Global Markets Comment: Beyond Relief—A Cross-Asset View

Dominic Wilson
+1(212)902-5924 |
dominic.wilson@gs.com
Goldman Sachs & Co. LLC

Vickie Chang
+1(212)902-6915 |
vickie.chang@gs.com
Goldman Sachs & Co. LLC

- Markets have seen substantial relief as the ceasefire and negotiation process have progressed and oil prices have dropped, with US equities and some other assets already at fresh highs. We revisit our cross-asset frameworks here to answer the questions we are encountering about what might come next.
- The cross-asset pattern since late March is broadly consistent with what we would expect from a "relief" scenario based on a fall in oil prices and some reversal of growth and policy fears. But that relief has come with less of a fall in oil prices and in interest rates, so oil prices and bond yields are still clearly higher than they were before the war began. US growth pricing is close to our baseline forecast already, though the market has unwound less of the initial hawkish policy shock.
- We think it is more common than skeptics might think for relief to occur largely on the reduction of deep tail risks. So long as the market can maintain its conviction that a resolution is likely in the coming months, near-term economic damage and setbacks—even material ones—may not have a large impact on equities and other longer-duration assets. But with markets now leaning heavily on that assumption, deeper downside tails look underpriced again. We think maintaining, and potentially increasing, hedges makes sense.
- Given that the contours of a sustained arrangement that would restore normal oil flows are still not clear, downside tail risks still look larger than before the war, and because the market has become more confident in resolution, developments that are large enough to shake that confidence are likely also to have meaningful market impact. Downside in European assets and upside in US credit spreads and volatility continue to screen well as potential hedges, with more cyclical assets like AUD and CAD potential hedges if broader recession fears were to re-emerge. We think there is still some modest scope for relief on growth and policy risks, especially if oil prices and oil volatility fall further. European assets and Nasdaq screen well as beneficiaries of any further shifts in that direction.
- But with substantial relief already reflected, the outlook beyond the war is becoming a larger driver of the potential opportunities ahead. Relative to the pre-war period, we expect lower growth, higher inflation, higher long-term oil prices, and somewhat higher policy rates, at least in the near-term. Rising earnings expectations have also lowered US equity valuations. This makes the outlook less cyclically supportive but more tech-friendly than early in the year and favors assets on the right side of the terms-of-trade shock.

- We think Nasdaq, EM equities (both AI-focused North Asia and commodity producers) and parts of cyclical FX and CNH should benefit from this mix of relief and the broader outlook. Against that, we favor shorter-dated downside hedges in European and US equities and credit, and continue to like pairing risk positions with long positions in longer-dated equity volatility.

