Fidelity Viewpoints®: Market Sense

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TRANSCRIPT

SPEAKERS:

Jim Armstrong Jurrien Timmer Leanna Devinney

Jim Armstrong: Hello, and welcome to Market Sense. Thanks for joining us today. I'm Jim Armstrong with Fidelity. If you've watched our Market Sense webcast in the past, you've probably heard us talking about the importance of sticking with your long-term financial plan. But of course, the reality of doing that, especially when the market's a little bit rocky, is a lot, a lot easier said than done. And the past few weeks have been great examples. You know, we've had what's moved the markets in the past few weeks, have included fears about what's happening in China, the US debt ceiling here at home last week. There was a lot of talk about the government possibly shutting down.

So we're going to talk about all of that today along with, by the way, a really great question that we got from a long-time viewer of the Market Sense webcast who's going to help us, hopefully, keep in perspective what we need to be thinking about when it comes to long-term planning. So to have that conversation today, we are happy, as always, to be joined by Fidelity's Jurrien Timmer. Again, he takes a look at the high-level outlook of the entire economy using history as a guide as well. So he'll be doing that for us today. And Leanna Devinney, we're happy to have you back as well. She's going to be talking about how to break things down in ways we can all understand and talking about how the big picture can really help us and how it affects our investments. So Leanna, Jurrien, thanks for making time to be with us today.

Leanna Devinney: Thank you. Great to be here, as always.

Jurrien Timmer: Nice to see you guys.

JIM: Jurrien, let's start with you. It is Tuesday, October 5th—already October, incredibly. We're into the fourth quarter of the year. And again, as I mentioned, tons of market movers over the past couple of weeks. Again, Chinese economy and the global impact there, domestic earnings season, which again, we can talk about here, COVID underlying all of it, and concern about the Fed's next moves. Maybe you could talk a little bit about where we are, sort of, with all of that as a lens.

JURRIEN: Yeah, there's certainly a lot to unpack. There is news out of China, the property sector, at least some companies in the property sectors are under some financial strain. You know, a few of them are, sort of, missing bond payments. And the question is not how that affects the US economy because, in all likelihood, it won't, but if that has some spillover effects on the Chinese financial system, then what does that do to global growth, for instance? On the other side, here the Fed, of course, is eyeing an exit to its period of extremely accommodative policy. You can see in this chart here just how easy the Fed's policy has been and even, really, as accommodative as it was after the financial crisis or during the financial crisis.

And of course, we have good news in the US where the Delta wave, the Delta variant of the COVID pandemic seems to be cresting in a pretty meaningful way here in the US. So number of hospital beds occupied by COVID patients is now starting to decline, and so that means that the economy, hopefully, gets a shot in the arm—no pun intended—in terms of being able to, really, more fully come back to life. And the Fed, of course, sees that and realizes correctly, I should say, that this extraordinary level of accommodation through 0% interest rates and asset purchases really is no longer justified.

So the thinking is that the Fed will decide after this week's unemployment report, so that comes on Friday, if the Jobs Report this Friday is in line with what's expected, which we don't know, of course, if it will be. But if it, the Fed supposedly is eyeing a start in November of starting to taper asset purchases, maybe going from $120 billion a month and reducing that by $15 billion a month until it's at 0, and then in 20—late 2022, early 2023, maybe to start raising rates.

So that's a ball in the air. And you mentioned earning season. That really starts in earnest next week. And earnings by all accounts are expected to continue to grow in a very robust way. But the rate of growth seems to be peaking now. And by peaking, I mean at 40% or 50% year over year, so incredibly robust numbers. But when you add it all together and you have a peaking of earnings growth, you have a Fed that is going to be removing some liquidity from the system, and you have some headlines out of China, you put them all together and you could see why maybe the market might have a little wobble, which is kind of what we're seeing, right in line with the typical September/October timeframe. You know, that's the season where people like to worry. And low and behold, the market has just a ever so slight wobble. You know, it's down 5% from its peak. But that's kind of—that's kind of the juxtaposition of things that are really driving the market right now.

JIM: Can I also ask about—I don't know if it's wobble-inducing or it's just sort of coincidentally happening right now—the one thing that we didn't ask in that first question because we wanted to devote a specific question just to it, is the US debt ceiling. We devoted a whole webcast to that back this summer, you'll remember, when we were approaching that July 31st deadline. The country was approaching its borrowing limit, what would happen next. You sort of gave us reassurance in the long-term that we would be okay, just based on what's happened historically. But investors, the markets, don't like this feeling. And here we are again.

JURRIEN: Yeah, this is something that comes up every once in a while, whenever the debt ceiling has been—the debt limit has been reached. And as you can see here, debt to GDP is on a very, very steady upwards track, and it really has been since the 1980s. But it really skyrocketed during the pandemic, of course, because we had the CARES Act and then the fiscal stimulus back in March. And now, we're on the cusp of potentially having an infrastructure bill followed by the American Families Act, I think it's called, you know, the Build Better Back.

