MARKETS

Goldman's M&A Bankers Shine, Traders Stumble as Malaysian Scandal Looms

The Wall Street firm's profit rises, stock responds by rising 9.5%, its best day in nearly a decade

Goldman's fourth-quarter revenue from underwriting of stocks, bonds and other securities fell 38% as choppy markets forced corporate executives to shelve offerings. **PHOTO:** RICHARD DREW/ASSOCIATED PRESS

By Liz Hoffman

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Goldman Sachs Group Inc.'s GS merger bankers bailed out its bond traders, who fared badly in late 2018's choppy markets and saw their bonuses shrink as a result.

Goldman's fourth-quarter profit of $2.54 billion, or $6.04 a share, rose from a year ago and easily beat the $1.64 billion, or $4.27 a share, predicted by Wall Street analysts. Quarterly revenue of $8.1 billion was flat, while full-year revenue was the highest since 2010.

The fallout from Goldman's dealings with a Malaysian investment fund known as 1MDB loomed over the generally strong results. The firm socked away an extra $500 million to help cover legal costs stemming from a U.S. Justice Department probe, and Chief Executive David Solomon acknowledged a "reputational dent that we'll work through."

Goldman shares -- the worst-performing among big banks last year -- rose 9.5% Wednesday for their best day in nearly a decade.

It was a warm welcome for Mr. Solomon, who took over as chief executive Oct. 1. He inherits a firm that is struggling to grow and is pinning its hopes on unproven initiatives like consumer banking, commercial payments and new trading technologies.

The financial costs of those ambitions were clear Wednesday. Technology spending cracked $1 billion for the first time, head count rose 9%, and marketing costs rose 26% to pay for television ads, branding and direct mail used to bring in new retail customers and burnish Goldman's Main Street image.

Offsetting those higher costs, Goldman's bonus pool shrank as a portion of revenue. "We know where our priorities lie," said Stephen Scherr, the company's chief financial officer. "If circumstances change, we know where there are levers to throttle back if we need to."

"It was a really treacherous quarter, and they navigated it fairly well," said Charles Lemonides, whose fund, ValueWorks LLC, bought about $10 million worth of Goldman shares as the stock price tumbled this past fall. "To have as difficult an environment as we saw and have a 12% return on equity shows you're doing something right on the cost side."

In Wednesday's earnings report, Goldman's merger bankers led the way. Their $1.2 billion in quarterly revenue was the highest since 2007, a year of megabuyouts that showered Wall Street with fees. Of the $1.3 trillion in deals its bankers advised on, about one-third were under $5 billion in value. Goldman has historically dominated megadeals but is now chasing smaller transactions, hiring more bankers and courting the thousands of companies owned by private-equity firms.

Another bright spot was Goldman's own portfolio of investments, which contributed nearly $1 billion in revenue. Despite falling stock prices during the quarter, Goldman's mostly-private collection of company stakes held up well, boosted by partial or outright sales of stakes in firms including Uber Technologies Inc., racetrack owner Centaur Gaming, and events-managing firm PSAV.

Fees from underwriting stocks, bonds and other securities fell sharply as corporate executives shelved offerings in the face of turbulent markets. Revenue in those businesses fell sharply across Wall Street firms, which are pinning their hopes on the long line of startups teed up to go public this year.

Goldman's traders extended their slump, struggling as much with the market's recent volatility as they did with the years of calm that preceded it.

Revenue in fixed-income, which trades bonds, commodities, currencies and other products, fell 18% from a year ago to $822 million, the lowest since 2008. Stock trading was up 17%. Nervous investors dumped shares rather than hedging their risk in synthetic ways, boosting cash trades but sapping demand for derivative products that make more money for the bank.

Debt trading was particularly weak, Goldman said. As interest rates rise, banks can get stuck holding bonds and loans that are worth less and out-of-favor with yield-hungry investors.

Goldman executives pulled tens of millions of dollars from the fixed-income division's bonus pool in the last week of the year, reflecting a particularly weak December, according to people familiar with the matter.

"Let me be direct," Mr. Solomon said. "We are fully cognizant of the reduction in industry wallet over the past decade and we will not be complacent waiting for the market to return." Goldman is shifting capital out of the trading division and into investment banking and its faster-growing consumer business.

After years of blaming weak trading revenues on calm markets and low interest rates, banks have fared no better amid the recent volatility and rate increases. The Federal Reserve raised interest rates four times in 2018.

David Solomon, Goldman's CEO, has been leading the firm's recent capital shift out of trading into investment banking and consumer businesses. **PHOTO:** LUCY NICHOLSON/REUTERS

Traders should, in theory, be able to capitalize on price moves. But if swings get too wild, nerves set in and they tend to pull back. Fixed-income trading -- a more risk-taking business than stock orders that can be routed to exchanges for a fee -- were down between 15% and 22% at JPMorgan Chase & Co., Citigroup Inc. and Bank of America Corp. Morgan Stanley, a smaller player in fixed-income trading, reports earnings on Thursday.

Goldman's asset-management unit, which manages money for institutional investors and wealthy individuals, posted record annual revenue of $7 billion. Dwarfed by giants such as BlackRock Inc. or Vanguard Group, the business has focused on high-touch service for big pension funds and governments, though it also offers a smattering of low-fee, passive funds.

Assets under supervision -- a measure that includes money investment in Goldman-branded funds as well as clients' money that the firm steers to competing products --were down slightly to $1.5 trillion as stock prices fell.

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