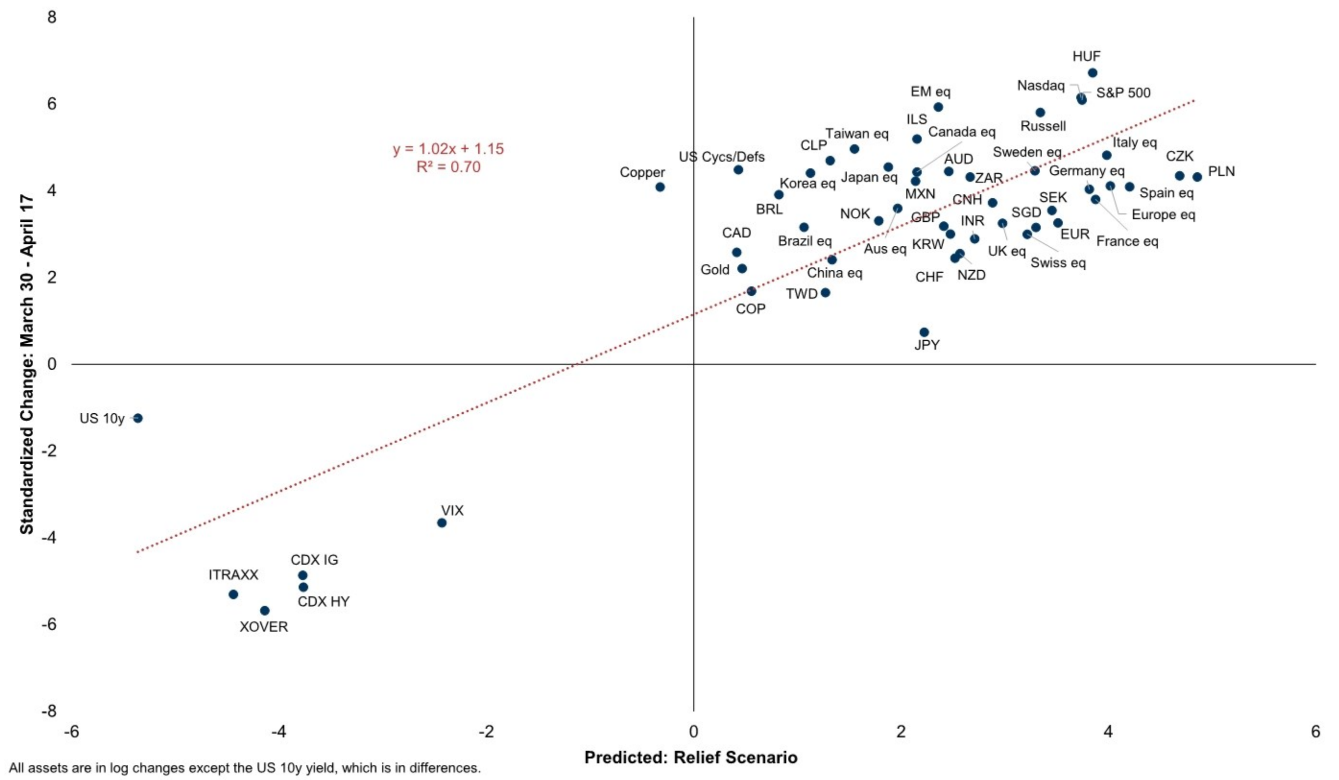
Beyond Relief—A Cross-Asset View

At the end of March, we set out the potential paths ahead for asset markets as the war with Iran progressed. Since then, we have seen substantial relief as the ceasefire and negotiation process have progressed and oil prices have dropped. US equities are already back to new record highs and volatility across many markets has fallen sharply. We revisit the same set of frameworks we used before to answer some of the key questions we are encountering about what might come next.

1. Does the pattern across assets match the relief scenario you laid out?

Mostly yes, but with some important exceptions. We set out a relief scenario two weeks ago and compared it to options pricing. That scenario was based on a fall in oil prices and a reversal of some of the growth and policy fears that had accompanied the onset of the war. As Exhibit 1 shows, since risk markets troughed on March 30, the asset pattern across the major equity, credit, currency and bond markets has been more than 80 percent correlated with the scenarios we laid out and the magnitudes are comparable. There is also some modest evidence that assets that underperformed our fundamental estimates of the oil price shock in the downturn outperformed on the way back up. Relative to their historical volatility, the moves in EM and US equities look particularly impressive (Exhibit 2), but compared to the options volatility available at the time, European assets have also performed very well.

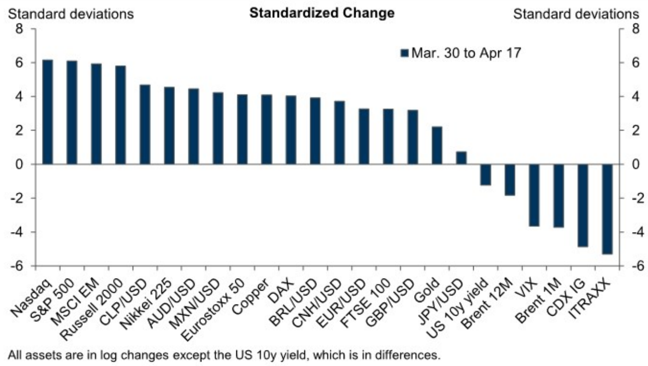
Exhibit 1: Recovery in markets has largely followed the relief scenario we laid out across assets



Source: Goldman Sachs Global Investment Research, Goldman Sachs FICC and Equities

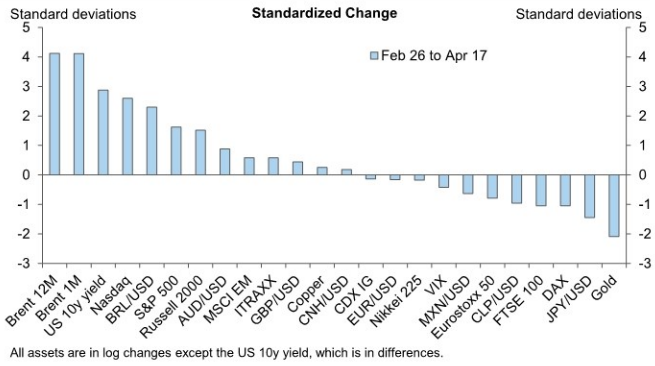
In two important respects, there are some differences to the scenario we laid out. The first is that the magnitude of asset movements has been larger relative to the move in oil prices themselves than we assumed when we generated our assumptions of relief, though that gap has narrowed as oil prices fell sharply on April 17. The second is that at the margin at least, the relief in rate markets has been a bit more modest than in the relief scenario we laid out. These two differences match the observation that while US equity markets (and some other equity, credit, FX and volatility markets) have already more than fully reversed their declines from before the war began, oil prices and bond yields are still very clearly higher than they were then (Exhibit 3).

