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

Week 18, August 4, 2020

TRANSCRIPT

SPEAKERS:

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

It's August. Not only have we entered the back half of summer, we're now a full month into the second half of 2020. While we're hoping, hoping that the market has already seen the worst that 2020 has to offer, we definitely still want to talk about preparing for whatever might come next. With COVID on the upswing in parts of our country, the presidential election less than 100 days away at this point, there are definitely some potential market moving events on the horizon. That's what we'll be talking about today, how you can get and stay prepared for the possibility of choppy seas ahead as well as potential financial market movers to keep an eye on in the months ahead.

For today's update, we're joined by Jurrien Timmer. As Fidelity's Director of Global Macro, Jurrien studies what's happening in our economy, the large scale, and explains what trends he's seeing and what it means to us as investors. We'll also hear from Leanna Devinney. She holds a certified financial planner designation and she and her teamwork with Fidelity customers to build custom financial plans to help people meet their personal goals.

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

Leanna and Jurrien, thanks for joining us. One note, I think it's worth pointing out. There's a hurricane coming up the East Coast. The three of us are on the East Coast, so fingers crossed that technically we can get through the next half hour or so.

Leanna Devinney: Yes. And thank you for having us again.

Jurrien Timmer: Yeah. Hopefully we survive this call without any Wi Fi interruptions.

JIM: Fingers crossed. Let's see if it happens. Let's get started then. Today is Tuesday, August 4th. Jurrien, I want to start with something that we've been talking about over the past few weeks on this webcast, earnings season, when companies tell us how well or not they did over the last quarter. You prepare this chart for us every week and there are some big changes on it this week, especially when it comes to this year's second quarter. What happened, Jurrien, with that spike there?

JURRIEN: Yeah. We knew that this was going to be an interesting earnings season just because those lines which you can see on the chart, those are the estimate progression, and they fell early and by a lot, of course, when COVID happened, and then they flatlined, which to me was really representative of companies not getting any earnings guidance and therefore analysts really not having anything to change to their estimates. But that flatline is pretty unusual because typically

JIM: I think we may have lost Jurrien for a moment. Let's see if he can come back in. Leanna, I know that it's not exactly your territory   sorry, Jurrien. We lost you, but you're back now.

JURRIEN: Okay. We didn't really know how accurate these numbers were going to be, and that could mean that they're too high but also too low. It turns out now that the numbers actually were too low and that earnings are beating expectations. At this point, about two thirds of companies have reported their earnings. Eighty-five percent have beaten their estimates and by an average of about 22 percentage point, which is a huge number. You can see that purple line really showing a very significant bounce from where we started the season. So by all means, at this point, this has been a very successful earnings season with the caveat that these are very unusual times. Obviously, going from -46% growth to -35, it's still -35, but it shows that, in hindsight, the numbers ended up being too low.

JIM: A quick follow up, Jurrien, if you can. What does that mean for us as investors, that spike that maybe took some folks by surprise?

JURRIEN: What it means is that, as we know, in March, the market bottomed very substantially and created sort of this V-shaped recovery and price always leads earnings. Generally, it does, and certainly at turning points. And so it was always kind of a leap of faith, if you will, that price was correct in anticipating this V-shaped earnings recovery, and it turns out that the market was correct in anticipating that. So it gives some validation that the market was not too far over its skis a few months ago when it bottomed.

JIM: Got it. Okay. Thank you for that. Leanna, I want to turn to you. No shortage of surprises in 2020, that's certain. I'm curious at a high level, though, at this point in the year what you're here hearing from customers, the folks you and your team sit across from pretty much every day. There's so much to keep our focus on these days. We're seeing the market stabilizing, as I said, even in the face of COVID cases surging and ongoing unemployment. Last week's news, for example, about the U.S. economy actually shrinking rather than growing. I'm curious how you help people help keep perspective, help people keep perspective.

