GLOBAL STRATEGY VIEWS

Momentum, rotation and the value in growth

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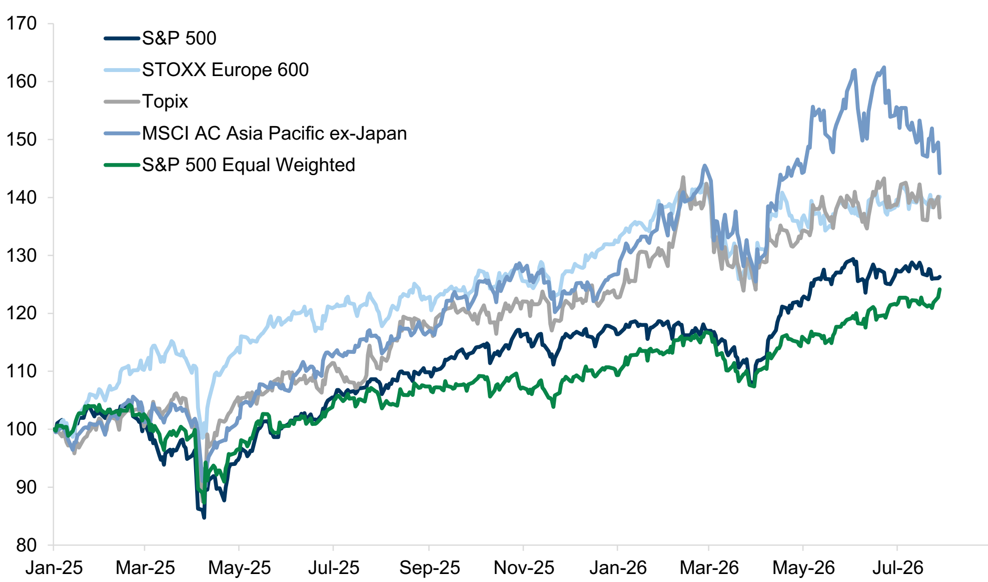
1. In early 2025 we argued that a series of dynamics would broaden out the returns available for investors, increasing the rewards to diversification. In the fifteen years that followed the financial crisis, equity markets were very bifurcated. The US equity market dominated regionally, Technology consistently outperformed sectorally, and Growth persistently outpaced Value. **Since 2025, and again through this year, the opportunity set has shifted. Equities have performed well, but the geographical spread has widened (Exhibit 1). The US has been the weakest of the major regions.**

Exhibit 1: Geographical returns have broadened, with the US lagging other major regions
World equity indices (USD), indexed price performance

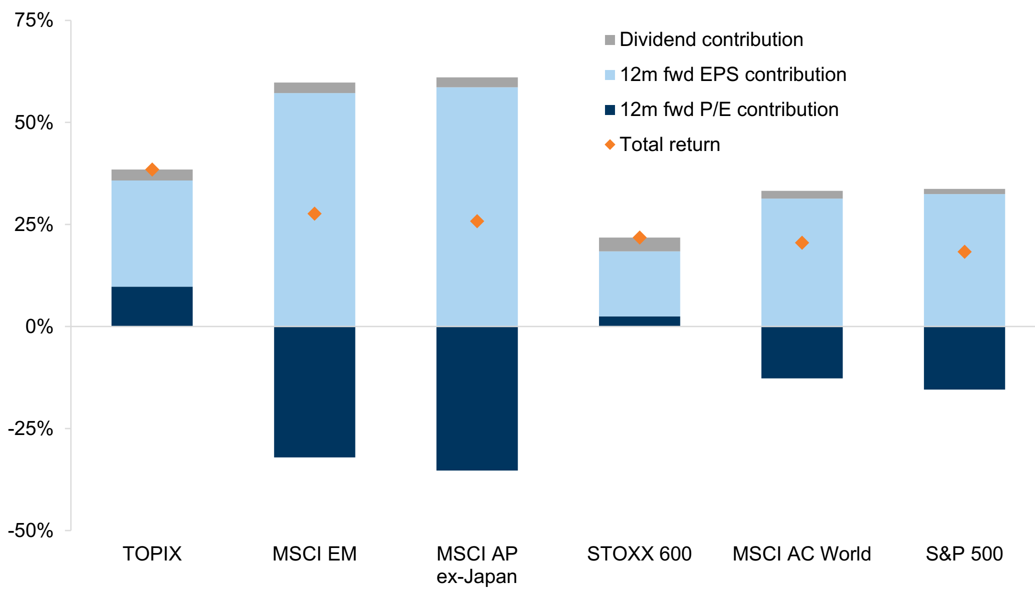


Source: Datastream, STOXX, Goldman Sachs Global Investment Research

2. While the strongest returns (in local currency) have been in Japan, Asia Pacific and EM, the bulk of the returns across regions over the past year have been driven by strong earnings growth (Exhibit 2). Asia, EM and the US have all de-rated, while Japan and Europe have seen modest increases in their valuations. This is an important change from previous periods when much of the return across equities was driven by rising valuations and the support of lower interest rates. **More government debt, increased issuance, and persistent inflation have all contributed to a higher cost of capital, leaving earnings as the key driver of**

returns. We think this trend will continue.