Exhibit 2: Larger recovery in equities and credit indices, as oil and volatility fall.



Source: Goldman Sachs FICC and Equities, Goldman Sachs Global Investment Research

Exhibit 3: US equities are through the highs, but oil and yields are still well above pre-war levels



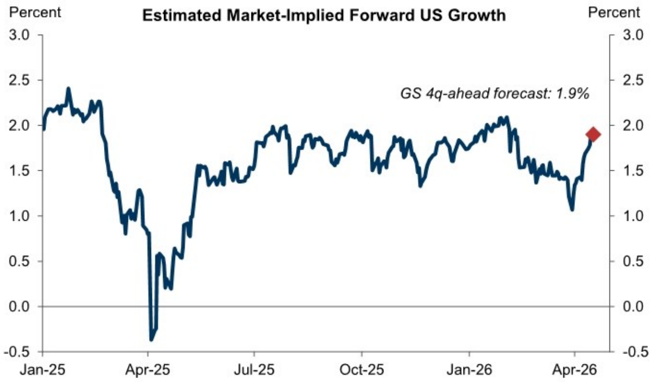
Source: Goldman Sachs FICC and Equities, Goldman Sachs Global Investment Research

2. Has the market already moved to price your baseline growth forecasts?

Growth pricing already looks close to our baseline forecast for 1-year-ahead US GDP growth, though lower than our forecasts for growth beyond the next 2-3 quarters. Our usual benchmarking method suggests that the market is pricing US 1-year forward growth of around 1.9-2.0%, right around our current forecast for that horizon of 1.9% (Exhibit 4). Our preferred basket of US cyclical vs defensive stocks is also clearly back above its pre-war level, though not yet back to the February highs. Our growth and policy shock decompositions show too that the market has more than reversed the negative growth shock since the start of the war, while the hawkish policy shock has only partially reversed (Exhibit 5).

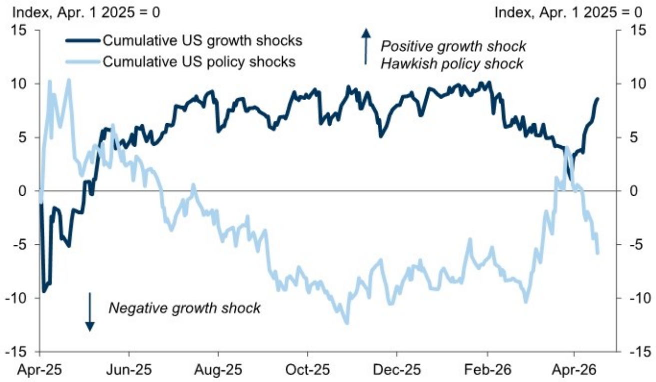
Our medium-term growth outlook is a little stronger—around 2.2% through 2027—so to the extent that markets are willing to extend their horizon beyond any near-term slowdown from the oil shock and fading fiscal support, that deeper forward view may not yet be fully incorporated. But relative to the situation we described two weeks ago, where the market was putting meaningful weight on adverse scenarios (our growth pricing measure troughed around 1.1% on March 30), there has clearly been a sharp relaxation about growth risk already.

Exhibit 4: Our estimates of market pricing of US growth are now close to our baseline forecast



Source: Goldman Sachs Global Investment Research

Exhibit 5: Market has reversed more than all of the growth shock, but only part of the policy shock, since the war began.



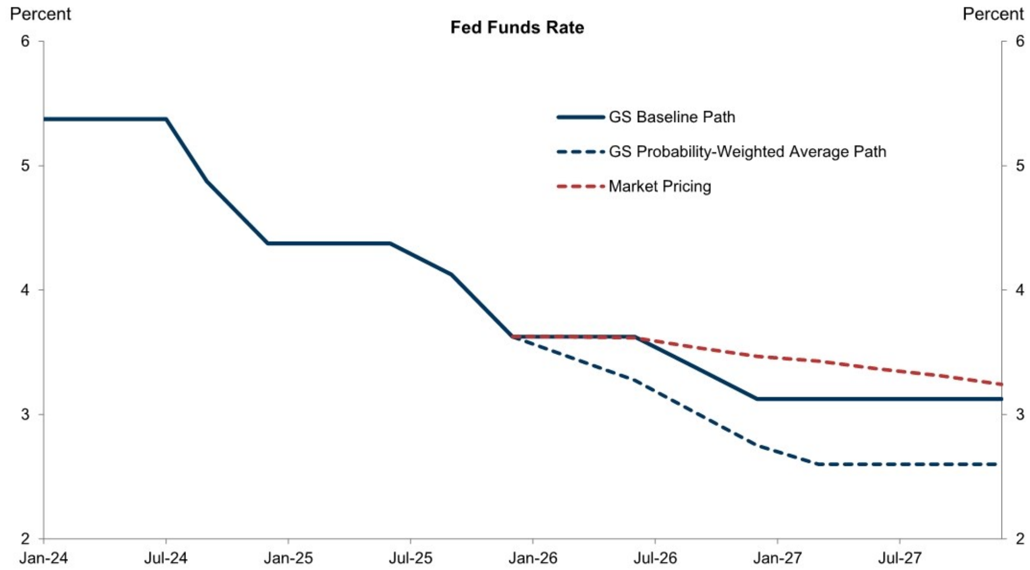
Source: Goldman Sachs Global Investment Research

