GS MarketStrats | Trades for another leg of US equity weakness

In this edition of our "*Trades for…*" series, we focus on implementations for the most common question we've received from investors of late: what are convex hedges in FICC for the scenario where US equities continue (accelerate) their march lower? The downside has been attributed to the confluence of a number of events/developments: Doubts about the health of the US economy, the reflexivity from economic uncertainty into consumers' and corporates' behaviour, the pushback from the US administration on the strike of the "equity put", the realisation that global tariff wars are likely going to be a constant feature going forward. This has inevitably resulted in disappearing appetite to fade risk weakness and that makes more likely further weakness. Whilst valuations have already adjusted to some extent in US equities, many FICC metrics have failed to keep up with the moves, providing some convexity to position for an acceleration of US equity weakness. Clearly the 2 April tariff self-imposed deadline in the US can be the next catalyst. Against holding some underlying longs ahead of the event-risk, the desk has looked at ideas that can help mitigate a left tail arising from another acute bout of US equity weakness.

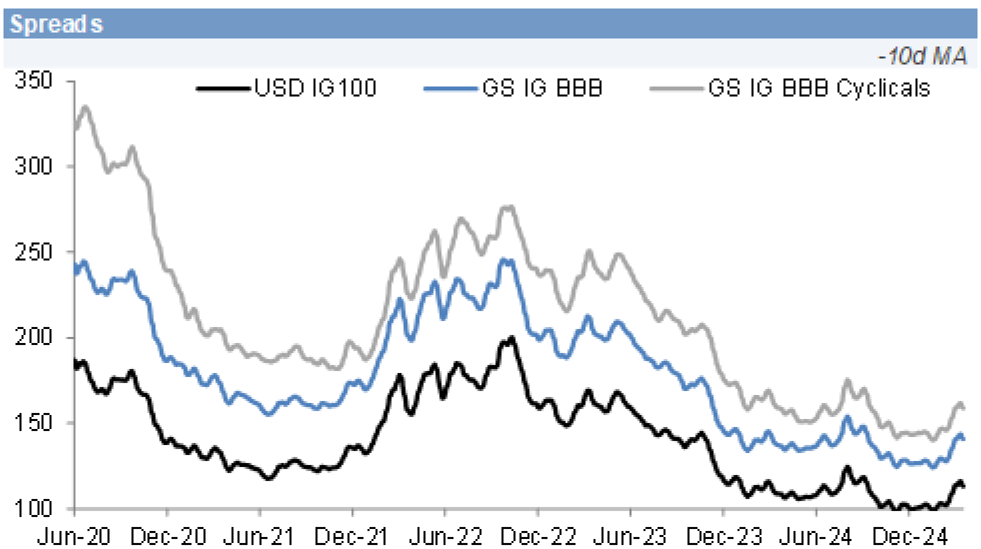
Themes & Top Trades

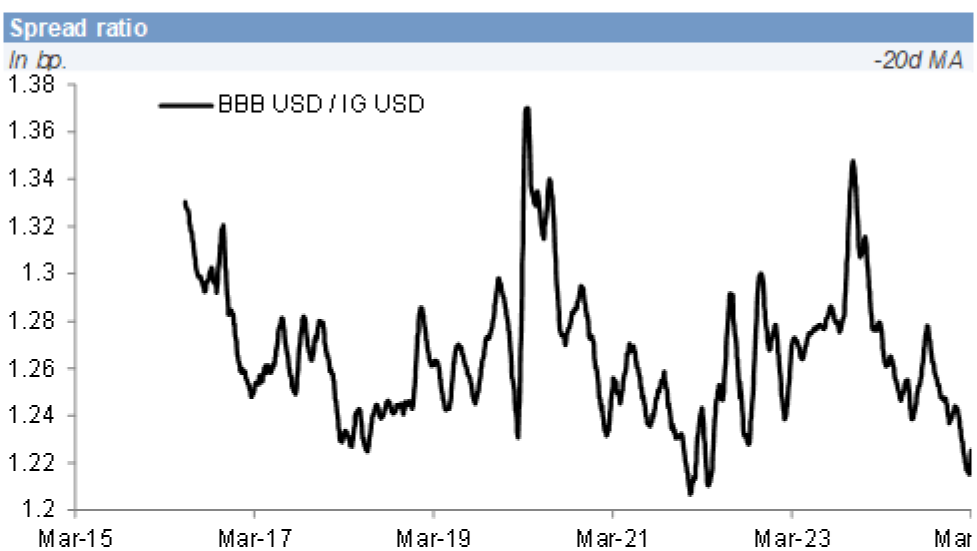
- DM Credit : Short risk a bond basket of USD BBB Cyclical companies
- DM Credit : Buy CDX HY OTM put spreads
- EM Credit : Position for spread widening (e.g. via paying CDX EM spread)
- EM FX : Buy a 3m 25d USDILS Risk Reversal for zero cost
- STS : Position for IG bond-CDS basis worsening with GSCDBUI1 Index
- STS : Benefit from US Equity sell-offs via with SPX Weekly Long Gamma (BBG: GSVIWLG1)
- Commodities : Buy 6m Gold KO Calls
- DM Rates : Sell Italy 10yr vs Bunds / Rec 50% EUR 2y1y
- G10 FX : Short AUD and Long JPY

Pricing below is indicative only.

