

# *Fidelity Viewpoints®*: Market Sense

Week 101, June 7, 2022

## TRANSCRIPT

### SPEAKERS:

Jim Armstrong   Leanna Devinney   Jurrien Timmer

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**Jim Armstrong:** Hello and thank you for joining us for Market Sense. I'm Jim Armstrong with Fidelity.

It's been another rough and tumble week in the markets. More volatility, more concern about prices on the rise everywhere we look. And amid all that, with the war in Europe, there is increasing worry here at home about the threats of cyber-attacks and scams, often from online hackers. And one of those scams is hitting close to home, targeting Fidelity investors.

So today, of course we'll be talking about the markets, and also discussing potential ways to help keep your financial and other sensitive information safe.

Jurrien Timmer and Leanna Devinney, I am thrilled to say, are both back with us again this week to help guide our conversation.

Jurrien brings his focus with what's moving the markets and the economy at large and of course, explaining what it means to us as individual investors.

And Leanna will this week give us a closer look at some scams targeting financial institutions and what we can all do to try and protect ourselves from them. So, thanks for coming back, everybody.

**Leanna Devinney:** Thank you. Missed you both.

**Jurrien Timmer:** Yeah. Good to see you again.



**JIM:** It is Tuesday, June 7th. And yeah, it does feel like more than two weeks since we've been away, Leanna, but we were off last week for the Memorial Day holiday. So, a couple weeks' worth of news and events for Jurrien to catch us up on to start us off this morning.

As I mentioned, a couple fairly rough weeks in the markets. Ongoing concerns about the potential for near-term recession, inflation, interest rates hikes all dominating the headlines. Again, to say nothing of the fact that—what it feels like these days to go grocery shopping or to fill up our tanks. So, lots to talk about, Jurrien, so just get us started with what you're seeing, please.

**JURRIEN:** Yeah. So, you know, the stock market, the S&P 500, from its peak on January 4th to its intraday low so far a couple of Fridays ago, has fallen 21%. And obviously, you know, what the Fed is doing features very large in that. What the—how the economy is going to fare with all of this, whether a recession is or is not imminent has, of course, is part of this conversation. And, you know, there is a lot of different inputs, right? Inflation, of course.

So, the way I like to distill it down to the bare kind of essentials at least for the stock market is to think of the stock market or the price that, you know, that like the S&P or the Dow Jones or the Nasdaq or the price of the stock, it's essentially at the intersection of two things. One are—one is earnings, what do companies earn or what are they expected to earn? And two, what are investors—what as investors should we be willing to pay for each dollar of earnings? So, that's the P/E ratio, the price to earnings ratio, or the valuation.

And again, price is what we pay but value is what we get, right? So, think of the E and P and the price to earnings itself as the two moving targets and then price is at the intersection of that, just trying to keep up with those two moving targets.

And so, what we have seen so far over the last, you know, five or six months since we've been in this correction in the stock market, has been all about the P/E ratio, the price to earnings ratio. What are we willing to pay for a dollar of earnings?

And when you look at valuation models, when interest rates rise, which of course is what they're doing, and when the Fed is removing liquidity from the system, when it's making financial conditions tighter rather than looser, what happens then is that people want to pay—are willing to pay less for earnings than they would normally do because when interest rates go up and you calculate the present value of future earnings, that present value goes down.

So, so far what we've seen is a—what I call a D rating or a re-pricing in the stock market purely based on that half of the equation.

Now what people are starting to worry about is the other half, which is the E, the earnings. And, you know, there is lots and lots of talk about recession and is it imminent or not? I'm not seeing a

lot of evidence that it is when you look at the labor market. They are still very strong. We had the employment report just last Friday which really was a very solid report.

So, I think the E in the P/E is still okay. But that I think is what the conversation is going to. And if you look at this chart here, this combines both of these elements, right? So, you see the S&P is the black line there and you see all those bands. Those are the earnings applied to different P/E ratios from 10 at the bottom to 24 at the top. And you can see that at the peak, we were trading at around 22, almost 24 times expected earnings. We're now down to about 16 times expected earnings. And that's a vast improvement. I mean, it doesn't feel great when you're in the throes of it, but that is a lot better valuation given where we are in the world right now than where we were back in January.

