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. The ups and downs that we all see in our investment accounts are determined by the performance of the investments we choose. And whether you run for the hills or kind of white knuckle your way through market volatility, it all depends on how personally comfortable you are with risk. And the thing is, when it comes to risk, there's definitely no right or wrong answer. It's got everything to do with what feels right to you. So that's what we're talking about today: the three key questions you can ask yourself to find—potentially—some suitable investments. And as always, of course, we'll discuss the latest market news and what that might mean for you and your investments as well. For today's discussion, we'll be asking Jurrien Timmer to catch us up on our economy's big picture and specifically asking about his latest thinking when it comes to the potential for future inflation concerns. Now, regular viewers of the webcast will notice that we're usually joined by Leanna Devinney, but she will be taking the next few months off to tend to her newest job, which is brand new mom. So we've got a special guest this week. Jenn Sirois joining us. Jenn holds a certified financial planner designation, and has got years of experience working one on one with people just like us helping build financial plans to meet their goals. So Jenn, Jurrien, great to have you here. And Jenn, welcome to the big show.

Jenn Sirois: Thanks, Jim. Thanks for having me. I'm really excited.

Jurrien Timmer: Great to see everyone and Jenn, welcome. Welcome to the team.

JIM: Jurrien, let's start with you. It is Tuesday, April 13th, and in just a minute or two, Jenn is going to, again, talk to us about how to perhaps choose your investments, but I think a great place to start, then, is with you and looking at the stock market, which is where a lot of people think when they think about investing. And if you could just sort of set the table with what we have seen over the past—I was going to say few months, but really, full year or more.

JURRIEN: Yeah. I mean, it really is amazing how this market has evolved from, you know, the depths of the pandemic and then the recovery and then sort of the reopen, if you will. And, you know—I think 70 million people have been vaccinated, and 31 million people have gotten COVID in the US, so you're already at—kind of—over 100 million or around 100 million people who have reached some form of immunity. And the market sees this, right? Markets always discount. And what we're seeing is actually a really constructive picture. So the S&P 500 as well as the DOW making new all-time highs. The S&P is now at around the 4100. Not many people saw that coming a year ago for sure. And if you look at the bottom panel in this chart, that shows the number—the percentage of stocks in the S&P that are above their 50-day moving average. And that's just a simple way of keeping track of how broad the rally is, right? How many stocks are participating? And so you'll remember that a year ago, as the market was recovering from the lows, it was really a pretty narrow rally. It was, you know, the fang stocks, the large growth tech stocks, you know, the work from home stocks, if you will, that were leading the charge. And then we were kind of worrying maybe six months ago that as the leadership rotated from large cap growth stocks to smaller cap value stocks, would the market be able to hold up given how big those big growth stocks were and still are? And it turns out that the answer is yes. The market not only held in there as the rotation happened and the leadership broadens out to a point where you would normally see it in an early cycle recovery. Right? Normally it is cyclicals and financials that are doing well. All of that is happening, but at the same time, 91% of the stocks in the S&P are above their moving average, and that's a really impressive thing to see. You can go back on this chart and see that back in May/June it was 98%, which is very common right off of a depression like that where you go from 0 to 100. And then it's really up to kind of how the market evolves from there. So to be more than a year later and the market is up, you know, at least 75% or so—to still be at 91% participation is really impressive to see. So as a market analyst, as a chartist, this is what I want to see. And then, you know, we have earnings season starting up and we're seeing the numbers be really strong as well. Upward revisions. Again, this is what you want to see if you want to feel somewhat comfortable being invested in the stock market.

JIM: Thank you for setting the table there, Jurrien. That's really great, because, Jenn, I think turning to you for that sort of boots on the ground perspective here, I'm sort of struck by how Jurrien's chart does sort of that—that up and down, almost roller coaster-like feel, which is exactly what your next chart is going to talk to us about here. And that ties into the first question that folks can ask themselves. And it's really about your emotions, right? And how much you can stomach those sometimes-wild waves. So how do you explain and how do you get people around that idea?

