Goldman Sachs The Markets

Why US stocks could keep rising in 2025

Ashok Varadhan, Co-Head, Global Banking & Markets, Goldman Sachs

Chris Hussey, Host, Goldman Sachs Research

Date of recording: December 18, 2024

Chris Hussey: The Fed cuts and stocks sink. What's the trade from here? This is The Markets. I'm Chris Hussey with Goldman Sachs Research and this week I'm joined by Ashok Varadhan, co-head of Goldman Sachs Global Banking & Markets. Ashok, thanks for joining us.

Ashok Varadhan: Thanks for having me. It's fun to be here. And it's good timing, right?

Chris Hussey: Terrific timing because we're taping this three hours after the Fed released its statement this week. What are your initial reactions? Is the Fed now ahead of the curve?

Ashok Varadhan: I really wasn't that surprised. I think on the trading desk we had a little bit of a different view than our economics group. Our feeling was they would sort of inelastically recalibrate rates lower in 2024. We thought that would be 100 basis points. Obviously, that didn't come 25 basis points four times in a row. You had one move of 50 and then two subsequent moves of 25 basis points each.

And now they're at 4 3/8. That's still restrictive by any sort of metric in terms of where underlying inflation is and where you ultimately think the neutral rate is. But it's not that restrictive. And so, therefore the bar for subsequent cuts is going to be higher, especially since economic output continues to be very formidable, right? You're going to grow this year at above 2.5 percent, which by most measures is above trend growth. And inflation has come down a lot. And we've made a lot of progress. But it's still a ways from their 2 percent goal. So, why not move more gingerly from here?

Chris Hussey: Yeah. As you point out, they have taken a little bit more of a gradual approach here, now looking for only two cuts in the year ahead. We had been expecting three. Markets had been pricing as much as four earlier. What does that mean? A slower pace of cuts, what does that mean for markets?

Ashok Varadhan: I think, and again, what those dots reflect is just sort of the median aggregation of all the members' forecast. And who knows? You know, the realization could end up being no cuts. The realization could end up being four cuts. Obviously, that's going to be very data dependent.

But certainly, in our view we felt like that had to gravitate to less cuts given the pace of economic data that we've seen coming in. And so, I think the market is making, frankly, a little bit too much of it. Obviously, we were in a place where the market had run up a lot subsequent to the election and obviously concurrent with some of the better economic data. And so, we were vulnerable. And it just turned out that we, today, we're vulnerable to an expectation of three dots being two dots. But I wouldn't read too much into it.

Chris Hussey: Let's unpack that place, where we are, because equities are trading at a P of about 22 times. A lot of corporate credit carries. Practically no spread at all. Ten-years stuck above 4 percent. It's climbing even higher. Are you worried about valuation here? Or do you think markets will keep trading that US exceptionalism, that GDP growth that we expect for 2025?

Ashok Varadhan: So, I'll start by saying in the risk business, you always worry about valuation. You know? How can you not worry about valuation? If you think something is expensive or you think something is high, you worry about gravity. And if something is low, you think about all the reasons for why it's low. And you can rationalize the price being there. So, I'd start by saying in the markets we always worry about valuation.

That being said, when you think about the public markets, and in particular the companies that are driving the valuation in public markets, they're extraordinary companies with the market leading position producing, you know, extraordinary earnings, but with a lot of capability to buy back stock. And so, there's a story there where, one, you could argue that the equity risk premium associated with those marquee names should be waning. Coupled with the fact that they're still growing in such a way that they can grow into their valuations. And so, I don't worry about valuation here more than any other time in my life, which is all the time in terms of worrying about valuation.

As it relates to US exceptionalism, I don't see why that trend should stop in terms of that's something that's been underway for a long period of time. If you look at how global stock markets have grown, the US has been an absolute outperformer. And we can sit here and detail all the reasons why it's better to do business here than necessarily in other jurisdictions. And certainly, if you look at an administration that's coming in that wants to be a little bit more protectionist as it relates to American companies and American industries, there's no reason to think why that can't continue.

Chris Hussey: Yeah, as you point out, the administration literally has an America-first agenda.

Ashok Varadhan: Yes.

Chris Hussey: So, you would expect that to carry over to markets. And we just held our financial services conference last week in New York. There was a lot of talk about how capital markets are poised to finally pick up in 2025. Opine on that a little bit. Because is there a cyclical pick up here on the come? Or are you worried at all that private markets have sort of stolen from the public markets a little bit here?