But in order for that valuation to hold, the earnings now need to come through and so that's kind of the next part of this whole conversation.

**JIM:** As always, really, really valuable context, so thanks for explaining that to us. Next, could we dive a little bit deeper into—into recession, right? We see it in the headlines. We hear it talked about. And you just said you don't think it's in the near-term. But you know, we haven't looked at a chart like this that you've created before, so I wonder if you could just walk us through it, and also again, through what we're expecting to hear from Jay Powell and the Federal Reserve going forward.

**JURRIEN:** Yeah. So, I think it's really a stretch to find evidence that a recession is either already underway or imminent. I really don't—I mean, it's—people like to be—to be dramatic about that stuff.

**JIM:** Right.

**JURRIEN:** And clearly, the economy is slowing, which is good because the economy can't run on all cylinders all the time because then, you know, you get excesses and then the Fed would really have to step on the brakes. I mean, it already is of course, and like you said, the Fed is about to meet for its June FOMC and it will very, very likely raise rates by a half point and then do it again the next month and probably again after that. Which sounds bad but it's—that's already happening in the bond market anyway. The bond market is already doing all the Fed's work for it. So, it really doesn't matter so much in my view.

But back to the economy for a moment, the economy is still running pretty hot but it's softening. And just using the employment report, what we saw was that the unemployment report, the unemployment rate is down to I think 3.5% now. But what's interesting is that people are coming back into the workforce.

So, remember during COVID that several million people just left the labor force because maybe they thought, well, if I'm going to retire in a few years anyway, why don't I just do it now because we're in a lockdown and the market is up. Now, wages are rising, stock market is down. So, maybe if you are that 63-year-old, you are like, well, maybe I'll go back to work. And that actually is a good thing because that should help the supply/demand imbalance in the labor markets which are causing wages to go up which is causing inflation. So, maybe that will kind of help kind of calm—calm the seas a little bit.

But just to give you an illustration in this chart, and I realize this is maybe a little bit of a nerdy chart. But if you think about where the economy goes from kind of the—the recessionary levels which would be the lower left corner, to the—to the booming levels of the upper right corner, that's where we have been and we are starting to come back down that a little bit. But as long as we are in that upper right quadrant, the economy is still growing.

And so, it is just growing at a less robust pace as it was six to twelve months ago and that's a good thing, right, because we need the economy to slow because the Fed is not going to stop raising rates until that happens. So, the Fed wants the economy to slow. It doesn't want it to go into a contraction, but it does want to take some of kind of the heat off the economy, and that seems to be happening. So, in that sense, you could consider it good news.

But again, in terms of evidence that a recession is either imminent or here, there is basically almost no evidence to say that. I think people need to be, you know, I think we need to kind of take that in stride.

And the good thing to remember is, you know, you can think, okay, we are in late cycle recession. Winter is coming eventually, right, to use an old Game of Thrones meme, but we don't know when it's going to happen. We don't know how bad it's going to be. And even if you did know, you would then still have to think about how much of that is actually priced in?

So, I want to caution people against just thinking very simply about well, if we're expanding now and we're going to have a recession someday, why don't I just sell everything now? It is not that simple.

**JIM:** Great. And thank you in advance—thank you for your patience in advance for I anticipate asking that question of you quite a bit more in the coming months. So, thank you again in advance for your patience.

Let's do a little bit of a pivot now, Leanna, to a slightly different topic but one we talked about just a moment ago at the top of the show, this idea of potential scams that are out there, that the universe of things that Jurrien just talked about are largely out of our personal control, what the Federal Reserve does, how the markets respond in general. For us as individuals, we sort of are

just bystanders trying to figure out our reactions to it. But we can be a little more proactive when it comes to protecting our financial and other accounts.

So, maybe start us off, Leanna, if you could, by talking about how we can do that.

**LEANNA:** Sure. And just to start, lately we've been having some imposter scams. So, Fidelity and many other institutions are often targets of an imposter scam. And so, that's where you may receive a call, a text message, email, even a social media connection now or request, by someone claiming to be a registered securities professional or a customer service rep, but in fact they are an imposter.

So, these fraudsters will often assume the name and professional details of an investment professional, create a fake website or social media account all to try to gain your trust. And they will convince you to provide them with information about your financial accounts like log-in credentials or account numbers or personal information like your Social Security number which of course you never want to give out.

