Jim Armstrong: Hello and welcome to Market Sense. Thanks for joining us today. I’m Jim Armstrong with Fidelity.

A dollar is a dollar is a dollar, or is it? It’s been a few decades since we’ve had to ask that question and give much thought to inflation here in the US, but as the economy starts to reopen after the pandemic, the whispers are getting louder that pretty soon our dollars might be worth a little bit less.

So, that’s what we’re talking about today. The cash in our pockets and the cash in our investment portfolios. We’ll also be touching on the panel’s thoughts on gold which is sort of a new topic for us on this show.

To have this discussion, we’re joined by Jurrien Timmer who is going to be sharing as always, what he’s been thinking as he continues to study the market trends. And Jenn Sirois is here as well to talk about how investors can put all the pieces together in their own lives.

Jenn, Jurrien, great to have you here.

Jenn Sirois: Thanks, Jim. Great to see everyone again.

Jurrien Timmer: Great to see everyone.

JIM: Yeah, for sure. Jurrien, let’s start with you. It is Tuesday, May 18th, and I know we’re going to touch on inflation a lot but I was really hoping to start with sort of again your look at the big picture of the economy and the sense that the market is due for—the word we can use right now is consolidation. That starts to get people a little bit concerned about what’s to come. So, sort of set the table for us and tell us why you are thinking that and what it means to us.
JURRIEN: So, you know, markets never go up in a straight line. And it’s good to sometimes take a rest, right? And so, if you look at where the market was, you know, fourteen months ago, where it is now, that’s the black line on this chart. It’s been a pretty, you know, impressive journey. I mean, the market fell 35% very, very quickly during the lockdown, of course, last March, but it is up about 90% from the low. And you can see all the other little squiggles there, all those gray lines are basically every other bull market recovery going back a century. You know, I like to geek out on history. So, there is a lot of cycles in there. It basically outperformed all of them.

And the one that comes closest is the blue line which was the recovery after the financial crisis back in 2008 and 2009. And from the March 2009 low, the market went up, you know, by about 500% for years, but even then there were breaks along the way, you know, corrections of 10%, 15%, even 20%, and one of them actually happened in April of 2010 which, if you are a history geek, you’ll know that that is when QE1, the fed’s first series of asset purchases, ended, and the markets, even though the fundamentals were really starting to improve, earnings had bottomed, starting to really come in. The market was worried about liquidity, about the lack of it because the fed was kind of going cold turkey on quantitative easing.

And guess what? We’re kind of having the same conversation right now. I mean, the fed has told us it’s staying the course, it wants unemployment to come down, but still the markets are worried about inflation which is what we’re talking about today, worried about rising interest rates, you know, the fed reducing liquidity, and that’s exactly where we were at this point in the last cycle back in 2009. And you can see from the blue line the market went down about 15% over three months but you know what? That did not end the bull market. It was just a pause, a consolidation. And we’re at that point where a lot of good news has been priced in.

The earnings numbers that have come in, just off the charts bullish, but it is in the market, right? We’ve talked about this many times. It is not enough to just know how the cycle is going to unfold. We have to also know what is priced in, and right now a lot is priced in and that tells me that the market needs a rest, and I think that’s good. I think bull markets are more sustainable when they take an occasional break.

JIM: Fantastic, helpful perspective, certainly, Jurrien. Thanks for that.

JENN: Great question, Jim. So, the discussion around inflation is really not a new conversation. The question’s being asked a lot lately. So, comments around, Jenn, my grocery bill has gone up significantly. We were looking to do a long overdue home improvement project and the quote is just astronomical now. And of course, let’s get the trifecta in here, let’s talk about gas prices. So, lots of conversation around that.
And now we’re hearing economists are talking about inflation could potentially double from where we are now at about 1.7% to more than 3% over this summer. So, at the same time, you know, I have a lot of families that have cash sitting in their checking, their savings, their money markets, and we know that that’s not really yielding much of anything.

So, if we do some simple math with the chart on the screen here, so a 0% return in our checkbook and 3% inflation means ultimately a negative 3% real return in your purchasing power.

So, one thing to just clarify here is what you are not going to see on your investment statement, your bank statement is a negative 3%. Where you are going to feel it is in that purchasing power. How much can you buy for the dollars you have?

So, the inflation adjusted return on savings accounts as we see here is negative and can continue to become more negative. So, I think a really great question for individuals and families to ask themselves today is how much do I really need to have parked in cash, savings, checking, money markets at this point in time?

**JIM:** Yeah, and I think that’s a question a lot of us are trying to figure out. So, I want to get your—some answers to those questions in just a minute but first I do want to bounce back to Jurrien for a moment too to go back to that sort of high level look, that macro look at inflation. What is happening now and how you see it going forward?

