



Macroeconomic and Equity Update

August 28, 2023

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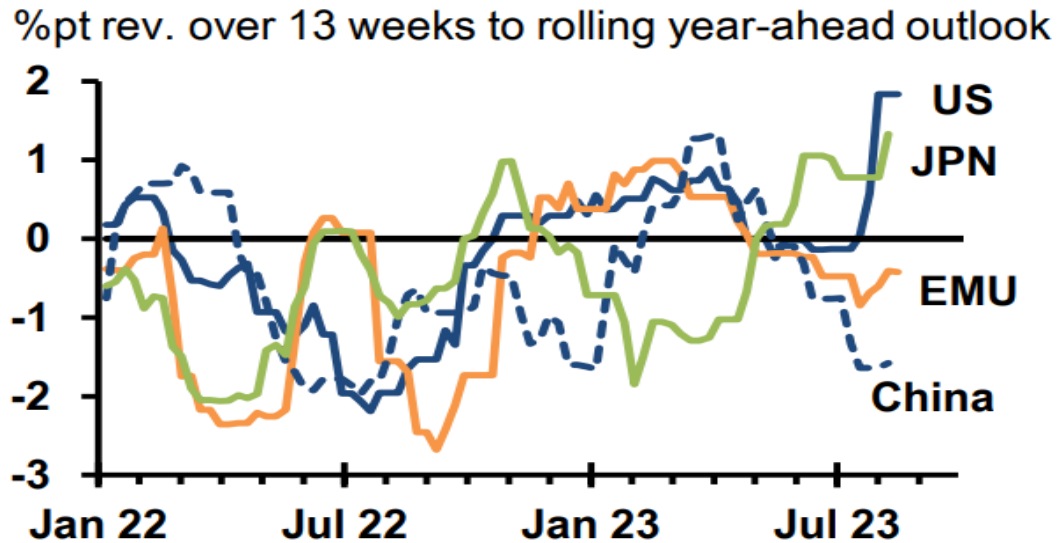
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- **GDP Forecast-Surprise Indices Underscore Growing Country/ Regional Divergence**
 - US and Japan delivering upside surprises
 - China and Euro area delivering downside surprises
- **August Flash PMIs Disappointing Signals Bear Watching But May Overstate Current Weakness**
 - Available hard data more encouraging¹
 - G10 consumer indicators still positive on balance
- **Jackson Hole Speeches: Inflation Still Too High**
 - Powell (Fed): Intend to hold policy restrictive ... until confident inflation tamed
 - Lagarde (ECB): Interest rates need to stay high as long as necessary to slow inflation
 - Broadbent (BoE): To ensure inflation doesn't become long-term issue, rates need to stay high
- **Special Topics**
 - China's recent weakness requiring downward revisions in our cyclical outlook
 - Generative AI becoming an important consideration for investors
 - Post-pandemic inflation opinions: Transitory ½ right, Fiscal stimulus key, Victory lap premature

1. JPM Economists: PMIs important monitoring tool, but not a substitute for hard data. Key PMI attributes delivered earlier than other indications and diffusion indexes tend to be less volatile from month-to-month. Possible concerns: JPM's PMI model has understated GDP growth 1% per year since 2019. Latest readings not consistent with US GNP— currently tracking 2.5% in Q3 and manufacturing data from Asian bellwethers look to be improving.

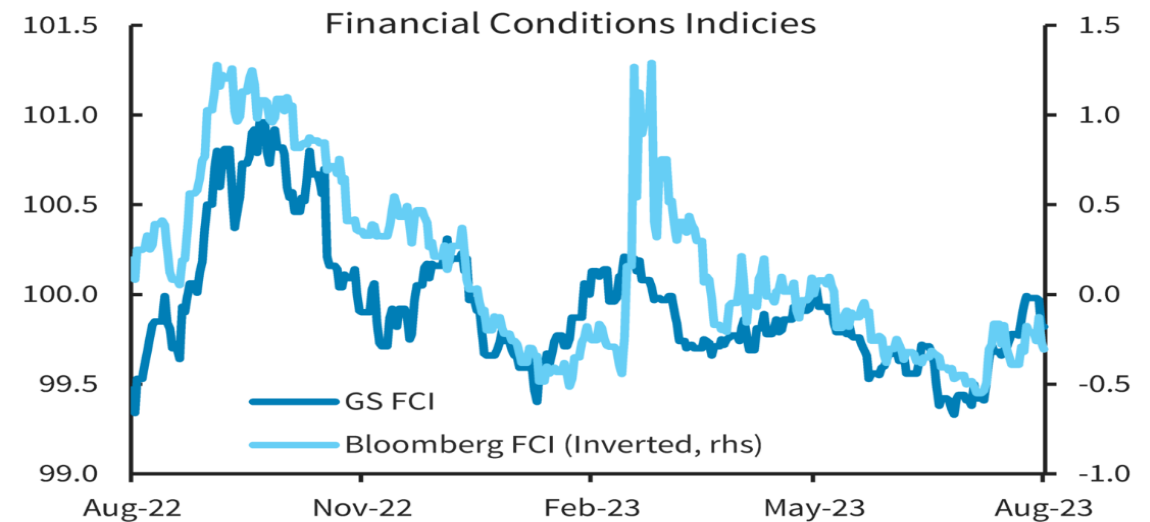
Macro Backdrop: Forecast Revisions & Financial Conditions Indices

