

Insights Live: Strategies for Rising Interest Rates

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TRANSCRIPT

SPEAKERS:

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Trey Jarrell: Good afternoon, and thanks for joining us everyone. My name is Trey Jarrell here at educational events at Fidelity Investments. Today's webinar is our *Insights Live: Strategies for Rising Interest Rates*. So with those covered, why don't we go ahead and get started.

I would like to introduce Chris Sheldon to start us off. Chris Sheldon of Fidelity Investments. He's a chief investment officer, excuse me, of our Personal and Workplace Advisors. Thanks for joining us, Chris.

Chris Sheldon: Thank you, Trey, and thank you, everybody, for joining us today and tuning in, and most particularly, for all the questions you submitted in advance. They really helped us to shape today's discussion, which, after a long period of historically low inflation and interest rates, the Federal Reserve has begun raising interest rates in hopes of bringing down inflation fairly quickly. We recognize the challenging times for clients with market volatility, uncertainty about the future, and how rising rates might affect your investments and the ability to reach goals.

So in that vein, our panel of professionals is going to help us do a deep dive on the current state of the market and inflation, the potential outlook for the coming months, considerations for bonds and other market sectors, and finally, strategies for asset protection and other planning considerations. Let me quickly introduce our panelists. I have Naveen Malwal, Institutional Portfolio Manager, Strategic Adviser, and he's the leading portfolio manager for most of our managed account clients; Denise Chisholm, Director of Quantitative Strategy; and Michelle Caffrey, the vice president for Advanced Planning.

So in a previous webinar recently about inflation, we talked in depth about what higher inflation and rising interest rates might mean for the economy and for markets. But given the current



volatility, a month feels like a really long time. Things certainly don't feel like they're going in a positive direction. And so to catch us up, I'll ask each of our panelists to bring us up to speed on recent developments in their current thinking in the areas of focus that they specialize. So Naveen, let me start with you.

Naveen Malwal: Chris, I think you nailed it when you opened up, right? I think if you're at home right now feeling anxious and kind of stressed out, we hear you, and we feel it too. I've got my folks, my grandmother in the Boston area who retired living on fixed income, dealing with lower account balances, high inflation, uncertainty abounding. We came into this year with so much optimism. Yet, things are going really differently, so it's really tough to experience that.

And then looking at the markets more specifically—what's driven the volatility—we've entered a bear market, the S&P's off about 20% from its highs last week. What's been driving that is the uncertainty around inflation and the Federal Reserve's attempts to mitigate that inflation. So by raising interest rates, they're hoping to cool off the economy from something that's overheated, call it a rolling boil, down to more of a comfortable simmer. But along the way, it does mean slower economic activity. And the outcome is unknown, and that's what the market is digesting right now.

Does the Fed succeed, in fact, in bringing inflation down and keeping the economy growing, or do recession risks start picking up and do we face a different kind of outcome? That's what I think is driving most of the market volatility.

CHRIS: Yeah, it really has happened suddenly, and I think that's what has caught so many people off guard. And obviously, it's hit all of the asset classes pretty much that people invest in. So definitely good to highlight that. Denise, what's your take?

Denise Chisholm: Yeah, it is typical to see corrections around the time the Fed starts normalizing monetary policy, but this has been much steeper and quicker than historical averages. So whenever that happens, I usually try and focus on critical drivers that have been predictive. What are the things you want to watch that determines the outcome in the future?

And one of those things is earnings. And our earnings have been pretty solid throughout the course of this year. So when you look at expected earnings, even over the last month—and this might not seem like it—actually numbers have come up for the aggregate S&P 500. And the weakness that we've seen in a month-on-month basis has been some highlights in consumer discretionary, and so you've seen some softness in select areas. But when you aggregate it all up, it's very few, relative to historical averages. It's only three sectors on a month-on-month basis, which is around historical averages and well below levels that we've seen in prior recessions, where the diffusion of sectors taking earnings down—you see 5, 6, or 7.

So we are not at those stages yet, and that puts into play the fact that this correction has been more of a valuation compression than it is about recession risk. So we've started the year on

multiples of the S&P, what investors were paying for, aggregate S&P earnings, around 24 times. We're almost down to about 15. When this has happened in the past, when earnings growth is strong and it's been a valuation compression, you usually see better forward odds for the market on a go-forward basis than any kind of recessionary risk.

