The Goldman Sachs Group (GS) Q1 2016 Results - Earnings Call Transcript

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Q1: 04-19-16 Earnings Summary

SEC *10-Q*

EPS of $2.68 beats by $0.18 | Revenue of $6.34B (-40.30% Y/Y) misses by $-185.46M

The Goldman Sachs Group, Inc. (NYSE:GS) Q1 2016 Earnings Call April 19, 2016 9:30 AM ET

Executives

Dane E. Holmes - Head-Investor Relations

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Analysts

Glenn Paul Schorr - Evercore ISI

Christian Bolu - Credit Suisse Securities (NYSE:USA) LLC (Broker)

Michael Roger Carrier - Bank of America Merrill Lynch

Matthew Derek O'Connor - Deutsche Bank Securities, Inc.

Mike Mayo - CLSA Americas LLC

Elizabeth Lynn Graseck - Morgan Stanley & Co. LLC

Guy Moszkowski - Autonomous Research US LP

Kian Abouhossein - JPMorgan Securities Plc

James F. Mitchell - The Buckingham Research Group, Inc.

Brennan McHugh Hawken - UBS Securities LLC

Steven J. Chubak - Nomura Securities International, Inc.

Matthew Hart Burnell - Wells Fargo Securities LLC

Eric Wasserstrom - Guggenheim Securities LLC

Devin P. Ryan - JMP Securities LLC

Brian Kleinhanzl - Keefe, Bruyette & Woods, Inc.

Richard Bove - Rafferty Capital Markets, LLC

Marty Mosby - Vining Sparks IBG LP

Operator

Good morning. My name is Dennis, and I will be your conference facilitator today. I would like to welcome everyone to the Goldman Sachs First Quarter 2016 Earnings Conference Call.

This call is being recorded today, April 19, 2016.

Thank you. Mr. Holmes, you may begin your conference.

Dane E. Holmes - Head-Investor Relations

Good morning. This is Dane Holmes, Head of Investor Relations at Goldman Sachs. Welcome to our first quarter earnings conference call.

Today's call may include forward-looking statements. These statements represent the firm's belief regarding future events that, by their nature are uncertain and outside of the firm's control. The firm's actual results and financial conditions may differ possibly materially from what is indicated in those forward-looking statements. For a discussion of some of the risks and factors that could affect the firm's future results, please see the description of Risk Factors in our current annual report on Form 10-K for the year ended December 2015.

I would also direct you to read the forward-looking disclaimers in our quarterly earnings release, particularly as it relates to our Investment Banking transaction backlog, capital ratios, risk-weighted assets, global core liquid assets and supplementary leverage ratio. You should also read the information on the calculation of non-GAAP financial measures that's posted on the Investor Relations portion of our website at www.gs.com.

Our Chief Financial Officer, Harvey Schwartz, will now review the firm's results. Harvey?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Thanks, Dane, and thanks to everyone for dialing in. I'll walk you through the first quarter results and I'm happy to answer any questions.

Net revenues were $6.3 billion; net earnings, $1.1 billion, and earnings per diluted share, $2.68. Net earnings to common included a $161 million benefit related to the successful tender of our APEX securities. The tender added $0.36 per diluted share.

The first quarter of 2016 was challenging. It started with renewed uncertainty about the global economic outlook, with the possibility of a recession even being raised. These concerns included growth prospects from China, plummeting oil prices, a strengthening U.S. dollar, and multiple geopolitical events, to name a few. All these came into focus during an eventful first quarter.

These concerns translated into significant price pressure at the beginning of the quarter across both equity and fixed income markets. The Dow declined by 6% in the first week. This is the worst start in its nearly 90-year history. The index ultimately reached its low point in mid-February, declining 10%. Equity markets in other geographies endured even more material declines during the quarter, with the Shanghai down as much as 25% and the Nikkei down as much as 21%. Credit spreads also widened significantly intra-quarter, particularly for high yield and energy-related issuers.

Global Central Bank activity was front and center again during the quarter. After raising rates in December for the first time in more than nine years, the market heavily debated the Federal Reserve's future actions. In the eurozone, the European Central Bank took additional stimulus measures well beyond what was initially expected by the market. And finally, the Bank of Japan moved interest rates into negative territory.