GDP Forecast Revisions



- Common factors lifting global economy: disinflation, strong employment, post pandemic re-openings
- Latest data, however, reflect considerable country/regional diversity
- US & Japan enjoying upside surprises, China & Europe to lesser extent experiencing downside surprises

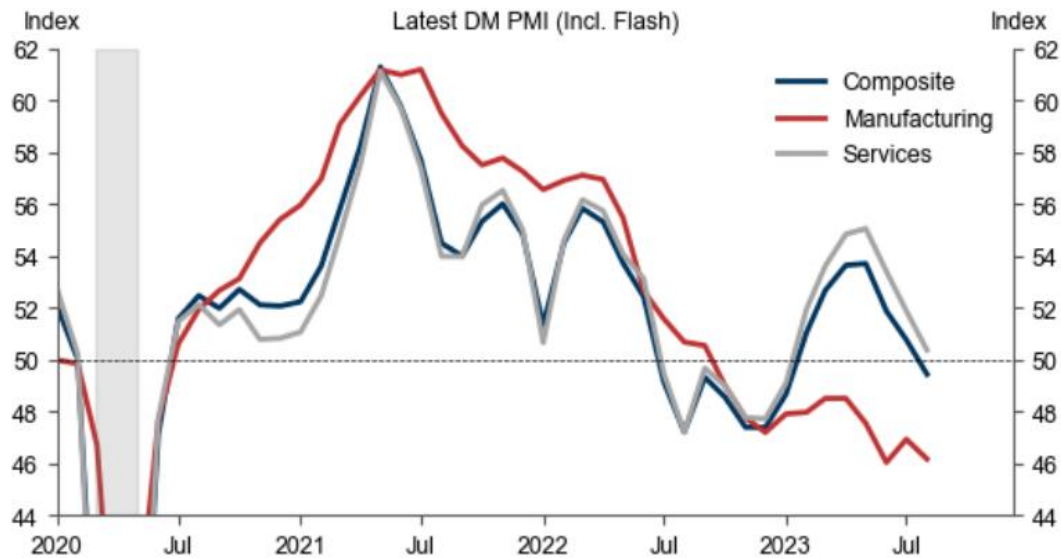
US Financial Conditions



- US Treasury yields higher — partially in response to economic strength — unlikely to derail economy
- Financial conditions easier than in late 2022 due to higher equity prices, tighter spreads and weaker USD

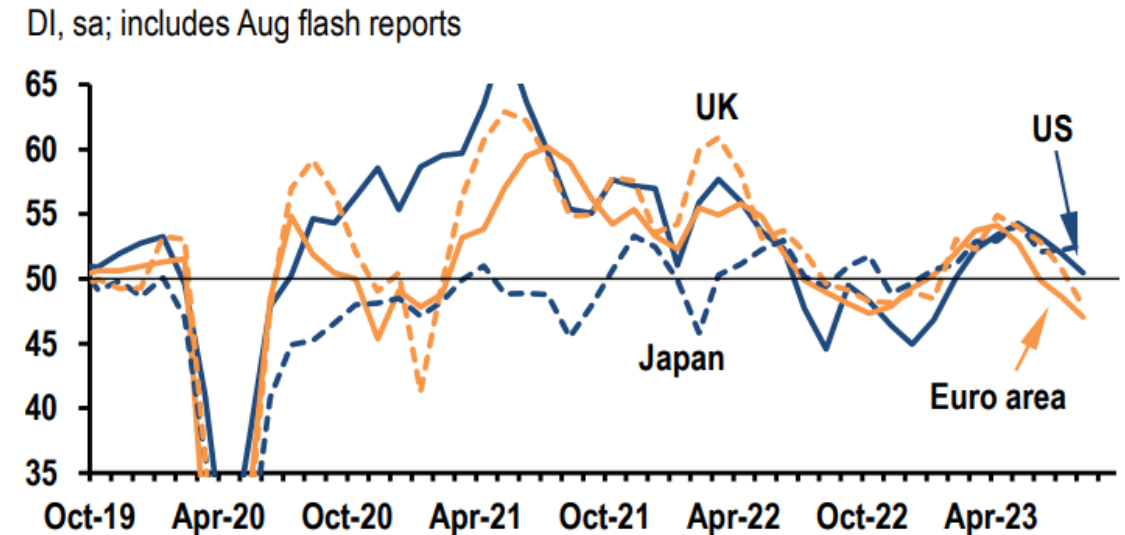
Macro Backdrop: Flash August PMIs Disappointing

