Global Markets Daily: Cross-Asset Implications If the Fed Eases More Quickly (Chang)

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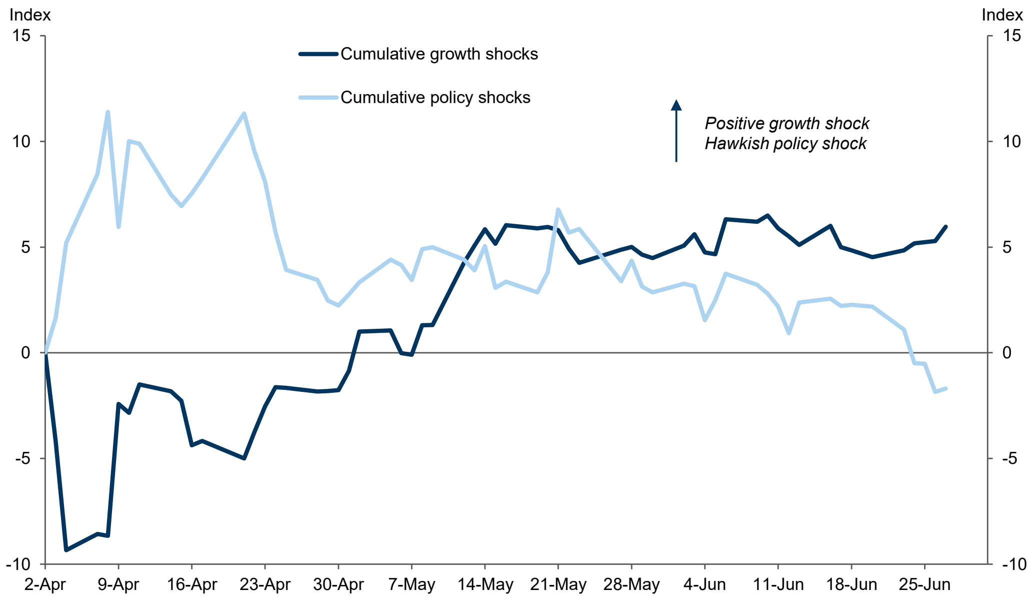
- Since late April, the market has upgraded its growth views while pricing a more dovish Fed. The tighter policy shock that the market priced in early April has reversed by less than the negative growth shock, although the market has begun in recent days to push more sharply towards pricing more Fed easing.
- Strong labor market data and higher inflation prints over the summer would now likely pose a challenge to the easing the market has priced, but another month or two of friendlier inflation news could create more room for the market to push further towards pricing earlier and deeper easing, even without a sharp rise in the unemployment rate. Conditional on that scenario, what should investors do? We illustrate here what various versions of the market moving towards pricing more Fed easing might look like across assets.
- The best expression of the market moving towards pricing more rate cuts depends on the growth backdrop that accompanies that dynamic. Directionally, rates lower, reserve and safe haven currency strength vs. USD, and gold upside are more consistent across scenarios. Equity direction depends on getting the growth call right, as does positioning for strength in riskier currencies.
- Equity upside is clearly the best expression for a "dovish policy plus positive growth shock" scenario, while yield downside is clearly the best expression in a "dovish policy plus negative growth shock" scenario. A shift towards pricing more Fed easing has the potential to reinforce USD weakness and steeper yield curves, which are both medium-term trends that we think are likely for other reasons too.

Cross-Asset Implications If the Fed Eases More Quickly

Our macro tools suggest that, since late April, the market has upgraded its growth views while easing its view of the Fed's reaction function. The market has reversed less of the tighter policy shock that it priced in the wake of the reciprocal tariff announcement than the negative growth shock.

Exhibit 1: Less of a reversal in the post-April 2 tighter policy shock than the growth downgrade



Source: Goldman Sachs Global Investment Research

The market is now pricing a full cut by September and more than two cuts by the end of the year. An obvious way that earlier and potentially deeper cuts could come is if the labor market slows more sharply. But more recently, FOMC members like Governors Waller and Bowman have expressed openness to the idea that rate cuts could come sooner rather than later. The underlying inflation news has been better than expected, and the tariff impact on inflation has so far been more limited than expected. It is premature to draw strong conclusions from a month's data, but if that dynamic continues, more paths to an earlier easing could open. Our US economists now see more routes to earlier cuts than before, and have revised their forecasts to show three cuts this year and a lower terminal rate.

