

Fidelity Viewpoints®: Market Sense

Week 108, August 2, 2022

TRANSCRIPT

SPEAKERS:

Jim Armstrong Jurrien Timmer Leanna Devinney

Jim Armstrong: Hello and thank you for joining us for *Market Sense*. I'm Jim Armstrong with Fidelity. Quite a bit to talk about this week as we continue to process the effect of the Federal Reserve's latest interest rate hike and the news that the countries the GDP, the Gross Domestic Product fell for a second straight quarter. You know, in the face of all those things we know that it can be a bit stressful to look at your portfolio, look at the bottom line on your investments there especially when the markets are volatile. And you can feel helpless in that uncertainty. So, today we are going to talk about how to possibly prepare for the unexpected with an emergency fund as well as talking about the current events of the day.

To help give us much needed perspective, as always, Jurrien Timer is going to join us. He's got his high-level look at the markets both at home and globally as well as a sense of what it means to us as individual investors. Leanna Devinney has her finger on the pulse of our clients' top questions so she's going to talking today about how she and her team really help people build and update their financial plans to stay on track even during times like these where it seems like there is more questions than answers. Guys, thanks for making time again today.

Leanna Devinney: Thank you, it's great to be here.

Jurrien Timmer: Thank you and greetings from Cape Cod. I'm here for—in the final days before my annual bike-a-thon, the Pan-Mass Challenge. I'm near the home base for that ride.

JIM: I think it's our third August with you so the third time you've gone out of your way to make time for us even in the midst of your planning there, so thank you for that, Jurrien. But let's start with you too, as we typically do. It's the second of August, Tuesday August 2nd. And we've got—let's start with the Fed rate hike from last week. Well telegraphed, Jurrien, you and many others



predicted it would be 75 basis points. Three quarters of a point. They are—the Fed of course trying to rein in inflation without triggering a recession looking for the theoretical soft landing. It strikes me sort of, they had the foot on their gas aggressively—the gas and then now they have to do this balancing act of a mix of it seems to me coming off the gas but maybe even tapping the break a little bit in an effort to get it just right.

JURRIEN: Yes. So, we are at a really pivotal fork in the road, I guess we can call it. If you look at this chart, you know the orange—that gold line is the Fed funds rate which is the interest rate that the Fed sets when it changes policy. And the orange line is the expected Fed funds rate over the next couple of years. So that's what the market is pricing in, in terms of what the Fed will do. The black line is the ten-year treasury yield. And you're just going to look at that chart and you see how fast it went from 0 to basically two and a half. Two and a half being what the Fed, at least thinks is a neutral policy. And the Fed in recent days there have been criticisms of Chairman Powell using that term, that maybe two and a half isn't neutral anymore given that inflation is at nine but we will leave that as a separate conversation for another time.

But you can see how quickly we got from neutral, from very, very accommodative to more neutral. And so, the Fed has been able to frontload a lot of these rate hikes. Now we are at a point where you can see the market is pricing in at an inflection point. You see that the ten-year treasury yield, the black line is coming down now. And you can look at the orange line is expected to peak in the next six months or so and then start coming down which is another way of saying that the Fed is expected to go another maybe 75 basis points and then start to cut rates. And if you look at the economy, you look at GDP numbers—we will talk about this a little bit later. Two consecutive quarters of negative growth. You look at what the market is expecting from inflation. That is that inflation is peaking, it would be great if that was the case.

So, all of a sudden, the Fed is getting to the point where it needs to be really careful that it doesn't overdo it because if inflation expectations are already starting to come down now, and growth is already starting to slow or even shrink, the Fed needs to be careful not to not keep tightening policy so much that it then really triggers a recession even beyond what we may call a technical recession. So, we are really at that point where the Fed—and the Fed has done a good job I think in saying we are going to be data driven from now on, right?

Three months ago, the Fed could go full steam ahead with raising rates because the economy was still overheating at that point. So, there really wasn't a lot of there wasn't a big price to pay for that but now the thing—everything is a lot more balanced and it's going to be data dependent from now on. So, maybe the Fed does less than 75. Maybe it does more than that. But it's kind of that tricky part in the cycle where the Fed really needs to kind of read the tea leaves as we are all doing.

