Goldman Sachs Exchanges

Equity risks and alts opportunities

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Allison Nathan: After dropping steeply amid recession fears, US stocks are just about where they were heading into the April 2nd so-called Liberation Day when President Trump first announced surprisingly high tariffs on America's trading partners. So what could be ahead and how should investors position their portfolios now? I'm Allison Nathan, and this is Goldman Sachs Exchanges.

Today, I'm joined again by David Kostin, our chief US equities strategist in Goldman Sachs Research, and by Padi Raphael, global co-head of the Third-Party Wealth Management business in Goldman Sachs Asset Management. They both recently presented at the RIA Professional Investor Forum, where they spoke to some of the largest independent investment advisors in the country. David, Padi, thanks for joining us.

David Kostin: Thanks for inviting us.

Padi Raphael: Super delighted to be here. Thanks, Allison.

Allison Nathan: So David, stocks are still down year to date, but, as I just said, they are now back to pre-Liberation Day levels even though tariff policy and the impacts on the economy and companies are still very uncertain. So what do you make of this recovery?

David Kostin: Allison, the way I would characterize the performance of the equity market in the last month has been the great concern that shocked the market when the president announced the tariffs on the so-called Liberation Day, and the market quickly pivoted to the idea there was a really dire outcome and the prospects of recession were quite elevated as a result. And the surprise that happened a week later on the 9th of April when the president delayed for about 90 days the tariffs gave a lot of portfolio managers the confidence that the off ramp was there and that ultimately the tariffs that had been discussed on the 2nd of April probably would not be implemented as originally proposed.

And as a result, the equity market has had a tremendous rally and is currently pricing, in our interpretation, an optimistic outcome. And the expectation right now that some fund managers have is that the economy will avoid a recession. And as a result, the US stock market has rallied back at a really feverish pace, and that would be my characterization of what's happening.

Allison Nathan: And we've also had first quarter earnings, which generally are coming out pretty strong.

David Kostin: Yeah, first quarter earnings have been better than expected. Coming into the first quarter reporting season, expectation was plus 6% year-over-year growth, and it's coming in closer to plus 12. So a pretty substantial beat. Larger beats than we've seen the last three years. Last 12 quarters or so have usually been around four percentage points, so obviously here we had six percentage points. Positive surprise.

And that's also given investors some confidence that the idea of the economic growth can continue. However, remind you that was the result in the first quarter, which went through March 31st. The tariffs came in on the 2nd of April, or were announced on the 2nd of April. And as a result, the first quarter results really are backward looking, and the investors really haven't given a lot of importance to that because really what they're focused on is what's the path forward with respect to these tariffs?

If I characterize the real topic of debate, which is the US stock market trades at 21 times forward earnings, 21 times forward earnings, which is historically a high multiple. With a prospect or probability of a recession, maybe close to 50/50 right now. And so you would generally not expect the stock market to trade at such an elevated valuation given those historically high probabilities of recession. And the only interpretation I can offer is that most of the fund managers have gravitated to the view that we're not going to have a recession. And that's priced in the market today.

Allison Nathan: I want to get back to that valuation point, but so as we've just been discussing, I mean, there are tariffs that have been implemented. But the bulk of some of these tariffs have not been implemented given the pause, but there's still a lot of tariffs that have been implemented. So what do you expect to see from second quarter earnings? Could you begin to see a bigger impact? Is that what you are expecting?

David Kostin: So the debate right now with management is who is going to pay the increased tariffs? Is that going to be passed through to the end customers? Or is that going to be absorbed by the company itself? Or is there going to be pushback on the supplier, and is the supplier going to have to bear some of that burden? And that's a reasonable debate. It will depend on the different industry groups, the nature of the product cycle.

There are certainly greater risks in the second quarter results, both from a revenue point of view in terms of actually the demand and how consumer behavior has been, and the input costs, which may squeeze margins as well. So I think there's a lot of concern. We're not going to get those second quarter results until middle of July to middle of August, which will also coincide with what is the end of that 90-day hiatus, which is the deferral of the implementation for a lot of the tariffs until the early part of

July.

So a lot of information is going to be revealed in the next 60 days that we'll know. Now, as a fund manager, investors have generally embraced the view that there's an off ramp for some of these hefty tariffs and will probably come back to much lower level than what's currently being considered out there right now. I think that largely is priced in the market. This optimistic view that there will be an off ramp from a lot of the debate in proposed high tariffs, and the market reflects that.

Allison Nathan: Padi, let me turn to you. You have been talking to investors at the conference.

