Fidelity Viewpoints®: Market Sense

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TRANSCRIPT

SPEAKERS:

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Jim Armstrong: Hello and thanks for joining us for Market Sense. I'm Jim Armstrong with Fidelity. As we have four weeks now, our attention today remains on inflation, interest rate hikes, and possibility of recession. In particular, we're keeping our eyes on the fed's meeting tomorrow as we record today and that where most folks are expecting another rate increase. Perhaps another three quarters of a percentage point hike. So certainly, today we'll cover all of that and then through that lens we're all very much aware that when inflation is high and there's this level of uncertainty about the market, every penny truly counts, maybe now more than ever.

So today we're also going to be talking about potential ways to maximize employee benefits. So, to help guide today's conversation, Jurrien Timer is here with his big picture look at everything that's moving our economy why and a look at what's to come. And Leanna Devinney will share how she and her team are helping people build and update financial plans. Really in an effort to help stay on track with their goals even during trying times. Guys thanks both for being here as usual.

Leanna Devinney: Thank you, great to be here.

Jurrien Timmer: Good to see you again.

JIM: Hey Jurrien, let's start with you if we could. It's the 26th of July, and as we often say big week for investor coming up but in particular this week, we've got the fed meeting which I just mentioned with the potential for another significant interest rate hike. But then also, we're about the second quarter GDP numbers, gross domestic product numbers come out. You know, for a lot of people that's a chance to look at and maybe decide that we've entered a recession or about to enter a recession. So, give us your take on what we should be making about all the numbers coming out over the next few days?

JURRIEN: Yes, it is a pivotal week. The Fed will be, in all likelihood, raising rates by quite a bit tomorrow on the 27th. The expectations are for 75 basis points or three quarters of a percent. There was some talk about a full percent, but the markets are pretty much pricing in 75 basis points. And my sense is that the Fed will do exactly that. And if you look at this chart here, you know, the orientation, the kind of the yellowish line is the current Fed funds rate. And then the orange line is the expected Fed funds rate over the next several years.

And so, it actually will reach a pretty important milestone this week, because if you add .75% onto the 1.63%, you get to around 2.5%. And if you look at those little purple dots towards the right, those are—we call them the long-term dots. But that is what the Fed and the market believes is a neutral policy. So, this week, the Fed will have returned to neutral, having been at zero as recently as, you know seven months ago. So, it is really a remarkable about face from an extremely accommodative monetary policy to now, at least, a neutral policy.

And of course, the next big question is, where will the Fed go from there? And as you can see from the orange line, the Fed is expected to not stop at neutral, but to go into a restrictive policy and then question is, how restrictive? And what's interesting is that we're at this juxtaposition now where, as you mentioned, we are going to get the 2nd quarter GDP number and it's entirely possible—I'm not an economist so I'm not going to predict what the number is. But it's entirely possible that that second quarter number could be negative. And that's after a negative number in the first quarter.

And so, a lot of people are going to kind of pounce on that and say, well, hey, two consecutive quarters of negative GDP growth means a recession. And I am not saying a recession isn't or is going to happen. It may very well happen at some point, but just to set the record straight, the NBER, which is the National Bureau of Economic Research, is the official arbiter of whether and when the US economy is in a recession. And it is based on a lot more than whether GDP contracts for one or two or more quarters. So, we could have a technical recession where there is an inventory cycle being corrected, even though a lot of people remain employed as they are, right? The unemployment rate is 3.6% still. And the most recent payroll number for June still showed a gain in employment of close to 400,000 people.

So, it is hard to say that we are in a recession when, still, people are getting jobs and are spending money, as we can see from the air travel and all of that stuff. But, at the same time, clearly the economy is slowing. We have the Conference Board Consumer Confidence Survey come out this morning, and the survey of present conditions, so, how people are feeling about what is happening now, has, you know dropped about five or six points. And of course, inflation has a lot to do with that. And we will talk a little bit about that later. But in any case, a milestone this week in that we will have finally a neutral Fed on its way to a restrictive Fed, at the same time that the economy is clearly slowing, and may even show an ongoing contraction for the second quarter.

JIM: It is crazy to think we are already in that neutral place. I remember you predicting that and talking about it being on its way. It's sort of shocking to think we are there already so interested to see what comes next.

Leanna, everything Jurrien just said is the context for my first question to you. This uncertainty that people are feeling isn't getting any better, even with a robust economy—robust jobs outlook, inflation may be coming down, prices at the gas pump coming down a little bit. If you could sort of talk about what questions people are bringing to you and your team, particularly through the lens of today's other topic which is Employee Benefits.