JIM: Interesting perspective there and Leanna that brings me to question that I wanted to ask you. Jurrien typically starts us off with that macro look at high-level inflation, the threats of recession, what interest rates are doing nationally. You know, to whether and to what extent I'm curious do

folks come in to you and your team with those concerns on their minds when they're thinking about what to do for themselves.

LEANNA: They do come in with those concerns and questions and I think top of mind this week just coming off last week we saw second quarter of negative GDP. The question we're hearing is are we in a recession and if not, when are we? So, my team provides clients with Fidelity's view of where we are in the economy, the process, and indicators that we look at. And really though no matter what phase of the economic cycle we are in, if it's a recessionary period or expansion, I think it's really important to have an investment plan and strategy that you are comfortable and confident in no matter what phase we are in.

So that is where we spent our time. I would say, in addition to building that investment plan, we want to make sure you have ample liquidity and flexibility in your plan. So, I know we were talking about an emergency fund. That is an important topic that we talk about.

JIM: Great and I definitely want to follow up with you on an emergency fund. But before we do I want to, sort of close that loop with Jurrien, the other big news making event last week was the second quarter of negative GDP, Gross Domestic Product. Jurrien, give us some perspective. Some people see that Jurrien and they make a lot of conclusions immediately.

JURRIEN: Yeah, and it may sound like we are splitting hairs when we talk about the nuance of a technical recession versus an officially declared recession and I'll explain that, right?

So, we've had now two quarters in a row of negative GDP growth and we know that most recessions, not all, but most of them that we know about, that we think back in history will tend to have at least that. And so, it's easy to conclude that while we have two negative quarters of growth, therefore we are in a recession. But the definition of a recession as defined by the NBER, which is the National Bureau of Economic Research, goes much further than looking at whether GDP is expanding or contracting because GDP is a formula. And when everything doesn't add up in the formula to a plus sign, it will be in contraction. And in this case, the last two quarters, we have seen a lot of inventory build because companies, kind of over ordered during the pandemic.

Remember in the lockdown we were afraid all the shelves were going to be empty. So, I think companies double and maybe triple ordered stuff. And then, as demand got saturated for the stuff and as inflation started eroding the disposable income of consumers, consumers have changed their buying behavior and maybe they are buying less and traveling more, for instance. And so, the GDP, you know calculations kind of have trouble keeping up with all of that. So, the NBER looks at the economy in a much broader way, not necessarily at whether growth is expanding or contracting, but are people losing their jobs.

You know, things like that and when you think about the consumer in the US economy and the consumer is 70% of economic growth, right? So, without the consumer either losing jobs or

really not spending any money anymore it's really hard for the economy to be in what we would traditionally call a recession. If you just look at the numbers, the unemployment rate is 3.6%, okay? Now jobless claims, which is the weekly filings for initial jobless claims are moving up a little bit and we just got what we call the jolt's report, not to throw too many acronyms at you. But it shows that companies are clearly hiring less and we see this in the earnings report, right? Companies are becoming more cautious but that doesn't mean that we have mass layoffs, right? Which you typically would associate with a harsh recession.

And, you know just looking at—I always look at the TSA data, right? The TSA is where we go when we go on a plane, we have to go through TSA checkpoint at an airport. The data from yesterday was that 2.35 million checkpoints were cleared yesterday alone. So that means 2.35 million basically flights are being taken. That is the highest still since the summer of 2019 and if you think of travel as maybe the most discretionary form of consumer spending, I mean, you have the option to go on a vacation or not or on a trip or not. If that number is still that strong, it's hard for me to see this as we are in a recession or that one is imminent.

So, again, it's maybe splitting hairs. You can see in this chart we have two very, very minor negative changes in quarterly GDP and it gets a lot of attention. But it's not—there is not enough there to say we are in a—what we normally would consider a traditional recession. It doesn't mean we are not going into one but it just right now the evidence is not strong enough that we are.

JIM: Makes perfect sense and thank you, again, as always in that great perspective in helping us go a little bit deeper than the headlines there. Leanna, everything that strikes me that Jurrien was just talking about are things completely out of our control as individual investors, right? I can't control what the Fed does, I can't control whether or not we are in a recession, or whether or not it's declared. I can control, sort of the decisions that I make in my house and about my own life and so part of that, I think has do with an emergency fund. And now is probably a good as time as any to thinking about a what if.

