

Fidelity Viewpoints®: Market Sense

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TRANSCRIPT

SPEAKERS:

Jim Armstrong Jurrien Timmer Leanna Devinney Stacey Watson

Jim Armstrong: Hey there, thanks for joining us for *Market Sense*. I'm Jim Armstrong with Fidelity. News has continued to move really quickly in the banking sector over the past week or so, and attention at the moment is on the Federal Reserve. They're currently meeting, their first meeting since the start of this most recent turmoil. Now to get the market's big picture today, we're going to be speaking with Jurrien Timmer, he's Fidelity's Director of Global Macro. As our economy, of course, is strained—we recognize there's also a strain put on the life goals each of us has as investors and consumers like buying a house, planning for kids, saving for college for those kids, changing jobs, things like that. So, to guide us through the conversation about financial goals through times like these, as well as planning for big life events, we're going to be talking with Leanna Devinney. She's a financial planner and a Massachusetts based branch leader here at Fidelity. And we're also happy to be joined by Stacey Watson, she is the head of life events here as well. I'd like to thank all three of you for being with us.

Leanna Devinney: Thank you. Great to be here and be back.

Stacey Watson: Thanks for having me.

Jurrien Timmer: Nice to be back in Boston. Nice to see you all.

JIM: Great to have all three of you here again. Hey Jurrien, let's start with you. It's Tuesday the 21st of March, and my gosh I feel like we could start in any number of places. But what I'm interested in hearing from you about is right now, with everything going on, what's got your attention at the moment? What are you the most interested in?

JURRIEN: Yeah, by the way, it's interesting that we've been doing this three years now I think, and every week it still seems like there's all this breaking news that we have to catch up on so I guess it never does stop.



But so obviously, we've had a few extraordinary weeks under our belt here with Silicon Valley Bank and Signature Bank being seized and then, of course, over the weekend the kind of the arranged wedding, if you will, between Credit Suisse and UBS in Switzerland which was more or less a bailout by the Swiss government but facilitated through another bank.¹ And it has, obviously a lot of people worried that we're going through a repeat of the global financial crisis of 2008. And I don't think we are, I think it is different but it is obviously disconcerting. And so, maybe to back up as to why exactly we're in this position to begin with. Obviously, the problems with Credit Suisse in Switzerland, that's a very long, long story and part of it is idiosyncratic. But the other two are more systemic of kind of what is going on and it does come back to the pandemic, which is when we started our show.

And so, you may wonder, what does Silicon Valley Bank have to do with COVID? But what happened during that time is obviously, the economy was in lock down. A self-induced coma as it was called, in terms of the global economy that necessitated or facilitated a very large policy response, both on the fiscal side and on the monetary side. And in retrospect, it's pretty clear that that monetary fiscal cocktail, if you will, was extremely potent. Maybe more potent than the Fed realized or appreciated at the time. The Fed probably, although it's easy for me to say, probably stayed too accommodative for too long and as the inflation genie got out of the bottle, they had to really slam on the brakes as a result which they may not have had to do if they had kind of moderated policy more quickly.

And so, what the result of that is, is that rates have risen very quickly as we all know, and that has caused what we call an asset liability mismatch with the banks. Because the banks saw a lot of deposits come in during COVID and in the aftermath as bank reserves really, really ballooned as the Fed, you know, increased its balance sheet. And those reserves have to be invested in something. The banks are not just going to sit on that cash. And oftentimes, banks will lend out those reserves or those deposits as loans, as mortgages, et cetera. But, in many cases, it will just also buy treasuries and mortgage-backed securities. So, a lot of the banks, especially Silicon Valley Bank, not to name names but they're one of the two, invested those deposits in bonds, and they did so when yields were very, very low because the Fed was so heavy handed, if you will, in the bond market.

So, now, a couple years later, short rates have gone up so banks have to pay more on their deposits while at the same time, the bonds that they bought with those deposits are underwater. And so, back in the financial crisis it was really a combination of this duration mismatch, if you will. But also, of course, credit losses, right? The whole housing crisis that we had back then. We don't have that today but we do have that duration mismatch so that's where the problems stem from. And so, you know banks are kind of, they have losses in their bond portfolios, which, there are accounting rules that deal with that. If they're not intending to sell those bonds then they don't have to mark to market, as we call it. But that's where the squeeze is happening right now.

So, it's not that banks have bad loans. It's just that the assets they have, at least those invested in the bond market, you know are underwater because interest rates have risen so much. And so, there's an old saying and we'll talk about the Fed later, but there's an old saying that the Fed tends to raise rates until something breaks. And so, Silicon Valley Bank, Signature Bank and in some ways also the problems in Switzerland are the things that are breaking during this cycle.