LEANNA: Absolutely. And I would say volatility is still top of mind in today's conversations, but with volatility, it is an opportunity to make sure your investment plan is still in line with the goals you have. So, at Fidelity, we really help build and implement comprehensive wealth plans for our clients and we look at a holistic plan. For those in a Workplace Plan, or your spouse is in a Workplace Plan, Fidelity helps educate you on the options that you have, to really make sure you maximizing your savings potential, going through your benefits, understanding your options and in uncertain times of market conditions, it can really make a difference.

JIM: Yeah, I love that idea of maybe having that conversation or reaching out to do that because as you said, people often feel they need to or they want to do something during times of volatility or uncertainty so that is a great first step there. We will touch on that in a second.

But it strikes me, Jurrien, this might be a good time to ask you, sort of what do you see moving forward, sort of coming around the bend in terms of markets? What do you look at for that indication?

JURRIEN: So, I—it is a great question. And as we know, the Fed's has a dual mandate, right? So, the Fed's job is to achieve full employment, to have everybody who wants to work at work. And, price stability at the same time. You know, over the past 15 years or so since the financial crisis, the Fed has had the luxury of sort of—not that it is not paying attention to inflation, but that inflation hasn't been a problem and therefore the Fed could kind of spend most of its focus on reaching that full employment. And certainly, that was the focus during the pandemic and in the aftermath of that.

But with inflation returning, it becomes more of a balanced, more nuanced thing. So, at this point, as we just talked about, the Fed has—is reaching neutrality on its way to restrictive at the same time that the economy is slowing. And so, from here it becomes, you know, kind of an interesting phenomenon where how tight the Fed will get will determine, you know, what happens to the markets.

Because historically, if the Fed goes too fast, or restricts policy too much, oftentimes a recession has followed. And who knows, maybe one will follow during this cycle. And so, how far the Fed goes, or has to go, because of inflation, will be one driver. And the other one, of course, is how quickly the economy slows.

And as I just mentioned, it is slowing already, but it is not contracting in all likelihood. So, that brings us to earning season which is now well under way. And I am glancing at my screen here. We have 132 companies having reported out of the S&P 500, 72% of them have beaten estimates by an average of about 4%. And we had an Earnings Report this morning from Walmart that lowered guidance, saying basically the consumers are not spending as much so more evidence of the slowdown that we are seeing.

And it's interesting, you look at this chart which shows the progression of earnings estimates expressed as a growth rate for the calendar year 2022 and other years prior to that. And, you know as I mentioned in past episodes, you know the estimate has been really steady, surprisingly so, given we are in a slowdown. And it is still at 10% which is where it has been for months, actually. It is not quite as robust as it appears though. If you look at what earnings expectations are, excluding the energy sector which is only a small part of the market, right? Energy is about 4% of the S&P 500. But if you strip out just that one pretty small sector, the earnings growth estimate drops to 4%.

And so, that is still positive, right? That is not a contraction. So, an earnings slowdown is not the same as an earnings contraction, but it is more evidence that the economy is slowing, and as I will mention a little bit later, inflation expectations are starting to fall.

So, we are getting into the really interesting part of the cycle, not that the other parts haven't been interesting, but, this part where that threading the needle of the Fed deciding how far they need to push it while the economy is slowing, that is going to be a real, real balancing act. That is going to happen, you know, in the next couple of months.

JIM: And that idea of threading the needle, I think is equally as applicable to us as investors and consumers. As we know, folks who have come to talk to Leanna and team about decisions they are making with regard to purchases. And you mentioned, sort of, Walmart acknowledging people are buying less because things are more expensive and they are worried about their futures. That is what people do. They spend less when they are worried about their future.

Leanna, you mention benefits that you might get through your employer here, I think it is a great time to talk about what is top of mind when it comes to that.

LEANNA: It is. And so, you really want to make sure you are maximizing all that you can be getting and it is July so we are through halfway of the year so it is a great time to look and make sure you are not missing out on any contributions. Or many will wait until end of the year and it can be a little bit too late. So, some things to think about is really making sure you make the most of your

Retirement Savings, and Health Savings Plans. Many companies have benefits such as tuition reimbursements, maximizing your mental health benefits, and then even just all the way down to tax free dollars for gym memberships or getting discounts. So, there is a lot out there to look at.