(1) DM Credit : Short risk a bond basket of USD BBB Cyclical companies by Abel Elizalde (Credit Strats, LDN)

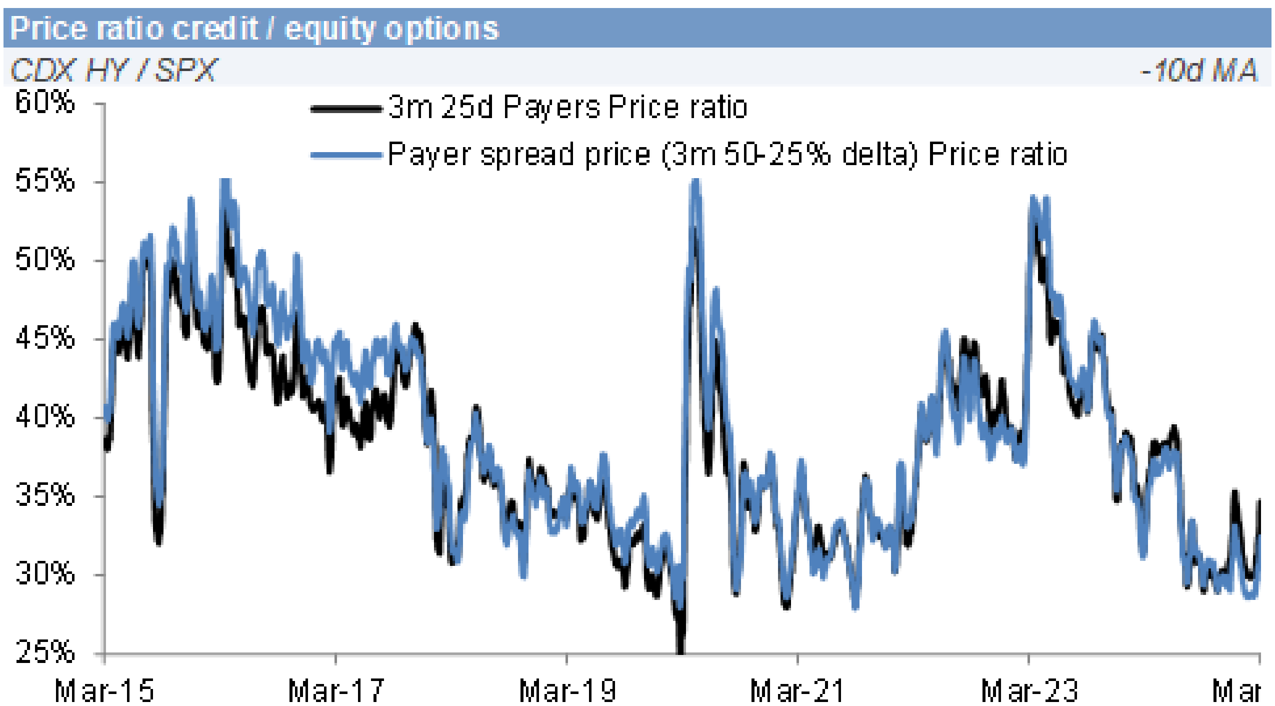
- **View:** If the equity weakness persists, we expect the beta of credit to equities to start moving higher from the lows; more so and quicker if outflows become prevalent. We believe that in such scenario: bonds will underperform CDS (on the back of outflows triggering forced selling in bonds – see STS basis trade below as well), cyclicals will underperform broader credit (on the back of economic worries), and BBBs will underperform within IG (from very stretched levels). Hence, shorting a basket of USD IG BBB Cyclical bonds is one of the most attractive ways to position to further US equity weakness. Investors can use GS Marquee basket here as an starting point; mid-spreads are around 160bp and investors can go short risk the basket via TRS (reach out for pricing). *Max loss: net premium paid / MtM of spreads going to 0.*





(2) DM Credit : Buy CDX HY OTM put spreads by Abel Elizalde (Credit Strats, LDN)

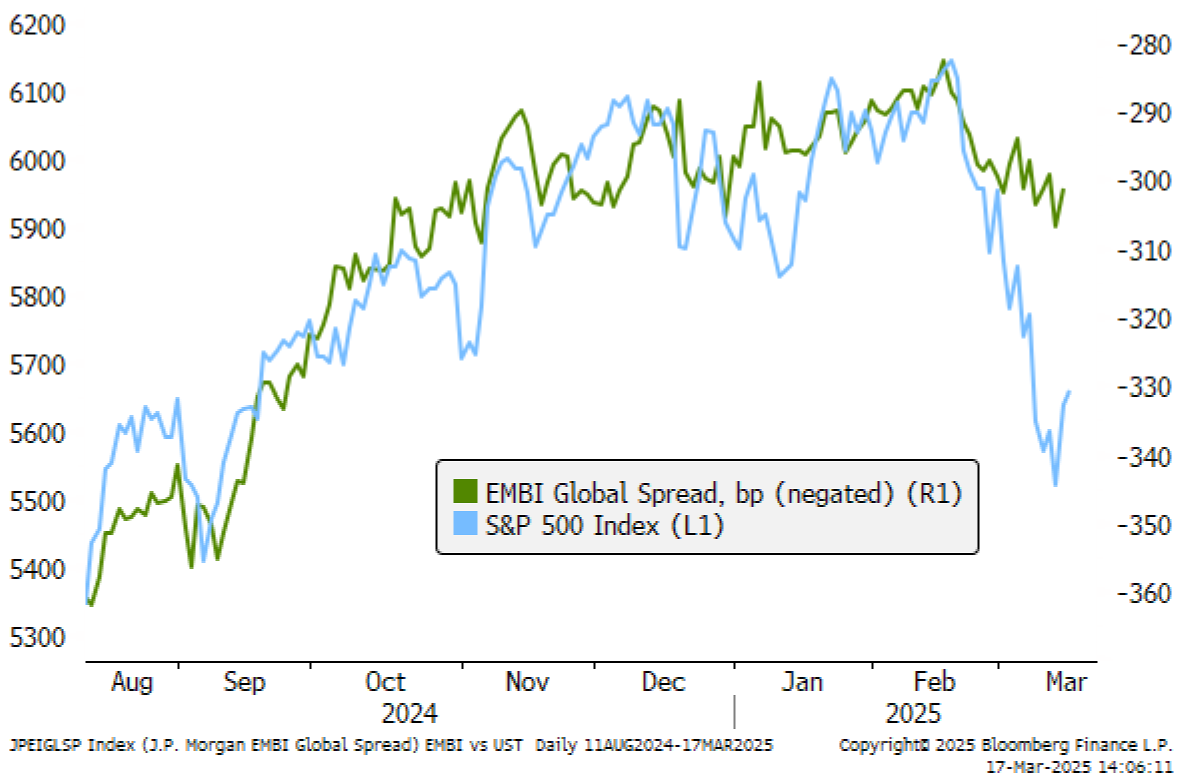
- **View:** As argued above, the beta of credit to equity is very low and starting to move higher. The price of CDX HY option hedges (payer and payer spreads) is still very low compared to equivalent equity hedges, indicating that investors are pricing higher credit betas if we move wider. To own a well priced hedge for the second leg of the recent equity weakness, we like CDX HY OTM put spreads (~25-15% deltas), which generate above 11x gross payout ratios (using May-Jun-July expiries) due to low implied vols and steep vol skews. US HY spreads should be, like IG cyclicals above, the most reactive to lower equities on the back of economic concerns. Reach out for pricing. Example: HY43 Jun 101/96 put spreads ref 106.125 14d /36 dfm 32.75 (13.9x gross payout ratio). *Max loss: net premium paid*. Link to Visual Structuring Tool here. CDX IG bearish seagulls is another alternative we like (here).