Padi Raphael: Yeah.

Allison Nathan: When you think about David's comments and the optimism that has been now priced back into the market, is that what you're hearing from clients as you speak to them?

Padi Raphael: Sure. So first of all, delighted to be live from the RIA PIF, the Professional Investor Forum, where we've gathered about 100 of the leaders of the top RIA firms across the country. In aggregate, the investors and the leaders that are here with us and their firms manage $1.3 trillion of their clients' capital. And so it's a very important group that we've assembled here. And overall, RIAs are a fast-growing part of the investor segment in the country.

Sentiment right now as we're experiencing it is, I would say, still pretty uncertain but super engaged. So the clients aren't shying away from the uncertainty. They're not paralyzed by fear. They're highly engaged with the markets, with solutions, and with their clients.

And what I would say is there are an increasing range of products in the market that really offer different ways to capitalize on market movements, whether markets are going up or going down. For example, we have solutions that can benefit from higher levels of volatility in the markets and increasingly looking at short-term dislocation opportunities that present really interesting long-term portfolio benefits. And so I would say those types of conversations are dominating our time and mind share with those clients.

Allison Nathan: There's been a lot of discussion about the loss of US exceptionalism. Are you hearing clients considering pivoting away from the US, which has obviously been the most popular place to invest for quite some time now?

Padi Raphael: Sure, sure. So in my capacity as global co-head of the Third-Party Wealth business, I actually travel intensively across not only the US but Europe and Asia as well. In fact, I'm heading to Asia next week, and I'm heading to Europe the week after that. And so I would characterize slightly different sentiment across the globe.

From US investors, I would not say shifting away from US, but I would definitely note that there has been a higher interest in some of the international markets, in particular some of the European markets. And so we are seeing a desire to add where people have been already successfully investing globally and internationally, to add to some of those positions.

I would say from European investors, we are seeing a bias towards repatriating towards more home country exposures. And then from Asian investors -- and I'm being super reductive and generalist here.

Allison Nathan: Right, right.

Padi Raphael: But I would say US exceptionalism and the brand recognition around US companies is still very strong, and so my recent conversations with investors from that region, from Asia, have not reflected any kind of loss of the shine of US as a destination for investing.

Allison Nathan: David, from your perspective, listening to what Padi has to say about this, I mean, do you think there are more compelling opportunities abroad relative to the US than there perhaps has been in the recent past? How are you looking at this?

David Kostin: Well, I was in London last week, and the perspective of the European investors was that the weakening US dollar and expectation of a secular weaker dollar does present some headwinds as a non-US-based asset manager owning US assets. Now, offsetting that is the US companies have better growth, much higher return on equity, and trade at higher valuations. And so the US stock market trades at 20 times earnings right now. The rest of the world trades something like 14 times, approximately. But you get much better growth and higher profitability for US corporations.

But when you adjust that for growth and think about it in terms of a PE-to-growth ratio, a PEG ratio, they trade pretty similarly. And they have over time in terms of that you're paying a higher multiple for the US, you get better growth. And what it comes down to is the US has a lot of technology companies, which of course everyone knows and they're global leaders. And that has been the real allure and been the right strategy for 15 years. And now the concern, as a fund manager, is, well, what is the prospect of these companies given they are investing an extraordinary amount of money in CapEx, particularly around artificial intelligence, and what is the return on capital going to be for all those huge dollar amounts that are being invested?

So we think about it from a risk-adjusted perspective, the US is not as exceptional as it was in the past, as perceived given some of the dollar headwinds. And there's been a desire to repatriate some capital overseas. We see that in our fund flow analysis that we've seen in the last couple of months. Money is coming for European investors in particular. Money coming out of the United States, back into their home countries, if you will.

The concern has been the lack of liquidity, so are there opportunities internationally? So US is somewhere between 65% and 70% of the global equity benchmark. Depends on what benchmark you use. Just the size of the market and the liquidity that's here means that investors aren't just going to leave entirely. But on the margin, money is being viewed as perhaps interesting opportunities abroad right now.

Allison Nathan: And do you agree with that? I mean, is that something that you think is justifiable?

David Kostin: Well, the Goldman Sachs Portfolio Strategy team globally, we have been arguing for a broadening of the return structure in the market. Inside the United States, that would be an equal weighted index, as an example, as opposed to a cap weighted index as a way of getting a stronger risk-adjusted return.

And we take that on a global level, the idea of opportunity sets globally in other equity markets, somewhat more attractive than the US. They certainly start at a lower valuation. They've had better returns this year. There are some concerns about the multiple for the US, and that is a view that would suggest, from a return opportunity set around the world, maybe more attractive than the US right now.