JIM: How about—can you talk a little bit more about those employer sponsored retirement plans. Lots of different flavors and lots of varieties—easy to get a little bit overwhelmed by everything going on there.

LEANNA: Yes. So, starting with the bigger ways to really make the most of your money would be your Workplace Savings Accounts so your 401(k), 403(b), 457 plan if you have a work place saving account it's likely one of those, you or your spouse. So, you first want to take a look at what your contribution limits are so we put a chart up here showing the 2022 contribution limits. But also taking a look at what your employer offers for matching retirement contributions, and make sure you take advantage of that.

Really you want to go at least enough to get to the full max, because that is really essentially free money. These accounts all offer double doses of tax advantages. So, the contributions you make reduce your current taxable income and then any investment growth is Federally tax deferred, so it is a great opportunity to really maximize your savings on the retirement end. We see so often, pensions are further and fewer, so here is really the vehicle to save for the long-term retirement.

Very often I do see clients who have active 401(k), 403(b), these employer sponsored plans and they really haven't taken a look at their contributions from when they really even set up the plan. And so, income changes, sometimes you have more bonuses or variable compensation. So, it is really an opportunity just to make sure you are maximizing your savings and again, in times of volatility, this is a great way to be dollar cost averaging into your employer sponsored plan right into your paycheck.

JIM: And a switch flips kind of, right? When you are 50 years old all of a sudden there is more money, you can contribute.

LEANNA: There is. That is the catch-up provision.

JIM: Excellent. Okay, one other thing I wanted to ask you also, HSAs those get confusing, as well.

LEANNA: Yes. So, this is another way to save. HSA is a Health Savings Account. So, this really allows you to save for your health care expenses now and in retirement so it can be used as a long-term savings vehicle which I will talk about in a moment. But if your employer offers an HSA eligible health plan, you may have access to an HSA option. Or if you have a high deductible health plan on your own then you consider buying or—sorry investing in your own HSA account. So, these accounts provide a triple tax benefit. So, first your contributions are tax deductible, so they reduce your current taxable income. Second, the savings can grow tax deferred and then you may be able to withdraw those savings completely tax free if you are using that money for qualified medical expenses.

JIM: I think we have a slide for this, too, there is another slide?

LEANNA: Oh, we do, yes. The HSA account will be on the next one. I'll go into why we invest them in a moment. So, if you use the HAS account for any qualified medical expense—so this could be prescriptions, this could be copays, this could be eyeglasses to use. So, in 2022 the contribution for an HSA account for an individual is $3,650. And for a family it is $7,300. So, just on investing versus not investing, some people will like to have their HSA as that rainy day fund in case they have a medical emergency, or they are using it, you know at the local store for things like your eyeglasses or prescriptions. But an HSA account is also a great way to boost your retirement savings. We see health care costs as the largest expense for retirees. A couple of aged 65 this year, our study showed that the amount going to health care expenses is $315,000 needed to cover your health care expenses in retirement. So, this chart is really showing the power of investing your HSA account, versus keeping it in cash. So, you can see the red is showing the HSA invested, versus the blue is keeping it in cash. It is hundreds of thousands of dollars in a difference. It is a big opportunity to invest all, or even just a portion of your HSA account to set aside for those long-term savings.

JIM: Certainly, worth investigating. I have another question for you tied to workplace benefits but I also want to talk about it because of COVID, frankly. I think a lot of us found ourselves in the position of becoming caregivers during COVID, maybe unexpectedly, or at least we know somebody who has. And as a matter of fact, Fidelity just did a recent study on American caregivers and it found that planning and securing resources to take care of somebody who has a disability or a special need can really be difficult, but also feel really good to be able to do and I think a lot of people, we learn, aren't really seeking out available workplace benefits to make that happen.

So, where would you direct people who might be in that circumstance.

LEANNA: You are right and so many of the families we partner with are supporting their loved ones in the caregiver capacity. And there are two parts of the relationship so there is the person with the need, then the caregiver themselves. So, the study showed seven out of ten caregivers are so focused on their care giving duties that they put off addressing their own needs. So, many—there are a lot of benefits out there in terms of Employee Assistance Programs for just the mental health and physical well-being. That can be really valuable.

The study also showed top concerns on what happens to their loved ones when that caregiver can no longer be doing those duties and just making sure you are making the best decisions for your loved ones. Caregivers surveyed, they said the top benefits were job flexibility, paid and unpaid leave—again, those Employee Assistance Programs are really helpful. Then other benefits of the plan sponsors did include the Health Savings Accounts which we talked about. Care coordination programs, there is legal help, back up care and counseling, so it is definitely worthwhile to explore these benefits if you are a caregiver, and going to your benefits program to help.

