Goldman Sachs The Markets

The key US equity theme for 2025

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Chris Hussey: The Trump trade has been on for months. Now that he's actually in office, which sectors have more room to run? This is The Markets.

I'm Chris Hussey. My guest this week is Shawn Tuteja, who oversees the ETF volatility options trading business in Goldman Sachs's Global Banking & Markets business. Shawn, great to have you here.

Shawn Tuteja: Thank you for having me back.

Chris Hussey: All right, Shawn, so we got the inauguration on Monday. How would you characterize the action we've seen in the markets so far this week?

Shawn Tuteja: Well, I would say since Trump got elected, and frankly, even before he got elected, there's been one word on the mind of every investor when it comes to Trump and his policies. And that magic word is tariffs. And the whole market has been waiting to see what's going to happen with tariffs. Are there going to be tariffs on day one via executive order like he had said? Are there going to be universal tariffs? Is it going to be tariffs on China? If so, what's the percentage amount? Are they going to be on Mexico or Canada?

And we got the inauguration. And so far, there haven't been tariffs enacted yet. Now, later, post the inauguration in the Oval Office, Trump made comments about potentially by February one having 25 percent tariffs on Mexico and on Canada. But again, this is talk so far. It hasn't actually been enacted.

And when you look at the market and the reactions across the assets, they've been very mixed. If you look at the foreign exchange markets, since Trump got elected, what's really happened is that the dollar has strengthened, especially versus the other currencies of the countries that could be the subject of tariffs.

When you look at the bond market, bond yields have moved higher and higher, in some part due to the strong labor market that we've seen. And in some part, due to the fear of tariffs, which people think are inflationary.

But then equities tell a very different story. We have a basket of names that we look at that are tariff exposed names. They're the names that mention in their earnings report or in their business model where they say tariffs would hurt our business. And those names have actually outperformed the rest of the market over the past couple of months. And so then, you get to day one of the inauguration and our best performing sector was our tariff exposed basket. That basket was up multiple percent that day because it was like, oh, sigh of relief, there's no tariffs.

And the broader market also seemed to kind of breathe a sigh of relief. So, in that lens you would look at the equity market and say it's very complacent. There is no fear of tariffs. They think it's just posturing. Similar to a lot of the tariff rhetoric that happened during Trump's first administration.

So, I think from our vantage point, something's kind of got to give in the market.

Chris Hussey: All right. I want to get into the Fed because the Fed meets next week. What are we expecting there? You've talked about the rates markets a little bit already. But what are we seeing?

Shawn Tuteja: I think when we look at the past two years of equity returns, first of all, especially in light of the Fed policy, they've been remarkable. The S&P is up north of 20 percent each year for the past two years. That hasn't happened since before the dotcom bubble burst. And effectively, when you boil it down, what we've seen in the past two years is, one, the equity market believes that a Fed put exists. Meaning if stocks were to go down by enough, the Fed will step in and intervene in the market.

And two, what we've seen the past year and a half is that the Fed is cutting rates into good growth. I think really the narrative shift that's happening in the markets right now is the second point about the Fed aggressively cutting rates into okay growth is probably coming to an end. That's kind of what they signaled in December in the FOMC where now when they're going to cut rates going further, it feels like it either, one, needs to happen because inflation has just fallen off a cliff. Or two, because the labor market is starting to weaken.

And we're sitting at a 4.1/4.2 percent unemployment rate. If that goes to 4.4 or 4.5 percent, the Fed's not necessarily cutting. And I think that's the problem that equities are having to cope with right now.

So, in my mind, what I'm looking for in the Fed is this whole trade-off in growth versus inflation. The market continues to kind of shift which one it puts into focus. If you look in 2022, 2023, the most important days for the equity market were the CPI days. The days where we find out what is inflation over the last month. And then over the last year or so, those have started to matter a lot less. And last summer, the days that really mattered were the employment numbers, the non-farm payrolls, the jobless claims numbers because people were content to say inflation is coming down, now we need to focus on the labor market.

But now all of a sudden, the shift is coming back towards inflation. You saw the market reaction a week ago with that inflation number where everyone was getting very bearish.

And then the inflation number came in low. Boom. Complete U-turn in the market.

