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. So it doesn't matter if you're 25 or 95—when it comes to your savings, you're probably thinking about how your money can work the hardest for you. How to squeeze every penny you can out of what you've saved. Certainly my perspective. That's what on our docket to discuss today. In fact, Fidelity has been researching strategies that could help your savings go further. Today, we'll also be discussing tax smart tips to help you put your money to work for you. For today's discussion, we'll be asking Jurrien Timmer, as always, to catch up on our economy's big picture and specifically about his thoughts going into the latest Earnings Season. And we're also joined again today by Jenn Sirois. Jenn holds the Certified Financial Planner designation, and she's got years of experience working one on one with people just like you and me, helping us build financial plans to meet our goals. Jenn, Jurrien great to have you here. Just a quick reminder to our viewers that Fidelity doesn't provide tax advice. So nothing we talk about today should be considered tax advice. Our discussion will just be general in nature. It might not apply to your specific situation. For questions about your specific circumstances, check with your tax professional. Now, with that said, Jurrien, it is Tuesday, April 20th. And, again, as promised, let's start with Earnings Season, when companies tell us sort of how well they did or didn't do over the last three months and specifically sort of what these numbers mean to us as individuals.

Jurrien Timmer: Sure. I mean, so—we know that, of course, the economy is reopening. People are getting vaccinated. So things are looking a lot better. There is a little bit of a new wave coming up, but supposedly that's not supposed to be as bad as the last one, especially where more and more people are immune. And we've seen, you know, the—we've seen the data kind of show up. More people are traveling going, through TSA checkpoints, more restaurant reservations, et cetera. So now we have Earnings Season really underway in full swing. You know, 60 companies have reported so far out of the 500 in the S&P 500. And so we kind of know that earnings are going to better because we see it in the real-time data in the economy. And, indeed, Earnings Season is off to a really, really good start so far. As I said, 60 companies have reported. They—about 78% of them are beating estimates, and they're beating them by a very, very wide margin. About—looking at my screen here—about 42 percentage points better than estimates. And if you look at chart here, you see the progression of estimates over time. You know, that vertical line on the chart is the start of Earnings Season. So this is a whole bunch of squiggly lines for a whole bunch of earnings seasons. But the green line is the current. And you see already kind of a hockey stick up where the estimate for the growth rate is up six percentage points just from a week ago. So this is—this shows you to what degree companies are beating estimates. Of course, the last few quarters—and you see that black line is the second—is the last quarter of last year, the pink line is the third quarter, the blue line is the second quarter. This has been a very unusual year, of course, because it's a pandemic year. And so, normally, what you see is those estimates will kind of drift lower and then they will hook up. But in—over the past years, though, the estimates basically flat lined. Mostly because nobody really knew what to expect, right? Companies were not giving guidance, which is often how these estimates will drift because companies are kind of putting out, you know, we expect sales to be here or there. But we didn't have any of that. So these lines were just kind of flat. And then there was this huge, huge bounce. And so we see the same thing with the green line. Even the yellow line, which is the next quarter, the second quarter. But so far, it's been of a booming Earnings Season, and that supports what we've already seen where the economy's finally reopening after a prolonged lockdown. People are flush with cash. At least, many people are, because of stimulus payments, unemployment benefits. So there's all this pent-up demand. We all we want to go out and do something. And people are starting to do that. And we're seeing that reflected not only in the economy, but in earnings as well.

JIM: Got it. And that's I think a perfect set up to Jenn, who we'll turn to next. This idea of people perhaps having cash to spend. Implication is you might also have cash to invest, and therefore, you might be looking for some tax-savvy ways to do that. Another way just to make your money, as I said earlier, work the hardest for you. How do you sort of get us started thinking about that, Jenn?

