Fidelity Viewpoints®: Market Sense

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TRANSCRIPT

SPEAKERS:

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Jim Armstrong: Hey there, thanks for joining us for Market Sense. I'm Jim Armstrong with Fidelity. So, coming off the heels of last week's mid-term election, we've got Democrats retaining control of the Senate. Republicans looking like they're going to have a majority, all be it a narrow majority in the House of Representatives, setting the stage for two years of divided government. As we've talked about on this show in the past few weeks, that set-up of divided government has traditionally, historically been a recipe for strong markets. But that's by no means a sure thing, especially right now with other things going on. So that's what we'll talk about today. Also, through the lens of that kind of unpredictability, we know one thing is for certain as the saying goes, taxes. As we closer to the end of this calendar year, we're going to be talking about some tax planning essentials that, really everybody should know about. To have that conversation today, we are joined by Jurrien Timmer, he is our director of Global Macro here at Fidelity. He's going to share some insights into the latest world and national news, market conditions and what they mean as investors.

We're also thrilled, as always to have Leanna Devinney with us again this week. She's a branch leader in Massachusetts and today she's going to be talking to us about year end tax planning. Alright, now before we dig into that topic, I do want to remind folks that Fidelity doesn't provide legal or tax advice. You definitely want to consult with a tax professional, an accountant, or some other adviser in your life regarding your specific legal or tax situation. So with that aside, hello to both of you. Podcast listeners, you are missing out on a sharp dressed man this week.

Leanna Devinney: I was going to say, I'm very jealous of Jurrien's background compared to mine.

Jurrien Timmer: Well, Leanna, I have to thank you for this because I am actually at the Wall Street branch of a private investing network. And Leanna knows everyone in that network so she arranged for our colleagues here for me to have me use their conference room. So thank you very much.

LEANNA: Oh, yes.

JIM: Coming to us live from New York City, love it. Thank you Jurrien. Let's start with if we could. It's Tuesday the 15th of November and as I mentioned, we now have—if we can call it clarity, let's call it clarity—about the balance in power in congress for the next couple of years. Historically, maybe start us off with what that has—what that might mean, what it has meant to the markets following midterm election?

JURRIEN: Yeah, so I've been studying election cycles for a long time going, actually all the way back to the 1700s, not me, but the cycle. And there's a few things that I've learned, and that the markets know, with the major caveat that it's all else being equal and of course, nothing is ever else, you know, being equal. And certainly, these days, with all the stuff that's going on in the markets. But, one thing is that as you can see from this chart, is that the second half of a presidential cycle, so that four-year cycle, tends to produce better returns in the market and the first two years tend to produce below average returns.

And when you look at that purple line, we're exactly at that point. That was mid October, which it happens to be exactly when the market has, at least so far bottomed, we don't know if it's the bottom or a bottom. But, from that point on the market tends to do better, historically, during any presidential term but especially when there is a divided government. And, you know, that's not a political statement. But the markets, I think generally like Washington to kind of stay out of their business a little bit. And so, divided governments usually mean less regulation which, you know has in the past at least, produced better returns. And when we overlay that against a market that has, of course been down this year as we all are painfully aware, you get that pink line which shows a very strong seasonal pattern of a bottom being formed in mid-October of that mid-term election year. And so, you know it's just an anecdote, take it with a grain of salt. These are obviously market cycles, there's not a huge sample size because there's only elections every so often in so many year.

But it's kind of one hint that the seasonal pattern is about to get better. And I think the prospect of gridlock and less fiscal—whether it's stimulus or other fiscal programs. Again, without saying that that's good or bad for society. I think from the Fed's perspective, I think that's probably welcome, because the Fed in March is kind of cleaning up after this very large fiscal and monetary policy response during the COVID, of course, period. And not—and having some sense that there's not going to be a curve ball coming from the fiscal side in the next year or two, I think will help the Fed kind of do its job without having too many variables at play. So, that's kind of my take on the election cycle here.