With all these factors at work, it isn't surprising that it resulted in a difficult operating environment for our clients and, by extension, constrained opportunities in each of our business segments. Within Investment Banking, for example, industry-wide equity underwriting volumes declined by 57% year-over-year.

Performance was challenged for many of our ICS clients. For example, nearly 80% of the largest active U.S. equity mutual funds underperformed their benchmarks in the quarter. As you would expect with markets flat-to-down worldwide, our equity investing business was negatively impacted. And finally, incentive fees declined during the quarter due to limited harvesting opportunities.

With that as a backdrop, let's now discuss individual business performance in greater detail. Investment Banking produced first quarter net revenues of $1.5 billion, 5% lower than the fourth quarter as we saw lower client activity across M&A and equity underwriting. Our Investment Banking backlog decreased since the end of the year but is still up relative to a year ago.

Breaking down the components of Investment Banking in the first quarter, Advisory revenues were $771 million. 12% decline relative to the fourth quarter reflects a decrease in the number of completed M&A transactions. Year-to-date, Goldman Sachs ranked first in worldwide announced M&A.

We advised on a number of important transactions that were announced during the first quarter, including Syngenta's $43.6 billion cash tender offer from ChemChina; Valspar's $11.3 billion acquisition by Sherwin-Williams; and ADT's $12 billion acquisition by Apollo.

We also advised on a number of significant transactions that closed during the first quarter, including BG Group's £47 billion acquisition by Royal Dutch Shell; BT Group's£12.5 billion acquisition of EE Limited; and PETCO Animal Supplies' $4.6 billion sale to a consortium of investors.

Moving to Underwriting, net revenues were $692 million in the first quarter, up 4% sequentially as a pickup in debt underwriting more than offset a slowdown in equity issuance. Equity underwriting revenues were $183 million. This was down significantly compared to the fourth quarter due to a decrease in offerings industry-wide. Debt underwriting revenues were up 16% to $509 million and benefited from strong investment-grade issuance.

During the first quarter, we actively supported our clients' financing needs, participating in Newell Rubbermaid's $8 billion financing to support its acquisition of Jarden, Vista's $4 billion loan and bond offering to support its acquisition of Solera, and Devon Energy's $1.5 billion follow-on offering.

Turning to Institutional Client Services, which comprises both our FICC and Equities businesses, net revenues were $3.4 billion in the first quarter, up 20% compared to the fourth quarter. In the quarter, we early-adopted the new accounting standard for DVA, which is now captured in other comprehensive income. DVA for the current quarter was immaterial. FICC Client Execution net revenues were $1.7 billion in the first quarter, up 48% sequentially, as client activity improved in many businesses from weak fourth quarter levels.

As I mentioned, the operating environment across the FICC complex was quite difficult due to macro uncertainty and volatile markets. This led to a challenging backdrop for our clients with weak investment performance and drove difficult market-making conditions for the firm. The environment in the first quarter of 2016 stands in stark contrast to the environment in the first quarter of last year. Consequently, there was a substantial downward revenue pressure year-over-year.

Interest rates and currencies were significantly lower. Client activity and interest rates held up relatively well. However, activity within currencies declined compared to a strong first quarter of last year.

Credit also decreased significantly as market conditions remained difficult, particularly in Europe. Commodities was weaker as client activity was muted with energy prices remaining low. Mortgages continue to be challenged as spreads widened for some products and client activity remained low.

In Equities, which includes equities client execution, commissions and fees, and security services, net revenues for the first quarter were $1.8 billion, up 1% sequentially. First quarter results in Equities were roughly consistent with the back half of last year but significantly weaker compared to a robust performance in the first quarter of 2015. Net revenues declined 23% year-over-year and reflected the impact of a challenging environment for our clients and the firm.

Equities client execution net revenues of $470 million were down significantly year-over-year. Higher volatility and global equity market weakness at the beginning of the quarter impacted investor conviction and risk appetite.

Commissions and fees were $878 million, up 9% year-over-year as client activity increased in our lower touch electronic channels. Security services generated net revenues of $432 million, up 10% year-over-year on improved spreads.

