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

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TRANSCRIPT

SPEAKERS:

Jim Armstrong Leanna Devinney Jurrien Timmer

Jim Armstrong: Hello, and welcome to Market Insights. I am Jim Armstrong with Fidelity. Thank you for joining us today.

With all the volatility we've seen in the markets over the past few months, a lot of us have been thinking about the importance of stress testing or pressure testing our financial plans, figuring out where we stand so we can take steps to stay or get back on track. And while that's what we are talking about today, our thoughts are certainly elsewhere, as we share the mix of sadness, fear, anger, shame, and frustration that are playing out in cities across our country as we continue to confront the inequalities and racial discrimination that are both longstanding and unacceptable. As a company, Fidelity continues to look for ways to make a positive difference in the lives of our customers, our associates, and our communities.

Now, during today's update, we'll hear from Jurrien Timmer. As Fidelity's Director of Global Macro, Jurrien studies the overall economy and offers real time analysis of what it means. We are also joined by Leanna Devinney. She has worked one on one with customers for years and she now leads a team of people helping Fidelity customers build financial plans under all kinds of circumstances.

Remember, the views and opinions in this webcast are those of our speakers. This discussion is for educational purposes and should not be considered investment advice.

Jurrien and Leanna, thank you again both for being here. I know we took last week off for the Memorial Day holidays. It feels like I haven't seen you for a while.

Leanna Devinney: I know. I missed you both last week.

Jurrien Timmer: It's nice to see you guys again, and certainly looking forward to a good conversation today.

JIM: Great. Thank you both again. It's Tuesday, June 2. And since the Memorial Day holiday, we've seen markets continue their recovery and parts of the economy continuing to reopen, and that is in contrast to more grim unemployment numbers and, of course, to the daily and nightly protests now, riots and civil unrest reflecting the longstanding inequalities of racial discrimination that I mentioned just a moment ago.

Jurrien, I am really interested to hear your perspective on how the markets handle all of those moving pieces.

JURRIEN: Yeah. You know, certainly, it was already a confusing picture, at least for most people, even before the developments of last week. But now it seems even more surreal that the markets are just going about their business, it seems, even though we are having, you know, these extraordinary developments happen. But it's a good reminder that the markets—even though it may sound cold hearted to say, the markets are focusing on things like earnings and interest rates and, obviously, for the current corona crisis, the pace of reopening, the pace of new cases. And the good news, of course, as we know, has been that the COVID curve has flattened in the U.S. and in many other parts, and the economy is reopening in different stages by different states in different phases. And when you look at we have the COVID curve, if you will, which has flattened and even started to bend, but as you can see in this chart, even the earnings curve or the economic curve is flattening.

So you look at these lines here, which show the earnings estimates on a week-to-week progression, you can see that they are no longer falling or at least not falling at the same degree that they used to, and it gives you a sense that the economy is starting to stabilize and is starting to bottom. We may still be a few months away from an actual bottom, but, you know, markets do discount the future, and we are seeing some hopeful signs. For instance, last week, obviously, we know that the unemployment situation is devastating with millions of Americans out of jobs, but the number of continuing jobless claims—so you have the initial claims and you have the continuous claims—continuous claims last week went from 25 million to 21 million. Now, these are mind-boggling numbers still, but that's still an improvement of 4 million. One of the old sort of adages that we have in the market is when the rate of change starts to improve by things going from getting more bad to less bad, at least economically speaking, the market kind of has a way of sniffing that out. And so with that in mind, the fact that the market continues to gain on the hopes that the economy can reopen and so far is doing so without a second wave I think is really ultimately what's driving the markets here.

JIM: Can you also talk a little bit about—I know you've described it as a disconnect between what the market is doing versus what a lot of folks watching right now, for example, might feel like it should be doing?

