Fidelity Viewpoints®: Market Sense

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TRANSCRIPT

SPEAKERS:

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Jim Armstrong: Hello, and thanks for joining for Market Sense. I'm Jim Armstrong with Fidelity. We're all pretty conditioned these days to go to the doctor and get a checkup of our physical health once a year. With our cars, we probably kick the tires, go in for an oil change more often than that. But the question today is how often do we or should we take a peek at what's going on inside our investment accounts? If you're not sure of your answer, then today's conversation is definitely for you. Joining us to tackle that topic today is Fidelity's Lars Schuster. Lars is an Institutional Portfolio Manager in Fidelity's Strategic Advisor's Group. He's going to be talking portfolios, in general, but also, offering his thoughts on the market, on economic growth, and inflation from a high-level perspective. And, of course, we're excited to have Leanna Devinney join us back this week as well to walk through her thoughts on how to do a successful portfolio checkup of your own. Lars, Leanna, thanks for being with us today.

Leanna Divinney: Thank you, great to be here. Happy Thanksgiving week.

JIM: Happy Thanksgiving—great to have you here. Before we get started, two quick notes: We're always interested to hear what our viewers and listeners have to say about the Market Sense experience, so we've created a brand-new survey, which you will find below this video—takes less than a minute to fill it out. So we'd love it if you would please consider filling it out after the webcast is done. And, by the way, we also wanted to let you know Market Sense is now a podcast. If you happen to be a podcast person and like to listen to your content, you can search for Market Sense wherever you download your favorite podcasts. And you can listen to us on the go.

Okay, down to work now. Today is Tuesday, November 23rd, Thanksgiving week. Lars, first of all, welcome back to our show. It's been a while since we've had you on. And by the looks of things, you're back in the Fidelity office, I can see.

Lars Schuster: I am, Jim. And it is—it's great to be back here. And it's great to be back on the program. Thanks for having me.

JIM: Absolutely. So before we dive into the topic of the day, that portfolio analysis that we talked about, I definitely want to pick your brain a little bit, Lars, on that big picture of the economy, especially, I think, with supply chain crunches that a lot of us are experiencing, longer wait times, higher prices. It's probably never been clearer how interconnected all of the world's economies are. So how would you start off that discussion for us?

LARS: Well, I would say you're right, Jim. The world is definitely interconnected. But that doesn't mean that every economy is operating the same. So maybe at this very high level that you're talking about, let's start at how we think about it at Fidelity's Strategic Advisors in viewing the world. It's something we refer to as understanding where we are in the business cycle. And it's very different for different economies around the world. And so maybe just for today's purposes, I'll just stick with the two largest ones: the US and China. And you see the US on your screen there in that green larger bubble on the middle of, what we would refer to as, mid-cycle expansion. But you just alluded to a couple of things that are concerns of many investors today, and it's seemingly every time you turn on the TV, you read a story, it's something negative or it's concerning. But I think it's important that we just take stock of some of the positives.

So here we are, in the US in mid-cycle expansion from our view. Corporate earnings are solid. The employment situation continues to improve. Wages are rising. Interest rates remain low. Credit remains readily available as banks are well-capitalized, willing to lend. And inventories are low, meaning that businesses need to restock the shelves given strong consumer demand that, in turn, can help boost manufacturing and business activity. So typically, this is a good time for stocks and other risk assets like high-yield bonds. It's just not as strong as when we were on the far left-hand side of the slide in early cycle. That's when you really see the strongest equity-like returns.

Now, I think many investors these days believe that we've moved through much of the cycle pretty fast so far. And that may be true versus maybe the last cycle in the 2010s. But some of this really is driven, in my mind, by a tight labor market, meaning that there are a lot of available jobs and just not as many people looking for those jobs. And that's typically a late cycle indicator. However, I think that that will continue to improve as government programs to support unemployed workers during the COVID pandemic have ended, meaning that many workers will continue to return to the workforce. But this is just going to take time. There are some that retired early, others are having a tough time maybe coming back because of childcare issues, or maybe just some discomfort with the health situation, in general. But I am reminded of the fact that you can see it on this slide here, that that center section is, in fact, mid-cycle, the longest and broadest phase of the business cycle. We could be there a while.