3. Is the market still pricing central bank policy too hawkishly?

Yes, but the market opportunity is less clear than it was. We felt strongly that markets were overpricing the risk of hikes across a wide range of economies towards the end of March. At the point of maximum stress, options markets were pricing a high risk of large sequences of hikes not just from the ECB and BoE but also the Fed. As bonds have rallied, especially at the front-end of the yield curve, and volatility has declined, markets have moved closer to our policy views. For the US, market pricing is still clearly above both our baseline and scenario-weighted forecasts. The same is true to some degree in Europe and the UK.

While this leaves us biased to look at front-end rate markets from the long side, the opportunities offer less asymmetry than they did. First, the gap between our forecasts and market pricing has narrowed. Second, the possibility of an extended period in which the Fed (and others) simply keep policy rates stable has clearly risen. Third, given the relaxation in pricing, any re-escalation of oil price risks has more scope to reignite fears about potential rate hikes than it did when multiple hikes were priced. Fourth, at the long end of global yield curves, we continue to think that rallies will be limited by fiscal pressures unless we see meaningful economic weakness. We think there is scope for rates volatility to decline further if we remain on a resolution path, as the market narrows the range of outcomes. There is also still a clear asymmetry towards cuts in the first few months of Fed pricing, when hikes seem especially unlikely. But the opportunity to be long rates is muddier than it was, at least in the short term.

Exhibit 6: Fed pricing still above our baseline and probability-weighted forecasts



Source: Bloomberg, Goldman Sachs Global Investment Research

4. With no peace deal yet in sight, isn't it clearly premature to price this kind of relief?

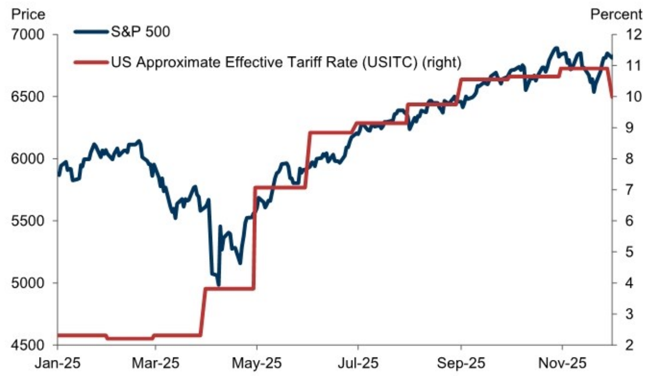
We don't think that it is clearly premature, especially for forward-looking equity markets, but it does leave markets vulnerable to any meaningful challenges to a resolution path. We have encountered a lot of skepticism that the current relief is justified, given that there is still plenty of room for negotiations to break down in ways that renew the upward pressure on commodity prices and generate more visible signs of shortages and rationing. We have argued that this kind of disconnect is not uncommon during relief from crises. For equity markets in particular, the bulk of asset relief comes when the market feels comfortable reducing weight on the deep tails, not when the worst of the economic reality is being felt. As in corrections driven by monetary policy tightening, the market may feel comfortable looking beyond upcoming economic weakness if the main source of the pressure appears to have peaked, even if the worst of the economic impact has not been felt. We do not think it is inherently surprising that the market has reacted to incomplete but positive steps towards a resolution that it was even less confident about ahead of time.

If the market can maintain its confidence that a resolution is coming, even meaningful delays to the resumption of oil flows, and the possibility of larger shortages and economic disruptions, may not have a sustained impact on equity pricing. Given that there has been revealed capacity to negotiate a ceasefire and some desire on both sides (and from other influential actors, like China) to end the conflict, the threshold to reignite the deeper downside risks is higher than before. The market is more likely to view bouts of escalation in the context of negotiations for a peace deal and may be wary to react too much to disappointing news given that those periods have been quickly reversed so far. The real challenge will come if the market again worries about much more pronounced downside risks—either because of a clearer breakdown in the negotiation path or because economic damage threatens to become non-linear. The key assumption that the market is making is that this threshold will not be breached. That assumption could be wrong, and the market is leaning heavily on it now, but we do not think it is as obviously misguided as some skeptics maintain.

