into the year around the holidays.

Now, what is the net impact of all this is another question. Is this enough to slow down the economy or to derail it? Well, we have a research team here, the Asset Allocation Research team. And they've done some research on this. Their latest report indicates, their estimate right now based on announced tariffs—this can change quickly.

But as of right now, their estimate is maybe an 18% average tariff on stuff that's imported from around the world. So that's not going to be a universal tariff on everything. But certain things will be higher, some will be lower, but the average might be 18.

The net effect of that—their estimate is maybe inflation goes from around 2.73% up to 3.5% or 4% over the course of the coming months. So some pressure on inflation potentially. But we're not talking about going back to the levels we saw in, say, 2022, where inflation was 7%, 8%, 9%. So some pressure on inflation, but not necessarily a crisis-level spike.

And on the economy, if the tariff does have an impact on prices, that could lead to lower spending, lower earnings as we talked about. So perhaps the economy slows and grows more modestly.

So does that mean—over the last four quarters, GDP has grown in the US by over 2% a quarter. Maybe it goes from about 2%, 2.5% down to 1! % 1.5%. So still positive growth. It's not a 0 or a negative number, but it's just definitely more moderate, at a slower pace because of these potential tariff implications.

HEATHER: All right. In keeping with the topic of trends, another major trend that we saw in quarter 2, Naveen, was the continued success of international stocks. They've been outshining domestic stocks with double-digit returns. I know that you and your team have been actively adding international exposure to your clients' portfolios for a while now. Do you see this shift towards international stocks continuing? Do you think this will continue to be a big story in the back half of the year?

NAVEEN: It potentially could. So the tailwinds for international have been numerous. They've included things like an improving earnings story, which is still in place. Their valuations were lower than US stocks heading into the year. And even after the rally, these stocks still remain cheaper than the US stocks. Plus, you add in some of the tariff considerations, there's less interest in investing in just US companies now and most investors are looking to diversify beyond that.

So the dollar has softened a bit. That has been a tailwind to international performance. There's no reason that can't continue in the back half of the year because many of these trends do stay in place.

Now, do I expect the gap to be nearly as wide as it was in the first half of the year, where were international beat the US stocks by almost double digits? Probably not. That is historically wide. But what we have found is historically, it's also really hard to time. Hey, what's going to do better, US or international?

So typically, it tends to make more sense for most investors to have some exposure to both as part of a longer term plan. And by having both in the portfolio, typically, the investor generates a nice healthy return in the stock market, both US and international combined. But they experience less volatility because each of them can smooth out the other when different regions are experiencing different challenges.

So I think the outlook is still pretty good for international. I just wouldn't try to time my entry and exit into US versus international.

HEATHER: Don't try to time it. Hey, Jurrien, I'd love to bring you into this part of the discussion, too, because we know the weaker dollar is contributing to this trend of internationals outperforming. But there's also speculation that perhaps the age of American exceptionalism is coming to an end.

I know this is something that you've talked about here on *Market Sense* and written about in papers. Can you explain for our audience what you mean by that and why it's something that you have been watching so closely recently?

JURRIEN: Of course. So for the last 10 years, if you look at global markets, the US has really dominated. So bond yields have come down. Stock prices have gone up. The dollar has gone up.

Trillions and trillions of dollars have come in to the US from overseas investors, searching or looking for those high returns, which, of course, have been delivered. And there's nothing to say that the US can't remain the powerhouse that it has been, of course. It's a very dynamic economy. We got the whole AI tech thing going that isn't as visible in other places.

But the exceptionalism part, I think, speaks more to when you look at fiscal policy in the US and you look at all the debt and the deficits that are being issued and now with the Big Beautiful Bill, that's, of course, not a uniquely American story. Japan, China, Europe, Canada, the UK all have very high debt levels, but it's almost like the US always got a pass, if you will, because of the exceptionalism story, the growth story, the strong dollar, its reserve status.

And what's happening now with this fiscal bill and some of the policy movements with tariffs that wants to move away from this US-dominated world trade order, if you will, is that maybe the US loses a little bit of that premium, what I call a supremacy premium. And so we always talk about the US has a debt problem. But compared to the rest of the world, it's the cleanest dirty shirt.

And in a way, the US shirt is kind of becoming as dirty as the other ones, if you will. And so my guess is that we're going to have a little bit more of a level playing field in terms of what investors are willing to pay for every dollar of US earnings, or every euro or yen of European or Japanese or emerging market earnings. And my sense is that playing field is leveling out.

And as Naveen said, the fundamentals for overseas stocks are improving. Their earnings are converging on US earnings. There is that big valuation discount overseas. And the dollar has been losing ground.

And so for especially an American investor or a US-based investor, that currency translation can matter. So again, I don't see it necessarily as one dominates the other. But the playing field levels out. And that creates a much broader menu for investors to invest from.

HEATHER: Cleanest dirty shirt. That was the best analogy you could come up with, my friend. Not the most great of images there and positive of images. OK, thank you.

Naveen, we've seen a lot of headlines, too, about people spending, but at the same time falling behind now on debt payments. Is that something that your team is concerned about? We consumer spending can be a sign of a healthy economy. But when do you start getting concerned about all that debt?

NAVEEN: Consumer spending is vital to the US economy, and we have seen healthy spending so far. And to your point, we have seen some delinquencies rising, especially for lower income consumers. Now, the levels at which these delinquencies have risen is off of some very low levels. And the levels we've seen more recently are still well below previous recessions, so something we're watching closely.

