Fidelity Connects

Jurrien Timmer, Director, Global Macro
Pamela Ritchie, Host

[00:06]

Voiceover: Hello and welcome to Fidelity Connects - the Fidelity Investments Canada podcast - connecting you to the world of investing and helping you stay ahead.

We are joined again by Fidelity's Director of Global Macro, Jurrien Timmer, for his final global macro update for 2020.

Jurrien and host Pamela Ritchie discuss a variety of topics today, including what the rollout of the vaccine means for the markets, last weeks IPOs, gold, bitcoin, and Janet Yellen's appointment as Treasury Secretary.

Jurrien also looks at how the year started vs how it's going, and how some his thoughts from March ended up playing out. These thoughts line up with some charts presented in a Twitter thread, so please head to AT Timmer Fidelity on Twitter to follow along.

This podcast was recorded on December 14th, 2020.

[01:46]

Pamela Ritchie: The vaccines are arriving and the members of the U.S. Electoral College are voting today, bringing to the markets this week, a bit of a sense of finality; finality to the U.S. elections and to a healthcare crisis that had been without a solution. There is a sense that a new chapter is opening soon, which is apt for this time of year as we look to close out 2020 and look forward to a new year ahead. What are the big movements taking place today that will shape tomorrow and the new year?

To help us with this discussion today we are joined by Fidelity's Director of Global Macro, Jurrien Timmer. Jurrien, great to see you. Welcome.

Jurrien Timmer: Good morning, Pamela.

[02:27]

Pamela Ritchie: It is a busy week, no doubt, as we close out this year.

Jurrien, I'm going to begin. I had scheduled to obviously talk about the vaccines right off the top, but there appear to be a new layer of lockdowns coming in. In the question of growth, what do these new announcements of lockdowns in London, Germany, other parts of Europe mean for all of the world economy?

Jurrien Timmer: If this was happening a few months ago before we had all the promising news on vaccines, this would have obviously seriously undermined the market's performance, especially with all the stalemates going on in Washington about fiscal. Hopefully we will get more fiscal maybe as soon as this week, because there is some momentum going on there. As we've been talking about for a long time, we had that initial plunge in the economy as the whole world locked down. We went from100% of capacity to 20%. Then the economy opened up again, we went back to 70%, and then since then for the last few months that 70% has been stalling out.

Voiceover: As I mentioned off the top, head to @Fidelity on Twitter to follow along with these charts. This chart here, you'll need to scroll back a bit for, it's the "Bloomberg activity tracker" posed on December 1st, in the morning.

Jurrien Timmer: This is a Bloomberg series that shows these daily activity indicators, and other than China and Taiwan, which are back to pre-COVID levels, most of the western world is sort of languishing as we either wait for more fiscal relief, a vaccine, or just for COVID to go away so economies can reopen. At least, right now, we have obviously the vaccines actually getting rolled out as we speak today. My daughter is an ICU nurse in Boston and I suspect she will be one of the first people to get it. That's happening.

The fiscal seems to be happening and it's very much needed, because if you're going to shut down economies you're going to need to give people a chance to survive that. So there is light at the end of the tunnel and I think the market is seeing that. It's taking it in its stride. That's why the markets today are up even though, like you said, the U.K., here in California we're back into lockdown. I'm hearing New York might go into a lockdown. We're seeing it in Holland, Germany, etc., but in isolation I think that would be, obviously, a negative for the markets. Right now the market can look through that. If you want evidence of it, you have to look underneath the market by looking at who is leading it and today it's tech and health care, whereas cyclicals are lagging behind. That's been an ongoing revolving door if you will.

[05:18]

Pamela Ritchie: It's fascinating. You point to exactly that. We've spoken briefly about the fiscal relief and how that might work. As you say, maybe an announcement even today. We'll see on that.

I have to take you to last week, because we need your perspective on that IPO madness. What was that?

Jurrien Timmer: Yeah, it was madness. It's funny, I was asked about that. I was on Bloomberg Radio this morning and the same question came up.

