Global Market Views: From Macro to Micro Volatility

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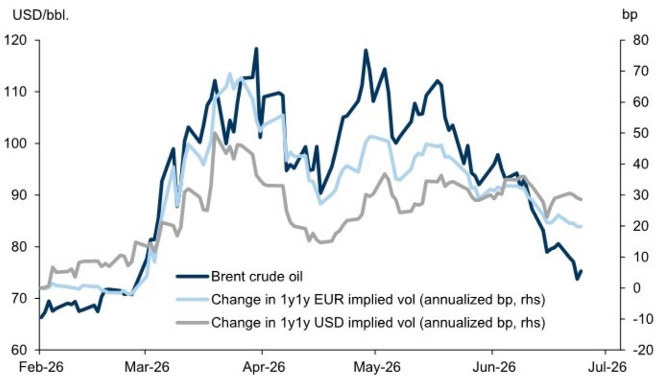
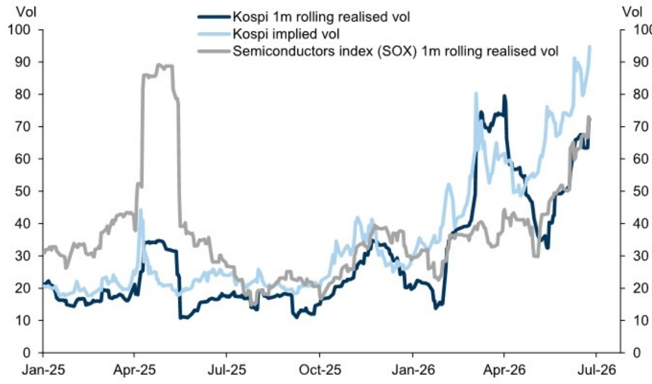
1. Oil, Fed and AI. The US-Iran deal and the pick-up in energy transit through the Strait of Hormuz reduce the biggest source of macro uncertainty for global markets. Arguably, the deal simply formalizes something that was already embedded in market expectations, especially in long duration assets such as equities that had moved well past pre-Iran War levels. But the move lower in oil prices has been meaningful even since the deal and lowers the probability of deeply adverse outcomes involving high inflation and low growth. In its stead, Fed hike risk is now the main macro concern, following a more hawkish Fed meeting in June. That risk is likely to stay on the agenda for a while and could cause more local volatility with a deliberately less-transparent Fed, but it looks to be quite well priced in rates and energy-induced inflationary pressures may ease further. As those conventional risks recede, from a market standpoint, we are back to the tension we have identified before: a friendly fundamental/cyclical backdrop but one that is reflected in high valuations. That tension is most acute in the AI space, which is now also the primary source of volatility in equity markets. We expect this combination to sustain—lower macro volatility as the oil shock fades and leads to narrower ranges for oil prices, rates and growth, but more micro volatility as shifting views around AI investment returns remain centre-stage.

Exhibit 1: Room for macro volatility to move lower as the oil shock fades...



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

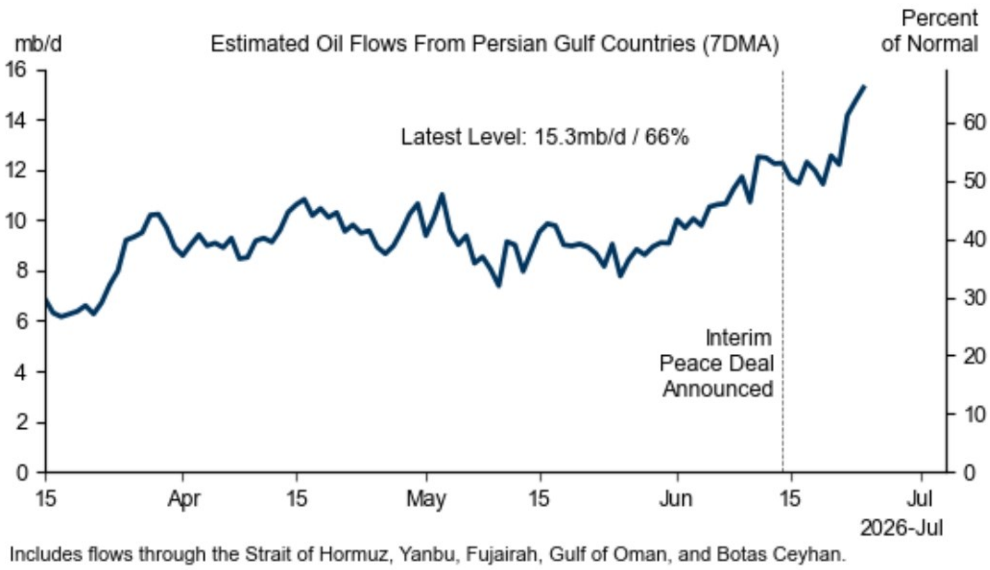
Exhibit 2: ...but more micro volatility as debate around AI investment returns remain centre-stage