DM: Composite/Mfg./Services



- DM composite flash PMI for August fell 1.4 points to 49.4
- Services flash August PMI 50.4 / manufacturing 46.2
- Composite flash employment PMI remained modestly expansionary across major DMs

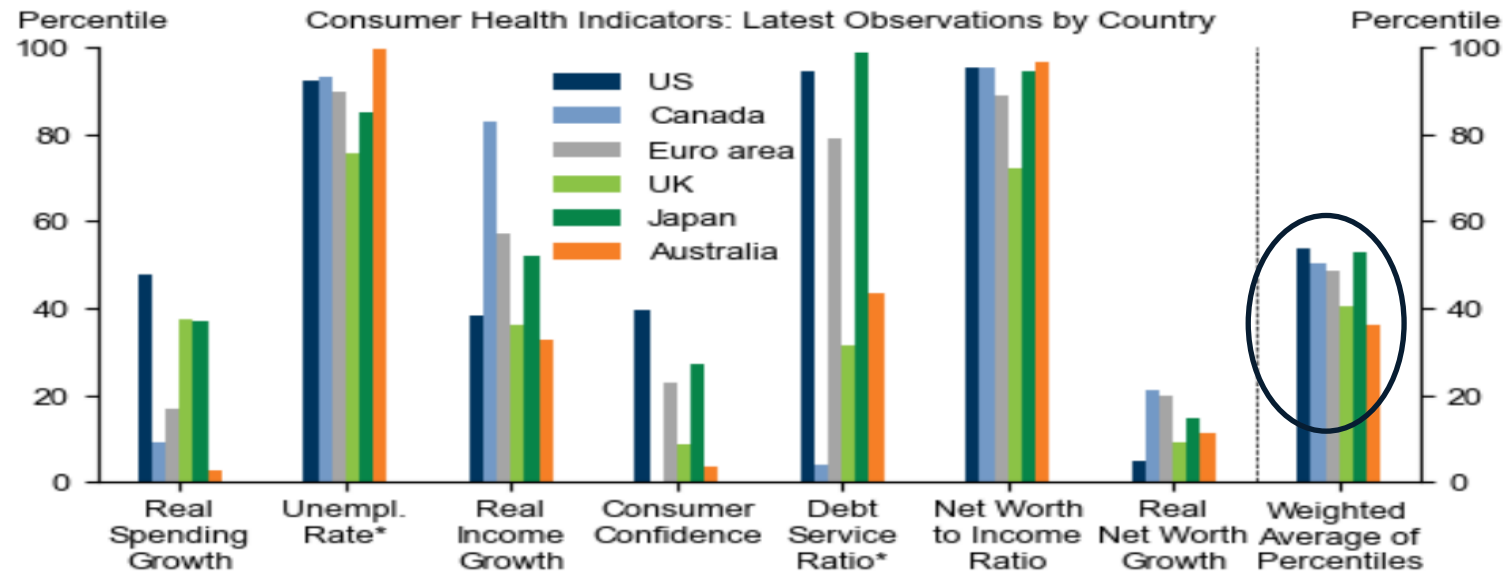
Major DM: All-Industry Output PMI



- All industry output flash August PMIs weaker for major DMs ex Japan
- US remained slightly above 50, and in expansionary territory but...
- Euro area and UK below 50 based in August flash

Latest Readings for G10 Consumer Indicators Still Positive on Balance¹

G10 Consumer Dashboard



- Weighted averages of the historical percentiles of major DMs in ~30 - ~50 range²
- Labor markets and net worth-to-income ratios comfortably above 50th percentile, while high inflation is continuing to depress confidence and real-net-worth growth
- Debt service ratios near-average-to-strong across major DMs ex. Canada, while real spending and income growth, to lesser extent, subpar with few notable exceptions

Source: Haver Analytics, GS, *percentile invented

1. Dashboard updated on August 12, 2023

2. Consumer health survey stands above the 50th percentile in US, Euro area, Canada and Japan, and at or below 40 in the UK and Australia.

