Fidelity Viewpoints®: Market Sense

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TRANSCRIPT

SPEAKERS:

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Jim Armstrong: Hello and welcome to Market Sense. Thanks for joining us today. I'm Jim Armstrong with Fidelity. You know, every couple of years it seems we find ourselves waiting to see what's going to happen with the federal debt ceiling and this summer we're back at it. Remember the last time we had this debate back in 2019, an agreement was made to suspend the federal borrowing limit but that expires on July 31st of this year, less than a couple weeks away.

So, that's what we're talking about here today. On one hand, what Congress might do about the debt ceiling and perhaps more important, what that could mean for our investments, plus we'll take a close look at the markets and what's driving this week's activity.

So, to have that conversation, Jurrien Timmer is here to talk about his ongoing work analyzing the markets as well as our overall economy. And Randelle Lenoir is back as well this week. She's going to be talking about how she and her team of Fidelity representatives discuss topics like the debt ceiling and other big potential market movers with their customers pretty much every day of the week. So, Randelle, Jurrien, thanks for joining us today.

Randelle Lenoir: Hey, guys. Glad to be here.

Jurrien Timmer: Hey. Hello from Boston again where I have to cook for myself again. My mom isn't there to cook for me anymore.

JIM: It is a tough life. It is a tough life but really great to have you back home. And now let's actually start with you, Jurrien. It's Tuesday, July 20th, again, just eleven days out from that July 31st deadline for the debt ceiling. And before we get to that though, we definitely want to talk about what went on in the markets yesterday on Monday. It was a rough start to the week, feeling like a bit of a rebound today. Completely unrelated—or can I say that—to the debt ceiling concerns?

JURRIEN: Yeah, so the markets are—were certainly under some pressure yesterday for a number of reasons. Obviously concerns about the Delta variant really kind of seeping back into the markets. I think a lot of investors were hoping and expecting that we were kind of finally done with this pandemic.

But as we all know, cases are rising rapidly in the UK and they're not rising as rapidly in the US, but the Delta variant is kind of the dominant strain.

And so, with a lot of good news priced into the markets, you know, it's not too much of a surprise that investors are kind of curtailing their enthusiasm a little bit. And on top of that, of course, we have the topic that we've been talking about for several months now which is that the Fed has kind of entered the conversation by saying that it is thinking about normalizing policy again.

And this is kind of a chapter in the story of the market cycle that every cycle has to deal with, right, because things get bad. The market goes down. The Fed eases policy, the market recovers, and then the Fed at some point wants to kind of normalize its policy back to something resembling something more neutral. And so, that has been the case in recent weeks or even a few months.

So, I think, you know, we're in that mid cycle correction phase which is not a correction—I'm not concerned that it's a significant correction or the end of the bull market, but it's a transition between from early cycle to mid cycle and the market just has to kind of adjust to maybe interest rates eventually rising a bit and now also the risks that the Delta variant will impose some restrictions for the economy.

And sometimes those corrections can be kind of swift and sharp like we saw in 2010. Other times, they will just produce kind of a sideways pattern. We saw that in 2018. We saw that in 2015 when the Yellen Fed was trying to lift rates. We saw that in 1994. Every cycle has that. And so far this cycle has been kind of that sideways.

So, in this chart you can see the S&P 500 in the black there still making higher highs and higher lows, which is how we define up trends. But if you look at the other lines there, large cap growth, small cap value, et cetera, really only large growth has been driving the markets higher and all the other elements have been in some form of correction.

And my sense is that that will continue for the next few months as we kind of go through this COVID scare with the Delta variant and also we go through this kind of—this dance between the market and the Fed.

And again, it's something that every market cycle has to contend with at some point and it's almost never the end of the cycle. It's just, in a way, it's actually a sign that the cycle is progressing.

And actually, if we get to the next slide, you can see that, that even though the markets are being jittery and interest rates are back down and we're worrying about the Delta variant, and earnings, and we're in—just at the start of earnings season for the second quarter. Earnings are booming, right? You see that black line there shows 37% expected earnings growth for this year. And so, we have to kind of, you know, weigh all the pros and the cons and certainly fundamentally in this cycle, without—even after worrying about the things that we just discussed, the fundamentals are very, very solid and I think will carry the markets on from here.

JIM: Thank you for that. That's great. So, with that as context, can we also just segue now to the discussion of the topic of the day, the federal debt ceiling. Again, at a high level, that's just the amount of borrowing the government can do in order to have the money it needs to pay its bills every day.

I guess from your perspective, Jurrien, what are we looking at today and maybe how have the dynamics changed since the last time we had this conversation a couple of years ago?

JURRIEN: Yeah, so, this, you know, unfortunately, we're in a position as a country—and the US is certainly not alone—Europe, Japan, China, they all face the same issue which is that demographics are aging. The debt levels are very high and occasionally the debt level exceeds where the debt ceiling is and then that ceiling needs to be raised in Congress, at least in the US version of that.