Turning to risk, average daily VaR in the first quarter was $72 million, up slightly from $71 million in the fourth quarter.

Moving on to our Investing & Lending activities, collectively, these businesses produced net revenues of $87 million in the first quarter. In equity securities, markdowns on public investments entirely offset net revenues in private investments. Net revenues from debt securities and loans were $87 million. Revenues were driven by net interest income. This was partially offset by increased provisions on our corporate energy exposures.

In Investment Management, we reported first quarter net revenues of $1.3 billion. This was down 13% from the fourth quarter, primarily as a result of lower incentive fees and management and other fees. During the quarter, management and other fees were down 6% sequentially to $1.2 billion due to a change in the mix of client assets and strategies.

Assets under supervision increased $35 billion sequentially to a record $1.29 trillion, primarily due to net inflows into liquidity and long-term fee-based products. We had $16 billion of net inflows into liquidity products, $10 billion of long-term net inflows, primarily driven by fixed income and equity products, and $9 billion of market appreciation.

Now let me turn to expenses. Compensation and benefits expense, which includes salaries, bonuses, amortization of prior-year equity awards and other items such as benefits, declined by 40% versus the first quarter of 2015. The significant reduction in compensation and benefits expense reflects the more challenging revenue environment and translated into a compensation to net revenues ratio of 42%.

First quarter non-compensation expenses were $2.1 billion, significantly lower than the fourth quarter and 6% lower than the first quarter of 2015. This is the lowest quarterly level since the second quarter of 2009.

Now I'd like to take you through a few key statistics for the first quarter. Total staff was approximately 36,500, down 1% from year-end 2015. Our effective tax rate for the first quarter was 28%. Our global core liquid assets ended the first quarter at $196 billion and our balance sheet and level 3 assets were $878 billion and $24 billion, respectively. Our Common Equity Tier 1 ratio was 12.2% under the Basel III Advanced approach. It was 13.4% using the Standardized approach. Our supplementary leverage ratio finished at 6%. And finally, we repurchased 10 million shares of common stock for $1.55 billion in the quarter.

In conclusion, the first quarter was obviously a difficult period for our clients, the markets and our opportunity set. While clearly we don't control the opportunity set, we proactively took action in key areas that we do control: our cost structure and our capital. In addition, this is the first quarter in a while that we faced significant headwinds across each of our business segments. Given that we operate in a cyclical industry, it shouldn't be surprising that there will be difficult quarters.

That being said, we don't create deep client relationships in a quarter, we don't hire our people for a quarter, and we certainly don't build businesses for a quarter. Our success has been predicated on having a strong culture that promotes both a long-term perspective, while simultaneously being very focused on managing to the current environment. That long-term focus has been the foundation for building a leading global investment bank and creating superior results for our shareholders.

As we look forward, we are committed to remaining nimble and efficient operators, disciplined capital allocators and prudent risk managers. Our commitment to these principles has been and will continue to be the basis for our performance over time.

Thanks again for dialing in, and I'm happy to answer your questions.

Question-and-Answer Session

Operator

Please limit yourself to one question and to one follow-up question. Your first question is from the line of Glenn Schorr with Evercore ISI. Please go ahead.

Glenn Paul Schorr - Evercore ISI

Hi. Thanks very much.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Hey, good morning, Glenn.

Glenn Paul Schorr - Evercore ISI

Good morning. Maybe we could talk about Fixed Income first. I'm just looking big picture. Revenue is a little more than half the big banks and that was obviously not always the case. I'm just curious, are there specific things about your business mix and client mix that doesn't compare as much versus the past in activity levels, things like credit being real slow right now? And if you feel like any of the balance sheet reductions or Volcker implementation has impacted the forward earnings power?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Obviously, I don't have great transparency into the competitors' footprints. I don't think that any of the things you mentioned, sort of the balance sheet actions we've taken because they've been very surgical – although meaningful they've been very surgical over time and very thoughtfully executed. I don't think those are issues and, obviously, all firms have adjusted to Volcker. So, I don't think those are drivers. I think when you look at the year-over-year, obviously, we had a very strong first quarter 2015 relative to the peer set. And I know revenue is the most transparent benchmark you have. But when you look at the performance in the first quarter, obviously we outperformed in the first quarter of last year and obviously much more challenging for us this quarter.