(3) EM Credit : Position for spread widening (e.g. via paying CDX EM spread) by Mikhail Galkin (EM Strats, LDN)

View: This time around, EM Credit has been showing remarkable resilience compared to US assets. Spreads are near multi-year tights. We see two main reasons for that. First, so far it has been a USD-weaker risk-off, which generally helps EM sentiment. Second, EM Credit has had 3 years of outflows, so technicals are as clean as they can be. However, should US equity weakness continue, we think resilience of EM Credit spreads will break. In such a scenario US investors will likely start "home bias" type of rotations, taking money out of EM Credit and buying US assets. **Sell CDX EM Index at 97.4 (equivalent to buying CDS basket protection at 161bp spread wise). Max loss: net premium paid / MtM of spreads going to 0.**

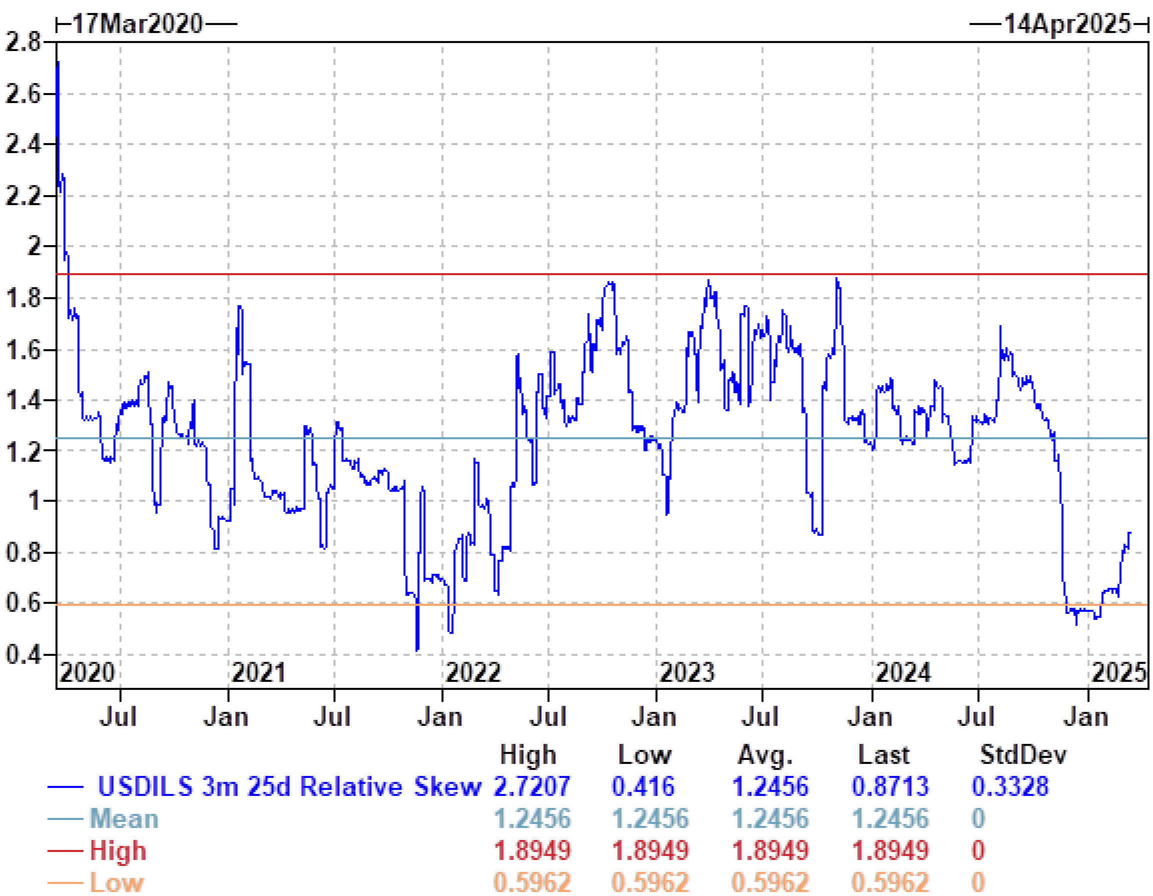
EM Credit spreads have materially out-performed recently; but this is unlikely to continue, should US equities drop further