But this, to me, is not quite at a point where I'm overly worried about it. I think this level of delinquency is, quote, "more normal than it has been." And at the level it's at, 97% of consumers are still very current with their debt payments. So that could support further consumer spending. With Jurrien, I notice a theme here, about five countries, one carry-on, and dirty shirts. I'm wondering if that's what's on his mind right now.

HEATHER: I know. Do you have to do laundry? Is today laundry day, Jurrien?

JURRIEN: Doing laundry is very therapeutic, I find. It's a mindfulness exercise.

HEATHER: Is that when you start envisioning some of your charts and some of the data that you're trying to pull together when you're doing laundry, watching it all just swish around in the washing machine? All right, let's talk about government debt.

Naveen was just talking about consumer debt.

A lot of investors are worried about the deficit, Jurrien, and worried about the tax and budget plan that was just signed into law. We haven't talked to you since that happened. There's concern that this will potentially add to our national debt. This as the 10-year Treasury yield is approaching 4.5%, which is its highest level in a decade.

And, of course, that impacts other rates too, including mortgages. So what do you think the potential impact could be of all of that, both in the near term and in the long term, Jurrien?

JURRIEN: Yeah, I think this is going to be very interesting to watch. So just to back up a little bit. During COVID, we had a $5 trillion fiscal spend. And that was at the same time the Fed, which had cut rates to 0, was buying, I think it was 120 billion of assets per month.

And so for the first few years as the debt was being built up, the Fed was sort of offsetting that. Some people might call it monetizing it. So the debt was rising, but the Fed was also buying more bonds. So the supply and demand of treasuries was kind of in balance.

Then, of course, the Fed went into quantitative tightening mode. It started to reduce its balance sheet. We went through the first debt ceiling thing a couple of years ago. And now we have another run of this. So now if you count back to 2020 before COVID, the national debt is up $12 trillion and counting.

And when you add up all the bonds that were bought by the Fed and then were reduced with quantitative tightening, the Fed has absorbed about 2.5 trillion of that. So there's almost a $10 trillion gap. And the Fed is now at 4 and 3/8. It doesn't really have the green light to cut a lot. It has room to do a little bit.

And what's happening on the long end of the yield curve, as we call [AUDIO OUT], so long rates, which the Fed does not directly control. And right now, it doesn't even indirectly control them because it's not buying any bonds on its balance sheet. That yield has been in a range of 4 to 4.5.

But I'll give you another metaphor. There's an old saying that nothing good ever happens after midnight. And I'll say nothing good ever happens above 4.5%. So we're at that point where the government is issuing a lot of debt.

The Fed is not buying it. Other central banks are not buying it either. Rates are relatively high. And the bond yield, the 10-year yield, is knocking on 4.5 again. And so this is something that we really need to watch because we don't have the same background as we did five years ago when that kind of money was being spent the first time.

HEATHER: I want to move you along because we're getting close to time here, Jurrien. But another big story from quarter 2 was the surge of gold and Bitcoin. And I just mentioned at the top of the show, Bitcoin just ascended to new highs. So what's your outlook for both those asset classes?

JURRIEN: Yeah, I mean, it's not a coincidence that gold was running pretty hard back in April when we had the whole tariff story going on. And it comes back to the US exceptionalism that if the dollar loses some of its reserve status—it'll never lose all of it, at least in my view.

But if it's eroding a little bit as the dominant reserve asset in the world, gold has proven to be the other side of that equation. So that's why gold has really doubled in value over the last three years.

And Bitcoin is trying to be like gold. It's its younger sibling. But Bitcoin also acts like the NASDAQ. So you're never really quite know which Bitcoin shows up. But right now, the stock market is strong.

And again, this fiscal story is very dominant. So Bitcoin is kind of getting the best of both worlds right now. And I think that's why it's making new highs. And it's easier to execute that view these days for people with all the ETFs and ETPs that are now in circulation.

HEATHER: And then just to pull this discussion together, and, Naveen, could you highlight for us what you see to be the biggest risks and then the biggest opportunities for the back half of the year?

NAVEEN: Yeah, I think the risk—the obvious one is the tariff questions with that potentially higher prices. We're sharing my list right now on the screen for those of you watching, so potentially higher prices. And that's more obvious. It could also potentially then lead to a slower job market. If companies are struggling to make as much money, if they try to make do with less workers, we'll have to see.

So far, we haven't seen the tariff impact come through, but it's something we're watching closely. But the opportunities are also there. On the flip side of that, we talked about potential earnings growth.

Jurrien mentioned the recent bill that passed that might be stimulative for the economy as well. And on the tariff story, if we start to see potentially more trade deals, that could be beneficial to the economy. And on rates, so far, we talked about no rate cuts. But if the Fed does cut rates, that could be further support for the economy in the second half of the year.

HEATHER: Plenty to watch in the second half of the year. Thank you, Naveen. Jurrien, before we go, Timmer's Take, what are you watching this week?

JURRIEN: Earnings season. We'll see if earnings estimates were cut too much back in April and May, as Naveen was saying earlier.

HEATHER: OK, got to leave it at that. But for everybody out there, thank you so much for watching and listening. And be sure to bookmark Fidelity.com/MarketVolatility, where you'll find the latest articles from our Viewpoints partners. You can also sign up for Fidelity's Viewpoints newsletter there and find a link to some of our most recent *Market Sense* episodes while you're there.

I also want to say we read all of your viewer questions when you register for the show, and we do try to incorporate them into future shows. So keep those coming.

On behalf of Jurrien Timmer and Naveen Malwal, I'm Heather Hegedus. We hope to see you back here next week where our planned topic is tech stock performance. So we hope you will join Jurrien and Denise Chisholm for that. Remember, we are on live every Tuesday at 2 Eastern. Take care, everybody. Bye-bye.

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