Voiceover:

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

Investors are turning their attention to what to expect in 2021. Director of Global Macro, Jurrien Timmer, is back to kick-off his regular market update. Today, Jurrien and host Pamela Ritchie discuss the vaccine rollout while the world is going back into lockdown, as well as emerging markets, Georgia's run-off elections, bitcoin and Day vs. Long-term investing.

Jurrien will breakdown where we're going in this new year of trading, and what you should be keeping an eye on. As always, you can follow Jurrien on LinkedIn or Twitter @TimmerFidelity for more analysis, including charts referenced in today's show.

Today's podcast was recorded on January 4, 2021.

[01:04]

[01:46]

Pamela Ritchie: Happy New Year, Jurrien. Great to see you.

Jurrien Timmer: Happy New Year, Pamela.

Pamela Ritchie: Happy to have you join us back here to kick things off. I'm going to begin with a discussion, a thesis that you have, called minding the gap. I want you to tell us where we're standing right now.

Jurrien Timmer: This is a conversation, of course, we've been having for months especially when we were talking about the outlook for 2021. What I mean by that is that obviously we all know almost a year ago the economy was at full potential, full capacity. Things were just humming along very nicely and then COVID happened. We had the global lockdown, the economy went from, let's say, 100% to 20% and then gradually it started to fill that gap back to about 70% or so a few months ago. Since then it's been stalling out, but the markets being the markets and being always discounting the future basically assumed first through these policy bridges of fiscal and monetary policy, but then later on with the promise of vaccines which, of course, now are being rolled out that that remaining 30% gap would get closed in 2021. Maybe not the first half but at least the second half. You see that in the earnings estimates, you see that in the market essentially front running the recovery by bidding up valuations which then normally would come down later as earnings kind of follow through.

So that was the theme for 2021. It's that gap, that 30% gap, needs to be filled for the market to be right in terms of discounting that that would happen. If that gap is filled quicker, then that's great. Initially the vaccine news kind of created that hope. But if it gets filled slower for whatever reason, then maybe the market is over its skis. Now we're here, January 4th, and this is still very much a live conversation because we have kind of this paradox or this juxtaposition of vaccines are being rolled out as we speak, but at the same time most of the world has gone back into some form of partial lockdown. We're seeing it here in California, back in Boston, in Europe, we're seeing it everywhere. That gap actually is starting to grow again where we've gone from 100 to 20 to 70, maybe we're now getting back to 60 or 50. So it creates a little bit more of a dicey scenario where you have to really hold on to the hope that it's all going to be okay in six months or nine months. But the patience of the market is going to get tested here I think.

[04:40]

Pamela Ritchie: So on that test, take us through essentially how investors were tested last week. These in-between times there's thin trading, but there's been lots of discussions about day traders being in the market, big tests create interesting outcomes. What did you see?

Jurrien Timmer: Last year was very unique in many ways, of course. How often do we have a global pandemic?

[05:08]

Voiceover:

So this slide here is Jurrien's Return vs Volatility of the S&P 500 tweeted the afternoon of January 4th and again his profile is @TimmerFidelity.

Jurrien Timmer: If you didn't pay any attention during the year and you look on December 31st, you see the S&P was up 18%. Okay, that's great, that's a pretty robust year. Typically market's up around 10, 11%. But this chart I show the return on the vertical access and the 12-month rolling volatility on the horizontal access. You can see that pink dot is where 2020 ended up. You can see that the 18% return came with much higher volatility than you would normally expect along that scatter plot. We know why because that 18% took a pretty wild turn… first down 35% and then up about 70% from there.

So it was a good year, but it came at a high price in terms of the volatility that came along with that 18% return. Really, it shows that for most investors, not the day traders, but for most regular type of investors the real battle in 2020 was holding on so that you could actually realize that 18% return. Some people did, but many other people did not. They sold at some point on the way down and either they have not gotten back in or they got back in well beyond the bottom. That was really the key variable, just being able to have those nerves of steel and trusting the math, the market math and the market's history and being able to ride that storm and still realize a pretty good return.

[06:57]

Pamela Ritchie: People sort of earned a few grey hairs, as they say, going through that and holding on. Let's go to the question of the extreme bullishness which is, it seems, consensus. The question is, can you blow holes through this argument? Are the risks that the market consensus is just not seen?

Jurrien Timmer: This is a tricky question because I think there are two types of participants in the markets. One is, you mentioned, the day trader, kind of the shorter term and certainly one of the things that the COVID pandemic brought that really was not around for a long time before was basically the speculator. The initial story was this was a bored millennial sitting at home because of the lockdown, getting a $1,200 stimulus cheque, at least here in the U.S., and there were no sports to play or to gamble on so why not go follow some blog on Twitter and buy whatever stock is trading for a dollar or two. That's become a thing. Generally these are considered to be small players but if you add enough of them together they become big.

So that's one cohort. If you look at the call-put ratio and you look at some of the more high frequency sentiment data, you can see — just look at some of the stocks and where they're trading — you can clearly see that this is a force and that the market's, by almost any definition when you look at it through that lens, the market's at a euphoric extreme not unlike we saw in the year 2000.

