THE DAILY CHECK-IN WITH GOLDMAN SACHS

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HOST: LIZ BOWYER, GLOBAL HEAD OF BRAND AND CONTENT STRATEGY

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LIZ BOWYER: Hi Zach.

ZACH PANDL: Hi Liz.

LIZ BOWYER: You help our clients navigate macroeconomic risks in global markets and to adjust their portfolios accordingly. What are the main risks that you're focused on right now?

ZACH PANDL: That's right. And needless to say, the COVID pandemic has brought macroeconomic issues, really, to the forefront of the issues that investors are dealing with in their portfolios. And these include ultra low interest rates after the Federal Reserve's rate cuts. They include dollar depreciation. Many investors have been overweight the US market in past years because of strong performance. Now that's beginning to be a drag on returns. And they also include relatively scarce equity market returns. Now, the technology sector has had a very strong year. Other sectors, not so much. So, investors are increasingly struggling to find places for persistent returns in their portfolios as well.

LIZ BOWYER: And how are low rates and the Fed's new approach to inflation targeting affecting how investors are thinking about asset allocation?

ZACH PANDL: Low interest rates and the Federal Reserve's stated intention to raise inflation, raise inflation expectations really have weakened the rationale for holding US treasuries and other high-quality bonds in a portfolio. If the Fed is in any way successful in raising inflation expectations, treasuries are likely to deliver negative returns for investors because interest rates will set higher. We've also seen much less sensitivity of the treasury market to macroeconomic and political developments. And so, the market seems to be losing its value as a hedging instrument as well.

And so, we've seen investors turn increasingly away from fixed income markets and towards other assets to express their views and to try to protect their portfolios against macroeconomic risks.

LIZ BOWYER: And given who closely related interest rates are to currencies, how are these near zero rates affecting exchange rates around the world?

ZACH PANDL: So, as interest rates have come down, bond markets have really lost their sensitivity to stocks and other types of assets. And so, we've seen interest rate volatility come down. At the same time, currency markets have become more sensitive to these developments. So, currency volatility has gone up. So, investors are increasingly using currency markets to express their views on macroeconomic developments, on political developments, and to hedge their portfolios. We've also seen increasing hedging of currency risk in general. Because interest rates are so low, it's become very cost effective for investors just to remove currency risk from their cross-border investments. So, if investors don't want exposure to currency, it's relatively easy to remove that risk these days at very low interest rates. So that's been an increasing trend recently as well.

LIZ BOWYER: And what about the US dollar specifically, which is obviously top of mind for investors? What's your outlook for the dollar?

ZACH PANDL: We have a negative view on the US dollar reflecting its high valuation, very low interest rates in the US, and a recovering global economy. We see this as a kind of standard recipe for dollar weakness, a set of factors that we're always looking for on our team to inform our broad dollar views. So, as long as those three things remain in place, we're likely to remain negative on the dollar. We can expect to see a depreciating trend over time.

LIZ BOWYER: So, equity market performance in recent years has been pretty narrowly concentrated on technology names and other firms with high top line revenue growth. Do you think that that will continue? Or should investors be looking in other segments?

ZACH PANDL: There are, of course, many great companies in the technology sector. But we think that investors should increasingly be looking to diversify, both by industry and by country. Some of the factors that have helped tech sector performance, really the low level of growth around the world and falling interest rates, may no longer be with us in the years ahead. The global economy is picking up from the coronavirus recession. And as we've been discussing, interest rates can't fall much further from current levels. So, some of these tailwinds from the tech sector may be fading at a time when the sector has pretty high valuations. So, more diversification, we think, does make a lot of sense. And if we see a successful COVID vaccine developed late this year, which is our expectation. We think it will accelerate a rotation into other sectors and into other countries.

LIZ BOWYER: But even so, the technology sector and the US dollar are places where investors have found the most value in recent years. So, where else should they be looking?

ZACH PANDL: We think investors should look, first at traditional cyclical sectors, which tend to be pretty undervalued today and could benefit from a strong global recovery as the world pulls out of the coronavirus recession. And investors may also want to look at a number of emerging markets, especially China. You know, China has relatively high interest rates today, a pretty strong currency, a pretty strong equity market. So, these would be natural options to diversify both equity and fixed income portfolios today.

LIZ BOWYER: Thanks, Zach.

ZACH PANDL: Thank you.