CHRIS: Yeah, I definitely want to come back and explore that later because the question, obviously, is you mentioned recession, and not that that's necessarily a high likelihood, but something we need to think about. So let's explore that a little further in the presentation. But thanks for that. Michelle, given everything that we just talked about there, what are some of the key concerns that you're hearing from clients right now?

Michelle Caffrey: I would say in a sentiment from those nearing retirement is, should I work longer? My account values are depressed and I may need additional time for values to recover before I may have to draw on my portfolio. And then a concern from retirees is, the expenses I planned on are increasing. And this provides us an opportunity to revisit someone's plan with increased expenses for a period. And I'll say that it's important to consider the recent pace of inflation versus long-term inflation using historical data.

So depending on somebody's age at retirement, a long-term plan may have a 20- to 30-year or more time horizon. So it's important to not apply short-term fluctuations to well-researched long-term assumptions.

CHRIS: You touch on important things because if you just retired or you're living in retirement on that fixed income, as Naveen mentioned, we recognize that can be very difficult. And there are some things that can be done, but sometimes it's very difficult. So [I] definitely hear you on that one. Are there some of the concerns that you're hearing that might be more universal that would apply to everybody as opposed to kind of specific people in your cluster of retirement?

MICHELLE: Yeah, so I would say the top question is, does my plan still work? Would it still be successful? And to answer that question for our clients, we use a comprehensive financial planning process that starts by identifying our client's goals, both short- and long-term, and reviewing the breakdown of the portfolio and cash flow. So that involves looking at the taxable accounts and the retirement accounts, overall asset allocation, earnings outside of investment growth, spending—including income tax implications, assumed rates of return, risk or standard deviation associated with that allocation, and historical market returns and inflation assumptions to test the probability that somebody can meet their desired goals.

Another concern, I would say, is borrowing, right? So borrowing is a part of most people's financial plans. And clients are concerned about the impact of higher rates on loans and just borrowing in general. So clients are thinking through timelines for variable rate loans, and asking, can I afford to set aside some money to pay off these loans sooner rather than later? And then for those clients that are house hunting and will be using financing, they're looking to balance the potential

increased value in real estate with rising mortgage rates. And then for students, so clients who are students or supporting students, thinking about rising interest rates and the impacts on loans. And then not so much of a concern, but I would say for high-net-worth clients, there's a focus on taking advantage of depressed market values through gifting techniques, Roth conversions, and evaluating other interest rate-sensitive strategies.

CHRIS: It is important to point out there are some things that could be beneficial. Not that this is a good outcome for looking for silver linings, but that can be helpful. Because you bring up an important point on the lending, which is, the Fed can only do very little about supply, so they have to target demand, and housing is part of that, but it's very challenging obviously for folks looking to buy in this environment or who need to finance loans for sure.

So I can't ignore it any further. It really does lead us to the question that I mentioned further up. Could there be more downside for equities? And are we headed for a recession? That probably was one of our biggest single set of questions. Denise, let me turn to you with your great historical context there.

DENISE: Yeah, let's talk about just the market overall in terms of bottoming. And usually when, instead of picking bottoms, when you study historical probabilities what usually helps is picking out on certain levels and looking at forward odds when you extend your time horizon over the course of the year. We should all remember that the market tends to v-bottom, so that loss into the low tends to be the quickest thing you get back. And when I look through time, we are starting to see those—if you're willing to extend your time horizon—some opportunities in the market. This isn't about picking a bottom, but it is about opportunities where you've seen consumer sentiment hit all-time lows, and where you see valuation spreads—which in my mind is an expression of fear—hit pandemic highs, usually offers opportunity.

But I think that the biggest risk that most investors have been following is energy prices. And that has been the historical factor that can create a tipping point. That tipping point usually happens when consumers are forced to spend a lot of their income on energy goods and services. And that's really been the interesting thing this cycle because that comparison is really the most important part of how you think about energy translating back to the U.S. consumer and to the overall stock market.

So we have two moving pieces: gasoline hitting \$5 a barrel—\$5 a gallon—but also income growth into June on the Atlanta Fed wage tracker. What you've seen is an acceleration in wage growth to 6.5%. If you net those two things out, we're still just below 5% of energy goods and services as a percentage of income, which is well below levels of the 1970s, which was almost 9, and still below averages that we've seen in 2011 to 2014, which was manageable for the U.S. consumer.

