Market Insights: New Developments, What to Consider, and Top Questions Answered

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TRANSCRIPT

SPEAKERS:

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Jim Armstrong: Hello and welcome to Market Insights. Thanks for joining us today. I'm Jim Armstrong with Fidelity. Well, happy birthday to our weekly webcast. It has been incredibly, incredibly one year since we started coming together each week to talk about what the markets have been up to and other current events. As you know, we've covered everything connected to COVID and stimulus packages to civil unrest last summer to the run up and aftermath of a presidential election and a whole lot more. So today, we thought we'd take a look back at how our financial predictions panned out over the past year and what that could mean for our money and investments in the year to come—especially with inflation concerns connected to the latest round of stimulus spending these days. For today's discussion, we are joined by Jurrien Timmer, who will be talking about his latest work analyzing our economy's big picture. Leanna Devinney is also here to talk about how she and her team of Fidelity representatives help people create and update their financial plans.

Guys, I want to start off by saying thank you. We've had a lot of special guests join us over the past year—a week or two here and there, but you two have been consistently with us week after week, making time in your schedules to prep for these discussions and then to deliver them each Tuesday, and I just wanted to say thank you again for making that commitment to us and our customers.

Jurrien Timmer: The same goes to you, Jim.

Leanna Devinney: You're very welcome.

JURRIEN: And to the A team that you can't see on the screen, but that's behind the scenes making all this work.

JIM: I'm going to do it. I'm going to put up a little -

LEANNA: It's really been incredible.

JIM: Get a little surprise party happening.

LEANNA: Nice celebration.

JIM: Yeah. Thank you again so much. So let's get started. It is Tuesday, March 23rd. To level set, this show premiered March 24th of last year. So there's no way we could have known it then, but the day before we premiered—which is, again, one year ago today, March 23, 2020—that ended up being the day the market hit what would become its bottom. Of course, there's no way to know you are at the bottom until you've long since passed it. So, Jurrien, if you could, kick us off with kind of a high-level look at what happened in the past year versus what we expected to happen.

JURRIEN: Yeah. And, you know, this market cycle has been a perfect example of—you know, we can all come up with things that the market should be doing based on this and that. But what the market actually is doing is also important. This is why I've been looking at charts for the last, you know, 35 years or so. And I remember exactly a year ago, on March 2013, that was the low point for the cycle. The S&P was down 35%. And on that day, only 98% of all the stocks in the S&P 500 were below their 50-day moving average, which is a technical indicator that chartists like myself and others will look at. That was a near record oversold. Like—you would have to go back 100 years and find maybe only two or three other times in history that so many stocks were down relative to their moving average. And that doesn't tell you that the bottom is in, but it did tell us at the time that, you know, if nothing else, this thing has moved a lot very fast. You know, 35% in—I guess it was five weeks or so. And now that we have the benefit of hindsight, we can actually see that a lot of what we said actually over the past year was fairly accurate. You know, a lot of what Leanna and I were saying on these shows and in front of clients elsewhere, especially in March/April was, you know—if you had a good plan before COVID, it's probably still a good plan today. So don't second guess it. If it wasn't a good plan, then that's an opportunity to sit down with your financial adviser and make sure that you do have the right plan. But just selling just the market is going down is generally not a good strategy. Because then you are trying to time the market and you're actually second guessing your own plan that hopefully was a good plan to begin with.

So, having said all that, in retrospect, whether you look at the average market cycle, which is what I am showing here on this chart, the gray line is the S&P 500 price, and that is indexed to where it reaches a cyclical bottom. The blue line is earnings, which typically bottoms six months after price. And that's, again, another reminder that the market is always discounting the future, right? And remember, we had this conversation last year where the market seemed so disconnected from reality. You know, things were getting so much worse and yet the market was already rallying. Well, a lot of that has to do with the policy response, which I'll talk about in a moment. But a lot of that has to do with just the way the markets work. They anticipate the future. And so, typically what happens is price bottoms first, earnings bottom next. During that time when price is already bottomed and earnings are still falling, by definition, the PE ratio—the price to earnings ratio—is going up. Because that's just the math. It's price over earnings.

