Allison Nathan: As companies and investors head into the home stretch before year's end, what are their key concerns about the global economy, markets, and the deal making environment?

Jim Esposito: When you look at the global economy, it's not performing in lockstep. There are big differences between how the US, Europe, Asia, China specifically, are performing at the moment. And so, our corporate clients are having to navigate a much trickier and a much more fragile global economy compared to prior years.

Allison Nathan: I'm Allison Nathan and this is Goldman Sachs Exchanges.
For today's episode, I'm sitting down with Jim Esposito, co-head of Goldman Sachs' Global Banking & Markets for his perspective on how companies in investing clients are approaching opportunities in the current economic climate.

Jim, welcome to the program.

Jim Esposito: Thanks for having me.

Allison Nathan: Jim, you have an interesting and, I would say, pretty rare vantage point at Goldman Sachs because you spend time with all sorts of clients, companies, private equity firms, a range of institutional investors. So, at a high level, what would you say is top of mind for each of these types of clients right now?

Jim Esposito: That's a good place to start, Allison, because I think there are definitely differences amongst our clients, much like in politics, where you stand depends upon where you sit. So, let's take each client consistency in kind.

And I'll start with private equity. I think it's important to bear in mind, you know, over the past ten years, the
private equity industry has grown exponentially when you look at assets under management. The past decade of zero rates, ample and cheap funding and liquidity was very kind to the private equity industry.

A decade ago, private equity would have accounted for about 20 percent of the global merger volumes. This past year, it was closer to 40 percent. So, private equity is a huge accelerant in deal making and the capital markets.

Now, the obvious issue right now is we're coming off a period where the IPO market was very anemic. Financing conditions have gotten tougher and more expensive. And so, private equity is grappling with how do they monetize all of the companies they own in their portfolios right now? And we need a more robust IPO market. We need more robust financing conditions for private equity to get back on their front foot. So, they're navigating through all of that right now.

I would say on the other side of the equation, our corporate clients are really doing exceptionally well at the moment. Their businesses continue to surprise to the upside. I think if you look around the globe, but particularly in this
country, central banks are closer to the end than the beginning of the rate hiking cycle. Were at or near full employment. And those conditions are really allowing our corporate clients to put up what are some very impressive results. Even though there's not that much global growth at the moment, our corporate clients are faring incredibly well at the moment.

And then lastly, institutional investors. I think here it's important to bear in mind we came into this year with kind of the consensus market view that we were going to have a hard landing. So, investors were not fully invested. They came in with a defensive posture. I'd say over the past couple of weeks and months, that's shifted a little bit. Now the market seems to be pricing in more a soft-landing scenario. But while that transition from hard to soft landing is happening, equity markets have performed surprisingly well. But many of our institutional investing clients missed that rally. So, there's a little bit of frustration amongst the investing crowd at the moment.

**Allison Nathan:** And you touch on this a bit, but if you think about sentiment broadly across these different client types, has it improved? Obviously, you've gone from hard
landing to more soft-landing consensus. But are clients taking more risk?

**Jim Esposito:** They're starting to take more risk. So, they're getting pulled into this rally at the moment. And look, I think it's fair to say that we're coming off close to 15 years of literally extraordinary monetary and fiscal accommodations. Money wasn't just cheap. It was pretty much free. Interest rates were zero or negative.

And so, we have just lived through an unprecedented and uncharted period in the global economy. And so, there's a fair amount of anxiousness amongst the investing crowd at the moment. Everyone's wondering are there more business models that might break as interest rates have gone from zero to a more normalized rate. And so, while that's going on, I think investors are respecting the fact now that central banks, and here particular the Fed has done an incredibly good job, and they might actually stick the proverbial soft landing. Again, not something people expected as we came into this year.

**Allison Nathan:** You think about the macro environment right now relative to history. What strikes you as
particularly interesting or notable or difficult about the current moment?

**Jim Esposito:** When you go back over the past 25 years, I think we're in a market backdrop right now that feels very typical. Very middling. Nothing overly exciting about this period. We're not seeing the stresses and the strains that we saw in the 2008 global financial crisis. So, the markets are performing well. But it's not a particularly robust period at the moment.