JURRIEN: Yeah. There is clearly—at least it appears to be a disconnect. But again, the markets discount the future; right? So it's a question of is the market discounting, or is it disconnecting? And my sense is that it is discounting a better future; right? So if you think of the COVID crisis, if the analog is a natural disaster type of scenario where you have a sudden stop and then a fairly quick rebound, not like a V where it goes back to normal right away, but maybe it goes back to normal over the next two years, the market is sensing that. And, of course, as we have talked about in past weeks, the policy response from the Federal Reserve and from Congress in terms of the CARES Act have played a very powerful role in building a bridge over the abyss, if you will, and to the other side.

When you look at this chart, for instance, again, on the surface, the numbers seem to be making no sense. So if you look at the expectations for earnings growth, right now the market is expecting an earnings contraction over the next 12 months from where it is now, and I think that is correct, but that rarely really happens. The only other time we've seen that was actually during the financial crisis in early 2009. At that point, the expected earnings were 4% below the trailing earnings. But if you go even further out, you look at the gray bars in this chart, the expectations for earnings two years from now versus this year—so this is a fiscal year number, fiscal year 2, which is 2022, versus fiscal year 0, which is 2020, the expectations are for a 50% increase in earnings. Now my first impression would be, oh my God, that's way, way too ambitious. Market is over its skis. But if you look at the chart, actually, the same thing happened in March of '09, which was at the bottom of the financial crisis, after a 57% decline in the stock market, the market actually was pricing in a 58% rebound in earnings, and it actually turned out that way. The market was actually correct and in fact, was actually not bullish enough. Earnings ended up gaining something like 70% over the following two years, as unlikely as that would have seemed at that time in the dark days of the financial crisis.

So I don't know if that 50% number is correct. Nobody really knows. Maybe it's 30 or 40. Maybe it's even too low. But I am using this just as an example to explain why the markets are continuing to kind of climb this wall of worry, if you will. And the wall of worry is very steep, as we can see, but there is a method to the madness, if you will, and that hinges on the expectation that the economy will eventually fully reopen. It may take a while. And that earnings will eventually come back. And that is what the market is anchored on.

JIM: Great. That's such important perspective, so thank you for that, Jurrien.

Leanna, I want to turn to you sort of in the context of what Jurrien was just describing here, the market swings that we have seen plus the uncertainty that seems baked in. I know that a lot of your clients want to sort of check in to confirm that they are still on track to achieve their goal. So what questions do you think they should be asking themselves to pressure test or, like we said, stress test those plans?

LEANNA: Yeah, so it is what I hear most from clients, the question of am I still on track, or do I have to be playing catch-up to the goals that I have, such as retirement? So I'd say when we are working and partnering with clients, we always start and end with the plan and the analysis that we go through, and it will show clients the impact market events like this can have. So after big market swings, I recommend reviewing and understanding if your plan is still on target, and if it isn't, there are steps that we can take, so those are some of the questions we can be asking.

So what you are seeing here, this is the Fidelity's Retirement Score, and it's a tool that we use, and it can quickly do—it assesses your retirement preparedness, and it will show on a scale of 0 to 150 how equipped you'll be to cover your estimated retirement expenses. So on this screen, it's showing a score of 103. It's very in the green. It means a client is on track to cover 103% of the expenses that they will have—they said they would anticipate in retirement. What I love about this tool, it's a quick way to really help start the planning conversation, and it's also accessible to anyone via Fidelity's website, and you just answer six simple questions to get started. And so many will ask, though, because we don't often have in the green right away 103, so how can we improve the score, and we'll talk about three things that you really can do.