Voiceover: Here we have Jurrien's "Sentiment" chart, posted December 3rd, in the afternoon.

Jurrien Timmer: That speaks to sentiment and froth. Of course we already know the whole Robin hood story here in the U.S.; retail day traders just going after anything that moves, anything that has momentum. Is that the sign of a top? Obviously we saw this in 2000 at the top of the tech bubble. Many people are making comparisons to that period.

Also, a lesser known period, where we say an IPO frenzy, back in the late '60s, 1968. I wasn't in the industry back then, but I've been told that that was also formidable. So my answer it could be a sideshow, it could be a bell-ringing event where you just want to get the hell out. I don't think it's that. It does show confidence and that speculation is alive and well; but when I look at sentiment, I look at a whole host of indicators from call-put ratios, the CNN fear and greed index, the various investor surveys... They all show the market that sentiment has become quite ebullient. People are coming back in.

Of course this is always unfortunate to point out, but the amount of money coming in now is about equal the reverse amount of money going out back in March, nine months ago, even though the market is now about 70% higher. It's unfortunate. I'm not saying these are the same people that sold low and are buying high, but it is an attribute of the market that sentiment works that way. Sentiment is an attribute of price, but it doesn't on its own really cause the market to flip negative. What it does tell you is that if the fundamentals were to change, and everyone is on the same side of the boat, if you will, and then they all go to the other side of the boat, the boat can capsize. That's where sentiment really comes in.

I wanted to put this chart in a little bit of perspective. The first slide suggests that everyone is all in, but that really needs to be taken in context, because we have to remember that since the financial crisis investors have been selling stocks and buying bonds throughout that whole period, even though the market went up fivefold from 2009 until 2020. We've talked about this wall of cash in the past and that how that wall of cash has been reversing. When you look at the equity flows in relation to the other two asset classes – cash and bonds – the inflows into the stock market are really nothing. If we look at the cumulative year-to-date flows, so into money markets,, into bonds, and into stocks, which is the black line. You can see that the black line is barely above zero on a year-to-date basis with almost 12 months under our belt. Most of the money that went out of money markets after it had gone in back in March has actually gone into bond funds, not into equity funds.

When I look at those things, yes, I see the froth in the IPOs, Airbnb, DoorDash, you look at Tesla, it's off the charts... but that is a pretty finite little universe of speculative stories – although Tesla is now in the S&P500 of course. When I take a step back and look at the overall flows, I do not see a bubble or a frenzy. People are not falling all over themselves buying equity funds. They're buying them, but in relation to the last year or the last ten years it's nothing. I'm not really concerned by this widespread sentiment story.

[09:42]

Pamela Ritchie: I feel like this is almost a moment to take a look at what you've been... you do not have a crystal ball I know that, however you've been pointing to certain themes and many of them have actually played out. It is sort of astonishing to watch week after week.

I know that you have a slide that shows a little bit of where we've been and where we are now. Can we go to that now?

Voiceover: This is kicking off a series of slides presented in a Twitter thread, tweeted by Jurrien the afternoon of December 14th on the 1987 vs 2020 comparison, as well as Market Breadth if you would like to reference those.

Jurrien Timmer: Anyone who has been on Twitter will have seen the how it started versus how it's going theme. It tends to be political or pandemic or life related. It's kind of a funny way of showing the then versus now. I figured let me do that based on my own calls this year. Obviously six to nine months ago the world was very, very uncertain and nobody that the answers, including myself; but this is where market history really plays a role, and we can at least try to see what we can learn. This is the most obvious one here; back in March, The Economists had a cover saying 'Closed'. Here we are last week this magazine – which is a British magazine – has the Roaring 20s with Janet Yellen on the cover. It just shows you how far we've come in those nine months in terms of one extreme to the other. COVID is still raging. It's obviously still... that sad story is still part of where we are. Obviously, this deals with the financial markets.