So when we think about the shocks that have happened historically, and we think about as uncomfortable as the energy price increases have been, could still be manageable for the U.S.

consumer from a historical perspective. I think it puts into play a potential for a non-recessionary bear market. And that's important for investors to understand, because as quickly as you can decline, you actually can quickly increase on the upside as well. And historically, it only takes six to eight months on average to get your money back to prior peaks, unlike recessions. So I think we need to be open-minded to volatility in the equity market happening both ways.

CHRIS: Yeah. It's a good point. Somehow it feels here like there's just so many factors in addition to energy, but everywhere you turn, it seems something. But that would be great if we could turn to something like seven- or eight-month recovery. I know there's not a prediction, but something to keep in mind. Naveen, how about you?

NAVEEN: Yeah, Chris, building on Denise's point, I agree with her, right? Sometimes, actually quite often, you will see after we get to a minus 20 in the market, you do see a recovery starting off. And then it depends on how things go with the economy, as Denise was talking about, in terms of how long the recovery might take. So if, for instance, we see some signs of growth slowing from where they were, say, a year ago, that is still positive growth. And it feels uncomfortable, but that might lead to perhaps a more benign or helpful outcome for investors.

But then there's the other side of that risk too. What if things just deteriorate? So where do we stand now? I think looking at the economy, it does feel less comfortable day to day for most of us. It definitely doesn't feel as good as it did earlier in the year, or even say last year. But looking at things like corporate profits, corporate profits grew by about 10% in the first quarter for nearly 80% of the S&P 500 companies. Now, that's not as fast as the 30-plus percent we saw last year, but it's still close to the long-term average.

And on adding to that, consumers are still spending money. Gas prices are going up, but they are still spending. We haven't seen any pull back, a big pull back, on spending. Some lower-income consumers, yes, they've had to tighten their belts. But on average, consumers are still out there spending money. We're still seeing banks lending out. They have higher interest rates now on things like mortgages, so they're happy to lend out money. And manufacturers are still just trying to keep up with demand for goods.

So all this activity, I'd say, has slowed from where it was a few months ago or a year ago, but it doesn't feel yet that it's gotten to those recession levels we would typically see. So with earnings, for instance, you would see negative earnings or negative sales heading into recession. We haven't seen that quite yet.

CHRIS: It's an important point you bring up there that the consumer did enter this episode stronger than before. And hopefully, that's enough to withstand much of what you mentioned there. We'll see. But maybe let's stick with you, Naveen. What factor would you think about or look at to indicate if a recession might be coming?

NAVEEN: Yeah, I touched on one, the profits, right? So beyond that, I would look for bigger signs of strength in the consumer. So you're already seeing some pressure. So some folks are feeling their budget is not going to go as far so they're having to pull back. If we see it happening more and more, I'd expect to see perhaps retail stores announcing more earnings warnings, perhaps seeing their profits slow more than perhaps other parts of the economy. I would expect to see manufacturing activity slowing down, that people are not buying as much stuff, you don't need as much manufacturing, and inventories will start to rise in the warehouses across the country.

Banks would also start to pull back on lending. If banks realize, hey, wait a minute, if people are getting pinched, maybe not as easy for them to repay these loans, maybe don't make these loans as much. So those are the kinds of trends we're closely following here at the investment team at Strategic Advisers, when the time is right, we can de-risk client accounts heading into—if a recession were to come into that kind of environment.

CHRIS: That's helpful. That's a good checklist. Although, they never seem to happen to unfold the same way at the same time from the last time, but hopefully that will help not only you, but everybody listening. Denise, maybe let me turn to you. You do a lot of work on the sectors. How—and clearly, inflation is having an impact in the different parts of the market—how do you see this impact in the different areas in the market so far?

DENISE: Yeah, in some ways, we've seen a lot of what history told us we were likely to see as inflation has accelerated and as interest rates have risen, where technology, on average, is the sector in the crosshairs, where technology, on average, underperforms and sectors that are more inflation sensitive, like energy and materials, outperforms. What has been atypical this cycle is it's not just been macro-factors. It's actually linked up to relative valuation, which has been more important for investors to understand when you look through history, meaning that inflation started to hit not just having causing higher odds of technology underperforming, but it actually hit when technology sector overall was in the top quartile of its relative valuation, so it was already expensive. And when it hit, energy stocks and materials stocks were already cheap.