Ashok Varadhan: I mean, private markets have definitely taken share. Certainly, if you look at the capital formation that exists and that has grown around private markets, that's an ecosystem unto itself. That capital formation, for lack of a better description doesn't force things to necessarily come to the public markets perhaps in a way before that they would have to do that. But I believe that you will see, and you've already seen it this year, equity capital markets activity picked up. You know, debt capital markets picked up a lot. I anticipate that to continue, especially as you have, again, rates that have normalized 100 basis points lower, easier financial conditions, pro-cyclical policies in the administration. I think all of that will lead to higher capital markets activity, higher levels of M&A, which are coming off of, you know, still historically lower levels.

And so, I think as it relates to the banking channel, I think things are on the rise.

Chris Hussey: Yeah. And of course, even if we only get those two cuts that the dots are talking to, rates are still going to be going lower. And so, that's going to to be a nice tailwind.

Ashok Varadhan: Sure. Certainly relative to what we experienced, right? I mean, in 2022 and really all of '23, really not until, I guess, not until the onset of the fourth quarter of this year we were hovering around 5 3/8. And so, that's certainly going to be a relief.

Chris Hussey: Yeah, very different place than where we were back then. Okay. Let's cut to the trade. What do you like here? Where do you want to be positioned?

Ashok Varadhan: You know, obviously, I gave the talk for US equities. I think, who knows, you can ebb and flow. I like my entry point today. At the end of the day better than at the beginning of the day. but I think US equities will poise to be higher. If I think about the US and I just think about sort of the high-level macro economic parameters, which is ongoing fiscal support, we can talk about whether that's going to increase or decrease, but I think the fiscal support will continue to aid the economy. Normalization of interest rates. Those two things together should be a good cocktail for full employment or close to full employment and healthy levels of growth. And so, I think you want to be in US stocks. So, that would be first and foremost.

And then I would say on the value side, there are some things in the emerging markets that are starting to look interesting. I think Brazil has cheapened up a lot and has been under a lot of pressure over the course of the last few months. And so, I would look at some of those things too. Because as you get more normalization in the US and more calm in the US and a resumption of normalcy, you should start to see some of the things on the periphery participate as well.

Chris Hussey: Yeah, that's a great point. Brazil rates going in the opposite direction. But partly because their economy's going so strong.

Now, do you want to be hedged or unhedged? Earlier you said you're a risk manager. Is this a year in which you want to be more hedged than usual? Or not really?

Ashok Varadhan: I don't think so. I think one of the things-- you know, there are many different ways to risk manage. I think one way is obviously to think through not having any beta and just thinking about all the different alpha exposures you want to have. Another way is to say, okay, I want to have this beta, but what's my tolerable loss? What is the tolerable loss I'm willing to incur? That's sort of been my mantra, certainly over the course of the last couple of years. And that will be mine going into 2025.

Chris Hussey: Okay. Last question. Take yourself back to your childhood. What was the best present you ever got as a kid?

Ashok Varadhan: It wasn't around Christmas. I was born and raised in New York City. And around the time where I don't know if they do it anymore, but you used to have something called Bat Day at Yankee Stadium. And so, my dad, I would always anticipate my dad getting Yankee tickets so we could go to a Yankee game. And not only would I go to the game, but I'd get a bat that I would be able to use for the summer. So, that's sort of the-- that's my thing.

Chris Hussey: It was the greatest thing in the world, Bat Day at Yankee Stadium. I remember that as well, going with my dad. No better day. Bat Day and Cap Day were two of great days at Yankee Stadium. Ashok, thanks so much for taking the time with us today.

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 happy holidays from The Markets.

legal, investment, accounting, or tax advice through this program or to its recipient. Certain information contained in this program constitutes "forward-looking statements", and there is no guarantee that these results will be achieved. Goldman Sachs has no obligation to provide updates or changes to the information in this program. Past performance does not guarantee future results, which may vary. 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 program and any liability therefore; including in respect of direct, indirect, or consequential loss or damage is expressly disclaimed.

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. 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 therefor (including in respect of direct, indirect, or consequential loss or damage) are expressly disclaimed. The views expressed in this transcript are not necessarily those of Goldman Sachs, and Goldman Sachs is not providing any financial, economic, legal, accounting, or tax advice or recommendations in this transcript. In addition, the receipt of this transcript by any recipient is not to be taken as constituting the giving of investment advice by Goldman Sachs to that recipient, nor to constitute such person a client of any Goldman Sachs entity. 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, please consult the original content as the definitive source. Goldman Sachs is not responsible for any errors in the transcript.