Look, I think the big thing on everyone's mind is can we come out of this period where central banks did things to markets that were never seen before, that massive amount of accommodation and stimulus that got put in the global markets, we're in the process of weaning ourselves off of that stimulus. So far, so good. But I think we're still not all the way through with that project. And until we get a little further along, I think there's going to be a certain amount of cautiousness and a certain amount of trepidation amongst the investing crowd.

**Allison Nathan:** And if we drill down further into some of the macro issues you commented on, we've obviously also
seen oil prices surging again here. A problem we thought was behind us. Seems to be back. What are commodity markets telling us about the global economy right now?

**Jim Esposito:** That's a good question, Allison. I think if I could come back and start my career all over again, I'd like to come back as a commodity trader. It's a particularly interesting part of the market for us to review, in part because there's a finite supply/demand balance. And I think commodity markets oftentimes act as a very good leading indicator for conditions that are going to play out in the global economy.

So, here at Goldman Sachs, we spend a lot of our time thinking about and analyzing commodity prices. So, to your point, oil has started to rally. And prices are up fairly materially, potentially showing signs and signals that the global economy is starting to really get its legs underneath it.

Now, when you look at the rest of the commodity complex, here specifically energy and power prices, we're still well off the boil from where we were 12 or 18 months ago. Now, we're not quite in the winter period. But weather matters
for commodity prices. And we saw what happened in continental Europe last year with commodity prices.

And so, look, suffice to say we're keeping a very close eye on commodity prices. We think it's a good leading indicator for conditions playing out in the global economy. But right now, commodity prices at large across the complex are reasonably well behaved.

**Allison Nathan:** And if you look at the recent performance of oil, there were some supply side factors contributing to that as well. Right? It's not just demand.

**Jim Esposito:** Correct. That's exactly right.

**Allison Nathan:** And so, if we think beyond the macro, obviously, geopolitics in focus feel particularly uncertain right now. What are you hearing or observing in terms of how geopolitics are influencing companies' strategic decisions?

**Jim Esposito:** It's probably the biggest difference that's been playing out the last, call it, two years compared to the rest of my career. I started at Goldman Sachs a long time
ago, 28 years ago. And for the vast majority of my career, we've had an unencumbered, straightforward march towards globalization. And for the first time, really in my 28 year career, that globalization is getting called into question. And it's not just the conflict between Ukraine and Russia. If you look anywhere else around the globe at the moment, the world's in a much more fragile place. And geopolitics are raising their ugly head in all parts of the globe.

Obviously, the US and China's relationship right now is far more challenging than it's been compared to the prior decade. You look at the Middle East and Latin America, geopolitics are playing a very important role in how corporations think about their global supply chains. It's playing a very important role as to where global investors are allocating dollars in their portfolio. And that's a big change.

I never thought we would have to question globalization. It was so ingrained in all of our psyche, my generation's thinking, and that's been probably the biggest change that we faced compared to prior periods.
Allison Nathan: And if you think how much the global outlook in general is factoring into company decisions, we're seeing a lot of disappointing news out of China right now. How concerned are they not just about the US macro outlook, but really, the global outlook, politics, geopolitics, aside?

Jim Esposito: Yeah. I think it raises two issues for our corporate clients. The first is many of them rely on global supply chains. And those global supply chains got disrupted during the global pandemic for obvious reasons. But they're now questioning which markets they want to rely on to source supplies. And many of our large corporate clients are in the practice of diversifying, onshoring, reshoring nearshoring their global supply chains. So, that's a major theme playing out in the global economy at the moment.

And then look, obviously, what's going on in different parts of the globe impacts demand for products, for consumer products. And that, too, is having a big impact right now. When you look at the global economy, it's not performing in lockstep. There are big differences between how the US, Europe, Asia, China specifically, are performing at the
moment. And so, our corporate clients are having to navigate a much trickier and a much more fragile global economy compared to prior years.

Allison Nathan: And how are trading markets more generally responding to this macro landscape, this geopolitical landscape? As you mentioned, the equities have rallied pretty substantially. So, what are you seeing?

