

Goldman Sachs The Markets
Turning tail risks into tailwinds
Alexandra Wilson-Elizondo, co-chief investment
officer, Multi-Asset Solutions, Asset & Wealth
Management, Goldman Sachs
Sam Grobart, Host
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Sam Grobart: A soft landing's in sight, but there are still some risks to consider. This is The Markets.

Hi, I'm Sam Grobart. Today I'm joined by Alexandra Wilson-Elizondo, co-chief investment officer of multi asset solutions within Goldman Sachs Asset Management. Alexandra, thanks so much for joining us today.

Alexandra Wilson-Elizondo: Thank you so much for having me again, Sam.

Sam Grobart: So, you've recently written an article called "Last Mile Investing" and in it you say that while a soft landing is in sight, there are still some complicating factors that could knock things off course. Inflation is still a little stickier than people would prefer. What are some of those key factors you're watching? And what could be their effects?

Alexandra Wilson-Elizondo: Our view has been for some time that growth should be around trend and prices are declining, albeit it sporadically. But there are things that could lead to a fatter left or right tail in this very unusual cycle.

Sam Grobart: So, when you're talking about left and right tail risks, left tail risk is to the negative? Right tail is to the positive? Yes?

Alexandra Wilson-Elizondo: Exactly. And the distribution of outcomes. And some of the things that we're watching as it relates to that are commodity prices, which have been benign, but an extension of recent strength like we've seen over the last couple of weeks could really dampen inflation progress.

But if you move away from just the inflation and interest rate and Fed narrative, global central banks--

Sam Grobart: And we've been on that narrative now for a while.

Alexandra Wilson-Elizondo: Exactly. There are some

things that really merit an extra lens, a deeper dive. So, some of those things for us that we're looking for potential ripple effects are China's ongoing macro economic challenges, what that could mean. Geopolitics, especially in the run up to the US election. Right now, you could argue that the election footprint is actually small. You're starting to see it in some sectors, maybe some currencies. But we think that as policies start to come to the forefront, that you could see a much bigger impact taking place in the markets.

Sam Grobart: Given all of these factors, how should investors navigate this, what is effectively highly uncertain environment?

Alexandra Wilson-Elizondo: As investors, we strive to really build portfolios that are robust and navigate some wide range of outcomes. And we are constructive on the return prospects for both stocks and bonds given the global cutting cycle should still come to fruition this year. But at the same time, we remain focused on incorporating portfolio themes that may benefit from growth reacceleration, cyclical upturns, as well as some structural tailwinds.

So, think about the four Ds: digitization, decarbonization, deglobalization, and demographics. So, in that way you can hopefully turn some tail risks into tailwinds into the portfolios. So, considering the abundance of uncertainties that you described, we think investors should also continue to evaluate whether the expected returns are sufficient to compensate for some of those risks. So, you may be adjusting your portfolio a little bit more tactically than you otherwise would in this environment just given prices are moving quickly, information is changing very rapidly.

Sam Grobart: You talked about equities and bonds. But where else can investors look to diversify?

Alexandra Wilson-Elizondo: There are two ways we're thinking about this. One is while many economies have been moving in sync in terms of central bank policy and growth, there are some that are moving to their own rhythm. So, when you think of Japan, which we can talk about, yeah, at length, and I'm sure we will, you can play into some cyclical upturns in those geographies.

Sam Grobart: Got you.

Alexandra Wilson-Elizondo: The other segment that we have in the portfolio that we think is really important as a broader diversifier are alternatives. And as we've talked about in the past, they have some vol dampening properties. But they also can have acyclical properties. So, if you think about private equity, you can have the dynamic of control and operational levers where you're turning the outcomes don't really depend on what's happening in the market around you.

Sam Grobart: They're rather self engineered, if you will.

Alexandra Wilson-Elizondo: Exactly.

Sam Grobart: Or self directed.

Alexandra Wilson-Elizondo: Exactly.