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

2. Coming to an understanding. The Iran War MoU has further served to crimp the highly adverse upside tail of oil prices, a process that was already in train since the April ceasefire. That narrows the distribution of outcomes for oil prices and products first and foremost, but also the distribution of inflation and interest rates. Markets had already been looking through the oil shock to a reasonable extent—more in equities and less so in oil contracts and rates—and so there is more premium to wring out in oil prices where December-2026 contracts are still above pre-War levels. Given uncertainties around MoU implementation and the supply rebound, our Commodities team sees risks on both sides of their Q4 Brent oil price forecast of $80/bbl, but the market is already exploring the downside tail where production rebounds quickly and there is a short-term glut before inventory restocking demand recovers. At any rate, it increasingly looks like this source of macro volatility at least is being put back into a box, with lower risks of an adverse supply shock.

Exhibit 3: Oil Exports from the Persian Gulf Have Returned to 66% of Normal Levels

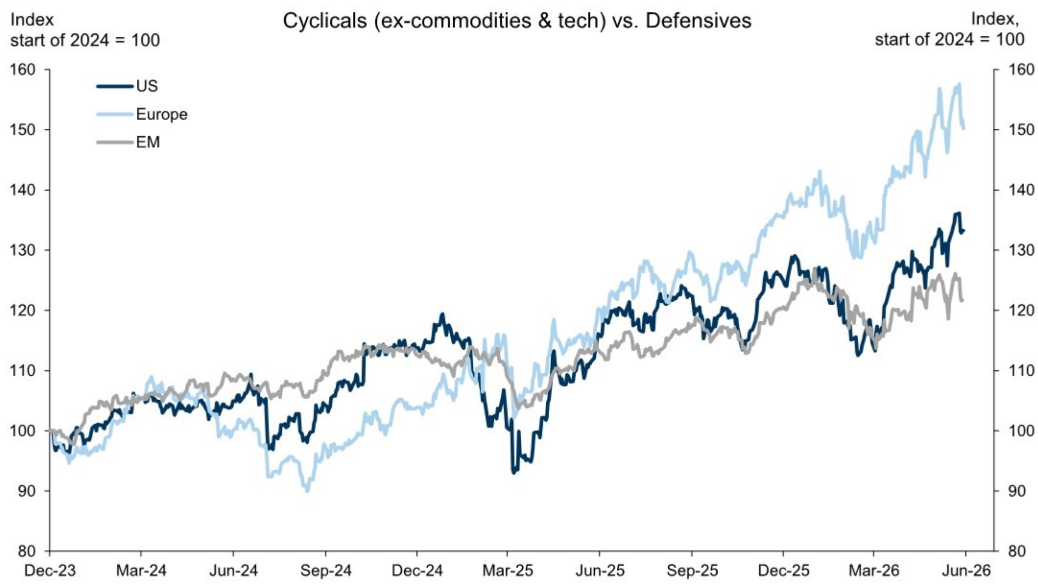


Yanbu is on the west coast of Saudi Arabia, bordering the Red Sea and connected to Saudi eastern oil fields via the East-West pipeline. Fujairah lies east (outside) of the Strait of Hormuz and is connected to Abu Dhabi's onshore fields via the Abu Dhabi Crude Oil Pipeline (ADCOP). The Gulf of Oman connects the Strait to the Arabian Sea (southeast). The Kirkuk-Ceyhan pipeline allows northern Iraqi crude to be pumped through Türkiye to the Mediterranean sea. \"Normal\" flows are assumed to be 20mb/d for Strait of Hormuz and 2025 average for Yanbu (1.4mb/d), Fujairah (1.7mb/d), Gulf of Oman (0mb/d), and Botas Ceyhan (0mb/d).