So even if you put macro aside, and say, I don't know where interest rates and inflation are going to go over the next 12 months, what you can still see is this very wide valuation gap, and I think that that's the anomaly this cycle that investors can really exploit. There's more value in value stocks this cycle than any time since the early 1990s, and I think that has the potential for value stocks to be much more long lived leadership than even whatever you might think in terms of what might happen to inflation or interest rates going forward. And we've already seen the market essentially divide up on that.

Really, the Russell 1000 value as of today is only down a little over 10% from the beginning of the year. So you're starting to see this divide in the market where it matters what you own as much as just being invested in the market.

CHRIS: That's actually interesting and helpful, because on the one hand, the markets have been going up and down in tandem for quite some time, and that has to do with a lot of factors, like liquidity and things like that. But maybe now we're returning more to a market of stocks instead of a stock market. I don't want to try too hard for a silver lining, but it may be good for active managers or people who are picking stocks. Sounds helpful. Thank you.

So whether it's at the pump or in the pocketbook or in the portfolio, almost all of us are feeling the impact of higher inflation. Some of the clients have been asking what they might do to reduce the impact of inflation on their financial plan. Michelle, what are a few things they might consider?

MICHELLE: Yeah, so this is a great question too. As an opportunity to remind clients, right, to keep the long-term place in mind, and to separate current market volatility and increased expenses from the long-term growth needed to produce a successful plan in retirement. So if a long-term plan is in place today, I'd urge clients to stay the course. If they don't have a plan, to work to create one sooner rather than later, with a focus on an emergency fund and a diversification of assets.

And as I mentioned before, I would also remind clients to review their current expense assumptions and determine if they should be increased for a period of time. And this may be particularly important for someone who is nearing retirement, or is in retirement, and wants to ensure that the cash and fixed income portion of the portfolio is adequate. And then for our younger investors, I'd remind them to focus on a diversified investment approach designed to meet long-term goals.

CHRIS: Thank you. Yeah, that's a whole bunch of good stuff there. So hopefully folks got that. I want to turn now to bonds and fixed income, and that's obviously been a very challenging area because they haven't done what they've kind of historically done in terms of offsetting some of the risk of equities. Naveen, maybe you can shed some light on why bonds have done so poorly recently.

NAVEEN: To your point, Chris, historically, when stocks sell off, bonds normally retain their value, if not go up in value, and also provide a positive yield to offset some of that stock market volatility in a diversified portfolio or account. We haven't experienced that this year, and that's been very frustrating for investors. I think investors normally think of bonds as quite stable, so to see volatility of 5% to 10% in a matter of months is especially jarring. It's not unprecedented, though.

So just as Denise mentioned earlier, when we see a turning point with interest rates in the Federal Reserve policy, there's market volatility for stocks. We've seen similar experiences in the bond market before. Maybe not as sharp as what's happened this year, but it has happened, and that is unsettling. Now, going forward, just like Denise talked about with stocks, when does the recovery come? The good news is there is a recovery for stocks, and we don't feel as much different for bonds.

In fact, because yields have appreciated, we would say that the opportunities for bonds going forward is actually much more attractive than it has been maybe since the Great Financial Crisis. So for the last nearly 15 years, people have been wondering, why am I getting so little yield on my bonds? Well, now, getting close to 3% on treasuries, maybe close to 3½ or four on high-quality AAA-rated corporate bonds, and even more than that on other types of bonds in the marketplace. An investor has an opportunity to build a portfolio that could provide better protection from volatility and perhaps higher income than they've been able to do for quite some time.

CHRIS: You bring up a good point there. It has been many years, though, since we've seen this type of episode. And so an investor who hasn't been around for that long hasn't seen this and I can understand why that was so surprising to folks. One point you made is really important there, which is before the inflation, before the bond yields went up so much, they were starting from extremely low levels. And that, on a mathematical basis, can really impact those returns. On a percentage basis, we've seen that as well. Naveen, I'll stick with you in a little bit. Can you talk about, historically, what are some of the bond areas, the bond market areas, that have performed better during periods of higher inflation or rising rates?

