Fidelity Viewpoints®: Market Sense

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TRANSCRIPT

SPEAKERS:

Jim Armstrong   Lars Schuster   Leanna Devinney

Jim Armstrong: Markets are as rocky as they've been any time this year. Inflation is showing signs of slowing down and the tech industry is shedding thousands of jobs. On top of all of that, we're in for two years of divided government at the federal level. Democrats have the Senate, Republicans the House, so there's no shortage of things to talk about on today's episode of Market Sense. Thank you for joining us. I'm Jim Armstrong with Fidelity.

To get the market's big picture today, we're going to be speaking with Lars Schuster. He's a friend of the show, he's been on many times in the past. He's an Institutional Portfolio Manager here at Fidelity. And as we head into the holidays, we're also going to be talking about some ideas about annual giving. We'll discuss those with Leanna Devinney, she is a Massachusetts based Branch Leader. She's going to offer some guidance on giving to loved ones and possibly to charities as we approach the end of the calendar year. And we'll also some other planning related topics as well. Thank you for both for making time to be here with us on this holiday week.

Leanna Devinney: Thank you. Happy Thanksgiving week.

Lars Schuster: Yes. Great to be here and I hope everybody has a great Thanksgiving.

JIM: Absolutely. Again, I know it's a busy week for everybody so we appreciate you both for carving time out of your schedules. It is the 22nd of November, Lars, let's start with you if we could. We have, as I just mentioned, seen some pretty big layoffs in the headlines recently, a lot of large tech companies announcing they're going to continue to eliminate workers. Certainly, I mean, there's a lot going on here, right? We look on from the sidelines and feel bad for people losing their jobs but then we also wonder, you know is our industry next, and/or, you know is this a sign of a recession or something bigger than what happening just in the tech space?

LARS: Yeah, Jim, it's definitely concerning and it certainly bares watching. And for all the individuals, and I think families, impacted by the layoffs at these tech firms, it is a travesty. But to your question, is it a harbinger of trouble at the broader US labor market? Maybe not. Maybe let me give you a few reasons why. First, tech companies represent a pretty small percentage of overall employment in the US, somewhere in the low single digits according to the Bureau of Labor Statistics. Compare that to something like leisure and hospitality, which is about 10% of all employment. The second reason is that many tech firms really went on a hiring spree in the past few years, and in particular during the pandemic when we encountered this e-commerce boom. Now they're just simply cutting back some. There's been a down turn in revenues for some of these companies and market valuations have fallen in 2022 as rates have risen.

And the third thing I would maybe point to is that many other industries are still struggling with labor shortages. In fact, when you look at job openings, they continue to far outpace the number of job seekers and that really highlights a tightness in the labor market. And some of this is really being driven by aging demographics and slower pace of immigration, but we're also hearing evidence of some job hoarding by businesses. And so, what I mean by that is that just given the competitive job market, many companies have spent considerable time, energy, and money trying to hire workers over the last one or two years. And so, given all that energy and time and money, they are just looking to hold on to those workers perhaps a bit longer than we've seen in past cycles. And maybe this is one of the reasons why is what we're seeing, is that weekly jobless claims continue to remain near historical lows, something I'm showing here on this graphic in front of you. This is looking at continuing claims, they are still down near 50-year lows. So, all this being stated, we are closely watching the jobs picture, because any rise in unemployment is one of those early signs of recession. And we have seen a very small uptick in weekly jobless claims, but not the sort of uptick that would really be consistent with an imminent recession.

JIM: Got it. Thank you for that, that's a great perspective. I appreciate it. Leanna, speaking of tech companies and things making headline news, the CEO of a pretty big company recently announced that he's planning to give away almost all of his fortune, estimated at maybe $124 billion, with a B, $124 billion dollars. Those of us who have maybe less to give, I mean my charitable inclination is just a little bit south of $124 billion. What are options for people, especially at this time of year?