Source: Kpler, S&P Global Commodities at Sea, Goldman Sachs Global Investment Research

3. Less oil risk adds to positive cyclical picture. Growth outturns had already been quite resilient in the US and other key oil-importing parts of the world even with higher oil prices. And with prices moving lower, that should help support real incomes and rebuild buffers that have been run down to support consumption through these months. Our US team has nudged up their growth forecast for H2 and lowered their 12-month recession risk estimate to the long-term norm, although we still see a sequential slowdown as the impact of higher tax refunds and lower final tax payments in Q2 peters out. The labour market also looks healthier than was the case before the war with a string of strong payrolls reports, but with muted wage pressures. Even in Europe, where survey data and data surprises have been weaker on account of the energy shock, the hard data have been less bad than widely expected; the outlook for 2026 H2 looks improved and our Europe team has nudged up their growth estimates. Lower oil prices should allow a resilient cyclical picture to extend further and provide a positive tailwind for assets. Here too, however, the challenge is a familiar one, with cyclical equities already having outperformed defensives, including in oil-sensitive regions across EM and Europe, so market growth pricing appears robust already.

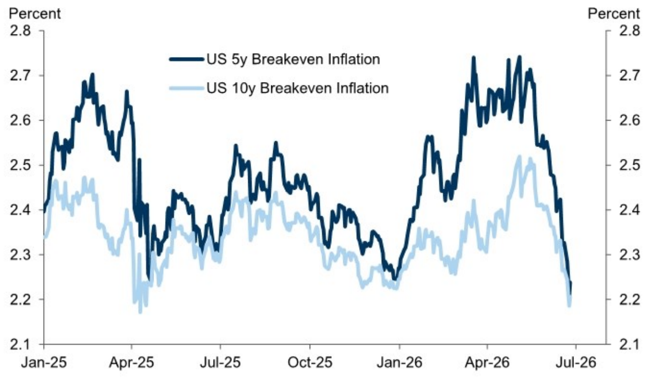
Exhibit 4: Lower oil price supports resilient growth picture, but markets already reflecting cyclical optimism



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

4. Regime change or language change at the Fed. The June FOMC represented a clear hawkish shift, and markets have moved to pull forward rate hike expectations, while leaving the terminal rate little changed. With guidance eschewed, and few clues from Chairman Warsh about likely reactions, it is still unclear how large a regime shift is underway and how much the Fed is just taking a cautious approach to buttress credibility. The fall in 10-year breakeven inflation to levels not seen in well over a year, alongside a flattening yield curve, does not signal much of a threat on this front. And over time we expect the inflation news to look better, helped by falling oil prices, so we think the case for hiking will look less compelling beyond the next 2-3 months. But with a wider range of possible outcomes on the table, the market is likely to be even more data-sensitive, and hotter short-term news on payrolls or prices could firm up pricing of July and September hikes. Our bias is to look through this for opportunities to receive rates, especially if pricing rises further, and we think the current distribution underweights many ways in which rates could end up lower in 2027 and beyond. Worries about "debasement", however, have been laid to rest and some of the push towards flatter curves, lower gold and crypto prices and a stronger USD may reflect a further cleansing of positions initiated on that basis.

