

Exchanges at Goldman Sachs

**Goldman Sachs CEO David Solomon on the economy,
markets and the firm's performance**

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Allison Nathan: Against a complicated macroeconomic environment, what are business leaders most focused on in 2023?

David Solomon: To some degree, I think CEOs feel like the economic construct that we're going to operate in for a period of time is resetting. And they're therefore thinking strategically about how that impacts them. And they're operating with a little bit more caution.

Allison Nathan: I'm Allison Nathan and this is Exchanges at Goldman Sachs.

[MUSIC INTRO]

Allison Nathan: Today we're sitting down with a very special guest, David Solomon, our own CEO and chairman

of Goldman Sachs. We'll talk about his views on economic growth and the markets, the firm's strategic priorities, and what he'll be most focused on ahead. I look forward to this conversation. Welcome back to the program, David.

David Solomon: Thank you very much, Allison. It's great to be with you.

Allison Nathan: So, let's start with your views on the macroeconomic environment. 2022 was a difficult year by all accounts. And at one point, you and I would venture to say, the market seemed pretty concerned about the economic outlook for this year as well. But that seems to be changing, maybe, a bit. Is that true? What are your views on the macroeconomic environment at this point?

David Solomon: So, I think there's no question, Allison, that if you look back over the course of the last six to nine months and you're surveying a broad group of CEOs running big global businesses, the sentiment around the likelihood of a very difficult economic recession has certainly softened. If we were sitting here last June or July, I think I would have advocated that in the distribution of outcomes, the likely outcome was that we saw a real

recession in 2023 and that inflation was at quite high levels. It was going to take a very significant tightening to try to get that in check. And it was important to get it in check. And that historically when you go through that tightening cycle very quickly, and it felt at that point like the Fed was behind the curve, the chances were that you were going to have a real economic slowdown.

Now, there are a variety of reasons that I think the economy has been more resilient. And as we sit here today, I think we're still in a period of uncertainty. But I think the chance that we could muddle through with either a shallow recession or a soft landing certainly feels more likely.

Our economists here are calling for a relatively soft landing, I think about 1.3 percent economic growth in 2023. I do personally think that inflation is going to be stickier and harder for us to manage. I do think when I think about rates, the trajectory of rates, higher/longer. The market, I think at the moment, thinks a terminal rate is just over 5 percent. I actually think it's going to be higher than that. I do think we're still in an uncertain period. But we've got very strong employment. The consumer has been very resilient.

I do find that big global businesses are operating a little bit more cautiously. They're paring back capital spending to some degree. They want more of a clear trajectory before they look ahead. And so, a period of uncertainty. But it certainly feels a little better than it felt last summer.

Allison Nathan: Let's dig into that a little bit more. As you talk to CEOs around the world, what are they saying? What are they concerned about right now?

David Solomon: They're concerned about inflation. There's no question they're concerned about inflation. And they're concerned about our ability to get back to an inflation target that's seen through the lens of recent history.

I think most of them believe it's going to be very hard to get back to 2 - 2.5 percent inflation. And they're starting to think about, and I think this is a perfectly workable economic environment if we had 3 to 4 percent inflation for an extended period of time, what are the impacts in growth? How do they think about investing? How do you think about asset appreciation in that environment? And

it's certainly a different environment.

And so, to some degree, I think CEOs feel like the economic construct that we're going to operate in for a period of time is resetting. And they're, therefore, thinking strategically about how that impacts them. And they're operating with a little bit more caution.

I'd highlight, one of the things I always look at that speaks to CEO confidence is M&A volumes, announced M&A volumes. And we're off to a very slow start this year on a relative basis. I think you'd have to go back 20 years to see announced M&A volumes six weeks into the year as slow as it has been. And so, it's not necessarily a direct correlation to CEO confidence. But CEO confidence has an impact on that, obviously. And it's just a sign of something to watch. It'll give you an indication as to how CEOs are feeling.

Allison Nathan: Just to get the full picture, you also spend a lot of time speaking with small businesses and entrepreneurs as part of our flagship 10,000 Small Business program. How are they holding up in these uncertain times? And are they also feeling the same type of

pressures as the big companies?

