Goldman Sachs The Markets

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Date of recording: March 12, 2025

Chris Hussey: US stocks have been sliding. Are they primed for a bounce? Or is this the start of a significant correction? This is The Markets.

I'm Chris Hussey and today is Wednesday, March 12th. I'm joined by Ashok Varadhan, co-head of Goldman Sachs' Global Banking & Markets division. Ashok, great to have you back on the show.

Ashok Varadhan: Good to be back, Chris.

Chris Hussey: All right, let's cut to the chase. What's driving US equities lower? Has the narrative shifted? Or is it still the same as it's ever been?

Ashok Varadhan: I'd say maybe some of the narrative has shifted, but I think it's important to think about initial conditions when you think about, we came into this year and subsequent to the inauguration at fairly elevated levels, right, by any historical metric. And certainly, if you look at ‘23/’24 US economy sort of grew above trend. That was a little bit of a surprise for most market gurus. And a lot of that was driven by continued government spending, the benefit from supply side labor immigration, and of course the AI theme, not only the investment-led spending, but also the market leaders rallying significantly and sort of driving up the indices associated with that.

And so, we ended up having a presidential election and the president having a mandate with respect to essentially the Republicans having both chambers of Congress. And so, I think there were animal spirits, the prevailing conclusion was that the US economy would continue to grow above trend and that the European economy, and the Chinese economy would remain very challenged.

And so, it wasn’t going to take a lot when you had that much consensus and positions reflecting that degree of consensus thinking, it wasn’t going to take much for gravity to reveal itself. And so, to me, where we are right now is maybe a little bit more a reflection of where we were coming into the year as opposed to a harbinger of where we're going.

Chris Hussey: Yeah. We've taken the froth off the market. But we haven't actually seen the growth scare materialize in the data yet. We had CPI today. That came in even soft. What would you say about the data so far? Are you concerned with what you've seen yet? Are you watching for something?

Ashok Varadhan: Obviously, some of the policy news that we've had come in with respect to the desire to decrease government spending in certain areas, some of the increased geopolitical tensions around Russia-Ukraine and how that ends up getting resolves, and then of course the uncertainty around the ultimate implementation of tariffs, all of that. So, you're not going to see that show up in the underlying data until maybe well into Q2.

And so, I'd say what we've seen thus far is data that has been sort of modestly a little bit softer. But really, you have to see if this is going to show up in the next ten to 12 weeks.

Chris Hussey: So, given that data lag, do you sit on your hands, or do you take advantage of this 10 percent almost correction? You know, where's the opportunity?

Ashok Varadhan: I think, you know, someone had mentioned this to me and people talk about this a lot, if you actually look at the multiples sort of X the Mag 7 and you look at where the multiples were, certainly they were elevated. But I wouldn't characterize them as stretched.

And so, to me, I would say when things like this happen and you end up getting corrections of this magnitude this quickly, people have a tendency to throw the baby out with the bathwater. And I think it's an opportunity to look at good companies that you think have good prospects. Certainly, growth has been downgraded from call it the mid twos to maybe the high ones in the US this year. But certainly, if the US economy grows at 2 percent real, and things don't fall out of bed, there's probably some good value on the board.

Chris Hussey: Is there anything that's catching your eye in terms of where you would want to be if you're going to lag into US?

Ashok Varadhan: I think just broad-based cyclical names are due to perform well. I still think if you indeed have two percent growth, inflation will moderate. And that will certainly put pressure on resources. That will allow the Fed to be, you know, accommodative. We have an FOMC meeting next week. I suspect, leadership in the Fed will pencil in an expectation of two to three rate cuts this year. That should provide underlying support for risk assets.

Chris Hussey: That's a good point. So, is the US still the place to be? Or do you like non-US assets here?

Ashok Varadhan: I still think the US is the place to be. Obviously, you can get into debates over relative valuation. Certainly, you've seen a lot of anticipation in Europe and a big rotation into Europe over the course of the last few weeks and more recently in anticipation of some of the fiscal expansion. But I think the proof is going to be in the pudding. There's still a lot of political hurdles to make sure that those spending plans can get approved.

Chris Hussey: And of course, they'll be facing tariffs as well. And back to rates you mentioned the Fed might pencil in two to three rate cuts, as you said, that could be a nice tailwind. Are rates going to go lower from here do you think, especially if inflation stays subdued?

Ashok Varadhan: I think the distribution for front end rates are lower. Again, you already have a couple of cuts priced in. And so, the front end of the rate curve seems fairly well priced. And the back end of the rate curve is really going to depend on whether or not we end up making fiscal progress. If we don't make fiscal progress, then it's going to be hard to get US long rates lower. That being said, if we do, they could go lower.

Chris Hussey: Yeah, people do forget that tariffs raise a lot of revenue for the fiscal progress side. But if the tax cuts were to come in, that would be the flip side of that. All right. Tail risks. Is there anything you've got your eyes open for in the tail risk side?

Ashok Varadhan: Well, I think we certainly lived through some, I don't know if you'd call it tail risk, maybe it's like lower body, you know, it doesn't get all the way to the tail, I don't know. What I would say is it has to still be in the geopolitical arena. I would say what growth ends up being, what inflation ends up being, even if you have some unevenness around trade policy, those are all things that are manageable and there may be some speed bumps, but I think the market will be able to absorb that.

Geopolitical risk, I think, really changes the tenor of how you think about investing over a medium-term time horizon. And that has gone up a little bit, certainly given the fact that when you look at a little bit of what's transpired. There's been more polarization on how to deal with conflict.

Chris Hussey: Agreed. Last question. What is your favorite trade?

Ashok Varadhan: Put me on the spot like this. I think I'm going to pick a combination. I still really like being long the linear combination of US bonds and stocks. We obviously, on the asset management side of house, preach stay invested. I'd say never more now in terms of a good 60/40 portfolio in the US.

Chris Hussey: Great. What are you watching for next week and the weeks ahead here?

Ashok Varadhan: Certainly, FOMC meeting. We'll pay attention to that. Obviously, people are paying a little bit less attention to classic economic policy and paying much more attention to policy in Washington. My, maybe a little bit out of consensus view, is I think some of the noise in Washington will die down a little bit. And I think we're going to get back to looking how the US economy evolves.

Chris Hussey: And finally, MLB, believe it or not, kicks off in Japan next week. Do the Yankees have a shot to get it back to the real game?

Ashok Varadhan: You know, it's still too cold for me to think about baseball. Starting in April is, like, unfathomable to me. And so, when you have me on in the summer we can talk baseball.

Chris Hussey: All right, we're going to do that.

Ashok Varadhan: Okay.

Chris Hussey: Ashok, thanks so much.

Ashok Varadhan: Thank you.

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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