Fidelity Viewpoints®: Market Sense

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TRANSCRIPT

SPEAKERS:

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

I hope you all had a nice, relaxing Thanksgiving with family and friends. And while we're all getting ready now for the December holidays—and many of us are shopping for gifts, I know I have been—we're also unwrapping a lot of economic data about inflation and the strength of the economy. We know the Fed's watching it all closely as they decide whether another interest rate cut may be on the table in December.

So to talk about what this might all mean for investors at this moment in time is Jurrien Timmer. Of course, he's Fidelity's Director of Global Macro. And as I mentioned, it's a busy time of year for all of us. But we do want you to be aware that the clock is ticking right now to review some important choices that are designed to help lower your 2024 tax bill that you might want to consider taking action on before the end of the year.

So to try to make things a little bit easier for us and break down some of the biggest strategies out there—and of course, we'll do our best to keep this discussion to 20 minutes—we've got Kenny Davin, a branch leader here at Fidelity. Thank you both for joining us today. Hope you guys got to spend a little bit of time with family over the Thanksgiving holiday.

KENNY DAVIN: Thank you for having us. Happy Holidays.

JURRIEN TIMMER: Yeah, Happy Holidays. Welcome, Kenny, to the show.

KENNY: Thank you.

HEATHER: Well, today is Tuesday, December 3. Hard to believe that here we are, the last month of the year. So Jurrien, let's start things off by talking about 2024. Can you unpack for us some of the highlights and lay out for us how we got to where we are right now?

JURRIEN: Absolutely. Every year I do my review in Outlook. And I got a few things right, a couple of things maybe not so right. But my big take was that 2024 would be a bullish year, a bullish broadening—and that's something we've talked about—so more stocks participating, and that certainly has been the case.

And the market made a new all-time high actually a month later in January. And history shows that when that happens, it tends to gather a lot of momentum. So normally, the market goes up, let's say, 70% of the time by 8–9% in terms of price, 10–11% in terms of return. When the market makes a new high after having had a correction, the odds go to 90%, and the return is 14%.

So the odds were in our favor, and it turns out that the market has actually done a lot better than that. The cap weighted S&P is up about 28%. The equal weight is about 20%. So really a banner year.

And where I underestimated the strength of the market was that my sense was that this would be a year where earnings would do the heavy lifting, and the PE side of the rally—so if you deconstruct the total return in the market, it's dividends, plus changes in earnings, plus changes in the PE, and the dividends we kind of know. And so the earnings did come through. They're growing at about 10% this year. So got that one right, as well.

But the PE side I underestimated. I figured that it would be a baton pass from PE to earnings, which is typically how things work. But instead, we got a double-barreled rally, where already solid earnings gain was amplified by an even bigger increase in valuations.

And, of course, valuations can cut both ways. When markets get too expensive, it can become a problem. So that's why I think the market has been as strong as it has. And, of course, we had the election and the outcome is generally deemed as market friendly. And so the animal spirits are alive and well in the markets as we head into the home stretch.

HEATHER: Well, given how strong the market has been and how resilient the economy has been, what do you think that means for whether the Fed will cut in December? Do you think they're going to go for a cut number three, or do you think the Fed will take a pause?

JURRIEN: I think the Fed is on the fence and the market is on the fence. So if you look at the implied probability of rate actions, which you can detect from looking at where short-term rates are trading, market's at about 50/50, in terms of whether the Fed will cut. And so just to back that up for a moment, the Fed cut 75 basis points, so 3/4 of a percent back in September and in November. And based on various metrics that I follow, the Fed is exactly where it should be.

So there's no longer a justification to be as restrictive as they were, because the labor market has returned to balance, the inflation data—which, of course, are still problematic for the average person who is looking still at the price of eggs or a carton of milk in the grocery store.

But the rate of inflation has improved, although it's proving to be a little bit more sticky here in a 2.8%, 3%. And so my sense is that if animal spirits are returning to the economy and next year will show a re-acceleration—and we don't know if that's going to happen, but that's the sense in the market—and inflation is still not quite at the Fed's target at 2%, then I think the Fed could very well be justified to take a pause either this month or after cutting 25 basis points more, but then signaling that at that point they're 4-3/8, 4-1/2. Maybe they wait and see whether the economy does re-accelerate in 2025, and whether inflation stays sticky at around 3% or continues to move to 2%.

And clearly the economy is not hanging by a thread waiting for another rate cut. I mean, we were just talking before the show. I was in New York with my kids for Thanksgiving. The drive down was long.