Now, let's juxtapose this to China on the far right-hand side. We do believe China is in a growth recession—not negative growth, but below average growth versus recent history. And so it's not uncommon to see this with many emerging market economies, but particularly, China, which went through multiple growth recessions in the last decade alone. So this slow-down most recently has really been related, in our mind, to real estate, which has been a key driver of growth for the economy. Now, the government is looking to broaden access for all individuals under this term, common prosperity—so common prosperity for real estate, education, healthcare. However, just given some of the very large debt and leverage in the system, it's going to take a while for this to shift and improve.

So in the meantime, the government—and remember, it's a century-planned economy—will likely try to manage this process while also trying to ensure some level of growth in employment. It's a little like driving a car in traffic. You give a little gas. You pump the breaks, hit the gas, hit the breaks. And it's just starting to see some early signs of improvement and growth, in our mind, of what the government may be trying to do to instill a little bit more growth—so could be seeing some of the early signs of that bottoming process in China. Of course, what does this all mean from an investment perspective? From our lens, in most well-diversified client accounts we manage, we have slightly more exposure to stocks, real estate investment trusts, high-yield bonds when compared to a client's neutral asset allocation mix. And it's just those are weightings that aren't as high as they were 12 months ago when we believed many world economies were very much in that early cycle environment.

JIM: That's a great perspective. Thank you for setting that context up for us. I wanted to also ask, Lars, if you could focus a little bit more on US markets, in particular, this concern that we think a lot of investors have right now about what they're calling all-time highs. I think a lot of folks in the market are feeling like the post-COVID boom, like you alluded to, happened really quickly and might not be built for the long-term. And they're nervous about what to make of that—of that fear. What would you say?

LARS: Yeah, I mean, after a year or so of very, very strong returns, which really is consistent with an early cycle recovery, we have started to see a little bit more choppiness in the last few months. And that's consistent with mid-cycle. But that's a time when we typically do see positive corporate earnings. And I know investors, though, can, after a while of having some of these really good returns, see some of these maybe headlines, or maybe it's concerns of all-time highs, and say, boy, that's it, Jim. This is going to be the end of this really great run on the stock market.

So maybe let's just dive a little deeper into your comment about all-time highs. Just because the market is at an all-time high, doesn't mean the market needs to decline. What matters, in my mind, is the mix of conditions present for continued corporate earnings growth, which I believe is a key driver of stock prices over time. Now, the outlook for corporate earnings is positive. Currently, estimates are high single-digits for late 2022. That's not too bad. It's kind of in line with historical averages. But it is a slower pace of growth than what we've seen over the last 12 months or so.

So this moderating pace of earnings growth is quite normal and really kind of highlights that cycle shift from recovery to expansion. But also, just keep in mind that some of the conditions that I mentioned earlier, like improving employment, low interest rates, those are things that can really support consumer spending and, in turn, can be supportive for corporate earnings growth. But we've looked at this question of all-time highs from a historical perspective. And that's what you see on your screen there. It's a look at US stocks, dating back to 1950, and all those green shaded areas are moments in the market when stocks hit all-time highs. And on average, what we found is that stocks have historically been more likely to experience a positive and stronger returns after they hit an all-time high. And part of this comes down to the fact that there is momentum in the market.

But also, it partly comes down to that we tend to spend a good amount of time in periods of economic expansion where you see positive earnings growth. So all put together, this doesn't mean we won't experience periods of volatility and some market corrections. I think that's all very normal. And for those who have well-diversified portfolios of different types of stocks and bonds, you can kind of help it weather those ups and downs while still potentially helping you achieve your financial goal. And I think this mix of stocks and bonds, though, really needs to be informed by taking stock—and I know we're talking about that today—but taking stock of your various goals, your time horizons, and your overall financial situation.