But then you look at the other cohort which are the long term kind of typically the buy and hold investors, people who are saving for retirement which in the U.S. is something you have to actively do because the government is not going to give you much of a pension, and those people, I don't see any sign of speculation or any sign of euphoria there. You look at fund flows, it is still predominantly going to bonds. We've talked about the flows into the money markets, that mountain of cash, that mountain is now receding and some of the money is going into stocks now finally but still the lion's share has gone into bonds and that's been the case since the financial crisis in 2008 that most of the new money has gone into bonds and not into stocks. That traditional cohort, which I think is where the big pool of money is … these are like your baby boomers saving for retirement, not the millennial day traders. That's where the money is and there I don't see any sign that we're in this lopsided equity culture where everyone is euphorically bullish for no good reason. But that other side, I think that's what's driving the bus here. I think that cohort is now big enough that it can actually influence stock. Just look at Tesla and Bitcoin. I mean, off the chart moves.

[10:01]

Pamela Ritchie: We're going to come back to Bitcoin. I'm going to put together a couple of questions here. One is about the Georgia election tomorrow and the question is a bit about how much does it matter essentially to the markets, and the other is a question about fiscal policy and what is needed to get the United States, and you could probably extrapolate around the world, through the vaccine rollout, ups and downs of that? So if you can kind of put the election and the fiscal policy together.

Jurrien Timmer: Those two questions are related. We did get another bout of fiscal relief. There was some drama around that, but we got the $600 cheque and then the president wouldn't sign it and then he did sign it and then he challenged Congress to make it a $2,000 cheque and the Democrats very smartly immediately said, sure we'll do that and now it's up to the Republicans so there's that whole drama going on. But the bottom line is that the fiscal relief needed to be extended because a lot of those benefits were running out right after Christmas. So that was done, so that's good. We've talked about this that if the economy isn't opening quickly enough because COVID won't go away or it takes time for the vaccines, you need to have that bridge to the other side of the pandemic and that involves monetary policy which we know the Fed and other central banks including the Bank of Canada have been doing and will continue to do. But they can't do it alone so it does require fiscal and the longer it takes to close that gap, coming back to the gap, the more fiscal we will need. With all the consequences thereof.

So that ties into the runoff election in Georgia. Tomorrow is the election. Of course, the 6th we have the counting of the Electoral College votes and there's all kinds of drama around that in terms of senators and House members objecting to the count, and even whether the vice-president, Mike Pence, will actually count the votes so most of what I'm reading about — and I'm not a political expert — but most of what I'm reading suggests that that's all theatre and drama and that Joe Biden will be the next president on January 20th. But the Georgia runoffs are important because that will determine which party controls the Senate. We know the Democrats control the House. If the Democrats can take control over the Senate which they would do if they win the Georgia runoffs, both of them, then it would be a 50/50 tie and then Kamala Harris would cast the deciding vote. If that happens there will be more potential for more fiscal policy. Not necessarily COVID relief, although including that as well, but more like part of the big Democratic playbook, you know, infrastructure, environment, etc. So that has a bigger chance of passing if that happens. If the Republicans hold on then there's very little chance — not to mean that there can't be a bipartisan common ground, I'm sure there will be especially on infrastructure because every senator and congressman wants their state to get nicer roads. So there'll be some room, but fiscal policy will be less expansionary if the Republicans hold on to the those two Georgia seats. That will determine how much the deficit goes up and what happens to the dollar so it does have its repercussions.

[13:34]

Pamela Ritchie: Let's bring the dollar and Bitcoin in there. It looks like the continuing trend of the dollar which you had been pointing out to us for some time in a discussion about EM. Please help us understand Bitcoin. What is there to say?

Jurrien Timmer: It's interesting, I had resisted going down the rabbit hole on Bitcoin because the learning curve is very steep. But we all read about it, we see it, we see it's trading at 32,000 and it's easy to dismiss as a speculative bubble. People call it digital gold, but they could also be digital tulip bulbs so for a long time Bitcoin was a side show. It went to 20,000 in 2017, then to 3,000 so it's actually had a 90% correction three times in its short history. It's a very volatile asset. It's owned by a very small group of players. But as we hear more stories of large institutions, also called whales, getting involved and of course, Fidelity here in the U.S. is very involved on the blockchain and the custody side. At some point over the holidays I'm like, okay, you know what, I'm going to start peeling this onion and see what happens. It's too much to discuss today. Maybe we can have a separate session on this, but I did a lot of work over the holidays.