JIM: And the lot that I want to follow up with you on, specifically what you were just talking about in terms of the Fed and inflation, we're going to ask a couple more questions about that in a moment. But I wanted to bring Leanna in, a little bit sooner rather than later, to start talking about taxation, right? Through the lens of everything Jurrien was just talking about, all the volatility, uncertainty, the one certainty that is bit overstated is taxes and taxation. So, what are at a high level some end of year tax—I don't know—tips and advice, planning elements that people might want to be thinking about?

LEANNA: I'd say there are really two areas that are timely for year end to focus on. So, first is making sure you've maximized your contributions to tax advantaged retirement accounts. So, looking at your 401Ks, your HSAs, your IRA accounts. So, many have been worried about the impact of volatility on their goals, but even just maximizing your savings, and that power of compounding interest is really significant. So, you can make contributions all year round to those accounts. You actually have until April for the IRA accounts but you only have until December 31st to contribute to your 401K account.

So, contribution limits can change year after year so certainly take a look at where you are and make sure you're maximizing as much as possible. I'd also say many advisers on my team are doing year end check ups, and many folks have year end bonuses they may receive. And so that could be a good opportunity to carve off some of your bonus to that pre-tax contribution in a 401K account if that allows. A second item that's more timely for year end. It's been a really volatile year for stocks so considering tax loss harvesting. So, this is for your taxable account. So, your nonretirement brokerage accounts.

Tax off harvesting is a mechanism to really net your gains and losses against each other to help mitigate some of the tax burdens that you can pay on capital gains tax. So, many investors will ask, how can I be proactive during times of volatility? This is a huge one. So, tax loss harvesting really allows you to sell investments that are down, replace them with reasonably similar investments, and then offset those gains and losses against each other. Losses can be carried forward indefinitely really, but you can offset $3,000 of losses to your income every year.

JIM: Got it. Thank you for that. And more follow up for you too in just a minute. But I wanted to ask Jurrien a little bit about volatility. No crystal ball, of course, but it's been a rough year and volatility I think people sometimes think of it as just a straight line down and it's rocky on the way down. But volatility means there's ups and downs and it's really hard for people to wrap their heads around, as Leanna always explains to us, what to do when you don't know what the next week or month will bring. So, again, no crystal ball but any chance we can close the chapter on 2022 in a few weeks?

JURRIEN: Yeah. It's a great question and of course we don't have a crystal ball and we do have to, you know deal with volatility not only in the stock market but also in the bond market. And that actually is where the volatility has really come from this year. I mean, obviously the stock market has been down all year, but it's been down in a not very volatile way—I hate to say an orderly way.

But it's not been volatile in terms of day-to-day movements but the bond market has been very, very volatile.

And so, I think obviously a diversified portfolio is one way to navigate that. You know, having enough cash on hand for emergency, as Leanna always reminds us, is another way. And keeping a long-term outlook and kind of trying to get, you know Zen enough it past the day to day. And maybe lowering expectations a little bit after a number of years of very out sized returns from both the stock and the bond markets. These are all good, kind of life hacks for investors but I think more to your point, you know this has been, of course, a year full of uncertainty, right?

So, we have, of course the election uncertainty. Not that the mid-term is the end all, be all of election cycles. But how far the Fed would push, you know when the bottom would come in, whether there is a recession on the horizon and whether earnings are at risk. And we still have a lot of those uncertainties but at least on the election side, we kind of have a sense of where the outcome is. And I think, I know you're going to ask me about inflation next so I won't steal your thunder. But I think after the inflation report last week, I think there's a little bit more of a sense that the worst is behind us. And that we know—we don't know, but that we have a better sense of how far the Fed will kind of take things towards a very restrictive policy.

