Fidelity Viewpoints®: Market Sense

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TRANSCRIPT

SPEAKERS:

Heather Hegedus Jurrien Timmer Jake Weinstein

HEATHER HEGEDUS: Hello there, and thank you so much for making the time to join us today for *Market Sense*. I'm Heather Hegedus with Fidelity.

So the markets are relatively quiet right now. We're waiting right now at this point for some new information. And that includes some inflation data that's coming out tomorrow and also any new developments in the US China trade talks that are going on right now. Just to refresh your memory, the clock is ticking on that 90 day reprieve of reciprocal tariffs, which expires next month.

The big headline at the end of last week was the resilient job market. You may have heard about the latest jobs report, which showed stronger than expected growth and stable unemployment. And that might have come as a bit of a surprise to some investors. Now, the big question is, how is the Fed going to interpret this data? And we are gearing up for the Fed's FOMC meeting, which is going to be happening a week from today. When we're doing our show next week, they will be meeting.

So to talk about what these headlines might mean for investors today we're lucky to be joined by both Fidelity's Director of Global Macro, Jurrien Timmer, and Jake Weinstein from our Asset Allocation Research team. So Jake is a newcomer to the show. You're going to be talking today, Jake, about signals coming from the bond market, especially Treasury auctions and long term interest rates. You're Senior Vice President for our Asset Allocation Research team, and you look at potential implications of financial market trends, macroeconomics, policy changes, and you're taking all of that data and you're using it to inform Fidelity's portfolio managers and investment teams. So we are excited to get the primer from you on some of that. And welcome for the first time.

I should also mention Jurrien is on a speaking tour right now. We actually have a shot, Jurrien, from your Canadian leg of the tour. Larger than life.

JURRIEN TIMMER: Yes, that was Vancouver.

HEATHER: And I know you spoke to lots of clients at that tour, and you're going to be talking to many clients today as well, and you've been answering questions about today's topic. So thrilled to have you both.

JAKE WEINSTEIN: Thank you. Appreciate it.

JURRIEN: Yeah, welcome, Jake. And it's funny, I'm in Salt Lake City, where my colleagues here in the investor center have lent me an office space. And Jake is sitting literally 10 feet from where I normally would sit in Boston. So there you go.

JAKE: Where all the magic happens. Happy to be here.

HEATHER: The brain trust over there. Well, thank you for logging in today from Salt Lake City, Jurrien. Today is Tuesday, June 10. We did start off June pretty quiet, as I said, after an extremely strong May. So there's the old adage sell in May and go away. That doesn't apply to just May. But so far, it has not applied this year, because we witnessed one of the sharpest market recoveries in decades after that tariff tantrum, as you call it, Jurrien.

The S&P delivered its best performance since 1990, which was largely led by big tech. The S&P is now pretty close to reaching the all time highs that were set back in February of this year. Are we out of the woods at this point, Jurrien? Is panic mode over or do we still need to have our seat belts on for potential further volatility ahead?

JURRIEN: Yes, that's a very good question. It has been a very, very sharp recovery. And if you look at all sort of down declines of 20% or more going back 100 years, you'll see that this rebound is pretty much the strongest ever other than the rebound that came in 2019 following a 20% decline in 2018, when the Fed was maybe pushing things a little bit too hard on raising rates and then had to walk back from that. We called that the Powell pivot back then.

And now we've had something similar not from the Fed, but certainly the more aggressive tariff talk was walked back, at least for now, back in April. And that has given the market a reprieve to price in less of a downside risk than it was fearing would happen back in April. And as a result, a 10% tariff across the board, which is kind of what we have right now, is something that I think the markets have concluded they can live with. It might add a little to inflation. It might take a little bit out of growth. But that has been somewhat priced in now, with earnings estimates having been marked down from a 12% growth rate expected for 2025 to now 7%.

So I think the market is on a fairly balanced footing right now. But we do have other issues still lurking. And of course, bonds is one of them that we're going to talk about today. And also that 90 day reprieve does have an end date. And we have to see what happens next. It may be over, but it may not be over. We just don't know at this point.

HEATHER: Yeah, that 90 day tariff reprieve expiring in July. Hey, Jurrien, any thoughts to how long you think this rally could last? Do you think it has legs?

JURRIEN: So basically, we're back to within 2% of the all time highs set in February. So if you think about it this way, and I know I talk about this a lot, price discovery is always happening 24/7. And back in March, the market had to price in for what we call a left tail. If you think about a bell shaped distribution, a right tail is really good things happening. A left tail is really bad things happen.