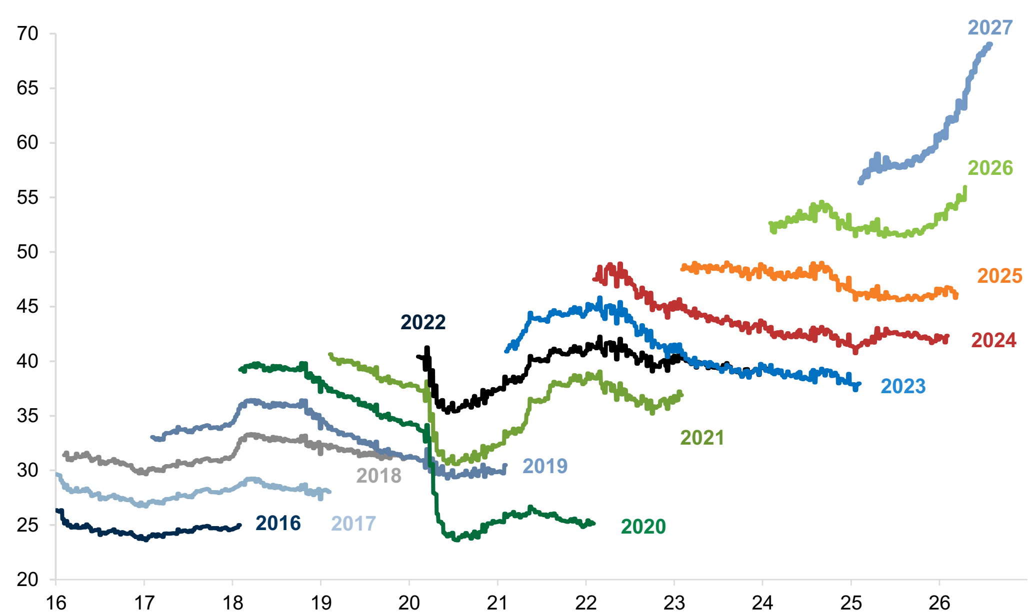
Exhibit 2: Earnings growth has been the main driver of returns across regions
12m trailing return contribution in local currency



Source: Factset, Datastream, STOXX, Goldman Sachs Global Investment Research

Rather, unusually, not only have earnings been strong but revisions have been rising (Exhibit 3), again justifying the fundamental support for equity markets.

Exhibit 3: Earnings have been strong and revisions have continued to rise
MSCI AC World EPS consensus estimates (USD)

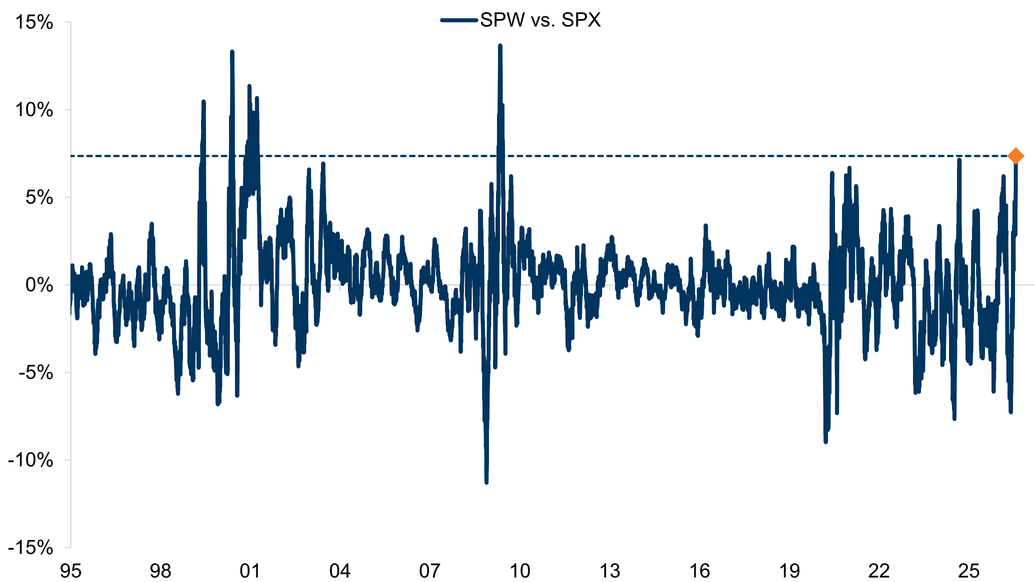


Source: FactSet, Datastream, STOXX, Goldman Sachs Global Investment Research

3. But while geographic returns have broadened, so too have opportunities across sectors and factors. We have argued that concentrated markets create problems for active managers while increasing risk for investors. Up until recently, many equity

markets had been concentrated both in market capitalization (with a few companies dominating the market) and in contribution of returns (a small number of companies driving most of the index performance). Most equity markets are now broadening. For the first time since 2009, the equally weighted S&P, for example, has outperformed the S&P 500 by more than 7.3% (Exhibit 4).