Jim Esposito: I would point out that it's one of the more narrow rallies we've seen in equity markets. Here in the US, the vast majority of US equity market performance is contained in a small handful of large cap tech stocks. So, it's really large cap tech. Those that are involved in generative AI that have seen significant, and I do mean significant positive performance. But it's not a rally that's been particularly broad-based year to date. So, we'll see if that changes for the balance of the year. So, that's definitely on people's minds at the moment as we think about where we are in terms of investment performance.

Allison Nathan: And I wanted to get back to a couple comments you made earlier about the difficult financing environment with these higher rates. You spent a lot of
your career running our financing group and you speak to clients, as you said, every day on this topic. So, how are clients approaching financing decisions in this more difficult environment?

**Jim Esposito:** I think our global corporate clients demonstrated incredible discipline. They took advantage of this period coming out of the pandemic when interest rates were close to zero and financing conditions were positive. And financing itself was very ample. They did the prudent things. They termed out debt. They issued a lot of long-term debt. And so, we come into today's period with corporate balance sheets having delevered. And probably being, from a starting place, stronger than at any other point in my career. So, corporates globally are sitting on very strong underlying balance sheets.

Now, the past six months or so have been frustrating. So, financing markets, they weren't closed, but conditions were far less positive than going back to a year like 2021. The good news is we're starting to see signs that financing markets are becoming unglued and unstuck.

Just this week, you know, we're in the market with a
handful of large IPOs. These IPOs look like they're going to go well, at least at the moment. And I think if you get a couple of these IPOs out the door, pricing well, with some positive performance in secondary markets, you're going to start to see a calendar build of deals getting executed. It's true in equity underwriting. But I think it's equally true in debt underwriting as well.

So, we're just starting to see, call it green shoots of activity with financing conditions getting better and corporates starting to come to market. And if these current deals go well, I do think between now and year end you could see a material pick up in the deal calendar.

**Allison Nathan:** Any other conditions you're looking for to really return to prior levels, more normalized levels of activity?

**Jim Esposito:** Deal performance matters. I think it is important that we have a series of deals that get priced well, have some performance, and that will leave investors craving and wanting more. So, there is a bit of a psychology and a cycle to that. So, I think that's important.
Equally important, I think, is just getting some consensus and perhaps drawing a line under the current rate hiking cycle. So, I made a point before. I'd like to think we're much, much closer to the end than the beginning of this rate hiking cycle. We'll see if there's one or two more, you know, rate hikes left. And it's not just here in the US, the same can be said in Europe as well.

If investors get the confidence that rate hikes are behind us and in the rearview mirror, I think that will allow them a bit more stability and a bit more certainty in terms of putting money to work into the market. We're not quite there yet, but we're very close.

**Allison Nathan:** And in this period, we've seen a lot of spin offs. Divestitures. Do we think that was just a function of that moment in time and those macro conditions? Or do you expect to see that type of activity continuing?

**Jim Esposito:** I think that type of activity will continue. I think a big theme playing out amongst equity investors are they're instilling a discipline on a corporation. They want to put their dollars to work in companies that are really accentuating their core competency.
And so, the idea of large-scale corporate conglomerates doesn't mean they won't exist in the future. But I think equity investors want to see real definition, real discipline. They're asking the questions of companies, "What are you world class at? What are you best in class at? Accentuate that. Really make that your sort of reason for being."

And so, I think that discipline is healthy. And I think a lot of the spin offs and divestitures that you're seeing are companies tightening up around what they think their core competency is. I think that's very healthy. And those deals that we've seen getting done have typically been rewarded with a positive price reaction in the equity market.

**Allison Nathan:** And if we take a step back for a moment, over the course of your career, the way that people trade in markets across every asset class has really shifted. What are some of the benefits, some of the pitfalls of the changes you've observed?

**Jim Esposito:** So, I think there are a couple things embedded in your question. Look, I think with each passing year, the amount of transactions and trades that
we get involved in at Goldman Sachs get more and more electronified with each passing year. So, there's no debate that the vast majority of liquid products that we trade are now getting handled by computers electrically with, sometimes, little to no human intervention. And I think that theme is going to continue.

Now, within that, has our role as an intermediary or a market maker changed? Not really. We're still providing advice, content, guidance to our clients, how they might access liquidity or markets. Our role is really unchanged. The actual medium by which the trade might go through the pipe, or the system is changing and getting more electronified. But speaking bluntly, I don't think it's changed our overall role as financial intermediary all that much over the course of my career. So, I think that's almost business as usual.