Really, Fidelity has resources and tools for everyone on all the things we talked about to help with these major life events.

JIM: Yeah, I have heard you say that in the past that's why they call them benefits, right? So, look into them and see if there is things you can take advantage of that you didn't know were there.

With a couple minutes left, Jurrien, I would like to turn back to you for, you know a sort of backward look, that one of the things that you do so particularly well is tell us what lessons we can learn or infer from what has happened in the past. We talked about the potential for recession. What do we know historically how recessions have affected us looking back?

JURRIEN: Yeah, so as I mentioned the Fed has a real balancing act here between growth and inflation. And until now or including now, the Fed has just been, kind of hammering away at the inflation side because the economy was very, very strong, and it is still growing. But you know as the Fed gets too neutral this week, and then beyond neutral in the coming few months and as growth clearly is slowing, a lot of this is going to come down to whether our inflation is peaking. And if it is peaking and I think most people believe on a rate of change basis the inflation rate is going to start moderating, but from that point it depends on how quickly it moderates.

So, if we look at this chart, purple line is the CPI year over year change and you can see it's like the highest in 50 years at 9%. The orange line is what we call the core PCE, the Personal Consumption Expenditures inflation rate which is the one that the Fed uses and it tends to be a little smoother as you can tell. And then the black line is what the tips market, the bond market, expects inflation to be in the coming years.

And the market expects it to go back down to about 2.5 and, you know wouldn't that be nice if that happened. If that happens relatively quickly, the Fed is going to be able to kind of take its foot off the brakes a little bit sooner, right? So, instead of going all the way to 3.5 or 4%, or some level that could really break the economy and cause a recession, you know, maybe it is wishful thinking, but the glass half full approach here is that if inflation starts to ease off sooner, maybe the Fed can, you know back off a little bit sooner, and not take rates all the way to that breaking point.

But so, we don't know the answer, of course, but either way, to your question, even if we have a crystal ball and we know that a recession is coming or isn't coming, or if it is coming, whether it is a mild one or severe one, whether it is more technical in terms of, you know companies build too many inventories because during the pandemic they double and triple ordered stuff because they were afraid they would not have stuff to sell. If it is just that then it is kind of a technical thing and obviously, it will displace some people, but it is not going to be like a financial crisis type of thing where millions and millions of people are without jobs or income. My guess is it would be more of the former than latter and at that point you have to think about, well how much of this is actually already priced in, right? And that becomes a very important consideration, because even if we know a recession is right around the corner, remember, the market already fell 25% at the recent lows. The typical recession bear market is good for a 35% decline, which means that the market already priced in 70% of that recession. And if it turns out to be a mild recession, maybe it won't go down 35, maybe it will only go down 25 and then it is already there. I want to put that out as a reminder that it is not as simple or lineal as saying, well, if this happens, then do I do that, because the market is way too complicated for that.

JIM: And that's why we're glad that we have the opportunity to speak to both of you every week to help sort things out and to get that really important perspective. So, thank you again for making time to be with us today. Same thing goes for the folks in the audience, thank you as well. If you've got questions about making a financial plan or staying on track, as we remind you every week, Fidelity is here to help, right? You can always go online, give us a call, visit our website, download our app to learn more.

You will also, by the way see a new QR code on your screen right now if you are watching us on a computer, laptop or desktop, use your phone to take a picture of the code. Just tap on the code and it will take you to the Fidelity brand new On Demand Webcast that takes a deeper dive into exactly what we talked about today, how you can maximize employee benefits, specifically during a job transition, whether you have chosen to leave work or whether is under other circumstances, this is a webcast that can help you figure out some of your best next steps. Also, by the way on the phone watching us already, you can use the URL that you see on the screen right now, that's Fidelity.com/maximizebenefits. Again, huge thanks to you guys, Jurrien and Leanna. We'll hope to see you back here next week.

About the American Caregivers: Caring for a Loved One with Disabilities Study

This study presents findings from a nationwide survey of 766 U.S. adults ages 18+ who have current caregiving responsibilities for a family member or loved one with special health care needs or expect to in the future. Interviewing for this survey was conducted May 20-30, 2022, by Engine Insights, Inc., which is not affiliated with Fidelity Investments. The results of this survey may not be representative of all adults meeting the same criteria as those surveyed for this study. For a detailed look at the Caring for a Loved One with Disabilities study, go here.

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