

Fidelity Viewpoints®: Market Sense

Week 112, August 30, 2022

TRANSCRIPT

SPEAKERS:

Jim Armstrong Denise Chisholm Leanna Devinney

Jim Armstrong: Hello and thank you for joining us for Market Sense. I'm Jim Armstrong with Fidelity. Hard to believe but we are approaching the end of the summer. If that's not depressing enough, it also a particularly unsettling time for a lot of investors. Ongoing talk about recession, potential for future layoffs, as well as an overall slowing economy. So today, we want to spend a few minutes talking about what's going on in the markets, in the economy, and what it all might mean for you and for your investments. So, for today's talk, Leanna Devinney will walk us through our economy's business cycle and talk a little bit about why it matters for us as individual investors. She'll also share how she and her team are continuing to help people understand what's going on in the larger economy and then build and update their financial plans to stay on track.

We are also thrilled this week to have Denise Chisholm back on the show. She's Fidelity's Director of Quantitative Market Strategy which means, among other things, she'll be sharing insights on how different investments in sectors of our economy have preformed historically, at time like this and what that history could tell us about what we might expect next. Thank you both for making time to be with us today.

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

Denise Chisholm: Great to be back, Jim.

JIM: Yeah, absolutely Denise again, thanks for making time to be with us today. It is Tuesday August the 30th, and Denise we'd love to get started with you. With just, you know its sort of the question—I was going to say the question of the day but it's more like the question of the month or of the quarter. Sort of whether or not we are in a recession, is a recession looming? What's your take on that question and I imagine you're probably getting asked pretty frequently these days.



DENISE: Well, I do get that a lot. So, let's certainly tackle it. There is a government organization that is designed to actually call recessions and it's the NBER, the National Bureau of Economic Research. So, they have a—I'll call it a 'know it when you see it' approach, which is a persistent decline in employment or production. So usually what happens is you don't know that you're in a recession until, let's say about six months of being in one. But Jim you probably follow the Asset Allocation Research Team through the quarterly market updates, and they have more of a 'now casting' approach, where they evaluate the data that they're seeing and predict which portion of the business cycle we are actually in. So based on the data that they are seeing, it's a higher probability that we are in the late phase of the business cycle and not in a recession. So, we're still growing and not contracting from a Gross Domestic Product perspective.

JIM: Okay. And I have probably half a dozen follow up questions, Denise, for you, just on that topic right there, and then what it means to us as well. But before we go any further, I know Leanne, that you and your team, in trying to communicate that very fact to people, you have to talk about late phase, midcycle, business cycle. How do you help people who aren't economists by training, make sense of what that all means?

LEANNE: We do spend a lot of time sitting with our clients and educating them on really what the business cycle is and why we use this framework. So really the business cycle is the name economists give the pattern of changes and the key indicators an economy sees and the changes that economy has and takes place over time. And we use the business cycle because we believe it's the key indicators of stock and bond returns over time. So, when we talk about the business cycle with our investors, we're really using it to talk about our economy, where we are in the economy and the health of our economy. So, to you point, many people are coming in and asking, like are we in a recession? And we'll show this slide right in front of us. And many clients first ask is that trend line the stock market and it's not. It's a measure of GDP, Gross Domestic Product. And that's really a measure of how healthy our economy is and there is various indicators, aside from the GDP, to help share where we are. So, indicators such as inventory, you know interest rates, unemployment, consumer spending—Denise will do a better job listing all of this for us.

But we talk about the business cycle and where we are so there are four phases: early, mid, late and recession that we see listed here. You can go through a business cycle in seven years. It can take, you know, longer than ten years to go through each but it's actually healthy and cyclical to go through the different phases of the business cycle. Some clients we like to share, it's kind of like the weather. So, when we think about recession, we know fall and winter are coming, just like late and recessionary periods come, they're natural. But, exactly when and how severe the winter will be is kind of like a great way to explain the business cycle. So, the way we help clients, just briefly is we just, we want to make sure that you have an investment strategy aligned to your goals and make sure that you have a repeatable process no matter what phase of the economy that we're in.