Let's go the next slide. Probably the best analog. Back in February, I started with the 9/11 analog. That ended up being a really bad call because the markets went down much further than happened in 9/11, but then the market got really oversold after it basically crashed. I started looking at the 1987 crash analog. This shows the VIX, or the VXO back then – which is the old version of the VIX – and you see this is how it started and the next slide is how it's going. You can see that that analog ended up being exactly the right one. The other analog I used was 2008, and also the 1940s, which I'll show you in a moment.

Let's go to the next slide.

Voiceover: This is Market Breadth slide, posted 6th in Jurrien's twitter thread.

Jurrien Timmer: Probably the most important thing that I did back in the heady March and April days was just continuously looking through all my technical data. It's been a really good year to be a technical analyst, because the tape was miles ahead of the fundamental data in telling us what was being priced and what wasn't. Probably my best call this year was to point out this chart in the third week of March, right after the market had reached its low point. It showed that the number of new highs minus the number of new lows reached -80%, which was the second most oversold reading since the Great Depression, with 2008 being the most oversold at -82. Even if you count the Great Depression, which is all the way on the left hand of the chart of course, it's still one of the most oversold conditions ever seen. It required a leap of faith to say this is not like the Great Depression because of the policy response, which I'll show you in a second. With that leap of faith, there's always assumptions that need to be made that you're never going to get a clear straight answer. There's always caveats; but with that caveat having been made, my conclusion was I don't know if this is the low or a low but this is oversold enough that probably the forward returns in 6 to 12 months will be positive. Lo and behold, that's what happened. If I have to point to one technical indicator that really saved me in terms of allowing me to make a bold call without saying things that were unknowable, which of course many people did, and they had to eat their words for it later, it was this particular indicator that I looked at.

Let's go to the next slide. The reason why I was willing to say "this is probably not going to be another Great Depression" was the policy response. In this chart…

Voiceover: This is Earnings and the Fed, #8 in the Twitter thread.

Jurrien Timmer: This is how it started. You see the Fed balance sheet at the top. You see the earnings growth, projection at the bottom in the blue, and the New York Fed's weekly indicator in the green. Then we'll go to how it's going, and you can see that the combined fiscal monetary policy relief that happened in late March really was a game-changer. That allowed us to look past other really, really bad episodes; obviously including the Great Depression, but even the financial crisis because even there the policy response it was similar but it came much slower than it did now.

We were talking earlier, when our conversation started Pamela, about how we went from 100 to 20 back to 70, but it's all about that remaining gap that needs to be filled. This green line really shows you that. The economy fell off a cliff, then it started to reopen, but we're not back yet to where we started. This is the story for 2021; is that closing of the gap – which presumably will now happen with vaccines getting rolled out and with more fiscal relief as well coming. That's a 2021 story.

But let me give you one more example.

[15:48]

Pamela Ritchie: And then we'll come back to that.

Jurrien Timmer: Yeah. The next slide, while a lot of people were focusing on the Great Depression – and I certainly did a lot of work on why this might or might not be a repeat of that –, to me the better analog going way back in history was not the 30s, but the 40s. We've talked about this many times.

Voiceover: Jurrien is keeping us on our toes with slides today. This is the 1942-1946 analog, posted the afternoon of December 16th.

Jurrien Timmer: In the 40s, the U.S. entered World War II, ran up its debt levels, the Fed monetized that debt by increasing its balance sheet tenfold and by pushing real rates to sharply negative levels. That's kind of what's happening right now. This chart shows how it started and the next chart shows how it's going. This is the 1941 to 1946 period. Again, a pretty good analog there, one that was I think a good one to latch onto because this 1940s period, very few people talk about this. They like to talk about the '30s, but this is to me a very relevant analog even though we obviously don't have a world war and all that bad stuff. If you look on this chart in the bottom panel, those are the breadth numbers, new 52-week highs and lows. We're getting to that point where breadths should be really expanding even more than it already has over the past few months. I do think that this will be the story for 2021; not that the market goes vertical because a lot of this closing of the gap is already priced in, but I think what the 2021 story will be underneath the surface a broadening out towards more value, more small caps, more non-U.S. including emerging markets stocks. This chart kind of hints at that.