Glenn Paul Schorr - Evercore ISI

Yeah, totally fair. Okay. Maybe if we switch over to Investing & Lending. I want to focus on the equity side specifically. In some markets, you had the markets go down and then come back. Asia didn't snap back. So, I wonder if you could talk about the contribution of that in the quarter. And then, more importantly, for the equity dynamic going forward, like maybe size the portfolio fair value versus cost basis, see if there are any marks in the quarter that, knock on wood don't repeat next quarter? And then just see if you can update us on what's left to sell down to get compliant?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

So, okay, that's a multipart question. So if I miss anything, get back.

Glenn Paul Schorr - Evercore ISI

All right.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

No, it's fine. So in terms of the I&L balance sheet, let's just start there. The I&L balance sheet is $99 billion. Of that, in terms of – you spoke about equity, roughly $15 billion of that is corporate equity. In terms of the equity line, both private and public, basically the public portfolio was down roughly $140 million during the quarter and that was offset by private marks. Of those marks that were positive, they were virtually all event-related. And you remember, that's the language you use, Glenn, to describe the fact that there's a sale or a refinancing and then there were negative marks in the portfolio obviously also. So that's really the structure in terms of the course of the quarter. In terms of Volcker, because I think you're asking about the equity funds?

Glenn Paul Schorr - Evercore ISI

Yes. Correct.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

So, in terms of Volcker, basically if we start at the top of, let's just say the waterfall, there's $7.5 billion in covered funds. You then have to take out approved Volcker activities. Then you take out the public money. And the way we've asked you to look at it is there's roughly $4.5 billion remaining. And that money obviously sits alongside our clients in these funds. Is there anything else you asked that I missed?

Glenn Paul Schorr - Evercore ISI

No, that's perfect. Thank you.

Operator

Your next question is from the line of Christian Bolu with Credit Suisse. Please go ahead.

Christian Bolu - Credit Suisse Securities (USA) LLC (Broker)

Good morning, Harvey.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Morning, Christian.

Christian Bolu - Credit Suisse Securities (USA) LLC (Broker)

So you mentioned a mix shift in asset management impacting revenues. Can you give a bit more color on this and if you expect it to reverse going forward?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

So quarter-to-quarter and year-over-year as we work through, obviously, there are various client segments we work with, whether they're retail clients, private wealth, also institutional clients. And what we're really seeing is a mix shift more to institutional mandates during the period. That had an impact. I think longer term, obviously, I can't predict the longer term. We're looking to basically provide service to all those clients as best we can through long, long cycles. But you're seeing obviously the positive inflows which are quite good. So if you ask me to think of the future, I would point more to the flows than the asset mix.

Christian Bolu - Credit Suisse Securities (USA) LLC (Broker)

Okay, thank you. And then on the GE deposits that you got in, just curious how we should think about what kind of economics you can earn on that and any time line for deployment?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

So the transaction closed on Friday. It went quite smoothly. We're up and running under the GS moniker. I would encourage you to think of this really as we've described it, which is, this is all part of our funding diversification. In that sense, we always, as you know, look to have a diversified funding base. This is just an extra toolkit for us in the financing and so we'll view it over time. But in terms of driving revenues, it's really part of our liability management strategy.

Christian Bolu - Credit Suisse Securities (USA) LLC (Broker)

Okay, helpful. And then a very quick modeling question for me. Tax rate was a bit lower in the quarter. Just curious how we should think about the go-forward tax rate?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Yeah. So in terms of the go-forward, I guess if I was to give you a best estimate, I'd say something similar to last year.

Christian Bolu - Credit Suisse Securities (USA) LLC (Broker)

Okay, great. Thank you very much, Harvey.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Thanks, Christian.

Operator

Your next question is from the line of Michael Carrier with Bank of America Merrill Lynch. Please go ahead.

Michael Roger Carrier - Bank of America Merrill Lynch

Hi. Thanks a lot.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Hey, Mike.