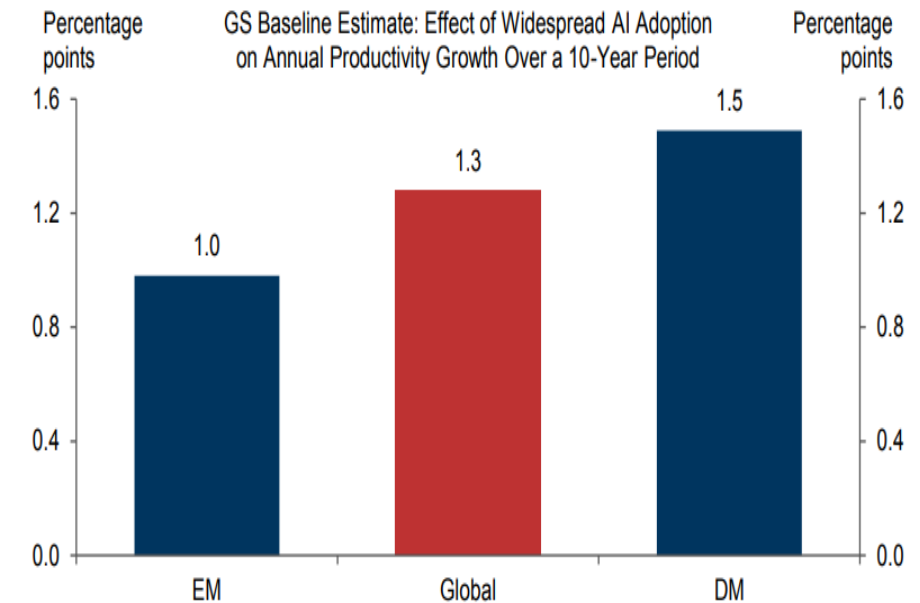
China's Recent Weakness: Our Revised Cyclical Outlook

- **Recent Revisions In OUR Cyclical Outlook for China's GDP Growth**
 - 2023: Revised to 5% from 5.7%, 2024: revised to 4.6% from 5%
- **Prior Outlook Incorporated Well-Known Pluses and Misuses**
 - Pluses: Potential reopening growth surge/industrial and export strengths
 - Headwinds: High-debt levels, aging population, 20+% youth unemployment
- **Increased Financial Distress — Evergrande and Country Garden Defaults and**
 - Limited response thus far from policymakers triggered revision
 - Property sector reportedly accounts for as much as 70% of household wealth
- **Key Factors Underpinning Expectations That Cyclical Growth Will Approximate 5% Target**
 - Further, albeit measured, fiscal and monetary stimulus
 - Current drag from excessive inventories fading
 - Ongoing strength of favored industries: solar panels, EVs, computer chips
- **Global Economic Fallout from Latest Troubles in Property Sector Expected to be Limited**
 - Foreign exposure to China's property sector has fallen sharply
 - Policymakers expected to step in to prevent meltdown in China, if necessary

Generative AI: Becoming Important Consideration for Investors

- **Generative AI Holds Significant Promise for:**
 - Productivity, economic growth¹ and investment returns
- **Widespread Adoption Needed for Economic Lift, However**
 - Likely to come faster than after prior milestone inventions
 - But premature to imbed benefits in our 2023-24 outlook
- **Generative AI: Investment Opportunities/ Possible Risks**
 - Investors in stocks such as Nvidia gaining outsized returns
 - CE² raised their expected S&P 500 2-year return to 50%
 - AI-focused PM: Cautiously optimistic/ warns timing key
 - GS market strategist: Past innovation-led productivity booms led to sharp equity increase that became bubbles and ultimately burst

AI's Estimated Productivity Lift



Source: GS

Source: GS

1. GS economists in their baseline scenario assume that generative AI adoption could drive a 7% or almost \$17 trillion increase in global GDP over a 10-year period.