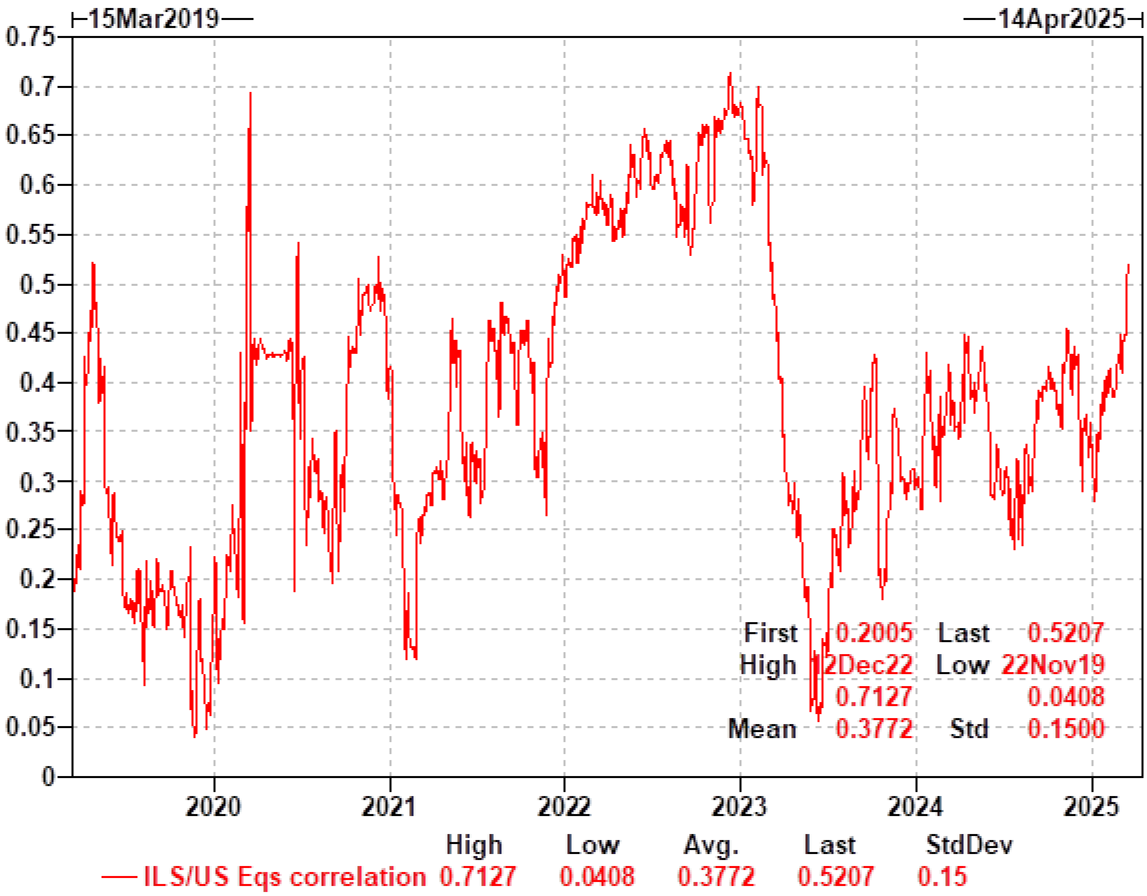
(4) EM FX : Buy a 3m 25d USDILS Risk Reversal for zero cost by Vitali Meschoulam (EM Strats, LDN)

- **View**: Given the importance of the domestic tech sector in Israel, ILS has tended to have a material correlation to the US equity market—especially on sharp drawdowns. The correlation broke down materially since the October 2023, but has been consistently increasing again. An environment that leads to a material equity selloff in the US is likely to pressure USDILS higher, as a result. With vols trading roughly fair but skew trading toward the lower end of multi-year ranges, the desk prefers to use topside risk-reversals as overlays to protect against further equity weakness. Buy a USDILS 3.77 call vs sell a 3m USDILS 3.54 put for zero cost (SpotRef 3.6567, Fwd 3.6488, as of 17-Mar-25). Max loss: unlimited.