Michael Roger Carrier - Bank of America Merrill Lynch

Hi. Harvey, maybe first just on the revenue backdrop, I just wanted to get your sense when you look at the January/February trends versus, say, March/April, maybe areas where you're starting to the see some improving trends. I know in any given quarter it's kind of tough on, I think, the market share standpoint, but I feel like when revenues are weak you can't really tell market share and then when revenues rebound, you can figure out who gained and who lost. But just given some of the competitive dynamics, just wanted to get a sense if you're starting to see any of that in terms of the market share?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

So, I just want to make sure understand – I answer your question completely. In terms of the quarter, the way I would describe it is March was better than February and February was better than January. It's early in April, so it's obviously pretty early in the quarter, but I would say that it really feels like many of the factors that were impacting the market in the first quarter, particularly early on, seem to have abated and although the market feels a little fragile from all that, it feels like – for the most part, that feels like that's behind us. But we'll see how the year progresses.

In terms of the longer-term observation around the competitive dynamic, again, in a quarter like this, hard to see it when our clients are experiencing such volatility and such stress, but I think based on announcements and parts of the business where we're seeing client flows move, engagement with clients is quite good and we're getting good feedback. So I think a quarter like we just had actually only makes the competitor forward look better, but we'll see.

Michael Roger Carrier - Bank of America Merrill Lynch

Okay, that's helpful. And then just on, I guess, I&L and Investment Management, obviously I&L had some pressure and then Investment Management, just like the performance fees were weaker than expected. When you look at what has happened through the quarter and the rebound in the markets, I'm trying to just gauge on the parts of the business that are as simple as markets are up and so you should start to see some improving trends versus maybe on like the I&L, you mentioned the provision on the debt side. So how significant or how much follow through are we going to see that could maybe weigh on that part of the business? And same thing on the incentive fees or the performance fees in Investment Management. I don't know if there's a way to gauge the types of products that generate the performance fees, how much are absolute versus relative or what products are below hurdles?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Yes, so as it relates to I&L, just to level set everyone, obviously we created that disclosure to provide more transparency, and that is, as you described it, the most price-sensitive asset parts of the balance sheet. And so that's why I provide it that way. So, as I mentioned, for example, there are parts of the portfolio, as you know, that are public equity securities where, again, we may sit alongside our clients. As those are monetized out of a fund, there are restrictions and lockup periods. And so that portfolio, as I mentioned, was negative roughly $140 million during the course of the quarter.

And so there will be some element idiosyncratic movement. Sometimes that portfolio will outperform. When you look at history, it has generally outperformed. Even if you take the last eight quarters including this quarter, the entire I&L segment has generated $11 billion in revenues. In terms of incentive fees, it's going to be specific, obviously, to performance, which has been solid, but obviously markets are going to have an influence on incentive fees also.

Michael Roger Carrier - Bank of America Merrill Lynch

Okay. Thanks a lot.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Thank you.

Operator

Your next question is from the line of Matt O'Connor with Deutsche Bank. Please go ahead.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Morning, Matt.

Matthew Derek O'Connor - Deutsche Bank Securities, Inc.

Can you hear me?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Matt, are you there?

Matthew Derek O'Connor - Deutsche Bank Securities, Inc.

Yep. Can you hear me?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Yeah. We can hear you now.

Matthew Derek O'Connor - Deutsche Bank Securities, Inc.

Okay. Sorry about that. Just a big picture question. Can you just talk a bit about the disconnect between the markets, the improvement that we're seeing there and what still feels like sluggish client activity, maybe better than January/February, but here's the S&P up a couple percent year-to-date, credit spreads have tightened. I guess the question is, like, is it a timing issue where we need more stability for activity to pick up in a bigger way, or is it the underlying economy's not strong enough? Just any big picture thoughts you have on that disconnect?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

So something that I think you're certainly seeing a pickup – if you look at IPOs, I think there were something in the first couple weeks of April approaching 40 IPOs during the first couple weeks. So certainly elements of the marketplace which obviously slowed down very specifically. But I think after a tough first quarter like the whole market has experienced, I think that there may be a slow reaction function in terms of how various market participants engage the marketplace. But it feels like, as I said before, the most significant factors impacting the first quarter seem to have abated, at least for now.