And so, I think next week we're not really going to hear too much new from the Fed. They seem to be on hold right now until they get a couple more months of what they would consider promising inflation data. Right now, the market has around two interest rate cuts priced in for this year. I think really what's going to be the tell factor for that is either does inflation come closer to the Fed's 2 percent target? Or do we see a deterioration in the labor market happening quicker than people would think? Are we seeing non-farm payroll numbers coming in at less than 100K? Something we haven't really seen yet so far.

Chris Hussey: All right. So, the markets are going to continue to dance this growth/inflation tango. In the meantime, though, corporations are going to have to report their earnings. They're going to have to be making money. Let's go into earning season because we're in the middle of it now. Any themes catching your eye out of earnings? What do you got?

Shawn Tuteja: I think the theme of 2025 is going to be quality in the equity markets. And what I mean by quality is the market is going to reward names with strong balance sheet versus those with weak balance sheets. It's going to reward names that have cash flow versus the non-profitable names.

And when we look at the market as a whole, a few things have changed over the past month or so. They've essentially come out and told you that they're not going to be cutting rates unless there is deterioration in the labor market. And when that's the case, you want to be in the names that are kind of the more safe names, the more quality names that we think are going to outperform.

And I think that either way that this unfolds, it backs me into thinking that quality is going to be the theme. Because it can unfold in two ways. Either, one, the economy is going to stay strong. The labor market is going to stay strong. And then that means bond yields are going to stay high. And that disproportionately hurts the non-profitable names and favors the quality names with a lot of cash.

Or the labor market is going to break and something's going to go wrong in the market, in which case it still backs you into the quality theme and favoring the more secure, strong balance sheet names in the market. We still think there's a lot of froth in the market. When you look at the Russell 3000, there are about 12 percent of the names in there that trade at ten times sales or more in terms of valuation. But those 12 percent of companies represent over 20 percent of the market cap of the Russell 3000. That type of divergence hasn't happened since the dotcom bubble.

So, we think that as the market continues to eliminate some of the froth that exists, it's going to favor the stronger, more quality names in 2025.

Chris Hussey: So, is quality the hedge for this market as well? Or are you thinking about other ways you can hedge risk in the market today?

Shawn Tuteja: Yeah, so I think the options market provides a great way to hedge for investors. So, normally when you look at the market, on a given day it's expensive to hold options because normally you're paying some insurance premium to be long them. But what's interesting is that this market is so concentrated on a few days where it moves, those few days are the macro events. The day when the inflation number comes out. The day when the non-farm payrolls comes out. The FOMC day. Earnings days for single names.

And what we've noticed over the past year or two is that those days are underpriced by the market in terms of how volatile they're going to be. So, when you're making a decision about whether to hedge, you really have to ask yourself, one, are we in a trending market? Because if you're in a really high, sharp market, it's very expensive to hedge and it costs you returns.

I think our view is that we're in a market where the paradigm is shifting a little bit. Where the Fed is not really your friend. And so, it induces a little more volatility. And two, you have a new administration come in. Now, I say that and it's very easy for us to sit here and say, well, Trump brings volatility. He's a wild card. One tweet could move the market. Everyone said that seven years ago when he took office. And then actually in 2017, we had our lowest vol year basically ever in the market. So, I would put that caveat out there.

But I think our general view is that hedging makes a lot of sense in this environment. But it's more important, rather than hedging the broader market, you need to hedge the sectors that you're actually exposed to because normally in the first year of a new administration, it's really the sector dispersion that happens. You know? You can already see it where the Trump trades - energy, financials, you can also see, like, healthcare has really struggled on this whole very of DOGE or Department of Government Efficiency kind of coming in and curtailing, maybe, some of the defense spending, some of, like, the big pharma names, etcetera.

So, I think that it's important for investors to use the options market on earnings days and on big macro catalysts to hedge the actual sectors that they're invested in.

Chris Hussey: Shawn, thanks so much for joining us.

Shawn Tuteja: Thank you for having me.

Chris Hussey: That does it for this week's episode of The Markets. I'm Chris Hussey, thanks for listening. And if you want to hear more from Goldman Sachs, listen to

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