Recently, I got a text from a popular bank but I don't use that bank, but it was asking me to click on a link all to gather information. So, these are things called those imposter scams.

Fidelity has been targeted as well as other financial institutions. So, yes. There are certain things that we can do and certain things that are red flags as well.

**JIM:** I've gotten one of those, now that you mention it. I haven't thought about it until you said it just now. But I'm a—a joint account with one of my parents, which is something that we chose to do as they get older. So, I got an email from one of the—a text rather from one of the—one of their banks, and I thought maybe I should, but I feel like it probably was a scam. So, I just—if you need me, you're going to find me. That's my thinking, right. They're not just going to try to reach out over—over a text.

**LEANNA:** Right. There are certain red flags too. So, first, knowing, like, of course, no one is going to contact you and say hi, you know, I'm Leanna Devinney from Fidelity. Can I have your Social Security number? So, like, that could be a red flag.

Other common ones that aren't so apparent, we see poor grammar or misspellings in communication. That's a big one. Either in an email, a text, or some link that you are getting has a small, but there is a grammar error or misspelling in it.

And again, if you are contacted in a way that an investment professional or a firm wouldn't normally contact you, that's another thing to look out for.

**JIM:** That's such a great callout too. I think people probably don't realize, on the other side of that email getting sent, an official email from Fidelity is spell checked and proofread and—and, you know, scrutinized to within an inch of its life to make sure it's perfect. It's not going to have random capital letters and it's not going to have bad grammar.

**JURRIEN:** I have a good one too, that I'll get a call sometimes from someone claiming to be in the government, like, you know, and like, threatening me or like saying, you owe taxes. Like, nobody from the government calls you. Like, they send you a letter in the mail. I am pretty sure that that's how it goes. So, that's a red flag right there, right?

**LEANNA:** Exactly. The IRS will never contact you—anyone from the government will never contact you.

Sometimes we get these calls and it's—they are imposters and it's very convincing because they may have one piece of information and then you think, okay, this must be Fidelity or another firm.

So, they may ask questions on what is your password or a security question, just again, to verify. So, it's just a reminder to never give away your one-time passcode that you often get to help secure an account. Never give away your password. The two-factor authentication, security questions, none of that should ever be shared. These are just ways that they are trying to kind of scam and get these pitches. They're—they're calling and saying here is something that we can guarantee for you, or another, you know, strategy or there are sales pitches out there. So, all other things just to remind you to be wary of.

**JIM:** And it's true, certainly, that an official email would come from the official place itself, right? So, a Fidelity email would come from @ Fidelity, for example.

**LEANNA:** Fidelity email would come from @ Fidelity. The IRS is never going to call or email you. That is always one, as Jurrien's point, to look out for. Ignore phone calls that say IRS as well. So, all of these things is just something to make sure because this is the first thing criminals and scammers are doing.

**JIM:** I wonder—

**JURRIEN:** I find checking—checking the return email address is a very easy way. Just hit reply without actually sending it. It's like, okay, no, that's not from AT&T or whatever.

**LEANNA:** Exactly.

**JIM:** Yeah. And just mousing over the link itself before you click on it. I mean, I guess the good advice is never to click on a link from a sender you don't know. But if you hover over it sometimes,

you can see the link appear where you would go if you did click and it is often like a terrifying—you definitely don't want to have clicked on it.

**LEANNA:** Yes, exactly. Exactly.

**JIM:** Can you talk a little bit—I mean, it's just—it's good that we're having the conversation. It feels like a lot of these things are sort of common sense steps to take. But everyone gets busy, everybody sort of is looking for shortcuts. What other sort of watch outs would you suggest or warning signs, Leanna, that people be on the lookout for through that lens?

**LEANNA:** I think there is also those deals that look too good to be true. So, we talked about again, ignoring those phone calls or texts, suspicious information, downloading those attachments. If an email claims to be from a company, doublecheck the link as an example.

And I think also, this was a new one too, if we could just look at the next slide too. When your phone will say no service or emergency calls only, that actually has come up that that could be a hacker going in to take the information from your phone. Just reading and learning this. That's happened to my phone a couple of times before. So, an interesting one. And the recommendation is to just call your phone carrier and make sure that your phone hasn't been hacked.