So what's interesting, if we go to the next slide—and this slide is a little bit busy I apologize, because it now has six lines. But you got the two blue lines, which is earnings now, earnings the average cycle. You got the two gray lines now versus the average. And the two yellow lines, which is the PE now versus average. You can actually see that this cycle has in many ways unfolded in fairly textbook fashion. So earnings did bottom two quarters after price. The price is up about as much as it normally would be in a typical cycle a year later. You know, we're up 50% on this chart. If you look at a daily chart, we're up a little bit more, but this is using monthly closes. And if you look at the PE, it's up 45%, and it's now starting to come down, which is what typically happens when earnings start to broaden out and go up and, therefore, the market can kind of grow into its valuation. So I guess it's an example of the more things change, the more they stay the same. Because as strange and as unusual as this cycle has been, I look at this chart and actually, it tells me that the market has kind of done what it typically does.

JIM: Hard to believe at the time, but great to have that perspective now with hindsight for sure. Leanna, I'd love to bring the perspective of the customer in now. Again, talking with hindsight as well. I can only imagine the things that you and your team of representatives have had to do to talk to clients and to calm their fears over the past year. Anything rise to the top in terms of lessons learned for you guys?

LEANNA: Yes. And I'd say just reflecting, a year ago, I remember my team and I most would be advising people to stay the course, not make any knee jerk reactions, and especially as Jurrien just mentioned, if you had a good plan in place. And if you didn't, then it was an opportunity to come in and make sure that you had that well-diversified plan. And it can be very hard information to hear and believe, especially when we were living amongst the pandemic like we were a year ago. Our feelings and emotions begin to take over. But I always like to show this chart. And we do know and we've seen just historically on average since 1926, stocks have dipped into what's called bear market territory on average every six years. And that's been with losses averaging almost 40%. So while it felt very different, we had seen this before. And not every market downturn is going to feel the same. But when I reflect, what we heard most was, "This feels different, though. This is unprecedented." And there is truth to that. In our lifetime, we certainly did not have to transition full time to home—working at home, child care at home—all in the pandemic. But this chart shows—and in my ten years in the industry and I know Jurrien has more—I've heard that before. That Brexit felt different. The global financial crisis—this was all unprecedented. So I think the lesson I would share is just while it can feel different, we know that how we react to the events should stay unemotional and being able to stay the course. Jurrien, anything for you to add on that too?

JURRIEN: Yeah. No. This is great insight. And, you know, I followed, you know, all this stuff for a long time myself. You know, the market on average goes down 10%, 15% every other year. It goes down 20 or more percent every five years. But yet, over the long term, it tends to compound at about 10 or 11%. So having that long term plan is essential. And just—you know, one other thing that was especially relevant for this cycle, especially a year ago when things were moving so fast, and that is that, you know, as the fundamentals are evolving—and they're evolving right now, but they were certainly devolving very quickly a year ago—what it means for the market, it's all—for an investor who has to make a decision whether to hold, buy, or sell, a lot of it comes down to what is actually priced in, right? So you could be totally right on the direction of the economy and earnings, but if that's already priced into the market, then you can actually still be wrong by acting on, you know, that foresight. And what happened a year ago is exactly that. The market fell 35% in record time—five weeks. And by that point it, had priced in a lot of a lot of negative news. All that negative news actually did happen, but it was already priced in and, therefore, there was really nothing left to do for investors other than to just hold on.

JIM: I want to actually—

LEANNA: It's true. I would just say lastly on that, Jim, we—the emotions can be hard. So what we did notice, just in reflection, is that those that work with professionals or collaborate, it helped ease some of the nerves—even if it's just meeting once a year were more calm in 2020 and felt more prepared.

JIM: Yeah. That for sure makes sense. Thank you for that. I did want to sort of build on what Jurrien was just saying, though, Leanna, talking about this move in 2020 that a lot of customers made to cash. Like, leaving the markets in part or in total, figuring—hoping that that would be the best way to protect their investments. Didn't turn out that way for folks, did it?

LEANNA: It did not for many people. And so when the market pulls back and we sell out, often times we're selling at a loss because the markets have gone down. So the hard part, though, is we make a gut reaction of when to get out of the market. But the challenge is: when are we going to get back in? And so often, we miss out on some of the best days. And that's exactly what we saw in 2020. The market would unexpectedly skyrocket back and for those who weren't participating in it, didn't get to participate in those gains.