JENN: That is a great question, Jim. And roller coaster, I think, is a perfect analogy. So the first thing that I ask families to be honest with themselves about is: how much risk can they actually stomach? Because we all know that investing does come with risk. So investing in stocks, for example, can be one of the best ways to help achieve the longer-term financial goals you have. But you have to ask yourself: how would I react if the stock market dropped 30% tomorrow? So, the answer to that would certainly lead to what you hear us typically refer to as your risk tolerance.

And that risk tolerance can certainly change based on age, time horizon, your own personal financial circumstances. So, if I take a trip down memory lane for a minute—if we go back to March of 2020, there were a number of families that I spoke with that were very comfortable—I should—maybe not very, but they were comfortable sticking with their investment strategy because we had talked about that question. How would they feel if the value dropped off by 30%? What would their reaction be? Would they be able to stick with it? And their honest answers led to the investment strategy that they had. So, if we talk about investing in only stocks, that is really about as aggressive as you can get these days. It certainly offers potential for higher returns, but it comes with those extremes—that, you know, that roller coaster in both directions. So, on the other hand, you could certainly avoid stock all together. So the ride might be more smooth, but the tradeoff is you may end up earning less over time. So, historically, stocks have certainly provided those higher returns over bonds or short-term investments like cash. But, as the visual here shows, stock prices rarely go up in that straight line there, Jim. So they may go up, they may go down, they may stay flat for a bit and go up again. Ultimately, at the end of the day, your investment mix is something you should be comfortable with no matter what the market brings you. That's the gut check, if you will.

JURRIEN: Well, you know, all good things come at a price, right? So if you want that 10, 11% return it comes with a 15% annualized volatility, so you need to be able to survive those drawdowns in order to get the prize at the end.

JENN: Definitely. Definitely.

JIM: Jurrien, I'd like to get your perspective on a slightly nuanced topic here before we get onto Jenn's next key question because I think, you know—to the extent where feeling comfortable as investors, it's got a ton to do with, you know, what's happening in the world around us. And today, I think a big thing on a lot of investors' minds is inflation. Prices rising, maybe people worrying about their dollar being able to buy less, savings being eaten away. I think you're ready to take us on a trip back to the 1790s, in part, to help us get situated.

JURRIEN: Well, I do love my market history. But yes, you know, you are absolutely right. So the market, as we know, is always discounting the future. It's not always discounting it correctly. Right? The market on March 23rd of last year, when the S&P was literally half of where it is now at 2200, was pricing in something that ended up not happening, right? So the market is not always right. But the market, in this case, correctly anticipating a recovery in earnings, a reopening of the economy, the vaccine news obviously was a very nice surprise for the market. And so now we have to think about, okay, what's next? What is the market—what is the next thing we have to get right incrementally as investors? You know, most of us are in some sort of 60/40 type of portfolio of stocks and bonds.

And so right now, the big question—and it really is the big question—is the economy is reopening, supply chains have been disrupted because of Covid and also because of some tensions with mobilization between the US and China in recent years. Inventories are down. And so now, as demand surges, right? I mean, stimulus checks, reopening of the economy, people feeling better, they got their vaccine shots—at least many of them have. What is the price we have to pay going forward for this? And the question really is around inflation, like—will this kind of sudden reopening amid constraint, supply chains, and reduced inventories—will it create inflation? And there is no question I think in anyone's mind that it will create some inflation for a while, and part of that is just math, right? Like, the CPI—the consumer price index—it falls during kind of deflationary shocks like we had a year ago. And then the increases after that come off of that lower starting point. It's called the base effect. So no matter what, mathematically, we are going to have a pick-up in inflation in the coming months just because of that base effect as everyone starts going out again. And that base effect will then run off. So maybe inflation goes from 1% a year ago to 3% and then maybe back to 2%. But the bigger question is: what are the structural consequences? And in that sense, you know, this chart may be a good history lesson. It shows the monetary base. So the amount of money that is in the system—in the pink line—against the economy, GDP. And the bottom panel shows the monetary base as a percentage of GDP and the federal reserve's balance sheet as a percentage of the GDP.