Exhibit 7: In COVID, market bottomed well ahead of the main rise in confirmed cases

Source: Bloomberg, Goldman Sachs Global Investment Research

Exhibit 8: Last year, the market bottomed ahead of most of the actual increase in effective tariff rates



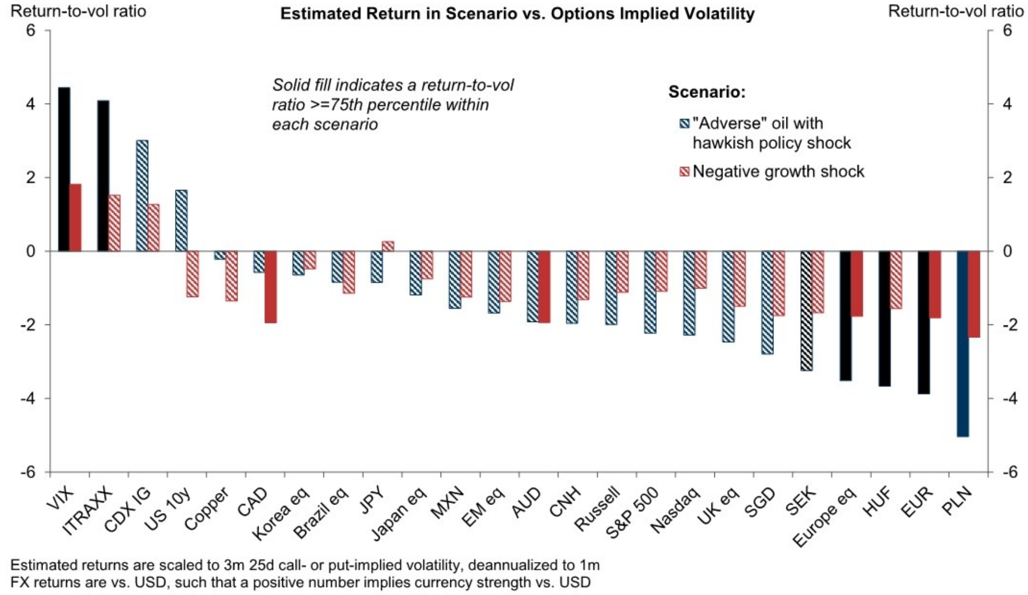
Source: Bloomberg, Goldman Sachs Global Investment Research

5. Is the downside tail underpriced and what are the best hedges against that tail?

Although we think deeper downside risks have become less likely, we think markets are now underpricing them, so hedging those risks still looks worthwhile. Precisely because the market has been more relaxed recently that periods of escalation will not change the ultimate destination, a sharper adjustment may be needed if that proves incorrect. We agree that the market should be placing less weight on some tail risks than a few weeks ago, before ceasefires and negotiations began. But given that the contours of a sustained arrangement around the Strait of Hormuz are still not clear, downside tail risks from an extended closure or renewed conflict still look meaningfully larger than before the war. A renewed breakdown in the ceasefire over the weekend, and indications that the two sides disagree on key issues, are likely to keep this uncertainty alive. Although we think the relaxation that we have seen can be justified, we think it now leaves too little weight on some of the more adverse outcomes in most assets. This is particularly true of the deeper downside tails: because the market has become more confident in a resolution path, developments that are large enough to shake that confidence are likely also to have meaningful market impact.

We revisit the re-escalation scenarios we set out in late March and their impact across major assets. We consider two variants again, one in which oil prices move sharply higher again (we assume a somewhat more hawkish policy shock now given the relaxation we have seen since then) and one in which broad-based recessionary worries reappear. We find that the positions that offer the best leverage to the re-escalation scenarios in options markets come from downside in European assets, and in (US and European) credit and volatility indices. Oil itself is a clear beneficiary from re-escalation, so long positions in oil obviously protect against this risk. But implied volatility in oil options has fallen much less than for many other assets, so it offers less attractive leverage in options markets than these other assets. Deep downside in more classically cyclical assets like AUD and CAD also continue to screen well if a sharp re-escalation in the crisis leads to fear of a deeper slowdown. They may also provide protection against other downside growth risks (AI reversals, private credit, new shocks) that the market had worried about ahead of the Iran war.