The market has, in recent days, already begun to push in this direction. Further benign inflation data, or weaker jobs data, could further support the narrative of earlier and faster cuts. Conditional on that scenario, what should investors do? We consider here what various versions of the market moving towards pricing more Fed easing might look like across assets, using our cross-asset frameworks. As always, these are illustrative scenarios that miss asset-specific dynamics but aim to highlight broad lessons across assets. Exhibit 2 shows estimated outcomes for four scenarios and compares those outcomes to implied volatility in options markets.

Scenario 1 considers a dovish policy shock that lowers 2-year yields by 25bps. This could happen if inflation news continues to be better than expected or the Fed becomes more confident that tariff-related impacts will be temporary. In this scenario, equities rise, yields fall, and the curve steepens. The Dollar weakens across the board. Compared to options-implied volatility, S&P 500 upside and US yield downside are the largest moves.

Scenario 2 is one where US growth expectations fall by 50bp. In this case, the increased chance of rate cuts is driven solely by the normal response to growth weakness. This could happen if further weakening in the labor market and activity data challenges the market's ability to believe that the economic damage from tariffs will be limited. Here, equities and yields fall, and the curve steepens. The broad Dollar weakens slightly, but performance is mixed across currencies and Dollar weakness is clearest against reserve and safe haven currencies. US equity downside, VIX upside, and US yield downside are the largest in volatility-adjusted terms.

Scenario 3 considers a scenario where markets price a dovish Fed shift and simultaneously downgrade growth. It combines the dovish policy shock and negative growth shock above. US equities fall modestly, yields fall by more than in the previous two scenarios, and the curve steepens. The Dollar weakens across the board. On a volatility-adjusted basis, the fall in yields is the most pronounced move.

Scenario 4 considers a scenario where markets price a dovish Fed shift while upgrading US growth expectations by 50bp. In this scenario, risk assets rise most clearly, yields are slightly lower (caught between a more dovish Fed and stronger growth), and the broad Dollar weakens modestly, with weakness most pronounced against more cyclical currencies. Equity upside and VIX downside stand out most on a volatility-adjusted basis.

Exhibit 2: Estimated cross-asset outcomes in different macro scenarios where the market prices more Fed easing

	Scenario 1 Dovish US Policy Shock		Scenario 2 US Growth Down		Scenario 3 Dovish Policy Shock and US Growth Down		Scenario 4 Dovish Policy Shock and US Growth Up	
	Change	Vol-Scaled	Change	Vol-Scaled	Change	Vol-Scaled	Change	Vol-Scaled
Equities								
S&P 500	2.5%	0.41	-2.9%	0.33	-0.5%	0.06	5.5%	0.92
Russell 2000	2.8%	0.28	-3.1%	0.27	-0.4%	0.03	6.0%	0.61
Nasdaq 100	2.8%	0.35	-3.3%	0.30	-0.5%	0.05	6.3%	0.79
Eurostoxx 50	2.1%	0.31	-1.5%	0.17	0.6%	0.09	3.6%	0.54
Nikkei 225	1.2%	0.13	-2.0%	0.19	-0.9%	0.08	3.2%	0.37
MSCI EM	1.7%	0.25	-1.1%	0.13	0.7%	0.09	2.8%	0.40
VIX	-10%	0.33	15%	0.33	4%	0.08	-22%	0.74
FX								
EUR/USD	0.8%	0.18	0.6%	0.14	1.3%	0.32	0.2%	0.04
AUD/USD	0.7%	0.15	0.1%	0.01	0.8%	0.16	0.7%	0.14
GBP/USD	0.8%	0.19	0.1%	0.02	0.8%	0.21	0.7%	0.18
JPY/USD	1.1%	0.19	0.9%	0.15	1.9%	0.34	0.2%	0.03
CHF/USD	0.8%	0.16	0.5%	0.10	1.2%	0.26	0.3%	0.06
CAD/USD	0.4%	0.14	-0.1%	0.04	0.3%	0.10	0.5%	0.17
MXN/USD	1.0%	0.22	-0.2%	0.04	0.8%	0.17	1.2%	0.27
CNH/USD	0.3%	0.11	0.2%	0.07	0.4%	0.18	0.1%	0.03
USD TWI	-0.7%	--	-0.2%	--	-0.8%	--	-0.5%	--
Commodities								
Gold	1.2%	0.15	0.9%	0.11	2.0%	0.26	0.3%	0.04
Rates								
UST 2y	-25bp	0.47	-18bp	0.34	-43bp	0.82	-7bp	0.13
UST 10y	-20bp	0.43	-11bp	0.24	-31bp	0.67	-9bp	0.19