USDILS 3m relative skew trading toward the lows

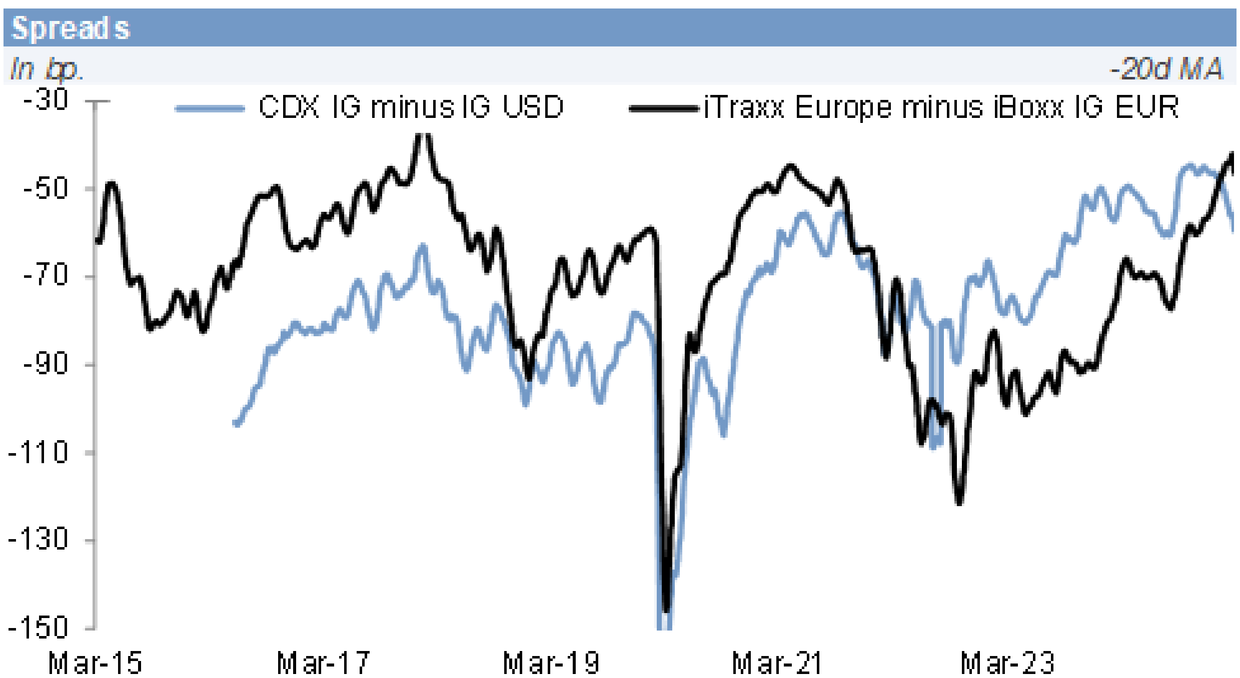


ILS v US equity correlations continue to normalise



(5) STS : Position for IG bond-CDS basis worsening with GSCDBUI1 Index by STS Strats (LDN)

- **View**: credit beta remained well behaved over the last weeks, but the two macro stress metrics we track (implied vol and bond-CDS basis) moved quite meaningfully in comparison. For the bulls, we've observed tactical vol selling via our systematic strategies given the elevated historical percentile. For the bears, if there is a further leg of US equity weakness, bonds may start to suffer substantially more than the synthetic market on a macro basis, especially if credit fund outflows pick up – hence for this scenario it can be attractive to enter into our packaged systematic exposure to such basis, maintaining the target exposure via a combination of iBoxx TRS, CDS indices and interest rates swaps. USD IG bonds trade at historically tight levels vs. CDS indices and are starting to underperform (see charts below). **Enter TRS long GSCDBUI1 Index. More details here. Max loss: unlimited.**



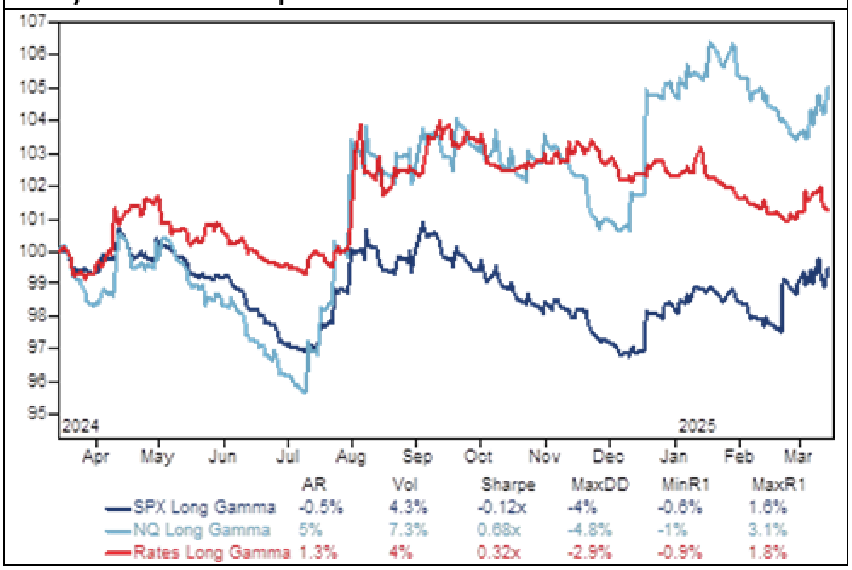
Last 1y – backtested performance:

Source: Goldman Sachs FICC and Equities, as of March 2025. For illustration purposes only. Performance is net of transaction costs and gross of swap fee. Backtesting analysis/simulated results are for illustrative purposes only. GS provides no assurance or guarantee that the strategy will operate or would have operated in the past in a manner consistent with the above backtesting analysis. Past/Backtested performance is not a reliable indicator of future returns. Backtested performance does not reflect actual trading, is subject to a number of assumptions and has inherent limitations. The analysis has been conducted in good faith by the desk. Backtested performance may use different data sources, approximation and limited differences in methodology to those prescribed in the strategy disclosure document. Please contact GS for further information. Data range: past 10y first chart, past 1y second chart.

(6) STS : Benefit from US Equity sell-offs via with SPX Weekly Long Gamma (BBG: GSVIWLG1) by STS Strats (LDN)

- **<u>View:</u>** For investors who need/want to protect against 1-2% daily sell-off in US Equities, while aiming to reduce the cost of carry over the long term. Implementation: the strategy buys short dated and close to ATM Friday strangles on SPX with delta hedging. Buying Friday carries cheaper than other expiries, and buying ATM also carries cheaper than OTM (especially on the put side). The strategy further adds a mean reversion tilt. We have a version of this strategies on SPX (GSVIWLG1) and Nasdaq (GSVINLG1), as well as a comparable one for Rates (GSVLRCB1). **Trade: enter TRS long GSVIWLG1 Index.** *Max loss: unlimited.*