And you know, we're sitting on a $28 trillion debt right now. The economy is around $21-$22 trillion. And of course we know that with the pandemic, there's been already over $5 trillion of spending, the CARES Act, the $1.9 trillion stimulus back about three, four months ago. And so, the debt ceiling, you know, kind of caps that and it needs to be raised and like you said, it's not the first time.

We've that the most visible last time that we've had this conversation was 2011. You know, the summer of 2011. The US even got downgraded in terms of its credit rating. We also had the eurozone debt crisis flaring up back then in 2011. And so, the market actually briefly fell 20%. But I would not lay that at the feet just of the debt ceiling negotiations that were going on.

This happens, as you said, every couple of years and it always gets resolved in the direction of raising the debt ceiling because there's really—there really is no other choice. I mean, you know, the debt is there. We have a lot of unfunded liabilities in this country. And so, ultimately, even if there's some political back and forth in Congress, ultimately all sides tend to agree on this.

So, you know, it's something the market worries about, but generally we kind of get past it in the market and then the debt ceiling gets raised and we kind of forget about it until the next time.

JIM: Until the next time, exactly. But until that next time and certainly now, and Randelle, I want to bring you into the conversation because now there are real concerns that investors—people have if the unlikely were to happen and the government were to default or something, the debt ceiling extension would be delayed or something like that. So, we know that some customers are asking folks on your team and elsewhere about that. Sort of, how do you help set the stage for what that could mean to people?

RANDELLE: Yeah, so, if the debt ceiling isn't raised, the US will be in danger of defaulting on our own national debt. So as Jurrien described before, it's a huge deal but it's unlikely. You know, it hasn't happened in the modern era. But because it hasn't happened, that also means if—and that's a huge if—if it happens, no one really knows what could come next, right?

So, if Congress doesn't raise the debt ceiling, the US government would have to operate on a cash flows basis, meaning that they can only spend money that's coming in. Of course, that requires that they have to prioritize payments that they're going to make.

So it's possible, for example, that Social Security payments or veterans' benefits might be impacted. I know that's a concern for millions of people.

Other payments that could be affected, unemployment benefits, Medicaid payments. And of course, we can't overlook or forget the millions of Americans who work for or are retired from the US government. These people rely on their salaries and their retirement payments for life, for living, so that could also be interrupted as a potential.

JIM: Yeah. And Jurrien, I want to go back to something you said as well, sort of at the risk of stating the obvious. Markets don't like uncertainty. This—the debt ceiling conversation injects some level of uncertainty into the markets. Again, highly unlikely that the federal government would be unable to meet its debt obligations. But I think even coming this close does have consequences, right? Is that fair to say?

JURRIEN: Yes. And again, as you just said, investors do not like uncertainty. And it's, you know, it's a serious, serious issue. I mean, when you have a lot of debt, it's a very serious issue. But there's a lot of political drama around it, right, because of the different sides of Congress, they like to make points about this. But ultimately, the debt ceiling historically at least has gotten passed because there really is no other choice.

But it speaks to the general conversation that a lot of people are having about, you know, how much money can the government spend? And we're seeing the inflation numbers, right? The CPI is now 5.4% higher than it was a year ago.

So, you kind of combine the inflation that we're seeing and all the money printing, not only by the Fed but by Congress as well, again the CARES Act, all very necessary, but still, you add them all together and there's a sense of, you know, the purchasing power of my money is being destroyed, right? That's kind of generally the conversation that we're seeing a lot of people have.

And you know, it's actually a good reminder to make sure your money's always working for you, right? I mean, here's a chart. This goes all the way back to 1900. Actually, I have this chart going back to 1700 but 1900 is far enough.

JIM: That'll do. That'll do.

JURRIEN: We were not alive back then anyway. But it just shows you, you know, that red line shows the purchasing power of $1 back then, today. So $1 in 1900 is worth only $0.03 today. That is part of that monetary devaluation that inflation will do. And again, inflation and the money spending, all part of the same conversation.

But if you look at that dollar invested in the stock market would be worth in $65,000 today. Invested in the bond market would be worth $224 today. Even sitting in cash, it would be worth $65 today. So, it's very important when we're having this conversation is to not put your money under the mattress but have it work for you in whatever form, whether it's in stocks or cash or bonds.

And so, you know, again, regardless of all the stuff that we're discussing, your money does tend to grow in value if you're putting it to work even though inflation will actually erode the value of a dollar. But a productive dollar that is put to work will keep up with that or even exceed it.

JIM: Randelle, I see you nodding along to Jurrien's commentary there. So, what then—what's an investor to do sort of in this framework here with debt ceiling concerns or pandemic concerns? What do you tell people?