JIM: Thank you for that perspective. Thank you, also, by the way, for reminding us of our anniversary, I guess as is often the case when folks are together for a few years, you kind of forget the important milestones. You forget the important dates. So, Leanna, happy anniversary to you. The three of us have done about 150 of these shows so far and it strikes me that you consistently are able to bring in the voice of the customer, right? What are clients saying, what are really people really concerned about. So, through the lens of everything Jurrien just shared, how are you all in your branches experiencing that? What are people saying?

LEANNA: Yeah, thank you Jim and happy anniversary to you both as well. Three years going strong. So I'd say, what we're hearing most in the wake of bank closures last week and a lot of the news over the weekend and subsequent news that followed, most of the inquiries and concerns we're getting are around cash, safety, and the accessibility of cash. And so, for your money that's in cash, this has really opened up conversation around a lot of the cash management options that are out there. So, the most common places, really to hold cash, as we know, there are bank savings accounts, there are CDs issued by banks, there's money market mutual funds, all of those solutions are really designed to help protect the value of your cash while also paying interest in some form.

And there's many options out there, like I mentioned. So, we help clients just understand when it comes to your cash management options, where should you hold your rainy-day fund, where should you hold the money that's more allocated to the short-term goals that you need to be liquid and accessible. And then of course we help at the core with some of our intermediate and long-term goals that would naturally be outside of cash, we help build plans around that. But most of our concerns and inquiries have just really been around cash, the safety, security, accessibility, and some of the ins and outs.

JIM: Yeah, makes a ton of sense so thank you for walking us through a bunch of options that we have when it comes to cash. Easy to forget that we have options beyond, you know, investing. We have other things to do there. Hey, before we bring Stacey in, Jurrien, a quick follow up for you if you could. I'm curious what you think of the increased or decreased likelihood of the economy moving into recession. The R word that we talk about so often on this show as a result of everything that's happened over the past, you know, week and a half.

JURRIEN: I think that the risk of a recession has been brought forward a little bit by the events of the last few weeks. And again, I want to stress that, you know, as easy as it is to quickly go back to 2008—it's like oh, my God, it's a repeat. You know, I don't expect that at all but there are some

unintended consequences of these two bank failures because they are smaller, more regional banks. And what could happen is that even if they don't have credit losses on their balance sheet. Which, you know again, there's very few—there's very little evidence that that's an issue in any of the banks. Remember in 2008, we had a banking crisis, they had to get recapitalized. That was really a bailout, if you will. And as a result, the banks got highly regulated, they were forced to raise much more capital so they are—and now they are in much, much better position as a result. So, there's not an overhang of bad loans in the banking system.

At least, not in the US but what could happen is, as banks are forced to compete now for their deposits, right? We saw that deposits can leave very quickly. I mean, the banking system is, it requires confidence because what we call a fractional reserve system means that, you know banks don't have every dollar that's sitting in a deposit waiting in the wings to be redeemed to a customer if they want their money back. I mean that's how fractional reserve banking works and that's how it's supposed to work. But so, if the deposits are maybe more at question because, you know banks have kind of been behind the curve in paying competitive rates on their deposits. They may feel that they need to compete more with that and also, if they fear that customers might take their deposits out then they may be less willing to make loans into the real economy. So that's really the answer to your question that if banks are going to become may be less willing to lend money to customers, to regular people like us, or businesses, that maybe that will kind of hamper economic growth a little bit.

Like, credit—you know too much credit is a bad thing, of course, we all know that. But some credit is a good thing because it kind of lubricates the machinery of the economy. It's what makes it grow and so if we get a credit crunch, as they call it, where banks are less willing to lend money then that can be kind of the component that when you look at the shape of the yield curve, the difference between short rates and long rates, that has been signaling for a while that a recession could happen somewhere second half this year or first half next year. And so now we have potentially a catalyst in the banking system that could bring that a little bit more forward. And again, you know as tempting as it is to say, "Oh, if we're going to have a recession, I'm going to sell everything now." That's not how it works, because we don't know when it would happen, we don't know how long it would last, how deep the recession would be. And of course, it's a question of how much is already priced into the market.

Remember, the market fell 28% last year, and so a lot of that is already priced in. So I don't want anyone to come away with a binary response saying, "Okay, recession, I need to get out," because it's never that simple when it comes to investing. A diversified portfolio is much better strategy.

