

**Markets Update: Exchanges at Goldman Sachs
What's Behind the Record Level of Equity Issuance?
Benny Adler, Co-Head of America's Franchise Trading,
Host, Jake Siewert
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Jake Siewert: Welcome to our Exchanges at Goldman Sachs Markets Update for Friday, April 9th. Each week we check in with a leader across the firm to get a quick take on what they're watching in the markets. This week we're going to look at the surge in IPO and related equity issuance and the outlook for markets going forward.

I'm Jake Siewert, Global Head of Corporate Communications here at Goldman. And I'm delighted to be joined by Benny Adler, who's a legend. Co-Head of America's Franchise Trading. Benny, nice to see you. Welcome to the program.

Benny Adler: Thanks for having me.

Jake Siewert: So, been a busy, busy year for you. We've seen a record level of IPOs and SPACs in the market this year. Give us a sense of the scale of activity that you've been seeing.

Benny Adler: Yeah sure. And look, it's really been a slow build to the crescendo that's happening in Q1. I'd really describe the whole last 12 months as a foundry allocation of capital throughout our economy that's largely flowed through equity capital markets. But the first quarter has really been unprecedented in terms of the level of activity.

So, you know, put some numbers around it, just over 250 billion dollars of registered equity paper came to the market in the US in the first quarter. That would be a slightly below average year from over the last decade, full year. You know, what really stands out in that number of 250 billion are two categories. The first are IPOs of operating companies. These are the traditional IPOs that we all know and get a lot of press. 40 billion dollars of operating company IPOs in the first quarter. Full year average over the last decade is 51 billion. So, really, really extraordinary levels of activity for a single quarter.

Even more extraordinary is the level of issuance in SPACs. And there were 95 billion of IPO dollars raised by SPACs in the first quarter. That compares to 83 billion dollars last year for the entire year. 117 billion dollars over the last five years.

So, really extraordinary levels of activity in both operating company IPOs and SPAC IPOs.

Jake Siewert: So, Benny, talk a little bit more about the scale of the additional supply that's in the markets. Where is it all coming from?

Benny Adler: Yeah, look, the reality is that 250 billion dollars of registered equity paid for number really only scratches the surface of the total supply that's come to the market. And the less obvious channels are at least as evaluated as the obvious stuff. So, look, there are a few different pockets here that are worth mentioning. I'll touch on three. They're all pretty robust.

First, you know, we didn't talk about 2020 IPO activity much. But it was the second busiest year on record with 84 billion dollars of IPOs coming to the market in the US. The vast majority concentrate done in the second half of the year. When a company does an IPO, typically the share is not sold in the IPO or subject to a lock up for a period of time, typically about three to six months. In the first quarter, you were hitting that point of being three to six months removed from the IPOs. So, all those lock ups had started to expire. And in many cases, that brings multiples of the dollar sold in the IPO to the market in, sort of, much less obvious sell downs, trickle-form sell downs, by pre-IPO holders.

The second big pocket of supply has come from all these SPACs. As they affect their mergers, the holders of the companies that they buy, plus the SPAC sponsors, plus folks who invest in pipes associated with the deSPACing process all come free on shares that are usually several times the notional value of the dollars actually raised in the SPAC. So, I think there's something like a bit over 100 billion dollars of SPAC dry powder seeking targets. But when these companies ultimately do mergers, you'll get multiples of that 100 billion dollars coming to the market over the months and quarters that follow SPAC mergers closing.

And then finally, we've seen a massive uptick in block activity, over the quarter, but really just over the last few weeks. And so, you combine those three sources of supply with the obvious registered equity stuff. And this market has just been asked to digest a truly unprecedented amount of equities spot [PH].

Jake Siewert: Okay, so that leads to the demand side. You talked about, I mean, markets exist to reallocate capital. So,

how are investors thinking about this? And how's the additional supply affecting the way they're positioning their portfolios? Are they selling off existing equity to get that? Or do they just have dry powder?

Benny Adler: Yeah, well, when you get to a certain level of fullness you run out of dry powder. And so, they are left with no choice but to reallocate. And so, that's what's happening.

To put some numbers around dry powder, I think mutual fund cash balances are below 2 percent and it's the lowest level on record. So, when new paper comes to the market, the dollars have to be funded somewhere. And you know, a lot of that is being funded by buy backs which have ramped back up in the market in a big way. A lot of that's being funded by inflows into mutual funds and by individual investors. Money market balances have come down but are still at very elevated levels historically. So, there is dry powder out there.

But the big places this manifested itself over the last six weeks is in the growth space. So, growthy equity sectors like tech, healthcare, communications come under a lot of pressure. Now, recall that these are the sectors that really have led us higher for most of the, really, the entirety of the post global financial crisis period over the last ten years. But really, since the start of 2020. And the equity paper that's come to the market has really been concentrated to growth space.

The vast majority of the IPOs that we've seen have been in growthy-type companies in sectors like tech and healthcare and communications. And so, the growth sector or the growth spaces as we like to measure them, have actually underperformed value stocks by 25 percent over the last six or seven weeks. That's a historically very large number. To put that in context, from Jan 20 through the local high in February, they outperformed by 50 percent. So, 25 percent movement in six weeks is a lot.