2. Capital Economics

- **Transitory Adjective Seemingly Reasonable Depiction of Inflation in Early 2021**
 - Expected inflation based on TIPS pricing near 2% target during most of year
 - Rise in CPI from 1.4% in January 2021 to 5.4% in June due to energy prices and...
 - Supply-side bottlenecks which were expected to ease but ...
 - As inflation kept rising and reached 7% by the end of the year...
 - Powell appropriately retired using word *transitory* to depict inflation

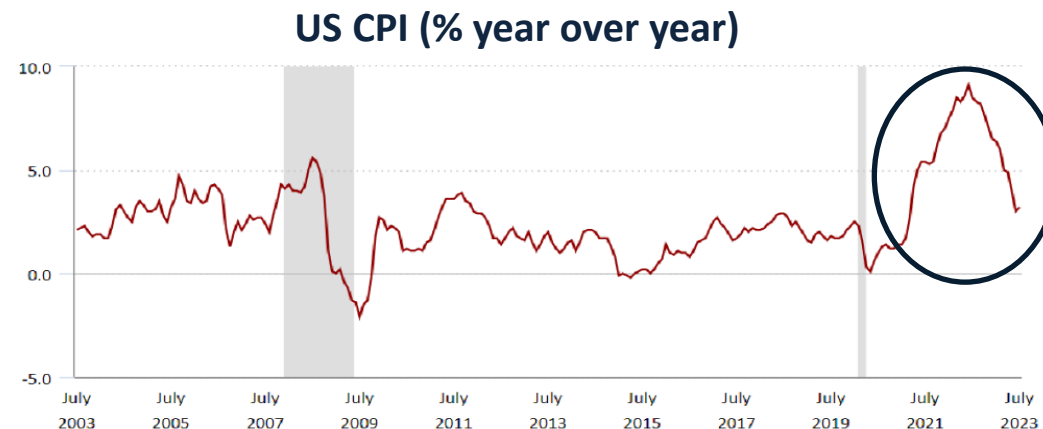
- **Blinder Concedes Transitory Proponents Underestimated Inflation's Persistence**
 - Even though inflation subsequently slowed to 3.2%, we didn't foresee it peaking...
 - At 9.1% in June -2022 / Process that took 2+ years to unfold not transitory

- **But We Were Right About Avoiding Recession**
 - Energy supply shocks and supply-chain bottlenecks seem to be ...
 - Behind us and inflation has fallen without appreciable slack in economy

1. Alan Blinder, "Team Transitory Had a Point About Inflation", WSJ, July 20, 2023

2. Surprises included invasion of Ukraine and the length and breadth of supply-side bottleneck; mistakenly assumed higher prices would result in supply increase.

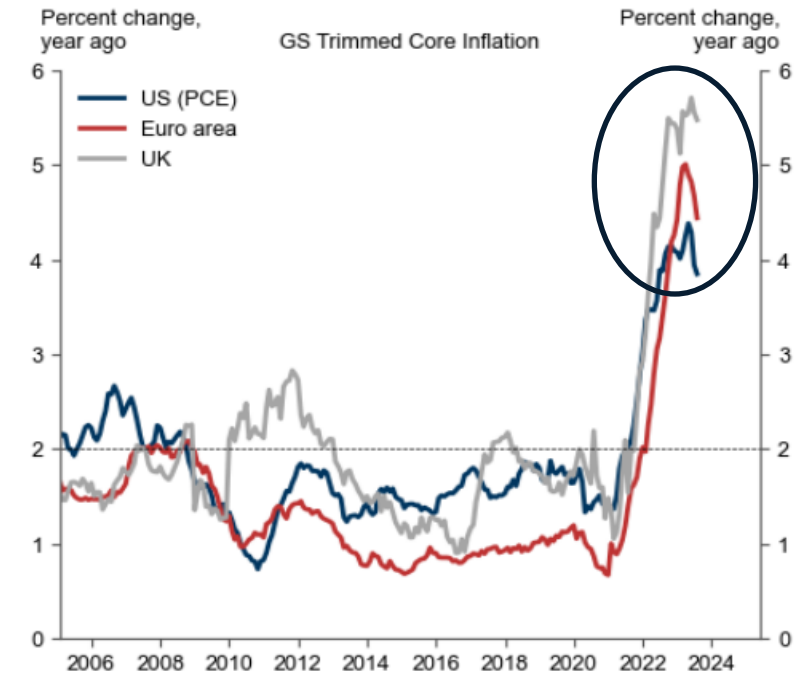
- **One-Time \$5 trillion Fiscal Blowout Caused One-Time...**
 - Price rise that would eventual stop even if Fed did nothing
- **Bottlenecks Cause Prices of Goods in Short Supply To Go Up But...**
 - Inflation requires government to give people enough money / debt to afford higher prices
 - QE in 2010s didn't cause inflation/money went into reserves not personal spending
- **Cochrane's Fiscal Framework Not Encouraging for Future**
 - US government currently running \$1.5 tr. deficit, while unemployment near historic low
 - Growing deficits from unfunded entitlement even more worrisome



