Global Markets Daily: Could We Have Seen the Worst in Markets Already? (Chang)

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- The most immediate question for markets is whether there is fresh downside to come. We said that a shift in trade policy was the most obvious route for recovery in risk assets, and there has been a modest version of that dynamic since April 9. Even though the economic impact is yet to be felt, it is possible that we are past the peak of new tariff "shocks" and policy uncertainty.
- In past equity corrections, markets tended to bottom near the trough in economic activity. But if there was a clear cause of the weakness, it was enough for the market to see the peak in pressure from that source to conclude that activity would bottom soon, and for equities to trough ahead of that. In episodes where the source was less easy to track, the market did not trough until economic growth itself started to bottom.
- What matters now is whether the current episode is more like past "shock"-driven corrections where the tariff shock having seemingly peaked could be enough to mark the market bottom, or whether this will ultimately be a scenario where the economic data needs to stabilize first. It is possible that simply being through the worst of the shock has allowed the market to set some limits on the process, even if the damage is yet to be felt and if the underlying economic situation remains bad for some time.
- Despite that possibility, we still think there is significant vulnerability in a recession scenario, even if the worst of the underlying "shock" has passed, for three reasons: 1) It has generally been true that in shock-driven corrections, there has been a meaningful reversal and not just a peak in the source of the pressure. So the tariff reversal may need to be more dramatic to be equivalent to those past peaks. 2) The unemployment rate matters a lot for the pricing of risk, and it has been some time since the economy has undergone a period of job and portfolio losses happening together. 3) The 19% drawdown so far would be relatively mild relative to past recessionary drawdowns and would have entirely taken place before economic damage is seen, which would be historically unusual.
- It is worth keeping an open mind given the unprecedented nature of the current shock, but continued market recovery from here means putting an increasing weight on the belief that recessionary dynamics will not take hold, and requires confidence in the market's ability to look through what is likely to be a further weakening in the data. We think the balance of risks still argues for expecting renewed declines in equity prices from current levels and for adding downside

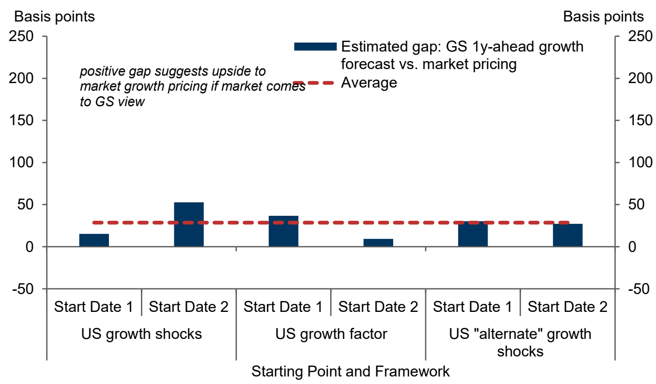
protection, especially if further relaxation makes that protection cheaper.

Could We Have Seen the Worst in Markets Already?

Risk assets have staged a partial recovery from their April 8 lows. For markets, the most immediate question is whether there is fresh downside to come. We said that a shift in trade policy was the most obvious route for recovery in risk assets. We have seen a version of that, starting with the 90-day pause on reciprocal tariffs, product-specific tariff exemptions, and seeming openness to negotiating with China. Those are modest shifts that still leave significant tariffs and recession risk in place. But it is likely true that we are past the peak of new tariff "shocks", and possibly past peak policy uncertainty.

Our focus has been on benchmarking what is priced versus possible growth outcomes. Through that lens, the market is close to pricing our baseline non-recessionary growth view and is far from pricing a recession, which our US economists see as a 45% probability in the next 12 months. We have favored taking a defensive stance as a result. And although we have argued that some relief was possible in the near term, we have advocated using that to add downside protection.

