

GLOBAL STRATEGY VIEWS

Competition for Capital

1. There are two themes dominating our investor conversations: the impact of AI and the rise in interest rates. The two issues are linked as demand for capital from both the private and public sectors increase. In the private sector a surge in capex spending to fund AI infrastructure has eaten into free cash flow and forced companies to raise more in debt and equity markets. Meanwhile, government borrowing needs have increased as priorities shift towards upgrading critical infrastructure, energy security and defense at a time when cyclical inflationary pressures driven by higher energy prices are also resulting in higher policy rates. The combination has pushed up the cost of capital. As recently as 2022, for example, 30-year bond yields in Germany and Japan were close to zero ([Exhibit 1](#)). A rise in yields, together with more uncertainty (over geopolitics and the future impact of AI) have, in combination, pushed up the cost of capital.

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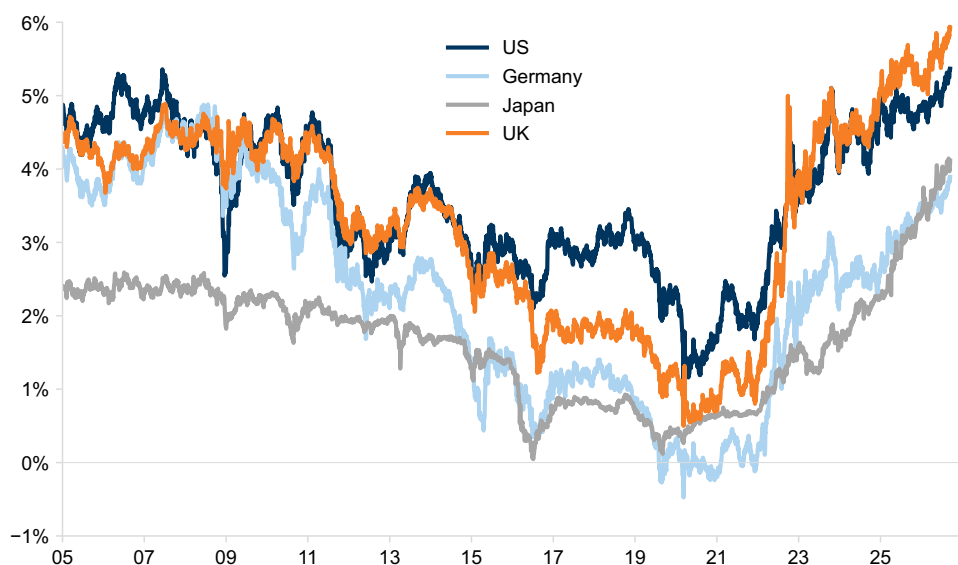
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Exhibit 1: Rising yields and uncertainty have increased the cost of capital
30-year government bond benchmark yields (%)

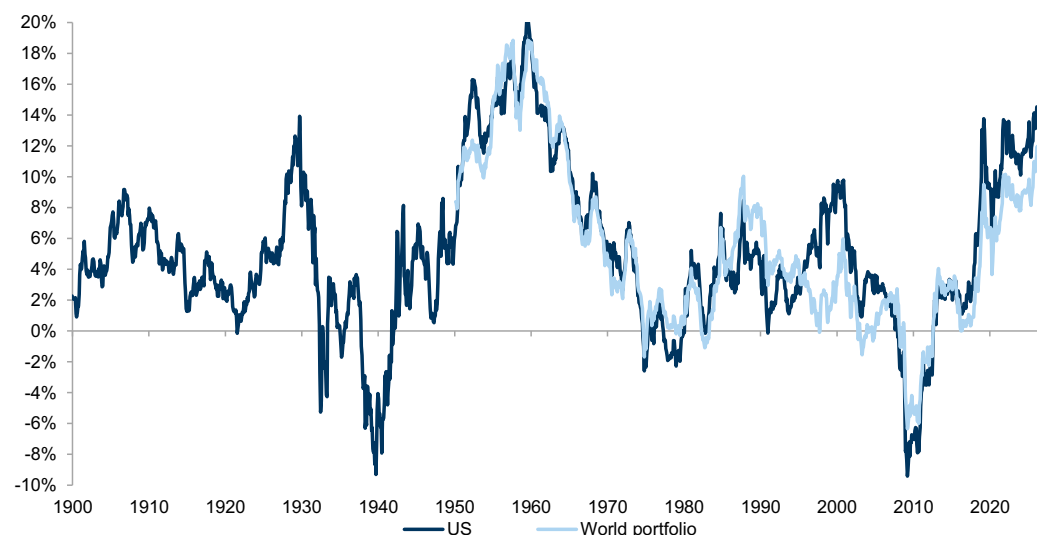


Source: Datastream, Goldman Sachs Global Investment Research

2. This rise in yields comes after a near-record period of equity outperformance relative to bonds over 10-year holding periods ([Exhibit 2](#)).

