Alex Lieberman [00:00:10] What is up, everyone? This is Alex Lieberman, cofounder and CEO of Morning Brew. And this is Fresh Invest, your favorite investing podcast sponsored by Fidelity Investments and powered by Morning Brew.

Alex [00:00:25] Fresh Invest is the jet fuel you need as a young investor. And, so sad to say this, this is our last episode of the season.

Alex [00:00:33] But today's topic is—drumroll, please—[sound of a drum roll] GDP. Gross Domestic Product. It’s one of those Econ 101 acronyms that sends shivers down the spines of all that have heard it. I am one of those people.

Alex [00:00:49] And I get it. GDP can be daunting to learn about, boring to talk about, and hard to relate to as an individual consumer. But I promise two things in this episode. The first, GDP has only been boring because you didn’t have Fresh Invest to show you the way. And second, GDP is potentially one of the most important business concepts for any individual investor to have a grasp on.

Alex [00:01:14] And while this measure of economic activity is always essential to understand, we sit at a fascinating time in history that lends itself even more weight to truly getting GDP.

Alex [00:01:25] In February of 2020, the United States economy officially entered a recession, bringing to an end the longest economic expansion in U.S. history of 128 months. We’ll talk more in this episode about what defines a recession and how it relates to GDP.

Alex [00:01:43] But I want to call out one very important fact as we get this conversation going. Despite GDP falling, the U.S. entering a recession, unemployment surging, and a global pandemic, the stock market is proving itself immune. As of this recording, the S&P 500 is up 13% year to date, and the Nasdaq up over 35% over the same time period.

Alex [00:02:07] It’s time for us to dive in with Denise Chisholm, Sector Strategist at Fidelity Investments, on this final episode of Fresh Invest. I want to understand what GDP means for me and my money, and how markets should work in relation to the major economic indicator.

Alex [00:02:20] Let’s get into it.

Alex [00:02:22] Denise, thanks for joining the conversation.

Denise Chisholm, sector strategist at Fidelity Investments [00:02:25] Thanks so much for having me. I’m excited to be here.

Alex [00:02:27] So, I have a very simple goal today. It is to make GDP fun and interesting. I want to start with the basics. Can you give me an overview on what GDP is and start by just literally telling me what the three-letter acronym actually means?

Denise [00:02:44] So gross domestic product, that’s what GDP stands for. And quite simply, it tells you how big the economy is and how fast it's growing, which is sort of critical for investors.

Alex [00:02:55] So, what does GDP, just as a measure of the economy, actually indicate about current markets and what’s happening in markets?
So let's talk about what GDP is indicating right now. So the snapshot that we've seen is GDP contracted or went down 31%. That's a really important signal because it tells you that you are in a recession. There are more monthly indicators that are more timely to watch that ultimately go into it. Now, right now, some of those are suggesting the economy is starting to grow again. But we have an organization called the National Bureau of Economic Research. Their job is to tell you when recessions start and end. So they haven't called the end yet. But from what we've seen historically, because you can't call the end until you see a sequence of data points that suggest growth, most often you have to wait six months before knowing that the recession ended six months ago. So that gets into the perspective of the GDP, as it relates to an investor, is actually a lagging indicator.

Got it. And so I also want to just go back to one data point that you provided, which was that the last data point around GDP was a 31% decline. I don't have a reference point, but it sounds like a whole lot. How should I as an investor, be thinking about a decline of that magnitude? And, also, is there a way for me to understand what actually the largest contributor of that decline was?