JIM: Again, fantastic perspective, thank you for that. Stacey, we love to bring you into the conversation and thanks by the way for coming to what turned into our impromptu anniversary party.

STACEY: Thanks for letting me join it.

JIM: You've been on the show a ton of times before so thank you for your support of the show. I wanted to ask, you know, you're the head of life events here. You know in the backdrop of what a lot of Jurrien was just talking about is job losses. With or without a pending recession, you know we heard again, thousands more jobs—of people being laid off, lost jobs in the tech sector, for example. That's a very difficult life event for folks to navigate so maybe start us off by talking about that in the context of the larger work that your team does.

STACEY: Yeah, well, changing a job is a major life event. And whether you plan for it or not, it's challenging. But it's also a good opportunity to just kind of pause and consider what really matters to you. And, you know what are your passions? What are your skills? What are your aspirations? And is this actually an opportunity to maybe do something that you've always wanted to do, perhaps even in different industry.

And then second, I would say, it's a great time to reconnect with your network. It can feel really uncomfortable to call someone and ask them for an introduction but you'd be surprised how willing people are to help. And it's also—networking is also a really great way to figure out if a career path is right for you. And then the third thing I would say is, think about total compensation. It's really easy to just get focused in on how much money will I make, but looking at your total benefit package is really important. For example, there might be a bonus or opportunity or profit sharing or a match for your retirement contributions. Or there could be healthcare benefits, vacation, maternity or paternity leave may be important to you. Also, what would your commute be like in a new job and how much would that cost? And the good news is that Fidelity actually has a job offer evaluator tool that can help you look at the big picture so you can make a good decision and feel confident.

JIM: That's great, thanks for mentioning that. Hey, Jurrien, I had another follow up question for you just based on what Stacey was saying there again. Thinking about planning long term goals and trying to make decisions. Inflation is the elephant in every room these days, trying to make those even medium term—short term decisions are harder because of inflation. What's your sense of what the Federal Reserve is going to do? They're meeting as we speak. You know, there have been suggestions they might change their upward trajectory of the rate hikes based on what's happened.

JURRIEN: Yeah, it's a very interesting time because the Fed is meeting today and tomorrow. And normally at these quarterly meetings, the Fed meets almost every month but in March, June, September, December, they have their big two-day meeting where they update the so-called Dot Plot and the summary of economic projections so those are big meetings. And for the first time in a while, I don't think anyone really has a sense of what the Fed is going to do. And so maybe the Fed doesn't even know because the Fed was on a track to bring rates to maybe five and a half, maybe even higher. And then to kind of keep them there until inflation which is still—which has

come down. It was 9% last year, June, but it's still down around 5 or 6% and it's kind of acting a little sticky. So the consensus has been the Fed would kind of keep pushing, and of course, Chair J. Powell was in front of congress just a week and a half ago or two weeks ago, saying exactly that. And they would keep rates high until inflation was all the way back to the Fed's 2% target.

Now, of course, we have that thing that broke, right? Something—cracks have emerged in the banking system and that's a big deal. And during times when inflation was not a threat, for instance in 2018—we didn't have a banking problem but the Fed, you know the markets were kind of telling—screaming at the Fed to stop. It would have been relatively easy for the Fed to pivot, as we call it, because inflation was not a clear and present danger. But, obviously today it's different, so the Fed has to really thread a needle here by continuing to respect the inflation data and not capitulate to the market pressures or banking pressures while ignoring inflation. Because, you know in order to battle inflation the Fed—the Fed needs to battle inflation to preserve its reputation, its creditably, right? Without that in their arsenal, they don't have anything to go on. So, my guess is that the Fed will raise rates by a quarter or maybe pause.⁵ I don't think they will cut rates. I don't think they will raise them by a half. And I think the Fed will prudently say, you know what we're still on this track, inflation is still a problem but let's slow down because we have some issues here to deal with.

And at the same time, the Fed will extend liquidity to the banking sector as needed. And if we go back, all the way back to 2008, again, not to bring up the financial crisis, but in the early days of the financial crisis the Fed did exactly the same, right? It had cut rates but it had created this liquidity facilities which were really loans, they are collateralized loans. So it's not QE, not quantitative easing. And the Bank of England did something similar last fall while it was still raising rates. So my guess is the Fed will kind of try to straddle this, keeping the message on inflation intact while at the same time providing liquidity where ever it's needed, provided it is on temporary collateralized basis. Which this bank term funding program from a week or two ago is. So that's where I think the Fed is going but again no one really knows right now.