And my son had flown in from Dublin, where he lives. And I brought him back to Logan Airport here in Boston on Sunday. And the traffic, I've never seen the traffic so busy.

And by the way, pro tip—when you're dropping someone off on the Sunday after Thanksgiving, go to the arrivals line where there was nobody and then make them walk up to departures. And if you're picking up a child or anyone the Tuesday before Thanksgiving, do the opposite—go to departures, not arrivals. It made a huge difference in possibly a missed flight. But it gives you a sense of things are pretty active. And the Fed can certainly afford to take a pause and say let's see how this all plays out.

HEATHER: Yes, exactly. The airports being so busy is a good sign that people are spending money and the economy is moving. All right, Jurrien. Thank you.

So it is also that time of year to think about year-end tax strategies. Maybe not as fun as thinking about the holidays, but this could save you some dough and then you'll have more money to spend on holiday gifts, maybe. And Kenny, the last time you came on *Market Sense* we talked about asset location, which involves considering the tax treatment of different types of investments to try to minimize taxes in general.

We're talking today about the annual tax bill. April might feel a long way off, but there are these important deadlines that are fast approaching before the end of 2024 that you've got to consider before we get into 2025. Walk us through some of those important deadlines, if you would, Kenny.

KENNY: Absolutely. And Jurrien, thanks for the travel tips. There are deadlines that we want to be mindful of, which is why we're doing this show now to give you some time before December 31 to think about some of these considerations.

Like you said, careful planning, taking advantage of certain deductions could potentially keep even more in your pocket. So to start, savers—remember, the deadline for contributing into most workplace plans is December 31. It's typically a good practice at the end of the year to review and make sure that you're taking full advantage of the limits for these accounts.

Pre-tax contributions allow you to save for retirement while reducing your after tax income. Roth contributions, you get no tax deduction on the front end, but the growth in the eventual distribution is tax-free as long as certain rules are met. So whether you're contributing Roth or pre-tax, preparing is very important. And taking action is crucial, because here at Fidelity we do believe saving for retirement is one of the most important financial goals that you need to plan for.

A little about numbers. For traditional 401(k)s and Roth 401(k)s, you can contribute up to $23,000 for 2024. If you're 50 and older, the amount goes up to $30,500, due to an additional catch-up contribution of $7,500. And these contributions are likely to go up next year to account for inflation. So just to summarize, if you haven't done so already, consider reviewing your workplace contributions, making some adjustments before year-end, if you still have time.

One later deadline I want you to be mindful of, as well, when it comes to IRAs and health savings accounts, you do have until the tax filing deadline in April to make 2024 contributions.

HEATHER: And Kenny, I do think there are a lot of misconceptions out there about HSAs. Or it could also just be general lack of knowledge about what you can do with an HSA. Can you just quickly give us some high level snippets on the benefits of HSAs?

KENNY: Yeah, I'll be happy to. First of all, health care continues to be one of the largest expenses in retirement. I have 165,000 reasons why it's important to have a plan to cover those costs. On average, according to a 2024 Fidelity retiree health care cost estimate, a 65-year-old individual may need, you guessed it, $165,000 in after-tax savings to cover health care expenses.

So that's where health savings accounts come in. They accompany a high deductible plan. They offer a tax advantaged way to help save for health care expenses. They do offer triple tax advantages. Contributions are tax deductible, lowering your taxable income.

Number two, any earnings are tax-deferred, and the distributions are tax-free if they're used for qualified medical expenses. Health savings account assets, they're also not subject to a use it or lose it rule, meaning the balance continues to build year over year and can be used now or in the future to cover health care costs. So to sum it all up, a health savings account is really one of the most tax-efficient savings options available, and could really be a powerful tool for tackling health care costs as well as saving for retirement.

HEATHER: And as I mentioned, you talked about tax loss harvesting the last time you came on *Market Sense,* Kenny. And if anybody missed that episode, it's still up right now on our website and on YouTube. But quickly walk us through how tax loss harvesting can help this time of year.

KENNY: Sure. Even with the market gains in 2024, it's possible that you may have lost money on some financial investments that were lemons this year. You can still make lemonade, though, turning these investment losses into tax benefits by tax loss harvesting.

So this strategy typically involves intentionally selling investments at a loss. Those losses can then be used to offset the gains from any investments that you sold that were up in value to lower your taxable income now or in the future. I have a slide that illustrates this really simply. If you're watching us as a webcast, you can see it. If you're listening to us on the podcast, I'll walk you through it.

