THE DAILY CHECK-IN WITH GOLDMAN SACHS

GUEST: Lou Miller, Global Markets
HOST: Liz Bowyer, Global Head of Content
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Liz Bowyer: Hi Lou.

Lou Miller: Hi Liz.

Liz Bowyer: You help our clients in global markets invest in key themes in the equity markets. One significant theme, recently, has been the rotation from growth stocks to value. What are some of the catalysts of this shift?

Lou Miller: Yeah, the catalyst has been the economic recovery that we've seen. And it's really been accelerated by the Pfizer vaccine, the vaccine rollout, the reopening headlines, the reopening materializing in reality in the US. And then the prospect of reopening happening in Europe and in the rest of the world over the course of the next six months. So, it's really been a function of that. And that's really led to higher interest rates, higher commodity prices. And then really, that's showing up in the equity market through value going up and growth stocks really not performing well. And in some cases, the highest multiple, most expensive growth stocks, indeed, going down.

Liz Bowyer: And where are we now in the rotation, do you think?

Lou Miller: So, it's tempting to say we're far along because in the second quarter, the US GDP growth from a rate of change perspective will peak. And we have seen a lot of these value growth price performance charts normalize from pre-pandemic levels. But I don't think we are in the latter innings of the trade. I think that there is a lot more room to go.

Global growth, and I really do think these are global dynamics that matter, won't peak until the third quarter. And commodities are still 62 percent below their super cycle highs. And we see commodities going up over 10 percent over the next six months. Long-term interest rates are half of where they were in 2018. And you know, the narrative around when tapering occurs is going to play out over the next six months. And we should still see really strong data from June through August. So, I think we're definitely halfway through this trade. But I don't think we're, like, close to the end. I think there is still room for this rotation to continue.

Liz Bowyer: And talk more about some of the sectors that are benefiting from the rotation.

Lou Miller: Taking a step back, like, energy, materials, and industrials are just 14 percent of the S & P. Technology is double that. And that doesn't take into account that Amazon and Tesla are classified as consumer discretionary stocks. And Facebook and Google are classified as communication stocks. So, from a market cap perspective, you know, this is really impressive, the starting point of how low it is. But it's clearly these commodity-sensitive areas of the market, like energy and materials, these real economy areas such as industrials and the reopening sector, such as consumer discretionary, and then lastly financials. Financials is one of the sectors that is classically considered value. And would heavily show up in the first quintile of value.

Liz Bowyer: You mentioned a few names in the technology sector, where we've started to see more differentiation between stock names. What do you see as some of the best and worst performers out there right now?

Lou Miller: Yeah. So, in tech, GDP sensitive areas like tech hardware have done fine. And have held in, relative to where the index is. And areas, high duration tech, so, tech stocks that have, you know, inconsequential profits today in high growth rates, those stocks are some of the worst performing stocks in the market. Some of the quintessential stay-at-home stocks from last year, some of those stocks are down 40 percent from their highs. So, there really does seem to be a bias against high multiple tech. and there seems to be a strong preference for stocks that have valuation support.

So, tech stocks that screen as growth at a reasonable price, areas like mega cap tech that also have buy back support have had done pretty well of late and have outperformed in the most recent period.

So, I think tech can be fine. But I think having an anchor, a valuation anchor that makes sense is a pretty key characteristic that investors are looking for.

Liz Bowyer: So, looking broadly at the rotation from growth to value, what, if anything, do you think could trigger an unwinding of the rotation?

Lou Miller: Yeah, I think a few things. So, we brought up earlier that US growth is already peaking. So, clearly, you know, have seen ISM manufacturing decelerate this month, was a little bit of a cause for pause. Additionally, inflation expectations have increased a lot. Despite the fact that inflation has been below 2 percent for a lot of the last ten years, it's expected to be above 2 percent over the next ten years. And that may or may not materialize.

The other dynamic at play is, you know, because this has gone on for now over a year, many of the value stocks that we're talking about now screen as long momentum. Which means from a positioning perspective, there's a new group of investors that are investing in these stocks. So, the positioning dynamic is less light. And so, that, you know, could play a role.

And then this catch-up trade for the rest of the world growth to materialize, it may not materialize. You know? There may be issues with vaccine distribution or new variants affecting global growth in a negative manner. And so, those are some of the key items that, I think, could derail the rotation.

Liz Bowyer: Well, one group of investors that have certainly been in the spotlight this year is retail investors. How has that cohort impacted the rotation from growth to value?

Lou Miller: Yeah, retail's impacted everything in this market. And as we dissect retail, we actually see them active in both growth and in value. So, for a big part of the past year, they were very into the reopening trade. And in some of the highly shorted stocks, which also can often screen as value. But on the growth side, you know, some of these non-profitable tech business models had been very well positioned by retail. And we've seen, you know, a good deal of recent underperformance there.

And I think part of this is, you know, after the last stimulus check, we really saw declining retail activity across the board, in call option activity, in the stocks that are most traded by retail, and the stocks most popular on Reddit. And maybe, you know, folks are just enjoying the real economy and not sitting on screens. Or maybe it's a focus on new, nascent asset classes that have nothing to do with the stock market.

And then also, you know, as we get into mid May, you know, taxes are due, and a lot of retail investors have a lot of short-term capital gains that they may need to realize by selling certain stocks. So, you know, I don't think it's going to matter to the balance of growth versus value at a macro space. But in a micro case, you know, certain high multiple tech companies could be under pressure of late as a function of that. And, you know, certain highly shorted stocks, I think, have been bullied around a bit by the retail investor.

Liz Bowyer: So, finally Lou, any other big trends in the equity market that you're focused on at the moment?

Lou Miller: So, we brought up earlier commodities going higher. Is that transitory or not? That has a big effect on certain equities. Certain equities have pricing power. Others do not. A lot of workers are renegotiating their wages as they re-enter the workforce. A lot of input costs are going up. And so, that has big implications. So, we're really focused on winners and losers there.

The other thing is, you know, the US reopening trade has largely played out. But in Europe, you know, we finally have vaccinations picking up into full gear. And we think the European reopening trade has room to catch up. And similarly, the emerging market reopening trade, probably early days there, but we're doing work and think that that could be interesting as well.

And finally, we're focused on infrastructure. President Biden has a very large infrastructure plan that has huge implications for certain industrial material stocks. And that will be a big theme over the next six months. And additionally, that package will likely need to be paid for. So, there will likely be winners and losers from higher corporate taxes, higher foreign minimum taxes. And think that that could be a big theme over the next six months.

Liz Bowyer: Thanks Lou.

Lou Miller: Thanks Liz.