Allison Nathan: And Padi, we've heard so much about private markets versus the public markets. When we think about the private markets, private equity, private credit, what are the investment advisors thinking about right now? Have we seen allocations continue to rise? Is the interest growing?

Padi Raphael: Absolutely. Private markets is definitely coming into the sunlight, I would say, as an asset class or as a collection of asset classes around the globe. Again, I would say there is huge amount of interest from a growing base, a broadening base of individual clients as represented by their financial advisors. And I would say from our perspective, from a GSAM perspective, we believe very strongly that individual investors and particularly high net worth individual investors will benefit from having the same kind of access to institutional-grade investing opportunities that the most sophisticated institutions and the wealthiest individuals have enjoyed for decades. And private markets is the perfect example of that.

Allison Nathan: If you think more broadly, is there anything that investment advisors are focused on that retail investors might actually need to be more focused on than they are?

Padi Raphael: Yeah, absolutely. One kind of opportunity or challenge in the market that, you know, we're paying a lot of attention to is the concentrated stock phenomenon. So there are tens of trillions of dollars of brokerage assets, equity brokerage assets, sitting in clients' accounts, of which a very large proportion are concentrated, which means more than 25% of the account is dominated by a single position.

Investors are often very emotionally attached to these positions. They've been in their family for generations, or they're a result of having worked for a company for many years. But history guides that holding a single-stock position is a coin toss relative to a broad-based index exposure, diversified portfolio. Some stats to help bring that to life, since 1992, there have been 9,227 stocks that have ever been part of the Russell 3000 Index. So many of those stocks -- about 6,000 odd -- have come out over time leaving 3,000 odd in there today. The median performance of these 9,227 stocks is just 2% with about 50% of those stocks having exhibited positive performance and 50% negative performance.

In fact, if you take those 9,200-odd stocks, you'd see that 46% of them, or nearly 50% of those stocks, experienced a 75% drawdown during their life, of which eight out of 10 of those stocks never recovered. Relative to if you'd held the Russell 3000 Index through an ETF or mutual fund, you would have had about a 10% return since inception. So that's the value of diversification versus having a single-stock exposure.

Allison Nathan: So David, we started out this conversation you feeling that the market was perhaps slightly too optimistic relative to some of the risks that we still have in this market today. Again, tariff uncertainty very high. Policy uncertainty in general very high. Very quickly, if even our expectations in terms of tariffs play out from here, what would that mean for the S&P 500?

David Kostin: So the S&P 500 direction will move higher. The index will move higher under our baseline forecast. Our baseline forecast has the economy growing, albeit at a pretty weak or low rate but not have a recession. And in that context, earnings are growing. And so as we move through the balance of 2025, the investor community will be more focused on the growth into next year, and the earnings growth usually over time will take the market higher.

Allison Nathan: So, yeah, we're somewhat positive as well. What's the downside, though? I mean, if we do end up in a more severe -- because some of the things that are still being talked about, although the market has viewed it as a reprieve, they're actually worse than we ar
e expecting. So what's the downside?

David Kostin: So in a downside scenario, earnings could fall by around 10%. They could fall a much greater amount of course, but in a scenario, looking back in history, earnings typically fall by around 10% in a recession. And again, that's not our baseline forecast, but in that scenario of a recession, you'd have earnings come down and the valuation would contract as well. And so you could see the market at the S&P 500 level, for example, trade around 4,600 in a more recessionary environment scenario.

And so balancing those two outcomes, it seems as the recent news flow would suggest, perhaps there is this off ramp in some of the draconian tariffs that have been proposed originally on the Liberation Day of April 2nd perhaps will be avoided. And as a result, the economy is likely to direct itself towards a non-recessionary outcome. In that case, what's priced today in the US stock market is the more optimistic scenario that we're envisioning will transpire.

Allison Nathan: Right. But the risks are wide, and the spectrum of outcomes as well.

David Kostin: That's correct. And there are always risks. There's wide distribution on the risks. And the market is pricing the more optimistic scenario, and we think that's probably appropriate given the news flow that we're getting from Washington, DC.

Allison Nathan: David, Padi, thanks so much for joining us.

Padi Raphael: Pleasure.

David Kostin: Thanks, Allison.

Padi Raphael: Thank you so much, Allison.

Allison Nathan: This episode of Goldman Sachs Exchanges was recorded on Friday, May 9th. I'm Allison Nathan. Thanks for listening.

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