And back in January, the market was focusing on the right tail. This animal spirits meaning this roaring '20s, economies of lower taxes and less regulation. And then it had to start pricing in a left tail when we had that liberation day announcement of these reciprocal tariffs. And now that that has been put on the back burner for now, we've unpriced the left tail and we haven't repriced the right tail, but we're kind of back in the middle.

And so my sense is, and this is just my own personal hunch, is that it's going to be more of a two way market from here. So I think the markets are comfortable that the lower boundary has been set. But at the same time, we do have other issues. Earnings growth is slowing. We don't quite know how much of the tariffs that we do have will eat into profit margins. And that, of course, affects the fundamentals in the economy and the stock market. And of course, we have the interest rate question with the big beautiful bill being discussed right now and what that does to the deficit. So my sense is it's more of a two way market rather than a one way street, and that the market will continue to try to find its balance here.

HEATHER: All right. We're going to go through that tax bill. We're going to talk about that tax bill going through Congress in a minute. But Jake, let's bring you in here to talk about what is happening with government bonds. So typically, investors consider US Treasury bonds to be one of the safest investments in a portfolio. Lately perhaps they haven't felt so safe to some investors. First we had that bond sell off back in April. Then there was the Moody's credit downgrade. What do you think is happening here, Jake? Can you interpret this for us? And why does the bond market have investors and Wall Street on edge at this point?

JAKE: Yeah, I mean, it's a fair question. US treasuries, they are historically the safest investment out there. And when you start seeing—investors start seeing days when interest rates are pretty turbulent and rising rapidly, it raises some questions. So it's very natural. But the way I think about this is look at the entire year of what's been transpiring. Interest rates generally were heading lower as more and more tariff concerns were occurring.

Even in the first couple of days of after liberation day, like interest rates were heading lower, which was basically a reflection from the market that there was going to be higher odds of recession. But then something funny happened, kind of to your point, where you actually started seeing Treasury yields rise unexpectedly. And a lot of these are just day to day type of things where if there's too much turbulence in the market, there's some extreme hedge fund positioning that has to be unwound.

But ultimately, if you look at a longer term horizon, treasuries are actually doing what they're supposed to do. And so lately, when rates have been going higher, kind of what Jurrien was saying before, it's really a reflection of that left tail topic, that left tail probability being taken out of the market. And so we should expect to see higher interest rates as indeed recession probabilities have lowered as some of that tariff news has really dissipated from its extreme concerns back in April.

HEATHER: We know tariffs were a concern, but bond investors are also worried about what you're also hit on, the trillions of dollars in government debt that the tax bill that's working its way through Congress would actually not just—it wouldn't address, it would add trillions of dollars to the deficit. So can you talk about why fiscal debt is worrisome to investors and what the relationship is here, what the correlation is here?

JAKE: Yeah, for sure. So I've been in this industry for nearly 25 years, and it's a question I get all the time first, right off the bat. How can we handle $17 trillion of debt? How can we handle 22 trillion? And now we're up to 36. And the answer has always been at some point, it is going to be an issue. And you never know when it's going to be an issue really until the bond market tells you it's an issue.

And what's interesting about this go round is that deficits right now are at about 5% to 6% of GDP. And even an expansion, it seems kind of different that the Congress is looking to not really bring the deficit down, but actually doing things that might actually cause it to go higher. So this has historically, at times, resulted in some kind of concerns from the market. I'd say the level of interest rates right now where they're at, it's not really a concern. I think the US economy can handle the 10 year yield at a 4.5% or 5%.

But the news that we're hearing or the things we hear is back to those bond market vigilantes of the late '80s and '90s. And for people who may not really know what that means, that basically was there was high deficits at the time. The government saw that there was high deficits, and they took care of it and really got their deficits under control. And what's kind of interesting this time is it may not be the case. So I think there's definitely reason for concern. But at these level of interest rates, I don't think the increases we've seen in yields or the sell off we've seen in treasuries is really as significant as a concern as it was back during those bond vigilante years.

JURRIEN: Yeah, and I would just add to what Jake is saying. We're at 4 and half-ish. And bond yields have been basically rangebound now for a couple of years. We pushed to 5 back in October of 2023. And so 4 and 1/2 we're below. If you think about it this way, the economy has to grow faster than the cost of its debt. And if that's the case, you could argue it's sustainable. And nominal GDP is at 5%, 6% and the bond yield is below that. So that's why right now nothing is sort of breaking, if you will.

HEATHER: OK, let's talk about so much has been written lately about foreign investors abandoning US treasuries because of deteriorating relationships, because of these trade negotiations. For people's backgrounds, foreign investors are a major source of funding for the US government. They own about 30% of treasuries. So how concerning is that? And is this a trend that you think might last, Jake?