Exhibit 2: Equities have enjoyed a near record period of outperformance relative to bonds

10-year rolling annualised equity vs. bond performance (ex post equity risk premia)

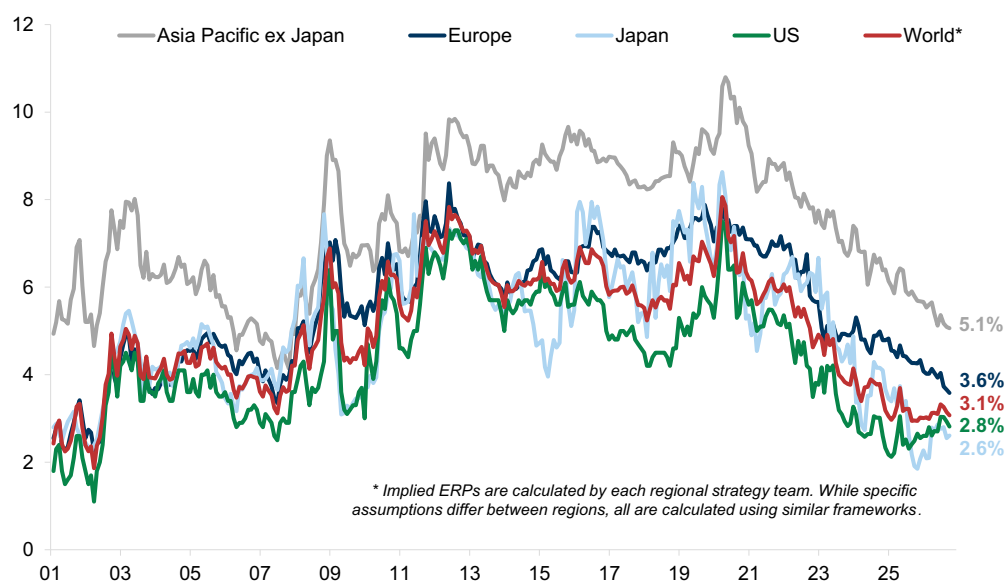


Source: Robert Shiller, Datastream, Haver Analytics, Goldman Sachs Global Investment Research

As equities have continued to outperform bonds, equity risk premia have fallen back to levels last seen in the late 1990s, leaving equity markets more vulnerable to further increases in bond yields. That said, in the US and Japan, the ERP has bounced off recent lows ([Exhibit 3](#)).

Exhibit 3: Equities have re-rated versus bonds amid higher inflation

Global market implied ERP (%)



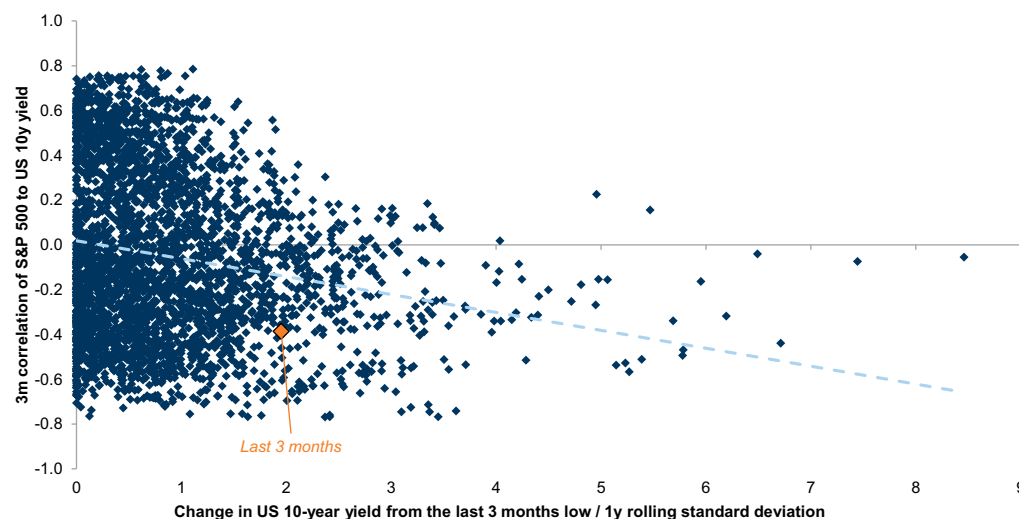
Source: Goldman Sachs Global Investment Research