Why don't I stop there so that I don't take up all this time looking at my hits or misses from nine months ago.

[17:48]

Pamela Ritchie: No but it's great. It actually speaks to how much work the stimulus needs to come in and d,o and therefore the amount, and again that's been bandied around. There's lots of questions around that. I'd like to get to that but there's so many questions rolling in. I'm going to put some of these to you right now.

One of them is; do you feel that we have a few more years before, types of stimulus, particularly QE, is slowed down? Where do you see that line? What do we need to get to? Do we need to get to those levels where there's another 30% to get back to? How do you see that playing out?

Jurrien Timmer: That actually speaks to the last chart I showed. I do think the 1940s are relevant in that sense that we're now in that fiscal monetary coordination, and Janet Yellen running the Treasury is very fitting in that sense because she knows the Fed, she knows how all the plumbing works. I do think that fiscal monetary coordination will happen, and I think it needs to happen. We want the Central Bank to be independent of course, but in the 40s, the two branches of government worked together. The Fed was able to absorb the debt that the U.S. had to run. That debt eventually got paid off when you measure it against GDP. Debt to GDP back then went from 40% to 120% and a few decades later it was back to 30%. I don't know if that's going to happen this time around, but both Yellen and Powell have already sort of indicated that the Treasury and the Fed could be rung through a kind of ESG type of lens, where they look at social justice as one of the inputs. So maybe running policy hot until the unemployment rate goes back to full potential is not going to be enough, because they want to look at the unemployment rate for, let's say, minorities or other disenfranchised parts of the population, which suggests that policy will run even looser, even longer. I'm not looking for any signs from the Fed any time soon that they are going to normalize policy. The fiscal side, I think, is where the action is going to be. Who will control the Senate of course, we don't know that until January with the two runoffs in Georgia, and that will determine how much Joe Biden can get through in terms of fiscal expansion. I know the Democrats' wish list is about seven trillion in infrastructure, climate, education... That will all get absorbed by the Fed, in my opinion. We won't have the story we had ten years ago where the Fed giveth and the fiscal authority taketh away, because we had the Tea Party movement back then during Obama's second term. You had lots of loose policy from the Fed, lots of QE, but that QE stayed trapped in the financial system because the banks were the ones that were sitting on the cash and were not lending it out because we were just in the aftermath of the financial crisis. The Treasury, the deficit was only down to about 3% at that point, so that's not austerity per se, but it's certainly not loose. If we get that combined loose fiscal, loose monetary which I think is much more probable now, then it will actually create the animal spirits and possibly inflation, and that would feed on its own into the whole value, non U.S. trade because that should continue to drive the dollar lower.

To me, that's a big theme for the next couple of years.

[21:35]

Pamela Ritchie: So you read all the Nile Ferguson books that talk about how empires end with debt and so on, but anyway it sort of fits into that.

Lots of questions rolling in. I'm going to put these two together. One is comments on Bitcoin. The other is on precious metals, a bit of lagging. How much is this associated with the virus?

Jurrien Timmer: Let me take gold first. Gold has been in a correction now, and especially relative to copper, because I look at the gold/copper ratio as a good proxy for bond yields, and it kind of makes sense. During the pandemic gold was going up because it's a flight to quality and it suggests lots and lots more fiscal and monetary stimulus, which would normally bring up the price of gold, and then copper was depressed because the economy was closed. Now we have the opposite. Even though inflation expectations are still rising through the TIPS markets, if less of a fiscal bridge is needed because the vaccine will do the work that fiscal otherwise would have to do, then you could argue the 1940s playbook will still work, but to a lesser degree, and therefore gold becomes less of a hedge against the fiscal [*indecipherable*], if that makes sense. I still like gold. I still have part of my assets in it. I'm not planning on changing any of that. For gold to work, you need to have some inflation because, if the Fed is going to keep rates at zero which I think is extremely likely for a long time to come, and inflation goes up, then real rates will do what they did in the '40s, which is to go negative. Real rates is a very good indicator for gold. I like gold over the long term, but right now I can understand why gold is taking a backseat.