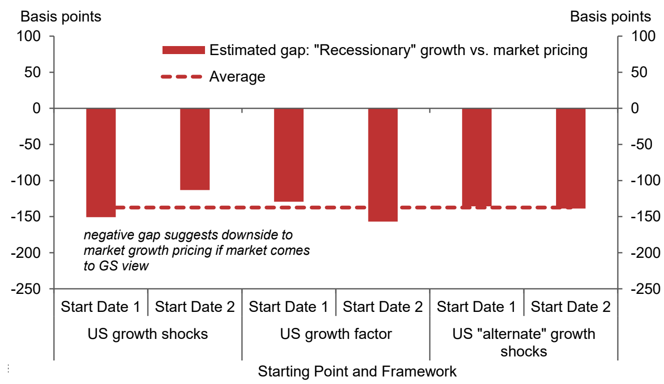
Exhibit 1: Market growth pricing is close to pricing our baseline forecasts...



Start Date 1 considers changes in market pricing since August 2023, and Start Date 2 considers changes since July 2024

Source: Goldman Sachs Global Investment Research

Exhibit 2: ...but is a long way from pricing a recessionary growth scenario



Start Date 1 considers changes in market pricing since August 2023, and Start Date 2 considers changes since July 2024

Source: Goldman Sachs Global Investment Research

If recession is avoided, it is clearer that the market likely does not need to fall again past its early April lows. The simplest route for risk assets to have troughed is for the economy to track along our baseline path. But it is worth considering whether passing through the peak of the tariff and uncertainty shock is enough to have established a floor under prices, even if the economy deteriorates properly from here. It is helpful to step back from our growth pricing work and to take a broader perspective than that simple exercise allows.

We looked in the past at historical stock market corrections and the macro conditions that marked the bottom in those episodes. Exhibit 3 shows those episodes, where the S&P 500 fell by more than 15% peak-to trough, categorized by contributing factor where one is relatively clear.

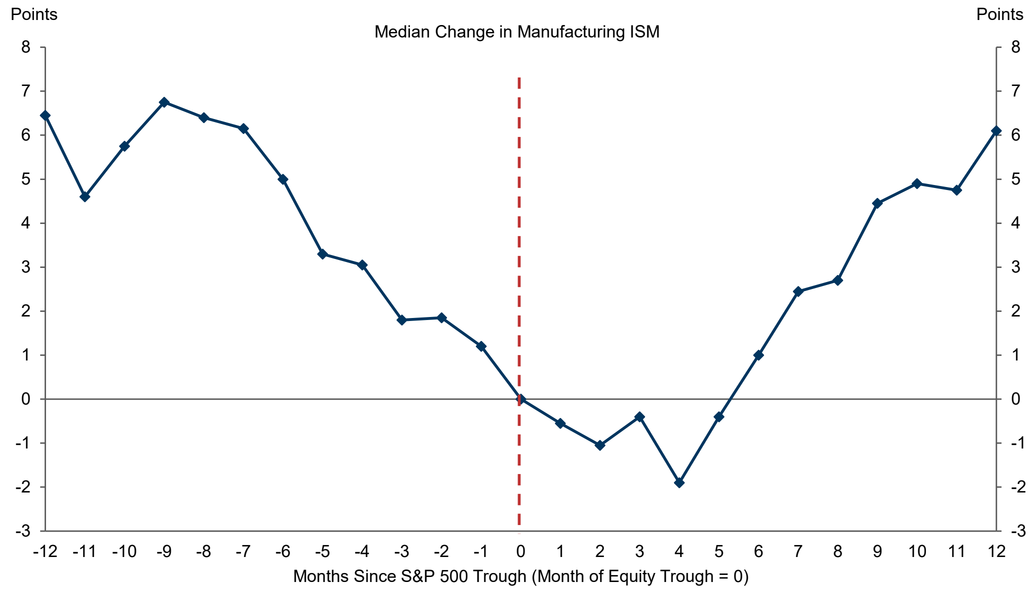
Exhibit 3: S&P 500 peak-to-trough drawdowns of more than 15% since 1950