Well, consumption is always going to take the lion's share. And in essence, consumers really, even if you had money to spend, and many got stimulus checks, you couldn't actually spend it. So consumption actually declined the most on record. And that 31% contraction, in any quarter, is the biggest we've ever seen. That said, I think it's really important for investors to understand that as much as people want to talk about stocks versus GDP, so you have this story of cognitive dissonance between what stocks are saying about the economy—and they're back at their highs—versus what gross domestic product is saying about the economy, that we're still in a contraction, or a recession. People are sort of struggling to understand that. I think what you need to know is that that's very common during recessions. Stocks actually don't follow gross domestic product at economic troughs because they're a discounting mechanism. So I think that this cognitive dissonance is very typical. And I think it illustrates the fact that GDP is a tough indicator to use for an investor. I guess then basically what you're saying, that, you know, as I'm putting money to work as a young investor, that I shouldn't be aware of or paying attention to moves in GDP more broadly?

I think you always need to think as an investor of watching something that's informative, rather something that's predictive. So you can always be informed. But I think that you have to understand what variables drive the market and sort of what we just talked about is GDP, given its lagging nature, isn't one of the main variables that should necessarily change your investment philosophy.

So I should be informed by GDP, but not necessarily be using GDP as a predictive measure. How are specific sectors or asset classes impacted, or how should my view of them be impacted based on moves in GDP?

GDP isn't predictive of stocks broadly, but it can sort of help you as an investor by telling you what ponds to fish in. So economically sensitive sectors, like consumer discretionary, energy, technology, industrials, are actually called economically sensitive for a reason. And that's because when the economy is accelerating, GDP growth is accelerating, they tend to grow earnings faster than other sectors and therefore tend, and in a big bucket, tend to actually outperform the market. So if you believe as an investor that GDP is going to reaccelerate potentially from troughs, those might be more efficient ponds to look in. Now, defensive sectors, in contrast with that, are things like sectors like consumer staples, utilities, and, to a lesser extent, health care and the telecommunications services sector. Now we call them defensive because even during times of economic uncertainty or recession, you still tend to buy toothpaste, pay your electric bill, go to the doctor, pay your cable bill. And even if you don't pay those things in recessions, you're more likely to pay them than, say, get a new bank loan, get a new iPhone. So it's sort of the relevant differential. And those sectors tend to do better when economic growth is decelerating or
contracting. So I think that what GDP is going to do can help you in terms of what sectors you'd rather fish in.

Alex [00:07:42] That's super-helpful. So, I know you're the GDP guru, but outside of just GDP, are there any other quarterly reports or even more frequent reports that I, the young investor, should be paying attention to? And I'd also love to understand, are these strong lagging indicators or leading indicators for me to look at?

Denise [00:08:02] One is the Institute of Supply Management, or ISM, which tells you how many of the manufacturing economy, how many are growing, how many are contracting. So that's an important monthly indicator to watch. Another is advanced durable goods orders, which sort of shows you the same trend. They're a little bit correlated in that advanced durable goods ends up in GDP accounts. Those are the things that investors can actually watch. And the reason for that is because those trends' investment tend to have a strong corollary to earnings growth. And almost more importantly, to margins. So when investment spending is rebounding, margins tend to increase, which means that companies are getting more profitable over the next year. So some of the leading indicators we're seeing right now do suggest that that's likely to be the case.

Alex [00:08:52] Got it. I want to now personalize kind of all the insight that you're giving me. If I'm thinking about, as a young professional, putting my money to work in an informed manner. What are some of the things I should be thinking about kind of with this ear towards macroeconomics and GDP in, you know, having smart investment strategies?

Denise [00:09:13] I think the first thing you have to understand is that stocks are a discounting mechanism, and that means they can look through bad news. I mean that's the historical data point that keeps coming up to me. Sometimes you can see this in valuations, meaning when stocks are inexpensive. And sometimes we call that inexpensive based on price to earnings, or P/E. Sometimes when stocks are inexpensive, being inexpensive can actually be more important than the bad news that's coming. That's sort of a discounting mechanism. Now, more often, you actually see that discounting mechanism in what I'd call sentiment, which are usually surveys of how investors feel about the market or valuations spreads when some stocks are expensive, but other stocks are really cheap. And both of those can show you when investors are really fearful. And sometimes, when there's a consensus in sentiment surveys and people are fearful when you see it in valuation spreads, if there's a consensus that stocks aren't a good place to be, there might be less incremental sellers going forward, and that might translate into a bottom.