Post Pandemic Inflation – Chris Giles: Premature for Victory Lap

- **Chris Giles¹: Inflation Extremely Hot Over Last Two Years**
 - Double digit increases in US, Euro area, and UK
- **Central Bankers Active Inflation Fighters Over Last 18 Months**
 - Headline inflation has declined / many bottlenecks fixed or eased
 - Progress uneven, however, among US, Euro, and UK²
- **Far Too early to Declare Victory or “Immaculate Disinflation”**
 - Core inflation still too high / labor markets not yet in balance
- **Key Question for Central Bankers...**
 - Are interest rates roughly right now or do they need to
 - edge them a little higher?

Core Inflation



Source: GS

1. Chris Giles, “It’s far too early to declare end of inflation, FT, 23 August 2023

2. US has seen some encouraging trends ECB has raised inflation forecast and core inflation appears sticky. In the UK most data points to a post-Brexit wage-price spiral.

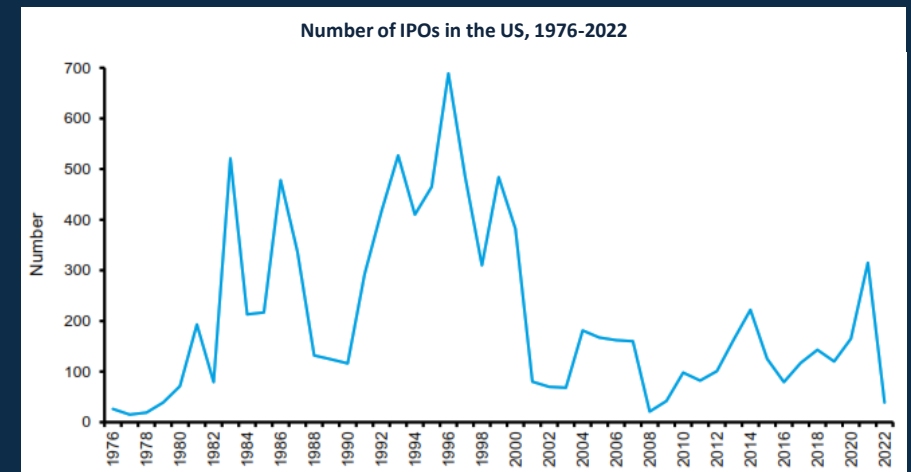
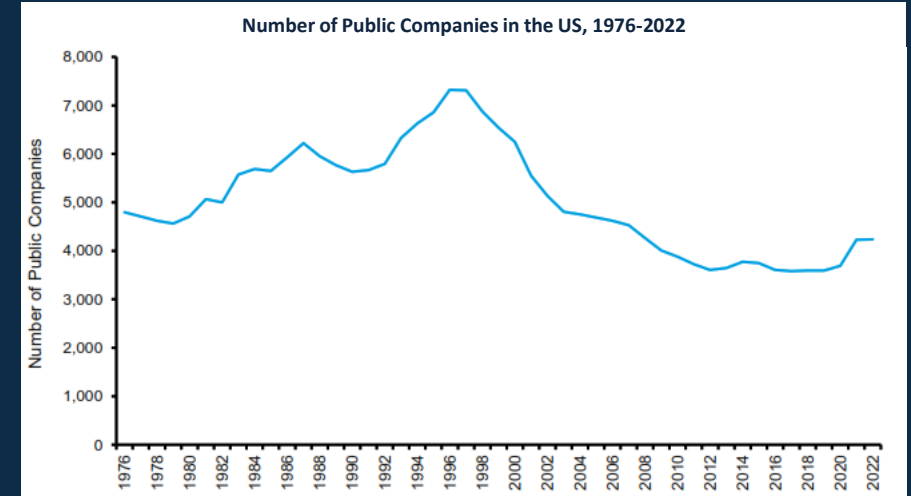
Equity Update