Without the loss in the middle for investment B, an investor might have paid significantly more in taxes—almost $1,200, just selling investment A alone with a $5,000 long-term capital gain. However, by realizing the loss from selling investment B, what will happen is that that loss can offset the $5,000 gain, reducing the overall investor's net capital gain and ultimately lowering the taxes owed, being reduced to about $200. So losses can be carried forward, meaning that if you don't have any gains to offset, those losses can go against your income—$3,000 worth of it. And the remaining losses can carry forward into the future for the life of the taxpayer.

I want to pause here and just share that that was a very basic example. Here at Fidelity, we believe that tax loss harvesting is more than just a year-end exercise. So to really get the true value of tax loss harvesting, it's really important to look for opportunities throughout the year. And doing so then has the potential to produce better long-term after-tax returns for you.

HEATHER: So in that example alone, tax loss harvesting saved that investor almost $1,000.

KENNY: Yeah.

HEATHER: But everything does seem to be up in the stock market this year. Jurrien was talking about the strength of the market this year. Jurrien, are you able to tell us what percentage of stocks in the market are down right now, or if there are any areas of the market that were underperformers this year that investors might want to potentially look to potentially leverage for tax loss harvesting purposes?

JURRIEN: Yeah, it's funny, I just had this conversation with my 28-year-old daughter to explain what tax loss harvesting was. And it's a little counterintuitive. Why would you sell stuff at a loss? But it makes sense.

This is a year where actually most stuff is up. The bond market has underperformed, so maybe there are some bonds that are at a loss. But 77% of the stocks in the S&P are in uptrend. So this may be a more challenging year to find losing stocks, because it's been a rising tide for many boats.

HEATHER: OK, so maybe look to the bond market. Kenny, another tax saving strategy is a Roth conversion. Talk about why those are so popular at the end of the year.

KENNY: Yeah, absolutely. So Roth conversions also have a December 31 deadline, just like those workplace retirement account contributions. One reason why a lot of people choose to do Roth conversions at the end of the year is that's when they have a clearer picture of their income and tax situation.

For the benefit of those who don't know, the Roth conversion involves transferring money from a traditional IRA or workplace plan to a Roth IRA or a designated Roth account, if your employer offers one. You pay taxes on the converted amount. But once the money is converted into the Roth, it has tax-free growth potential and can be withdrawn tax-free, assuming you've met the five-year rule for Roths and are at least 59-1/2 years old. You also don't have to abide by the required minimum distribution rules, which typically comes with 401(k)s and traditional IRAs.

HEATHER: I know those RMDs, those Required Minimum Distribution rules, can be a real pain point for some people. But can you give us some examples of how Roth conversions can be beneficial?

KENNY: Sure. You can stagger a Roth conversion over multiple years, converting just enough to keep you at the top of your current tax bracket, avoiding a higher rate. If you are worried about RMDs pushing you into a higher tax rate in the future, you may want to consider Roth conversions to reduce the amount of those tax deferred accounts. You may also consider a Roth conversion in a year where your income is significantly lower than usual for any reason, or if the stock market is down and your investments are worth significantly less. Upon the conversion, those funds have the chance to recover in an account that has tax-free growth potential.

There's also a strategy called the Backdoor Roth, used by high income earners to contribute to a Roth, even if their income exceeds the limits. And it typically involves a nondeductible traditional IRA contribution followed by a conversion in a Roth IRA. So there's a lot of considerations here.

I know we covered a lot. So trying to figure out what makes the most sense for you, it's a good idea to talk to your financial professional or your tax advisor who knows your goals, your specific situation, and then will help determine what's appropriate for you. So as an example, if your funds are earmarked to be left to charity or someone in a really low tax bracket, a Roth conversion may not be beneficial.

HEATHER: Well, speaking of charity, today is Giving Tuesday. And if you gentlemen are like me, your mailbox is probably full of letters from charities right now asking for year-end contributions. But we all know that this is something that not only is helping others, but something that can also be personally rewarding.

And also, it's tax efficient. So I just listed three good reasons to donate to charity. And I was wondering if you could walk us through some of the best tax-smart charitable strategies that people might want to think about around the holidays, Kenny.