And so we have potentially another 3, 4, $5 trillion coming. And obviously, that can't happen without the debt limit going up because without a debt limit increase, the Treasury cannot issue—it can't issue any debt. So this comes up every once in a while, and sometimes the markets like to worry about it. And it always makes for good hairlines—you know, good headlines, and people on the talk shows like to talk about it. But this always kind of goes away on its own because Congress usually just ends up raising the debt ceiling. And—but right now, we're kind of in a politically-charged environment, of course. We have the mid-term elections coming up already next year. The fiscal stimulus that came in March was completely a partisan plan from the democrats who have 50 seats in the Senate but have the tie-breaking vote when needed.

So I think this will be resolved. It may not be resolved by a bipartisan Congressional vote. But the democrats have the means to fix this through reconciliation, which is the exact same way they will—they did the fiscal stimulus back in March and that they will do the second tranche of that at some point later this year. But it's politically not as pleasing because then one party cannot use the other party as cover saying we did this all together.

JIM: Got it. Okay, thanks for that. And with that—with that big picture well painted, I want to turn to that excellent question that I mentioned at the start of the show about—that came from a long-time viewer of the webcast. Like all of us, this gentleman is just simply trying to get the most out of his investments. And navigating today's environment, especially in conditions like Jurrien was just describing, doesn't always make for the most restful night's sleep. So Leanna, this question came to you because of the three of us, you are the most customer-facing, as we say. You and your team are meeting with Fidelity customers pretty much every day of the week. So just sort of lay out the question that this man had for us, if you could, please.

LEANNA: Yeah, absolutely. And we were really excited to get this question. And for privacy, we won't mention this person's name, but really thankful that we got it. And this gentleman has done a great job planning, saving, and investing. But here's the gist of his question. So a long-time viewer, like you mentioned, he noticed that Jurrien's charts always show, over the long term, the market has always gone up. That's looking at his charts showing the S&P 500. But he also noticed that Jurrien and I often point out that individual investors should, of course, have a plan, stick with that plan no matter when times get tough, and you will—should—end up ahead, come out ahead by sticking to those fundamentals. But yes, if that's true, wouldn't it make sense to be 100% invested in stocks or if you had a cash need, should it then be a 90/10 split? Why do we speak to the power of diversification so much? And he did begin to answer his own question saying, because it does go into risk tolerance and time horizon, which we will talk about. But Jurrien, we know that was the question asked. What did you think of it, first?

JURRIEN: No, it's a great question. And of course, it all depends on timeframe, risk tolerance, right? So—so let's say someone has a lot of money is not going to need to touch that money for a long time, is going to leave that for the next generation, and that's going to be at least 30, 40 years away. And I'm just throwing something out there. Should that person have that money invested in a 60/40? Well, probably not because it's just going to be pure growth. But if you're someone like you guys and like myself where we have, at some point, we'll need that money maybe soon, maybe later, and we want to be able to sleep at night when the market goes against us. And remember, the stock market only goes up 60% of the time. Now, if you wait long enough, it compounds at about 10% per year, so you get that prize at the end, but only if you make it to the end, right? You need to be able to restrain yourself or ourselves from selling when the market really goes against us. And like I said, 40% of the time, the market is not doing what we want it to do.

And so one way of illustrating this is in this chart. I show the five-year annualized return in the horizontal axis and the drawdown from a five-year high in the vertical. So that's how much a stock portfolio might be down from its high-water mark. And you can see that the thing kind of moves to the lower left. And once you cross that zero line, that vertical line, the gray dots, which is all S&P 500, so all stocks, there are a fair amount of really scary moments there where you're down 50, 60, 70%. I mean, those are very rare moments, but it does happen. And then the orange dots are the 60/40. So 60% S&P 500, 40% Bloomberg Barclays Ag, which is the benchmark, the investment-grade benchmark. And there are still some dots there on that lower left, but there are far fewer of them. And so that's where we are kind of betting on the diversification of having some bonds in there because it's just going to be a little bit less difficult to weather that storm when those dots go less to the lower left than they otherwise would.

So the prize of compounding a 10% return over 10, 20, 30, 40 years, obviously, is a better prize than if you're compounding a 6 or 8% return in a 60/40. And the difference actually is about 2 percentage points. So that doesn't seem like much, but compounded over decades, that 2% really adds up. But again, all of that is assuming that you are holding on when things go against you. And a 60/40, you're giving up 2% a year, but you're gaining maybe a few nights sleep in return.