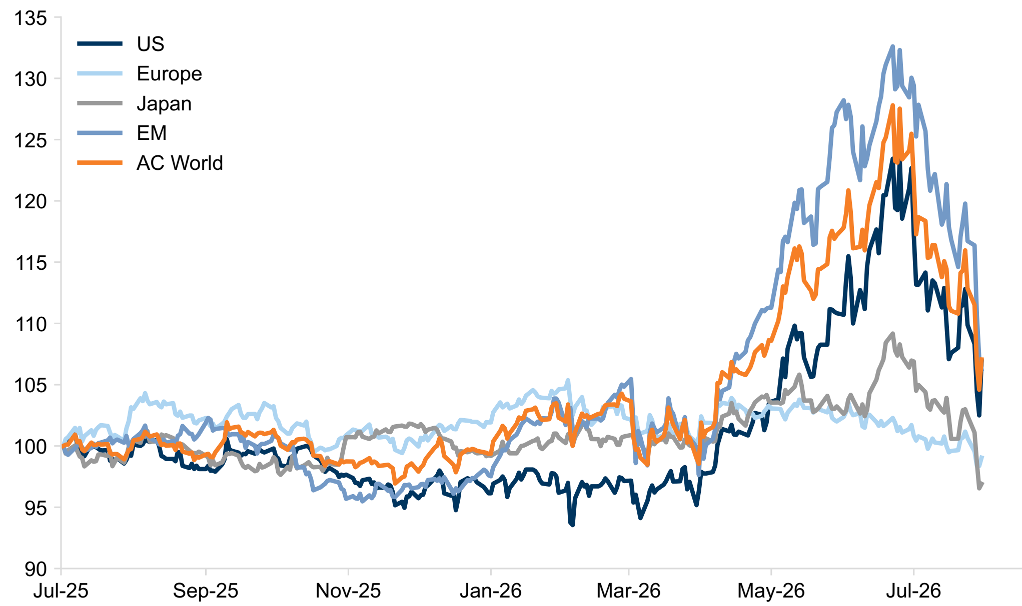
Exhibit 4: Market participation has broadened beyond the largest stocks
2m rolling returns of S&P 500 Equal-Weighted vs. S&P 500 Cap-Weighted



Source: Datastream, Goldman Sachs Global Investment Research

4. This has been supported by several factors. First, the resilience of the broader economies, particularly in the US and Europe, where the median stock has performed best. Second, the pick-up in M&A, which is attracting interest across the market, and away from the largest cap stocks. Small caps have outperformed large caps in the US. Third, the sharp momentum unwind of recent weeks has supported a widening of participation amid a rotation of leadership (Exhibit 5).

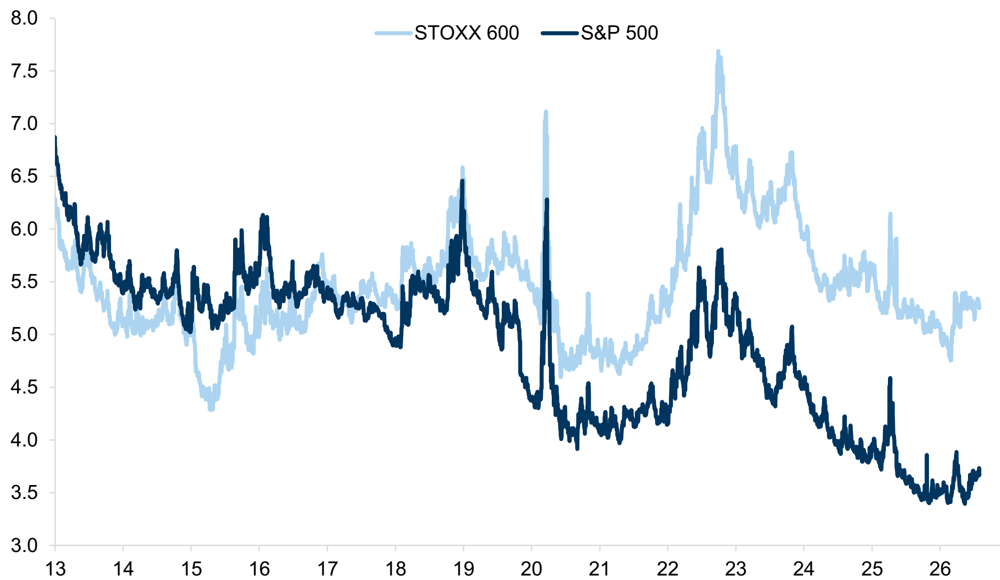
Exhibit 5: The momentum unwind has supported a rotation in market leadership
MSCI Momentum vs. Market, relative price returns (USD)