3. The impact of rising bond yields, however, depends not only on the level of yields, but also on the reasons as well as the speed of the adjustment ([Exhibit 4](#)). It is the speed issue that has caused the biggest impact in the recent past. As our US strategists note, stocks have usually generated positive returns alongside rising interest rates unless the pace of rising rates exceeded 2+ standard deviations and this is a pattern that is broadly

reflected in other regions too. Today, a 2-standard deviation move in 10-year Treasury yields would equate to about 50bps over a month or 30bps over two weeks, similar to the adjustments in recent days which explains the pullback in equity prices.

Exhibit 4: A continued sharp increase in bond yields could put pressure on equities

Data since 1962

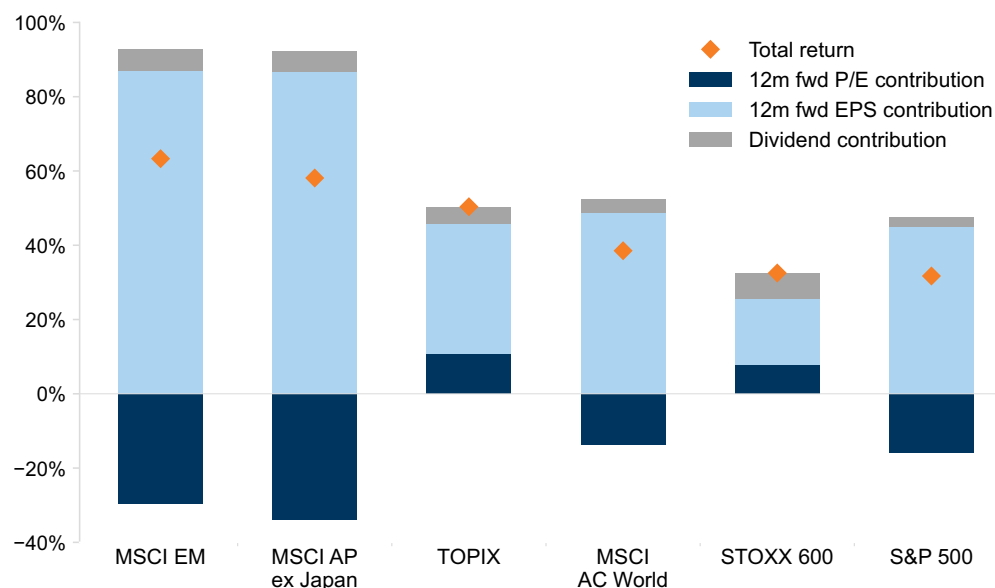


Source: Datastream, Goldman Sachs Global Investment Research

4. But despite the rise in yields, nominal GDP and profit growth remain strong and, until recently, the impact of rising bond yields has been offset by the strength in corporate profits. Earnings growth has been the main driver of equity returns over the past 18 months in all regions (Exhibit 5). This strength has meant that PE multiples have either been flat (Japan and Europe) or have fallen (the US, Asia and EM).

Exhibit 5: Earnings have driven most of the returns since 2025

Total return contribution since Jan-2025 (local CCY)



Source: Datastream, STOXX, Goldman Sachs Global Investment Research

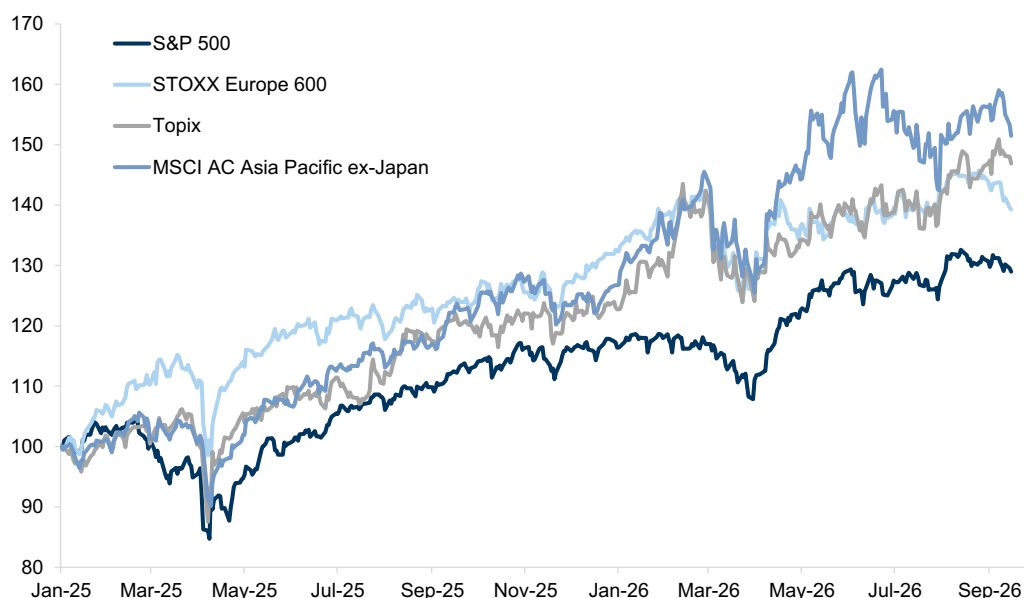
In the US, in particular, the forward PE multiple for the S&P has come down from 22x at