JAKE: Yeah. So it is something that in April, I was talking to my friends, and they're like, oh my gosh, people in other countries aren't going to buy our debt. What does that even mean? And we waited for the data to come out. And the Treasury releases something called the TIC data. And there has yet to be any evidence that foreigners are exiting in mass quantities and not purchasing US treasuries.

Now, if you think about the developments that have occurred over the last couple of months, it would not be surprising if different countries, maybe across Europe or in China, perhaps started to divest a little bit less from the US. And China's been doing this for the last 10 years. And it really hasn't had a meaningful impact on yields. But I think something that's going to be interesting is if this trend does occur, it could have more of an impact on currency markets and perhaps cause the dollar ultimately to go a little bit lower from where it is. But as far as evidence so far, we haven't seen any yet.

HEATHER: So could impact currency markets. And I'll pose this question to both you and Jurrien. Is it something investors should be concerned about?

JAKE: Yeah, I mean, so it's pretty interesting over the last couple of decades how the dollar has done so well. And different people have different concerns. Well, if the dollar was cheaper, it would be easier then to then go out and for our exporters to be able to make more money. But if the dollar is a little bit more rich compared to other currencies, it's good for consumers to buy things at cheaper levels of where the FX markets provide them. So there's two sides of the coin in all of this stuff.

But from an investor perspective, what's really been interesting is the dollar has gone up over the last couple of decades. It's also corresponded with just the dominance of US equity performance from a global perspective, where non-US equities have not really been able to do as well, not just from an earnings standpoint, but also from a currency standpoint. But if we enter an environment where the currencies start going the other way, this could make it a little bit more attractive to purchase, perhaps, for US based investors to purchase non-US equities perhaps going forward.

HEATHER: Anything to add to that, Jurrien? Yeah.

JURRIEN: Yeah, and I think Jake raises a larger question also that the US has enjoyed what I call the supremacy premium. US exceptionalism, dollar strong, capital flowing into the US, obviously the Mag Seven, US market producing higher margins, higher payouts. And it's produced a higher PE. 22 times earnings for the US, 15 times for non-US. If there is some sort of paradigm shift, whether it's abrupt or very slow, with all this trade talk and talk about a new world order, then you could argue that that might level the playing field between us and non-US assets. And that actually creates quite a big opportunity for US investors to paint allocation with a broader brush.

And I would just mention one other thing, and that is that the rise we've seen in US rates, both short rates and long rates over the last three years, is not just a US story. It's a global story. And so rates in England, in Canada, in Europe, and even in Japan now have been on the rise. And so that might also play in as a factor of foreign investors, whether central banks or others, might feel less of a need to buy our assets, because their assets are more competitive now. So there's a bunch of ways to put this puzzle together.

HEATHER: Interesting. OK. Yeah, perhaps paint allocation with a broader brush. Another factor that I think is probably on investors' minds out of this discussion that we're having, gentlemen, is given all of this discussion so far, what we've talked about, what is your overall outlook on what this could all mean for interest rates? And what could that mean for bond investors in terms of the types of returns they might expect to see when we talk about a portfolio mix, Jurrien? What do you think, Jake? What might this mean for investors with the kinds of returns they might expect to see?

JAKE: Yeah, so as Jurrien said, I completely agree, is that interest rates, at least the 10 year part of the curve at about 4.5%, are about fair value, given that's what our nominal GDP expectations are over the long run. Now, the Federal Reserve, as you mentioned in the beginning of the show, may be able to signal that it's raising interest rates higher or lower in the short end of the curve. But that's really more of a short term fluctuation thing. Bonds really matters more in terms of what interest rates are on the longer end part of the curve.

Now, what does that really kind of matter for investors? So one thing, one way to think about it is we came off of about a decade period where the real yield or the inflation adjusted yield, so the nominal yield, less inflation was negative for a long time. Not a very great environment for a bond investor, as the bond yield is not being to be able to keep up with the rate of inflation.

But right now, if you look at bond yields, they give a nice kind of healthy positive 2% positive real yield in the 10 year part of the curve and a nominal yield of nearly 5%, which is really a great way of basically saying you can have a safe asset, provide that income, outpace inflation. And I think as I mentioned before, that US Treasury is still behaving like a good risk asset that's going to provide ballast if there is volatility in equity markets.