Exhibit 5: US breakeven inflation lower as oil falls and Fed tilts hawkish



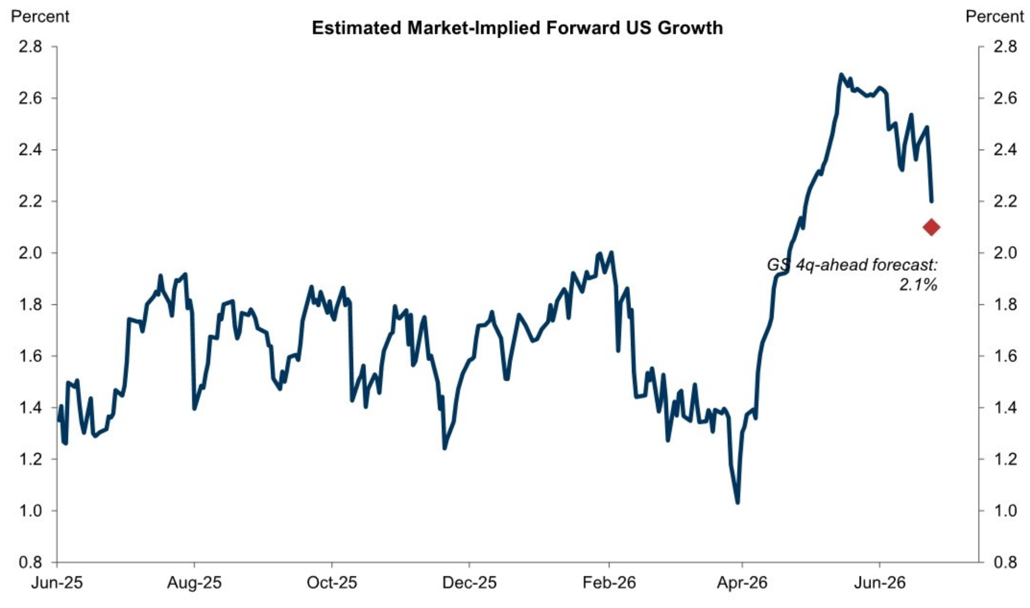
Source: Bloomberg, Goldman Sachs Global Investment Research

Exhibit 6: Measures of US risk premium decline further on Fed repricing

Source: Goldman Sachs Global Investment Research

5. Equities have so far digested rate shock. Equity markets wobbled on the hawkish Fed meeting but were quick to recover that ground. In part, that is because the macro cyclical backdrop remains friendly and the market does not anticipate that the scope of Fed tightening being considered will materially alter that. For equities—and long-duration equities in particular—a mild hike premium that keeps the back end of the yield curve anchored is likely a positive trade-off over the medium term. And if inflation breaks lower (and leads Fed pricing back down with it), the summer could develop more of a "Goldilocks" backdrop than the market currently envisages. If hikes are pulled forward further, there is likely to be some near-term risk to stocks again, and a more concerted effort by the Fed to slow growth through an extended tightening would have more of an impact. But we think the larger challenge comes from valuation, which has taken credit for good news already. As the risk of supply-driven inflation shocks recedes, duration becomes a better hedge for equity risk than it has been.