And, you know, as I like to say I can summarize the market in 14 words these days. One is that the Fed is solving for 2% inflation, and two is that the market is solving for the Fed. So, the Fed has been kind of the sender of gravity this year and during the cycle. And that has affected the bond market and the stock market and I think there is a little bit more of a sense that we know where it's going to end. And we still don't know if there's going to be a recession next year, it's entirely possible that we will, but a lot of that has already been discounted in the market. So, again, it's not a linear exercise saying, well, recession, therefore, it means this or that.

So, I do think we've seen the worst. Whether that means a brand-new bull market has begun, I think is anyone's guess. And I'll just make one final point. You know, we've seen some huge moves in the last couple of days, right? If you look at the meme stocks, there's an index of what's called nonprofitable gross stocks, you know if ever there was an oxymoron. In the two days after the CPI last week, that basket of stocks went up 25% in two days. And it also, sort of illustrates kind of how tethered the market has been to the inflationary if at all. So, but there is a lot of machines at work, right? Not every down move, leading to that volatility that you describe, is people like you and me or our clients saying, "Buy, buy, sell, sell," like it's not really that simple. So, there are a lot of algorithms and machines that will kind of catch a trend and then run it. So, I want to make sure we all kind of look through some of these big monster moves that we were seeing today and in the last few days because oftentimes, there is some noise to those moves.

JIM: Thank you for that perspective. That's why taking this breath with both of you every week is so valuable for me personally, so I can see through some of that movement so I appreciate that a ton. Leanna, but as we do march again towards the end of the calendar year for better or worse, I want

to ask you another tax related question. Because a lot of folks tend to think a little bit more about charities. Giving and donating to charities at the end of the year, certainly around Thanksgiving and as the holidays approach. There's a lot of doing good but also potentially tax implications and tax benefits from doing so.

LEANNA: There are. So we call it the giving season. So, there's a few ways to maximize your charitable donations and receive some of that potential tax relief, so I'll just go through a few of them. The ones I talk about, it is when you itemize deductions. So the first one is bunching your charitable contributions, so if you're one that gives year after year, it could be worthwhile exploring making two or more years' worth in one year. You can even do multiple. And that gives you a greater charitable contribution and a greater amount to deduct. A second one is donating appreciated assets, so many of us are donating cash, check, you know to various different charities. But if you're itemizing your deductions and you donate an asset like a stock that you've held for over a year, you're able to deduct that fair market value.

You're also able to mitigate that capital gains tax you would pay if you were going to, let's say, sell the stock and donate it. Third one is making those cash contributions. So, if you're doing that, just make sure that you're reporting it. And if you're itemizing deductions, remember that up to 60% of your AGI can be deducted for cash contributions made to qualified charities.

JIM: Got it. I have a couple more follow up year end questions, particularly for folks who are watching or listening who are at or near retirement. I know there's a bucket of things they should probably be thinking about as the year comes to a close.

LEANNA: There is. So, I'll keep flying through some of these hoping someone—you can find value. But for those who are in or approaching retirement, we talk mostly about your cash flows. So really, how are you going to take income? And then we talk about for those that are RMD age, required minimum distributions. So, if you turned 72 last year, you have until December 31st this year to take your first required minimum distribution. For many, your RMD is a way that you're really paying for your lifestyle in retirement, taking income from your portfolio so we help our client's kind of plan for how you take your required minimum distributions and what that may look like. Just something to be aware of, RMDs are taxed as regular income so for many you withhold taxes up front so you don't get surprises later on. If you choose not to withhold, then we definitely encourage you to set money aside to pay those taxes.

JIM: Got it. And one final question for your year end, Roth IRA conversions? High level, what are they about and why is now maybe a good time to be thinking about them?

LEANNA: It is, so this is an important one and a timely one we're hearing a lot this year really because account values are lower this year with volatility. So, a Roth conversion is when you're converting money from a traditional IRA, a 401K into a Roth. So, you pay taxes on the amount that you're converting. So, you're signing up to pay more taxes now. You certainly don't want to bump

yourself into a higher tax bracket, but the goal would be that you owe taxes today and then you have an opportunity to grow kind of tax deferred. And then not have to withdraw and pay taxes later on so anything you withdraw from the Roth IRA [inaudible for review].