Alex [00:10:19] Got it. And on that first point that you made about stocks proving over the long term to be a discounting mechanism for bad news, just to make sure I understand this concept, basically what you're saying is that stocks don't necessarily listen to the full severity of an economic situation in how they are priced. And so the language of discounting is really kind of a discounting of the importance of information. Is that kind of how I'm hearing it?

Denise [00:10:44] Yeah. And I think that said differently too, Wall Street and Main Street don't always agree. And in some ways, shouldn't always have to reflect each other. So I think investors always need to remember that in 75% of the years since 1960, stocks actually do advance, on average 9%. So some of this is sort of a timing mechanism issue. When you talk about timing of contractions, stocks can discount it earlier.

Alex [00:11:09] And dumb question for you, but what is Main Street?

Denise [00:11:12] Well, when I think about Wall Street and Main Street, Wall Street reflecting—and I'm using it sort of not literally—Wall Street reflecting the stock market and Main Street reflecting GDP. So you going about your daily life, who's unemployed, who's employed. That's what you live and breathe every day versus what you think stocks should be reflective of.
Alex [00:11:31] Awesome. And so, if I or any of our listeners are to leave this conversation with kind of one gold nugget of advice around GDP, what would be that advice you'd bestow upon all of the listeners?

Denise [00:11:48] It might not be as important as you think. The market is almost never a univariate equation—so where one variable matters.

Alex [00:11:54] And finally, I always ask everyone in these conversations the same question, which is let's say that Alex, the young professional, has just graduated from college. He's literate in financial markets, but not at all fluent, debatable on if he's proficient. He's just moved to a major city. He's working in finance or consulting. And basically, he's trying to figure out how to navigate today's financial landscape and just the financial markets more broadly. Beyond just GDP, as an investment professional, what would be a piece of advice you'd provide to Alex or any other young investor about how to navigate this ever-evolving landscape?

Denise [00:12:33] So I would say do three things, Alex. One, determine your risk tolerance. So that means how much money are you willing to lose. Two, determine an investment that needs that risk tolerance and then invest on a specific cadence, whether it be monthly or quarterly or annually. And then three—which is the most important—stick to it, even during times of volatility.

Alex [00:12:57] Awesome. Well, Denise, thank you so much for the time and for your insights. This has been incredible.

Denise [00:13:03] Thanks for having me.

Alex [00:13:04] If you made it to this part of the episode, guess what? I stayed true to my promise and actually made GDP informative and entertaining. Denise spared no details, walking us through the basics of GDP, the relationships between GDP and the markets, and how you and I as investors should think about changes in GDP with respect to our portfolios.

There was one part of the conversation, though, that I found especially interesting. There is a great shortcut for mentally organizing companies based on the sectors they sit in and whether we're in a period of economic growth or economic decline. For example, things like energy companies are generally more sensitive to the economy because so much of energy usage is determined by how businesses and consumers are doing and what their energy needs are.

With that, I'd like to step back for a second and give a huge thank you to our listeners. It has been an absolute blast to be a part of Fresh Invest this season, and I hope you have enjoyed this journey as much as I have. And as always, check out Fidelity.com/FreshInvest for more information and resources.

Alex [00:14:10] Thank you all for listening and have an awesome day.

Morgan Chmielewski, Producer of Fresh Invest [00:14:17] Hey, everyone, this is Morgan Chmielewski from Morning Brew. And as the producer of Fresh Invest, I'm here to let you know that this podcast was created on behalf of Fidelity Investments by the Morning Brew Creative Studio, and does not reflect the opinions or point of view of the Morning Brew editorial team. Sources are provided for informational and reference purposes only. They are not an endorsement of Fidelity Investments or Fidelity Investments' products.

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