Goldman Sachs The Markets

"Stocks Are Still Very Undervalued"

Anshul Sehgal, Global Co-Head of Fixed Income, Currency and Commodities, Global Banking & Markets Chris Hussey, Host, Goldman Sachs Research

Date of recording: July 31, 2025

Chris Hussey: This is The Markets. I'm Chris Hussey. Today is Thursday, July 31st, and we're coming to you from the Goldman Sachs trading floor with Anshul Sehgal, global co-head of Fixed Income, Currency & Commodities within Goldman Sachs Global Banking and Markets division. Anshul, thanks for joining us.

Anshul Sehgal: Great to be here. Thank you for having me.

Chris Hussey: All right, so I got to go to my notes because we had you on last time, just ahead of the May Fed meeting and the byline was the Fed does nothing, rates remain high, and uncertainty abounds. What does this all mean for investors? So a little less than three months later, did nothing change? What's your take on the meeting?

Anshul Sehgal: Yeah, so uncertainty continues to abound, though the world has turned and things are different today. There is more clarity in terms of where the tariff train is going. The economy held up exceptionally well. Last time when we met, Q1 GDP was a negative print. Q2 GDP nicely rebound as we learned this week. All in all, we are more optimistic.

We were plenty optimistic when we met last, but we continue to be very optimistic on the intermediate-term trajectory for the global economy. Like, we expect that there is a 30% chance that we go through a soft patch in H2 of this year. If you look through that, in 2026, we are seeing nothing but, like, good news for the global economy. Like, you've got Germany fiscally expanding because of defense. You've got the Big Beautiful Bill, which has the potential, especially in conjunction with AI and robotics, to unleash a credit boom domestically in addition to the fiscal expansion that we've witnessed over the last four years.

And similarly, China, to continue to hold onto its perch in AI and robotics, is already expanding in both credit and fiscal terms. So the combination of those things globally essentially mean that you're going to get, like, asset price appreciation in the intermediate term.

Now, in the very near term, because tariffs are on corporates if they absorb the losses. The number we're talking about $250-300 billion annualized based on where things are falling. That's about 1% of GDP, which is a non-trivial amount. That, if it's absorbed by the corporates, would be an impact on stocks. And if it's absorbed by the consumer, it will impact consumption in the near term. It is a one-time tax, though.

So once it's factored in and starting early next year, once you've got the bonus depreciation that's in the Big Beautiful Bill, you've got the Social Security tax benefits, and the lower taxes on tips, the combination of those things are very powerful for the US economy in our view.

Chris Hussey: Let me unpack a couple of those things because you said there's a 30% chance of a soft patch, maybe even you called it a recession, in the second half of this year but 2026 is going to look fine. And then you had this one-time sort of impact from tariffs, but that's a one-time impact so it's not a sustained impact necessarily on inflation. And we had two dissenters here. Two in the Fed who thought we should be cutting rates now. Unpack that a little bit. Are these two dissenters that you're sort of saying, "Yeah, that makes a lot of sense"? Is there any politics involved? How are you thinking about it?

Anshul Sehgal: Well, there might well be politics involved. I'm not going to go there. But that said, if the federal government took up taxes in any other way, that would be fiscal contraction and then the Fed would ease. This is similar except it comes with a one-time price adjustment -- so inflation -- but a one-time inflation, not necessarily sustained inflation. And then the question or the debate becomes whether the Fed should see through it or whether the Fed should adapt policy based on that.

Now, what we learned yesterday from Chair Powell is that he -- it's nuanced because he did not say that he's not willing to look through it. He might well look through it. What he's saying is he'd like to wait and see the cumulative impact of all of the things that have gone on in the last three months on the domestic economy, which is a fine stance to have. But then you look at Governor Waller and

Governor Bowman, their view is that the Fed should get ahead of this taxation that is coming down the pike and should start easing right away.

I think a divisive viewpoint is good. Only time will tell where things end up. My personal view is that we're definitely not getting a recession in H2 of this year. The economy will muddle through. And then starting towards, like, say, early Q4, CapEx will take another leg higher because there will be deregulation, especially in the banking industry. That's already underway. The combination of those things will be so much more powerful than the negative impacts of tariffs that, if the Fed does not cut in the next few months, odds that they cut in the ensuing six are quite low.

Chris Hussey: All right, so this is The Markets. Let's shift to the markets. Let's shift to the bond market. Diversity of opinion in the economy, diversity of opinion in the markets. What are you seeing in the markets here? The reaction to the Fed as well as just the broader market?