David Solomon: Well, I think small businesses have been incredibly resilient over the last few years. And the journey of small proprietorships and true entrepreneurs is so vitally important to the US economy. So, vitally important to job creation. They've had a very rough ride with the pandemic.

And the closure of economic activity for an extended period of time. Most of their businesses were massively disrupted. Many of them had to pivot or think about different ways to keep their businesses alive. Many of them were forced to lay off employees or contract their businesses very quickly.

And as the economy emerged and we've come out of the pandemic, they're all trying to rebuild, to repivot, and move forward. And a lot of them are having success. But it's not been an easy journey.

Inflation hits small businesses very hard. There's obviously been a lot of wage pressure, which for small businesses could be quite burdensome. A lot of them, though, are getting some pricing ability in things that they do. And so, they're trying to rebalance. But it's been a tricky time for

small businesses. And they run with a narrower set of kind of flexibility as they navigate such a sharply changing economic environment.

Allison Nathan: So, inflation, as you just said, big theme. Big companies. Small companies alike. Wage pressure is a big part of that. And so, a key question of the day seems to be how do we actually cool this overheated labor market? Firms in our industry, tech companies. We see headlines every day about layoffs and cutting the workforce. How far along are we in that process? Do you think we're nearing an end to these layoffs?

David Solomon: If you're talking in the economy broadly, I think it's very hard. We've got very low unemployment at the moment. And the job market broadly, I'm talking across the economy, is very strong. And so, it's very hard to cool inflation when you have a very tight job market.

And so, one of the things that I think is interesting, it's one of the reasons why I think inflation is going to be stickier, it's one of the reasons why I think the terminal rate is probably going to be higher, I think it's going to be harder for the Fed, and they're going to have to take more

aggressive action, to cool the economy.

And ultimately, if you're running unemployment at these low levels, it's very hard to get inflation into check. If you're playing a nine-inning baseball game, I'm not going to tell you, you know, exactly where we are in that game. But we're somewhere, in my view, in the middle of the game. Not near the end of the game.

And whether we're in the third inning or the sixth inning, it will depend. But it's very hard to cool off this inflation when you've got such a strong labor market.

Allison Nathan: And you talked about the slow start to M&A this year. Are there any green shoots you can point to?

David Solomon: There are green shoots. And there have been a handful of significant transactions lately. There have been one or two things this week that indicate activity is still going on. I'd say that we have great insight into what I'd call dialogue and shadow backlog, which is really-- our bankers actively engage with companies that are thinking strategically about what to do next. And I think that's

picking up. That activity level. That dialogue is picking up. You don't see that on actual transactions because all this stuff takes time. And there's a lagging effect. So, what we're seeing in January and February is really the result of how everybody felt in the summer and the early fall.

And so, I do see a little bit of a pick-up in capital markets, particularly investment grade capital markets. We had anemic capital markets activity levels last year. We still have very low equity underwriting levels.

I think generally speaking, it takes four to six quarters for people to adjust to significant market shifts when it comes to selling equity, selling debt, etcetera. And if you think about it, the market was very robust finishing '21 into early '22. So, we're four quarters through.

So, my expectation will be in 2023 we'll start to see a pick-up in capital markets activity as market sentiment adjusts and accepts valuation levels, cost to debt levels, funding levels, I think that process is ongoing. And so, I see them green shoots there.

Allison Nathan: So, we've talked about some of the

complexities and uncertainties in the macroeconomic environment. But what headwinds or risks are you most focused on right now?

David Solomon: I think inflation is a big headwind to growth. I think we've got to understand the trajectory of monetary policy and also the impact on unemployment, etcetera, because that will all have an impact on capital spending and investment for growth. And so, I think we're in a tricky period where there's still a lot of uncertainty. And I worry about that.

There are big picture risks that I worry about. I think the geopolitical landscape is much more complicated and it's certainly a headwind to growth. I obviously am very concerned about the US/China relationship and the complexity of that, which I think is a big headwind to growth over the course of the coming years. But just from a geopolitical perspective, with the War in Ukraine, the complexity of the West's relationship with China, in particular, the US/China relationship, we're just in a much more complex geopolitical environment. And so, that's going to get a lot of attention and something that I know people that are running big businesses are very focused on.