NAVEEN: Well, as an example, I can point to how we've been managing bond portfolios for clients who are in managed accounts at Fidelity. So we've been looking at building out diversified portfolios of bonds with an emphasis on parts of the market that historically have done well in either a high inflation or rising interest rate environment. So here, I'd point to an example of TIPS, Treasury Inflation Protected Securities, which were designed to, in fact, protect investors from inflation. That's a position we've held in client accounts for well over a year now, since about 2020.

I'd add to that things like high-yield bonds, which normally do carry a bit more risk than investment-grade bonds, but that higher yield can help investors grow. And again, during times of high inflation, it can help overcome some of that inflation hurdle that is out there for investors. Other ideas we've incorporated have included non-U.S. bonds, or even looking into asset-backed bonds, which can have pretty good credit ratings but higher yields and treasuries. That can help form a nice well-rounded portfolio that, in our opinion, because yields are higher, will actually provide better protection from volatility.

When yields are lower, the protection is not as easily there, and when rates go up, those bonds really struggle. With higher yields, you have less risk of more volatility from further interest rate increases and you probably have better support for diversification to allow bonds to play the traditional role of giving stability and income when stock markets might be experiencing volatility.

CHRIS: That would be nice if they could return to that more traditional role for sure. And you bring up a really important point. We oftentimes think of bonds to be one thing as if they are all the same, but there's lots of different types of bonds, as you highlight, so thank you. That's very helpful. One of the viewers was wondering, given the current volatility, their quote is, "I want to protect my assets, why would I not just move into cash?" Michelle, what's your thought about that?

MICHELLE: Chris, that's a great question, why not just move to cash? I would say that while a move to cash may temporarily help to ease some of the stress relative to the current market volatility, focus should remain on the long-term plan. So a move to cash likely will not provide the growth needed to produce a likely outcome of meeting the goals many years out and it will force clients to have to time their reentry into the market, which can be very problematic.

So a safe way to think of needs over the short- and long-term is to focus on three areas, and that would be emergency, protection, and growth. And emergency, just as it implies, is the emergency fund. So these are the funds set aside for additional expenses, unexpected expenses, a potential loss of income, and hedging the need to have to sell at an inopportune time. So the sleep at night funds. And then protection, protection helps to assure clients can stay invested and meet their expense needs.

And this may involve guaranteed sources of income, such as pensions or certain types of insurance products that may provide that guaranteed income stream. Another consideration from a protection perspective, may be altering the asset allocation. And this may be particularly important for accounts that have required distributions, such as traditional IRAs, where there's required minimum distributions at age 72 for the owner of the account or deferred compensation accounts that have set distributions schedules. So again, having funds available to fund those distributions to avoid having to sell at an inopportune time.

And then from a growth perspective, growth is staying the course—staying invested to try to keep pace with inflation and long-term accumulation. So for retirees, if that emergency fund is perhaps more than it needs to be, they may want to consider investing for growth potential. And then for accumulators, considering the impact of taking money out of the market relative to the long-term plan.

CHRIS: What you're really touching on there is that discipline to make sure you have all those covered, and hopefully that makes it a little bit more bearable on the growth part to stay invested because protection that you talked about there in specific ways. Also, you highlight in the growth areas against inflation, because in the long run, that can make a big difference. Naveen, anything you'd add to that?

NAVEEN: Yeah, I'll build off what Michelle is saying, right, with some numbers. So think about that. If inflation, let's say it's running at 5% a year. If you have \$100 in the bank, it's going to afford \$5 less of stuff in a year from now. So even if you invest that money in what feels like a safe investment and you make two or three percentage points, you're falling behind on your purchasing power. That's one of the risks of seeking out safety in this environment as you probably are going to unfortunately fall behind when inflation is putting up right now.

So as far as that risk, we do still think a diversified mix of stocks and bonds gives investors the best chance of staying ahead of inflation. And the other thing Denise has been touching on repeatedly, which I think is so important is, yes, bear markets happen, corrections happen, but over the long run, there is a recovery. And normally the recovery can start pretty soon after the bear market begins, and it's relatively unexpected. I think some investors think, hey, I'm just going to go to the sidelines for a little while. I'll come back again when the news starts to feel better, but it very rarely works out that way.