Exhibit 9: European assets, US credit and volatility screen as the best hedges against a fresh adverse oil shock



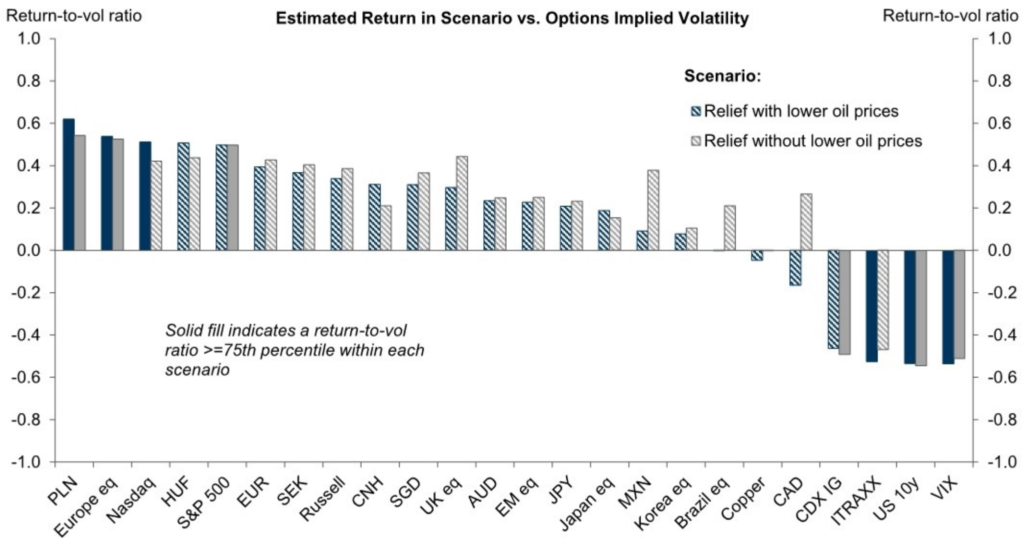
Source: Goldman Sachs Global Investment Research, Goldman Sachs FICC and Equities

6. Could further relief be warranted and how?

Scope for pure relief is now much more limited, but we still see circumstances where growth and policy relief could extend, especially if we ultimately see further relaxation in oil markets. Given that market pricing of growth already looks close to our baseline forecast, it is harder to see the scope for sustained upside through that channel. But if the market becomes more willing to look through the next two or three quarters of weaker GDP growth, as discussed above, there could be some further potential to push growth pricing higher. In principle, there is a bit more scope to unwind the hawkish policy shock since the war began, but without a sharper fall in oil prices, we think scope for further policy relief may also be more modest now. A larger drop in oil prices on a more permanent reopening of the Strait, and a further drop in implied volatility in oil markets (which is still elevated relative to many other assets), would be more obvious sources of further relief.

Looking at versions of further relief scenarios, including one with a clearer fall in oil prices and another with less of an oil price decline, we find that modest growth and policy relief would in most respects resemble a smaller version of what we have seen so far. Compared to options volatility, the best opportunities in that kind of scenario would be longs in European and US equities and credit and potentially in US bonds. More pronounced Fed relief would favor US equities and bonds further and create more opportunities to position for USD weakness. If oil prices were to fall further, this would reinforce the case for some European assets like credit and currencies like PLN and HUF, and for higher Nasdaq and lower VIX; and potentially weigh on oil-exposed assets like energy stocks and CAD. Because the market has moved a long way to price pure relief from war-related risks, asset trends from here will now likely rely more on the outlook beyond the war and its impacts.

Exhibit 10: US and European equities and European FX offer the best optionality for any further relief



Estimated returns are scaled to 3m 25d call- or put-implied volatility, deannualized to 1m
FX returns are vs. USD, such that a positive number implies currency strength vs. USD

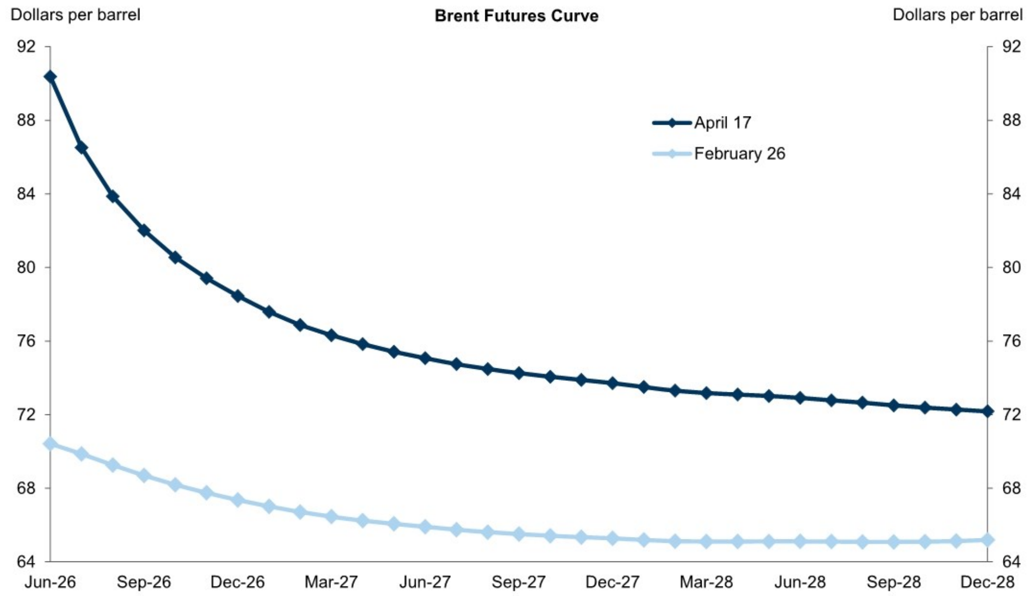
Source: Goldman Sachs Global Investment Research, Goldman Sachs FICC and Equities

