Goldman Sachs Exchanges: The Markets

What this week's CPI tells us about US economic health

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Recorded: August 10, 2023

Sam Grobart: This week we saw new CPI numbers, continued evidence of an economic slowdown in China, and, oh, regional banks are back in focus. This is The Markets.

Hi, I'm Sam Grobart. Today I'm joined by Ashish Shah, Chief Investment Officer of Public Investing within Goldman Sachs Asset Management. And we're going to talk about all of those topics and many more on today's episode. Ashish, thanks so much for joining us today.

Ashish Shah: Thanks for having me.

Sam Grobart: So, we recently got the latest consumer price index numbers. That index is up 3.2 percent through July of this year and up .2 percent from last month. What are you seeing in those numbers?

Ashish Shah: I think it reinforces the fact that the Fed's been effective, and that inflation is coming down. What we're going to see going forward is a question mark. I think people are legitimately worried about what we see four, five months from now. But in the near term, this really reinforces the fact that the Fed probably can be done. And so, you'll see a pause that's going to be supported for risk assets.

And I think it also reflects normalization from all this pandemic up and down, which has read throughs to Europe and potentially for places like Japan.

Sam Grobart: I want to move to another metric. Long-term treasury yields are at annual highs. What is causing that?

Ashish Shah: So, I think you go back to the beginning of the year and we were expecting a recession this year given that the pace of tightening we saw last year. And that hasn't manifested itself. We've seen strengthen the economy. The economy's decelerated. But we haven't gone into recession.

So, I think in part, it's reflecting that. It's reflecting the Fed's reaction to that, which we probably got a couple more hikes than we were expecting at the beginning of the year. I also think that there's a tremendous amount of supply going on in the market. And so, that supply definitely weighs on the market.

Having said that, we have valuations that are interesting. You have inflation that is coming down, at least stabilizing. And so, I think you're fairly priced on duration here. I think duration as a diversifier to your portfolio, it looks very interesting when you look at the absolute and real levels of interest rates that you get.

Sam Grobart: I want to go back to March of this year, which of course is when the regional banking crisis first hit. That crisis was considered well contained in the months that followed. And that's, in fact, contributed to many optimistic forecasts for the US economy. But this week, ratings agency Moody's downgraded the credit ratings of ten regional banks and put several others on its watch list. What do you think this indicates regarding the health of the US economy?

Ashish Shah: So, look, I think the downgrade is reflective of the information that we learned in March, which is that you have real challenges to some of the regional bank business models. You're going to see capital that needs to be raised. And that CRE is a real issue.

So, while we're not talking about commercial real estate anymore in markets, it continues to be a real thing that's playing out. Having said that, this is an asset is, which is relevant when it comes to investing. But it doesn't really spill back directly into the real economy because it's not like we were building new real estate at such a pace that suddenly you have to reverse that out. This is about asset values.

It's something that I think we're going to continue to see, this difference between what's happening in the real economy versus what's happening in asset values. And you have to kind of map those two things very carefully.

Sam Grobart: Let me just touch on that last part that you were talking about. The market has priced in much of that rosier economic projection. Does this in any way change that?

Ashish Shah: I don't think that the downgrade changes that. But I think your point around the market having repriced the risk of recession does change risk/return. Our view is that we are late cycle when it comes to the economic cycle. All the kind of different indicators we see definitely demonstrate that.

It doesn't mean that you want to sell everything down. But you have to be cautious around what could transpire next, given the fact that the Fed is very tight. And that creates risk, which you have to factor into your overall position.

Sam Grobart: Let's look outside of the US here for a second, Ashish. The main economic story here, of course, has been inflation. But China has been looking at the flip side of that, of course, with a deflationary economy. Consumer prices there continue to fall. And real estate prices are also quick to follow. How does this slowdown in the world's second largest economy affect your global outlook?

Ashish Shah: Yeah. So, there are a lot of global companies that really benefit from Chinese consumer demand as well as Chinese investment. And so, while the investments haven't been nearly at the pace, particularly in areas like real estate, and so you haven't seen kind of those areas of commodities benefiting from China coming back, consumer companies had been benefiting. And so, when we think about subsets of the European stock market, some of the US players that are global that really benefit from China, we're doing a good job of mapping that Chinese consumer demand back into how those companies should be valued.

And as you were alluding to before, I think understanding risk/return based on price is becoming increasingly important as we go through this cycle.

Sam Grobart: Ashish, of course the traditional investing mix for most people is the classic 60/40 portfolio. 60 percent stocks. 40 percent bonds. Is this a good time for that mix?

Ashish Shah: So, I do think it's a good time for that mix. I think how you compose that mix requires a lot of thought in the environment that we're in because you are seeing dispersion across global economies. So, the US is probably later cycle because it was one of the first to come out of the pandemic.

Europe was probably six to 12 months later. We're seeing a lot of people going to Europe, enjoying their summers in Europe from other parts of the world. And then, you know, as you alluded to, China is in a very different spot. And so, I think we've generally been encouraging our clients and from our own portfolios looking at European stocks as diversifiers given the run up of US stocks. And we've been liking bonds as a diversifier to overall growth risk, given how late into the cycle we are. And knowing that we can't predict the future perfectly.

Sam Grobart: And of course, last question Ashish, what are you going to be paying attention to next week?

Ashish Shah: There are three things that we've been looking at from a big picture perspective. It's inflation. It's jobs. And it's the secular rebalancing that we're seeing when it comes to supply chains on a global basis. Coupled into that is also the, you know, secular dynamics around sustainability and the investments that are happening as a function of sustainability.

We've just gotten CPI. We had jobs. The thing that's coming up is Jackson Hole where interestingly the topic ends up being around thinking about this diversification that's going on as companies and countries look to add diversification to their supply chains. And the impact on that when it comes to global real rates, global financial policy that needs to be pursued, and how to think about that in the context of the global economy.

Sam Grobart: Ashish, thanks again.

Ashish Shah: My pleasure.

Sam Grobart: That's it for another episode of The Markets. You can subscribe to this podcast on Apple Podcasts, Spotify, or wherever you get your podcasts.

I'm Sam Grobart. Thanks so much for listening.