So, today, we believe we're in the late phase of the business cycle. Top economist, and our Asset Allocation Research team believes that. Which just means that growth is slowing, but remains

positive. And with rising inflation, and a tight labor market, that's why we believe where we are is in the late phase of the cycle.

JIM: Got it. Perfect explanation. Thank you for that Leanne. Denise, I'd love to turn back to you now because you know, on Market Sense we always try to straddle that line between explaining where we are at that high level, almost academic perspective, but then bring it back down to what it means to us as individual investors so that will be my first question to you. Sort of, given where we are in the economy right now, what does that mean to folks like me and like you who are planning our investments—planning long term, medium term, short term, things to do with our money.

DENISE: So, it's a little bit of a trick question in the sense that the stock market can discount a lot of bad news in advance. Now, there is a lot of bad news out there and we just talked about one data set which is we've had two sequential contractions in Gross Domestic Product. Maybe it's not an official recession, but we certainly know that we're growing less fast than we were last year. The interesting thing not on this slide yet, we'll talk about this in a second, is if you looked at the nine months following any two sequential contractions in GDP any time since 1962, regardless of the arc of the economy over the course of the next year, stocks ended up higher 100 percent of the time. So again, that sort of goes to show that stocks can discount a lot of the bad news in advance.

And here's another thing about, in terms of what we've seen. So, from the peak in the stock market to the trough we've seen recently in the stock market and the S&P 500 was down about 25 percent, so, a little over 20 percent. If you just knew that as an investment fact, held your nose and looked a year later, you'd find 87 percent of the time, regardless of whether or not there was recession, stocks ended up higher. And a hundred percent of the time, stocks ended up higher if you didn't have a recession. So, I think even despite the bad news, given what the indicators are, stocks actually might still be a positive risk reward here.

JIM: That's like a very glass half full perspective which I'm happy to hear. I'll take that for the time being. I'll push my luck with another question. Is it fair to ask, given that, sort of rosy outlook for stocks, is it fair to ask if there are any stocks or sectors or industries that you think could perform especially well in the months ahead?

DENISE: Yeah, I think one of the more interesting sectors that I'm looking at, Jim is consumer discretionary. So, if you think about consumer staple companies, they're the companies that sell stuff you sort of need to buy like toothpaste and toilet paper. The discretionary companies are companies that sell things that you, sort of don't have to buy but want to buy like autos or think about vacation so they tend to be more economically sensitive.

JIM: So, I understand that. But, isn't it also the case that as the economy starts to cool, people are worried, as we said at the outset, about the potential for recession or layoffs? Inflation certainly

eroding buying power. It seems to me that what you just described, people would be less willing to spend money in stocks and those types of companies and industries would suffer because we are all a little less consumer-y.

DENISE: Right, that's exactly right. So, profitability of these companies or business trends has gotten worse over the last couple of months and I don't expect it to get a whole lot better, either. But that's not the reason for the optimism about the sector in terms of their outperformance because again, back to that stocks are often a discounting mechanism. And it's really the dramatic underperformance that you've seen over the course of the last six to nine months that have potentially pushed those shares lower to discount that bad news in advance.

So, what you see, and you see this a lot in consumer discretionary from cycle to cycle, is that despite the news is bad or even sometimes gets worse, stocks can outperform or go up more than the market on a go forward basis. In fact, for consumer discretionary, the worst that earnings trends look or profitability of those companies looks, the higher your odds of outperforming or being better than the market over the course of the next year. And that's where we are right now. Which creates that potential for a positive risk/reward if you're willing to look over the course of the next year.

JIM: And that's super encouraging. Any other stocks whose performance you think we might want to pay special attention to?