Source: Datastream, Goldman Sachs Global Investment Research

5. One of the other key reasons for these changes in market dynamics has been the dramatic rise in capex spending by the leading Tech companies. For a decade or so after the financial crisis, these companies became hugely profitable, benefiting from the surge in demand for Software and cloud computing while piggybacking off the capex that was installed in the dot.com era; they were capital light and enjoyed the valuation support driven by zero interest rates. In an era of weak nominal growth and excess capacity in many 'old economy' industries, the Technology sector's remarkable margin and ROE progression made it hugely attractive. With the introduction of ChatGPT, an explosion in capex among the hyperscalers has increasingly eroded their premium cash flows, forcing them to turn to debt and equity markets for funding. **The US equity market, dominated by the hyperscalers, has experienced a sharp decline in FCF yield relative to more value-oriented markets, such as Europe, helping to support the rotations of relative performance (Exhibit 6).**

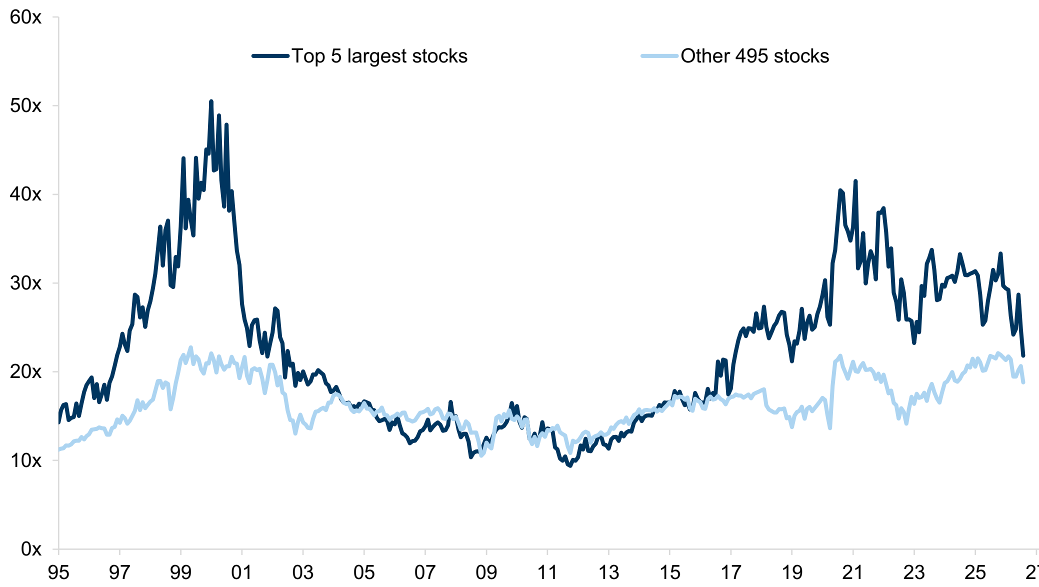
Exhibit 6: US FCF yield has been weighed down by capex spending recently
Free-Cash-Flow Yield



Source: FactSet, Bloomberg, Goldman Sachs Global Investment Research

6. Driven by a growing anxiety about the returns that the capex might generate in the future, these dominant Tech companies have de-rated. As Exhibit 7 shows, the biggest five stocks in the US now have a P/E ratio only marginally above the other 495 but had previously been on a premium consistently since 2017. It also marks a very big change from the dot.com era. Back then, valuations reached a much greater high, but they came down as stock prices collapsed. This time, prices have adjusted more modestly, but earnings have remained exceptionally strong.