LEANNA: Really, the sentiment we hear most from clients is just overall surprise because of the news events that we are seeing like COVID or unemployment or what's going on in the economy, so most clients are surprised that we're not seeing it translate to the stock market returns that we saw earlier this year. But when we have the volatility conversations with clients, I do urge, as a start, to really look at the long term. I've shown this slide before, but I think it does a nice job at highlighting these major past market events, global financial crisis, dot com, Brexit. And now when we look at it, and they felt very large and real and nerve-racking, but they have merely become blips when we look at the long term upward trend. When we're planning for client goals, retirement, college planning, leaving a legacy, it is often that longer term time horizon, even for those in retirement where we're planning for that long and healthy life. But no matter what, when the markets slide, we tend to get nervous and rightfully so. It's emotional and it's difficult to stay invested. But we like to remind people that falling markets can change. And historically, we see severe downturns and then they're followed quite quickly by large gains sometimes. So one thing to take away from the discussion really today, I'd say, is to review your plan and your investments. It certainly can be a time to rebalance, if necessary, in building that road map so that you are confident about achieving your goals no matter what short term market events that we are going to see.

JIM: Perfect. Thanks for that, Leanna, because that takes me to my next question for Jurrien there talking about potential market events. We're about 90 days away, three months from election day, and that almost always introduces at least some measure of uncertainty to the markets. Jurrien, I know we've touched on the upcoming election a little bit over the past few weeks in the webcast. My prediction is that we're going to be talking more about it over the next few weeks.

JURRIEN: Yes. The election, obviously, is one of these day certain events that is on our horizon and people do like to worry about it. And this is going to be, obviously, an important election, but I guess every election is important. But what I've learned with studying the election outcome for the stock market going all the way back to the founding of the country back into the late 1789, I guess, is that while the election can have an impact on the markets over the short term, and by short term, I mean the first one or two years after the election, over the long term, those differences pretty much usually go away. So in this chart here, you see different outcomes based on which party wins the White House, which party has control over the Congress. Is it a sweep? Is it a gridlock situation? You can see that the variance in the different outcomes widens over the first 24 months, but then it narrows over the subsequent 24 months. To me, the message here is that, over the long term, the markets are going to do what they're going to do, and the economy is bigger than politics. And also, we have this unique feature of the U.S. electoral system which is that we have mid term elections and oftentimes the mid term election two years after the presidential election has a way of sort of course correcting whatever was going on. We know that the stat, of course, that oftentimes when a President wins the White House and the election, two years later, he or she, but in this case he, so far historically loses the House of Representatives in terms of the political control. So the mid terms have a way of mitigating whatever lopsided event might have happened during the election. I think the convergence of these lines after two years is, in part, represented by that. So over the long term, and I assume that our audience here are mostly long term investors, I think generally people will get too worried or too worked up about the election and should just be wherever they should be in terms of their portfolio.

JIM: Perfect. That takes us right back to Leanna then. I would love for you to weigh in here too about sort of pre-election sensitivity or anxiety that folks you're meeting with are talking to you about and then what you say in response to those concerns.

LEANNA: Yes. Jurrien really nailed it. It is looking at the long term fundamentals and the planning focus. But when we discuss elections and when we look back historically, it really comes down to policies that may change and impact. It's not President. It's not even party. As you can see on this chart, red Republican, blue Democrat, there are times that we can see negative return for both and positive return. There are just as many positive bars as negative bars here.

So when I think back to just even our last election in 2017, many clients I partnered with were nervous of the implications of an election and a party change. One client I think of often, they said, okay, I'm just going to opt out the month of November. November came and went. And then it was, okay, I'm going to opt out until after the inauguration in January. I'm just waiting for this volatility that's supposed to happen. In this case, we know it didn't happen. Instead, we did see major positive stock market returns. So the point of that story, again, it goes back to those emotions that they can come for us, but really the fundamentals are to have that diversified portfolio as we invest, which is on this next slide, tied to those goals and objectives that you have.

So this slide is showing a 60/40 mix compared to the S&P 500. So the S&P 500 is being in all stocks, U.S. stocks, compared to 60% in stocks and 40% in bonds, fixed income. That's what we call a diversified portfolio. So when we are diversified, you can see the purple line is the 60/40 and the black is the S&P 500, it helps manage risk because we're spreading that exposure where we're not all in the stock market, and it can also provide that cushion and that downside protection for times when there is heightened volatility.