S&P 500 >15% Peak-to-Trough Drawdowns				
Peak	Trough	Drawdown	Recession	Source
8/2/1956	10/22/1957	-22%	Yes	Monetary Policy
12/12/1961	6/26/1962	-28%	No	Unclear
2/9/1966	10/7/1966	-22%	No	Monetary Policy
11/29/1968	5/26/1970	-36%	Yes	Monetary Policy
1/11/1973	10/3/1974	-48%	Yes	Monetary Policy/Oil
9/21/1976	3/6/1978	-19%	No	Unclear
2/13/1980	3/27/1980	-17%	Yes	Monetary Policy/Oil
11/28/1980	8/12/1982	-27%	Yes	Monetary
8/25/1987	12/4/1987	-34%	No	Financial Panic
7/16/1990	10/11/1990	-20%	Yes	Monetary Policy/Oil
7/17/1998	8/31/1998	-19%	No	Financial Panic
3/24/2000	10/9/2002	-49%	Yes	Financial Imbalance
10/9/2007	3/9/2009	-57%	Yes	Financial Imbalance
4/23/2010	7/2/2010	-16%	No	Growth/Fiscal
4/29/2011	10/3/2011	-19%	No	Fiscal
9/20/2018	12/24/2018	-20%	No	Monetary Policy
2/19/2020	3/23/2020	-34%	Yes	Pandemic
1/3/2022	10/12/2022	-25%	No	Monetary Policy
2/19/2025	*4/8/2025*	*19%*	?	Trade Policy/Policy Uncertainty

Source: Goldman Sachs Global Investment Research

We showed that markets tend to bottom near the trough in economic activity (Exhibit 4). On our current forecasts that does not take place until Q3 of this year, but markets having bottomed in early April on that kind of timeline is not inconsistent with history. If a recession were to occur, the trough would likely be somewhat later—our brief recessionary forecast had GDP growth contracting in the last two quarters of the year.

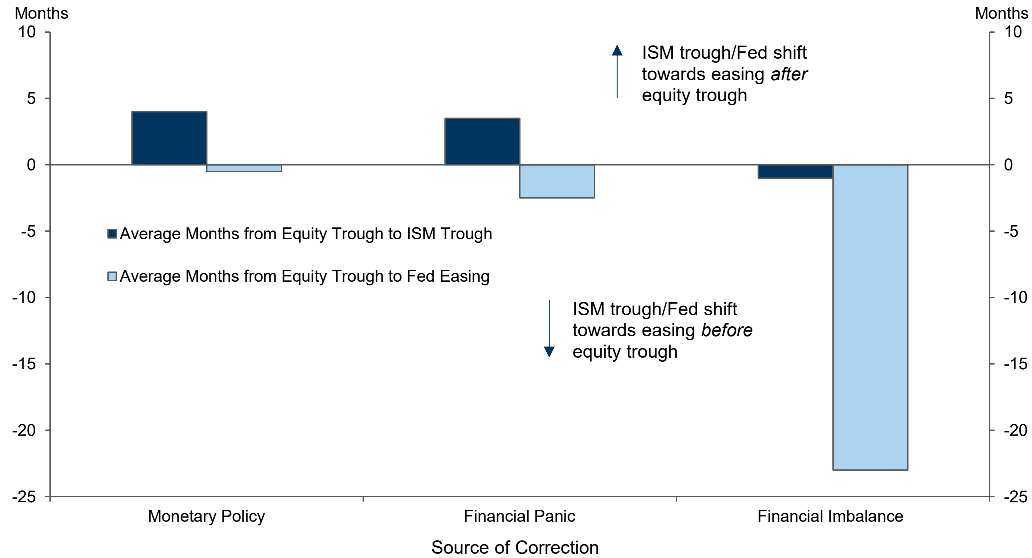
Exhibit 4: Markets have tended to bottom near the trough in economic activity



Source: Goldman Sachs Global Investment Research

But the more nuanced lesson from history was that in corrections driven by monetary policy tightening, a Fed shift away from tightening was enough for the market to trough ahead of the bottom in economic activity. More generally, if there was a clear cause of the economic and market weakness, it was enough for the market to see pressures from that source peak for it to conclude that the activity trough was in sight and for equities to trough ahead of that ("monetary policy" and "financial panic" episodes in Exhibit 5). In 1990, equities troughed on the same day as the peak in oil prices, and in 2022 around the peak in core inflation measures. By contrast, in episodes such as the early 2000s recession and the Global Financial Crisis, where the source of the pressure was less easy to track, making it so that the market could less clearly see the likely limits of the economic damage, equities did not trough until economic growth itself started to bottom ("financial imbalance" episodes in Exhibit 5).