Sam Grobart: Okay. 2023 was, obviously, the year of AI and that continues into 2024 with a small number of stocks powering indices to all-time highs. How do you see that force in markets evolving across this year and into the

future? What are some of the second or third order effects from AI?

Alexandra Wilson-Elizondo: So, my response will be somewhat interesting because AI is still relatively new.

Sam Grobart: Absolutely.

Alexandra Wilson-Elizondo: But I'm going to refer to it as the ecosystem is maturing. Okay? So, people are getting more information about the real-life outcomes across certain companies. There are distinctions happening in the market as it relates to rising tides aren't going to lift all boats for someone who attaches themselves to AI. And we do think that the opportunity set, not only will it be a distinction amongst the existing, you know, magnificent seven, if you will. But it's going to broaden out into other sectors that play a part into the ecosystems of delivering AI to the broader economy.

Sam Grobart: Does that get you into, like, mid and small caps, as well as these mega cap tech companies?

Alexandra Wilson-Elizondo: Yeah, it does because a lot

of them are suppliers or, even in some cases, they're delivering not just the software, but the individuals or some of the intellectual capital.

Sam Grobart: To implement this, to operationalize it, to actually make it real and effective?

Alexandra Wilson-Elizondo: Exactly?

Sam Grobart: Right.

Alexandra Wilson-Elizondo: But away from AI, and I think this is really important, the head of the equity team mentioned the other day, there are sectors that are materially outperforming the index that are not tech. So, if you think about energy right now, I think it's close to plus 15 percent positive on the year. So, there are themes emerging elsewhere. And there's some depth and breadth to the market at this point, which is encouraging.

Sam Grobart: More than just AI itself.

Alexandra Wilson-Elizondo: Exactly.

Sam Grobart: You mentioned Japan earlier. I wanted to ask you your sort of regional and global perspective right now. What areas outside of the US are getting your attention?

Alexandra Wilson-Elizondo: So, I'll start with Japan.

Sam Grobart: Please, obviously, they're undergoing a pretty exciting time right now.

Alexandra Wilson-Elizondo: It really is. And we have a very positive outlook on the Japanese economy because we believe that they're exiting a deflationary era. And you're starting to see things like very tight labor market, higher wage pressure to real inflationary forces come to the forefront. And that, in combination with a lot of the corporate governance reform that we've seen--

Sam Grobart: I was going to ask you about that. That's been happening over the past several years, right?

Alexandra Wilson-Elizondo: It has been. But now you're really starting to see tangible outcomes. So, not only did you have the peer pressure version for corporates on we

need to get more women on the board, we should have--

Sam Grobart: Greater transparency.

Alexandra Wilson-Elizondo: Greater transparency. You know, a better control over the capital structure and what we're doing with share buybacks, etcetera. Now you're seeing some regulation, which we've seen come into the insurance sector recently. And that's caused some single name stocks to have some strong outperformance that we haven't seen in some time. And we still think that momentum will persist.

The only thing to be thoughtful around is that the TOPIX is very heavily focused on cyclical sectors like autos and semis. And so, should there be any pressure from global recession trends, then that could put a little bit of a derailment there.

Sam Grobart: Right. Any other areas besides Japan that you're looking at?

Alexandra Wilson-Elizondo: Yeah, we're looking at Europe. So, we have a very close eye on Europe. Valuations

are a bit more reasonable. Macro momentum turned positive, I'd say, call it, let's call it February. And that's been evidenced in PMIs. Better than expected headline inflation prints. And we think that it's a good way to play the breadth expansion across the globe. So, it was an underperformer versus the US. If you want to get into more sectors than just one, it's a nice way to start opening up your portfolio to more outcomes in the broader global soft-landing scenario.

Sam Grobart: Alexandra, always a pleasure. Thanks so much.

Alexandra Wilson-Elizondo: Thanks so much, Sam.

Sam Grobart: That does it for another episode of The Markets. Be sure to find us on Apple Podcasts, Spotify, or wherever you get your podcasts.

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