Other things to do, and Fidelity does a great job, as well as other firms like Fidelity go at great lengths to safeguard your account, so that's just making sure you have two-factor authentication. Password protection. Making sure you have really strong passwords. Making sure that your passwords for streaming services are not the same as your passwords for your financial services.

So, again, like we said, all common sense, but we get into habits and it is very common that we're using, you know, child names and pet names and birthdays as these passwords, and that's—that's where the scammers go first. So, just like reinforcing the security of strong passwords, two-factor authentication, doing credit checks regularly, updating your phone and computers, all of these great habits to ensure that your accounts are protected.

**JIM:** The password one too is such a—I mean, that's such a burden, right? For probably 100% of people in our audience right now, no one likes maintaining all their different passwords and changing all their different passwords. But that happened to both my wife and I by keeping too many of the same passwords on different accounts. Once one of them gets compromised, the bad guys go in and just birr right down the list and then they're able to get into other accounts using that one password they got.

**LEANNA:** Yeah. And for all of them.

So, many use a password manager too, so that's helpful. Clients will come into the branch and not have their log-in identification. They never want to change their password because they're going at great lengths to keep it secure. So often, a new way to really secure your accounts is using your voice. And it's a very secure way in doing so. No one can duplicate your voice like that.

So, just, again, I would encourage you to reach out to your financial services firm and just say like, what are the ways that I can make sure I have strong protection on all of my accounts and just take extra precaution when we can.

**JIM:** Super smart. Two-factor authentication, I want to voice my love for that too as well. You can go on Fidelity's website, look up two-factor authentication if you're unfamiliar with it, learn more about it, and then if you are interested, sign up for it. But it can save you some headaches in the future.

Leanna, thank you for that. Maybe other potential headaches in the future—how's that for a segue—Jurrien, let's wrap things up with you looking ahead at what the Fed's possible moves are. You alluded to it the next couple of FOMC Open Market Committee meetings. More rate hikes in the future but that's kind of what the economy is calling for.

**JURRIEN:** Yeah. So, markets are very, very efficient, and we have a Federal Reserve that likes to telegraph what it is going to do because nobody likes surprises. And so, whatever the Fed is going to do in the next few months is in the market already. So, I don't want anyone to think like, oh my god, the Fed is going to raise rates by half a point. You know, what do I do?

It's in the market. And you can see this in the chart. The black bars there, that is the ten-year Treasury yield. The orange line is what we call the forward curve. So, in other words, it's what the market is pricing in for its expectation of when and by how much the Fed is going to raise rates and then what happens after that.

So, if we're looking for anything new to happen in the next FOMC meeting, it is those purple dots. That is called a dot plot. And that comes out every quarter. So, the last one was from March and the next one will be in June this month. And it will be very interesting to see what happens to the dot plot.

So, the dot plot is basically the sixteen FOMC members of the Fed all get to say where they think the Fed funds rate is going to be at different intervals over the next few years, and that's why there is a range of them. And then, you know, it is a favorite pastime for the market to then say, okay, what is the median dot? Where is there a cluster? You can see there is a cluster, right, where the dots are, and they are generally around 2.5 to 3.

And so—so, that is kind of—will be kind of the reading the tea leaves part of the June FOMC. But the actual rate hike is baked in the cake and then there will be several more until the Fed gets to

what is called the terminal rate which is around 3 to 3.25 at this point. It's a moving target. It can be different next week. But that's what is in the market. And neutral is considered around 2.5. Neutral means not too loose, not too tight, kind of Goldilocks. And so, 3 is moderately restrictive policy, and I think that is completely justified given the inflation issues that we are having. And so, that's kind of what we're looking for in the coming week or two but also beyond that.

**JIM:** Glad to be able to bend both of your ears in the coming weeks to get some analysis and some thoughts about what the markets are doing.

That's going to do it for us this week. Before we go though, something new for folks in our audience who might be looking to learn more about what's happening in this volatile market or maybe looking for additional webcasts on a variety of financial topics.

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Again, huge thanks to Fidelity's Jurrien Timmer and Leanna Devinney. The three of us will be back here next week with a fresh look at the markets, what's moving them, and what it means to you. Hope to see you then.

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