Exhibit 5: Equity corrections driven by a clearer cause (monetary policy/financial panic) have tended to end before the trough in economic activity

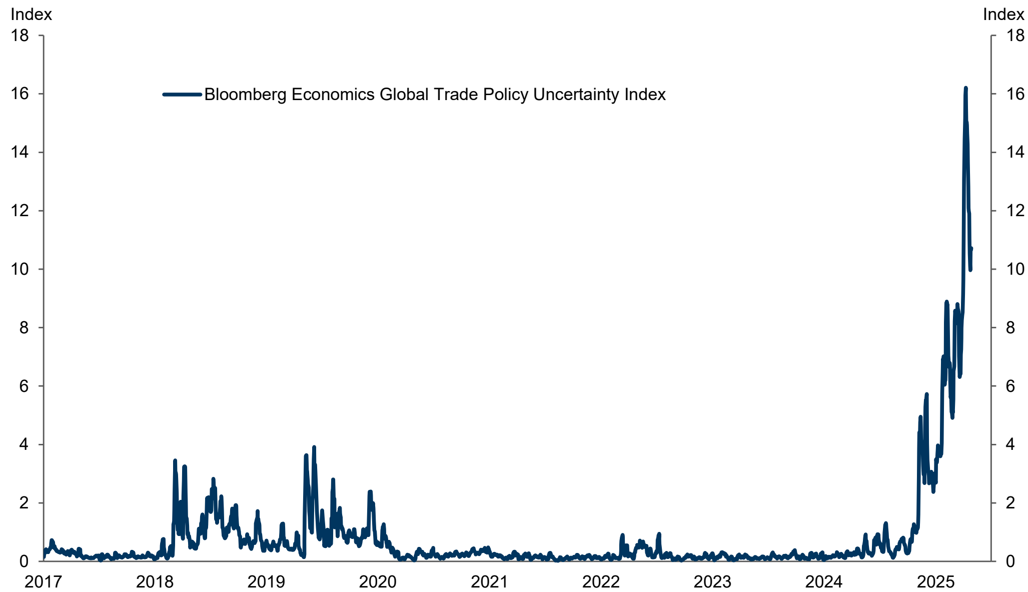


Source: Goldman Sachs Global Investment Research

Behind this is the idea that simply being able to put limits around the potential damage plays a large role in markets troughing. The market struggles to find those limits while conditions are actively deteriorating, and so it puts heavy weight on deeply negative tail risks initially. Inflection points often come even before true economic recovery is visible, when the market can simply price a limit on those deeper tails.

The 19% peak-to-trough drawdown so far already puts this episode on the list in Exhibit 3. What matters now is whether this, in the end, is more like past "shock"-driven corrections (like the monetary policy and oil-driven episodes in history), where the tariff and uncertainty shock having seemingly peaked could be enough to mark the market bottom, or whether this will ultimately be a scenario where the economic data needs to stabilize first. This is a new kind of shock—so it is hard to have confidence—but it is possible that simply being through the worst of the shock, even if the damage is yet to be felt, has allowed the market to set some limits on the process and to begin to look past it even if the underlying economic situation remains bad in absolute terms for some time.

Exhibit 6: Trade policy uncertainty may have peaked



Source: Bloomberg, Goldman Sachs Global Investment Research

But we still think there is significant vulnerability in a true recession scenario, even if the worst of the underlying shock has passed, for three reasons.

1. First, while the evidence is limited given small sample sizes, it has generally been true that in shock-driven corrections, there has been a meaningful reversal and not just a peak in the source of the pressure. The Fed often shifted towards easing, and oil prices came down sharply in 1990. So the tariff and uncertainty reversal may need to be more dramatic than the small shifts that we have seen so far to be equivalent to those past peaks. It is also possible that there are fresh shocks to come or that the modest reversals we have seen are themselves unwound.
2. Second, the unemployment rate matters a lot for the pricing of risk. There are strong theoretical reasons for this. Consumption-based asset pricing models attribute this to countercyclical risk aversion and investors' perceptions of risk changing as their wealth fluctuates—people are significantly more risk averse when facing significant loss of income than they otherwise would be. Changes in the unemployment rate feature in our models of equity valuations and forward equity returns, and in our macro models of equity volatility as a result. We also find evidence that the drag from overvaluation on forward equity returns is larger when the unemployment rate is rising than when it is falling. It has been some time since the economy has undergone a period of job and portfolio losses happening together.
3. Third, if there is a recession and the April 8 low was the market bottom, the 19% drawdown would be relatively mild relative to past recessionary drawdowns and would have ended before economic damage has been seen. That combination would be unusual relative to history. The 1990 equity correction was shallow, but the economy was already 3 months into a recession, and payrolls growth had turned negative by the time the equity market troughed. In 2020, the market bottomed in