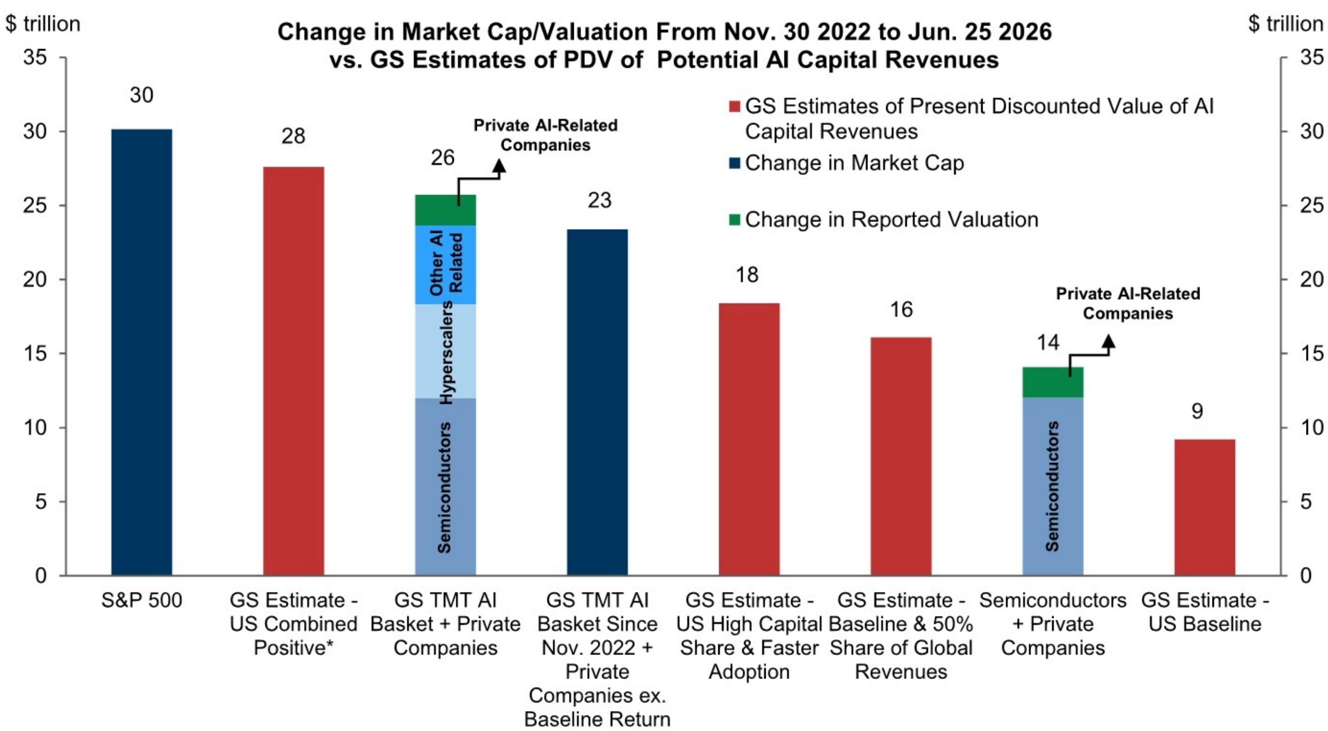
Exhibit 7: Growth pricing is already high, as equities mostly shrug off Fed shift



Source: Goldman Sachs Global Investment Research

6. AI—more optimistic assumptions required to justify pricing. The AI complex remains the poster child for this tension between a positive cyclical backdrop and high valuations. On the macro front, the good news is that the imbalances that ended the 1990s cycle are not yet visible, largely because profits are so robust. But to square the value added in AI-related names with the potential gains from AI for the broad economy needs increasingly optimistic (though not yet implausible) assumptions. The growing risk is that the market is overestimating the persistence of above-average earnings, especially those generated by the investment boom itself. As long as that investment boom looks secure, we expect the positive impact on near-term earnings to dominate valuation concerns. But pricing makes us more vulnerable to challenges to that optimistic view, as we have seen in the semiconductor space again recently. We continue to look for ways to stay invested while protecting downside tail and think equity volatility is likely to rise further. We also think markets are underestimating the scope for much lower interest rates beyond the peak of the capex boom (and for the mix of lower rates and lower equity prices).

Exhibit 8: Value added to AI equities requires more optimistic assumptions about the future macro benefits to companies

