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

Week 47, March 30, 2021

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. In the coming weeks, stimulus checks and tax refunds are going to continue to make their way into mailboxes and bank accounts. Now, for folks who have an immediate need for that money, that's great news. But there are plenty of people who might not have an immediate need, and for them as well as for those who maybe have been able to save more cash over the past year or so, they're likely wondering about where the best place for that money might be. So that's actually what we're going to be discussing today. Possibilities for the cash that you might have sitting relatively idle on the sidelines along with some very specific customer questions on that exact topic. And of course, we'll also take a look at what the market's been up to over the past week or so since we last spoke.

For today's discussion, Jurrien Timmer will join us as always to talk about his latest work analyzing our economy's big picture. Leanna Devinney is also here as always to help us—give us a sense, I should saygabout how she and her team at Fidelity representatives help people create and update their financial plans. Leanna, Jurrien, great to have you here again.

Leanna Devinney: Thank you. Great to be back as always.

Jurrien Timmer: Great to see you guys.

JIM: Jurrien, let's start with you, if we could. Today is Tuesday, March 30th. And as we get ready to talk a lot about cash and maybe where to keep it today, I think the idea of cash directs a lot of our minds pretty quickly to thoughts of inflation in the near term—thoughts about interest rates, about the government borrowing and spending, about our borrowing and spending, long-term investing goals. So sort of set the table for us, if you could, on all those topics.

JURRIEN: Absolutely. So we know that, you know, in recent weeks—even, really, in recent months—you know, the conversation has gone from, you know, the economy is shut, how much more fiscal stimulus do we need? What does the Fed need to do in terms of, you know, building that bridge to the other side of the pandemic? And since that time, you know, as we've indicated in recent weeks, you know, the COVID curve has really, really come down. I mean, it's kind of flattening out now. But, you know, the number of hospital beds occupied by COVID patients went from 19% to I think 6% or 5%. We got another $1.9 trillion in fiscal. That brings us to over $5 trillion now since the pandemic started. And that's over 20% of GDP. And now, you know, the conversation has gone to, okay, the economy looks like we're actually going to reopen for real. You know, fingers crossed, of course. And consumers are going to be willing and able to spend. I mean, I'm seeing this—you know, I was on an airplane over the weekend, and Logan Airport here in Boston was absolutely packed. So it's coming back.

And so now the conversation in the markets—which, in hindsight, correctly discounted that happening—now the conversation is about, okay, will we have to pay the price through inflation? And will that inflation be temporary or long-term? What does that mean for monetary policy? And so this is what the market, I think, is kind of grappling with right now. And if you look at this chart, you know, this is the ten-year treasury yield, which is the black line there. The yellow line is the Fed funds rate, which is the Central Bank's monetary policy rate. Then the little pink circles are the so-called dot plot. I won't go into detail what that is, but that's the Fed's expectation of where short rates will be in the coming years. And then that dark line is the futures market, pricing in what it thinks—what the market thinks the Fed is going to do. So what this shows is that the Fed is saying—and the market seems to be believing—that the Fed will only kind of take the punchbowl away, as we like to say it, very, very gradually, with maybe a rate hike in late 2022. Maybe another one in 2024. Really, it's not going to even reduce its asset purchases for a while.

So what the Fed is saying is that we're going to let this run hot—the economy, that is, and we're not so worried about inflation. Let's worry first about getting everyone back to work. And I think that's also the message we're getting from the treasury and from the Biden Administration. So it looks to me like both fiscal and monetary policy will remain on full throttle for several more years before the Fed will start to normalize policy.

And so, you know, for the markets, that means ample liquidity. It probably means a good outcome for stocks. But it also means that interest rates are rising, and you can see in this chart that they are. They're actually approaching 2% now, which in my opinion, actually, you know, offers some value. But the question of inflation and whether the Fed will let the genie out of the bottle, if you will, and won't be able to put it back—I think that's going to be a conversation we're going to having and many people in our business are going to be having, not just for the next few months, but for the next few years.