**JURRIEN:** Yeah, so, you know, as Jenn mentioned, the fed is deliberately pursuing a negative real rate strategy, right, because that’s reflationaly, right. It really adds fuel to the recovery but it comes at a penalty to savers who are sitting in a money market fund earning, you know, very, very little.

So—but the big question is, you know, we know that there is inflation right now. It was actually very predictable because during the lockdown a year ago, during the pandemic, you know, obviously nobody was making anything so then as demand returns, inventories go down, they get drawn down, supply chains were disrupted. They were already getting disrupted from kind of the US/China trade tensions a couple of years ago. But then during COVID when everything shut down, supply chains got severely disrupted and we see that—we see that now with lumber, we see that here with the pipeline getting shut down for a few days and now you can’t get gasoline, or at least a few days ago you couldn’t get gasoline down in the Southeast.

So, it shows you how fragile the system is, this kind of just-in-time inventory system. And so as a result, you get bottlenecks. There are supply shortages not only in terms of materials, lumber, et cetera, but also labor, right? We saw from the Unemployment Report a few weeks ago, the number was—the report was amiss, right? Fewer people went back to work than expected even though there are eight million job openings and eight million people unemployed. You would think the two would go together very quickly but, you know, people have had to make changes
over the last year. They were working from home, they moved, they got other jobs, and so it is proving to be much more—it is proving to be more friction than was expected.

So, inflation is spiking, we know that. The CPI number was 4.2% year-over-year. Core CPI excluding energy and food which tend to be more volatile, was still up 3%. The question is, is it transitory? Right? A year ago, everyone was looking for toilet paper. Now we have toilet paper, right? So, supply chains do get replenished. From what I’m—from what we’re hearing talking to our companies is that companies are working 24/7 to fix these supply chains. It is not like there is no lumber out there. It’s just that they can’t get it from there to here. So, I do think that this will be transitory, but the question then to get mathematical on you, if you look at this chart here, the orange line is the year-over-year inflation rate. The blue line is a smoother, longer-term version of that. So, what we’re looking at or what I’m looking at as an analyst is this inflation spike will come and go and will it then go to what we consider a higher low, right?

During the 60’s into the 70’s, we all remember the stagflation days of the 70’s—and I am not suggesting we’re going there by any means but that inflation started very slowly and very calmly during the 60’s and you had these little upticks, but they kept going to a higher low. You see that in that orange line until it became entrenched. We can call it inflation creep.

And so, we won’t really know whether that is going to happen until this cycle, this spike, passes, comes back down, and whether it then kind of makes a higher plateau from which it goes up. And again, I don’t think anyone knows the answer to that. I think the fed is assuming it’s transitory. I think we can all assume that it is at least for the most part transitory, and the reason that I’m assuming that is if you look at that purple line on the top of the slide there, that is the long-term growth rate in the labor force. And then the gray line is union membership in the US.

So, back during the 70’s when inflation became really entrenched, and of course it was compounded by the OPEC embargo, so there were supply shocks as well, but also those supply shocks became entrenched into wage negotiations, collective bargaining by unions. And you can see back then, the labor force was growing pretty rapidly and about 20%, 25% of the country was unionized.

Today, the labor force is not really growing at all and only 6% of the private sector is unionized, so I don’t see where the tinderbox is of wage inflation that could cause a transitory spike to become entrenched.

There is a lot of information there, but that’s how I’m looking at it. To me, it is not a given that we are going to have a 1970’s-style inflation because the labor demographic picture is completely different from where it was then.

**JIM:** Excellent. Thank you for that perspective. Great news. I’m sure a lot of people will hear that and breathe a little bit of a sigh of relief.
Also recognizing, Jenn, as an individual investor, I can sort of hear what Jurrien is saying and try to make sense of it, but know that I have no control over any of it. I can control what I have, what I’m holding in cash. So, back to your earlier question from a couple minutes ago. What’s a rule here? What do I need in cash?

JENN: Yeah, so the obvious answer here, Jim, is not zero. We talk all the time about the importance and the need of an emergency fund. So, and that is not changing even with the threat of inflation.

So, rule of thumb, as we can see here on the chart, so set aside about 50% of your take-home pay for those essential expenses. Another 15% for the retirement. Remember, we talked about this before that 15% represents what you are contributing, but also the employer is matching you. But we also recommend that having cash or cash equivalents for say three to six months of expenses for emergencies depending on your own personal situation. And you can grow that by committing to putting 5% of your take-home pay into the cash accounts.

Of course, all of those—these numbers you are seeing here are highly personal and very dependent on what is going on in your own household and your own risk preference, but if you have dollars over and above your emergency fund, this is where I just want to focus a little bit of time here.

So, over the last year, I’ve seen a number of families with uninvested cash. Maybe they sold off about a year and a half or fourteen months ago and it’s essentially been sitting there collecting dust. So, now that inflation is coming in, that money that is sitting I’ll say idly on the sidelines is in danger of losing some of that purchasing power. And as inflation rates rise, it is going to become more noticeable to those families.