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Public Company Demographics

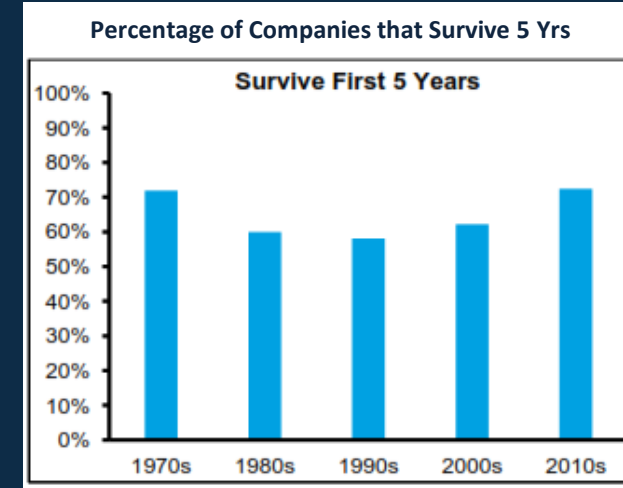
- The number of public companies in the US has declined from over 7,000 in the 1990s to 4,000+ today
- The primary reason for this has been the decrease in the number of IPOs over the last couple of decades



Public Company Demographics

- **Another possible explanation – that today's companies have shorter life spans as public companies – is not supported by the data**
 - Post-IPO company longevity bottomed during the 1990s which saw many low-quality companies come to market before the TMT bubble burst; more recent IPO vintages have enjoyed a higher 5-year survival rate, in line with the 1970s

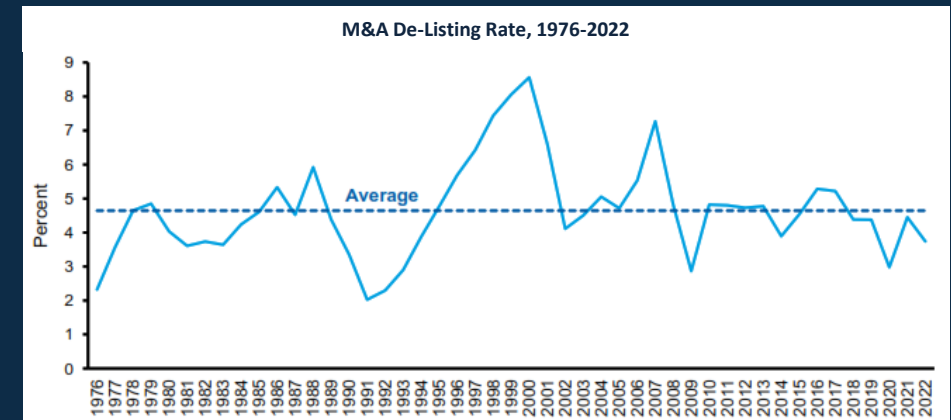
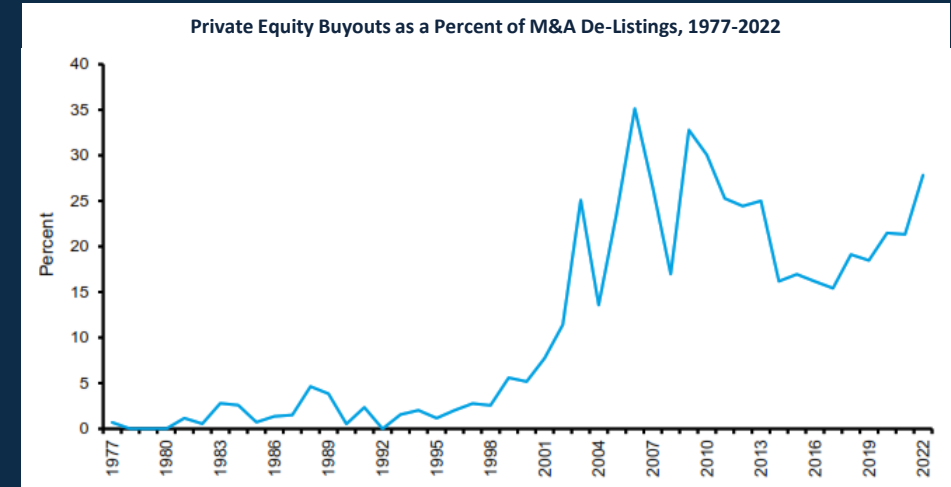
- **The median IPO over the last 55 years only managed to generate 30 cents of earnings over its life for each \$1 of IPO price**
 - Roughly 40% of IPOs were non-merger de-listings and generated almost no earnings over their lives
 - IPOs that subsequently merged had the strongest operating performance
 - Companies that survived from IPO date to the end of 2020 exhibited a high level of skewness in their earnings generation relative to their IPO price with a mean 1.5x but a median of just 0.4x



