**Goldman Sachs The Markets**

# Tariffs could spark "a new rotation" in US equities

**Shawn Tuteja, Head, Custom Baskets and ETF Volatility Trading, Goldman Sachs Global Banking & Markets**

**Chris Hussey, Host, Goldman Sachs Research**

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**Chris Hussey:** Trump has made his long-awaited tariff announcement. What will it mean for investors?

This is the Markets. I'm Chris Hussey, and today is Thursday, April 3rd, and my guest is Sean Tuteja, who oversees the ETF Volatility Options Trading Business in Goldman Sachs's Global Banking and Markets Division.

Sean, great to have you back on the show.

**Shawn Tuteja:** Thank you for having me on this busy morning.

**Chris Hussey:** Yeah, it is a busy morning, and I thank you for taking time out of your day. So yesterday Trump announced the anticipated reciprocal tariffs and markets are indicating that they may trade sharply lower on the back of it.

And we're taping this at 9:00 AM. Help us make sense of how tariffs came in relative to expectations and what does it mean for markets going forward.

**Shawn Tuteja:** Yeah, absolutely. So if you go back to the first term that Trump served as president. There was always the threat of tariffs, but the market has gotten so used to hearing a lot of talk about tariffs and then very little action when it comes to tariffs. And you kind of saw that in the way that equities have kind of been asleep ever since the election. Ever since the dollars started rallying on fears of tariffs, equities continued to march higher and. Everyone continued to think that whatever the tariffs would be, would be less than what was said.

So let's go back to what the investors were thinking two weeks ago. If you surveyed our trading community, they would say that they expected the average effective tariff rate to be something at the nine to 10% level. Then last week you had the pre-announcement of the auto tariffs, which not only were pre-announced, but also were at the extreme end of what people thought, and then people started to get scared and sentiment started to sour in the market.

The market traded lower, and when you talk to the trading investor community, they said they expected the number to come somewhere in like the 15, 16, 17% range after this week's announcement. Now, the key point in all of these announcements was always going to be when do the tariffs take effect? People thought that if there was a delay in the tariffs, i.e., they were announced on April 2nd, but then they wouldn't go into effect until some future date, call it May 2nd, May 3rd.

Then that would be taken as positive for the market because then there's a long window of time for a deal to be formed. The art of the deal, so to speak. But what ended up happening, of course, was yesterday the average effective tariff rate came in. Somewhere around the low 20%, and they're going to go into effect as of April 9th.

The majority of them, some of them will go into effect, as of April 5th, and then the remainder April 9th. So it leaves a very small window of time for a deal to be made. And clearly that is worse than market expectations. Markets were very complacent going into it. If you look at the volatility market, it implied a 1.5% move for the broader market.

As we're talking this morning, the market's already down almost 4%, so. Clearly people were thinking that this announcement was gonna be somewhere in the consensus range that they had built. It's surprise to the upside, and in effect, the market is just going straight down.

**Chris Hussey:** Okay, so reasonable market reaction then, because we're getting something worse than what we thought. But is this a clearing event? I mean, in many ways uncertainty has been the operative word on this podcast ever since the Trump administration came in in January.

But does this remove the uncertainty and allow investors long or short to get more engaged?

**Shawn Tuteja:** Well, here's what I'll say. when I was little, sometimes I would be nervous going into a test, and when I walked outta the test, I said, well, the test is over, but it doesn't always mean it's a good thing, right?

I could get the test back and then I still fail, and then great uncertainty's outta the way. But now I am certain that I failed the test, and I think that the market is kind of grappling a little bit with how bad is this? We look at estimates that say that if these tariffs were to stay in place. It's about a one and a half to 2% hit to annualized GDP.

That then would translate into a five to 7% hit to forward earnings. Now this is very like, if these tariffs were to stay in place, but then also it doesn't assume any retaliatory tariffs that might come so. There's a lot of negatives that we could paint for the market. The market is at an expensive level.

We've had a really great run the last four or five years, but maybe this is a time now where growth starts to slow. The Fed really isn't your friend. They can't really cut interest rates now, especially because of tariffs, which might have an inflationary impulse. Now, the things that I would say that could make this a clearing event, 'cause I don't want to just give the bearish side for the market, is there are some positives.

One, the trading community was very de-risked going into this event. The way that we can best see that is through our Prime data, which shows that last month, the month of March was the largest drop in net exposure on our Prime book in any month since we started keeping records in 2016. What that means is that people have reduced their long exposures and they have some ability to step in and buy stocks at these levels that they think are too cheap.

The second thing that I would say is that the volatility market is not reacting in any crazy way. What that means is that the market is kind of taking this in stride and taking this calm and rerating. That gives me some comfort to think that this isn't just pure panic, people aren't overly invested or else the volatility market likely would be panicking.

I would also say that if we wanna look for silver linings for how uncertainty has now gone from the market, one thing you can point to is that the numbers that we saw yesterday are a ceiling as to what the tariff rates on each of those countries would be.