LEANNA: And I'll add in here, too, just what's on our clients' minds. With inflation still on the higher end, our clients are consistently asking us how this may be affecting their goals and ability to really meet their goals. So for shorter term goals some people have said they've put off buying homes or rethinking costs of weddings or, you know, purchasing cars just because of high inflation. And then the longer term goals like retirement, clients have come to us and asking, can we still retire at a certain age or can I maintain my lifestyle? That's where it's really important.

So, I would just say, two areas where we can add value and can help plan for the high inflation. First, is going through an analysis. We spend time with our clients taking a look at your income, your assets, your expenses, we go through our holistic planning tools and we do a stress test, adding in inflation, and help answer those questions of can you still meet the goals you want or do we need to have a conversation around spending less, maybe adjusting your time horizon for some of your goals or reviewing your investment strategy so we certainly help there.

And then just the other area, kind of back to cash, of course we want safety, security, accessibility but also taking a look at the rate that you're getting. So in this rate environment, there are competitive options and not everyone has the higher rates that can just help against these higher inflations so taking a look there.

JIM: So, Stacey, you had talked a couple minutes ago about changing a job in times like these. How about other life events? Lots of things other than job changes can be happening for folks right now. Any other general tips you can share for how to navigate things like that during times like these?

STACEY: Yeah, and really right now, when you're thinking about making a life change, finances are inevitably part of that decision process. And so many life events are interconnected, life kind of tends to hit us all at once. I know in my own life when my dad died, there was a whole series of life events that I went through. I moved home to be closer to my mother. I left my job, I needed to find a new job. My mom downsized her home. We both, you know revisited our finances. So these are all like emotional and financial things and they can be really stressful. But the good news is we do have a lot of resources that can help people navigate these things, set, and achieve their goals, and know how much they can afford. And the other thing I would say is during these times of uncertainty, it really helps again to pause, think about what matters to you, and that kind of focus can help you come up with a plan. And it also gives you a lot more peace of mind.

And then finally, think about any of these life events that you're going through may give you the opportunity to make a change to your workplace benefits. So, for example, if you start a new job, that can be a time to see if you can get help with student loan repayments. Or is there an opportunity again for your employer to make a match to your retirement contribution or maybe you have just gotten married or had a baby, that's another opportunity where maybe you can sign up for new healthcare benefits. The same situation is also true with divorce. So, whatever life is throwing at you though, we have tools and resources that can help people to navigate these situations and feel confident.

LEANNA: And on our end, this is what we do day in and day out so we help our clients navigate through these life events from a planning aspect so if you have any questions or you're going through similar stories, Stacey's powerful story, we're here to help.

JIM: Fantastic, as usual great conversation. I really want to thank the three of you for taking time to be with us today. For our audience, just a reminder, if you're going through a job change, or a birth of a child, death of a loved one, whatever the life event is, and you're looking to get your finances maybe in order to accommodate that change in your life. Stacey and Leanna were just explaining, Fidelity's got a ton of resources for you. You can scan the QR code that's on your screen right now, or just if you want to just type in the URL you see on the screen just under that code. That will take you to Fidelity's life events page and you can find a lot of helpful resources there.

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And as always, if you've got questions about your current financial plan, how it might need updating or frankly, if you just want to start creating one right now, Fidelity can help with all of those things. Give us a call. Go online to our website or download Fidelity's app. Those are just three ways you can continue to learn more. And finally, for folks watching and listening, just a big thank you. The Market Sense show started off, again, in March 2020, exactly three years ago this week. Leanna, Jurrien, and I started off on what was to be a six-to-eight-week adventure to help talk folks through the very start of the pandemic and it's really evolved into just a really robust, fantastic show. And we owe all of it to the people who show up and watch every week. So, thank you for giving us your time consistently and we'll be back here next week.

¹Huileng Tan. "UBS Acquiring Suisse Bank is "no bailout" says Swiss finance Minister—but top economist Mohammed El-Erian disagrees". MarketInsider.com. March 20, 2023.

²Matt Egan, Allison Morrow, David Goldman. "First Republic secures \$30 billion rescue from large banks". CNN.com. March 17, 2023.

³Anthony Tellez. "How unemployment reached a 50-year low despite massive layoffs". Forbes.com. February 3, 2023.

⁴Alicia Wallace. "Inflation fell for the eighth straight month in February". CNN.com. March 15, 2023.

⁵Jeff Cox. "Something broke, but the Fed is still expected to go through with rate hikes". CNBC.com. March 13, 2023.

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