So think back to 2020, right. The pandemic begins, stocks sell off by about 30% in February and March. Turns out the market bottom was March 23rd, yet I don't know too many investors who are clients of ours, or anywhere across the country or the industry, that were buying stocks at that point. It was very challenging because news headlines are telling you things like the pandemic might be here for a while, vaccines were thought to be a minimum of three or four years away, people were not traveling, not dining out, unemployment was at record levels. And in spite of that, markets started rising.

And I kept hearing from investors, Naveen, I don't believe this rally. The headlines are so negative. But that's what happens almost every time. The headlines stay negative, the market comes back, and many investors miss those opportunities to benefit from the recovery in stocks. And yes, if they come back at some point, they can eventually get there, but that opportunity to get there sooner to get back to a more comfortable level in their account savings, that can be a real stressor for families unfortunately.

CHRIS: It's a really important point. Missing those days when things go very quickly, if you do enough—miss enough of those, that can really impact your long-term returns, we've certainly seen studies of that and information. And you bring up a great point around when there's the most danger perhaps is when the valuations don't reflect the bad news, and the bad news maybe isn't even yet in the headlines. That's certainly not the case today. So not to say that there couldn't be more downside as we've explored, but certainly prices better reflect the current environment at least.

DENISE: Right. Selling bad news is a great strategy when you look through history, because off of any market low, the gains over the next two years, 75% are in by the time the recession is over. So if you use bad news to sell, you can't use good news to buy. Just like Naveen was saying.

CHRIS: That's almost backwards and it's very counterintuitive, but I totally get it. So let me turn that around. That's a great point too. And we talked a lot about what it might look like for a recession, what indicators. Naveen, what would you look for that might allow stocks to move higher from here?

NAVEEN: It's a great question, Chris. Here, at Fidelity Investments, at Strategic Advisers and my team, we talk a lot about the possible upside. But if you listen to the news media, it feels like

there's no hope for the market. But for us, you think about simple things. What if the Federal Reserve's actions to raise interest rates do, in fact, start leading to more modest inflation numbers? Not dropping back to 2% overnight, but going from more recent numbers just to tick lower. That might lead to investor confidence and move markets higher.

Other possibilities would include earnings growth. First-quarter earnings are pretty strong. Second-quarter earnings are about to get announced starting in July. If those come in healthy, and companies reiterate their view that we can still make money in this environment, even with inflation, even with Russia-Ukraine, we can deal with all this stuff. That can give investors confidence that this could become a better situation.

Then you add in some of the stuff that's happening overseas. If there's some sort of resolution in Russia-Ukraine, or even ways of getting some of the green and energy flowing from those regions around globally, that can help bring inflation down. Make for a more appealing investment environment. And then let's not forget, the second biggest economy in the world, China, has been struggling with COVID-19 and these shutdowns, and that is causing some supply chain issues here for the U.S. and causing inflation here. So if that starts to ease, that could be another positive development.

So none of these things is assured, Chris, as you know, or guaranteed. But these are the kinds of things we look at, saying, hey, there is bad news out there, but let's not lose sight of the fact that it might not take all that much for markets to regain a sense of optimism.

CHRIS: I recognize you're not saying those are the things you think will happen, but those are really important reminders I think for all of us to think about all sides of the issue because it's very easy to be pessimistic when things are that bad. And I'm not saying the things necessarily will get better, but you've given some good things to think about, and I appreciate that.

DENISE: As inflation has actually accelerated, I'm seeing more and more mathematical headwinds to inflation in the coming months. So just like markets can v-bottom, investors should remember that inflation tends to v-top as well. So that acceleration can work down the back side.

CHRIS: That's a great point. Sorry. But clearly, we have definitely seen a lot of movement in the asset class—many asset classes, and certainly not just stocks. That might create some strategies that investors might want to focus or consider right now. Denise, let's maybe stay with you. What do you think of that? Do you have any ideas or suggestions they might consider?

DENISE: Yeah, I think low volatility strategies are actually one area that might be of interest to investors. What you've seen through time, this is a group of stocks that move less than the market. And typically, they offer some downside protection. But many times you give away upside return potential for that lower volatility aspect to equities. We certainly saw this during the pandemic when low vol stocks were stocks that are more safe havens were quite expensive in those

pandemic lows as everybody rushed to the more defensive options. But that valuation threshold has actually worked off quite a bit, and low vol stocks are no longer expensive.

