The Markets

Anshul Sehgal, Global Co-Head of Fixed Income, Currency and Commodities, FICC and Equities

Chris Hussey, Host, Goldman Sachs Research

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Chris Hussey: This is The Markets. I'm Chris Hussey, and today is Thursday, September 17th. And we're here on the Goldman Sachs trading floor with Anshul Sehgal, who is global co-head of Fixed Income, Currencies and Commodities within our FICC and Equities business. Anshul, thanks so much for joining us.

Anshul Sehgal: Thanks for having me, Chris.

Chris Hussey: Okay, this is the third time this year we've had you on after every Fed meeting. We had you out in January, we had you in the April. It's not every Fed meeting, but this Fed meeting we definitely got some action finally. Walk us through it. What do you make from the market reaction so far?

Anshul Sehgal: Yeah, it was a real meeting.

We learnt a few things, few key things from Chairman Warsh's presser. Number one, the entirety of the committee coalesced around having two hikes this year. One of them we got yesterday, and likely another one either in October or December. Initially, the market had expected, given what the committee members had said in their speeches, that there would be more dispersion of opinion.

That was not the case. They all coalesced, at least for this year. The second thing we learnt is that they believe they're removing a dose of accommodation. It's not that they are moving to restrictive. They believe that the current Fed's Fed funds rate is accommodative, and they are removing a dose of accommodation.

He said this three times. Both of those were new pieces of information for the market. In the market's telling, the reason the market's been so frazzled about Fed policy is it's because the market believes that the Fed was making a decision on whether to hike or not based on just the CPI print we got last week or even, say, the last couple of CPI prints, and that is not how the market basically expects the Fed to set policy.

In the Fed's telling, it was catch-up. It was that they have missed their inflation target for five years. The employment side of their target has been met, and therefore they need to get a move on. Now, the difference between these two is, like, you look at what changed this meeting, in my mind, compared to what we've heard from the Fed over the last four years, is last four years has all been about if you're going to be running loose fiscal policy, we need to run tighter monetary policy.

That is not what the market believes is happening right now because even though fiscal policy is loose, that fiscal expenditure is not really going to labor. If you look at it, primary deficits, which is what the government spends is tracking the same, give or take half a percent rate that it was tracking in 2015 or 2017.

What has changed on this side of the pandemic is interest expense or debt servicing costs for the US government. But that does not accrue to labor. That accrues to capital. That accrues to the top decile of wage earners. And for the Fed to hike into that essentially means that labor spending is getting curtailed.

So that is not good for the long-term consumption prospects of the US economy, and therefore, what hangs in balance, at least

in the market's telling, is you can get closer to your inflation target perhaps sooner by doing all of this, but that would also thwart consumption.

Is that what the Fed… Is that what's in the crucible right now? Is that what … in that debate, it's unclear what the right policy will be. Inflation itself is, at best, a concurrent indicator, likely a backward-looking indicator. Deciding policy just based on that print, again, in the market's telling, might not, might not be prudent.

So that's the reason why the markets were frazzled. Equities were down yesterday. They're up today. There's oil prices going up. Like, all of it is just a lot, it's many different dimensions that the market has to handicap.

Chris Hussey: Okay. But if we take the Fed at face value, and they're talking about being accommodative, too accommodative, that means rates are going to be higher for longer. What's the path from here for rates?

Anshul Sehgal: That's a great question. So, the long bond, as you know, has traded about 5% for a few weeks now.

It's the highest yield the long bonds had in over two decades, and understandably, macro markets are quite worried about the long end being unhinged. It's not just a US story, it's a global story. The US Treasury is doing buybacks to, to rein in the yield of the long bond, all of that. That is what we again learned from Chairman Warsh yesterday.

He gave clarity on this issue. He does not believe that he has to police the long bond. It's for the market to do. There is also, in my view a good reason for the US Treasury to enact buybacks. A few things have changed over the last decade. Number one, demographics. As the boomers are retiring, the demand for the long bonds not as high from, from their pension savings.

Number two, you've got a lot of AI-related issuance, which is all long-dated. And the combination of those things has led to a crowding effect in the long end. So should the US Treasury reduce its long-end issuance when all of this other stuff is going on? It makes some sense to it. Should it be done to expressly with the intent of reining in the long end?