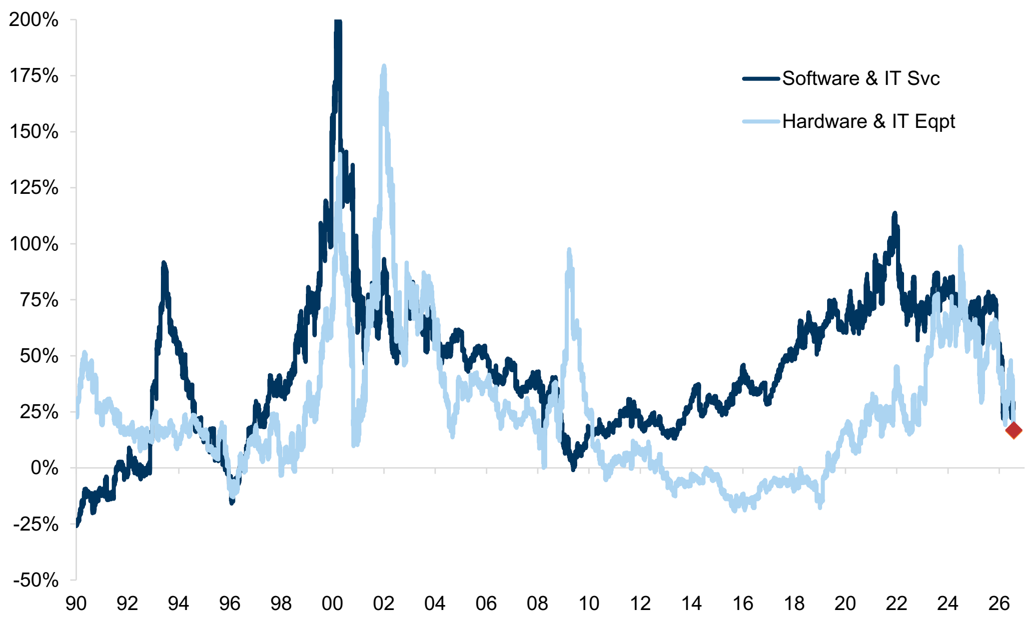
Exhibit 7: Premium for Top 5 stocks has almost disappeared
S&P 500 12m forward P/E multiple



Source: Datastream, Goldman Sachs Global Investment Research

The hyperscaler valuation convergence has been matched by a sharp de-rating in the relative valuation of Software stocks – among the biggest winners in the past Technology cycle – now at the epicenter of concerns about disruption. The sector's P/E premium globally has fallen to around 20%, a far cry from the near 200% at the start of this century. Performance leadership within the Tech space shifted from Software to Hardware, where the memory and chip stocks have seen explosive demand for compute, driving a surge in their earnings growth. Nonetheless, the cyclicality of these businesses – and the risk that their earnings are not sustainable – has driven them to de-rate too (Exhibit 8).

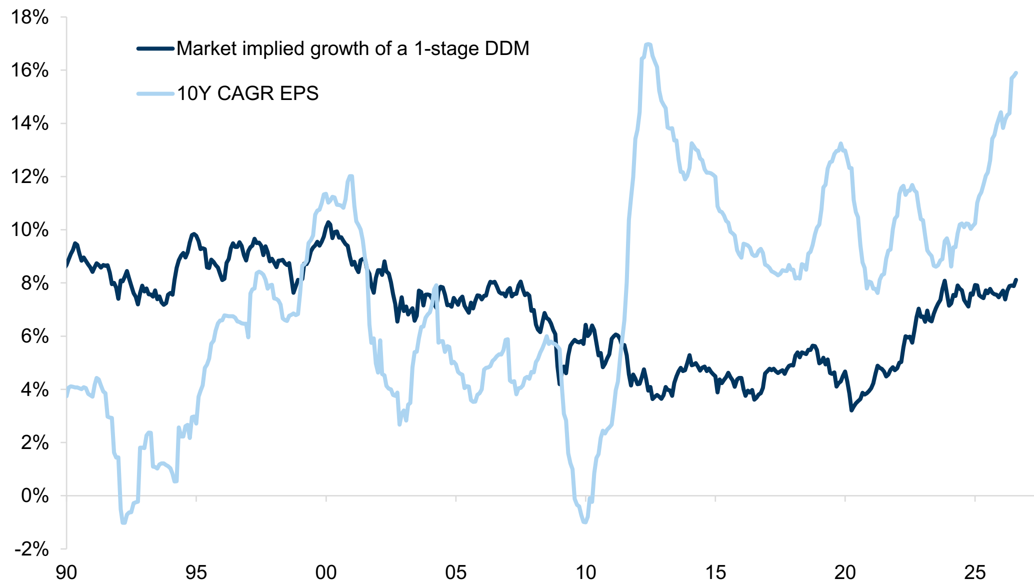
Exhibit 8: Software valuations have de-rated sharply from past extremes
Premium/(Discount) on 12m forward P/E vs. World ex. TMT. Global Sectors



Source: Datastream, Goldman Sachs Global Investment Research

While valuations have moderated, particularly on a P/E basis, implied future growth has been rising. A simple proxy, using a one-stage DDM, illustrates the increase in expectations for the sector since 2020. Nonetheless, forward implied growth remains well below the levels reached at the peak of the dot.com era, while the 10-year CAGR of earnings growth has accelerated well beyond the 2000 peaks (Exhibit 9). **Across Technology, there does not appear to be a valuation bubble, but there may be an earnings bubble. Investors have reflected these concerns and there is Value that is emerging.**