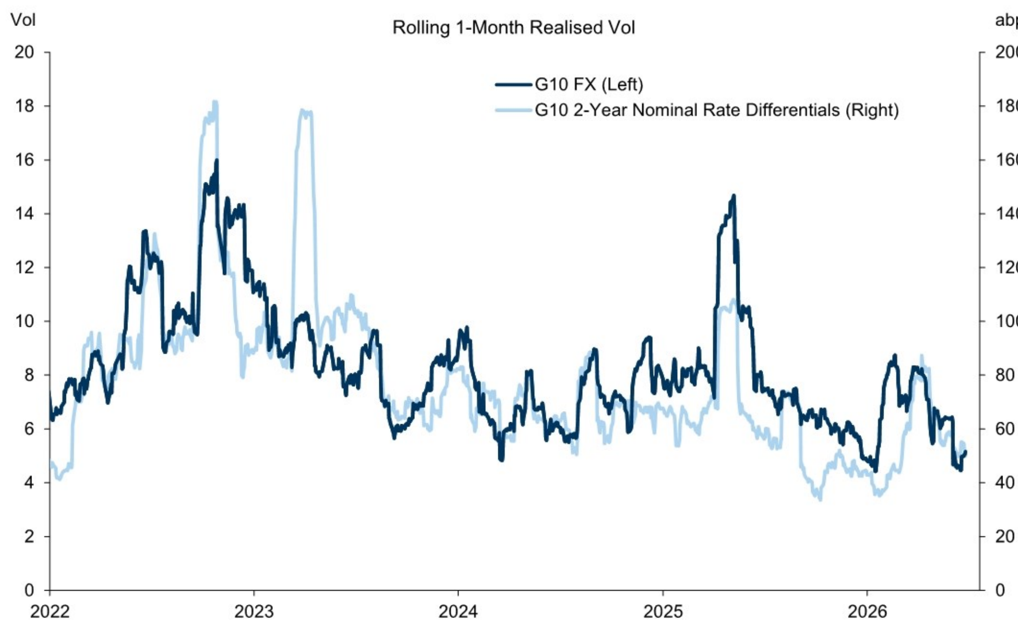


"Semiconductors", "hyperscalers", and "other AI-related" are constituents of the GS TMT AI basket (developed by GS Global Banking & Markets)
**"US Combined Positive" assumes high capital share, faster adoption, and higher productivity gains from AI*

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

7. Dollar divided. A hawkish Fed has replaced high oil prices as the primary support for the Dollar. Fed policy shifts and associated curve flattening tend to lead to more reliable Dollar gains versus low-yielders, and so it has proved this time as well, with the Euro and Yen breaking through recent ranges. Chairman Warsh's single-minded focus on inflation also served to mitigate any worries about a subordinated Fed and 'debasement' risk, pushing the Dollar stronger versus 'safe havens' such as Gold and the Swiss Franc. At the same time, the strong performance of AI-related stocks has meant that capital is again flowing to US equity markets, supporting the Dollar relative to other DM peers. Despite this, Dollar strength is less than expected, and we continue to expect Dollar performance to remain divided. First, currency management considerations continue to limit the size of moves in Asia – including the threat of actual and perceived interventions in the Yen, the managed gradual appreciation of the Renminbi, and measures to encourage capital inflows in India. Second, US equity outperformance is less pronounced versus EMs than DMs, and the concentration of gains appears to limit currency spillovers. Third, while a hawkish rate repricing can create indigestion for carry trades, we think EM currencies and carry strategies (with low-yielding funders such as EUR, CAD or JPY) can continue to deliver positive total returns as long as risk remains supported, even if the Fed path reprices modestly further. So even with recent shifts, a break higher in FX volatility still does not feel imminent.

Exhibit 9: Realised vol in G10 FX reset to a 5-year low following energy relief

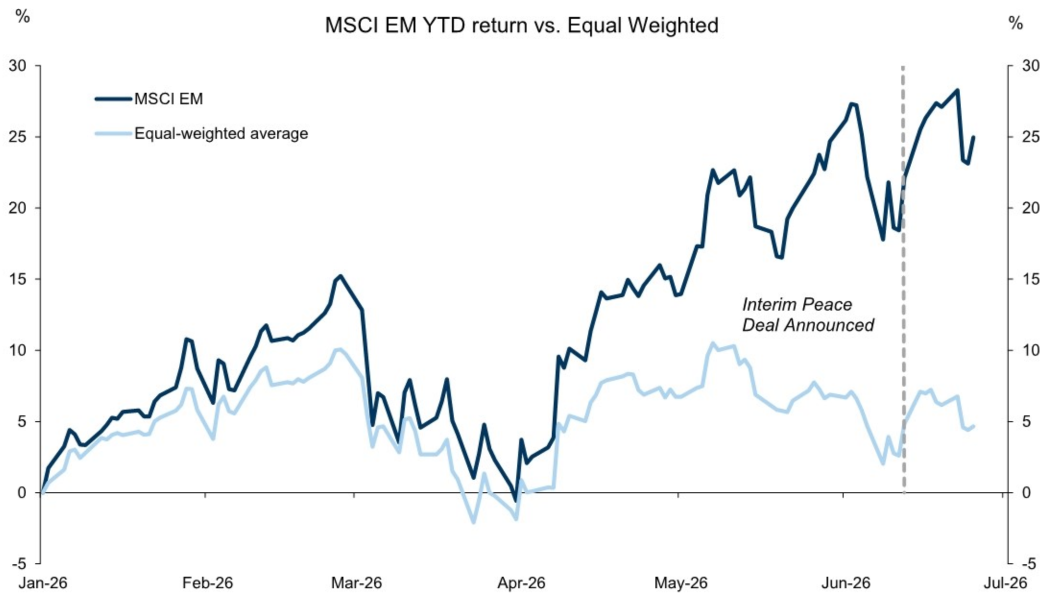


Realised G10 FX vol captures an average of EUR/USD, GBP/USD, AUD/USD, USD/JPY, and USD/CHF. Realised G10 rate differential vol captures an average of EU-US, EU-CH, EU-UK, US-CA, and AU-US yields

