Goldman Sachs The Markets

Is the Trump trade just getting started?

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Chris Hussey: Trump wins and the Fed cuts. Is this the perfect set up for US equities? This is The Markets.

I'm Chris Hussey with Goldman Sachs Research and this week I'm joined by Shawn Tuteja, who oversees ETF and custom baskets volatility trading in Goldman Sachs Global Banking & Markets. Shawn, great to have you with me.

Shawn Tuteja: Hey, thank you for having me on.

Chris Hussey: Shawn, the Fed just announced a 25 basis point cut. We're recording this right here on Thursday afternoon. It's the second cut of the cycle. Walk us through the market's reaction so far.

Shawn Tuteja: Yeah. I think that the market fully believes that a Fed Put exists and that the Fed has the equity markets back. I think that was called into question early summer when the Fed decided not to cut in July. And then right after they didn't cut and skipped that meeting, you had a weak job loss claims number. You had a weak non-farm payroll number. And then it felt like the market just started selling off. And then it did it again in September. After a weak NFP number the market sold off again.

But then when the Fed kind of did a U-turn and was, like, no, we have your back, we're going 50 basis points on our first cut of the cycle. It feels like after that, equity investors are like, "okay, if things get really bad, the Fed can always just cut 50 or 75 or even 100 basis points."

And I think that what we've seen over the past couple of months is that the Fed has endorsed cuts. You know, we've priced in 2/3 chance that there's going to be another cut now in December of 25 basis points. Growth is still holding in. Employment numbers are still holding in.

So, I think that the market sees this as a Goldilocks scenario where you're getting a Fed that's cutting into stronger growth. And that's why equities are reacting so positively.

Chris Hussey: Okay, so that helps us on the Fed, which was more of a summer issue maybe than November issue. But the bigger story this week, of course, is the US election result. The S&P 500 is now up 4 percent this week, extending the big gains we saw yesterday immediately following the election result. What's your view of the move in stocks so far? Too much? Too little? Just right?

Shawn Tuteja: I think the starting point matters. And up until basically all the way to the election, it looked like we were going to head into it with the stock market at the all-time highs. We finally got a little bit of a dip end of last week. Right before it we dipped a couple percent. And so, I think that some of the rally is making up some of that ground. And then getting back to the levels that we were at before.

You know, when you look at the historical analogs, four years ago, eight years ago, generally the broader market trades nervous into elections. And you see people coming in and derisking, etcetera. And like I said, we kind of waited up until the last week to see that action in the equities market. Our prime brokerage data shows that our fundamental long/short hedge fund crowd took down their gross exposures or, essentially, their overall risk to both their longs and their shorts. The lowest level since March of 2023.

So, I think the takeaway is that investors had chips to allocate to the market after the election. You know, I think a few other factors that kind of explain the rally and why it's maybe not overdone is that we saw volatility fall a lot after the election. You know, up until the election, the VIX or the fear gauge of the market had risen to over 23. That's now around 15 as we're speaking right now. So, that eight point drop in implied volatility generally brings more assets into equity markets as people want to invest in calmer markets.

And then lastly, you know, when you look at these last two months of the year, we're entering the best seasonals for the equity market. You know, November is the strongest month for corporate buybacks. We model potential five to six billion dollars a day worth of buybacks in the month of November. And on their own, November and December are like really strong seasonals for the market. But then in election years, that seasonal becomes even super charged.

So, you have a lot of tailwinds for the market right now. The Fed, as we just mentioned, cutting into strong growth. We're through all the major risk events of the year. So, you have a lot of passive demand from corporate buybacks into the market. Volatility is falling. So, it's really hard to get bearish the market, even though we're at the all-time highs right now.

Chris Hussey: All right. Perfect. Now, sitting on a basket desk, of course, makes you an expert in thematic investing. What are the themes that are playing out right now in this post election period?