Vol-scaled returns are the absolute value of estimated returns as a proportion of 3m 25d call or put implied volatility deannualized to 3 months
All FX vs USD changes are in XXXUSD terms. A negative change implies currency weakness vs. USD.

Source: Goldman Sachs Global Investment Research

The clearest takeaway is that the best expression of the market moving towards pricing more rate cuts depends on the growth backdrop that accompanies that dynamic. We see the following messages for investors from this analysis:

1. Positioning for lower yields and higher equities offers similar leverage to a pure dovish shock.
2. Lower yields but *lower* equities offer the best leverage to a negative growth shock.
3. Directionally, yields lower, EUR/JPY/CHF strength, and gold upside are more consistent across scenarios. Equity direction depends on getting the growth call right, as does positioning for strength in riskier currencies vs. USD.
4. Equity upside is clearly the best expression for a "dovish policy plus positive growth shock" scenario. Yield downside is clearly the best expression in a "dovish policy plus negative growth shock" scenario.
5. A shift towards pricing more Fed easing has the potential to reinforce USD weakness (particularly against reserve and safe haven currencies) and steeper yield curves, which are both medium-term trends that we think are likely even for reasons beyond the possibilities illustrated here.

The market has already begun to price Fed easing, and we think a lot will depend on whether the data cooperates enough to enable that shift to extend. Our growth benchmarking analysis suggests that the market is pricing a growth view that is somewhat more optimistic than our 1y-ahead view, but with potentially some further upside if the market moves more towards pricing the 2026 growth outlook. More visible weakening in the growth and jobs data could also reignite growth fears, even if temporary, and would be one route to pricing more easing. But this exercise also illustrates how a dovish shift from the Fed, so long as the growth backdrop holds up, could be a tailwind to risk assets even as the growth outlook looks more fully priced than in April. Strong labor market data and higher inflation prints over the summer would now likely pose a challenge to the cuts the market has priced. But another month or two of friendlier inflation news may create more room for the market to move further towards pricing earlier and deeper easing, even without a sharp rise in the unemployment rate.

TRADE IDEAS

Best Trade Ideas Across Assets

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1. 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 6.13%, as of June 26.
2. 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 41.75.
3. 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 1.26.
4. Stay long 3y SOFR-UST swap spreads, opened May 2, 2025, at -0.30, with a target of -0.23 and a revised stop of -0.29, currently trading at -0.28.
5. Stay long 3m10y USD payer on 3m 5s10s30s payer fly (return in bp running), opened May 2, 2025, at 0.00, with a target of 0.10 and a stop of -0.05, currently trading at 0.00.
6. Stay long the sovereign USD bonds of Poland, Hungary, Uruguay and Jamaica as an equally weighted basket, opened May 20, 2025, at 0%, with a total return target of 3% and a revised stop of 1.2%, currently trading at 2.1%.
7. Stay long MSCI Korea (M1KR Index) in USD terms, opened May 21, 2025, indexed to 100, with a target at 130 and a revised stop at 118, currently trading at 120.2.
8. Receive December 2025 BoE meeting OIS, opened May 30, 2025, at 3.85%, with a target of 3.50% and a revised stop at 3.75%, currently trading at 3.69%.
9. Stay long 5y TIPS on a beta weighted basis versus nominals (1:0.7x), opened June 6, 2025, at -1.13 with a revised target of -1.35 and a revised stop of -1.18, currently trading at -1.23.
10. 2s5s SOFR steepeners, opened June 27, 2025, at -0.07, with a target of 0.03 and a

stop of -0.12.

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