Category	Number	Mean	Median
Surviving	2,757	1.5	0.4
Merged	6,963	1.9	1.1
Delisted (Non-Merged)	6,666	0.1	0.0
Total	16,386	1.1	0.3

Public Company Demographics

- Although Private Equity now makes up a much larger portion of M&A de-listings ...
- The rate of M&A de-listings in recent years has remained near long-term average
 - M&A is the most common reason for de-listing (avg. 58% from 1976-2022)



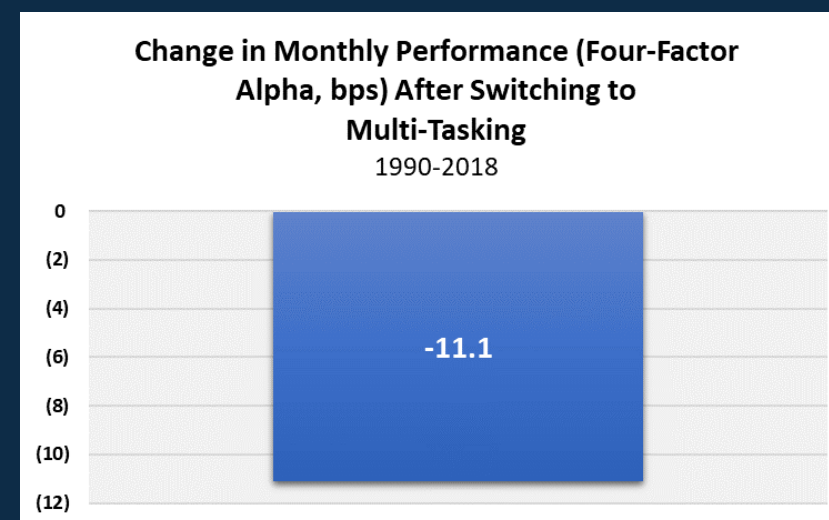
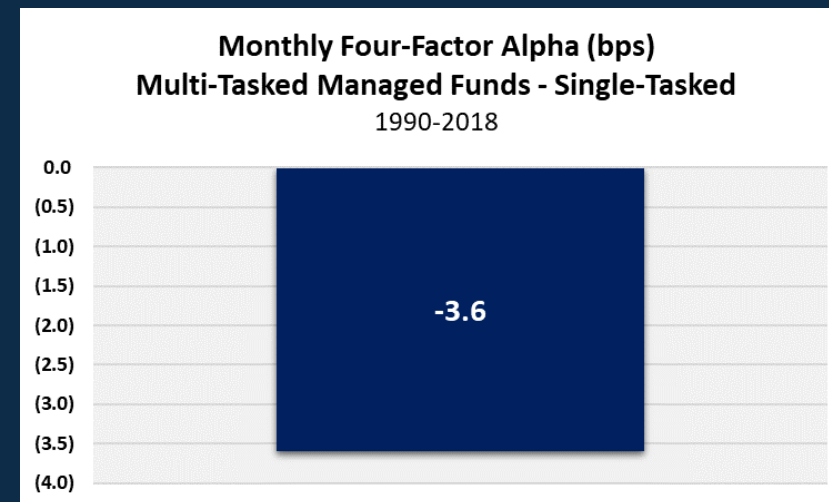
Portfolio Manager Multi-Tasking

- **Managing multiple mutual funds has become much more prevalent with 50% of funds managed by multi-taskers in 2018 versus 33% in 1990**

- **Managing multiple funds is associated with poor performance relative to single-task managed funds**
 - Funds managed by multi-taskers trail those managed by single-taskers by 3.6 bps/mo. from 1990-2018 on a factor-adjusted basis

- **Performance also deteriorates when a single-tasking manager switches to multi-tasking**
 - The performance of funds previously managed by single-taskers drops by 11.1 bps/mo. On a risk-adjusted basis in the 36 mos. following the manager assuming additional portfolio management responsibilities

Sources: Agarwal, Vikas, L. Ma and K. Mullaly, "Manager Multitasking in the Mutual Fund Industry", *Financial Analysts Journal*, April 2023.



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