And so what you're seeing is those headwinds that were coming out of the pandemic need not necessarily apply. So it might be a strategy where investors get some downside protection, but still have some optionality for total return and even potentials of low volatility areas in the market actually beating the market.

CHRIS: Interesting. Naveen, how about you?

NAVEEN: Well, Chris, I think about just simple things an investor can do day to day regardless of what's happening with markets. So one activity that we undertake on behalf of managed account clients is rebalancing their accounts on a regular basis. What that means is if an investor has come into the program with a target of say, half stocks/half bonds, that even if there's market volatility, we strive to get that balance back for the client. And we do this probably a month, every month or so, if not more or less often than that. I know some investors maybe wait once a year, once a quarter. But doing that regularly can be really important, especially in a down market because if there is eventually a market recovery, the last thing we want to do is have less exposure to stocks when the recovery begins because then the client can unfortunately miss out on some of that bounce back.

Then a second example I'd point to that we do on behalf of managing our clients is thinking about managing tax efficiently for those investors of taxable accounts. So here, looking to tax-efficient investments, like municipal bonds, can help investors keep more of what they earn after taxes. And then beyond that, you can also employ other strategies, like tax-loss harvesting, which is an attempt to build tax assets that can help offset future gains—another way of perhaps improving the returns after tax for investors. Similar things I'd point to, that you don't necessarily need to wait for the market to do something for you. You can undertake these activities year round if you really wanted to.

CHRIS: So that idea of tax-loss harvesting, that's the idea of selling something that's at a loss, buying something else to maintain exposure you want, but then being able to have those losses offset either existing current or future gains.

NAVEEN: That sounds right, Chris.

CHRIS: OK, good. That's helpful. Thank you. There are things, again, that can be done. Nobody wants the losses, but when they're there, trying to use them to some advantage is better than, I guess, is some type of silver lining. Michelle, how about you? What about from a planning standpoint?

MICHELLE: Yeah, so from a planning perspective, I would continue on what Naveen said in relation to tax efficiency. So clients may want to review their asset location between taxable and

retirement accounts to ensure tax efficiency within their plan. So for instance, if investments are creating interest income, those may be better suited in retirement accounts or tax-deferred types of accounts. If investments are creating qualified dividends, those may be better suited in taxable accounts since they're taxed at the preferential rate.

Also, clients may want to consult with their tax advisors regarding tax bracket planning. So clients could see less investment or taxable income, which could be coupled with perhaps a Roth conversion. So a Roth conversion is more attractive in depressed markets. And a Roth conversion is converting assets that are in a traditional IRA to a Roth by paying the tax now, and the tax is based on the amount of the conversion. So if the conversion is done with a depressed market values, a larger percentage of the traditional IRA lands in the Roth. Certainly, this has to be applicable to somebody's personal situation, and the specific rules of the Roth should be considered.

CHRIS: But that's helpful. There definitely seems like a number of levers they can pull to take some opportunity out of what's not a fun time for sure. Michelle, let me stay with you. And so, if a client has an estate plan in place, what are some of the steps they might take in light of the current environment?

MICHELLE: Yes, I think one thing is to review specific bequests in estate documents, as well as review the flow of assets to specific heirs using the depressed values and saying, does this still align with my goals? Another would be in relation to lifetime gifts or lifetime giving. So lifetime gifting would be transferring assets and future appreciation outside of somebody's taxable estate, and lifetime gifts are valued as of the date of the gift. So gifting with decreased values allows someone to gift more while having that cost them less. And the costs that I'm referring to is the taxable gift in excess of the annual exclusion, which reduces the lifetime exemption available to offset someone's taxable estate.

Now, certainly with that concept, the loss of step-up in basis for transferring non-cash assets out of the estate would need to be considered. And then to think about interest rate-sensitive strategies. Two that come to mind are grantor-retained annuity trusts, or GRATs, and intra-family loans, so keeping the financing within the family. And both of these are estate freeze-type techniques. So these allow clients to shift appreciation in excess of a defined interest rate outside of their taxable estate. And these techniques can become less effective or attractive in a higher interest rate environment as the hurdle rate for the techniques are higher.