So this chart—we've shown it a lot before, but it is a hypothetical $10,000 invested in 1980 and it grows to almost a million dollars by 2020 all by staying invested in the market. It then shows if this owner went to cash and missed even just the five best days in the market—and, again, it's often paired next to the worst—it brings that 2020 total down 40% to less than $600,000. And then showing the best—missing the best 50 days the $10,000 didn't even make it to $70,000 over four decades. So it is really important. And while, again, this is a hypothetical illustration, we did see this happen often last year. A client I worked with closely—she just said, "I'm going to hit pause. I know I'm supposed to stay invested, but let me hit pause and I'll be back in when this is all over."

2020, you didn't feel ready to hit play again, and there was a lot that was going on, and it can certainly make an impact on your long-term goals.

JIM: Yeah. For sure. Hey, Jurrien, I want to—speaking about the recovery that Leanna was just describing, I wanted to bring you back to something that you have talked about over the past year. Really, you've credited the U.S. Government with a lot of the recovery, right? Fast action; mountains of cash. But now, you know, a year later, I think there are a lot of people who are worried about inflation as an effect of that fast action. People worried about how rising prices are going to have the power to hurt them today and tomorrow as well. What can you say about that?

JURRIEN: Yeah. I mean, we have come full circle. And, I mean, in a way, this is kind of a luxury problem, right? Because the same forces that were able to break the fall in the markets a year ago—so the combination of fiscal policy and monetary policy. So fiscal policy in form of the CARES Act, of course, which we have talked about many times. And then that combined with the monetary accommodation of the fed dropping rates to zero, assuring the markets that it's not going to raise rates for a long time. And at the same time, expanding its balance sheet. So that one-two punch of fiscal/monetary intervention a year ago is what kind of saved the market. Or—I shouldn't say saved the market, but it allowed investors to kind of look past the abyss of the pandemic. And so the policymakers essentially built a bridge to the other side of the pandemic.

Now we are getting to the other side of the pandemic, right? You see in the chart here that the gray bars is the percentage of hospital beds in the US occupied by COVID patients. It's gone from 19.3% to 5.7%. So the curve is not only flattening, it's crashing, basically—which, of course, is great news, and we hope that it continues. And, you know, 125 million vaccine shots have now been administered, so all really good news. But now, we have all of that policy stimulus, right? And you can see in the top panel the accumulated increase in the federal debt since the pandemic started. So $4.5 trillion of additional debt, fiscal stimulus. And the fed's balance sheet has gone up by $3.5 trillion. So there is a price to be paid for that. And we're seeing that now. So bond yields have—they were half a percent a year ago. They're 1.7% today. Inflation expectations have come up. And you could argue these are all good things. Because, you know, if they weren't coming up, something would be wrong with the system, right? So a year ago, we were wishing for this to happen because it would be a sign that things are getting better. And they are getting better.

So you know, for an investor—again, where you are on that portfolio diversification, what you do on the bond side of the portfolio—and I know Leanna will talk about this in a second—how much, you know, duration you have, which is a technical term for how long the maturity of your bonds are. These are all questions that can be answered and played with. But, again, we are now on the other side of this, and you would expect to see what is happening, happening.

JIM: Perfect set up there for Leanna, then. If you could take it over, Leanna. So let's say someone sits across from a member of your team or you and says, "I want to protect potentially against inflation and what it could do to my portfolio." What's sort of options does an investor have?

LEANNA: Absolutely. It's perfect timing. I was in a client meeting last week and they referred to it as a silent assassin, which I have heard before—inflation being the silent assassination. But to Jurrien's point, it's not necessarily a bad thing. What we can do to make sure is that when we're building plans, we're incorporating hedges to inflation. And this client, specifically, was in a lot of cash. And cash in this environment is not going to keep pace with rising inflation. And so it doesn't mean you have to go right from cash to stocks. So we're going to help understand what your goals are, build that diversified portfolio to hopefully meet those goals, and keep inflation front of mind.