JIM: Fantastic context, Jurrien. Thank you for that context for Leanna's question, here, because, you know, we've talked on this webcast, Leanna, a lot about the reasons why somebody today might have more cash than usual. You've talked about a lot of investors who, last spring, when everything was feeling—and was—pretty crazy, they pulled out of the market in sum or in part, moved to cash to protect themselves. What short-term solutions are you seeing today that people can or should consider for their cash?

LEANNA: Thank you, Jim. And you're right, many people do have cash on hand for various reasons. If it was getting out of the market out of fear, or saving more because they were home, or now anticipation—potentially refunds. We're starting to talk more about what to do with cash on hand. So I love these questions here as a start—just how much do I need to pay for my expenses? Planned and unexpected. Along those lines, making sure that you have an emergency fund. So we believe that should cover three to six months of your total expenses. You want that in cash. Flexible so it's ready and available for that emergency, God forbid.

Now, outside of the emergency fund, when you hold a lot of cash, you really need to ask yourself if you're willing to accept lower returns from your investment portfolio in the future that could result in holding too much in cash rather than investing it in stocks and bonds. So what we do know in today's interest rate environment, leaving large amounts of cash—again, outside of that emergency fund—can be a drawback. And that's simply because it's not going to be keeping pace with inflation in the long term. Historically, we know that both stocks and bonds have delivered higher returns than cash. And this is what we—me and my team and advisers can help with. Making sure that we can help you invest cash for your long-term goals, but also, there's a number of options for you, for your cash, for short-term and medium-term goals as well that we'll dive into that still provide that safety and flexibility. And opportunities to earn some interest.

So it reminds me, I met with—me and my team—a client last week who had recently retired. 62 years old. They had an emergency fund and then the rest was in a retirement account. And she felt very comfortable splitting that retirement account in protection, we called it, and growth. And the protection bucket was a hedge against the market, per se, that wasn't in the stock market. It was fixed, but it did more than cash. These are the ways that we can help and we can dive into some of those options.

JIM: Yeah, thank you for that. In fact, I have a couple follow ups for you, Leanna, on exactly that topic. But first, I want to turn to Jurrien and get your perspective kind of on the same question, because I know that, you know, we talked about when people moved to cash last spring, you've been following what they've done since then sort of on a macro and high level. What can you tell us about where—generally speaking—those folks are today?

JURRIEN: Well, what's interesting is that, actually, people are putting more cash into money market funds, but it's not coming at the expense of stock or bond funds or ETFs, and that tells me that actually, you know, these might be the stimulus checks. Right? It's actually people having cash.

JIM: Yeah.

JURRIEN: They're putting it to work kind of across the market. So, you know, just to explain this chart, the top panel is—shows the amount of assets sitting in money market mutual funds. And we all know the story from a year ago because we discussed it many times, and that is that right during March, right when the market was, you know, cratering but then finding its bottom, people were pouring money into money markets. And, again, it's totally understandable. It's not always the right thing to do because the whole value proposition of being—of earning a return for your retirement is to keep that money in the market so it can keep working for you. Right? That's the magic of compounding, but totally understandable that when the market goes off the rails, you want to, you know, sell first and ask questions later. And we saw a year ago that's exactly what many, many people did. So people put about $1.15 trillion into money markets, and it mostly came at the expense of bond funds and equity funds, and then it took a while for that to return. But you can see if you look at the blue and the yellow line in the bottom panel, money has been coming back into bond funds and stock funds. And now, there's slightly more money going into stock, mutual funds, and ETFs than there are into bond mutual funds and ETFs. But as I mentioned earlier, what's interesting is that even the gray line is now rising. So bond stocks, money markets are all taking in assets, and that can only mean one thing, and that is that people have more money to invest or to spend. And they're putting some of that money into all parts of the markets. And so it's not cannibalizing one particular area. So it does give you a sense that people have the cash, and that's, of course, why we're having this conversation today.

JIM: That's fascinating. I hadn't noticed until you called it out—that top gray line, even a couple of weeks ago, was making a steady track down, but now it's popping back up again. That's fascinating. That's showing extra money or more money in the economy.

JURRIEN: Correct.