Last year – backtested performance

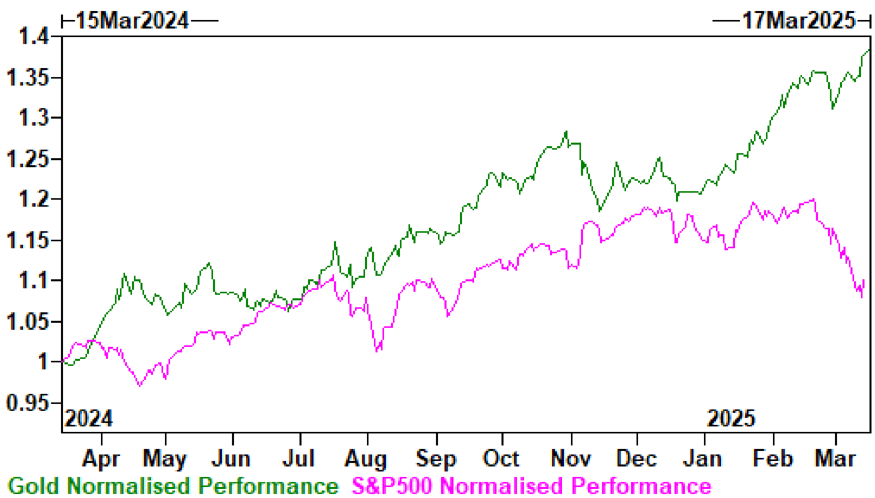


Last 10 years - backtested performance

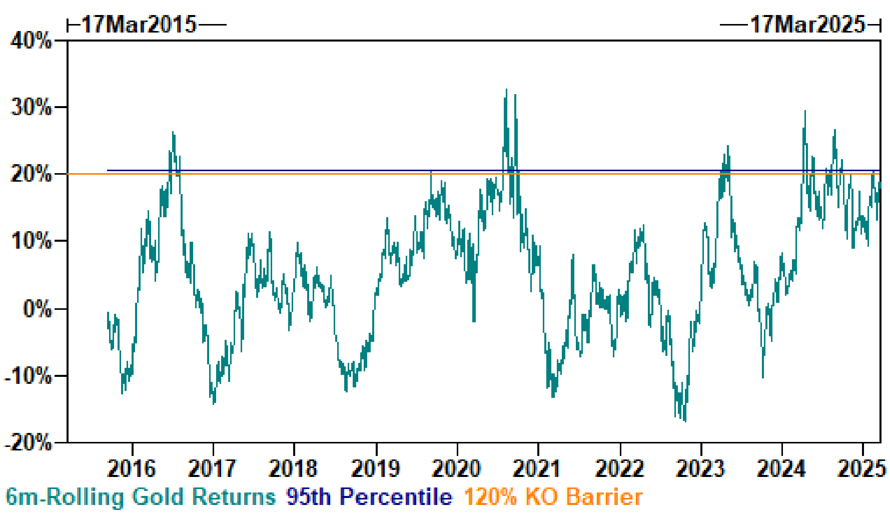
(7) Commodities : Buy 6m Gold KO Calls by Ketty Downie (Commodities Strats, LDN)

- **View**: The recent selloff in US equities has been met with an all-time high for Gold which reached 3,000 $/oz as the S&P500 crashed to its lowest in the past 6m. Increasing recession fears and persistent US policy uncertainty are likely to drive this divergence further, while sustained gold buying from ETFs and Central Banks provide further support for a continuation of the Gold rally. Buy 6m Gold ATM Call with 120% KO for 4.7x leverage (Gold spot ref 2,996 $/oz; Gold London PM Fix as of 17 Mar 25). Max loss: net premium paid.

S&P500 vs. Gold Normalised 1y Performance shows recent divergence



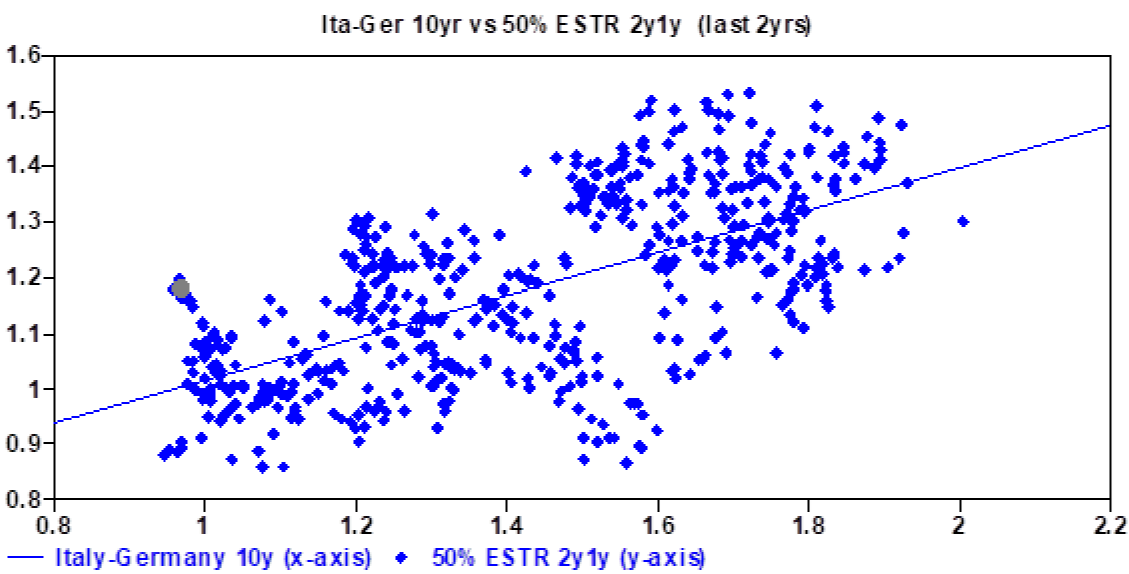
A 120% KO Barrier is close to the 95th Percentile of 6m Gold Returns



