Goldman Sachs The Markets

What the volatile bond market means for investors

Ben Snider, senior strategist, US Portfolio Strategy macro team, Goldman Sachs Research

Sam Grobart, Host

Recorded: October 18, 2023

Sam Grobart: As geopolitics dominates the news, how are investors reacting? This is The Markets.

Hi, I'm Sam Grobart. Today, I'm joined by Ben Snider, senior strategist on the US Portfolio Strategy Macro team in Goldman Sachs Research. Ben, thanks so much for joining us today.

Ben Snider: Good to be with you.

Sam Grobart: Ben, obviously, the big story right now in news has been the violence and the conflict in Israel and the Gaza Strip. Can you tell us a little bit how that is being reflected, if at all, in today's markets?

Ben Snider: Now look, as human beings, it is something we're all very much affected by and focused on. And we feel extraordinarily concerned and saddened by the headlines we see every day.

But from a markets perspective, especially with regard to the US equity market, so far, we've been pretty insulated. You know, if you look at the S&P 500, 70 percent of revenues come from within the US. And so, there really hasn't been that much of an effect. In fact, over the last week, the S&P is about flat.

Now, there are some places you can see it. So, for example, crude oil is about 10 percent higher now than it was a week ago. The Israeli shekel is down about 5 percent. And even within the US equity market, you can see stocks that are more focused domestically outperforming those with more exports internationally.

But really going forward, the issue is going to be what happens next and how does this develop?

Sam Grobart: Speaking of the domestic US market, we've been seeing a lot of continued volatility in the US treasury market. Can you tell us a little bit what we have been seeing and what's behind it?

Ben Snider: This has absolutely been the biggest focus for most US equity investors. Even though technically it's happening in a different market, it's had a lot of implications for US stocks as well.

And I think there are a number of drivers here. One reason for the huge increase in yields has just been a change in the inflation outlook. You know, the oil price I mentioned earlier is part of that. Last week we also had a CPI inflation data print that was a little bit stronger than expected.

But from a fundamental perspective, I think the biggest issue is just the resilience of the US economy. You know, we saw earlier this week very strong retail sales report. Our economists' GDP tracker suggests that in the third quarter, the run rate of the US economy was something like 4 percent, which is about twice the trend pace. And this is despite a very aggressive Fed hiking cycle.

Sam Grobart: Right. Everything we've seen for the past few months now.

Ben Snider: Exactly. And that suggests, you know what, the economy can handle the level of interest rates. The term investors have been using is higher for longer. In other words, the Fed can keep rates higher for longer. And that, we think, is really what's driving the repricing in the treasury market.

Sam Grobart: 2023 has been an extraordinary year as far as issuance of US federal government debt. You estimate that the federal government will have issued around $2 trillion in debt this year. That compares to 1.4 trillion in 2022. Is that a problem?

Ben Snider: I wouldn't describe it as a problem. But certainly, it has consequences. Right? So, anyone who took economics 101 knows that when you have more supply and less demand, that changes the price. And we are indeed seeing bond prices fall and yields rise. And part of that is the issuance that you described. Part of that is less demand from the Fed, which has been a major buyer in the last few years. And so, the consequence of higher yields, I think, is totally reasonable.

One other consequence or potential consequence that we're thinking about is now the federal government is going to have to spend even more just covering the interest on the federal debt. And that suggests that down the road, there might be some consolidation, some pullback in fiscal spending, which could have implications for economic growth. But that's not something we expect to happen in the very near future. Especially with a presidential election coming up next year.

Sam Grobart: You focus on US equities. One of the big holders of US equities, of course, are pension plans. How are they handling this higher rate environment as far as their equities are concerned?

Ben Snider: Yeah. Pensions are one of the investor groups that are the most sensitive to interest rates. And part of that is because just of the way their accounting works. When interest rates rise quickly, their fiscal financial position improves. And what that means is in terms of asset allocation, they can be a little bit more conservative. They don't need to push for the return in equities as opposed to just holding cash or bonds.

And the second dynamic that is occurring there is with higher interest rates, they can simply generate stronger returns owning bonds or cash than they used to. So, for example, the average pension in the US has an annual return target of about 6 or 7 percent.

Now, the ten-year US treasury is yielding over 5 or just about 5 percent. Corporate bonds are yielding over 6. And so, it really reduces the incentive to own stocks. And in fact, what we saw in the first half of this year is pensions selling about $300 billion of US stocks. And we expect that selling will continue into next year.

Sam Grobart: Foreign buyers have been the net buyers of US stocks this year. Why is that? And where do you see that going?

Ben Snider: Yeah, so a lot of pension supply has gone to demand from foreign investors. Again, there are a few reasons here. One is earlier this year the US dollar weakened. And generally speaking, if the dollar weakens, that means for foreign investors, US stocks are on sale. And that usually catalyzes some demand. And we have, indeed, seen that.

I think another key issue here is just that US stocks have been a very attractive asset. The growth and the performance of the US equity market has been very strong.

Sam Grobart: That strong economy that you were just referring to.

Ben Snider: Exactly right. And not just the economy. In particular, if you look at some of the largest stocks, they've grown even more quickly than the economy has. So, just to give you a statistic, so far this year, the S&P 500 is up about 15 percent. The global equity market, excluding the US, is up about 5 percent. So, it's just been much more attractive to be invested in the US market. We think that's part of the reason foreign investors have been buying. And likewise, when we look into next year, we expect that will continue.

Sam Grobart: Ben, what are you going to be paying attention to next week?

Ben Snider: Right. So, first and foremost, of course, we'll be watching the news out of the Middle East. I'd say in terms of data though, it'll be a busy week, or at least in terms of scheduled data it'll be a busy week.

So, from the macro perspective, we'll get the third quarter GDP news next week. And from a micro perspective, next week is the biggest week of the third quarter earnings season. Almost 40 percent of S&P 500 companies will report earnings next week.

Sam Grobart: Ben, thanks again. Great to have you on.

Ben Snider: Thank you.

Sam Grobart: That does it for another episode of The Markets. You can find us on Apple Podcasts, Spotify, or wherever you get your podcasts.

I'm Sam Grobart. Thanks so much for listening.

This transcript is provided in conjunction with the associated video/audio content for convenience. The content of this transcript may differ from the associated video/audio and Goldman Sachs is not responsible for any errors in the transcript. The views expressed in this transcript are not necessarily those of Goldman Sachs or its affiliates. This transcript should not be copied, distributed, published, or reproduced, in whole or in part, or disclosed by any recipient to any other person. The information contained in this transcript does not constitute a recommendation from any Goldman Sachs entity to the recipient, and Goldman Sachs is not providing any financial, economic, legal, investment, accounting, or tax advice through this program or to its recipient. Neither Goldman Sachs nor any of its affiliates makes any representation or warranty, express or implied, as to the accuracy or completeness of the statements or any information contained in this transcript and any liability therefore (including in respect of direct, indirect, or consequential loss or damage) is expressly disclaimed.