JIM: Perfect segue. Thank you for that Lars. To Leanna—and by the way, Leanna, I did notice you smiling and nodding along with Lars' answer there because I know you've told us on this show, in the past, that you and your team talk to Fidelity customers a lot, obviously. And you've heard this recurring question/concern: The market's at all-time highs. What do I do? What should I do? What's going to happen next? So I know that this is an area that you've dealt with a lot, personally, as well.

LEANNA: Yes, that's exactly right. So recently, especially we've heard our clients share that the market's at an all-time high. It may not be the time to make any changes due to uncertainty of what's next. So Lars, your points are excellent and, I think, perfect timing. So for us, again, it's all linked to what your goals are. So first things first—and we do have these checkups—we always suggest that we take time to first develop a plan that works for your specific needs and what your specific goals are, again.

So is that generating income today? Is that future income? Are we looking to maximize our savings and how we accumulate that? Is it other goals? So that's where it all begins. And then we take a look at how—if you've had your plan, how we review it annually, how we're monitoring it and making adjustments. So Jim, just like you said, when we go to the doctor's, same thing from an investment standpoint, at least annually. I always find, too, that being proactive, it can really be helpful before things go wrong or if there is uncertainty. Clients who are proactive and that they're comfortable and confident with their plan, and have they—being through these checkups, are also able to stay invested. So quick story, I always like to bring in some client examples. But recently, we had a couple in their early 60s come in and meet with a member of our team. And they were actually looking to invest some cash because friends of theirs had turned their head said, well, the stark market's doing so well. We have been investing in the stock market.

They hadn't had a checkup or met with an advisor in over ten years. Life just got super busy. So what we found, though, is they had accounts all over the place, just different employer plans, and it wasn't prudent, with retiring in three years, to invest in the stock market. And really, they should be in a more balanced mix. So we're going to talk more about the allocation, but for them, that checkup defined that they really need to be in more of a balanced 50/50 stocks to bonds versus where they were more growth-oriented at the time.

JIM: Yeah, and I love that story. Thank you. Thank you for sharing it. I recognize, obviously, that couple's perspective. That couple's situation was very unique to them and their circumstances. But are there any sort of general rules of thumb or any guidelines you can suggest for how somebody might approach the kind of review that they would need?

LEANNA: Yes, so I'd say first, again, it comes down to that goal and plan. That client, as an example, if we started and got right to the investments, we would have missed that, well, they're retiring within three years, so we're going to treat that very differently. So any goal—it could be saving for college, it could be just getting married, just having a baby, all of these things will help define how we're invested. Then we could take a look at your overall strategy and asset mix. So that's, again, that mix between stocks, bonds, and cash. And we want to make sure that target that you're comfortable from a risk standpoint, that you're financial situation can support what that target is as well, and then the goal in time we're going to be using that money.

And then what we'll do in that checkup is we revisit the positions and we review the concentrations, making sure that you're not exposed in any certain area of the market. We also make adjustments when that happens as well. So if you're not familiar with this, this is where we can help. And we do these annual checkups. And also, many clients will choose to have an option to invest in managed accounts to help support, and rebalance, and do these checkups for them. That comes with a cost, but of course, many clients find value in that managed account because it's someone keeping an eye on things.

JIM: Yeah, all right, back to Lars then. As a portfolio manager, this topic seems right up your alley, in particular. I wanted to ask about something that Leanna's been telling us she's been hearing a lot from clients and customers. And that's this idea of inflation, right? Well, we talk about it pretty much every week on the show because it is top of mind—excuse me—top of mind for so many people, what's your thinking about how inflation might figure into our individual sort of short-, medium-, long-term plans?

LARS: Sure, I mean, certainly, we're experiencing warmer inflation right now. I think that's an understatement. And some of this is just due to factors related to the pandemic. I know that may sound tired, but it's just true. There is supply chain disruptions. Consumers are spending way over trend on goods. And as we were all just stuck at home rather than spending money on services like dining out and travel, I think some of those factors related to supply chains and higher-than-normal spending on goods, they're likely to ease over time. But it could take several quarters.

