

Markets Update: A Biden Presidency, a Possible Vaccine and the Future of the S&P

Question: Welcome to our "Exchanges at Goldman Sachs Markets Update" for Friday, November 13th. Each week we check in with a leader across the firm to get a quick take on what they're watching in markets. It's been a particularly busy week with news around the presidential election and some news on vaccines and COVID-19. I'm Jake Siewert, global head of corporate communication here at the firm. And my guest today is David Kostin, our chief US equities strategist. David, welcome back to the program. Thanks for taking the time with so much going on.

David Kostin: Thanks, Jake. Appreciate you inviting me.

Question: David, as I mentioned, we've had two big developments in the past week, the Biden victory -- or we should say provisional victory -- and the announcement of a successful trial of a COVID vaccine. How do you view those two things? And how do they move the markets?

David Kostin: So absolutely the vaccine was much more important than the election. Of course it's always exciting and interesting to talk about the election, but we have to keep front and center that this was and is a public health crisis that started nearly a year ago. And ultimately, solutions to that crisis requires a medical advance. And of course the breakthrough -- what appears to be a breakthrough -- by Pfizer on its vaccine is a significant development because, for the first time, at least have a vision or a path, a perceived path, to how you get to a more normalized society.

And so the reason that the vaccine is so critical is from Goldman Sachs micro research point of view in our forecast from a markets perspective, this is supportive of a view that the economy is actually going to be growing pretty rapidly in 2021. And that supports a higher equity market and a whole bunch of other things. So the importance and the consequences of the vaccine really can't be overstated. It came a little bit sooner, Jake, than maybe we had been anticipating. They kept thinking closer to the latter part of November, so it was a bit of a surprise that it came, you know, when it did. But ultimately that is more important.

Now what you did see in the equity market, you know, the rally

in the stocks that depend on a more normalized society. So those would be hotels, the cruise lines, airlines, all these stocks that have reason now to be able to rally because people could look into the future and bring that more normal environment forward. So I think that was the real critical issue from an equity market perspective.

Question: Okay. So while the presidential election has been decided, with apologies to the holdouts, control of congress remains up in the air. How do you see that affecting policy initiatives out of Washington?

David Kostin: So in response to my last question, I didn't mean to suggest that the election was totally unimportant. It was just that the magnitude of the virus was still important, therefore the vaccine is critical.

So there is a lot of uncertainty. Even though the Senate would appear likely to remain in the Republican hands and more importantly to say that there's a divided government, divided congress, the uncertainty does remain that won't be resolved clearly until the 5th of January. So a couple more months of a little bit of uncertainty. But broadly speaking, what the market is expecting is that it's going to be a divided government. That is one of the reasons why the market rallied as well because you had a reduction in uncertainty. So policy uncertainty is one of the key measures we look at, and that has come down because the likelihood of major legislation with respect to either taxes or fiscal stimulus becomes less probable. And a reduction in uncertainty is also associated with a higher generally valuations in an equity market.

Question: Yeah, so smaller stimulus, less chance of a big tax package. So David, with all that in mind, how do you think about where the S&P will be at the end of this year and next?

David Kostin: So the forecast for the end of this year is 3,700. And so we lifted that by about 100 points as we had anticipated or telegraphed in our report back in September, saying that if you had a divided government you were likely to get the market moving a little bit higher. In fact, our forecast remains now or is 3,700 on the S&P 500. And equally important, if you look into 2021, we published earlier this week our outlook for the new year, and we have a 4,300 target at the end of 2021. So that's basically from this level forward, Jake, almost 20% return to equities over the next, call it, 14 months. And that's driven largely by the normalization of the economy,

equity markets earnings growing along with that, and ultimately that's taking the equity prices with them. Interest rates staying super low. But 3,700 end of this year. That's giving you an up side of about 4%, plus or minus, depending on the day.

Question: So you and I have talked, David, about the fact that a lot of the S&P performance, out performance, has been on the back of these mega cap stocks. But you have a different view now. Tell us more about that.

David Kostin: So the story of 2020 is all about we'll call it big tech, and the five largest stocks in the market -- Facebook, Amazon, apple, Microsoft, and Google -- collectively, they account for nearly a quarter of the S&P 500 equity capitalization. So roughly a quarter of the market is represented by five companies. We've never had a level of market concentration this high in history. So it's very, very chunky market. Use that terminology. And these stocks are up nearly 50% since the start of the year. Up 50%.

The other 495 stocks are basically up around 4%. So if we think about the nature of the return structure, market structure concept, that really has been the story of these companies. And the gap between the overall index performance and the typical stock is extremely wide. Much, much wider than normal. And so we think about looking into the next year, what kind of strategies, the more probable outcome is that you have some of the median stocks, the typically company probably outperforms some of these larger companies. Doesn't mean these larger companies don't do well. It just means that on a relative basis you probably have some catch up. And that's one of the areas that we focused on as a, you know, opportunity set in the market. It's been a big topic of conversation with clients this week.

Question: Okay. So beyond the catch up based on your current forecast, let's talk about sectors. What sectors do you expect to over and under perform based on your thinking now?