And the reason I'm showing this is because as we know, we had, you know, the Cares Act, we had another $1.9 trillion of fiscal, we have several more trillions coming with infrastructure and other projects or programs coming later this year. It comes up to so far $5.3 trillion, probably with another two or three coming. So that's like $8 trillion in a $20 trillion economy. Those are really big numbers. And on top of that, we have the Federal Reserve doing asset purchases of almost $4 trillion. And so the net result is that there's a lot more money sloshing around in the system, which you can see. That orange line there. We're actually—usually, we only see extremes like this during major wars—like, World War II is in the middle of the chart. Civil War is towards the left. So I guess you can say we are in a war against COVID and in that sense, the analogy is fitting. But we're at 24% and the Fed's balance sheet is at 35%. So we're really in uncharted waters in that sense. And so it naturally brings up the question—will this create inflation? Will this debase or devalue the value of the dollar because there is just too much money sloshing around. And if there is too much money, it has to go somewhere. And that could be into asset prices, but it could also be in inflation. So, for investors, that is an important thing to contemplate because the 60/40 model, which, you know, we may have different variations of that model in our portfolios, but they all kind of anchor on the notion that the 40 diversifies or ensures you against the 60. Right? You have the bonds in there to provide some income, but also to hedge yourself against shocks like what Jenn was saying before—the 30% drop. If inflation goes up structurally—not just transitionally, but structurally—maybe that 60/40 works in a different way than it has over the past 20 years. So this is where people like Jenn and Leanna come in because, you know, maybe portfolios need tinkering with if that's going to happen. But at this point, it's a question without an answer because no one—I don't think it's really anything anyone can predict, whether inflation can become structural at this point. So right now, it's really just a question.

JIM: Got it. And I have a follow up question about that in just a moment, but first, I want to bring Jenn in. And, Jenn, don't worry about it. It's your first week, so no pre-Civil War era questions for you. Don't worry about that just yet. We'll get to that. But how about the next key question to ask ourselves for our investments is about where we are sort of personally, financially at this very moment.

JENN: Yeah, absolutely. So not only do we have to ask ourselves, Jim, about that. That gut check—what can we stomach? We also need to take a look and ask ourselves: where am I at in my life? And make an honest assessment of where we really are. So that can help guide some of those investment choices. Your financial situation. Risk-bearing capacity. It's another important gauge of how much risk you can take on. But this time, we're looking at the financial ability to bear the risk, not your stomach can bear the risk. So if there's a strong chance that you might need or want to sell some of your investments to, you know, make sure you can eat, keep your house—your investments really should reflect that. So, for example, if you already have, say, 6 months of your expenses saved in an emergency account and you're fortunate to have a relatively safe job in a stable industry—excuse me—then you might be able to take on relatively more risk compared to someone who does not have the emergency fund or does not have maybe a stable job. So a couple weeks ago, I met with a family and they mentioned they had roughly 2 years of monthly expenses saved in cash. And that—so I said, "Well, was that by design or did that just kind of happen?" They said, "Yes, it's actually by design, Jenn. We do not want to feel like we're in a situation when the market is moving against us where we have to sell something. That's not the position we'd like to be in. We want to have that cash available for emergencies, unplanned but yet maybe fun expenses. We really want to let our investments grow as long as possible." So that was a bit of surprise, to see two years' worth of savings, Jim, but to each their own.

JIM: I was going to say, that seems like a lot. I mean, I know that the rule of thumb is three to six months, and personally, I'm closer to six months myself. I can't imagine 2 years' worth. But, as you said, like, if it's happened and you feel safer having done that, it's okay to have that much in cash, I guess.

JENN: Completely. It's—it is a guideline, and I'm a firm believer it's: what are you comfortable with? And this family was comfortable with the two years. So—great.

JIM: Got it. Makes sense. Okay, how about the third key question now that people can ask themselves?

JENN: Yeah. So I know Leanna has talked about this quite a bit before, so I'm sure this sounds very familiar to the webcast viewers. So that third question to ask yourselves is about your personal timeline. So how far away are you from your specific goal or goals? For example, are you saving for retirement? Are you buying a house? Are you funding a child's education? If you take a look at the timeline for each of those goals, you can understand how long you have to invest in order to reach what you are looking for financially. And that's what we refer to, Jim, as your time horizon.