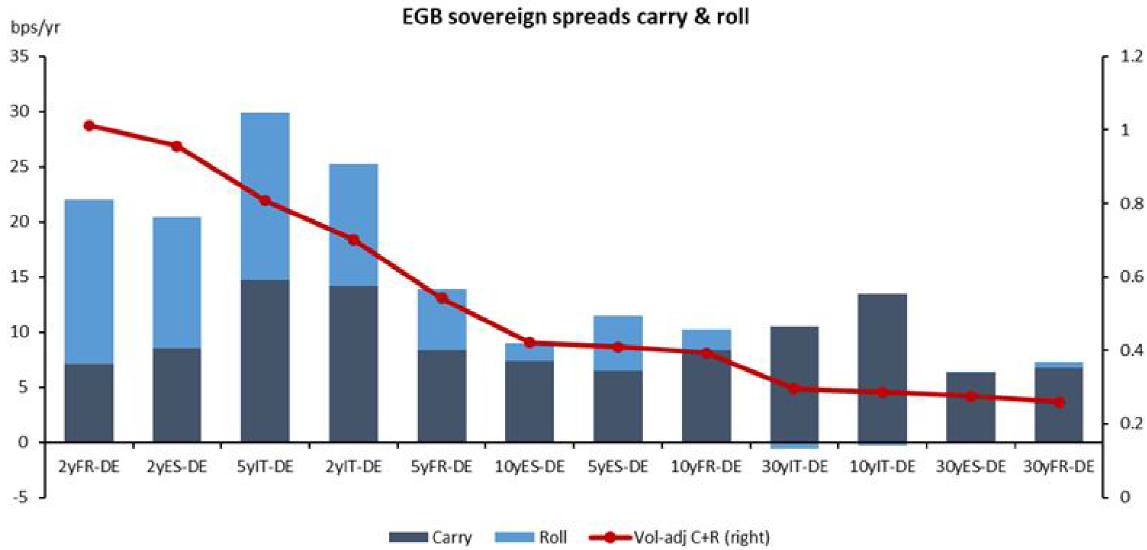
(8) DM Rates : Sell Italy 10yr vs Bunds / Rec 50% EUR 2y1y by David Curtin (Rates Strats, LDN)

View: Collapsing correlations offer good entry levels in EUR rates to protect against further US equity weakness. Euroarea sovereign spreads have performed well into the fiscal expansion-led cheapening of German bunds & concurrent rise in rate vol. Italy 10y is close to recent tights vs Bunds and Swaps, having been fairly immune to the US equity market weakness thus far. Italy's defence spending also lags behind the Euroarea average and with limited appetite shown so far from Euroarea sovs for more liability-sharing at the EU level, Italy may have to use deficit-financing to grow its defence industry at a faster pace. Vol-adjusted carry screens poorly at the 10yr point. In contrast, the front-end of the EUR rates curve has repriced higher on renewed optimism around Euroarea growth prospects, with a clear upward sloping curve beyond 2025. We think this collapse in correlations will not persist into further equity weakness – and in fact may be directly affected if tariffs against the EU are a catalyst for such a move. **Sell 10yr Italy vs Bunds at 110 & Rec 50% size in ESTR 2y1y at 2.485%.** *Max loss: unlimited.*

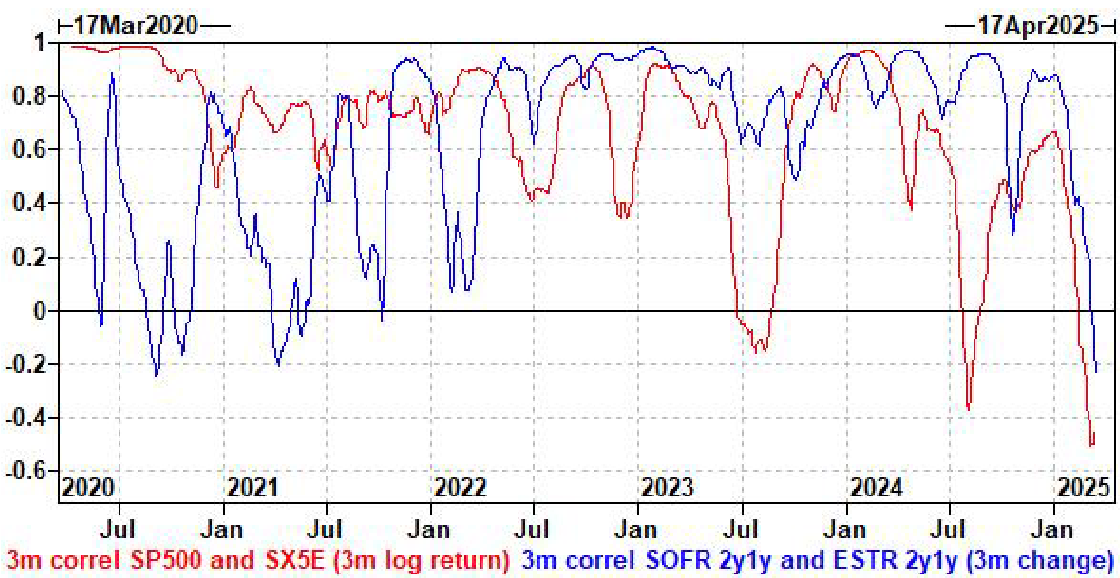
ESTR 2y1y & Ita-Ger spread have show n positive correlation over the last 2yrs