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

8. EM—From Iran War to "Family Fight". The move higher in core rates and the Dollar post Fed short-circuited the relief in EM assets, but with decent hiking premium now in the price and oil prices moving lower, we see fresh opportunities as well. In EM equities, more oil relief should come with broadening gains, allowing for oil-importing laggards in the index such as India, Turkey and Egypt to regain some ground, with equal-weighted EM and EM-ex tech indices already starting to recover since the Iran deal. To be clear, we see this as a broadening rather than a rotation, with the AI/tech-heavy North-Asian markets still in the lead on the back of exceptional earnings delivery. On the fixed income side, the picture is more differentiated: apart from idiosyncratic positive stories in HUF and COP rates, ZAR and BRL rates also have room to move lower after the recent sell-off, and that should also help the rate-sensitive parts of the local equity indices to recover. Long-end INR rates also look attractive again given their low sensitivity to the US and greater access for foreign investors. However, we view MXN front-end rates as the most vulnerable to the hawkish Fed shift given the combination of an expensive valuation starting point for rates there and high sensitivity to US terminal rate pricing.

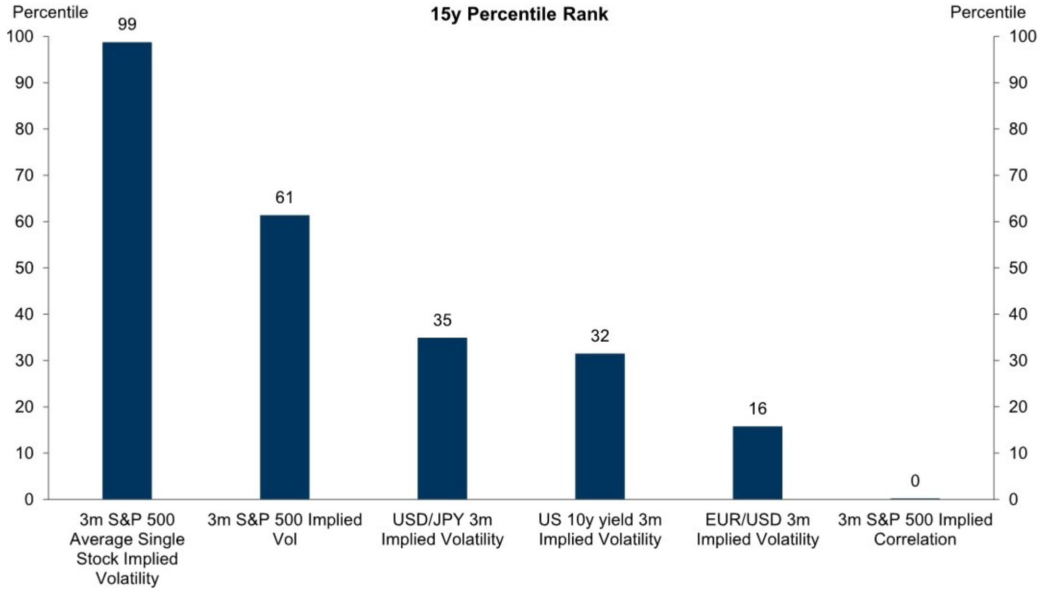
Exhibit 10: More oil relief should come with broadening gains in equities