LEANNA: And when I brought this up, actually, to a separate client who had also saved really well, we talked through this risk-reward should be all in stocks versus having that diversification. And he shared with me, I worked 30-plus years, and I want to have zero nail-biting events, or I don't want to have to worry. So it knew that, yes, I'm going to be giving up some potential reward and growth, but knowing I'm going to sleep very soundly through retirement. So to just say it really is the emotions that can come into investing, and then there's the math to it, too. And we help build plans for our clients that's best for you and seeing what you're able to stay invested through, and also, just the stomach that can go with investing sometimes.

JIM: I think I want to linger for just a moment on the length of time in retirement because you both sort of touched on it there. And I think, again, on this webcast in the past, we've talked about how today's investor would really be wise to plan with the assumption that they'll probably be retired for almost as long as they worked, maybe longer. We're talking about today's retirees living 25, 30, 35, maybe even more years in retirement. So through that lens, Leanna, how does that—how do you sort of interpret what Jurrien just said based on the length of time we're going to probably all be in retirement?

LEANNA: So I'd say before we get to retirement, it's often easier to stomach some of the volatility that we see because really, your account, you're just saving and maximizing for retirement. But the second that paycheck goes away and we need to start living off of our savings, it becomes a little harder to stomach because we have volatility while we're also paying for our lifestyle.

So this chart here shows the impact of withdrawing a percentage from your savings. And you can see that the rule of thumb that we talk about is a 4% rule. We're drawing 4% of your portfolio annually to pay your expenses. And the impact by just taking 5% or 6% and then 7%, has a big impact on your savings over time. And actually, in that 6 and 7% number, you could run out of your savings far sooner than if you withdrew 4%. So I like to quantify this. If we had a million dollars, let's say, and 4% of that would say, okay, I'm going to spend $40,000 a year from my savings. Let's say we have a poor market that year, and the market goes down. We need to have the discipline to take 4% of the balance of our accounts, that $1 million has dropped to $800,000. So instead of taking $40,000 that we said we needed, we now can only take $32,000. That's 4% of the $800,000. That's what gets hard because many clients do not want to adjust their spending. So that's why we speak to the power of diversification. This chart is actually assuming a 60% stock, 40% fixed portfolio to help navigate those times and stay in that 4% withdrawal.

JIM: And particularly, let's talk about those volatile times right now because as I said at the start of the webcast, that advice to stay the course, so much easier said than done. And the three of us, again, are still in that accumulation phase, right, if that's the right phrase to use. We're still—we're still saving for our eventual retirement. When you're in retirement, emotions play a big—a big part of your decision-making, whether or not they should or maybe they—I don't know how much they're supposed to play in the decision-making. But can you talk about how that can impact your long-term goals?

LEANNA: Emotions play a really big part of it. But for some, it's just clients say, I get this. I'm actually able to stay invested, but I don't have the time or I don't have the desire or even the expertise to do so. But emotions is a big part. And so this study comes out every year. And it's showing the index, performance of an index of the stock market and the bond market, and then it shows it against that of an average investor. And you can see here that on both sides, for equity, stocks, and fixed, and bonds, the average investor underperforms the index year after year. And why this is is really due to the emotions that can come in investing. And I just like to highlight, it doesn't mean that all of our clients are going from fully invested and jumping everything to cash. But when times get tough, I do see that some clients take a little bit of risk off the table, or they change their allocation that was suitable to them, or some do decide to go on the sidelines temporarily. And that's why this study comes out that the average investor does not beat that index year after year from a return standpoint.

JURRIEN: Yeah, I would just add to that. And it's so true, and I've done studies myself that support what we're seeing here on this chart. But it's so tempting when the market goes up a lot or it starts to wobble like now, is to say, let me just take some chips off the table. Where is the harm, right? Where's the harm in doing that? I can always get back in. Well those are very hard things to do. And often, even if we get out at the right moment and the market goes down while we were sitting in cash, and we're like, oh, this is great. Look how smart I am. Chances are, we would not get back in at the bottom. We would get back in sometime after that. And maybe the markets have already moved higher by then.

And the important thing is, you've lost that compounding time, right? Like, the—all these formulas depend on or rely on the compounding nature of the markets. You know, compounding 10% per year or whatever the number is, 6%, doing that year over year, that's where the magic happens. So if you get—if you step away from the market and the market goes up without you and leaves you behind, you've lost that compounding math. And that's why I think rebalancing obviously is important, either at some regular timeframe per year or whenever the market has moved up or down a lot. But beyond that, I think just sticking with the plan, as Leanna said earlier, is—is an underrated thing to do.

JIM: All right. Thank you both, again, for taking the time to be with us today. Good advice as always. And for our viewers, of course, thank you for making time to be with us today. Just a reminder, that if you need help with your financial planning or if you've got questions about how Fidelity can help you, you can check out our website or download our app. Those are both really ways to learn more about the topics that we just talked about, as well as anything else that might interest you related to your financial planning. Again, huge thanks to Fidelity's Jurrien Timmer and Leanna Devinney. And we'll see you right back here again next week. Have a great week.

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