7. If faith in a resolution path holds, will markets simply return to their prior trends?

Not completely: some aspects of the outlook are likely to have changed more persistently beyond any initial relief. These shifts are largely captured by the changes in our own forecasts since late February. Relative to the pre-war outlook, our GDP growth forecasts are somewhat lower; our policy forecasts—on average—are somewhat higher, especially in the next 12 months; and our oil price forecasts still show oil settling at significantly higher levels given depleted oil inventories. Away from the macro cycle and the war, steady upward revisions to US earnings—especially in tech—have also helped to cheapen valuations relative to the start of the year, as our Portfolio Strategy teams have highlighted.

Because of those shifts, we would expect the medium-term environment in our baseline case relative to the start of the year to be less supportive of some cyclical exposures; more favorable for countries and assets that lie on the right side of the terms-of-trade shock; and more favorable to the tech sector than before. The last of these is mostly unrelated to the Iran war and energy shock. Markets had worried about tech and AI-related valuations early in the year, but the ongoing strength of the AI capex cycle is calming those fears. There are echoes of 2025 here, when Q1 worries about the tech outlook overlapped with the tariff-driven drawdown, setting up for a strong recovery as both fears receded.

Exhibit 11: Oil prices remain well above their pre-war levels all along the futures curve



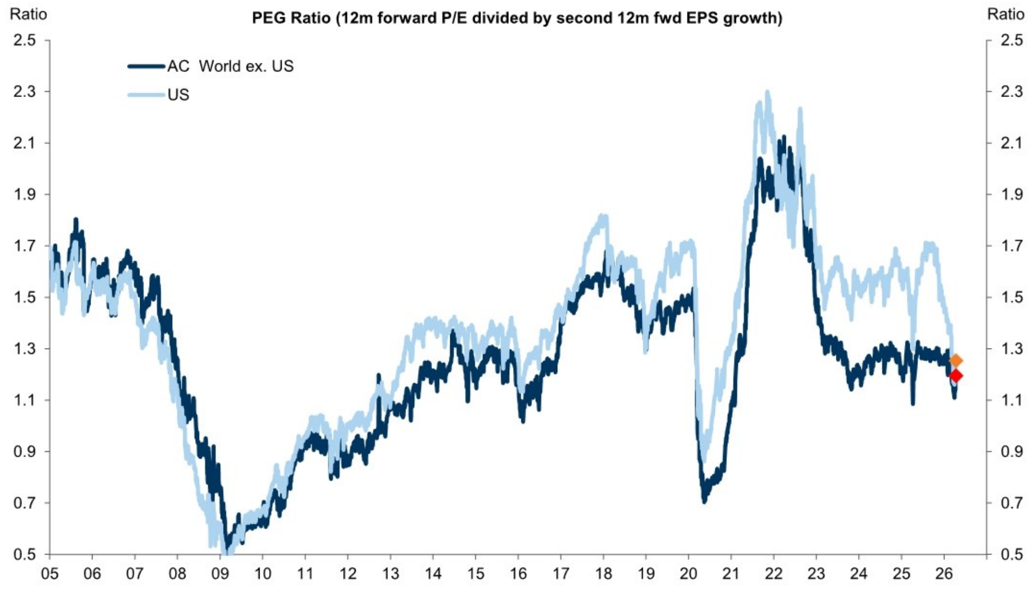
Source: Bloomberg, Goldman Sachs Global Investment Research

8. Will the US underperformance and USD weakness resume?

These same shifts complicate the story for the US equity and USD underperformance that dominated in the first two months of the year. For the FX story, our team has argued that there are forces on both sides. Some of the cyclical macro drivers may be a little more favorable to the USD than before (the terms-of-trade shift favors the US over much of the G10) and investors have had a reminder that non-US assets are vulnerable to any sustained oil risk. On the other side, rich valuations, a significant US current account financing requirement and worries about longer-term strategic shifts may keep the desire for increased diversification alive. We think the USD is more likely to remain on a weakening trend but continue to think that other axes may be at least as important. Our FX team favors some of the more cyclical currencies like AUD, some EM carry currencies and CNH.