LEANNA: Yeah, I think you're not alone in that, Jim, but we do help individuals and families talk about your giving strategies. And for many people we talk to, it could be leaving a legacy, part of estate planning, but many want to give during their lifestyle while they're alive. So, we'll start with within the family first, just a couple of items, then get to more charitable giving in a bit. But first, I would say if you're a grandparent, we talk often about helping grandchildren maybe it's pay for college. You would do that with a 529 college savings plan. So, that's a great way that has tax advantages, you have control, flexibility, and it also gives minimal impact on student aid. So, the contributions you make to a 529 plan are after tax, but earnings and withdrawals are federal income tax free when they're used for qualified educational expenses. So, that could be tuition; it could be books; it's room and board. So, it certainly runs the gamut there. What people will do is you can frontload a 529 plan. So you can give up to five years worth of an annual gift in one year, or you could do the annual gift amount which is $16,000 per year for this year, $17,000 for 2023.

Another account, just briefly is a custodian account. So, you may have heard the acronym UGMA, UTMA account. Those are Uniform Gifts Minor Accounts, that's separate from an educational account. So, that makes it easy to just give financial gifts to a child and it allows the adult, a family member maybe a grandparent again, to open the account for a specific child. Then that adult can add money to the account, there's a various array of investments you can choose from stocks, mutual funds, and then generally, when that child reaches the age of majority, which is 18 to 25 depending on the state, it then transfers to the minor when they're an adult for them to then have that asset.

So, two great ways if you want to give, kind of while you're alive to your grandchildren, children, family members, the 529 account for education, and the custodian account for all other things.

JIM: Great, I want to follow up with you in just a moment, Leanna, on other charitable giving, you know outside of the family options that people might have. But, before then, Lars, I want to sort of build on something Leanna was describing there. I think it's fair to say a lot of our planning and investing decisions are really influenced by things like charitable giving guidelines or tax laws or big public policy changes. And so, I'm curious what you think about with the divided Congress over the next couple of years, what's your sense of what that might mean for the markets and for other policy changes that in turn, could influence our choices?

LARS: Yeah, so, historically, markets have seemingly favored a divided Congress. Some of that just comes down to the fact that there's a smaller chance that Congress will pass meaningful legislation related to tax changes or spend it. And while not everything is quite settled yet, we know enough of the outcome that Washington is unbelievably closely divided. And I think with this as a back drop, it's unlikely we're going to see new taxes for businesses and individuals in the next year or two. It's also unlikely we'll see large spending packages, certainly not like what we saw in 2020 and 2021.

So, when you look at fiscal deficits as a percent of GDP, they're likely to actually recover next year, so the question here is what could we see? And I do think it's distinctly possible that you'll see some renewed focus on defense spending, as well as partisan political and not policy debate. So, here when I say partisan political, I'm really thinking of things like debt ceiling fights, delving into the origin of Covid, maybe even discussing relations with China, just to name a few here. These are unlikely to probably bring about economic turmoil but maybe some short-term market volatility could arise in those situations. So, this is where politics can be a real challenge when investing. It really can be difficult to separate the news from the noise, and I like to say that a focus on policy over politics may be more prudent when you're investing. So, while politics can elicit emotions and short-term volatility, policy or legislation that is enacted, that can have a much more meaningful impact on the pace of economic growth, the direction of corporate earnings, and really, those are the key drivers for stocks and bonds over time.

So, from these lines, I do think we should be mindful of the fact that over the last 12 months, we've had several pieces of legislation that were passed, including the Infrastructure Investment and Jobs Act, the Inflation Reduction Act, and a few others. And I think when you put all those together, these bodies of legislation, they're all going to provide some spending to the economy, spread out over a number of years that will be modestly supportive for growth and job demand over the next few years or so.

JIM: I like the mantra, I'll call it, of news over noise. I'm going to try to adopt that myself, it's good advice. Hey, Leanna, I wanted to double back on your conversation from a minute ago. You talked about giving to family if you're so inclined, and you've got the resources to do so. How about other considerations at the end of the year? Charitable giving, some people are thinking about for personal or maybe even tax reasons, sometimes?