March before much damage was visible in the data, but the correction was much sharper than now (-34%).

It is important to keep an open mind given the unprecedented nature of the current shock. Short-term equity implied volatility and skew already spiked sharply, to clearly recessionary levels at the worst of the market panic. It is possible that we have seen the worst on that front, even as the cyclical question remains an open one. But we think the balance of risks still argues for expecting renewed declines in equity prices from current levels and for adding downside protection, especially if further relaxation makes that protection cheaper. Continued market recovery from here means putting an increasing weight on the belief that recessionary dynamics, where job losses accelerate and risk aversion rises, will not take hold, and requires confidence in the market's ability to look through what is likely to be a further weakening in the data. A sustained recovery may still be some time away even if the market does not make new lows, especially with the market not pricing much cushion for downside growth risks.

TRADE IDEAS

Best Trade Ideas Across Assets

For pricing and a list of previous recommendations, please visit our Trade Ideas page.

1. KRW 2/10Y IRS steepener, opened September 4, 2024, at -12bps, with a target of 30bps, and a stop of -30bps, currently trading at 15bps.
2. Stay long Indonesia 1Y SRBIs fully FX hedged, opened on October 3, 2024, at 6.82%, with a target of 5.70%, and a revised stop of 6.70%, currently trading at 6.46%.
3. Stay short THB/KRW, opened January 10, 2025, at 42.30, with a target of 39.0, and a stop of 44.0, currently trading at 43.1.
4. Receive INR 2Y NDOIS, opened January 28, 2025, at 6.08%, with a revised target of 5.30% and a revised stop of 5.70%, currently trading at 5.55%
5. NSE India Consumption vs. NSE Infra outperformance pair trade, opened February 03, 2025, at 1.41, with a target of 1.70, and a stop of 1.25, currently trading at 1.30.
6. Receive 5y AUD IRS vs. Pay 5y NZD, opened February 21, 2025, at 0.26, with a target of -0.10, and a stop of 0.26, currently trading at 0.19.
7. Buy SFRZ5 96.25 put vs sell 0QZ5 96.25 put (in net premium), opened March 7, 2025, at -0.03, with a target of 0.12, and a revised stop of 0.00, currently trading at 0.04.
8. Close short AUD/JPY opened March 17, 2025, at 94, with a revised target of 85.0, and a revised stop of 91.5, for a potential spot gain of 2.8%.
9. Sell 1x2 A/A+17 3m 2s10s curve cap spread, opened March 21, 2025, at 0.00, with a revised target of 0.15, and a revised stop of 0.02, currently trading at 0.06.
10. Pay 2y2y CORRA vs receive 2y2y SOFR, opened April 4, 2025, at -0.98, with a

target of -0.65, and a revised stop of -0.9, currently trading at -0.81.

11. Stay long 2Y CGBs, opened April 6, 2025, at 1.47%, with a target of 1.05%, and a stop of 1.70%, currently trading at 1.48%.
12. Buy 30y TIPS on a beta weighted basis versus nominals (1:0.7x), opened April 17, 2025, at -0.77, with a target of -0.93, and a stop of -0.67, currently trading at -0.80.
13. Stay long BRL/MXN, opened April 17, 2025, at 3.39, with a target of 3.60, and a revised stop of 3.40, currently trading at 3.47.
14. JGB 10s30s flattener, opened April 25, 2025, at 1.36, with a target of 1.10 and a stop of 1.50, currently trading at 1.38.
15. Buy 3-month NOK/SEK 0.9450/0.9700 call spreads, opened April 25, 2025, at a spot level of 0.9282, currently trading at 0.9267.

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Reg AC

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