DENISE: Yeah, from a sector perspective, I think financials and energy. They're both similar in the sense that they have really strong valuation support at these levels. Now, energy has been leadership over the course of the last year. I don't see that style of leadership continuing, but I think that even if it's not an outsized performer, I think it's still likely beats the S&P over the coming year.

And on the flip side, I think of that valuation support, is technology stocks that had been laggards over the last year. They don't necessarily need to be down side leadership, but they still have valuation to work off through underperformance potentially.

JIM: I like how you described it a moment ago. This idea of holding your nose and then looking forward a year or doing your best to see through the volatility, and Leanne, I've got this question for you as well in just a moment, but I figured while I have you here, Denise, I'll ask you the same thing.

What is it about the mind set of the investor that you think makes it so hard to do that? To hold your nose and look through where we are in the moment?

DENISE: Well, because you always want to react to headlines because it's what you see literally in your face. And in some ways, that's why my title is Director of Quantitative of Market Strategy. I

ignore the headlines and just look at the data so when you just look at the data, you can see those contrarian patterns that the worse the news gets the more actually opportunities there typically is.

JIM: Perfect, well said. So Leanne, that's my next question to you, then, how do you help folks who don't have, sort of the economist training, see past that time. Hold their breath, pinch their nose and say, "Look now is not the time, necessarily to go to cash or get out of the market." Which, again as Denise said, when you're looking at some of these headlines feels like your gut is telling you that's the thing you want to do.

LEANNE: It can be very tempting and being one that doesn't sit in the data all day and sitting with clients, just over the years, I've learned really, you have to get two things exactly right if you're tempted to follow the headlines or just take a break. Some clients will say, I know I need to stay invested, but I just want to avoid this current market volatility or just this few months or this few week. And it turns into years because we say, "Okay, I want to jump out and we might get that right based on feeling but getting back in is even more challenging and hard." And you can see right here on the slide, it shows missing out on the best days, what the cost can be to investors. And so many clients will say, "Well no, I just want to skip out on the worst days."

But we've even seen the past few months with volatility, some of the best days go then to the worst days and those worst days are closely followed by better days in the market so that's why staying invested is so important. Fidelity does this third-party study every year and I'd love to bring it up to our clients. It's through DALBAR company and it shows the analysis of investor behavior and it compares over 20 year average period and it compares to the stock market. And it uses the S&P 500 as the index and every single year without fail, it comes back that investors consistently lag the market index.

And it's all due to this investor behavior that we're talking about. Because investors, it's natural. We want to chase that high performance, and then we go for higher risk investments when the market's soaring. And then on the flip side, during market downturns, we naturally go to lower risk investment, or we say I'm not going to invest right now or I might just sit on the sidelines for a little bit. And so that's we really believe, it's really important to have that investment plan aligned to your specific goals, your risk tolerance, your timeframe, your financial picture because again back to that business cycle, it's really normal for us to go through each of those phases.

And it's natural for an economy to do so, but it's really important to stay invested and that's what we help our clients do.

JIM: So, in keeping the trend of trick questions or potentially tricky questions going on, I can imagine, Leanne, people say to you, what's the best plan. Give me the best plan, whatever your top shelf plan, that's the one I want to be in. But there's no such thing, right? Because I would assume it's all customized to whatever my specific needs are. But, through that lens, then, what's a good plan in general look like?

LEANNE: Yes, there is no best shiny answer for you but the first is having that plan. So, you need a roadmap, an understanding of how much it's going to take to get you to the goals that you have so building that investment plan. And that's again, going over your risk tolerance, your timeframe, your whole financial picture. So, if you're farther away from your goals, let's say, it's something like retirement and you're younger, that plan is going to look very different than those who taking income in retirement now or closely approaching it.

The second piece of every plan is you need to make sure that investment strategy is aligned. So, when we talk about investment strategies, we're taking a look at your first asset allocation. So, having that healthy mix of stocks, bonds, and short term investment, again, all align to what those goals are. We want that asset allocation to be extremely well diversified in all the different categories of the market, the sub-asset classes that we have. We want to make sure that we're being proactive and rebalancing that portfolio, making sure that your allocation stays in line to the goals that you have and doesn't drift.