Matthew Derek O'Connor - Deutsche Bank Securities, Inc.

Okay. And then just kind of on an incremental basis, like where do you feel like the engagement – you mentioned the IPOs picking up, but I guess a timeline? Usually you see trading pick up first and then M&A tends to lag, or what do you think we see beyond IPOs in terms of areas that start to pick up first, assuming we get a pickup in activity?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

I think generally I would agree with your statement over very long periods of time, but I think in terms of the M&A cycle that we're in now, while off a little bit from the levels of 2015, the level of dialogue there feels quite good. As I mentioned, our backlog across advisory, equity and debt is up year-over-year after a strong year. So the dialogue and level of engagement feels quite good at this stage. Certainly there was an element to the first quarter which had a bit of a chilling effect for a period, but right now the dialogue feels good. We'll see how it goes in the future.

Matthew Derek O'Connor - Deutsche Bank Securities, Inc.

Okay. And then just separately on expenses, obviously good cost control in a tough revenue quarter. You did mention about continuing to manage to a difficult revenue environment if that continues, but maybe just expand on that? We've seen some things in the media about further cost cuts coming. So, anything you can elaborate on the cost side would be helpful.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

So obviously we're – look, we always have our eye on ways we can look to operate more efficiently. We've talked about it a lot, that this is a performance-driven culture, and the performance wasn't great in the first quarter and as a result you saw compensation and benefits expense down 40% year-over-year. Again, that's our culture, and so you're going to see those adjustments.

In terms of other cost initiatives, I know there's been a lot of stuff in the press. I guess I would really summarize it as follows. I would just say we're shareholders and we're doing things that you would expect shareholders to do.

Matthew Derek O'Connor - Deutsche Bank Securities, Inc.

Okay. All right. Fair enough. Thank you.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Thanks.

Operator

Your next question is from the line of Mike Mayo with CLSA. Please go ahead.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Good morning, Mike.

Mike Mayo - CLSA Americas LLC

Hi. The CEO letter talks about secular changes versus cyclical changes and you guys have been steadfast saying that the markets are simply in a cyclical lull, they'll recover. They haven't recovered but you've kept your infrastructure. So at what point do you say maybe these cyclical lulls are more permanent and you need to take more dramatic actions? And it looks like year-over-year your trading is the worst among the five big U.S. wholesale banks.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

So I think I just want to clarify one thing. Because I think one of the messages that maybe gets mistranslated as it comes across is – and let's just pick FICC, because I think that's really what you're talking about when you talk about trading. We have expressed a commitment to FICC. What we mean by that, very explicitly, is we're committed to our clients and we're committed to providing superior returns over the cycle. Commitment does not mean inaction, and I think that's what gets a little bit confused in this message. And actually, as far as I can tell, Mike, all of our U.S. peers, they're committed to FICC, too.

But back to Goldman Sachs for a second. If you think about the things we've done over the last couple of years, since the middle of 2013 we've taken the ICS balance sheet down 25% and FICC RWAs, market and credit down 30%. On the cost side – we've been very focused on the capital side, and on the cost side since the beginning of 2012, we've taken

FICC related head count down 10, and we've taken compensation down by more than 20%. So, I wouldn't say that there's been any inaction. However, I would reiterate that we've been quite committed to our clients and committed to the return.

Now, look, this has been, and I admit it, because I agree with you, Mike, this has been a tough period and this has been a long cycle. But we have a long history of managing our business across the cycle. In 2009, we didn't overinvest in the top, and we're going to be thoughtful about not underinvesting but we are certainly responding to the last several years of decline in (30:04) revenue.

Mike Mayo - CLSA Americas LLC

I guess, as a follow-up, I mean, what else can you do? You've danced pretty well the last three to four years without revenue growth, but it seems like you're getting to the end of what you can do and your return on equity is now in the single-digit range, and I think consensus has it in the single-digit range for the year. I know you would not want to see that. So what are your other options?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Well, look. I think you're right to point out that for four years running we are one of the very small handful of firms that have had double-digit ROEs. This is a quarter, I certainly wouldn't sit here and tell you, we are happy about this quarter, but we will do what it takes over time to make sure that we deliver for our clients and maximize the returns for our shareholders in a prudent way. So we are quite focused.