This bullet point here, it goes through some of the options you have to hedge against inflation and add investments to that portfolio that do well when prices are rising. So here are four areas. The first—bonds, as Jurrien was talking about—is treasury inflation-protected securities. We often hear of them as TIPS. But they're type of bond that is indexed to inflation. They are conservative, again, for those who don't want to go right from cash to stocks incorporating this. And they're backed by the treasury. And every six months, the treasury is adjusting the principal by the latest inflation numbers. The next is commodities. So these are things like gold, which you can invest in with ETFs, which are called exchange trade of funds, mutual funds, mining companies—these are commodities that have tend to keep pace with inflation. Non-US stocks. So if US rates are lower, that could bring the dollar down. So something like emerging markets out of US or international—they have natural resources like that commodities, again, that have tended to keep pace with inflation. And then last on my list is low-priced value stocks. So these are stocks that are often more income-oriented or dividend paying. And they're great hedge for inflation. These four areas are, again, what we can do to help hedge against inflationary concerns for building that diversified portfolio aligned to your goals.

JURRIEN: I would just add to that, Leanna—I mean, that's a great overview. So if inflation is going to rise or if the fed, the central bank, kind of manages rates so that they stay below the inflation rate—which, personally, is something that I think will happen—then yes, you are locking in kind of a decline in your purchasing power if you are in cash. So cash becomes expensive. You know, I like to think of it as a silent tax, if you will. But it doesn't mean you have to sell everything or buy everything. You know, a lot of this stuff can be done below the surface of let's say a 60/40 or some sort of diversified portfolios. And you could just tweak—you can sell some bonds, buy some tips. You can some U.S. stocks, buy international stocks, or sell some growth stocks and buy some value stocks—all of these different areas have different sensitivities to inflation and so it's not—don't think of it as a binary, I'm either here or I'm there. It can be tweaked at the margins.

JIM: Great point. Thank you for that, Jurrien. With just a couple minutes left, Jurrien, I wanted to end with one question to you. Revisiting a chart that I think we used quite in bit in 2020. This one, of course, is updated to the current moment. But you've talked about earnings estimates a lot, and I think this particular hart has a couple of stories to tell. I think there's one you could tell about how last year ended up versus where you thought it was going to end up. And the contrast between last year and the next couple of years.

JURRIEN: Yeah. So, to the point I made earlier about what we have to think about what's priced in addition to what is going to happen. And so, if you look at this chart, the vertical line is the beginning of the calendar year, and all the squiggly lines are the expected growth expectations from Wall Street analysts. So these are not my predictions, but just, you know, the consensus estimates. And half a year ago, the 2020 number—which is the orange line—was expected to come in at minus 22%. So that's a lot of bad news. And, you know, it doesn't—it's not like any year that earnings fall that much. It ended up falling minus 12.7%. So significantly better than was expected. And, again, it just speaks to—we have to look at what's priced in, because even if we are completely right and the world's going to hell, if that's already priced in, there really isn't very much to do.

And then, on the other side of that equation, of course, the blue line is the 2021 estimate. It was at 21% a few months ago. It's up to 24 and rising. That's an important thing because earnings, you know—valuations are kind of high in the stock market. And at this point, per the first chart that I showed, earnings are now joining price. They're now confirming price, and that will allow the PE to come down even though the market is still going up. And for that to happen, we need earnings to be revised even higher than where they were. And as you can see in the chart, that's exactly what's happening.

JIM: Thank you, again, for that prospective. And Leanna, thank you. What did you call it Leanna? Our Insight-versary?

LEANNA: Yes, Insight-versary.

JIM: Our Market Insight anniversary. The Insight-versary. Well, I'm incredibly pleased and lucky have been able to spend the last year with you. And let's do it for another year, if you're both up for it and willing to.

LEANNA: Yes!

JIM: We hope folks watching will continue to watch as well. Don't forget—if you need help with your financial planning or you've just got questions about building or updating your current plans, we want to consider visiting Fidelity's website or downloading the Fidelity app on a mobile device. Check those out if you haven't done so already. They can be really, really good ways to start getting your questions answered, learning about the topics that we cover here and a whole lot more. Next week, we're going to be talking about what to do with cash, whether you've happened to accumulate a lot more than usual from under-spending perhaps. Maybe you got a stimulus check, a tax refund, a bonus from work—whatever the situation is, we're going to have some long and short-term strategies to share next week. Leanna, Jurrien, thank you for being with us for this entire year and today in specific. To everyone watching, thank you and we'll see you next week.

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