Shawn Tuteja: Yeah. I think the biggest themes that we saw play out the day after the election on Wednesday were regional banks and banks getting bought. I think the market essentially took a page out of the 2016 Republican sweep playbook where any sectors that were linked to deregulation benefited. You can look at energy. Traditional energy versus renewables. You had energy up almost 4 percent. Renewable energy down almost 10 percent.

And when you look at the bank themes and these deregulation names, they really struggled over the past couple of years, especially because of the way the bond yield curve has been. They've been flat or inverted as investors have been worried about a recession as the Fed is hiking rates. And now we've seen the yield curve start to steepen out a bit, which supports their earnings and business model more.

I think what also stands out to me on a thematic side has been the resilience and strength of US tech over the past couple of days post the election. If you rewind back to 2016, there was a fear that if the markets started trading with the more pro cyclical, US-focused tilt, it would come at the expense of big cap tech. And that's what we saw in 2016 the first couple of days where the NASDAQ really struggled.

Now we're actually seeing tech trade extremely well. Moreover, we've seen less underperformance than we would expect in Europe and in China. Obviously, the new regime is talking a lot about tariffs on Europe, tariffs on China. But that's being counteracted some, especially in China, by more easy policy and more stimulus that the market expects.

So, I think that the market, in general, is trading a lot better across sectors than we would have expected.

Chris Hussey: How long do you think before markets get a little exhausted?

Shawn Tuteja: I think that what I would expect to come over the next couple of weeks is a continuation, A, on the factor level of the themes that worked post the election. It takes time for money to be deployed and for themes to play out. If you look back to 2016, regional banks and big banks rallied for months after the election. And they outperformed all of the other sectors in the market.

You know, we're kind of in the first inning, so to speak, post this election. Now the moves were very violent. But there's a lot more to go in our opinion. And so, what I would mainly expect is that factor volatility will increase.

You know, when you look historically post elections, generally the broader market kind of calms down at the S&P or index level. But under the surface, those sector moves become a lot more violent as correlations in the market break as people start picking winners and losers in the new government regime's policies.

I would say going forward, it's very hard to bet against the market over the next two months also because we're reaching year end where the S&P is up over 20 percent on the year. A lot of hedge funds and institutions are benchmarked to indexes in terms of performance. If you're not up 20 to 22 percent, you kind of have to chase the market into the end of the year. That's why people call it the Santa Claus rally because you're forced to allocate chips, even if you don't love the valuations of the market. Even if you don't like bond yields, etcetera.

And as I mentioned, all the passive flows that go into the market, like corporate buybacks, kind of make it hard sometimes for fundamentals to really override these flows. I think the market starts to worry about these things maybe beginning of next year. But in low liquidity tapes, it's hard to fight a market that's trending higher.

Chris Hussey: Yeah, it's a great point. All right, then let's strip away from the index level and if we went back down into your ETFs and your baskets level, you mentioned financials as a sector that could rally for a while here. What else are you looking at there that can maybe rally into year end and beyond?

Shawn Tuteja: One theme that we have high conviction in that we haven't really seen being talked about is focusing on companies that sell to small businesses. So, effectively, small business uncertainty is at multi year highs according to long-running NFIB surveys. An agenda of deregulation, potentially lower tax rates, and a more pro-business administration could benefit small businesses.

Now, obviously, you might say, well, small businesses aren't publicly traded. But you can buy the public companies that sell to small businesses. And we think that from a rate of change perspective, things should be better for these companies six months out from now than now. Which is why we're really constructive finding the names that sell to small businesses who we think are the biggest beneficiaries of the new government regime.

Chris Hussey: Great point about small businesses. You don't have to invest in small businesses. You can invest in the companies that sell into it, companies like uniform rental guys, office furniture, software companies. There's a lot of companies that sell into small businesses.

Shawn, terrific insights from our trading desks. Thanks so much for joining us.

Shawn Tuteja: Thank you so much for having me.

Chris Hussey: Hey, 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. In the latest episode, we dig into what the election results could mean for portfolios going forward.

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