Jenn Sirois: Sure. Great question, Jim. This is a great topic. So saving and investing in tax advantage accounts can help you really make the most of your money. Obviously, the less you pay in taxes, the more money you can put to work with growth and compounding potential for your future. But before we get into the tax talk, let's talk about leveraging the strength of your workplace savings accounts. So your 401(k) or your 403(b) or 457 plan—let's use them to the fullest. If your employer's offering a matching retirement contribution, take advantage of it. Be sure to contribute enough of your own dollars to get that full match. It's pretty much like free money. So you are not paying tax on the money that comes out of your check and goes into one of these retirement accounts. So you're lowering your tax bill today. But of course, Jim, in the future when you start taking that money out for retirement, that's when you'll end up paying those taxes. It's also a good idea to keep increasing the amount that you are able to save as you can. So, our rule of thumb is aim to save at least 15% of your pretax income each year. And that 15%—that includes what your employer is going to match you. So important to note that that's included.

JIM: That's good to hear. Yeah.

JENN: Yes, definitely. That 15%, it—you might need to increase it a little bit if you've started saving a bit later in life. But I'll tell you, it's never too late to start saving, and it's never too late to increase your contributions. So quick anecdote of a younger, single guy that I was working with a couple of years ago, Jim. So I'll tell you about Jeff. He was just getting started, wanted to know—how much should I be putting away for retirement each year? So I mentioned that we'd like for him to aim for that 15% pretax—again, including the employer match—and he says, "Wait a second, 15%?" He says, "I need to eat. I'd like to have some fun." And I said, "Well, yes, absolutely. We definitely want to you eat, we definitely want to you have fun, but we also feel that saving for your retirement is just as important." So we started to take a look at what his employer was going to match. And lo and behold, they were going to match dollar for dollar up to 5%. So if Jeff did 5% and his company did 5%—now he's already at 10. So we started doing a little bit of math, and we figured out that he could actually afford 7%, you know, throughout the year. So now he's at 12%. Comfortable with the savings rate. And what he also did was he signed up for an annual increase program. So that over time, in the next few years, he'll be able to get himself to that 15% target and still have, again, that money for food and money for fun. So it was a nice combination that we were able to pull together for him.

JIM: Yeah, that's great. Jurrien, I want to ask you—that makes me think, I know that sort of we've talked a lot on this webcast about how each of us as investors kind of just react to the world around us. People like Jeff, who Jenn was telling us about—particularly when it comes to long-term investment strategies. And you've certainly been studying the larger trends going on recently. So maybe just catch us up on where we are now and what that means maybe for our futures.

JURRIEN: Yeah, so, you know, of course, it's been a wild ride over the past year because normally, things are getting better or not, but everything is kind of trending. And of course, this last year was one of a major inflection point. Like a shock. You know, you see this kind of—it almost looks like a heart attack, right? I mean, the top line on this chart is unemployment claims. Weekly unemployment claims. So, you know—so you had the steady state and then this shock. And then almost an immediate recovery which, of course, came in part because of the CARES Act and the Feds monetary, you know, accommodation. And so the top—the bottom panel is like the mirror image of the top. The bottom panel shows—the yellow line is the New York Fed has this kind of indicator, a weekly indicator—it's called the weekly economic index. Very high frequency, fast moving indicator of where things are. And so that was the opposite of the jobless claims number. And also the earnings. You know, we were just talking about earnings. But the expectation of earnings growth, which is the Blue Line. And so we've come completely full circle. Not so much yet on the jobs part. So that number still needs to come down. It's running at 576,000 people per week filing first time claims. And the base, before COVID, was 256. So we're not full—we haven't come full circle yet, but if you look at those bottom two indicators, we've gone beyond full circle. So, you know, a year ago, that New York Fed Index was minus 11. Today it's plus 11. So what that means for me and for investors is that the reopen basically has been fully discounted, in my view. So, you know, we've had this conversation many times. My belief is for most investors, have a plan, stick with the plan, re-balance, don't—you know, don't freak out when things don't go in your favor because about a third of the time, they won't. But if you were to try to figure out where the cycle is going and how to invest, knowing that is only half the battle. Knowing what's already been priced in by the market is the other half. And that's my point with this chart, is that now that we're actually having to reopen, it's fully priced in by the markets as indicated by that chart of earnings as well as the New York weekly index. And so that tells me that the news is good and it's getting better, but it's in the market already. It's already reflected by prices. So, again, it's just an important thing to keep in mind. You can't just say, "This is going to happen, so I'm just going to go there and leap into the market," because you have to look at what's actually priced in already. If that makes any sense?