So first is to save more. And the sooner you start, you can benefit from potential growth over time, especially when there's compounding there. And that conversation of saving more is usually paired with a conversation on spending. So we are seeing now the impacts that we have on saving and spending less. I know me personally; I have been saving a lot instead of having my morning coffee on the commute into work, but things like that add up in small tweaks that can make a really big difference over time. And also, if you are over 50, there's more addition we can save in our retirement. It's called the catch-up, and that's a tax-advantaged contribution to your 401K or IRA. The second thing we can do is invest more appropriately. So absolutely saving more, but how do we invest and making sure we are investing for your timeframe, your financial situation, your risk tolerance. And I have shared this a lot, but having that diversified mix of stocks, bonds, and short-term investments to balance and have growth and steady returns over time. And then the third thing we can do, which it's certainly not a client favorite or anyone's favorite, but it is delaying retirement and working longer. This step can give you more time to save, more time to have growth potential and invest. So those are really the three lenses we look through.

JIM: Leanna, can you talk a little bit more, actually, about how someone's plan or maybe even their Retirement Score, if they have used that tool online, when it shifts because of what's going on in the economy and in the world around them, how do people figure out what to do when that happens? I would imagine that can be a little bit scary for some folks.

LEANNA: Absolutely. And many clients often assume that the market drop is going to have that same direct correlation to their score. So if we are seeing a 25% market turn, does that mean my score just went down 25%? And that's not the case. So what this is showing, this is a hypothetical saver. So 45 years old, anticipating retiring at 65. We'll call her Susie. And before the downturn, her score was a 97%, meaning she could have covered and was on track to cover 97% of those expected expenses in retirement. Now, after the market downturn in this scenario of a 25%, her retirement score, it dropped 6 percentage points to 91%. So again, you can see the market score, it has a couple different factors to it. So it's past savings and including the market downturns, and then it's looking at future contributions, how you are investing, also benefits we get, such as Social Security. All of that adds up to the Fidelity Retirement Score.

So I think in looking at this, the good news, again, is that we have options, and we can pull those three levers I talked about—saving more, taking a look at spending, and investing more appropriately—to help with that score.

JIM: Got it. Thank you for that.

And I want to turn back to Jurrien, too, because I like it when you two sort of bounce off of each other a little bit in terms of Jurrien taking the macro view and you going a little bit more micro there. Jurrien, based on what Leanna was just describing about how her customers are approaching their concerns, how do you talk about it, how do you think about it when you describe this disconnect again?

JURRIEN: Yeah. You know, these are extremely confusing times just because price does not unfold usually at the same timing as the fundamentals. Price leads earnings that leads to fundamentals. In a typical recession, it wouldn't be as confusing because typical recessions, they can last a year or even longer. Typically, it takes much longer for the economy to come back after a recession just because of the nuances of what causes that recession. If this is a steeper-than-normal and faster-than-normal recession, which I think is the expectation of the market and one that I would agree with, then it concentrates this disconnect even more because everything is moving so much faster. And again, you can see in this chart, this shows what we call a drawdown in the S&P in the black line and the drawdown in earnings estimates in the different rainbow lines there. And you can see the market was really falling very sharply about two months ago, more so than earnings actually have so far fallen. So the market was actually pricing in a worse scenario than we have so far gotten, at least in terms of earnings, and again, the understanding or the expectation is that the millions of jobless—of jobs lost, a lot of them will come back at some point as the economy comes back to life. So the market is recovering in anticipation of a recovery. But when you line up the price action today and what we see on the news today, it really doesn't make any sense. But it is an important reminder that the market is more rational than we may think, and it's often more ripe than we might think.

I will throw just one last tidbit out. We don't have it in the chart, but maybe we'll use it next week. A 60/40 portfolio, just basic 60/40, is only down 3% from the highs in February. So it's just another lesson just to be in the right portfolio, stick with it, don't sell at the bottom, rebalance, and, you know, in most cases, you will be okay.

JIM: Jurrien, I want to stick with you for just a second, a question that just piqued my interest based on what you were just talking about, it was just the speed with which everything is happening. It really resonated with me. What goes through your mind when you think about really how quickly everything has developed just over the past few weeks?