In equities, the valuation gap between US and non-US equities has narrowed meaningfully on some measures. And a less cyclical and more tech-friendly medium-term outlook also makes pronounced US underperformance less likely. This probably reduces the impulse for non-US outperformance relative to the start of the year but still leaves good reasons to keep healthy diversification into non-US exposures. EM equities look quite well placed if we see both a return to AI themes (which benefits Korea and Taiwan) and an improvement in commodity producer terms of trade (which benefits Brazil and some other Latam markets). With risks around our oil price forecasts now more balanced, we see value—where other structural themes are supportive—in having exposure to commodity importers as well as commodity exporters.

Exhibit 12: US equity valuations have narrowed their gap with non-US markets as earnings expectations have risen further



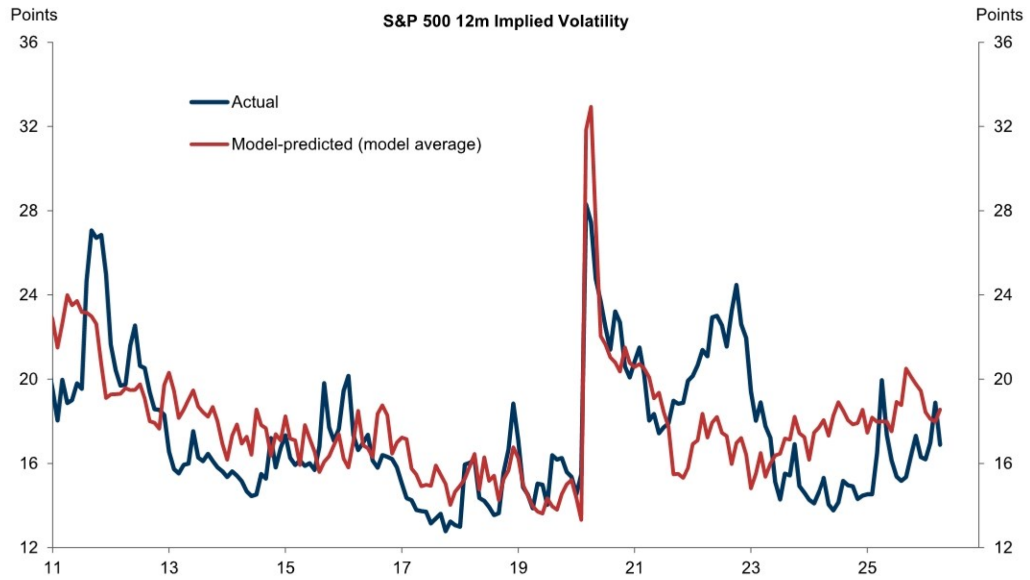
Source: Datastream, Goldman Sachs Global Investment Research

9. What opportunities look appealing still given this mix of considerations?

With relief from Iran-related risks already well reflected, we think the bigger balancing act now is between the opportunities from the medium-term outlook and the downside risks from re-escalation of the war and energy crisis. We continue to like the idea of pairing selective long risk positions with assets or hedges that will benefit if downside risks resurface. In thinking about the first bucket, we think it makes more sense now to look beyond the potential for any further relief from current war-related risks with views to how the medium-term outlook may evolve, given that a significant part of the initial shock has reversed. On that basis, Nasdaq (megacap tech) and significant parts of EM screen well on both metrics, as do some currencies like AUD, CNH, MXN and BRL. More pronounced policy or energy relief (or a mix of the two) would open up the scope for further rate relief and broader USD weakness and could support other rate-sensitive assets like gold, JPY and housing-related equities. But if energy risks escalate sharply again, these areas will be more vulnerable.

While we think the threshold to refocus the market on deep downside tails is higher than before, we still think those risks are worth protecting against, particularly alongside any other long risk positions. Volatility in equities and credit has fallen enough that deeper downside hedges—in European assets, US and European credit and volatility—look quite appealing again. We think that longer-dated equity volatility has the potential to move higher structurally even in our baseline case, so we continue to like pairing that too with long risk positions. Oil and energy-related assets should also protect against re-escalation risks. Until late last week, optionality remained very expensive relative to other major assets, but oil upside may become a more interesting hedge again if implied volatility continues to fall. We think shorter-dated hedges make most sense. The period of greatest risk is likely over the next couple of months both because the chances of re-escalation are highest over that period, but also because we think the initial energy shock may pass through the system more quickly than the tariff shock, and its economic impact may already be clearer by early summer.

Exhibit 13: Our models suggest that fundamental drivers should provide a floor for longer-dated US equity volatility



Source: Goldman Sachs Global Investment Research

Dominic Wilson

Vickie Chang

Disclosure Appendix

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Contributing Authors: Dominic Wilson Goldman Sachs & Co. LLC, Vickie Chang Goldman Sachs & Co. LLC.

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