Source: FactSet, Goldman Sachs Global Investment Research

9. From macro to micro volatility. With the backdrop of the war, macro uncertainty has seemed high until recently. But under the hood we think a larger shift in the cycle has been playing out towards lower macro and higher micro volatility. That shift has been masked by the macro shocks from tariffs and oil, but we think may become clearer as the energy shock fades. The shifts at the Fed are adding to rate volatility locally, but the Fed funds rate has been in a 3.5-4.5% range for over 18 months and is widely expected to stay in that zone for at least another year. Energy price relief is reducing the risks of much higher or much lower rates, and growth seems likely to settle in the 2%-ish range of the last couple of years. FX volatility has also fallen back to low levels and a positive cyclical picture and the "divided" Dollar may help to keep it there. But volatility at the micro level has been much higher—as the sharp moves under the hood of equity markets show. Fresh lows in implied correlation (the most macro-oriented component of index volatility) alongside very high stock-level volatility are the clearest signal of the macro-to-micro shift. And—at least once the Fed path is settled—debates over earnings, winners and losers from AI, technological obsolescence, disruption, issuance and investment plans may be the larger sources of shifting views for now.

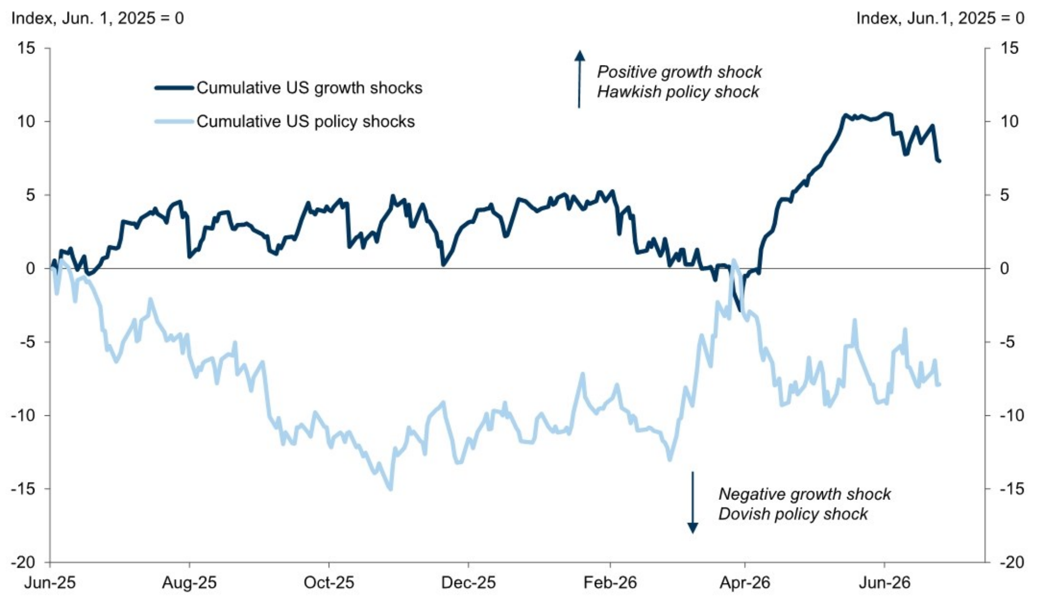
Exhibit 11: High stock volatility, lower volatility in macro assets



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

10. Balancing the opportunities and the risks. The shifts in the macro backdrop from the reopening of the Strait are mostly positive, especially for oil importers. Less inflation and less growth risk should be a supportive mix for risky assets and carry accrual strategies in EU sovereigns and EM FX. It is also a mix that should make central banks lives gradually easier. The high-level risk is that the market is already pricing good cyclical outcomes and substantial gains from AI. With earnings season ahead, and much more optimistic pricing than coming into the Q1 season, the hurdle for upside surprises looks higher. The obvious near-term risk on the macro front comes from continued hawkishness from the Fed. We think this worry may be hard to sustain, but the lack of anchors makes it easier for the market to push towards hikes if the data allows it. There is also a growing case that relief may be driven by fading inflation worry, especially if oil continues to head back towards pre-war levels. That—and the reversal of the terms of trade shock—could allow some broadening of gains relative to the narrow breadth in global indices. This mix keeps us looking for ways to find exposure to long equity and carry views, while trying to mitigate the risks by limiting exposure through options or through outright long volatility positions.

Exhibit 12: With growth pricing robust, inflation/policy relief is a more plausible macro tailwind



Source: Goldman Sachs Global Investment Research

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