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

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TRANSCRIPT

SPEAKERS:

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ELIZABETH: Thank you for joining us today. I'm Elizabeth Hare with Fidelity.

The year 2020 has been unusual in almost every way, and that includes our taxes. We had the delayed Federal tax deadline this summer. But with that behind us, there is still more to consider, especially when we start to think about 2021. So that's what we're talking about today, tax moves that you can make now so you can try to avoid penalties and fees later. We'll also take a look at what's been moving markets and where they might be headed.

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 and what it means to us as investors. We'll also hear from Leanna Devinney. She holds a certified financial planner designation. She and her team work with Fidelity customers to build custom financial plans to help them meet their personal goals.

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

Our host Jim Armstrong is off this week and I'm thrilled to be joining you today. Leanna, Jurrien, it's great to have you back.

LEANNA: It's great to be here, Elizabeth. Thank you so much.

JURRIEN: Yeah. Happy Tuesday from Cape Cod.

ELIZABETH: Happy Tuesday. Today, speaking of, is Tuesday, August 11th. Jurrien, these days, many of us are looking for a signal of what's to come in the economy, and you've been looking at our debt to GDP ratio. Can you explain what it means to us now and what it might mean for our taxes in the future?

JURRIEN: Sure, yes. This is a good one for the history buffs out there. As can you see from this chart, I'm going back to 1900 to look at debt levels, taxes, et cetera, and what it might mean for us as investors.

So one of the hallmarks, of course, of 2020 has been the COVID crisis, the very sharp decline in the stock market, the very equally sharp recovery facilitated by the CARES Act, massive amounts of fiscal stimulus coordinated with massive amounts of monetary policy stimulus in the form of the Fed increasing its balance sheet and cutting interest rates. There is a cost to all of this, of course, and that cost you can see here in the top panel of the chart, which is that debt levels are rising ever more now as a percentage of GDP, which is the economy. And, in fact, debt to GDP is now higher or it will be higher in the coming few quarters as the U.S. issues more treasuries than it was during World War II in the mid-1940s, so that is a pretty striking comparison. Obviously, things are, in many ways, much, much different this time around, but it was an equal run up of debt and ultimately it came with higher taxes, which is what we're talking about today.

ELIZABETH: So what impact might that have on the stock prices?

JURRIEN: Well, so there are always many, many things to consider, right. So taxes alone may or may not affect the stock market. It depends on whether they're personal income taxes or capital gains taxes or corporate taxes. Obviously, corporate taxes are part of the conversation this year because we're in an election year, and, you know, depending on who wins, corporate taxes may either stay where they are now or they may go up, and that would obviously depress earnings relative to whatever else would be going on, meaning that they might rise less rapidly than they otherwise might.

But as far as personal taxes are concerned, you know, history has many different examples, but I'll give you one. During the 1930s and early '40s, so that was, of course, the Great Depression, taxes went up very, very substantially. And actually, in the '30s, the top marginal tax rate went to about 80% and then 88%, and then in 1942, it went to actually 94%. But that 94% was only the top income, which at the time was $5 million, which is a lot today, but it was really a lot back then. In today's dollar terms, $5 million back in the early '40s would be $77 million today. So, again, not really that comparable to what we're seeing with taxes today, but it does show that when debt levels go up, sometimes, at least during the first half of the century, taxes would go up with it, and obviously that's something that everyone and especially investors need to keep in mind and plan for accordingly.

ELIZABETH: Leanna, Jurrien just gave us a lot to think about when it comes to the economy and how tax policy might be affected. I'm wondering what are some considerations that clients may want to keep in mind when it comes to their 2020 taxes?

LEANNA: This is a good time for me to mention that Fidelity does not give tax advice, so nothing that I discuss today should be interpreted as tax advice. But the information we're providing is

general in nature. So, if you do have tax questions after this discussion regarding your specific situation, I would encourage you to speak with a tax advisor.

But your income tax obligation could be very different this year for many people if it's significantly more or less, so you do have to pay attention to how much you have paid in so far from a tax standpoint and how much more you're likely to owe throughout the year and towards the end of the year.

A client that we recently worked with is actually retiring next year and he came in to understand just this. He wanted to know where he falls from a tax standpoint this year and next year before he retires. He had learned that he's not fully contributing to his 401(k) anymore because his retirement account in his eyes was really all set and ready for retirement, but because of that, he was paying more in taxes than he realized.

So I think the first step is to really understand where you may fall from a tax standpoint. And remember, you have your gross income, that is before taxes come out, and then you have the adjusted gross income, and that's after considerations such as contributing to your 401(k). So, if your income went up this year and you generally want to reduce your tax liability, you would consider increasing your contribution to your 401(k) or any other pre-tax retirement accounts offered through your workplace. If you're over 50, you also have a catch-up contribution on those as well. If you had medical costs this year, you want to watch out for those. So, if you had lower income but high medical expenses, you could qualify for a deduction if they exceed 10% of your income. And then lastly, and I think this is an important one that's impacted many million Americans, those who have received unemployment benefits this year. Those payments are taxable income at both the state and Federal level, so you want to be sure to pay estimated taxes on those so you don't have any surprises.