Not so much. In markets' behavioral finance, we use the term bandwagon effects that everyone wants to be on the bandwagon

that's winning. And therefore, if everyone is worried about deficits or the long end being unhinged, that sort of reduces the willingness of market participants to basically warehouse the long end.

Ostensibly, this is all because of debt-to-GDP basically blowing out. People are really worried about the US debt sustainability in the long run. For me, that's a red herring. It's October, it's the new fiscal year. We hear this the start of every fiscal year, that the US is going to be expanding its debt to GDP ratio by 6% to 7%, which is the amount of deficit spending that goes on.

But that's not what's transpired over the last four years, because what happens is that the US, at the beginning of the year mark 6% to 7% of additional spending. By the end of the year, if GDP grows by 6% as well, which is what has happened, nominal GDP has grown by about 6% over the last four years, debt to GDP doesn't move that much.

In each of the last four years, debt to GDP has worsened by one to one and a half percent instead. So I don't think the sustainability issue is really that credible in the long run. In the

near term, what's driving it, the rhetoric is sustainability. The effect, the way it plays out is the bandwagon effect.

Like the US had over 200% debt to GDP after World War II. In the ensuing 20 years, that came down to 60% debt to GDP with no austerity, largely because the economy grew its way out of it. So what's endogenous and what is exogenous? Could it be that GDP is just an endogenous effect?

Like when the US government fiscally expands more, endogenously GDP goes up, and therefore debt to GDP is more sustainable. It's possible. One has to be open to that. That's what we've witnessed in the last five years on this side of the pandemic. That doesn't necessarily mean that's how it'll play out in the future.

The US has run a 3% primary deficit. Should we be that worried about interest expense being 3%? Volker had much higher interest expense.

Chris Hussey: All right. So you're a FICC guy, but you're also, you know every market there is, and I love your view on stocks.

So let's go to your view on stocks here. What does all this mean for equities, credit, everything else?

Anshul Sehgal: I think long-term borrowing costs being in check is a net positive for the equity complex here.

What's changed from, say, a year ago to now is that the equity complex is more levered. Largely as I view it, the way the economy's gone on is that over the last few years, the excess interest expense went to the savers. Those savers then lent that wealth to, whether it's a hyperscaler or a Neocloud or pick your sector, essentially then extended credit to that part of the economy.

So as of now, the overall domestic equity market is more levered.

Chris Hussey: Yeah.

Anshul Sehgal: But that said, there is also the potential for a general-purpose technology that's going to revolutionize everything we do.

Which makes handicapping exactly how macro markets work that much more difficult. It's a more levered system today. We're

still very positive on equity, certainly certain parts of the equity market. I think long compute just makes a lot of sense to me here. But does that mean that the broader equity complex should do very well?

It's less clear, especially if tighter monetary policy is going to lead to less consumption down the road.

Chris Hussey: Alright Anshul, let's put a bow on it. What's the trade?

Anshul Sehgal: To me, it's being long compute, being long Neoclouds, being long data centers. We get a lot of calls from clients who want to basically buy the long bond north of 5% risk-free yield. It looks pretty attractive. To me, I'm not seeing the asymmetry there. Personally, I think the asymmetric expression is being long compute.

These are more levered expressions, of course, but at the same time, we think that they can go up multiplicatively. Whereas if you're long, long bond, especially if you're not doing it on leverage, the amount you can make on that, even if you're right,

isn't nearly as much. We're not expecting long end rates to go down to 3%.

We think that nominal growth should be north of 5%, and rates have generally hovered about 50 to 100 points lower than that. So the long bond can go to, like, 4.25%, but we wouldn't expect more of a rally from there.

Chris Hussey: Such a good point. All right. So much taking place. What are you watching most carefully for markets in the couple of weeks ahead?

Anshul Sehgal: I think handicapping the war, because if you take a step back, what we've learned from global central banks is that between certainly the Fed, between tariffs, fuel costs, energy costs going up, even away from the war, the combination of those things, they're not able to underwrite the inflation that comes out of it.

So, handicapping what comes out of the Middle Eastern conflict is the number one thing that'll dictate the course of monetary policy and equity markets and fixed income markets.

Chris Hussey: Anshul Sehgal, you're a torrent of knowledge every time we have you on.

Anshul Sehgal: Thank you for having me.

Chris Hussey: Thanks so much for joining us.

That does it for this week's episode of The Markets. I'm Chris Hussey. Thanks for joining us.

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