the start of the year to 19x, in line with its long-run average, despite the market being close to its all-time high.

5. While US equities have driven the bulk of equity outperformance for much of the fifteen years post the financial crisis, the improvement in earnings across regions, and the sharper de-rating in the US, has resulted in equity performance being broader-based by geography. Since 2025, the US equity market has been the weakest of the major regions ([Exhibit 6](#)), a turnaround from the dominant trend since the financial crisis and increasing investor returns from a more geographically diversified portfolio.

Exhibit 6: US equities have underperformed other major regions since 2025

Indexed price performance (USD)

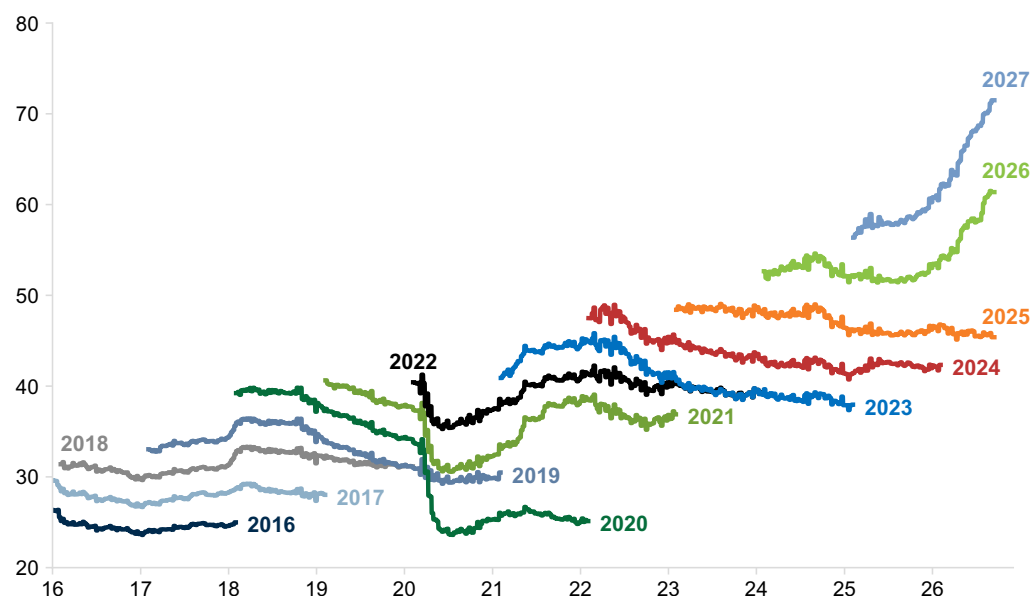


Source: Datastream, STOXX, Goldman Sachs Global Investment Research

6. Supportive profit growth has been accompanied by positive earnings revisions, with 2026 and 2027 estimates moving higher across major regions. There are four broad areas which have been driving much of this profit growth. First, technology earnings continue to be very robust. Second, rising energy prices have pushed up profits in the commodity sector. Third, banks have generally enjoyed strong earnings backed by positive nominal GDP growth, steep yield curves and strong private sector balance sheets. Finally, sectors such as Industrials have benefited from the surge in AI capex spending which has spilled over into improved revenues for the 'pick and shovels' of AI infrastructure. The breadth of the earnings' growth has also increased the opportunity for investors to diversify across sectors as well as countries.

