

Goldman Sachs The Markets

Can tech continue to power equities to new highs?

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Sam Grobart: Once again tech stocks are powering the S&P to new highs. This is The Markets.

Hi, I'm Sam Grobart. Today I'm joined by David Kostin, chief US equity strategist at Goldman Sachs Research. David, thank you so much for joining us today.

David Kostin: Thanks for having me here.

Sam Grobart: We don't usually focus on single stocks on this podcast. But it's-- I mean, NVIDIA, this week it's been insane. These last few hours even as we're recording this. I mean, maybe you can just kind of get us up to speed and your take on what's been happening with the semiconductor manufacturer and its affects across markets.

David Kostin: Sure. Well, the S&P 500 Thursday has reached an all-time high of about 50-70, 5,070. And one of the catalysts for the rally today was, as you indicated, the NVIDIA results that were released last night. And I have the benefit of my colleague Toshiya Hari who's our analyst covering the stock and has done the complete analysis of their results for the quarter. And it was reported revenue that was greater than the pretty optimistic view of the street. And I think that's the key message. A lot of questions about the big seven stocks, of which NVIDIA's one of those companies. And the results were spectacular.

And very importantly, they've raised the guidance for the upcoming quarter. And so, they had more than \$22 billion of revenue for this current quarter that was just reported. And they're giving guidance around \$24 billion for the coming quarter. So, the idea of this growth extending and management in their conference call indicated that things are pretty optimistic looking forward. Some new chips. New products will be developed.

And so, this is an indication that the AI revolution is in the early part and continuing to grow. That's pretty optimistic.

Sam Grobart: I've got to be a little pessimistic here just to balance it out. I mean, what are some of the risks that you might see? Is there a risk of over extension here? I mean, people are definitely going to be buying chips for more AI. But how long does that continue?

David Kostin: Well, I think from an investor perspective, we want to think about this in market context. And the idea that seven companies currently comprise 30 percent of the capitalization of the S&P 500. 30 percent is just seven companies. So, that's the most concentrated market we've ever seen in more than 40 years looking back in history.

And so, the risk there is that there's dominance of these leading companies, not all of which are AI oriented, but several are that to the extent their revenue growth was too slow, then the multiple could compress. And as a result, that would be downward pressure on the market.

And so, my earlier observation is that not just the positive results for the trailing quarter that was just reported, but the guidance going on forward was so optimistic was, I

think, an important validation of the idea that this can continue in terms of a lot of these companies are likely to benefit going forward. And that's the current time why our forecast for the S&P 500 is we will end the year at 5,200. So, modest upside from the current level and that sort of continuing positive trend.

Sam Grobart: I want to get to that forecast in a minute. But I do want to ask you another question. It might be a slightly dumb one, but I'm going to go with it. If these magnificent seven companies have such an outsized impact right now on the S&P 500, does it call into question the use or the validity of a 500-stock index?

David Kostin: It's an excellent question and one that has been vigorously discussed in the investor communities. One of the ways that we think about this is to look at the equal weighted index as well as the cap weighted index. And so, for investors, you think about the index of the S&P 500, it's cap weighted. And that multiples around 20 times. The aggregated index trades around 20 times, which is statistically pretty expensive, historically.

But the equal weighted index trades around 16 times. So, if

every company was to have a similar weight, that's the equal weighted index, SPW, that's around 16 times which, while it's a little elevated, it's not dramatically elevated, and particularly in the context where interest rates are right now. So, that's a discussion point.

We come to the conclusion that in this context the fair value of both of those are relatively fair value, meaning the equal weighted index is about where it ought to be trading or where it's established fair value now. And the cap weighted index, 20 times, is high. But it can be supported given the revenue growth that's expected for some of these big companies.

Sam Grobart: You were talking earlier about your estimates for the S&P. I want to bring us up to speed here. So, in December of '23 you raised your year end 2024 S&P price target from 4,700 to 5,100. And then this week you raised it again to 5,200. NVIDIA notwithstanding, what else has changed?

David Kostin: So, what's changed is that in December, late November in fact, but in December in particular you saw a pivoting, a view that the Federal Reserve would be

starting to cut rates this year. So, the market was trading that. And the idea of rates coming wouldn't was a valuation boost to our framework of valuing the overall market. And so, as a consequence of that, as you indicated, we did increase our valuation. And as a result, therefore, the index target, we raised that. And that was valuation driven.

In this context right now where we most recently lifted the target slightly, it was an earnings-driven decision. Or the impetus was more earnings driven and not so much a valuation story. And that also was a reflection of not just the fourth quarter results that came in across the market, which were better than expected, but also the idea that margin expansion is likely to continue to have effect in calendar 2024. And higher margins is basically the story and the driver behind higher earnings. Higher earnings are likely to take the market higher. And that's the general trajectory. So, that's the way we would think about it.

And to put numbers on it. We were looking for 5 percent earnings growth for this year. Now we're looking for 8 percent.

Sam Grobart: What is the macro picture looking like

for you right now? What are you seeing in terms of GDP, labor, these other factors driving into that?

David Kostin: So, the US equity market right now is pricing the idea of the economy growing at greater than a 3 percent rate. We make that statement based on looking at the performance of cyclical stocks compared with defensive stocks. And that is clearly indicating that the equity investor is pricing in the idea of the economy growing. That is, in fact, consistent with the Goldman Sachs economics team where they have GDP growth in the United States on average growing around 3 percent, a little lower than 3 percent.

The consensus expectation is around 1.5 percent. So, Goldman Sachs more optimistic. Higher growth rate for the overall economy. It's largely a function of the consumer and the idea the consumer is in a strong position and is going to continue to spend. The consumer is almost roughly 2/3 of the US economy so that is an important barometer there.

The idea of the Federal Reserve cutting interest rates is another backdrop. The forward market is pricing somewhere between three and four cuts. The Goldman

Sachs a little bit, perhaps as many as five cuts in their forecast. And so, those are two tailwinds: economic growth and lower rates that are going to be a benefit for equity prices this year.

Sam Grobart: David, it's already been a heck of a week, but I've got to ask you, what's on your radar for next week?

David Kostin: Next week, we're looking at inflation indicator PCE, personal consumption expenditure data will come in. One of the key risks and variables that we're looking at along with many investors is the trajectory of inflation. To the extent that the inflation continues to fall or come down at a slower pace, then the Fed would give them, perhaps more confidence to begin to cut rates. And so, that's, I'd say the variable we're looking at most for next week.

We will, basically, at the end of this week, we'll have completed all of the companies, more than 90 percent of the S&P 500 earnings will have been reported.

Sam Grobart: David Kostin, it's been a pleasure. Thanks so much.

David Kostin: Thanks always.

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. And to learn even more, please visit GS.com and sign up for Briefings, our weekly newsletter on the global economy. I'm Sam Grobart. Thanks so much for listening.

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