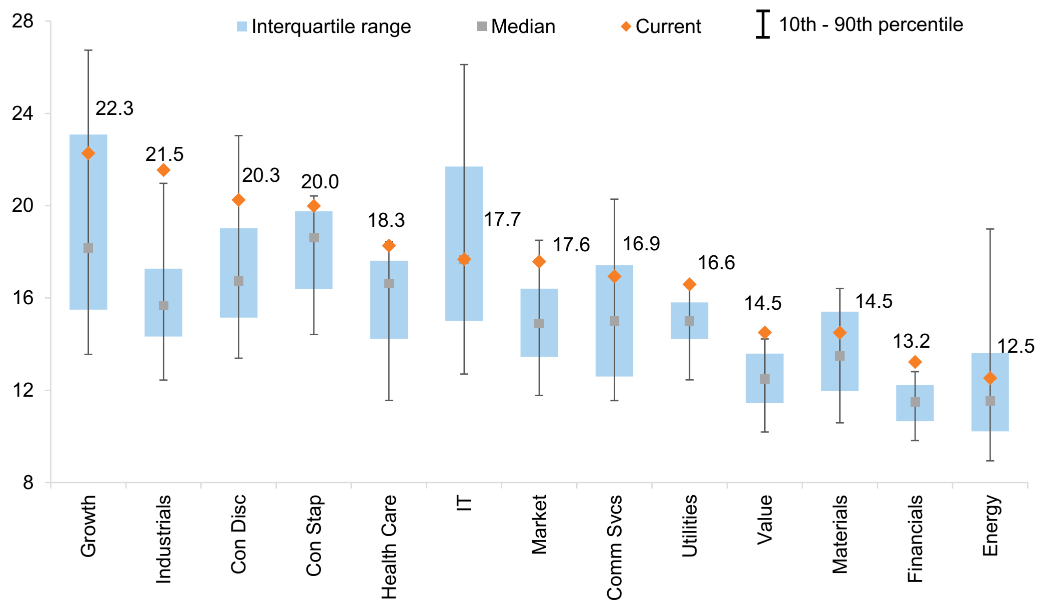
Exhibit 9: Implied growth has risen, but remains below dot.com era peaks
US Technology sector: one-stage DDM implied growth (ERP fixed at 4.0%) and 10-year rolling EPS CAGR



Source: Datastream, Goldman Sachs Global Investment Research

7. While Technology has de-rated, other parts of the market have seen a re-awakening of interest. The enormous scale-up in Tech capex by the hyperscalers and chip companies, coupled with increased government borrowing to fund improvements in Energy security, critical infrastructure and defense, has led to the start of a capex 'super cycle'. The spillover effects of this have boosted the growth prospects and valuation of many 'old economy' industries that had been neglected for so long by investors seeking long duration growth. Looking at current global valuations by sector re-levels this shift. In Exhibit 10 the orange diamonds are current valuations, which are compared with the mean over 20 years and the ranges. **Industrials now have the highest sector valuation (which has risen to above its 20-year range), whereas Technology has de-rated from being the most expensive sector to now in line with its 20-year average.** Consumer staples, Discretionary and Healthcare are all now more highly valued that IT or communication services (at least on a P/E basis, though Tech is more highly valued on FCF multiples given the huge spending needs in the sector).

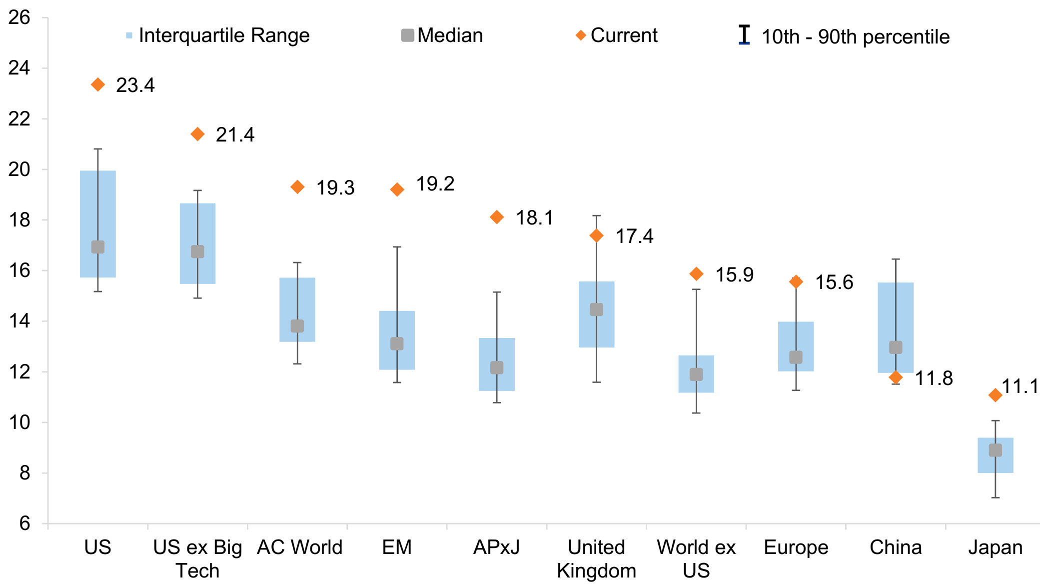
Exhibit 10: Industrials now trade at higher valuations than Technology
MSCI World sector/style valuations, 12-month forward P/Es relative to the last 20 years