Anshul Sehgal: Yeah, so super interesting time in markets. Like, Powell's speech yesterday kind of put a marker in how the dollar had been trading. So the dollar, going back to February, late February, before even Liberation Day, was on a downswing. The dollar was weakening versus every other currency. Gold was ripping. Silver was doing really well. All metals were doing really well, some because of global growth, some because of the dollar weakening.

Yesterday marked a change in that. So if you compare the dollar to the yen, it's crossed the 200-day moving average. If you compare the dollar to the euro, like, the euro's lost ground, like, 300 basis points of ground in just a few trading sessions. FX markets generally trend until there's a phase shift, so this is very meaningful. Like, if you look at the ECB, they cut because their economy was slowing in the near term, but they also predicated some of those cuts on the Fed being easy. And now the Fed's basically saying, like, "No, we want to take a wait-and-watch approach," in which case, like, the trend could reverse very meaningfully so that's super exciting. And I think this plays out much more in the currency space than the rates space.

There's still a fair number of cuts priced in the rates curve, especially out to end of 2026. Only time will tell whether they materialize or not. For me, I think that's too many cuts in the price there. I don't see this Fed cutting very many times. Of course, the next Fed, we'll see how dovish they are. But my expectation is that they will not be able to cut very much. Generally what happens is that, once you get the first few innings of a credit boom, that inevitably leads to more mortgage origination, which leads to higher home prices, which leads to inflation. So by the time the next Fed is in motion in May/June of next year, my expectation is that inflation is actually going to be looking like it's on the up drop.

So the combination of those things makes it very difficult for me to see a Fed that's being excessively easy. But also I don't see it as a rates story. I see it more as an FX story.

Chris Hussey: So interesting, right? So you have the Fed sort of holding the ground on rates, the UK not so much. ECB, though, they did hold the ground on rates as well. If the Fed were to start cutting, though, in September, does the short dollar trade come back on?

Anshul Sehgal: If the Fed were to start cutting in September then you have cross currents in the short dollar trade. Obviously, you would expect the dollar to weaken some quantum. How much really depends on the interplay of Fed policy. And generally when you get a credit expansion as well, which we envision for 2026, the currency weakens.

But then the offset to all of this, on the other side, is AI and robotics. That is mainly being done in the United States and in China. So if you want to basically partake in that as an investor, you have to own American stocks. To own American stocks, you need dollars. So then there are cross currents which makes the trade less clean and very difficult to say which side wins over, but if the Fed were to hold ground, then the strong dollar trade, both the AI wave contributes to it and so does Fed policy.

Chris Hussey: That's a great point. All right, we've talked stocks, bonds, and dollar now. What's your favorite trade?

Anshul Sehgal: Continues to be long stocks. I think stocks are still very undervalued. You look at the earnings that came out in the last 24 hours, they are blockbuster good. You're looking at two things that are playing out right now. Obviously the AI CapEx boom, that's contributing to GDP today. And conceivably because I'm a believer in the technology, I suspect over the next five to ten years it's the AI deployment that will add to GDP. So definitely long stocks.

Long the dollar. Long carry because rates aren't going anywhere. So long mortgage basis. Long US treasuries and asset swap. Short options on rates. Combination of carry strategies.

Chris Hussey: Good stuff. Okay, so you say stocks are undervalued but that runs a little counter to some of the stuff we're hearing about retail investors getting involved and meme stocks and so forth. Why do you say that?

Anshul Sehgal: Yeah, so that's a super interesting question. If you do bottoms up and look at what companies are saying how their earnings will be then stocks look a little rich in terms of PE, in terms of equity risk premium, and all of those metrics. For us as macro traders, we're looking at it top down. The way we're looking at is the US government's going to fiscally expand by another 6% this year and 6-7% next year. So just through debasement of currency or just, like, any real assist versus fiat currency should richen by about that much every year.

Then on top of that, if you're looking at a credit boom, especially a productive credit boom because that credit is being created and deployed into emergent technologies that have the potential to change the world, then essentially what ends up happening -- and that's how we're viewing it -- is that all of this accrues a lot more to US stocks than it does to other forms of investment. And when you look at it top down from that perspective, stocks continue to look very cheap to us.

Chris Hussey: All right, we're going to head in deep summer now. What are you going to watch out for in August?

Anshul Sehgal: Slow markets, illiquid markets always a problem. Going back over the last five years on this side of the pandemic, the middle of the year has always had a wobble. Last year, it was the Japan wobble up to August 5th. So one has to always watch out for that. But other that, I'm hoping that I get to take time off from work.

Chris Hussey: I hope you do, too. I will be as well. Anshul, thanks so much for joining us.

Anshul Sehgal: Thank you again for having me.

Chris Hussey: That does it for this episode of The Markets. I'm Chris Hussey. Thanks for listening.

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