So additionally, as interest rates trend up, if a client wanted to put a GRAT into place, they may think about using a longer term to lock in that lower rate. But certainly, just thinking about having those assets in the GRAT for a longer period of time should be considered. So there's always pros and cons there. And then another strategy, Chris, would be, if it aligns with somebody's overall plan, would be a qualified personal residence trust or a keeper. And this would be transferring a personal residence to beneficiaries after a term of years as dictated in a formal trust document.

So a higher interest rate reduces the actuarial value of the taxable gift, which is the remainder interest in the property after a term of years has passed. Now, all of these that I referenced are complex strategies. They may not be right for everyone. And we would implore our clients to discuss with their advisors, their attorneys, and their accountants to be sure that they fit in their overall plan, and to sort through the pros and cons.

CHRIS: Yeah, they do sound like some complexity. But because with the big moves we've seen in the markets, it's nice to know there could be opportunities that could be quite significant, but take some complexity. So I think your underscoring your last comment there is good. I can't believe it, but the time is flying by for us here and it's been very helpful for me, and I hope also for the audience there. Maybe what I can do is turn to each of our panelists and ask you to give us one or two key points that you would want viewers to take away from this discussion. Naveen, let me start with you.

NAVEEN: Sure, Chris. My group does help over a million families coast to coast with their finances. We understand the range of experiences, the stress level right now varies quite a bit. So I'll give you two pieces of thoughts here. One would be for most investors, if the current environment is stressful, but you feel like, OK, with some long-term view, I feel like I can wait this out. This isn't affecting my lifestyle. I would encourage you to just go back in history and take a look at what happened with markets in 2020 and 2008. You can add 2011, 2018. Those are other years that had these big pullbacks in the market.

And you will see, just as Denise and I have been talking about, there is a recovery that does happen. So as much as things might feel bleak in the moment, markets have come back from these moments before. This might feel like it's unprecedented, but the recovery does take place historically. So take that as a vote of confidence for staying with your plan.

For others, though, this might feel honestly just too much, right? Maybe going into this environment, we felt good because stocks had been doing well for the last couple of years, but now the reality of what a drawdown feels like is just too stressful. Here I'll go back to what Michelle's been talking about, which is the importance of planning. So whether you've been doing it on your own, or maybe for the first time you talked to an advisor, and really take apart what's been going on with your portfolio, what your needs are, what your goals are, and take it from there. Perhaps an adjustment in the amount of risk in your account or other strategies might be in order for that kind of investor.

CHRIS: Yeah, great point. It can definitely help to have a partner, even if just to confirm that you're on the right track and not missing something. So good points. Michelle, how about you?

MICHELLE: Chris, I think putting a long-term plan in place, if a client hasn't already, is certainly top of the list for me. And then also, if a plan is in place, for clients to think through short-term

adjustments for spending in cash reserves, but not to lose sight of the long-term focus to meet those goals many years out.

CHRIS: Thank you. That's helpful. Denise, any final thoughts from you?

DENISE: Yeah, I'm going to echo these thoughts in terms of stocks can discount a whole lot of bad news in advance when you look through history. So we just saw this in the pandemic, in one of the deepest recessions in U.S. history, we discounted it in a month. Historically, that actually has never happened before, but it shows you the power of that discounting mechanism. And I'll leave you with sort of one mathematical scrub of history. Any time the stock market's been down over 15% over a prior six-month period, you've seen 100% historical odds, past is not always prescient, but historical odds of stocks being up over the next six months, and that was through recessions, as an example, in 1970.

CHRIS: Well, I knew we could count on you for some math there at the end. Thank you for that. And thank you to all of our panelists. It's really been helpful. I've got a lot out of this. I hope everybody on the call has. It really has been a great session and we're committed to doing these as often and as much as necessary to help all of you here. So most particularly, thank you to all of the folks who joined us today, sent in the questions again. If you're interested in following up on any of these topics or on some of the resources shared here, subscribe to *Insights from Fidelity Wealth Management* for exclusive invitations to future wealth management webinars and access to our weekly newsletter for timely news and content from top Fidelity thought leaders. I'm Chris Sheldon. Thanks for being here. We hope to see you again soon.

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