So, if you happen to be one of those families that is in this position where you have a larger sum of money over and above your emergency funds, it is time to consider—at least consider moving some of that money into an area or an investment that provides you the opportunity, that chance to outpace the inflation rate.

JIM: Yeah, for sure. That makes a ton of sense. So, after the emergency fund is funded, you move on to some other options. Can you walk us through sort of historically what has worked for folks in the past?

JENN: Sure. I mean, there is an array of options. So, we could do multiple webcasts on this question alone, but I’m going to keep it simple here. So, first you want to think about what is it that you are looking to achieve as an investor? Ask yourself, well, how old am I? How much risk am I willing to take on? How long am I looking to stay invested for? What am I actually saving this money for?
And work with a financial professional that can help you build and/or update your own customized financial plan. So, you have X amount for project A, X amount for project B, et cetera, and what are the needs for those dollars?

The same thing is true when it comes to retirement accounts or that you have through your workplace. You want to be talking with a planner at least once a year to make sure that what you have for a strategy is matching what you are trying to accomplish long-term.

But back to I think your question before, Jim, we can look at investment returns over time going back to the 1700’s. So, I’m not the history buff that Jurrien is, but for instance, gold has historically been an effective hedge against extreme inflation.

I know Jurrien has some thoughts on that in just a couple moments here, but historically stocks have really done a great job of beating inflation. But for long-term rewards, you have to endure some volatility, and if you can handle that, that’s where stocks may be your best option to fight inflation.

We like to talk more about building an investment portfolio to help you reach your long-term goals. So, what we’re seeing here is a traditional 60% stock, 40% bond mix, as well as a 60% stock, 30% bond, and 10% gold mix. So, Jurrien, I’m going to turn this over to you so you can speak to the gold piece here.

JURRIEN: Actually, if we could stay on this slide for just a second. It is interesting. So, I created this dataset and it is interesting that you know, 1700 to now, 1800 to now, 1900 to now, gold was always just at the same level as the inflation rate because back then we were on a gold—well actually, gold was money really early on, and then we had the gold standard where dollars were kind of fixed to the price of gold. And so, gold by definition really didn’t move more than the inflation rate did.

Then the 1970 period is important because in 1971, President Richard Nixon went and took the US off the gold standard and then gold became freely traded. And all of a sudden gold started to become a much more competitive asset class even to stocks, but especially to bonds. And then of course, 1970 to 1980 alone, that decade was obviously a period of high inflation and was that first decade where gold was free to move around.

So, just an interesting bit of history, but if we go to the next slide, there is a lot going on here, but basically I think what is interesting about gold is that it is widely known as a hedge against inflation. But it is not just that. It is also a hedge against what we call monetary inflation, meaning if central banks or—or the fiscal authority, if too much money is created, whether it leads to actual real economy inflation or not, because it doesn’t always do that, but whatever—whether it lands there or not, when too much money is being created, the purchasing power of that money goes down. And then gold tends to hold its purchasing power much more.
So, in the top panel, that’s the purchasing power of gold in the blue line. The purchasing power of a dollar, of a paper dollar in the orange, and you can see that as a store of value, whether it’s real inflation or monetary inflation, gold has been an effective hedge.

So, when we’re in a period like we are now where the central bank, the fed is pushing real rates below zero in order to bring the economy back to life and there is a lot of deficit spending going on, a lot of fiscal policy stimulus, that’s a good backdrop for gold to do well. And that’s basically what we’re seeing now.

Now, whether it’s a 0% allocation, 1%, 5% or 10%, that’s obviously a completely individual question that every investor needs to explore and discuss with people like Jenn in terms of where it fits. And so, there is no—there is no one answer to that question, but to me this kind of frames why we’re even having this conversation about gold and other hard assets as we call them.

JIM: Yeah, no, and I’m sure this will be a conversation we’ll continue in the weeks and months to come because we know this is a big topic for folks, a big topic of interest for them.

So, Jenn, Jurrien, thanks for making time to be with us today. We appreciate it as always. For our viewers of course, thank you for watching.

A reminder that if you need help with your financial planning or you’ve just got questions about what we offer, you can visit Fidelity’s website or download the Fidelity app on a mobile device. Those are a couple of really good ways to explore our planning solutions and get answers to your questions and learn more about the topics like those we covered today.

Again, finally, a huge thanks to Fidelity’s Jenn Sirois and Jurrien Timmer. Next week we will be back talking about the people who might have needed to update their long-term plans, their retirement plans specifically. Maybe they’re retiring earlier or later than they wanted to as a result of the pandemic. Lots to talk about when it comes to shifting your timeline to match what is happening in your life, and what that can mean to your long-term planning. So, that’s what we’ll be talking about next week. We hope to see you then.
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