I worry broadly about cyber and cyber risk. It's something I've worried about for a long time. I think our industry is doing a lot to try to protect against those risks. But I think the risks exist in very different places in the economy. I think different parts of the economy are better protected, not as well protected. But I think this is a place where there's really risk for things to go wrong. And we'll have to adjust and adapt.

On the other hand, I think there are super exciting things going on from a technological perspective that also can spur growth and can lead me to be very optimistic. I think what's going on in MedTech and biotech and healthcare and improvements in the way we can advance against certain disease and the implications for life expectancy and quality of life, those are all things that are very exciting, and also very economically positive.

I think looking at some of the new AI technologies and the implications that they're going to have for workflows and business processes, we're thinking about it a lot in our business, are things that you can be very, very optimistic about that there are obviously super interesting, although

complex things, coming as those technologies continue to evolve.

As we always see when it's really good, it's never as good as everybody thinks. And when it seems like it's tough or it's bad, it's never as bad as everybody thinks. But we're going through a transition. We had a long period of very easy monetary policy. This pandemic was an out of the box experience, the way we closed down economic activity all over the world for an extended period of time and tried to compensate with massive fiscal support. And now we're rebalancing all that. And so, it's an unusual period of rebalancing that's going to take some time to work through.

Allison Nathan: Let's talk a bit more about some industry trends. You mentioned innovation in some exciting areas. Maybe we'll talk a little bit more about that. But a lot of conversations have centered around how long it will take to transition to clean energy, climate change focus is still there. How do you think about that transition to clean energy?

David Solomon: I think it's super important. I'm a huge believer in the transition and the need to transition. But

I'm also very balanced and realistic about where we are and what that transition's going to take. First of all, the transition is going to take a very significant amount of time. Last year, I think 81 percent of all the energy in the world came from fossil fuels. Last year the world grew its emissions by 6 percent. We've got a ways to go in all this.

We need trillions of dollars of investment to spur new technologies. Real risk capital to accelerate new technologies that can allow us to transition faster. I'm in the optimistic camp that those technologies will evolve over the next ten, 20, 30 years in ways that will surprise us.

But it's a transition. And Goldman Sachs is going to be financing fossil fuels for a long time. But Goldman Sachs is also going to be investing capital and giving advice and trying to raise capital to support acceleration of technologies that can really accelerate the transition. And I think we need to do both. It's not an or, it's an and. But it's going to be a journey and we're in the early part of that journey.

Allison Nathan: I'm interested to hear your thoughts about what you're observing clients thinking on this issue

at this point. We've just been through this high commodity price period. And so, are clients just as focused on the climate change issues in clean energy? Or do you think they've backed away a little bit?

David Solomon: Clients are focused on the transition. When you talk to people that are running big businesses, they're very focused on the fact that there needs to be a transition that's going to occur. But they're realistic about the fact that it's a transition and it's going to take a bunch of time.

And so, companies are focused on running their businesses, doing it appropriately, making progress in their transitions. Looking for advice, candidly. That's one of the places that as a firm we're trying to really provide support, is giving people advice as to how to think about it and how to drive that transition in their business. But they're also realistic but it.

And I think, unfortunately, the narrative around this gets caught on extremes. One extreme is we need this, and it's got to be instantaneous. And I understand why people are passionate about it. It's super important. And the other

extreme is, no, no, no, no, no, this is all hysteria.

The reality of it is, it's very important that we continue to develop new energy sources. We continue to develop ways to accelerate technologies that can spur this transition. But at the same point, it's going to be a transition over time. And there's no transition in the United States and not in the developing world. It's one planet. There's no question in the developing world emissions are going down. But emissions are still going up in the world. And so, we've got to get focused on ways that we can reduce emissions globally. And this a place where, candidly, we all have to cooperate around the world. This is a place where, obviously, the US and China have to cooperate. There is no climate transition without cooperation between the West and China.

Allison Nathan: And you've also talked about public/private partnerships being a key aspect of making that transition and getting it done.

David Solomon: Well, I think that the amount of capital that's needed to accelerate these new technologies, some of it can come from the private sector. But candidly, some of

it's got to come from governments too. And so, there's a great opportunity here for governments and public capital to partner with private capital technologies, on facilities, on things that can really accelerate what we can do. And I think we need a fresh look at energy sources and what's available and what works and what doesn't work.