So, kind of a long answer there but it's the fundamental. So, starting with that plan. Making sure it's really well diversified and sticking with your plan, which can be the hardest part.

JIM: And sticking with it, I totally appreciate you saying that because to go back to the first slide we were using, the business cycle itself, it's easy, I think, relatively, and tell me if I'm incorrect, easier to stick with a plan when the market is going, as they say, up to the right, everything is rosy and the sun is shining. Everybody can stick with their plan then but again; in our brains we want to dump out of the plan when the market starts to slow down a little bit.

LEANNE: Exactly. That's when our true risk tolerance can come out because we start acting with our emotions when we see that there's volatility in the market or we're seeing the headlines of, we're in a recession. But, that's when it's important to act unemotional. Which again, really challenging, this is the relationship with our money. Looking at things like retirement. Like sending our kids to college, like that second home. So, again, not an easy feat to take the emotions out, but my most successful investors and clients that I see through my team have really have just that. They have that investment plan aligned to the goals they have. They're able to stay well diversified, they're doing things like rebalancing and that allows them to stay invested.

JIM: And personally, I try not to look every day, that's my goal. Maybe once a week, if I can pull it off once a month. I mean as long as I meet once a year, right, looking every day—yeah can sometimes be more trouble than it's worth. I loved your analogy of the seasons, fall, into winter, into spring, and then into summer.

So, Denise, with a couple minutes left. I wanted to get your reaction to—you know we were talking about this right before we went live, this idea that sometimes when you hear about recessions, it sounds like they're put through the lens of, if only the president did more, we could avoid this recession. If only the congress got off its hands and went into action, we could avoid a recession.

But the truth is, the economy can't function without the contraction associated with a recession and the next recession will come. It's just a matter—and please tell me if I'm overstating it, it's just a matter of how severe or how deep or how steep but you can't have an economy that only goes up. But the next recession is inevitable, is that fair?

DENISE: Absolutely. I mean, what we've seen is a business cycle that averages between, let's call it five and ten years. Which is a big range of how long your economy can expand. But what you see, typically, is that essentially a contraction is an ability for the economy to continue on expanding. So, not every contraction is the great financial crisis and not every correction in the stock market is a peak to trough to climb of 66 percent either.

So, there are big ranges. Even sometimes when we talk about recession, we think of an on or off switch and off is bad but there's a big range of outcomes in terms of how a recession ensues as well. And I think that that's important for investors to understand. That it doesn't always have to be an extremely deep contraction in the economy or an extremely deep correction in stocks.

JIM: Perfect. All right, I want to thank you both again for taking time to explain a really thorny and, like you said frankly scary topic in ways that make it easy to understand so thank you for that perspective. And thanks as always to the people in our audience. We know you've got a lot of ways to watch and listen to Market Sense. But a quick note, if you happen to be watching today on Fidelity's website, you will find a quick three question survey right underneath this video. If you could take a few seconds to fill it out and let us know what you think about the program, we'd really appreciate it. And again, it takes less than a minute and it's only available if you happen to be watching on Fidelity's website.

Also, our regular reminder before we go. If you have questions about making or updating your financial plan, staying on track with the plan you have, Fidelity is here to help. You can certainly always give us a call, or go online, visit our website, download Fidelity's app and find many, many ways to learn more.

Again, huge thanks to both Fidelity's Denise Chisholm and Leanne Devinney. I'm Jim Armstrong, and I hope to see you right back here 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.

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.

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

The consumer discretionary industries can be significantly affected by the performance of the overall economy, interest rates, competition, consumer confidence and spending, and changes in demographics and consumer tastes.

The technology industries can be significantly affected by obsolescence of existing technology, short product cycles, falling prices and profits, competition from new market entrants, and general economic condition.

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.

923295.170.1