I should also point out diversification, it's important. It doesn't guarantee profit or ensure against loss, but it really does allow us to stay invested, we find, and provide that smoother ride. So I'd just say in sum that as we invest, it's tied to the goal, what we're investing for, retirement, college planning, legacy, again, estate, but also keeping in mind there's going to be many elections, there's going to be many more Presidents, there's going to be many different parties in your long term goals, so investing in that plan or partnering and speaking with a financial planner to help navigate these times is what's important.

JIM: Special shoutout to Jurrien for building that 60/40 slide special for us this week. Jurrien, a anything you would add to Leanna's comments about a 60/40 portfolio?

JURRIEN: No. It's tried and true, so combining a 60/40 with dollar cost averaging is a pretty smart strategy. Even if you already have accumulated assets and want to diversify, maybe an all-weather portfolio, you could branch out even further into other asset classes, but I think the conversation always starts with these two asset classes.

JIM: Got it. Thank you. Leanna, I do want to bring up something else. I know that when we were preparing for today's webcast, you mentioned that you and your team have been getting a lot of questions recently about this idea of paying down debt and the concept of good debt versus bad debt and specific questions about paying down a mortgage. Frankly, I admit I'm interested in that because it's a conversation that my wife and I are talking about right now. Can you talk a little bit more about the types of questions you're getting and how you're answering them?

LEANNA: Absolutely. And we are hearing this often because rates are very low. Many are refinancing their mortgage for that lower rate. And then we're also hearing positive news. Many people are able to pay off some of that bad debt, such as credit cards or high car loans due to quarantine and being able to save money and not doing as much. But let's talk about the mortgage because we look at it through a financial lens, but we also need to look at it through the emotional lens. Owning your home free and clear, it sounds awesome, there's no more payments to the bank, you have lower monthly expenses, and just that pride in knowing that you own your home outright goes a long way. But a key factor to consider is thinking of what that money may be doing if it wasn't paying off the loan. If you could invest it and over time be earning more interest than the interest you would be paying your loan as they are low. For example, if your interest rate is 3% but you invest in that diversified portfolio that on average is earning 6%, it actually would be worthwhile to invest from that financial lens. But for many, if that cash is sitting in a bank with minimal interest not earning, then paying off the mortgage would be worthwhile. So there's scenario planning that you could do.

We recently met with a client who had inherited about $100,000. They had 20 years until retirement and about 15 years left on their mortgage. And he came in, the initial goal was I'm paying off the mortgage. But we ran through these scenarios and showed that if he invested for retirement, again, in that diversified portfolio, versus minimizing the monthly mortgage expenses now, it actually didn't allow him to retire when he wanted to. So having that, again, long term growth plan towards retirement can make sense in that financial lens. So when we talk through that, people are often surprised because they feel, again, what I listed, that sense of pride of paying down the mortgage. So I would say it's really what is best for you. If you feel that it's more of a goal that you're comfortable with risk in investing for the long term, then that would be something to consider. But if you're more conservative in nature and you feel that you would be keeping it in cash or short term investments or you just want that security of that house being paid off, then you'd likely do that.

This chart here, I apologize, I didn't mention it, it helps provide some guidelines. On the left hand side, it's referencing how you are invested. It goes from a conservative portfolio all the way down to the aggressive. And on the right side, it's showing the interest rate. It's showing break points to consider if it is worthwhile paying down or not. And then the last thing is we are talking about mortgage debt. So I know you mentioned this, Jim. But for consumer debts with high interest rates like credit cards, that we always encourage to pay down. That's an entirely different story. So—

JIM: Great. Good conversation. Thank you for that. Jurrien, in the few minutes we have left, I wanted to sort of pick your brain a little bit about maybe what could possibly be coming down the pike in the near-term, specifically with regard to potential government stimulus. I know it's been in the news a lot over the past couple of weeks. What can you say about sort of where we are in the process and what another round of stimulus might mean to the economy as a whole and maybe even to us as individuals?