Source: Factset, Datastream, Goldman Sachs Global Investment Research

8. At the country level too, opportunities to broaden exposure have been increasing. The hit to the biggest stocks and the largest sector in the US (despite strong earnings) has led to a lower P/E ratio, despite the US remaining by far the most attractive from an ROE perspective. Only China, among the major markets, has an ROE below its historical average (Exhibit 11). It is enjoying a boom in exports and is a major competitor to the US in Technology but has much lower profitability and returns. This lower rating gives investors an opportunity to re-engage with the US equity market while being selectively diversified across regions.

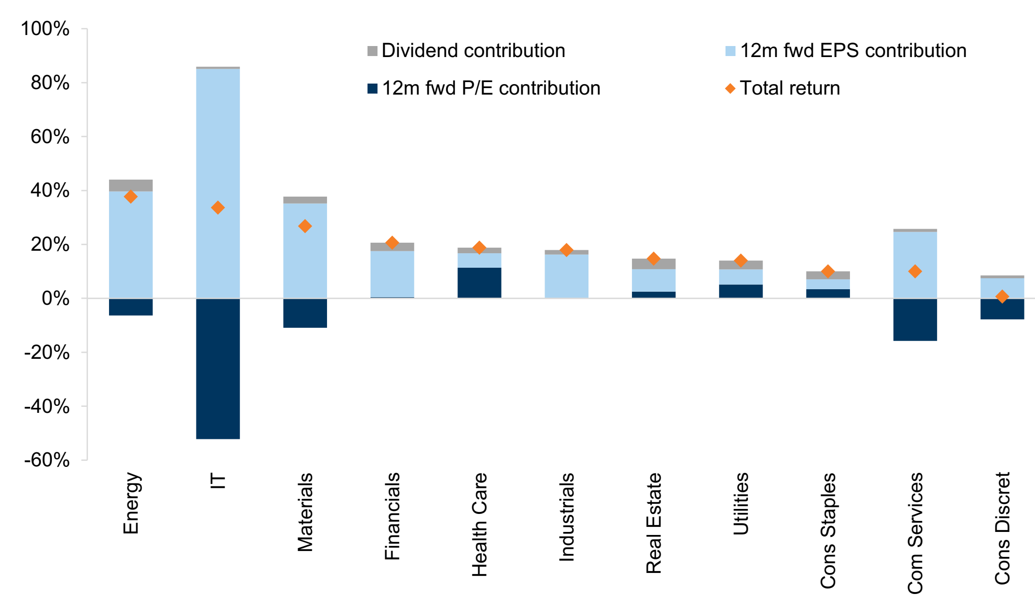
Exhibit 11: ROE remains elevated across most regions except for China
12m fwd ROE Regional Valuation Range



Source: Factset, Goldman Sachs Global Investment Research

9. The reversal in momentum, and the shifts in country and sector leadership are also being reflected in a rise in alpha opportunities across all major regions. This shift in leadership, accelerated by the recent momentum unwind, is leaving opportunities for investors to add alpha. For example, the IT sector has continued to enjoy the strongest earnings growth this year and has seen the biggest de-rating, whereas Energy has performed better but seen lower earnings growth (Exhibit 12). The opportunity to selectively find value in growth areas is rising.