JIM: Okay. You ran through a lot there but we appreciate it. Just today we got another education wholesale price is rising a little bit more slowly than some of the experts had anticipated. So, I think, a charitable reading of recent headlines maybe could be, hey, everybody, look, the Fed's actions worked. We did it. The economy is cooling off. Inflation and whether it's potentially slowing down. You mentioned the CPI report, I just today—we got another indication of wholesale prices rising a little bit more slowly than any of the experts had anticipated. So a charitably reading of recent headlines maybe could be, "Hey everybody look the Fed—the Fed's actions worked, we did it." The economy is cooling off, inflation is under control. Is that too charitable?

JURRIEN: No, I mean, look, the Fed has raised rates significantly, right? The Fed was at basically zero not too long ago and we're at 3 7/8th now on our way to about 5% in the next three to six months or so. And I think the markets have largely discounted that and kind of moved past it, if you will. With the understanding that what we call base effects, basically the math of how a rate of change is calculated, which of course is what the inflation rate is. It's a rate of change in a basket or index of prices. Clearly that is now, that the rise in that rate of change is now hopefully in the rear-view mirror and the numbers are starting to improve. And of course, the monster rally last year was on the back of CPI, the Consumer Price Index coming in, you know softer than expected and softer is a good thing in this case. And so, I think, you know it was expected, like the rate of change can only go up for so long before it starts to level out.

So, the leveling out, I think, is kind of a given but the degree to which it came down and just the relief that it is finally is coming down, Because, we've had times this year where this is the month where the numbers are going to start getting better and then it got worse. So I think it gives the market just a little bit more comfort that it can look past what we call peak Feds, like the peak in interest rates, and onto a more moderated time where the interest rates can start to come down. They're not going to go all the way to where they were, but they might go back to 3% or 3.5%. And so the faster the inflation rate comes down to the Fed's target of 2%, 2.5%, the faster the Fed can kind of take its foot off the brake and say, "We can have a neutral policy rather than a restrictive policy." Not an accommodative policy which is where we were two years ago during the COVID lockdown, but at least not a restrictive policy.

So I think that is going to be the theme for the next year. I'm sure we're going to be talking about outlooks and all that kind of stuff for 2023. And I think the rise in the CPI rate of change hopefully is behind us. But then it's almost like the hard part begins. Then we have to see how fast the CPI will come down to the Fed's target. Maybe it goes quickly, maybe it goes slowly, maybe there has to be a recession along the way to make it go more quickly. And again, a lot of variables still, so we're certainly not out of the woods in the uncertainty department. But I think that's what the

market is focusing on, and of course last week and again today's CPI report was a very big step in the right direction on that.

JIM: Excellent. Excellent, Jurrien. Thank you, again. Leanna, thank you again as always, a fantastic conversation. For folks in our audience, if you're not already watching on a mobile device, you might want to grab your phone in order to maybe learn more about what's happening in the markets during volatile time like this. Or if you're just looking for additional webcasts on a variety of financial topic, you can scan the QR code on your screen and that will take you to on-demand video education available anytime you're looking for it. You can do that just by opening the camera on your phone, if you've not done that before, and just hover over the QR code and then click on the link that appear, it will take you over to Fidelity's Webcast hub. Or you simple just type in the web address listed as well.

And as a reminder, as always, if you've got questions about making or building a financial plan, or trying to stay on track with the one you built a while ago, Fidelity is here to help. Go online, visit our website, download our app, and learn more. And certainly, as we mentioned if you want a refresher on any of the things Leanna covered in terms of strategy for year end, you can certainly find those on our website as well. Again, huge thank you to Jurrien and Leanna and have a great week. And we hope to see you all back here next week.

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