LEANNA: It is, and I love that you're saying that about controllables because it is hard. We can't control where we are in the economy or what decision the Fed is going to make, but we can instill these healthy habits that then give us some piece of mind when there are curve balls. So, starting with an emergency fund and even thinking back to the pandemic, so a really good example. There were plenty of Covid curve balls as we like to say so loss of income or needing to help a loved one. That is where we learned emergency funds are really important.

I have also seen that with market volatility, emergency funds provide that emotional comfort and it really allows us, when we have our short-term needs met by an emergency fund, we then allow our longer-term goals and investment plans to really stay invested and stay in that appropriate risk level when we have an emergency fund. So, first and foremost, an emergency fund is really there to provide liquidity and flexibility so that it's accessible for you in case of an emergency. Fidelity

suggests that you should have about 3 to 6 months to cover your essential expenses, but that can be customized to you and your comfort level.

JIM: So actually, I want to ask you specifically about that, I've heard us talk about that three-to-six-month range quite a bit and that's a wide gulf, right? If three is X, six is 2X, how do I decide where I should lay?

LEANNA: Yeah, it's a great question. So, you definitely want to have enough so if you lose income, say your job or your partner's job then you are covered. So, what we say generally if you are single, you may be comfortable on the lower side so three months. Whether you are in a relationship or have family or a heftier mortgage or other dependents you might feel comfortable with six months or more.

I have had clients who are still helping family members so they allocate even more than that and they have a dollar value versus a month value in their mind. So, again customized to you. I'd say though, some may be listening and thinking, "Well, three or six months that's very hard to plan and allocate." So, we recommend thinking about an emergency savings almost like a bill that you pay monthly and that you get it to that goal of three to six months and beyond.

So, we're just going back to that next slide for a moment. I just wanted to touch on the options to invest in a money market, in an emergency fund. So, we have savings account, money market funds, or CDs. For the CDs that is coming with a term so you may have a little bit higher rate versus money market funds. But we would really recommend making sure you have a three-month CD or six-month CD, because a goal is they are liquid and flexible for you to access in need.

JIM: Alright, we have a sneak preview of what you are going to be talking about next there. But in addition to an emergency fund, what are other, sort of guidelines that might be useful to folks?

LEANNA: So, again I think an emergency fund, it really provides that foundation and it gives us the stability and can help with the emotions that can then come with investing. So, general guideline was three to six months. We also have some general guidelines for our spending. So, we believe in this 50, 15, 5 general, kind of rule here. So, consider allocating no more than 50% of your take home pay should cover essential expenses.

15% would be towards your retirement savings. So, this is 15% of your pretax income and that is including an employer contribution for retirement. 5% is that emergency fund saving for the unexpected of your take home pay. And the other 30 leaves you with discretionary spending. So as Jurrien mentioned, we are seeing a lot of travel, people are going on vacations. If you allocate for that and budget for it that would be part of the 30%. So, moving to the next slide.

JIM: I wanted to ask you. You said budgeting, too and that is a word that gives people pause because they're not really sure. Many of us have challenges budgeting and saving and the two competing with each other.

LEANNA: Yes, budgeting can feel almost like the b-word, a swear word. So, we like to show just a hierarchy of like, what do I do next? You know, we talked about building an emergency fund, we talked about spending, right? Like where do I go? So, I like this list of just six almost in order of operations. We want to you build that foundation first, having that emergency fund and if it's a lot to chew, we say use that pay yourself a monthly bill.

Then we can't take a loan for retirement, so we are going to prioritize that and making sure we can maximize our retirement savings for our long-term goals. Then come some of the high interest loans, so it could be credit cards, paying off student loans. After that we are going to go back to that retirement account. It's, again really important for the long-term savings. So, these are the areas where you can help starting with emergency fund, how we are spending and then the debt hierarchy.

JIM: I think I've heard you say this before. The foundation of all of this is having diversification, right? All of your eggs shouldn't be in one basket. So, final question to you, how does that work?

LEANNA: Yeah. So, really the foundation of our core philosophies is making sure that we have a diversified investment plan aligned to the goals that we have and certainly not having all of our eggs in one basket.