The bottom line to me is that it is a speculative asset. It does rely for many people, not for everyone, but for many people on the belief that the U.S. and other countries will just debase their paper currency because there's no gold standard anymore and as we run these deficits and everyone gets fiscal relief and we get into some form of MMT or MMT-Lite, currencies will pay the price and then you need gold and you need digital gold which Bitcoin is the gold standard for lack of a better word, because it was the first player and it has the biggest adoption. I will say though that Bitcoin is unique in that it has a supply characteristic where the supply is designed to be reduced in terms of growth. It has a built-in scarcity, much like gold does, and actually Bitcoin is more scarce than gold because this supply curve is already predetermined. It also has a demand side where you look at Metcalfe's Law which is the network effect that as Bitcoin becomes the foundation for blockchain, and more and more users are using it, you reach this parabolic curve. Think of it as the number of mobile phone users 10 years or 20 years ago, that is this parabolic curve. So it has a unique supply dimension, a unique demand dimension and then if it really is digital gold, which it's hard to know in real time, then given what's happening with money printing by central banks, the money supply going through the roof, you can see why people are excited about Bitcoin.

The ultimate question is are we going to have a big inflation because of all this money printing? That is a question I'm still actually sceptical of because Japan has done all of what we're doing here in the U.S. and more, and they did it years ago and there is no inflation in Japan. The Japanese yen, the currency, is very stable and interest rates are zero, and so if that combination didn't create a collapse in currency over there, why are we so sure that it's going to happen over here? So I can poke holes in the argument but I see why people are excited.

[17:24]

Pamela Ritchie: Okay. I want to ask you though, Japan was X decades ago and now we can do it. How much of it is just because now we can have digital currencies? We couldn't back then but we can now. I don't know.

Jurrien Timmer: I think the bull case for Bitcoin rests on the idea that all countries will have a digital currency. The bear case would say that as countries create digital currencies they're going to outlaw Bitcoin because a country wants to have control over its currency. But the bull case would be Bitcoin would become the gold of a new gold standard, or even a very loose gold standard, and that if countries have a digital currency it still needs to be anchored to something and maybe Bitcoin would be that anchor because it has that early mover advantage. But a lot of this is theoretical. If we knew all the answers Bitcoin would not be doing what it does. That by definition is part of the price discovery. So you have to be a believer to be able to hold your nose and say, I'm going to buy something that I have no idea if it's worth anything at $32,000 per coin.

[18:35]

Pamela Ritchie: There's a lot of places to go with this discussion. As you say, we'll leave it there. Just sticking with an overall currency discussion, really just for the purposes of the EM trade. I wonder how much you look at the dollar discussion and what that does for either multinationals. Does that mean multinationals which are exposed to other parts of the world win, lose, is it material, or is the EM discussion with the dollar more a discussion for access to asserts, equities in Thailand or in another country around the world? What does it mean for multinationals, what does it mean for directly investing in EM which Fidelity obviously allows? Funds do that.

Jurrien Timmer: I think it's a combination of the two. 2020 was an experiment in, I don't know if we can call it MMT or MMT-Lite, but it was an experiment in the fiscal monetary cocktail which we've called it in the past. So large deficit spending, CARES Act in the U.S. and similar programs elsewhere, three, four trillion dollars of deficits essentially absorbed by the Fed and other central banks by raising their balance sheet by a basically equal amount. So the weak dollar part, I think that is something that we're going to be having for a while because the Fed is kind of in a unique position to win the race to the bottom, for lack of a better term, just because the fiscal monetary cocktail has proven to be especially effective in the U.S. as the reserve currency. So the dollar is part of it and just the process of currency translation, you buy overseas assets, is part of it. As you said, multinationals will get positive currency translation as they get in revenue from abroad. It is both a direct channel and an indirect channel.

I'm especially bullish on emerging markets and even though the EM price is still kind of in the sideways pattern that it's been in for over 10 years the total return is starting to break out and part of that math, I think, it has to do with the Fed really intent on keeping financial conditions very loose. So the dollar is part of that. Part of the financial conditions is the dollar, another part is the stock market, short rates, long rates, credit spreads, so as the Fed engineers ultra-loose monetary conditions, and if that gets helped along with more fiscal, that's a very powerful lubricant for non-U.S. stocks to do well and especially emerging markets because that tends to have the highest beta to the global economic growth picture.

As you said, I think it's a combination of both. You could play the multinational side over here and that'll be an indirect play on the dollar, but a much more direct play would be just EM or non-U.S. equities in general. You're going to get a lot more bang for your buck doing it that way.

[21:38]

Pamela Ritchie: Jurrien Timmer, thank you very, very much for taking us through where we're going. We're always grateful for the perspective and the charts and we'll see you again next week. All the best.

Jurrien Timmer: Great. Nice to see you.

[21:50]

Pamela Ritchie: Jurrien Timmer joining us today to start off the week, frame out the week, not just the week, the year really, for what you need to be keeping an eye on.

Thanks for joining us today. I'm Pamela Ritchie. We'll see you soon.

Ending: [22 :04]

Voiceover:

Thanks for listening to the FidelityConnects podcast. If you haven't done so already please subscribe to FidelityConnects on your podcast platform of choice - and if you like what you're hearing leave a review or a 5-star rating.

You can visit fidelity.ca for information on future live webcasts - and don't forget to follow Fidelity Canada on Twitter. Thanks again, see you next time.

[end of podcast]