Goldman Sachs The Markets

Bonds or Stocks: The 2025 Income Play

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Date of recording: March 20, 2025

Chris Hussey: Signs of a slowdown abound. And stocks swoon. Is it time to lean into bonds? This is The Markets. I'm Chris Hussey and today is Thursday, March 20th. And I'm joined by Ashish Shah, global co-head and chief investment officer of public investing within Goldman Sachs Asset Management. Ashish, thanks for joining us.

Ashish Shah: Thanks so much for having me.

Chris Hussey: All right. Let's get into the Fed because we had the Fed statement yesterday afternoon. Yields on ten-year treasuries are down while stocks, at least on Wednesday, were up. What do you make of it? Did Powell just reintroduce the Fed put?

Ashish Shah: This was the dovish hold. You had the Fed come out and essentially revise up its inflation forecast. Revise down its growth forecast. In aggregate, basically nominal GDP is going to stay the same.

But then, in the presser, it was the emphasis of how the Fed is thinking about things. This inflation that's going to rise is a function of tariffs being imposed. That's going to be transitional. And the Fed, you know, has a lot of uncertainty it has to deal with. It wants to maintain its credibility when it comes to fighting inflation. But also recognizes that growth is decelerating here.

When your starting point of having policy rates that are essentially serving as a break to the economy and trying to slow the economy down modestly, you can simply remind people that, hey, it's really easy for us to take the foot off the brake. And so, what you heard from Powell was, you know, Fed stands ready to do what's necessary if the data starts to show that we're slowing a lot faster than we expected.

Chris Hussey: Yeah, I think he did use that term, transitory. Last time he used the term transitory, the markets didn't buy it so much. This time maybe a little bit more. Peel back the onion of that lower growth forecast they have as well because the economy is a thing that has people concerned about right now. Are we seeing economic slowdown? Or is this just something that people think we might see?

Ashish Shah: When we hit December and the employment number, it looked like we were getting a reacceleration of employment. And the seasonals really generally point to a January/February that we would have expected to see that seasonal turnaround continue, or that strength continue. That's not what we've seen in the high frequency data.

And I think further concerning is that we've seen the consumer start to behave in a way that's very familiar to us, which is when prices go up on something, they slow down their spending in another place because their incomes aren't growing nearly at the same pace. And they aren't nearly as confident as they had been.

And so, I think from a growth perspective, the consumer is definitely weighing on the near-term concerns. And further out though, you have a lot of change going on between tariffs, between changes in policy. Some of those changes might be positive. Some of them are leading to a lot of uncertainty. And so, I don't think any of us knows how that's going to translate directly into the economy.

But we know when you're in an environment where there is uncertainty, that people say, hey, I'm not going to make the big bet. And so, I think there is that possibility that you start to decelerate. But again, the Fed just reminded you that they're there to cushion and they can restart parts of the economy that they've been holding back because the economy's been growing too fast.

Chris Hussey: Let's talk a little bit about bonds because as you pointed out, the Fed has room to cut. Rates have room to go down. Is 2025 shaping up to be the year of income?

Ashish Shah: We've definitely thought that 2025 was going to be the year of income. Bonds are one fantastic source of income. But I think because of the duration moves we had and because of the inflation concerns that we've just gone through, people are afraid of bonds again. But I think the reason we're calling it the year of income, not the year of bonds, is because there are a lot of different sources of income.

And when you think about the market pricing for certain parts of the equity market, we knew that the upside was going to be more limited. That so much was priced in terms of good news that you were going to have more kind of upside limit. And that by generating income by looking for dividend paying stocks, by looking at doing buy right strategies, and by looking at credit markets and fixed income markets, that these were all going to be good sources of income.

The fantastic thing about income is if you generate income, it gives you money to reinvest in whatever the cheapest asset is. And frankly, that's one of the reasons why you're seeing this stabilization in the market here is you're seeing kind of people reallocate out of their bonds into the stocks because the bonds have gone up a lot in the course of the last quarter. And stocks have sold off. And so, that rebalancing feature lends a lot of returns over time. You don't need negative correlation. You just need income. Bonds have income today.

I'd say the other thing that's really absolutely critical here to understand is that you don’t simply have to have duration risk, right? When you think about relative growth, you have a lot of different growth stories. You have Japan where they’re still hiking because inflation is high, and rates are low. You have now the US, we’re reopening the potential for rate cuts. And you have a reacceleration going on in Europe. And so, relative value trades, both in curve as well as across different markets, represent opportunities. Those have been some of the highest sharp ratio trades available. And that’s why we like saying let’s be dynamic in bonds. Don’t just anchor to one thing. But look at the full opportunity set.

Chris Hussey: So, yeah, there are a lot of opportunity there from Japan to writing a covered call, even just buying bonds. What’s the trade though? What’s your favorite here?

Ashish Shah: Yeah, so given what’s happened, given where we’re at right now, there are one or two things I would be considering doing here. First of all, part of the reason you’re seeing these big daily moves in equity markets is because what we’ve seen is retail likes to sell options to generate income. And when you move and shift levels as quickly as we have, the street runs out of gamma.

And so, they stop being a stabilizing force within the equity market.

And so, we think that you've restarted this gamma selling. You've restarted this kind of call selling against positions. And so, we like that trade. We think it's going to represent good opportunity within a range to restabilize the market as a good way of generating income.

And then the second thing is, you know, you've had a big drawdown, obviously, that's been driven by Mag 7. We can have an honest discussion around whether that reverses or if it continues. I'll tell you where the Mag 7 isn't, it's not in small-caps. You had a long period of underperformance in small-caps. You had some optimism develop around things like deal, volume, etcetera, as we were going into the year. That optimism's been taken out. And now, we're seeing clients look a lot more closely at small-caps, both the value and the growth side, and saying, hey, you know, sentiment turned the other way as positioning turned another way. And just a small reallocation back into small-caps, which had been left for dead in some ways, could move a lot of market cap. And by the way, small-caps are much more exposed to lower rates in a positive way, right, because a lot of them have this debt. And a lot of them benefit from lower financing costs. So, small-caps are a really interesting trade here depending on how you've positioned your broader equity portfolio.

Chris Hussey: That is an interesting trade. We haven't heard that in a while too. So, small-caps as an option here. Thanks so much, Ashish, for joining us.

Ashish Shah: Thanks 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 Exchanges, our weekly podcast about the long-term trends impacting the economy and investors' portfolios.

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