ELIZABETH: And your example just made me think about RMDs, Required Minimum Distributions. Can you remind us about the impact that the CARES Act had on RMDs?

LEANNA: Yes. That was a change this year, so let me start by explaining what RMD is. We do have a lot of acronyms in financial services, so those are your Required Minimum Distributions. And once you reach age 72, the IRS generally mandates that you take the required distributions each year from your traditional IRA or employer-sponsored retirement accounts.

So, let's say that you're 73 years old and you have $1 million saved, roughly, and I'm estimating, but you would be responsible to withdraw $40,000 as a required distribution, and that will shift over time as you age with the goal of depleting the account over the long run. So, you do pay taxes on what you withdraw, and so it depends on what your tax bracket is.

This year, Required Minimum Distributions from tax deferred retirement accounts, such as traditional IRAs, 401(k)s, they gave the opportunity to pause those. So those that were over 72

had the opportunity to potentially have less taxable income this year if they decided to stop the withdrawals. And in that $1 million example, it does make a big difference. That $40,000 can be a real cost savings for clients. It can be $8,800 or more if you decided to pause those. I would say I heard from many that they needed that income to pay for expenses, so it may be worthwhile to adjust and only take what is needed, or take from non-retirement accounts that aren't subject to that income.

ELIZABETH: Sounds like there are some real saving opportunities there. And speaking of savings, in April, the U.S. Savings Rate went up to 33%. What's interesting about that is that it's up from 8% the previous April, so April of 2019. Do you see this reflected in client conversations?

LEANNA: Yes, big time. I'd say it's maybe good news and bad news. A lot of clients weren't able to take vacations and they're wondering what they can do with the money that they've been saving. I had a family a few weeks ago who takes an annual trip as part of their retirement to an island and they spend three weeks in November and they do that before returning up here in the cold New England before the holiday season, so they were disappointed that they are unable to go this year, but they didn't want that money to just sit in the bank. They wanted to put it to good use and put it somewhere special in their words. We started talking about different goals that they have, and one of them was to help their grandchildren's child education. So we talked about 529 savings accounts, and those are vehicles that you invest and it grows tax free, and any distributions when it's put toward qualified educational expenses is a tax-free withdrawal.

So thinking of that, there are other ways that you can plan and have long-term savings goals. You can contribute to accounts like a Roth IRA account if you have earned income and you're under the income limits. You have health savings accounts and 529 college plans. Like I said, those are all accounts that the growth accrues on a tax-free basis. And then the last one is just the charitable giving. So everyone this year will qualify for the above-the-line tax deduction for $300 that can go to charitable giving if you have a standard deduction, so that can be significant tax savings as well. And I would just say that, again, every situation is different, so speaking to a financial planning professional or a tax advisor to help you navigate these discussions.

ELIZABETH: So just turning it over to you, Jurrien. Over the past few weeks on this webcast, I know you've spent some time talking a lot about earnings season. Can you tell us what happened in Q2 and what does it actually mean to us as investors?

JURRIEN: Yeah. So we've been talking for a number of weeks about earnings, because back a few months ago, you know, the big conversation, and to some degrees it still is, of course, is this apparent disconnect between what the market is doing and what the economy is doing, and I've been pointing out that there is actually not that much of a disconnect. It's just a difference of timing, because especially at turns, the market tends to discount the future and so price tends to lead earnings. So it was a really big question whether for the second quarter earnings season, which is pretty much wrapping up right now, whether the earnings that the market was expecting

and using to justify its gains on, whether those earnings would actually come through. The answer is that they have, actually. The earnings estimates that we were looking at a few weeks ago turned out to be too low, too pessimistic, and the market has, you know, companies have posted better earnings than were expected with the caveat that the expectations were super, super low.

So as a result, the numbers are now starting to drift higher from very low levels. And so this chart, I call it a spaghetti chart or a squiggles chart, you can see that what the market is expecting for next year's earnings relative to this year's earnings, so this is a growth rate, and this is measured by calendar year going back to 1995, and so the red lines on the right are the current year and next year, in the middle is the financial crisis, and towards the left is the bursting of the dot com bubble. And what you can see

is that earnings numbers are starting to bounce up a little bit but from kind of similar levels to the past when we saw a big earnings recession.

So that tells me that, you know, we can, I think, be more comfortable that the bottom is indeed in as the GDP numbers and the unemployment numbers already have indicated and that the market was justified for gaining so much ground so quickly. And really going forward, it's really more of a discussion about the slope of the recovery and whether the market is pricing in too much of a recovery, and that's sort of the conversation that we'll continue to have in the coming weeks.

ELIZABETH: Well, thank you both for sharing your knowledge and for taking the time to speak with us today.

Thank you to everyone for watching. Keep in mind, the rules keep changing, so stay tuned to the news that will affect you personally. Consult with a tax advisor for questions about your specific situation. As always, you can call Fidelity to speak with one of our representatives or go online to learn more. Also, feel free to bookmark this page so you can navigate back here easily for next week's webcast.

Again, many thanks to Fidelity's Leanna Devinney and Jurrien Timmer, and thank you for joining us today. We hope to see you here again next week.

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