JIM: Wow. Hey, I learned something. Awesome. Anyway, Leanna, Back to you. I learn something every week, frankly. A lot of questions recently from customers, and I wanted to get one of them in front of you right now. In particular, customers who have sold their homes and made a profit and they're not sure what to do with it. So here are the specifics that we heard from a customer. A woman wrote in and said "I've got $80,000 from the sale of my house. I definitely want to use it to renovate my new house. but not for two or three years. So how do I grow that money in the meantime?" What can you tell her?

LEANNA: Apologize—I froze for a moment here. So I'm back and want to make sure that I got your question. You heard me. That's a thumbs up, right, that I'm back on? Great.

JIM: You sure are.

LEANNA: So she has several options depending on how much risk she wants to take on, but there's some key points here. So first, $80,000 and she wants to use it in two to three years. That's not 20 to 30 years, so we're going to treat that very differently than we would long-term goals. So let's go through the list bulleted here. So first, she can consider a savings account at a bank. You're likely not going to earn much interest these days. We've talked about that. But what you do know is the money is safe and protected by the FDIC, Federal Government, up to $250,000. Similarly, there's cash management accounts at brokerage firms, and that's essentially money in a bank account as well. Relatively safe. Second on the list is the money market mutual funds as an option. If you invest in these, you're buying short term debt securities, and that's at a low credit risk. Like bank accounts, they offer easy access to your cash. You're putting money—if you need it in a short-term's notice, it's highly flexible. Those two are very similar. Another potential option is a certificate of deposit, also known as a CD that we may be familiar with. You're agreeing when you buy a CD—it comes with a term, a specific period of time. It could be one month; it could be 20 years. In this case that you brought up, she's expecting to use it in two to three years. So that would be the term of the CD you would buy. It is not flexible until that term is up. And then you get return of your principal back. That example I gave of the client in the beginning today—she also split her retirement account, saying, "I want to have safety in the form of a CD, knowing I may need this money in two years, and the rest I'll put it towards growth." It allowed her to have that growth and protection.

So then just the last two here—we have individual short duration bonds. That's an option if you have cash but you don't need to access it immediately. They carry more credit and interest rate risk than a CD or than the cash, the other options I mentioned. But it does come with a little bit more risk and also with more risk, potential for more return. Last is the short duration bond funds. These are a little bit more flexible than individual bonds because they're in a fund. But we actually encourage you to stay invested of the duration of the bond funds. They can come with some fees if they're actively managed or passively invested, but all of these options listed are, again, not going from cash right into the stock market. It's more of those short-term or intermediate-term options that you have for your cash.

JIM: Got it. And now for a couple of long-term questions, I'm going to bundle two customer questions into one here. We know one woman wrote in and said she recently refinanced her mortgage. A lot of people in that bucket. And so now she's finding herself with a couple of hundred extra dollars a month that she wants to invest but be smart with. And then similarly, another question, but a bit more general about options for investing beyond your workplace account. So your 401(k), your 403(b), et cetera. If, for example, you maxed that out, you put in the maximum contribution there, what's your—where's your next best dollar going?

LEANNA: Okay. These are great questions. And these are exactly what my team and I get day in and day out. Also very timely on both. So to answer both, it all comes back to the goals that you have for your money. And we want to build a plan that's diversified to meet those goals. Like I said before, we're not going to treat long-term goals like we would an emergency fund or short-term goals. And really what it comes down to is being too risk-averse or too conservative can often be just as risky as being too risk—or too much risk on—too aggressive. This chart shows the why behind that. It's showing an example—a difference of $100 invested over 50 years. And you can see the growth of stocks are blue here. Bonds are in green. That short term is in yellow, and we're also showing inflation. So as you can see, stocks have provided the highest opportunity for growth over time, but it did come with more fluctuations. We can see that zigzag—fluctuations in value. And then you can see on the bonds and cash a little bit more steady. It has that downside protection, but not as much growth over time.

So to answer the question on those two cases, if we are automating and investing a couple hundred dollars every month, it can make such an impact on your savings. If you're investing in a combination of these or stocks to bonds, these are things that we've talked about before, but all, again, based on the goals that you have in creating a diversified plan to meet those goals.