JIM: Oh, no, it does. And I actually have a follow-up for you on that exact topic. But first, I want to sort of build this idea of optimism for the future and ask Jenn a question, then, about how folks can perhaps save on taxes, be optimistic about the future. What are some ideas above and beyond the workplace plans, which you just talked extensively about?

JENN: Sure. So, beyond your workplace plan—again, 401(k), 403(b)—there are some employers that are going to offer what's called a health savings account, or HSA. So this account allows to you save for the future but also helps you reduce your taxable income today. So the HSA works with a high deductible health plan. A family I was chatting with not too long ago—they've been saving in their HSA on a regular basis, but hadn't been taking advantage of investing the money in the account for growth. So I asked, "Well, is that by design or just simply by default?" And they said, "Well, we have young kids. They're involved in sports. Our concern is: we have an injury; we've got to come up with a deductible. We want to make sure we have that cash on hand." So we talked through what was in the account and determined that, almost like an emergency account, if you will, we left a certain amount in cash and then the rest of it plus further additions would be invested within that HSA. So for them, the contributions would be made through your employer. Money goes in on a pretax basis, it lowers your taxable income. Contributions are also excluded from FICA taxes up to a certain threshold of your income. You can also open an HSA if you have an HSA eligible health plan on your own. In that case, you'll get the federal tax deduction for the year that you made the contribution, but it doesn't apply to the FICA taxes.

So, Jim, just to throw a couple of numbers at you. In 2021, IRS limits for contributions to an HSA are $3,600 for the year for an individual and $7,200 for family coverage. Now, if you're 55 or older during that tax year, you may also be able to make what's called a catch-up contribution for an additional $1,000 a year. Couple of extra perks when it comes to the HSA—you can take money out of the account to pay or reimburse yourself for qualified medical expenses. In that case, those withdrawals are tax free. And there's no time limit on when you can take money out of the HSA. If you don't need it for healthcare expenses now, you can save and invest it for healthcare in the future. Maybe even for retirement when it's likely to come in handy. You also can even wait years to reimburse yourself if you have those current care spending. The rule—the thing to remember is that you must have—the HSA must have been opened prior to the expense and you certainly want to keep your receipts. So, quick example. If you opened your HSA last year, and you pay $3,000 out of pocket this year, you can take money out of your HSA to reimburse yourself next year, five years from now, twenty years from now. Again, the key here is: keep your receipts. The other thing I'll just add is after age 65, you can use the money saved in an HSA for non-medical expenses. But I just want to remind you that you will have to pay income tax if it's a non-medical withdrawal just like if you were to take money out of your 401(k) or traditional IRA. So...

JIM: Got it. Okay, so you've explained the HSA, the sort of traditional workplace accounts. What other sort of options would you talk about in terms of tax efficient ways to invest?

JENN: Yeah. So a couple more ways to save from a tax efficient standpoint here that we can explore. So, first thing is you can save in a taxable brokerage account. So in order to reduce taxes, it can be a good idea to put tax efficient investments—like stocks you are holding for long term, tax municipal bonds—you can put that into your taxable account. And hold investments that may be less tax efficient into, say, your tax advantage accounts. This is a strategy we like to refer to as asset location. If you're looking to defer—or, excuse me—if you are looking to have more tax deferred savings, you might consider a tax deferred annuity. So taxed deferred annuities have no IRS imposed contribution limits. They're funded with after tax dollars. No mandatory required withdrawal at age 72. The one thing to remember is that you may have fees or tax penalties if you were to withdraw your earnings before you turn 59 and a half. Tax deferred annuities though, Jim—they're not going to give you a tax break for contributing today. But it does offer that tax deferred growth. So no income taxes on investment returns until you actually take the money out. So you're physically removing it. So—what we can see on the screen—so, hypothetical example—compares an estimated value in 20 years of a $250,000 investment in taxable bonds in two different scenarios.