RANDELLE: Well, for starters, my team and I always try to remind people there's only so much you can control and I'm sorry, the federal debt is not one of those things, right?

So, we say that whether someone's concerned about the debt ceiling, pandemic, market swings, whatever it is, take that opportunity to focus on things that are within your control, things you can control.

So, whether you make your own investment decisions or you work with a financial advisor, the key here is an updated portfolio. An updated portfolio will bring your financial plan to life.

So, at Fidelity there are three primary investment principles that we feel are key to designing and maintaining a successful portfolio.

So, proper asset allocation, that's what drives returns. So, spreading your investments out across different asset classes like domestic and foreign stocks, bonds, shorter term investments, for example.

Then understanding how the economy and different world events can influence your returns over time. That can help you manage your risk, just like this conversation that we're having today.

And then finally, ongoing maintenance in your portfolio is going to lead to long-term success and that's a big part of it. A major principle here is rebalancing.

JIM: Okay. And actually, I wanted to pause you there for just a second to explain a little bit more about rebalancing because I'm not always certain that everybody knows exactly what's involved with that.

RANDELLE: Happy to discuss rebalancing, really excited about it. So, let's say maybe you wanted 60% of your portfolio in stocks and 40% to be in bonds. But after some time, the market moves, the value of your investments will shift, and let's say now maybe you're at 70% and 30% which might not be lined up with your goals. Rebalancing is bringing that back into line, right?

So, this is something you could do for yourself or you could work with a financial professional to get it done. But this is something, again, that contributes to long-term, ongoing success of a financial portfolio.

I like to think about this like gardening, right? So, just because you cut the grass and you pulled the weeds last month, I think all of us understand that doesn't mean that right now it's okay and it's always going to be okay, right? I think all of us also understand that if you don't have an ongoing maintenance process for your lawn, that you're going to have an unruly mess, right?

So, you should think about your investment accounts the same way. You need an established and disciplined routine to maintain them. And don't worry if you struggle with this. We have a lot of resources available here at Fidelity.

JIM: I really—I like that analogy in part because it really stresses the long-term view, right? I mean, so the garden or the lawn you're tending to there is meant to last more than a month. You're not investing necessarily for a month although you could. You're probably investing for some medium or longer-term goals so you need that longer-term view.

RANDELLE: Right. That's exactly right. You're investing for something that's several years away or even decades away, think a child's college education or your own retirement.

Look, the bottom line is there's going to be volatility in the market. Your investment experience is not going to be a never-ending string of positive returns. That's not how investing works.

You know, I'm thinking about conversations that we've had this week, my team, with clients that are concerned about the market volatility. And I love what Jurrien said. The bottom line is to make sure your money is always working for you. It's about building and maintaining a portfolio that is appropriate to you, your goals, your risk tolerance. And your portfolio should be updated. It can reflect what's happening in the world to help manage your risk but it should also, most importantly, reflect what's going on with you. Right? Again, this is something that we can help out with here at Fidelity.

JURRIEN: I would just add to that. The market actually only goes up 60% of the time, right? And the odds of a 10% correction are about 40%/50%. The odds of a 20% decline is about 20%. But yet over the long-term, if you can ride out those periods of volatility, the S&P 500 has gone up about 11% per year.

So, you know, I guarantee you, if you like to worry and you're looking for a reason to worry, you're going to find one. And if that takes you out of the market, you have to remember that at some point you have to get back in. Getting out is probably a lot easier than getting in, especially if you were wrong about getting out in the first place.

And so, there's always going to be stuff to worry about but yet, you know, that rising tide, we call it the wall of worry. The market likes to climb that wall of worry. And you know, the debt ceiling is just one of thousands of things that happen over the course of someone's investing career and I think it's important to just remain really disciplined.

And this should be a numbers game, right? It's like what Randelle says, it's rebalancing either on a recurring basis or when there's been really large moves and just kind of dollar cost averaging month after month. And if you do that, you know, generally speaking, the returns are going to be there. But we can be our own worst enemy sometimes.

JIM: Keeping the long-term perspective that I hear you both talking about too, sort of taking things in stride, like negotiations around the debt ceiling and what that does to the market and other bigger movements, taking that all in stride and keeping that long-term view.

So, thank you again for taking the time to be with us today and reminding us how important that really can be.

And of course, thank you to our viewers as well. Thanks for being here and watching today.

A reminder, as Randelle said, if you need help with your financial planning or maybe you just have questions about how Fidelity can help, you can visit our website or download our app. Those are a couple of great ways to continue or begin the process to learn more about what we talked about today, get answers to your questions, and then of course, explore Fidelity's planning solutions.

So, again, huge thanks to Fidelity's Jurrien Timmer and Randelle Lenoir and thank you for watching. We'll see you here next week.

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