KENNY: Sure. As you said, Heather, there are more than one strategy to consider to be a charitable tax saver. So for the first one, if you're 70-1/2 or older, you may be able to reduce your Federal taxable income by making a qualified charitable distribution, also known as a QCD. A QCD is a direct transfer from your IRA, payable to a qualified charity. You can donate up to $105,000 directly from an IRA to one or more charities. And the QCD will be counted towards satisfying your required minimum distribution for that year, as long as certain rules are met.

There's another strategy that involves itemizing deductions. Let's say you don't usually donate enough to itemize, but you're close. If you have the resources, one strategy is bunching your charitable contributions.

Instead of several smaller annual deductions, bunching means involving making one larger contribution, several years worth, to a donor advised fund in one year. That allows you to itemize and take a deduction for the full amount, if when you combine it with other deductions that total exceeds your standard deduction. And thanks [? for ?] the fund structure, you can then distribute those funds to your chosen charity over various years.

One last thing I want to mention, because we always get this question, many are always asking, what type of assets do I donate? A great option is going to be long-term appreciated securities. Think stocks or investments that have gone up significantly in value. Donating these can be more beneficial than cash, or selling those investments or assets and then donating the after tax proceeds.

HEATHER: OK, long-term appreciated assets that have gone up significantly in value. Kenny, you also mentioned donor advised funds. It's worth mentioning that Fidelity does offer a donor advised fund known as the Fidelity Charitable account.

It offers an immediate tax deduction when you contribute. It also allows your money to potentially grow tax-free while you recommend what quality charity to grant money to. Jurrien, I know you're always very involved in the community and making the time to give back outside of work. Anything you would add to our discussion of charitable strategies here?

JURRIEN: No, but it's a good thing, obviously, to do. I've ridden in the Pan-Mass Challenge now 26 years in a row, and obviously I donate to that. But even more important, I have my network of sponsors donating on my behalf to fund this very important charity where it goes to cancer research. But it is that time of year where you have a sense of, how much can I afford to donate to what causes? And I think it's a ritual that is very rewarding, especially when you're doing repeat gifts to an institution that you're really fond of over time, because you really make an impact that way.

HEATHER: Very well put, Jurrien. And also, before we end our tax discussion here, I should mention that we're going to be keeping our eye on the Tax Cuts and Jobs Act in the beginning of the year. It's set to expire at the end of next year. And with the new Congress being sworn in next year, there's still a lot of proposals and provisions that need to be hashed out. We also want to remind everybody, just to reiterate what Kenny said, always consult your tax advisor for your own specific situation before making any decisions.

OK, before we wrap our discussion today, we always like to end things with a quick Timur's Take. I mentioned at the top of the show, Jurrien, that we've gotten a lot of economic data to digest recently, and we've got some more coming at the end of this week, right?

JURRIEN: Yeah. So the big one is the Jobs Report on Friday, and we had the Inflation Report last week. And, of course, in the next week or two, the Federal Reserve is meeting. So those will be the two big bookends for the year, in terms of economic data.

HEATHER: All right, on behalf of Jurrien Timmer and Kenny Davin, I'm Heather Hegedus. Happy holidays, everybody. But we will see you back here next Tuesday at our regular time of 2 o'clock Eastern.

[1]Fidelity Viewpoints, November 12, 2024: www.fidelity.com/learning-center/personal-finance/tax-planning-strategies-2024

[2]Fidelity.com: www.fidelity.com/learning-center/wealth-management-insights/year-end-tax-tips

[3]Fidelity Viewpoints, September 23, 2024: www.fidelity.com/learning-center/personal-finance/retirement/answers-to-roth-conversion-questions

[4]Fidelity Viewpoints, October 25, 2024: www.fidelity.com/learning-center/personal-finance/tax-brackets

[5]Fidelity Smart Money, November 1, 2024: 401(k) contribution limits 2023, 2024, and 2025 | Fidelity

[6]Fidelity Smart Money, November 1, 2024: IRA contribution limits for 2024 and 2025 | Fidelity

[7]Fidelity.com: Health Savings Account | Contribution Options | Fidelity Investments

[8]Fidelity Viewpoints, July 24, 2024: www.fidelity.com/viewpoints/personal-finance/hsa-healthy-habits

[9]Fidelity.com: https://www.fidelity.com/go/dsk-umh/harvest-tax-loses

[10]Fidelity Viewpoints, www.fidelity.com/viewpoints/personal-finance/tax-loss-harvesting

[11]Fidelity Viewpoints, January 2, 2024: www.fidelity.com/learning-center/smart-money/deducting-charitable-donations

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