JURRIEN: Yeah. I mean, I have been doing this 35 years, and I am still astounded by just how different it still is from normal. But again, we've never had this; right? Again, normally, recessions, they are homegrown because of excesses and monetary policy, all that stuff. This was a sudden shutdown, a self-imposed shutdown in a way, medically induced coma is how I've heard it described. And as we come back, it's just everything is concentrated. Everything is bigger, faster, you have more computer training, algorithms that kind of add to the information transmission as well. But that doesn't have to be our enemy; right? As long as we stay in the right place and we keep doing the right thing, I think, you know, even if it's a more volatile cycle than normal, over the long run the fundamentals always win.

JIM: Got it. Again, thank you for that, Jurrien.

Leanna, I want to turn back to you, returning again to this idea of pressure testing your plan, sort of operationalizing everything that Jurrien was just describing. I know you have said on this webcast a handful of times in the past that really having a plan, sticking to that plan can be crucial to navigating choppy market waters. How else can a plan be pressure tested?

LEANNA: Absolutely. And just as Jurrien just said, the fundamentals always win. As I said earlier, the analysis and the planning that we do, that's the fundamentals, and it's often a starting point and something we always revisit. So many clients who may have that positive score at first, they think, okay, I am all set. But we have to keep in mind the plan needs to have the ability to continuously navigate different types of market conditions, different life events that we go through. And especially given today's retirement, they can last 20-30 years. So we look even beyond the analysis, and we want to make sure that we have growth potential and income.

So you can see here there's three things that we look at when we are building that plan. So first we have guarantees to ensure your core expenses are covered, so this can include Social Security, pensions, annuities. And one of my core business beliefs as a planner is to really ensure we have a consistent income stream in retirement to cover your essential expenses so you don't have to worry about the challenging markets that we can see. The second is the growth potential to meet the long-term needs and goals that you have, and this comes mostly from stocks in a portfolio because we need to grow those over time, that helps cover inflation, or keeps pace with inflation, excuse me, and as expenses rise, we want to be able to combat that. And then the third is flexibility, and that's the flexibility to refine your plan over time and combining both income from different sources. Just like we believe in diversity in investments, we want diversity in our income that we rely on, and having that flexibility can help manage the key risks that we face in retirement or just financial investing and risks of inflation, longevity, market volatility. So I'd say, just, again, to speak on the fundamentals that we see when it goes into planning have elements of these three items here.

JIM: Got it. Leanna, Jurrien, I want to thank you both again. It was really good to spend some time with you again today. Virtually, of course, the only way to do it for the time being. But thank you so much again for sharing your knowledge and for taking the time to speak with us today. And, of course, a tremendous thank you to everyone watching as well. Be safe, be well, and we hope to see you here again next week.

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*This hypothetical illustration assumes investor Suzie is 45-years old and working. She makes $100,000 a year and contributes 15% (including employer match) to her retirement. She plans to retire at age 65. The estimated annual retirement expenses are assumed to be $70,000 (based on income replacement rate; she lives in MA; uses single as tax filing status; and is considering FICA in pre-retirement income. Rounding down to the nearest $5,000, her expenses are assumed to adjust annually with a 2.5% rate of inflation during retirement. The value of her retirement savings is $400,000 in a 401(k) account and the pre-tax value of Social Security benefits is $27,000 (assuming she is single and claims at age 62, rounding down to nearest $1,000, 70% taxable, adjusted annually with 2.5% inflation during retirement). Her savings are invested in 70% stocks, 25% bonds, and 5% cash. And a 16% total effective tax rate is assumed during her retirement. Market drawdown is assumed to be 25% drop in the stock market. Portfolio drawdown is a product of market drawdown and stock allocation of the portfolio, rounding down to nearest 1%. The Fidelity retirement score estimates the percentage of a retirement income goal that a user or household is estimated to replace in underperforming market conditions. View the complete Retirement Analysis Methodology (PDF). All indexes are unmanaged, and performance of the indexes includes reinvestment of dividends and interest income, unless otherwise noted. Indexes are not illustrative of any particular investment, and it is not possible to invest directly in an index.

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