JURRIEN: You know, I would just add, Leanna, you know—especially now with monetary policy essentially locking in a negative real yield, right, because inflation is likely going to go up and the Fed is likely going to stay at or near zero, that just having that money sit in cash doing nothing—you're kind of locking in a loss of purchasing power. So putting it in, you know, bonds and stocks, some combination of that, especially a little bit over time—and, of course, we talked about dollar cost averaging many times. I mean, it really is one of the greatest ways to invest, because you never have to worry about, you know, paying top dollar—you know, locking in the top of the market because you're putting a little bit of money to work over the long run and hopefully earning a real return that's positive.

JIM: So that's—thank you for that segue, because that's perfect—what I wanted to ask you about next, Jurrien. We talk about the performance of the stock market, of course, connected to the overall individual performances of all the different components of the markets. I wanted to sort of get your sense of what earnings are looking like. Corporate earnings come out quarterly. Companies tell us how they did, how well they did or not did the previous three months. What are we looking at right now?

JURRIEN: Yeah, so earnings have been very strong. So in this chart, I'm showing the progression of earnings estimates. These are consensus estimates from analysts—you know, Wall Street analysts, and the vertical line is beginning of the year. So these are calendar year earnings for the S&P 500, and they're expressed as a growth rate. So that orange line was—is the growth rate for 2020—or was the growth rate for 2020—progressing over time during 2019, 2020, and then into the beginning of 2021. And you can see that earnings have actually beat expectations quite a bit. You know, in the middle of last year, right during the pandemic, of course, expectations were for a 22% loss for that year. Turns out it's been a 13% loss—which is still a big loss, of course. But then look at the blue line. That's the 2021 estimate. That was at 21% toward the end of last year, and it keeps ticking up. It's now at 24%, 25%. And we're on the cusp—well, in a few weeks we'll have earnings season for the first quarter. Right? So that happens usually in the second week of the new quarter. So we're March 30th. So we'll have that coming up. And so far, that progression is moving in the right direction. And that's an important thing because, you know, the stock market is not inexpensive. You know, the market's trading at 22 times expected future earnings, which is among the higher side of market history. And so for   for the market to keep making progress in the upper direction without it having to come from higher P/E multiples, it will have to come from stronger earnings. And fortunately, that's exactly what we're seeing here.

And, you know, just to kind of tie it back to the inflation conversation earlier, what we're hearing from companies—because we obviously speak to many, many companies at Fidelity because we invest in their stock—is that more and more companies are finding that they have pricing power. Like, their costs are going up because supply chains were disrupted during COVID. Inventories are low. And they're finding that they're able to pass those higher costs on to their customers—which, of course, is bad for the customers, but it shows you that even the inflation narrative is kind of feeding its way into the earnings story.

JIM: Yeah. Again, another data point. More for me to learn and more for all of us to learn. So thank you, Jurrien. Thank you, Leanna for being with us today. Of course, for folks watching, thank you as well. A reminder that if you need help with financial planning or you've got questions about what we offer here, visit Fidelity's website or download the Fidelity app on your mobile device. Those are great ways to explore our planning solutions and get answers to your questions about topics like those we covered today and previously. Again, thanks for watching today. Huge thanks to—once again—Fidelity's Leanna Devinney and Jurrien Timmer. Quick note: we did mention it once or twice before. Leanna is pregnant. And, if I may, very pregnant at this point, right? Can you give us a quick update?

LEANNA: Yes, countdown 18 days. So I'll be—I will be here next week, I think, but we will see after that.

JIM: If Baby TBD has his or her way, right, we don't know what's going to happen. Our plan, right—that's why I wanted to bring it up. Our plan is to have Leanna back on the 6th. We've got some other fantastic folks lined up so that she can take a restful maternity leave over the spring and summer. But our hope to see you here next week. If we don't, pre-congratulations. We'll hope to put a picture of you and the newborn baby up at some point in the subsequent months ahead.

LEANNA: Thank you.

JIM: Absolutely. By the way, next week, we're going to be talking about the habits of successful investors, so we hope to see you there. Leanna, hope to see you there. Jurrien, of course, hope to see you too, for goodness' sake. Thanks, everybody.

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