LEANNA: Yeah, we call this time of year the giving season. And charitable giving is a big part of that. So, there are a few ways to give and we help our clients maximize their giving, especially in regards to the tax deductions or advantages that there are. So, I'll list a few, most of these are requiring that you itemize deductions so I think with any of this, just consulting with your tax adviser as well, just to be making sure you're doing it again the most efficient way.

So, first would be donating appreciated assets. So, if you're itemizing deductions and you hold an asset for longer than one year, so, think a stock or could be a mutual fund, you're able to give that directly to charity. And you would be able to deduct the fair market value of that asset without paying capital gains tax by donating it, so you are kind of off the hook for the capital gains tax that there are. And then you're able to do as much as 30% of your adjusted gross income. So, that's one great way to give.

Second would be just making cash contributions. So, that's what we see often, we write checks; we give cash. That's where the stock piece is something worthwhile exploring, but for cash contributions if you itemize deductions, you can give up to 60% of your AGI can be deducted for cash contributions made to qualified charities. Another one is bunching the charitable contributions, so similar to where we talked about kind of giving in advance on the 529 front—for front running college. You can make two years or more worth of charitable contributions as one. Again, itemizing deductions and this can be advantageous because you can be getting a larger deduction by doing that versus splitting them over multiple years.

Last, I would just like to talk about is a donor advised fund. That could be a great way where you have a dedicated charitable fund that's maintained by a public charity, or sponsored organization that would hold a donor advised fund, and this is exclusively dedicated to charitable giving. So, you can contribute into the donor advised fund and then you can invest it and grow over time, but the moment you give to that donor advised fund is when you get that charitable deduction. So, again, a great way to possibly invest what you're giving, it grows tax free, and then give more to charity.

JIM: Amazing the number of options you have even in that, so thank you. While I have you here, Leanna, though, I'd love to sort of change the topic just a little bit away from giving, and more to just about end of year planning. What's on customers' minds as they're coming to you and your team, and what are you telling them, especially given what a year 2022 has been? I'm sure folks are turning to you and your team saying, what's in store for 2023? How do I prepare? What do I do?

LEANNA: We are getting a lot of that, and I think Lars' sentiment earlier just on the noise over news—or Lars, you said it better, news over noise. But it has been a tough year, 2022. And I think our emotions can certainly be tested, so what we talk about with our clients is it really all comes back to your specific financial goals and needs. And when we built those comprehensive wealth plans for our investors, our goal is to really build you a plan that allocates your resources in three areas. So, first, we want to make sure you have a plan for the unexpected, so having that emergency fund. Second, we want to make sure that you're having protection in your plan, that could mean very different things to different investors.

And then last, we want to make sure that you have that diversified investment strategy that has that growth potential. So, our clients that have had those three core components have been able to navigate uncertain times, like we're in today. But just kind of breaking down those three, like that emergency fund, we know we're high inflation. The Fed has been raising rates to combat that inflation. You want to look at where your cash is held. What rate are you getting? Because it's very competitive out there so that's conversations we're having. On the protection side, we're seeing fixed income now be very more advantageous than it has been. So, we're finally seeing not only the stability but the income component of having fixed income. Another conversation we're having with clients.

And then that growth piece, that's that diversified portfolio that we want to make sure is built to you so having that mix of stocks, bonds, short-term investments that's well diversified, that's rebalanced. These are all the components that we're talking about with our clients and again, I think having those three things, three areas of your plan, has allowed clients to feel more comfortable and confident in times like this.

JIM: Crazy to think about how the conversation on fixed income has changed, right? I mean just a cut back to when we started the show back in 2020, I mean what a different environment it is?

LEANNA: It really is. I think there was a lot of times in our client conversations where we almost had to convince clients of why we own bonds. You know, they're there for income and stability, and over the past decade, we're really only seeing the stability component. Now, with the Fed raising rates, we're seeing them be far more advantageous.