JURRIEN: Yeah. The market is fully, I think, expecting another phase of he CARES Act or some fiscal relief. We know that transfer payments ran out last week. We know that the Fed is still very much committed to supporting the markets and building that bridge to the recovery. And, of course, in recent weeks with the COVID curve accelerating in some states and states having to kind of roll back on the speed of their reopening, the economy has been perceived to have been stalling a little bit after a pretty good rebound over the past few months. The market, I think, does require or is looking for more stimulus to happen. And you can just see on this chart that the difference between current economic output and what's considered potential output based on productivity and labor force growth, right now that difference is 10% which is huge. It's actually even bigger than the financial crisis, actually almost twice as big. So the economy does need more relief from both the fiscal and the monetary side, and I suspect that it will come. It may not be easy in an election year, but I do think it will happen and I think the market is pretty much counting on that.

JIM: Got it. Great. That's definitely something we'll be following up when we meet again next week and for the foreseeable next few weeks, I think, following up on everything we've talked about today. Thank you again, Leanna and Jurrien, for taking time to speak with us. And, of course, big thanks to everyone who is watching today.

As we mentioned, you're certainly not alone if you're feeling like now is the time to start creating or maybe even updating your personal financial plan to help you reach your own specific goals and to help you be more prepared for what's to come, exactly like the plans that Leanna was just describing a few minute ago. To make that happen, you can call Fidelity to speak to one of our representatives or go online on our website to learn more. Also, feel free to bookmark this page so you can navigate back here easily for next week's discussion.

Again, huge thanks to Fidelity's Leanna Devinney and Jurrien Timmer. And, of course, thank you again for joining us. Stay safe. Be well, especially if there's a hurricane in the area. Be well. Be safe. We hope to see you again here next week.

[1]The S&P 500® Index is a market capitalization–weighted index of 500 common stocks chosen for market size, liquidity, and industry group representation. S&P and S&P 500 are registered service marks of Standard & Poor's Financial Services LLC. The CBOE Dow Jones Volatility Index is a key measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices. You cannot invest directly in an index.

[2]The values in the chart are based on a Monte Carlo simulation–based approach to estimate potential growth of account balances and the corresponding cash flow from the account. The analysis is based on historical market data to estimate a range of potential outcomes for various hypothetical retirement income portfolios under different market conditions. Monte Carlo simulations are mathematical methods used to estimate the likelihood of a particular outcome based on market performance historical analysis. While over very long periods of time, markets have averages, it is often the case that the market performs both above and below these averages. The Monte Carlo simulations are designed to reflect this historical market volatility.This analysis used a retirement time horizon of 27 years comparing two scenarios 1) no changes are made 2) the entirety of the mortgage is paid off using assets from a savings account. The analysis does not account for income taxes paid on the withdrawal or investment expenses if the money remains invested. Taxes and fees could impact the benefits of either strategy. Using the Monte Carlo framework with proprietary near-term capital market assumptions, 1000 simulations are run on these scenarios. At the end of each simulation 3 main statistics are reported: 1) incidence of asset exhaustion, i.e. running out of money prior to the end of the planning period; 2) portfolio volatility; 3) ending wealth. If, at a given interest rate and asset allocation, the scenario which pays down the mortgage improves upon the base scenario in all 3 measures it is deemed a reasonable indication to pay down the mortgage given that interest rate and asset allocation. In the base case, the mortgage is refinanced if rates drop. Mortgage rates are proxied by the 20-year treasury rate plus a spread. Again, this analysis does not incorporate any taxes or investment fees. For taxpayers who itemize expenses these numbers may not be appropriate, and the required interest rate to consider paying down debt might be higher. Some housing fees, including taxes and insurance, will not change regardless of a mortgage.

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.

Bloomberg Barclays US Aggregate Bond Index is a broad-based, market-value-weighted benchmark that measures the performance of the investment grade, US dollar-denominated, fixed-rate taxable bond market. Sectors in the index include Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS, and CMBS.

The Barclays US Intermediate Government Bond Index is a market value–weighted index of US government fixed-rate debt issues with maturities between one and 10 years.

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