Other inflationary factors, though, may be a bit stickier: wages, higher rents, or housing, or a couple of key ones—for example, with wages, when you get paid more, you tend to spend more, which feeds into higher prices, which is inflation. When you put it all together, and it's certainly plausible for inflation over the next few years, in my mind, to be warmer than what we saw over the last decade or so. But I do not believe that a 1970s-style inflation scenario is really in the mix.

So let's say inflation is a bit warmer over the next few years than what we've experienced over the last ten or so. What do you do about it? In my mind, it's important to be flexible and adapt. And there are a variety of investments that can perform well when you have positive economic growth combined with a modest inflationary environment, including both US and non-US stocks, like those associated with industrials, materials, energy. But there are other investments in places like REITs, or real estate investment trusts, commodities, TIPS, or otherwise known as treasury inflation protected securities. I'm showing some of those investments on the screen here in front of you and how they performed in 2021. And these are investment types that we've owned in most well-diversified client accounts in the recent year as inflationary pressures have rose. I would note that one asset class that can be particularly troubled in an inflationary environment is cash. That's not on here. But there is a loss of future purchasing power if you hold a lot in cash in a rising inflationary environment.

So ultimately, when I kind of think about it all together—and we need to be humbled by inflation. It's a very difficult thing to call exactly, even six, 12 months out or so, that ultimately, maintaining a well-diversified portfolio can really help smooth out any bumpy ride we might have in the future. And then just ensuring that you have a broad mix of investments that is aligned to your situation can help ensure you are on a good path to financial success.

JIM: Leanna, in the couple minutes we have left, I wanted to turn back to you to sort of reflect on what Lars was just saying there about a well-balanced, diversified portfolio. I know you had another client story that spoke to that.

LEANNA: Yes, so it all comes down to diversification really and not having all your eggs in one basket. We hear that so often. But another client—and this is different from the first example where they hadn't had a checkup where someone looked at their plan in many, many years. Other clients that we meet with that do have the annual checkups, we still take a look and they may find that they're not as diversified as they thought. So just recently, we had a client who, again, has been meeting with an advisor year after year. But in March 2020, a portion of their investments got moved to cash just because of nerves of what was going on with the pandemic—not everything, but just a portion.

But in review of that, we also took a look and then there was overconcentration in a specific company. So Fidelity believes we don't want to have more than 5% in one specific company. And it's not just because of the company. When you're in a single stock, you're exposing yourself to maybe a larger stock and you're overweighting in large when there should be mid-cap and small-cap as well. In the type of company, it could be a growth company and you want to make sure you're exposed to value as well, just examples, or geographically where you are.

So annual reviews allow us to take a lens in making sure you're well-diversified and having that right balance and having the areas, as Lars was talking about, that we're combating inflation or anything that's going on. So these are the areas that we can help with. And conducting those regular assessments helps see and make sure that we're staying diversified, and of course, most importantly, that it's in line with the goals that you have and you're able to stay invested.

JIM: Yeah, that alignment with your personal goals, as they evolve, as you pointed out, too—births, deaths, marriage, divorces—as all those live events happen, it's really important to keep your portfolio checked up, in line with your goals as they evolve. So Leanna, Lars, thank you, both, for taking time to be with us again today.

LARS: Thank you.

LEANNA: Thank you.

JIM: Yeah, sure. For our viewers, of course, thank you for watching on this busy Thanksgiving week. If you're about to embark on a portfolio checkup or if you're thinking about putting one together for the first time, don't forget, Fidelity is here to help. You can start that process simply by going online to learn more or downloading our app and exploring some of what we've got there to offer and continue your process of learning about what you need to get done. Again, huge thanks to Fidelity's Lars Schuster and Leanna Devinney—quick programming note, we are off next week for the Thanksgiving holiday. So our next live show will be Tuesday, December 7th. And one final reminder, we've got that brand-new survey just under your video here. If you could spend a minute filling it out, we would be very grateful for your feedback. And again, podcast is up and available. Look for Market Sense where you download your favorite podcasts and take us wherever you want to go, if that's a good thought for you. Have a great week.

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