Mike Mayo - CLSA Americas LLC

All right. Thank you.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Thanks, Mike.

Operator

Your next question is from the line of Betsy Graseck with Morgan Stanley. Please go ahead.

Elizabeth Lynn Graseck - Morgan Stanley & Co. LLC

Hi. Good morning.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Good morning, Betsy.

Elizabeth Lynn Graseck - Morgan Stanley & Co. LLC

Couple of questions on the fixed income line or the debt line on the I&L?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Yeah.

Elizabeth Lynn Graseck - Morgan Stanley & Co. LLC

So, typically I think the NII is around $225 million quarter, and I know you posted $87 million, and you indicated the delta is largely due to energy. I'm just wondering, should I take that to mean that the reserve, or the provision, or the mark-to-market in energy was around $138 million or is there more there?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

So the NII was roughly $240 million and then the offset within provisions, and the majority the offset, about two thirds was in energy related.

Elizabeth Lynn Graseck - Morgan Stanley & Co. LLC

Okay. So that feels like it would probably double the reserve ratio that you had posted last quarter. Is that – it would more than double it. Is that a reasonable assumption? Or maybe you could talk us through how you're thinking about them?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

No, it is not. When you actually look at it – I think the best way to look at this is with the funded portion of the non-investment grade portion of the energy portfolio. It was high-single digits last quarter, and it remains high-single digits.

Elizabeth Lynn Graseck - Morgan Stanley & Co. LLC

Okay. And that's because you either used some of the provision to – you wrote off some of your exposure? Is that accurate or...

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Well, the exposure – why don't I just walk you through it?

Elizabeth Lynn Graseck - Morgan Stanley & Co. LLC

Sure.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

So – yeah. So in the oil and gas sector, this period, including funded, unfunded, investment-grade and non-investment grade was $10.7 billion. That's up from $10.6 billion in the fourth quarter. Now let's just focus on non-investment grade. Non-investment grade is $5 billion. That's up from $4.2 billion. In part, obviously that's driven up by ratings downgrades and actions by the ratings agencies during the course of the quarter, and the funded portion of that is $1.6 billion, and that was up about $100 million. So you can kind of matrix back through all that, and you can see the shift in the portfolio was a result of the ratings agencies.

Elizabeth Lynn Graseck - Morgan Stanley & Co. LLC

Got it. And then just ticky-tacky, is the fully phased in for the capital ratios, the CET1, the SLR?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

So on the fully phased-in ratios, they are flat quarter-over-quarter, advanced is a 11.7%, and standardized is 12.9%.

Elizabeth Lynn Graseck - Morgan Stanley & Co. LLC

Okay. Great. All right. Thank you.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Thank you, Betsy.

Operator

Your next question is from the line of Guy Moszkowski with Autonomous. Please go ahead.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Hey, Guy.

Guy Moszkowski - Autonomous Research US LP

Hey, good morning. So I'm going to ask a question that's really going to drill down on one that came a couple of minutes ago on the degree of commitment to FICC in particular. Goldman is obviously a leader in applying technology to traditional voice trading businesses and other things, and you've been pretty vocal in the past about how you transformed equities, and foreign exchange, and cut head count while picking up market share and the process. It seems like FICC has really reached a tipping point recently because of regulatory change and what's going on in the markets and yet the digitization process is maybe trickier in FICC. And, so I was hoping you could give us some color on how much transformation do you expect in the capital structure and the expense structure of fixed income for your business?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Well, first and foremost I'd say the thing that drive the strategy is not digitization in and of itself, it's how we engage our clients. You're right to point out that the equity business went through a pretty significant evolution. While that evolution in historical perspective feels short, it was a multiyear process that really began in 1999 and it finished in the mid 2000s and continues to evolve. I don't know necessarily that I would agree with that we're at a tipping point. It's all about opinions. But it feels like we're in an evolution where obviously clients are looking for efficiencies and we're looking for efficiencies, but the reality is that a vast majority of the fixed income market is more bespoke; it won't lend itself to that. But to the extent to which we can deliver to our clients and drive efficiencies, we're obviously very focused on it.