Exhibit 7: Earnings revisions have unusually been positive

Consensus estimates in USD. MSCI AC World EPS



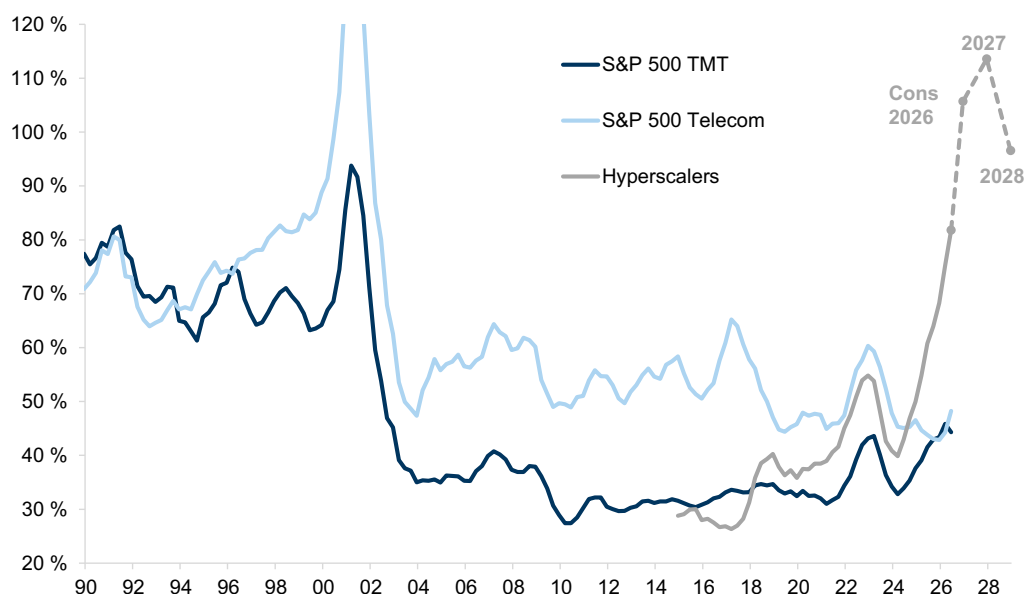
Source: Datastream, Goldman Sachs Global Investment Research

7. While technology profit growth has remained strong, the surge in capex spending among the hyperscalers has increasingly eaten through their free cash flow (Exhibit 8) prompting companies to look for alternative sources of funding, in the credit and equity markets. The capex spending growth for AA-rated issuers has been substantial: the 65% year-over-year growth in Q2 marks the 10th consecutive quarter that aggregate AA capex growth exceeds 35%. They have also turned to the convertible bond market where volume has also increased year to date reaching \$135 billion in the US, with AI-related borrowers driving 44% of total issuance, on our estimates.

Our Credit team raised their full-year US IG gross issuance forecast by \$200bn to \$2.3 trillion and AI-related issuers account for a quarter of USD IG gross supply this year, pushing overall supply to a year-to-date record.

Exhibit 8: CAPEX is concentrated in few companies

Hyperscaler capex as % of cash flow from operations, dashed line representing 2026 consensus