It's interesting. Because of what's going on in the world, because of what's obviously happened in Ukraine, etcetera, the lens around energy is a little bit different in the last 12 months. And people are looking at it through a lens of security. If you don't have secure energy supplies, okay, it puts you in a very, very difficult position.

And so, I think policy has to think about that. And when people think about supply chains, where they're getting their energy, who they're partnered with, etcetera, security is super important. And that's been a big evolution over the last 12 months.

Allison Nathan: And you gave a bit of a laundry list on the technologies and innovation that are exciting you. But are there one or two that you would call out as things that you're particularly focused on?

David Solomon: Well, everybody at the moment is looking at ChatGPT and other forms of artificial intelligence that can allow you to do things at scale differently and really accelerate or advance certain work processes in a very different way than we thought was possible only a short time ago. And so, I think if you're running a big business, you've got to be thinking about how these technologies allow you to think about your business processes differently. And that's going to be a journey too.

There are things that work very well with that. But we're still in the early stage of testing and verifying how that can all work and support it. But there is not a business leader that I'm talking to that's not thinking about the prospect for that as things go forward.

Allison Nathan: And so, let's talk about our own performance. Goldman Sachs had an unusually disappointing quarter to end 2022 relative to our peers. You've been quite frank about that. So, what happened? And how is GS addressing it?

David Solomon: We have a mix of businesses that is very

capital markets heavy. And the environment in 2022, the change from where we were at the end of 2021 to the end of 2022, amplified, in some ways, the mix of our business different than others. And I want to highlight a couple things that I just think are important to put in perspective.

Yes, we did have a very, kind of, outlier quarter in the fourth quarter. And I do think it was an outlier quarter in the fourth quarter. But we actually didn't have a bad year. It was disappointing compared to the prior year. But the prior year the firm had over a 20 percent ROE in gross book value by more than 20 percent. This past year, we had a 10.2 percent ROE. Now that's, when you actually look at the peer average and where it sits, it was a middle of the pack year when compared to the peer group. Of course, that's not what Goldman Sachs aspires to.

But when you look at our business, we had a handful of drags on our performance. The first is capital markets activity was anemic. And so, that's a big revenue decline.

The other thing is that there was a big headwind. The war in Ukraine started in early '22. We were an investor in Russia. We had activities in Russia. And we quickly closed

those activities down. And that was a big headwind. It was a significant markdown of our activities in Russia. That was a headwind.

The third thing is we run a very balance sheet intensive asset management business. And part of our strategy has been to reduce that balance sheet and raise more capital from clients, run more of a client-based model. We're on that journey. But we're kind of halfway through that journey. That asset management balance sheet is still very significant. And that balance sheet delivered meaningfully less revenue in 2022 than it did in 2021. In fact, the swing was almost \$10 billion dollars.

And then third, and this gets a lot of attention, is that we've been building consumer platforms and those consumer platforms, especially with the changing economic environment, had higher provision for credit losses as we've been scaling them. And that produced a drag on the business.

The biggest drag was actually the asset management performance of that balance sheet, which is why we're trying to continue to bring that balance sheet down and

run a more client fee-based model. And we're making progress on that.

And so, that really came to a head in the fourth quarter. It was the confluence of a number of those things. And so, we had a disappointing performance in the fourth quarter. Reasonable performance for the year, but not what we aspire to. And we'll continue to talk to investors about the strength of our franchise.

You know, at the same point, while factually we had a tough quarter, our core business, banking and markets, continued to gain share. It outperformed vis-à-vis competitors. And actually had a really strong performance in the year. And that's our core main business.

So, I think we're continuing on a journey that we laid out three years ago to grow and strengthen our franchise, to grow our asset management and wealth platform, and to significantly provide value for shareholders. I watch the stock in our TSR very carefully. And we're just going to move forward and serve our clients the best we can.

Allison Nathan: And we did make some organizational

changes last October to set us up for success. So, ultimately, remind us what those changes were and what the client and investor feedback has been about those and how those are feeding into your plan.

David Solomon: Sure. Three years ago at our first Investor Day ever, we laid out a plan to grow and strengthen our core businesses and to invest in a handful of opportunities that we thought could grow the firm and make the firm more durable.