Now, there's more going on here than just the supply side of the equation. Interest rates have moved higher. Growth stocks tend to underperform as rates go higher. And, importantly, people have been repositioning portfolios to get more exposure to the reopening of the economy, which is now very much a visible and happening event. And growth stocks have been a source of funds for that as well. So, they're sort of getting hit with a triple whammy of higher rates, a rotation into more cyclical sectors that will benefit from reopening, and unprecedented levels of supply.

Jake Siewert: Okay, so part of the rotation is from old growth to new growth. We just had Peter Oppenheimer who's one of our colleagues in research on the podcast talking about his new research on bubbles. Given your time in the capital market space, you know, do you see any parallels between the '99/2000 dotcom period and the explosion we've seen in equity issuance this time around?

Benny Adler: You know, I was a 22 year old kid fresh out of college in 2000 when I started here. But do I worry about certain areas? You know, look, we've seen some well-publicized pockets of frothiness in the market. I'm not going to get into specific names. But what I'm encouraged by is how quickly all these pockets have seemed to self correct, well before they become a systemic problem.

The '99/2000 period was a much, much more systemic problem that got much, much further than we've gone now. It was much, much more widespread. And it had much broader implications to the economy. And by the way, people like to forget that when that bubble burst it caused-- well, it was one of the shallowest recessions in our country's history.

On a more macro broader equity level, with the S & P literally sitting at an all time high, I find myself as bullish and constructive as I've been at any time in my 21 year career. And the reason for that is really very simple. And often not overthinking these things is the right approach.

The US economy is going to grow over 6 percent this year. And interest rates are 1.7 percent. Admittedly, they've gone higher over the last few weeks. But 1.7 percent is historically low. Let me put that in context for you. The last time the US economy grew over 6 percent was in 1984. Interest rates were 13 percent. The single best predictor of stock prices over the last decade plus has been something called the Fed Model, which basically just says the stock prices are a function of the difference between the earnings yield of stocks and the risk-free rate. Stocks are in their 40th percentile evaluation based on net metric. Stocks are cheap. The economy is going to grow at a very above trend rate, probably for several years. And that leaves me very, very constructive on the overall equity market despite some pockets of frothiness which are probably to be expected and self corrected fairly quickly.

Jake Siewert: All right Benny. I'm dating myself, but when I

was getting out of college, I had a little bit of money in a money market. And I think I was earning double digit percentage on that. So, 1.7 sounds awfully low to me, even if it's up a bit.

So, I'd be remiss in not mentioning that you lead the firm's trading efforts in capital markets transactions. You're also legendary in the industry for your role managing the open for the IPOs that we run, which now stand at close to 400. Talk a little bit about some of the lessons you've learned over 20 years of doing that.

Benny Adler: Well, this isn't a three hour podcast, so I won't try to hit on [UNINTEL]. Look, a few things stand out. First is that markets are never as good as they seem or as good as they feel during the best of times. And they're never as bad as they feel during the worst of times. What stands out about the market we're in right now is the speed with which we're traversing between fear and euphoria. But that lesson stands out.

You know, when I look back at just over a year ago and I cannot remember a market that felt worse than third week of March of 2020. And at the same time, I really can't remember a lot of markets that felt better than the first few weeks of this year. At an index level, we're on the high. And I think that markets are actually in a more sober place today for a lot of the reasons we talked about with the growth trade having slowed down. So, that's first.

Second thing that stands out is that a consistent approach is going to win. And trying to pivot approach to the cyclical fluctuations of markets is not an approach that's going to work. We always put customers first, both issuers and investors. When we take a company public what we always focus on and what has served us, our issuers, and our investors very well, is focusing on getting that company an A plus list of shareholders, an A plus list to investors that is one of the most valuable assets a company can have over time. So, I've always put that goal first. And then have found that everything else, like the price of a stock, tends to follow if you get that right.

And you know, I think the last thing that stands out for me, and maybe this is less of a lesson and more of an observation, is that through this tremendously busy time in equity capital markets, we are seeing equity capital markets evolve and the process change in a way, at a much faster pace than we have, certainly, at any time in my career. Probably at any time in

history. Now as recently as five or six years ago, if you were a company that wanted to go public in the United States you basically had one option. And that was to do an IPO. Today you've got a range of options. You can do a hybrid blind book build, which we've done several of very successfully over the last year. You can do a direct listing. You can merge with a SPAC. And all of those different options are evolving simultaneously.

And, you know, companies have a lot of different goals at the time they decide to go public. And we have way more tools today than we did just a few years ago to help them achieve those goals. And Goldman's been in the middle of that evolution. And it's, for so many reasons, just a really exciting time to be involved with capital markets.

Jake Siewert: All right Benny. Well, thanks for sharing your perspective with us. I always learn a lot from my time chatting with you. So, thanks for joining us today and sharing your wisdom.

Benny Adler: My pleasure.

Jake Siewert: That concludes this episode of Exchanges at Goldman Sachs. Thank you very much for listening. And if you enjoyed this show, we hope you subscribe on Apple Podcasts and leave a rating or a comment.

This podcast was recorded on Wednesday, April 7th, in the year 2021. Thanks for listening.

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