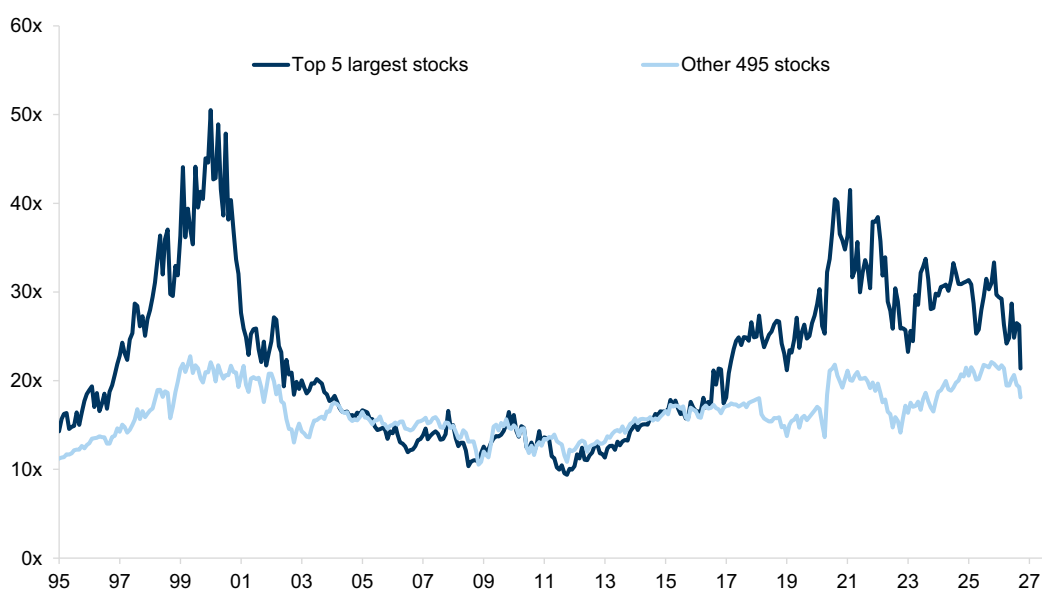


Source: Compustat, FactSet, Goldman Sachs Global Investment Research

The combination of higher cost of capital and greater capital intensity in the tech sector has reduced the value of their future cash flows and triggered a de-rating in the biggest companies. The dominant capex hyperscalers in the US now have a forward PE close to the average of the rest of the market.

Exhibit 9: Large-cap valuations are less demanding than perceived

S&P 500 12m forward P/E multiple



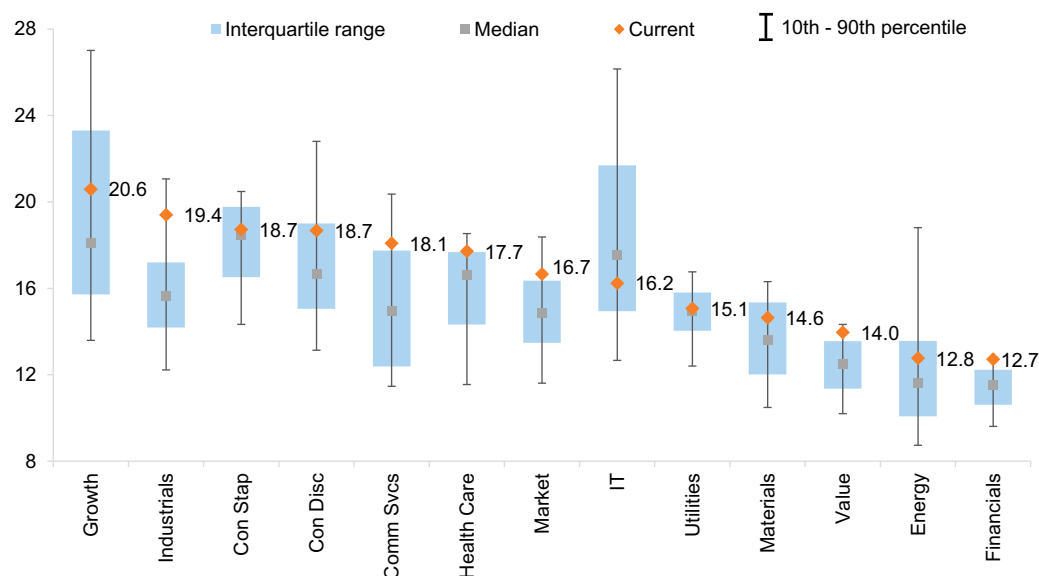
Source: Datastream, Goldman Sachs Global Investment Research

8. Software companies have also de-rated on the back of fears of disruption from AI while memory and chips stocks have also experienced lower multiples as their earnings

surge. Globally technology has seen its PE ratio moderate, falling below its 20-year median ([Exhibit 10](#)). Meanwhile, the spending of these companies has spilled over into better earnings and more visible cash flows in many other parts of the economy. Healthcare, Consumer Discretionary and Industrials are all more expensive in absolute terms than IT, and Industrials has re-rated and now has a PE close to the 90th percentile of its 20-year range.

Exhibit 10: Industrials now trade at higher valuations than Technology

MSCI World sector/style valuations, 12-month forward P/E's relative to the last 20 years