So, we first want to understand what your goals are. They can be short term goals, you can see on the left-hand side they are going to be lower risk, things more in cash, and more conservative investments. And then on the right-hand side these are going to be our longer-term goals, maybe more growth oriented, could be retirement, could be those goals 10-15 years out. We believe in, again building that investment plan, making sure you are really well diversified. We are rebalancing to manage risk and being able to stay invested. So, please kind of starting with that emergency fund and getting spending right and how we invest are all the ways we help our clients.

JIM: Tons of really important information. Leanna, thank you for that. Jurrien, I wanted to wrap up with you this week. And one of the things you are particularly good at is giving us perspective based on what's happened in the past, it's no guarantee of coming forward but as we look into a future that likely includes a recession, I mean according to the business cycle there has to be a recession eventually. But what is your sense, historically of how a bear market turns around? How do bad things get good?

JURRIEN: It's a great question and it's a good reminder that as investors we are always making real time decisions with imperfect information. And so, therefore keeping an eye on the long-term having the kind of diversified portfolio that Leanna was just talking about, I think is probably the

best that, you know an investor can do. And one example of that is right in the chart in front of you, right? The S&P in June was down 25% from the highs. The Barclay's Agg, which is an investment grade index was down 14% from the high. As of last Friday, the S&P is down 13% from it's high. So, it recovered a significant amount of loss that it had in the first six months. Even though, you know the economy is getting slower, right? And interest rates are getting higher. So, it doesn't really make sense except that the investors or the market is always discounting the future. It doesn't always discount it correctly, right? So just the fact we are off the lows doesn't mean that we can't have lower lows a few months from now, we just don't know. But all we know is what we can learn from history and for instance, right now, we didn't talk about the yield curve, but the difference between short-term rates and long-term rates is now negative as we call that inverted yield curve. That has been a good predictor in the past of recessions.

So, it is entirely possible we will have a recession if we are not already in it, maybe in the next six or 12 months. But that doesn't mean we should sell or do anything really in the portfolio because A, we don't know if it's going to be a bad one or a pretty shallow one, or like the technical recession that I mentioned that was really just about an inventory cycle correcting and not so much about mass layoffs, for instance. We also don't know when it's going to happen. The yield curve's prediction is pretty consistent but it can happen a half year after or two years after and then the third one is it all depends also on what is priced in, right?

And so, if you think about it this way, a typical bear market is 33% from high to low. At the lowest in June, we were down 25, and 25 divided by 33 is about 70%. So, we priced in 70% of a recession already back in June. And, if it's a really severe recession, then that is probably not enough. If it's a milder technical recession, then that is probably enough. And so, everything depends on what is priced in and I think, you know, I don't have the information. Nobody else does. All we can really do is rely on market math and have a sound portfolio that makes sense and to use volatility to rebalance. I mean volatility doesn't sound like it's ever our friend, but it actually can be useful in terms of rebalancing a portfolio if it needs to be done.

JIM: Right, and despite the fact that neither of you knows the future exactly, your weekly assistance helping us make sense of what is happening today is so appreciated. So, thank you, again for your time. And for folks in the audience thank you again for making time to be with us.

A reminder to you if you have questions about making a financial plan or maybe staying on track with your current plan, Fidelity can help. You can call us or go on line, visit our website, download our app to learn more. And as another reminder, *Market Sense* is a podcast if you didn't know that so you can certainly take us along on your commute, or a walk or go to the gym. Just follow *Market Sense* wherever you get your podcast currently and you'll be able to have us in your personal library and never miss a moment of the conversation. Again, huge thanks both to Jurrien and Leanna. Thanks for making time and we hope to see everybody again next week.

Information presented herein is for discussion and illustrative purposes only and is not a recommendation or an offer or solicitation to buy or sell any securities. Views expressed are as of the date indicated, based on the information available at that time, and may change based on market and other conditions. Unless otherwise noted, the opinions provided are those of the speakers and not necessarily those of Fidelity Investments or its affiliates. Fidelity does not assume any duty to update any of the information.

To the extent any investment information in this material is deemed to be a recommendation, it is not meant to be impartial investment advice or advice in a fiduciary capacity and is not intended to be used as a primary basis for you or your clients' investment decisions. Fidelity and its representatives may have a conflict of interest in the products or services mentioned in this material because they have a financial interest in them and receive compensation, directly or indirectly, in connection with the management, distribution, or servicing of these products or services, including Fidelity funds, certain third-party funds and products, and certain investment services.