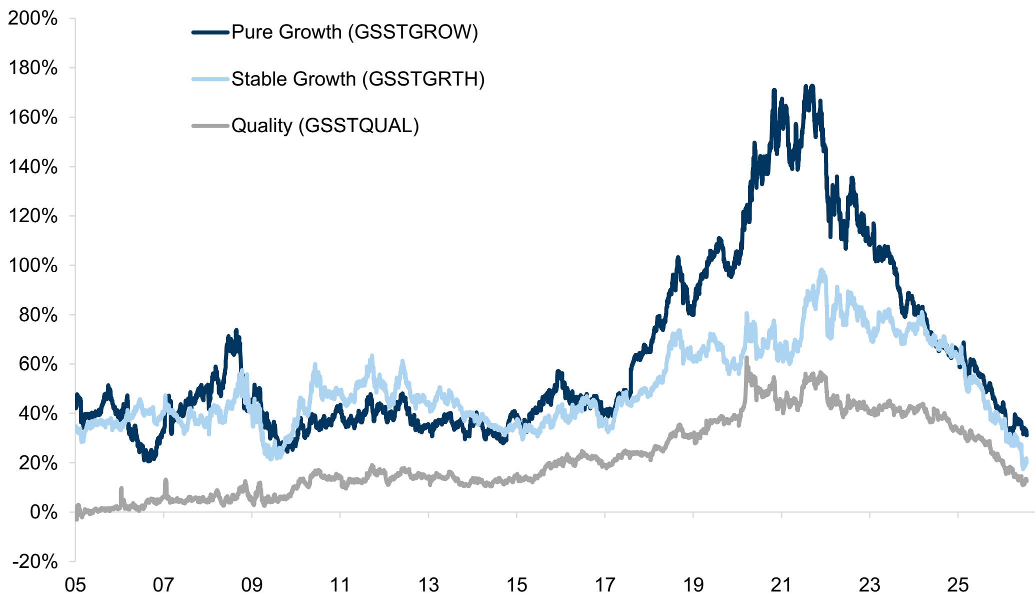
Exhibit 12: Strong earnings growth has not prevented a de-rating in Technology
MSCI AC World 12m trailing return contribution by sector/style in USD



Source: Factset, STOXX, Goldman Sachs Global Investment Research

By contrast, Consumer staples and Consumer discretionary have seen the poorest returns. Growth and quality have lost much of their premium, while more value-oriented sectors and HALO stocks have outperformed. Exhibit 13, for Europe, illustrates a broader trend of the de-rating that has taken pace in pure growth (our basket GSSTGROW), as well as in low volatility growth (GSSTGRTH) and quality (low volatility, strong balance sheet companies – GSSTQUAL).

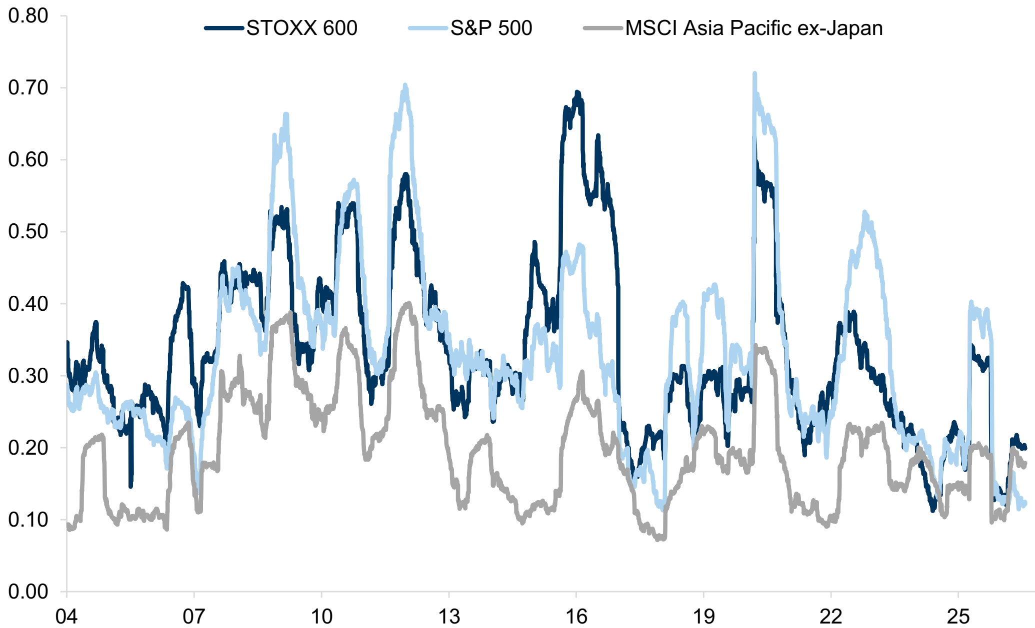
Exhibit 13: Quality and Growth areas have de-rated sharply
24m P/E discount vs. SXXP



Source: FactSet, Goldman Sachs Global Investment Research

10. Across the major markets, stock correlation (how much pairs of companies move together) has fallen (Exhibit 14). Not only is there a wider range of geographical, sector and factor opportunities, but even within sectors stocks are reflecting more idiosyncratic factors. While there are big moves among single stocks, these can often offset each other and volatility at the index level remains low even with the painful rotations in AI stocks and in momentum. This reflects a healthy departure from an asset class that exhibited record concentration of market capitalization as well as performance. We view this as a healthy normalization following years of very high concentration in both market capitalization and performance.

Exhibit 14: Pairwise correlation remains low
6m Average Pairwise Correlation



Source: Bloomberg, Goldman Sachs Global Investment Research

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