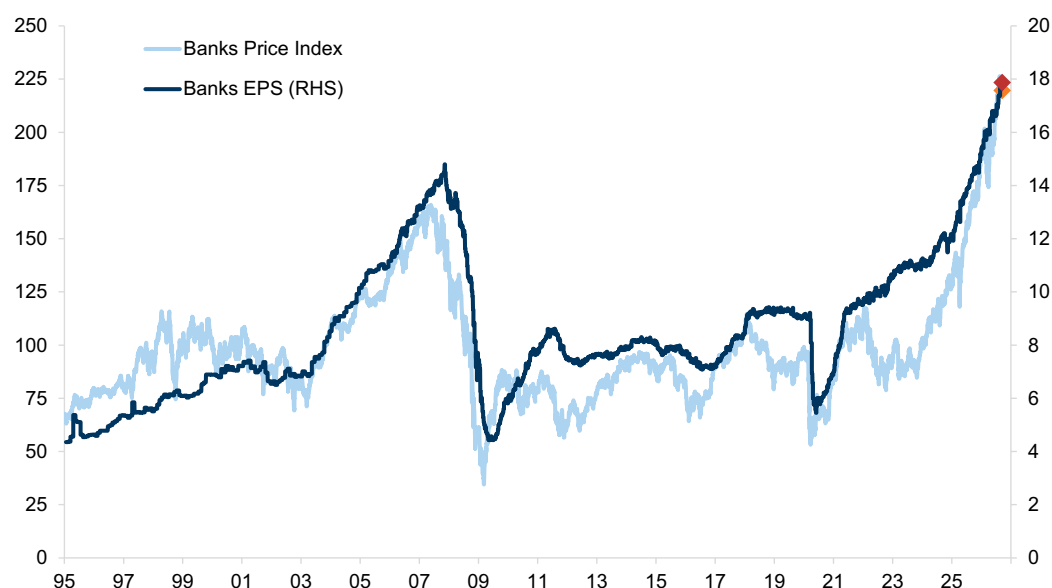


Source: FactSet, Datastream, Goldman Sachs Global Investment Research

9. For these reasons, we have argued that Technology equities have not experienced a classic bubble because valuation levels are much lower than in previous financial bubbles. Nevertheless, the risk for investors is less about valuation and more whether there is an unsustainable earnings bubble. Bubbles in earnings, rather than valuations, have occurred in previous periods. The Bank sector, for example, briefly became the biggest sector in the S&P 500 in the run up to the financial crisis of 2008/09 ([Exhibit 11](#)). Unlike the technology bubble of the late 1990s, or the Japanese bubble of the late 1980s, Bank stocks did not experience a major valuation bubble at the time, but the surge in earnings that drove the sector's outperformance proved to be unsustainable.

Exhibit 11: Banks peaked again on earnings momentum

MSCI World Banks



Source: Datastream, Goldman Sachs Global Investment Research

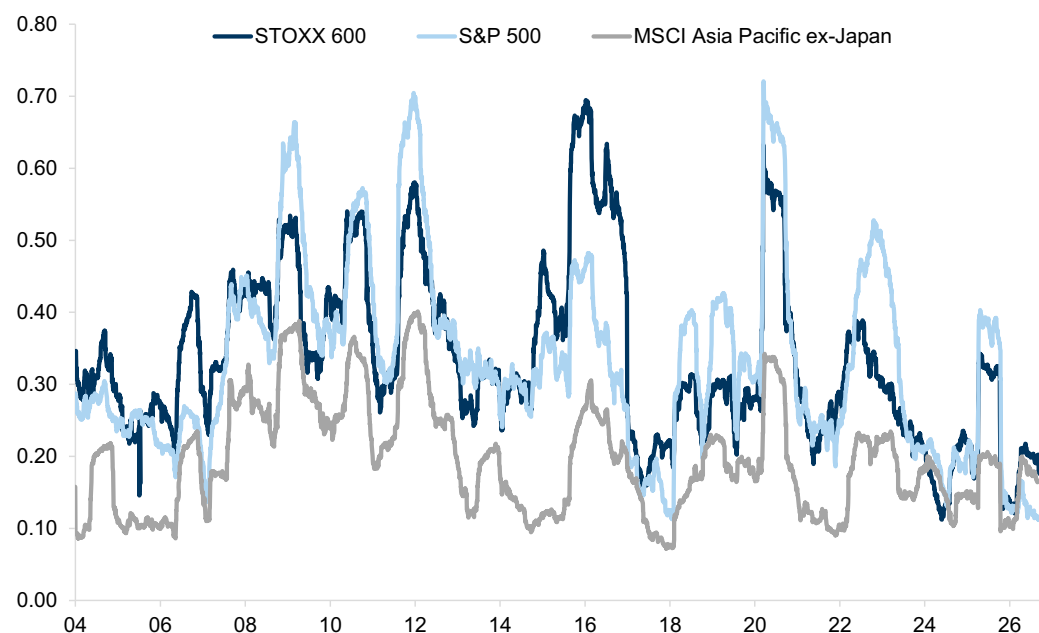
There are, however, important differences to the Tech sector today. The earnings of the banks were boosted by sharply rising leverage and the asset that they were financing – US real estate – did experience a valuation bubble. When the housing market collapsed, pushing economies into recession, it triggered a sharp fall in underlying earnings for the banking sector. There are important differences today. First, technology profits remain very robust, and balance sheets are strong overall. Second, interest coverage ratios for the aggregate S&P 500 and its median stock, for example, rank in the 99th and 68th percentiles relative to the past 20 years. Third, demand for compute is accelerating and outstripping supply; Microsoft recently declared their intent to triple data centre capacity in 6 years. The bottlenecks are increasingly power, land and data centre capacity rather than a lack of compute demand. At our annual [Communacopia Technology Conference](#), Nvidia reiterated its 2030 AI TAM outlook to \$3tn-\$4tn and supply constraints continue to be broad based. Nonetheless, any slowdown in profit growth, in an environment of a much higher cost of capital, could put downward pressure on equity prices, reducing confidence in future cash flows across the ecosystem from the hyperscalers to the ‘pick and shovels’ that have been benefiting from the capex boom.