Volatility-adjusted carry is low in 10yr Italy-Germany

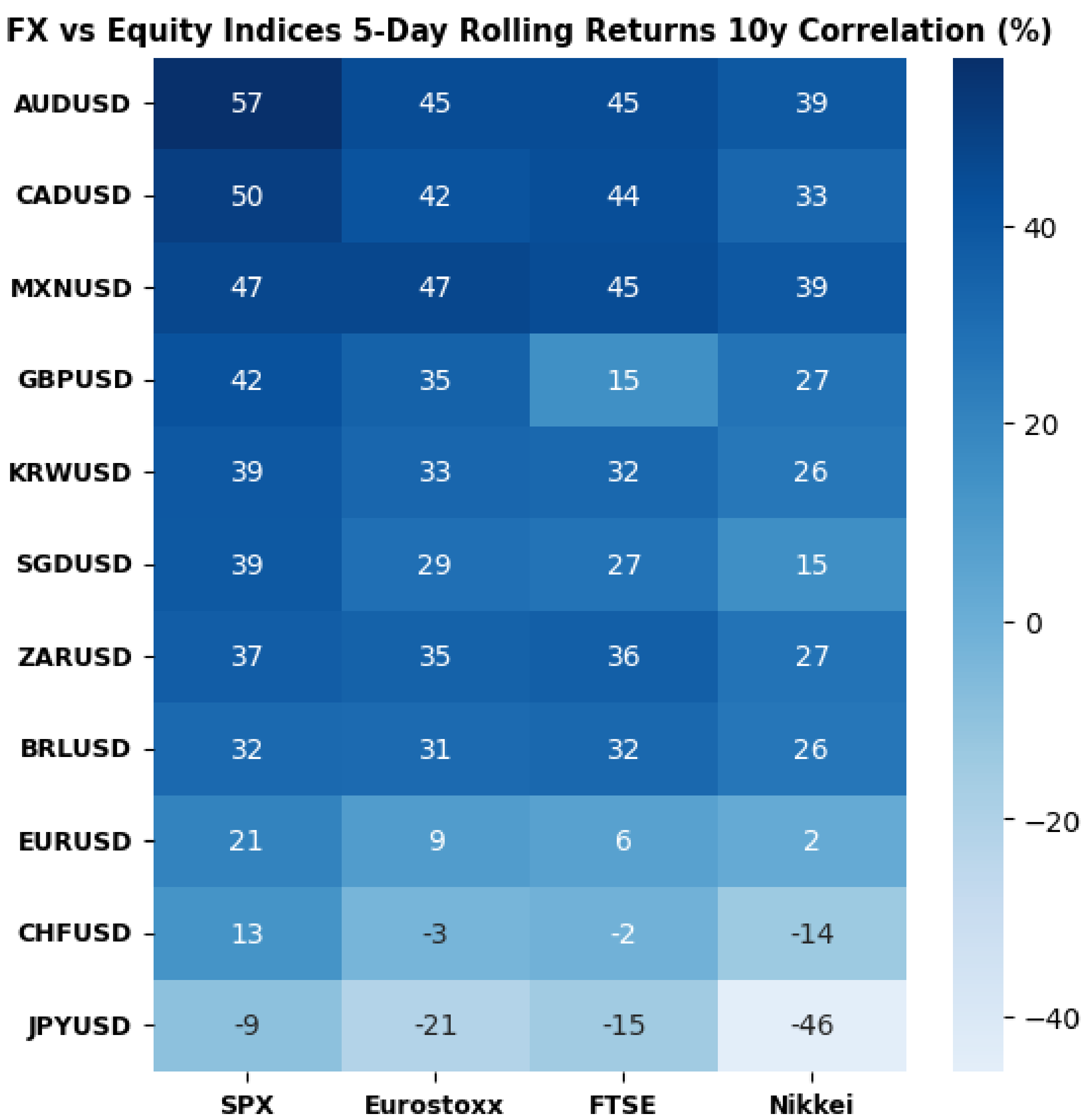


Correlations between Euroarea and US rates/risk have dropped sharply on diverging growth news

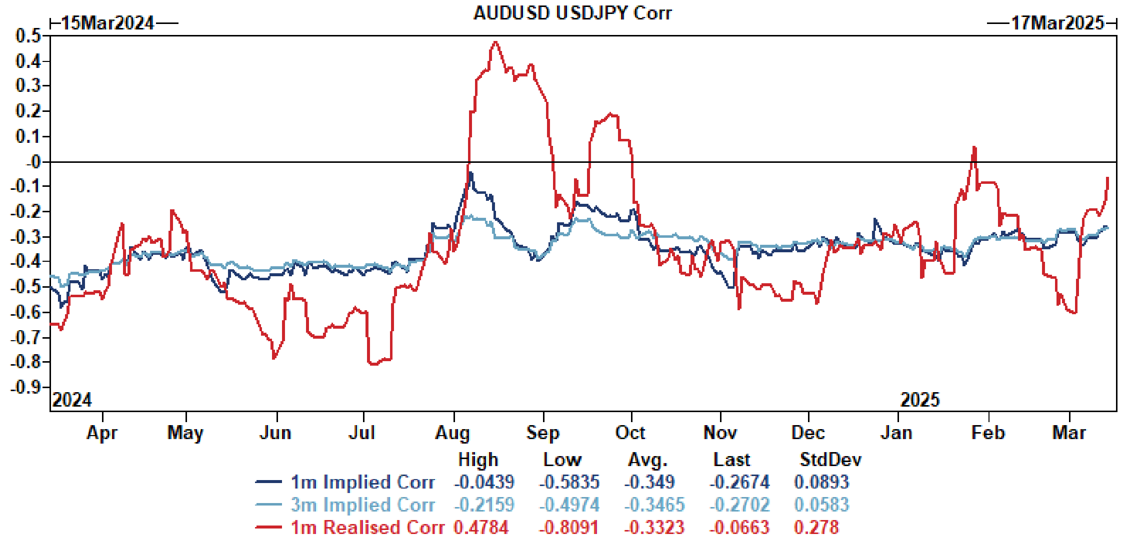


(9) G10 FX : Short AUD and Long JPY by Eric Dai (FX Strats, LDN)

View: If the equity weakness persists, we expect **JPY** to strengthen against USD as well the weakening of cyclical currencies, such as **AUD** and **CAD**. AUDUSD and USDJPY realised correlation has moved higher than the implied correlation, giving room for the implied to move higher. Among the top correlated currencies, **AUD** has less of tariff risks compared to **CAD** and **MXN**, therefore more viable for this implementation. For a convex FX implementation given a further leg of SPX weakness, buying a ***2-month (16May25) Dual Binary AUDUSD < 0.6250 and USDJPY < 146 costs 7.5%, max leverage ~ 13.3x*** *(SpotRef 0.6372 and 149.70; Implied Corr mid at -26%, as of 18-Mar-25)* gives reasonable correlation saving. *Max loss: net premium paid.*



Source: GS FX MarketStrats



*Source for all trades/charts (unless otherwise specified): GS FICC and Equities, as of 17Mar25. Past performance not a guarantee of future results.

**Risk is unlimited for the trades above (unless otherwise specified).

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