So, scenario 1, the investment is held in a taxable account. That's the darker blue bar there. Any other scenario, it's held in that tax deferred account such as a variable annuity, which I do want to mention has a 0.25 percent—or one quarter of 1%—annual annuity charge. There's a lot of options when it comes to saving additional over and above 401(k)s. So here's just a quick summary of—I met with Nancy and Mark, we've been working together for a number of years. They're in a position today to save over and above their 401(k) and 403(b)s they have available. Their kids are out of college, so those bills are gone, hence the extra cash flow. So they both wanted the opportunity to have their money grow, but Nancy really wanted access without additional tax penalties or fees. And Mark wanted to allow the investments to grow tax deferred until they needed the money in the future. So an interesting back and forth. We actually looked at this same slide that's up right now. And ultimately, they realized that they could have both, and so they ended up taking a look at the opportunities for both the tax deferred as well as the taxable brokerage account. So...

JIM: Love the stories of positivity and optimism, Jenn. So thanks for that. That's great. Jurrien, I do still have that follow-up for you. I am not going to say "but," I'll say "and." Positivity and optimism. And I know you are a student of history. You study a lot about what the markets have done in the past, and you've got a couple of charts that can maybe give some idea where we might be headed in the future.

JURRIEN: Yeah. So I think—and for me, the point is here—is just to remind, you know, our viewers that, you know, as I said before, you know, if the economy continues to get better—which I think everyone expects to happen as we reopen and people are getting out again—we have to compare that with what's priced in. Right? And so I mentioned peak reopen before. That doesn't mean the reopening has peaked but that kind of the recognition of it has peaked. And so oftentimes, you know, there's a saying: "buy the rumor, sell the news." And so we actually may be at that point where the market actually kind of needs to take a rest. You know, it's been straight up for months and months and months. And that's not always how the market works, right? The market has about a one in three chance of going down instead of going up and maybe going down 10 or 15%. And that would be basically not anything to worry about. And that is really my point here. And so it's interesting—you know, I use market—historical analogs. I am a student of history. I'm kind of a geek that way. And two of the analogs that have been serving me well during this crazy cycle has been the recovery since the global financial crisis back in 2008 and 9, and so this is an overlay—this chart here. So the black line is current off of the pandemic lows a year ago. The pink line is 2009 into 2010, and you can see that, you know, price bottomed six months before earnings. Again, that's also a conversation that we had a year ago: that things that don't seem to make sense actually make perfect sense once you realize that price anticipates and, therefore, leaves the fundamentals. But you can see on this analog that at exactly this point back, you know, 12 years ago, the market took a breather by about 10, 15%.

And if we go to the other analog, which is the World War II 1940's analog that we've discussed many times—you see exactly the same thing. Now, that doesn't mean it's going to happen this time, but my point is that if it does it, wouldn't surprise me. Even though you would think things are getting better, why would the market be correcting here? Because the market has already anticipated a lot of good news and maybe it needs to consolidate and just kind of get its bearings here. But for me, the bottom line for, you know, the average investor—for our viewers—is that these were corrections—10, 15%—but they were corrections within lasting uptrends that lasted many more years. So my point is that if this is what's going to happen in the coming few months, don't panic, it's normal. This is how the markets work. And just keep an eye on the long term.

JIM: There is a 100% chance I'll be following up with you on this exact topic in the coming weeks, so thank you for that. We're out of time this week, but this is something I definitely—we're going to want your continued feedback on in the coming months. Thank you Jurrien, thank you Jenn, of course, for being with us today. Note for our viewers: if you need help with your financial planning or you just have questions about what we offer, you can visit Fidelity's website or download our app on your mobile device. Those are really good ways to explore our planning solutions and get answers to your questions. Again, huge thanks to Fidelity's Jenn Sirois and Jurrien Timmer. And again, thank you for watching. Next week, we're going to be talking about how to possibly correct one of the most common mistakes people make when it comes to their IRAs—their individual retirement accounts. We'll talk about that next week, and we hope to see you then.

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