Now, of course, there can still be sectoral tariffs that come out down the road, but the administration has continued to say that those ceiling numbers can further be negotiated down. even if those numbers are unfriendly for the equity markets right now, investors could maybe take some solace in that.

Maybe there will be some headlines coming forward. about how they can be negotiated lower, whether it be in the next week before they're enacted or further down the road, similar to what we saw in 2018 and 2019.

So, If I had to paint a picture of the market going forward, I would say that the broader S&P is in a downtrend, very similar to what we saw in 2022, very similar to what we saw in Q4 of 2018, where there are going to be growth concerns. whenever we get economic data, it kind of can go two ways.

Either the economic data is okay, in which case. Bearish, investors could look at it and say, well, this one might be okay, but just wait until the next one. When the delayed effects of tariffs come in, then it'll start to roll over, or the data can be bad right away, in which case people will say, see, that validates that we're heading towards the recession.

The recession odds are up, et cetera. So I think that it's very hard to get a move back to the highs in the equity market until some of this. Other uncertainty about growth and the effects of these tariff policies on growth starts to get cleared. We don't yet know the effects of the DOGE policies. We don't yet know the effects of tariffs, and we're still sitting in a market with really high valuations.

So I think the best way for investors to try to navigate this market is to be nimble. I would say use pops in the broader market as a chance to reduce exposure and then on dips, look to scale into companies that you can believe in the fundamental story and hold long term.

**Chris Hussey:** Yeah. Just to go back to your analogy, you're coming outta your test.

You failed the test, but guess what? There's more tests coming up and they could be tough too. Alright, let's drill down a little bit, 'cause you guys get to see sector stuff. You do a lot of sector baskets. What are you seeing at the sector level going into this event and now going through the event?

**Shawn Tuteja:** Yeah, so coming into the event, I think what stands out the most is we can all look at the market and say the market has had a really tough start, a really tough Q1 to start the year.

But when you look at the sectors that are driving the tough start. It's actually the winners from the past couple of years. The Magnificent 7, for example. that basket of equal weighted stocks is down almost 14% as of yesterday's close to start the year.

If you compare that to an equal weighted version of the S&P, that was almost unchanged going into today. Why is that the case? There's been. A lot of questions about AI recently and some people thought that AI was in a bubble over these past couple of years, especially given that it seemed like a lot of these companies did not have competition. Obviously earlier this year we had news out of China and DeepSeek that there was new competition, and some people think that some of the froth needed to come outta the market.

And now, in our view, we think that a lot of that froth has come outta the market, both in terms of the AI names, but also in terms of the large cap tech names here in the US.

We think that if there is actually going to be a real growth slowdown in the market at these levels. Given how much de-risking we've seen.

Positioning is much cleaner in a lot of these names and the Mag 7 names in particular are the ones that will trade defensively going forward. That's very similar actually to how they traded. In 2018, at the end of 2018, the whole market kept going down in November and December, and these names actually stopped going down because people said if we're going to a recession, I want to own the names that have the best ability to navigate future growth concerns, potentially have the best ability in this case to navigate the future supply chains.

So I think that from here we, we think that the market, while it might still be in an overall downtrend, will start to have a new rotation under the surface where the large cap tech names start to outperform the rest of the market.

**Chris Hussey:** So consolidate that for us. What's a trade?

**Shawn Tuteja:** I think that you're supposed to look at the Magnificent 7 and the names that you like in that, and you're supposed to look at buying those names versus the rest of the market.

I think that it's more of a bet on which companies do you think have the most staying power in tough economic times. And so we like buying the Mag 7 in that case. The Mag 7 has outperformed the broader market, 10 of the past 11 years, and we think that people are now underweight these names.

And if you look at a valuation basis, the Mag 7 is trading at its cheapest, forward valuation. to the S&P in the past 10 years is that it's trough valuation. So we think that there's some value to be found in these names that no one seems to want anymore.

**Chris Hussey:** Let's cast forward to next week. The next test, what are you watching

**Shawn Tuteja:** what's really going to be important is that April 9th date we're gonna see do these reciprocal tariffs actually go into effect or how many deals are struck before then. And then on the flip side, we're gonna see how other nations retaliate in terms of tariffs and then what the United States' response is.

So I think that there's a lot of catalyst in the near term, not to mention earning season is about to kick off and I would say what's interesting is the past few earnings seasons, we've entered them on the highs of the market. This one, we're clearly entering on the local lows of the market. So does that kind of change the expectation and set the bar a little lower for some of these companies?

We're gonna be listening to earnings calls and seeing in the conference calls, what do people say about the future effects of tariffs? How do CEOs think that it's going to affect their business? So a lot to look forward to in the next couple of weeks for the market.

**Chris Hussey:** Yeah, earning season's gonna be fascinating. Less about what happened in January through March, more about what corporate America thinks is going to happen. Sean, terrific conversation. 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 Exchanges, our weekly podcast about the long-term trends impacting the economy and investors' portfolios.

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