We also, at that time, pledged to run the firm more efficiently. And if you look across the spectrum of things we laid out, we've executed well on the vast majority of them. We haven't executed perfectly on all of them. And there are places where we certainly could have executed better. But we made a lot of progress in lifting the overall return profile of the firm. We set targets for the first time and made a lot of progress in that.

One of the things we felt at the time, but we needed more time to get there, is that our banking and markets business, our core business, were increasingly working together to serve clients. And we had more and more

clients that overlapped across them. And also, when we looked at that business, all our peers, all the people we compete against stand that up as one individual business. And so, we always had the desire to organize the firm where that was one business so it could be benchmarked against people that we compete against. And so, we reorganized to have Banking and Markets be our biggest core division business in the firm.

Second, we've worked over the last three years to build a big asset and wealth platform. We have lots of asset management businesses in the firm. But as you well know, they weren't all organized together. And now, they're organized together. And we have the fifth largest active asset manager in the world. We have very powerful distribution channels. We've raised \$180 billion over the last three years of alternatives from clients. We set a \$10 billion asset management fee target. And we finished this year at 8.8. And we're clearly on track to meet that target, which we had laid out for 2024. And so, we're now positioned with that as a very significant business with a big opportunity to grow it.

And then we took our FinTech platforms. We operated in

two sets of platforms. One is transaction banking, which serves institutional clients in payments and deposits with us. And two, our consumer platforms, which includes our card platforms and our point-of-sale platforms. And we organized those together so there could be more transparency on those and around our desire to get those to pre-tax profitability and move forward with them.

So, we think this is a much cleaner organization for the firm. It also benchmarks and metrics, or is organized in a way that looks similar to the way others organize these businesses. And the feedback from investors has been very good since we made this announcement in October. And I take that feedback, because even with our tough performance in the fourth quarter, our stock price performance over that period of time has been good on a relative basis.

And so, we feel good about the fact that we think we have the firm organized now so that as we talk about it going forward, we have our business organized in a way that we can really drive the growth that we want to do.

Allison Nathan: You're going to have a lot of ability to

talk about our business at our upcoming Investor Day, which is Tuesday, February 28th. A lot of build up for that day. What should investors and the broader public expect?

David Solomon: I don't think there's a lot of build up. We have made a pledge to communicate with investors and keep them updated on our progress. And when we laid out our plan three years ago, and we set some targets, and we updated those targets, we just felt now that we've organized the firm differently, that it's important for us to give people an update on how the businesses are progressing.

And so, what investors will hear, they'll hear about the progress at our Banking and Markets business. They'll hear about how we've meaningfully over the last three years grown our client market share. And how we have a plan to continue to work at growing that client market share. How we also increased our financing activity with our clients. And that those two things have meaningfully increased the size, the durability, and also the overall return profile of our Banking and Markets business.

They'll hear from our team that's running our big Asset and Wealth Management Platform about the progress in

bringing those platforms together and raising money and partnering with institutional clients and individual clients, private wealth clients, to grow our Asset and Wealth Management business. And they'll get a little bit more clarity on how we think we can grow that business over time. And how we can deliver in that business, and the return profile of that business going forward.

And we'll also give them more direction on the trajectory of our drive to get our consumer platforms to profitability. And how we're thinking about that strategically.

And so, those are the high-level things. We'll talk a little bit about some of the expense work we've done this year in the firm and kind of our prospects for how we're sizing the firm going forward. And those are the key messages.

But it's a continued discussion of the progress. And I'm very focused on the medium term and longer-term progress of the firm. How we serve our shareholders. I'm less focused on the quarter to quarter and more focused on how we deliver over time. And so, those are the messages that we'll try to amplify next Tuesday.

Allison Nathan: David, thank you so much for joining us today and sharing your insights. It's always a pleasure to speak with you.

David Solomon: It's great to speak with you. Thanks, Allison. Nice to be with you.

Allison Nathan: Thanks for listening to another episode of Exchanges at Goldman Sachs recorded on Wednesday, February 22nd, 2023. If you enjoyed this show, we hope you follow on your platform of choice and tune in next week for another episode.

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