10. Given the near-term risks in bond markets, we remain neutral on equities, alongside other asset classes on a 3-month horizon, but continue to be overweight equities over 12 months. While profit growth is likely to slow from the recent strong pace, ongoing growth in nominal GDP should underpin equity markets and the earnings cycle propelling equity returns even without any valuation expansion from current levels and our economists continue to see a low risk of recession. As our asset allocation team has shown, earnings growth and ROE are likely to continue to be the key drivers of equity performance relative to bonds, and we expect these fundamentals to remain supportive for equity returns. Nevertheless, we continue to recommend well diversified equity exposure as opportunities continue to broaden across geographies, sectors and factors.

Stock correlations are at multi-year lows across the major equity markets ([Exhibit 12](#)).

Exhibit 12: Pairwise correlation is low across regions

6-month average pairwise correlation

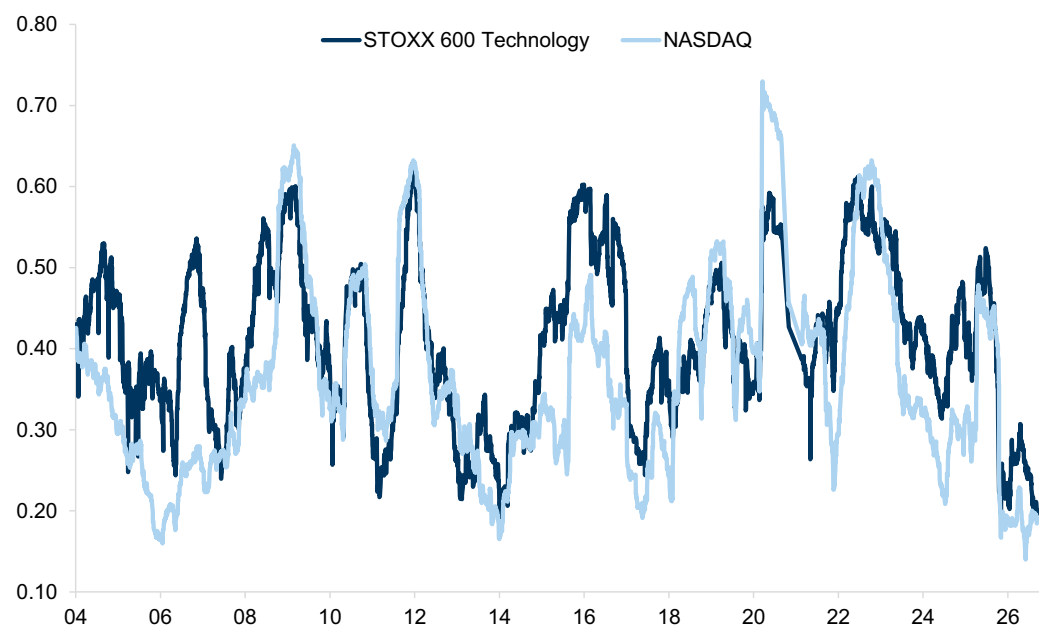


Source: Bloomberg, Goldman Sachs Global Investment Research

Even within sectors like technology, correlations have fallen sharply ([Exhibit 13](#)). The ‘magnificent seven’ that was long seen as a homogeneous group of technology winners has also seen significant dispersion of returns. Differentiation, diversification and alpha generation are likely to remain the key drivers of equity returns. With higher bond yields, valuations are not likely to rise making earnings the critical driver of returns for investors.

Exhibit 13: Correlations have fallen sharply within Technology

6-month average pairwise correlation



Source: Bloomberg, Goldman Sachs Global Investment Research

Disclosure Appendix

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