So combine your time horizon, your risk level, everything we talked about so far in this webcast. It can really help you build out an account—an investment strategy that matches what you are really trying to accomplish. So in our earlier example, we had talked about investing 100% in stocks versus 0% in stock. Odds are neither one of those extremes are really where you want to be. But the chart that's showing right now shows portfolios with different percentages of stock. So, from 20% for your conservative investment all the way up to 85% for your aggressive growth investment. Over a 12-month period, your worst-case scenario would have been maybe not the best if you held onto predominantly stock investments. But over 20 years, your worst-case scenario for an aggressive growth portfolio would have been relatively similar to what you would have seen with a conservative investment. So, of course, over 20 years, your aggressive mix could perform much better than a conservative one. But you would have had to have lived through those big swings—that roller coaster we talked about earlier. You have to live through that along the way. So the challenge here is: we just don't know what the outcome could be in the short term. So even if you have nerves of steel, it may not be the best idea for your own situation if all of your savings is earmarked towards stocks. Especially, Jim, if you think you're going to need that money, say, in the next two years. And there are many, many people that would say if you need it in two years, you probably shouldn't be invested in stocks at all for that particular piece of your money. So, it definitely comes down to: in that time frame, what are you comfortable potentially losing if the market moves away from you?

So, a quick story of another family that I met with probably a couple months ago now. But—younger couple with multiple goals, and they were really struggling to wrap their mind around—"Jenn, we're looking to purchase a house in the next couple of years. We have a couple of children that are going off to college in probably the next ten years. And we would really like to be well-positioned to retire or exit from our careers in about 25 years." So I suggested—let's just write this on a timeline. Let's map this out. And once we were able do that, they could see how the time horizons weren't really that much different and we were able to match an investment strategy for the house. They wanted cash. That was their down payment. That's where they wanted to be. Their children's college—yes, they have a ten-year time horizon, but they were willing to take some risk, but not huge risk, in their words. And then for their retirement, they realized, okay, we've got maybe 25 years, so we do have the room to take on a little more risk to achieve the—hey, we don't have to get up for work every day. We can travel, we can do outdoor activities, we can go hiking, we can volunteer, visit our grandkids in the future. So that really helped them put things in perspective and allowed them to understand how much risk they could take on for each particular goal.

JIM ARMSTRONG: Yeah, that makes sense. Sometimes, seeing it physically all laid out in front of you definitely does help. So thanks for that suggestion, Jenn. Jurrien, one final question for you before we wrap up, sort of building on your last one when we talked about inflation. Now what—sort of—I know you've looked to Japan for some clues about what might happen here. What can you tell us about that?

JURRIEN: Well, I—so, for me, the main thing is that, you know, when we look around us and we see the $4 trillion that the Fed has added to its balance sheet, we see negative real rates, we see the—all the fiscal policy stimulus, it's very intuitive and natural to conclude that, you know, this is going to be a huge inflation problem going forward. So what do I do to hedge myself against that? And one sort of cautionary tale against leaping to that conclusion, even if it's the right one, is to look at what happened in Japan. Right? So the Feds' balance sheet is 35% of the GDP. The bank of Japan's balance sheet is 128% of its GDP. And since the financial crisis, the debt to GDP went up 100 percentage points. All of that was monetized by the bank of Japan. Yet, the currency is stable. The Yen is stable. Inflation in Japan is 0 despite all of that money printing. And it tells you the demographic story is a very powerful one. High debt levels, which Japan has, and US is having as well, is deflationary—inherently deflationary. So is globalization. So is technological innovation. So whatever inflation we get from policy moves, fiscal and monetary, has to kind of overcome all of those deflationary structural headwinds. And so, again, to me, it's not a slam dunk at all that we're going back to, like, the 70s and have all this nasty inflation. I think that—you know, we have to kind of weigh both sides of this.

JIM: Super interesting perspective, so thank you for sharing that, Jurrien. Jenn, thank you for being with us as well today. And to everybody watching, thanks as well. Reminder to our viewers: if you need help with your financial planning or have questions about what we offer, you can visit Fidelity's website or download the Fidelity app on your mobile device. Those are a couple of great ways to explore our planning solutions and get answers to your questions and learn more about the topics that we cover every week on this show and a whole lot more. Again, huge thanks to Fidelity's Jenn Sirois and Jurrien Timmer. And thank you, once again, for joining us as viewers. Next week, we'll be talking about the places potentially you can put your long-term savings that have the power to help you make the most of your money. So we'll see you then.

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