At the same time, of course, Bitcoin is flying. I frankly don't know enough about it. I see the value proposition of Bitcoin. I totally get why it would work and it's a disruptor. It's early on in the discovery cycle, but that doesn't really tell me anything about what it's actually worth, because price discovery of an asset that doesn't generate a cash flow is really, really hard to do. This is why gold has always been volatile. You look at the volatility of Bitcoin and you look at the store value argument and I get it. Peter Lynch once told me "don't buy anything you don't understand", and I don't understand it. You have to be kind of religious about Bitcoin as being part of the future to buy it and hold on for dear life. They call them hodlers; that's like a crypto-Twit type of thing. I don't know beyond that. I don't know what it's worth. Is it worth 10,000, a million... There's a lot of Bitcoin fever on Twitter, I'll tell you that, but it comes from the people who own Bitcoin so therefore you have to always be a little suspicious of how much of the great stories you believe.

To give you one example. One of these metrics that you see all over the place, this notion of halving where they limit production and then the price of Bitcoin expands right on cue when they have the incremental supply, to which my answer is, "well, if we already know that's going to happen, why isn't that already not reflected in the press because markets discount the future?". It's a little too convenient for my taste, and that's why I'll just stay with gold because I understand it better. It has a lot of more history of proving itself as a store value.

[25:27]

Pamela Ritchie: We're bumping up against the end of the show but there's two really important questions to ask you. One is on default. If you can give some broad comments on it. It goes back to the question of if companies are being saved, what does that mean? Do we skip the default cycle or part of it?

Jurrien Timmer: I remember having this conversation on CNBC in March because Warren Buffett was saying that he wasn't buying anything. He didn't see anything of value, and that was blamed on the Fed because the Fed was buying junk bonds, the Fed was being the buyer of last resort and didn't allow companies to go bankrupt, which is what they typically do in a recession. Then the companies go bankrupt, and the companies that are strong enough not to go bankrupt, which are cyclicals by definition, those companies then survive and get rewarded and bid up. Someone like Warren Buffett can really buy low because the system works in that sense. The Fed kind of bypassed all of that. It short-circuited that and so we didn't get that. So we get more zombie companies that are being bought, you see corporate bonds in Europe actually trading at negative yields now, eighteen trillion dollars of global debt at negative yields… Yes, we didn't have that shake out, but I would see that as a good thing because that means that the policy response was successful in saving the economy during a pandemic. I'll take that as a win.

[26:53]

Pamela Ritchie: Right. Jurrien, I want to thank you for pointing us in the direction of light. It's actually been a dark period, but these discussions with you I think have provided everyone with an incredible piece of hope and incredible context. I just want to thank you for arming us with everything that investors need each Monday. We really look forward to seeing you in the New Year. Very happy holidays to you.

I have a question for you though. We're not finished. Tell us, when you join us in January, which I'm grateful that you will, just point us in the direction of active versus passive. Right now it's hard to know what is there on the value side of things. We're all talking about it, but just bring that to light for us right now.

Jurrien Timmer: I think 2021… This was a good year for active even though the leadership had been concentrated in a bunch of large cap growth stocks for a while. I think 2021 will be a year less about the top line of the market going up a lot. I don't think it will go up a lot. I think it will go up a little bit, but I think under the surface is where the action is going to be. It's going to be a broad tape and, of course, a broad tape by definition is ripe for active management. It's like do you have a barrel with a few fish in it or a lot of fish? I think next year we'll have a lot of fish in the barrel.

[28:14]

Pamela Ritchie: Okay, great. Very happy holidays to you and your family.

Jurrien Timmer: Same to you, Pamela.

[28:23]

Voiceover: Thank you for listening to the Fidelity Connects podcast. For more information on future live webcasts, please visit fidelity.ca. Don't forget to follow Fidelity Canada on Twitter and subscribe to Fidelity Connects on your podcast platform of choice.

[end of webcast]