JIM: Got it. Speaking of which, Lars, no way you're getting off the hook without this question which we pepper Jurrien with every single week. We're talking about the Federal Reserve and rate increases of course, with the backdrop of inflation. Curious on your perspective here, what tea leaves can read to suggest—are we nearing the end of interest rate hikes? Does the Fed get to say, we did it everybody, it's time to celebrate? What's your sense of where we are?

LARS: Yeah, we're not quite there yet. And like you noted, you've been talking with Jurrien and others about this all year, and it has been the number one question I think market participants have been trying to answer in 2022. Which is, when will inflation meaningfully ease and how much more will the Fed hike rates? So, like I noted, I think it's very unlikely that we've seen the end of interest rate hikes. In fact, at this point when you look at what the market expects, they're anticipating, and I would anticipate, to see something like a 50-basis point or a 0.50% hike in mid-December. And that's probably going to be followed by another couple of hikes in February and March, and maybe those might be of the quarter percent variety but it's just a little early to tell.

And that's because, you know, you got some areas of the economy that have slowed. And they could be in a recession-like type of phase, and that would be like housing. And there are some targeted layoffs like we talked about earlier, but much of the US continues to grow. We think we're in this late cycle expansion, and that's really been supported by consumer spending, particularly over the last several months in places like just dining out and traveling, the services side of the economy. And only just recently have we seen some of that start to slow.

So, and I think perhaps most importantly when you think about the Fed and interest rate hikes is it's about inflation. And at this point, inflation remains quite high. Now, I do believe that inflation is easing and it's just taking time. In fact, when inflation, you know may not even get down to the four-ish percent range until maybe 12 months out from now. And historically, 4% is still pretty high. We are seeing improvements though, in the prices of various goods like used cars and apparel as well as, you know, supply chain issues have been improving. But there are stickier or more persistent components of inflation that have really taken ahold. And here, I'm thinking about real estate, rents, wage gains, and remember what I noted earlier about the wage gains. We're in a very tight labor market. So, until you start to see a little release of the tightness of the labor market, it's going to take a little time for the inflation numbers to really come down.

So, these are likely to ease, these areas, but it's just going to take several quarters. So, with that as a back drop, Jim, I think the Fed is going to stay pretty vigilant on this. They're going to keep rates at a higher level, for longer than certainly we've gotten accustomed to over the last ten years or so, in order to bring prices down. I think it's also important to remember that at the same time they're also shrinking their balance sheet through something called quantitative tightening. And so, you collectively put those actions together and it may lead to slower lending, tightening financial conditions, and it could lead to higher unemployment.

In other words, I think the longer inflation stays warm, there's the higher risk of recession. I think the good news is that the pace of Fed hikes may be slowing. And we very well may be closer to the end of this tightening cycle from the Federal Reserve than we were certainly 9–12 months ago. Now, from a market standpoint, stocks have been attempting to try to price in some of this slowing environment already, and that's kind of some of this up and down nature we've seen maybe over the last 3–4 months in the markets. From a bond market standpoint, I think we can take some comfort that markets have likely priced in much of the potential future Fed hikes. And while higher rates have certainly been painful for bond investors this year, the set up today is way better than twelve months ago. And that's a little bit about what Leanna was talking about, high quality bonds today are displaying yields that we haven't seen in 15 plus years. And those higher yields can really help boost future total returns and perhaps most importantly, they provide this cushion for portfolios, should markets really remain volatile in the near term.

JIM: Really, again, thank you for that analysis. It's just amazing to reflect on how much things change and how quickly they change. So, I appreciate, again, both of you, Leanna and Lars, spending time with us today to help us take a breath and figure out where we are in the grand scheme of things.

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I want to thank you Lars and Leanna for taking time to be with us again. I hope you both have a fantastic Thanksgiving. And as a reminder to the people in the audience, we're not going to have a live Market Sense show next week on November 29th. We'll be off on an extended Thanksgiving break. Our next live show will be Tuesday, December the 6th, and we hope to see you then.

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