David Kostin: So the healthcare sector, Jake, is the lowest valuation, the cheapest relative valuation to the market in 40 years. That is a really powerful statement. You have to go all the way back to when the Clinton originally in 1993 or when Hillary Clinton was looking to help restructure part of the healthcare sector when stocks traded at a low level. Ten years ago, in the heart of the Obamacare debates, healthcare stocks traded at pretty low levels. But we're even at more of a

discount today. That's how dramatic it's been. So that's a value opportunity set. There's uncertainty on policy. But ultimately that is an area of focus.

Historically, the sector often dips down and trades, under performs heading into the election. And then once the election has passed, the sector tends to rally. There's always considered uncertainty around policy involving health care. Well, the election has now passed, and so these are the stocks. They start out with very attractive valuations, A. And B) they've had that tradition pattern and we expect a rally in the sector. So that's an area of focus on the value side.

Question: So we always keep track of consensus. How does your outlook compare to the consensus outlook for the US stock market over the next year? And how do you account for any discrepancy?

David Kostin: So the way to make money as a portfolio manager is to have a view, have that view be different from consensus, and have consensus move towards your view. That's if you're a portfolio manager. Same thing as a strategist, as an investor. Basically have a view that maybe is different from consensus and have that gap narrow. And so our forecast on earnings, if you think about profits for next year, \$175 of S&P 500 earnings. The average of the other strategists is around \$155, so that's about 13% gap. And the overall analyst community is around \$168, around 5% gap. And the expectation that I have is you'll have positive earnings revisions. And positive earnings revisions across the market is likely to lead to a higher level of equities.

What accounts for that difference is a couple of issues. One is that the vaccine, we have a very optimistic view at Goldman that there's likely to be not just the approval but the approval and the manufacturing and the distribution of enough doses to vaccinate a good portion of the country. And therefore that allows the economy to grow more rapidly. So the first issue is better medical outlook, therefore you get better economic growth.

And the second is the idea that some of the interest rate environment, because that's likely to remain very low, that does support some of the growthier sectors, some of the healthcare stocks, as well as a number of technology companies. And I think those are the two reasons why our level and price target for the market is pretty optimistic. It's above what the

consensus is right now.

Question: All right, well, better vaccines, quicker vaccines would be good for the world as well as good for the markets. So what are the risks to your outlook today, and how do you think about the downside risks?

David Kostin: So there are a couple of important risks. Clearly the spike in COVID-19 cases is concerning. That is probably going to remain an issue for the next several months for the Northern Hemisphere and its colder weather. So that does raise the concerns. So this is happening before there's an ability to manufacture and deliver enough of the potential vaccine. So that's one primary risk. And I would say that's a point of uncertainty. Investors ultimately will start to look through in terms of a path to normalization.

The second you could think about is some of the balance sheet issues. There's quite a lot of leverage that companies have taken on in terms of operating their business over the last seven, eight, nine months in the heart of the pandemic. So revenues are down for many companies. They've taken on more debt. The idea of does the economy recover? And what exactly is the ability of particularly small and mid-sized businesses to accommodate that?

I would say the fiscal stimulus will be the third item that there is some expectation and really need on a society basis for unemployment, given it's so high, to get more of the sort of bridge to the other side, if you will, some fiscal stimulus, extended unemployment benefits, things like that. I think a concern would be if you don't have a sufficient amount and size and timing of that, that would cause some concerns about the slowdown in economy. I think those are three primary risks that we think about.

Question: All right, David. Well, thanks again for joining us today. It's always great to hear from you

David Kostin: Thanks for having me.

Question: That concludes this episode of "Exchanges at Goldman Sachs." Thank you for listening. And if you enjoyed the show, we hope you subscribe on Apple Podcasts and leave a rating or a comment. This podcast was recorded on Thursday, November 12th, in the year 2020. Thanks for listening.

Speaker: All price references and market forecasts correspond to the date of this recording. This podcast should not be copied, distributed, published, or reproduced in whole or in part. The information contained in this podcast does not constitute research or recommendation from any Goldman Sachs entity to the listener. Neither Goldman Sachs nor any of its affiliates makes any representation or warranty as to the accuracy or completeness of the statements or any information contained in this podcast and any liability therefore, including in respect of direct, indirect, or consequential loss or damage is expressly disclaimed. The views expressed in this podcast are not necessarily those of Goldman Sachs, and Goldman Sachs is not providing any financial, economic, legal, accounting, or tax advice or recommendations in this podcast. In addition, the receipt of this podcast by any listener is not to be taken as constituting the giving of investment advice by Goldman Sachs to that listener nor to constitute such person a client of any Goldman Sachs entity.

This transcript should not be copied, distributed, published or reproduced, in whole or in part, or disclosed by any recipient to any other person. The information contained in this transcript does not constitute a recommendation from any Goldman Sachs entity to the recipient. Neither Goldman Sachs nor any of its affiliates makes any representation or warranty, express or implied, as to the accuracy or completeness of the statements or any information contained in this transcript and any liability therefore (including in respect of direct, indirect or consequential loss or damage) is expressly disclaimed. The views expressed in this transcript are not necessarily those of Goldman Sachs, and Goldman Sachs is not providing any financial, economic, legal, accounting or tax advice or recommendations in this transcript. In addition, the receipt of this transcript by any recipient is not to be taken as constituting the giving of investment advice by Goldman Sachs to that recipient, nor to constitute such person a client of any Goldman Sachs entity. This transcript is provided in conjunction with the associated video/audio content for convenience. The content of this transcript may differ from the associated video/audio, please consult the original content as the definitive source.