HEATHER: Well, I'm glad you brought up inflation, because I know your asset allocation research team really is devoted to watching that closely. Or you have people that are devoted to doing that. And it's something the Fed is watching closely. So just was wondering if you could give us your inflation forecast and where you think inflation is going. And could it influence what we've been talking about today, including interest rate dynamics?

JAKE: Yeah, absolutely. And there's a CPI release this week. Can't really pinpoint exactly what's going to happen with that.

HEATHER: It's too bad the show wasn't tomorrow, because that reports coming out tomorrow, right?

JAKE: Yeah, then I'd be on the hook for everything or I could just go right afterwards. But I think again, what matters to us is more over the intermediate term, like over the next six months, what are the trends? Because again, the point about interest rates before, they can go up and down any day for any particular reason. So any month that the CPI print could say whatever.

But the trends that we're seeing, if you believe and we believe that the US remains in expansion and we're going to muddle through this and there's going to be no recession, then given the tariffs and given the supply and demand dynamics, we think that inflation actually can start, which has started coming down the first half of the year. It could actually stop falling and potentially, I think, re-accelerate into the back half of the year.

So we don't think it's going to be a major shift upwards super, super fast. But I would not be surprised if by the end of the year and, don't quote me, or you can quote me if I'm right, I guess, is that inflation is probably, I think, hitting up towards back up towards 3% as we head into 2026.

HEATHER: All right. We'll quote you if you're right. And maybe I'll just buy a couple extra things of chicken and freeze them in my deep freezer or something if you're right while the prices are lower.

All right. We covered a lot of ground today. Let's put it all together for us, Jake, if you would, please, because this was a great discussion. What are the takeaways that you want our audience investors to give thought to on all of this?

JAKE: Yeah, so I mean, the big picture from the bond market, it does feel like some days that interest rates are moving around more volatile. And we should actually probably expect that. When the level of interest rates is higher, you're going to get higher volatility. When you have concern about higher inflation or higher deficits and those risks are out there, you're likely to get more volatility in bond markets. And it is very normal to do so. But again, the beauty of bonds is if they're providing that positive yield, especially that positive real yield, they provide diversification. They provide insurance while providing a source of income.

And that could be in treasuries, that could be in credit markets, whether it's the investment grade or the high yield market. And it's just something where there could be rising risks of stagflation, where growth slows and inflation rises, and maybe some types of treasuries won't work. So thinking about your fixed income portfolio from a broader perspective, different types of sectors, different types of investments across different categories, I think, is a prudent thing to do for investors going forward.

HEATHER: Staying invested, thinking about long term objectives too, I'm sure. Great discussion, Jake. Great job. You're keeping it focused. We're right at the 20 minute mark, right where we want to be right now. But we do want to do a quick Timmer's Take where we get Jurrien's take on what he's watching in the coming week. We've already mentioned that CPI report coming out for the month of May, tomorrow, Jurrien. What else are you watching?

JURRIEN: Well, earnings season is over. We're still in that reprieve period on trade. And so in line with what we're discussing, the thing that I'm watching the most is that 10 year Treasury yield, which is right at 4 and 1/2. And above 4 and 1/2, it starts to have an impact on the stock market. So that's probably the most important indicator from my perspective.

HEATHER: All right. We'll be watching alongside you, Jurrien. Thank you so much. Thanks to everybody out there watching and listening for sending in your questions. And in fact, we got so many questions on bonds that we have another great show coming up for you next week, a part two of this discussion about bond opportunities with a Fidelity bond portfolio manager that we are very excited about.

So if you want to register for that episode, you can go to Fidelity.com/MarketSense. You click on the green registration box under the video player there. That's /marketsense. While you're there in the video player carousel too, just a little pitch here, check out our special edition of our 2025 *Market Sense* mid-year outlook.

It's something Jurrien and I are super proud of. Jurrien and our other thought leaders got together. You give a great recap on what happened in the first half of the year to help us prepare for the second half now, the back half of the year. So be sure to check that out. It's a little bit longer than 20 minutes, but still a very on point discussion.

On behalf of Jurrien Timmer and Jake Weinstein, I'm Heather Hegedus. Thanks for the pleasure of your time. We'll be back here next week. Remember, we're on every week live Tuesdays at 2:00 Eastern.

[1]Wall Street Journal, November 17, 2023: www.wsj.com/finance/investing/where-have-all-the-foreign-buyers-gone-for-u-s-treasury-debt-3db75625?msockid=3466f5ad0cdb66ee0e9de0de0dc267a1

[2]Bloomberg, June 2, 2025: www.bloomberg.com/news/articles/2025-06-02/buyers-strike-rocks-us-long-bond-as-doubleline-pimco-stay-away?srnd=homepage-americas

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