Investing involves risk, including risk of loss.

Past performance is no guarantee of future results.

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.

The S&P 500® Index is a market capitalization-weighted index of 500 common stocks chosen for market size, liquidity, and industry group representation to represent U.S. equity performance. S&P and S&P 500 are registered service marks of Standard & Poor's Financial Services LLC. You cannot invest directly in an index.

Bloomberg Barclays Global Aggregate ex-USD Float Adjusted RIC Diversified Index (Hedged USD) is a customized subset of the Global Aggregate Index, a measure of global investment grade debt from 24 local currencies. This multi-currency benchmark includes fixed-rate treasury, government-related, corporate and securitized bonds from developed and emerging markets issuers while excluding USD denominated debt. The Index is hedged in USD.

Diversification and/or asset allocation do not ensure a profit or protect against loss.

Stock markets are volatile and can fluctuate significantly in response to company, industry, political, regulatory, market, or economic developments. Investing in stock involves risks, including the loss of principal.

Foreign markets can be more volatile than U.S. markets due to increased risks of adverse issuer, political, market, or economic developments, all of which are magnified in emerging markets. These risks are particularly significant for investments that focus on a single country or region.

In general, the bond market is volatile, and fixed income securities carry interest rate risk. (As interest rates rise, bond prices usually fall, and vice versa. This effect is usually more pronounced for longer-term securities). Fixed-income securities also carry inflation risk, liquidity risk, call risk, and credit and default risks for both issuers and counterparties. Lower-quality fixed-income securities involve greater risk of default or price changes due to potential changes in the credit quality of the issuer. Foreign investments involve greater risks than U.S. investments, and can decline significantly in response to adverse issuer, political, regulatory, market, and economic risks. Any fixed-income security sold or redeemed prior to maturity may be subject to loss.

Because of their narrow focus, sector investments tend to be more volatile than investments that diversify across many sectors and companies.

Dollar-cost averaging does not assure a profit or protect against loss in declining markets. For the strategy to be effective, you must continue to purchase shares in both market ups and downs.

Fidelity Wealth Services provides non-discretionary financial planning and discretionary investment management through one or more Portfolio Advisory Services accounts for a fee.

Advisory services offered by Fidelity Personal and Workplace Advisors LLC (FPWA), a registered investment adviser. Fidelity managed accounts refer to the discretionary portfolio management services provided by Strategic Advisers LLC (Strategic Advisers), a registered investment adviser. **These services are provided for a fee.** Brokerage services provided by Fidelity Brokerage Services LLC (FBS), and custodial and related services provided by National Financial Services LLC (NFS), each a member NYSE and SIPC. FPWA, FBS, and NFS are Fidelity Investments companies.

The CFP® certification is offered by the Certified Financial Planner Board of Standards Inc. ("CFP Board"). To obtain the CFP® certification, candidates must pass the comprehensive CFP® Certification examination, pass the CFP® Board's fitness standards for candidates and registrants, agree to abide by the CFP Board's Code of Ethics and Professional Responsibility, and have at least three years of qualifying work experience, among other requirements. The CFP Board owns the certification mark CFP® in the United States.

Fidelity does not provide legal or tax advice. The information herein is general and educational in nature and should not be considered legal or tax advice. Tax laws and regulations are complex and subject to change, which can materially impact investment results. Fidelity cannot guarantee that the information herein is accurate, complete, or timely. Fidelity makes no warranties with regard to such information or results obtained by its use and disclaims any liability arising out of your use of, or any tax position taken in reliance on, such information. Consult an attorney or tax professional regarding your specific situation.

Before investing in any mutual fund or exchange-traded fund, you should consider its investment objectives, risks, charges, and expenses. Contact Fidelity for a prospectus, an offering circular, or, if available, a summary prospectus containing this information. Read it carefully.

Personal and workplace investment products are provided by Fidelity Brokerage Services LLC, Member NYSE, SIPC, 900 Salem Street, Smithfield, RI 02917

© 2022 FMR LLC. All rights reserved.

923295.162.1