The other big change is following the period of the 2008 global financial crisis, regulators made sure that banks were far less risky. And so, banks raised a lot more capital. A lot more liquidity. Banks, as a whole, are far less levered than they ever were before. And when you think about the eight systemically important banks in the US, they are far
more safe and secure, I think, than at any other point in time and history. And we have to give global regulators credit for making the banking system more secure.

So, I think it's important to bear in mind risk doesn't disappear, it just finds a new home. And so, much of the risk that was embedded in the global banking system now sits outside in the non-regulated banking system. And some of that went into institutional investing hands, global asset managers, private equity, hedge funds. We also see non-bank liquidity providers trading securities, whether that's foreign exchange or government bonds.

The ecosystem of the global markets has changed materially from that pre-2008 period that was dominated by global banks. Now we see many non-traditional players being active. And much of that sits outside of the regulated banking system.

And there I think we have to have some concerns. That part of the market hasn't yet really been tested. I think it's important and it's a positive that risk is less concentrated than it was in the period before 2008. But it's sitting in unregulated places where global regulators probably have
less of a chance to think about what they might want to do if the market or the system has problems.

And so, that's something that's on our mind. And when you look back over the past two years, there's been a couple of places where we've hit air pockets of liquidity. The UK LDI crisis. We saw very big moves in UK government bonds. Real air pockets of illiquidity. And that price action, I'm quite certain, would have been scary for regulators.

Here in the US, we saw some violent moves in the US treasury curve, particularly on the short end. And so, that's something I think we all have to continue to monitor and think through. As banks are safer and more secure, there's no debate, that's a massive positive for the system. But when liquidity is required and investors need to reshuffle their portfolios very quickly and for size, we've seen a couple of examples where markets haven't really lived up to the expectation that investors would want or desire. And that's just something I think the system has to continue to monitor and think through and, knock on wood, doesn't get tested any time soon.

Allison Nathan: So, what are clients, what are you most
closely watching heading into year end, heading into 2024, which is going to be, obviously, a very important US election year?

**Jim Esposito:** So, look, in the good news category as I suggested, I'm optimistic. We're seeing green shoots of financing activity. So, that bodes well between now and year end. I am someone who professes to still have a certain amount of anxiety that if you were to tell me that the price of what was that extraordinary and unprecedented monetary and fiscal accommodation that we lived through for close to 15 years, when I think back to that period, I do think capital got misallocated to the real economy. I also think that every type of investor was stretched out one, two, three categories on the risk spectrum because they couldn't find yield in a zero-interest rate environment.

And so, my gut instinct tells me society was going to have to pay a slightly tougher price for that period of capital getting misallocated, for investors being stretched out on the risk spectrum. And yet, that hasn't happened. We're talking about market consensus view being that we're going to have a soft landing, which is pretty incredible. And if
that happens, perhaps not a miracle, but that wouldn't have been my base case expectation coming into this year.

And so, optimistic about what I'm actually seeing here in the US real economy. Very optimistic about what we're seeing in financing markets. But just some lingering concerns around this period that I think it's prudent to still keep a very close eye on risk in your portfolios and risk at the companies that you might run.

Allison Nathan: And any views on how the election might factor into clients' behavior in the coming several months?

Jim Esposito: I think we see it in every election cycle, not just in the US, but globally, elections have consequences. And so, certainly, this one in the US will have major consequences. The flipside of that is, I think I hear this from institutional investors all the time, particularly from outside of the US, they continue to marvel, to be incredibly impressed by just how well the private sector gets on with it in the US running their companies, producing new products and innovating, and constantly evolving and adapting their companies to be fit for purpose and to continue to grow. That's not to say
politics don't matter in that. But I think the public/private sector dynamics here in the US are pretty special and pretty unique. So, no matter what that election result could be, here in the US I'm highly confident the private sector will adopt and evolve and get onto what they always do, which is growing their businesses.

**Allison Nathan:** Jim, thanks for joining us and sharing your insights.

**Jim Esposito:** Thank you for having me, Allison.

**Allison Nathan:** Thanks for listening to another episode of Goldman Sachs Exchanges, recorded on Monday, September 11th, 2023.

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