Guy Moszkowski - Autonomous Research US LP

So, is it right though, for us to think that there is going to be a significant transformation in the cost structure and the capital structure that you apply to FICC over the next couple of years? Or would that be too dramatic?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Well I think, look, you've seen some of the evolutionary steps we've taken in terms of the balance sheet reductions and the risk-weighted assets that I talked about earlier. It may be the case that over periods of time, depending on how much client activity there is, but the extent to which it shifts to electronic channels like we've seen under the regulatory framework for swap execution facilities, those transitions happen very, very quickly, and we adjust very, very quickly.

Guy Moszkowski - Autonomous Research US LP

Okay. That's helpful in terms of perspective. Thank you very much.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Sure. Thank you.

Operator

Your next question is from the line of Kian Abouhossein with JPMorgan. Please go ahead.

Kian Abouhossein - JPMorgan Securities Plc

Yeah. Morning, Harvey.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Good morning, Kian.

Kian Abouhossein - JPMorgan Securities Plc

Just wondering on market share movements, how you see that progressing, considering we have clear strategies of reduction of some of the European IBs as well as Nomura now. How do you see that coming through in your numbers? Do you see that at this point? And how you position to take part of these market share gains as others are retrenching?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

So, as you and I talked about over the last couple of years, I don't think we would have imagined a couple of years ago that the industry would be in a position where three of the largest firms were going through a change in leadership and what appears to be a very, very significant change in strategy. That change in strategy is different for all of them, some of them it's geographically driven, some so far, some of it is pulling resources back from certain businesses like derivatives.

To us, it feels like the feedback is quite good. Obviously difficult to see that in a really tough first quarter, but I would say on the ground, the feedback is good and it continues to improve our position. With respect to how we're positioned, I think we feel tremendously well positioned given our footprint.

Kian Abouhossein - JPMorgan Securities Plc

Okay. And in respect to your fixed income business, looking at your VaR in commodities, it declined a lot year on year, although volatility must have gone up in the commodity space. I'm just wondering it looks to me there's been a proactive reduction overall in the first quarter. Do I understand that correctly? And did that have an impact on your revenue impact in FY 2016? Just trying to put the picture together.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Yeah. So, as I spoke about in the early remarks, commodities were down year-over-year, that really – the VaR reductions you're really seeing are more reflection of the environment. While there was volatility during the course of the period, obviously in commodities, client flows were pretty muted as people really were a bit taken back, I wouldn't say in shock, but a bit taken back by the depressed energy prices and the movement down. It didn't translate into lots of activity during the course of the quarter.

Kian Abouhossein - JPMorgan Securities Plc

And if I may, just follow-up on that, do you see an improvement through March and April, both in liquidity terms and in terms of a client activity in the space?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Yeah. As I said before, March was better than February and February was certainly better than January. So I would say that's been the general trend. As I said before, the factors that really were impacting the market so severely in the first quarter, at least for now, they seem to have abated.

Kian Abouhossein - JPMorgan Securities Plc

Thank you.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Thank you.

Operator

Your next question is from the line of James Mitchell with Buckingham Research. Please go ahead.

James F. Mitchell - The Buckingham Research Group, Inc.

Hey, good morning.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Good morning.

James F. Mitchell - The Buckingham Research Group, Inc.

Just wanted to – I hate to beat a dead horse, but maybe just talk about FICC a little bit, maybe just more strategically? With regulators sort of turning their eyes to the buy-side and potentially cracking down on leverage and forcing more liquidity, do you worry that that just sort of postpones any cyclical recovery in the investor class trading? And then I guess as I corollary to that, could you – is it possible to sort of pivot towards more the plain vanilla flow businesses that are – corporate-driven flow businesses that the big universal banks seem to be benefiting from in terms of stability? Is there opportunities set there to kind of crack their market share on those businesses?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Yeah. So I would say with respect to the liquidity dynamic, if I had to rank factors and it's very hard to quantify these things, I would say factors like conviction around the markets because of the sharp decline in the oil price and obviously the negative interest rate environment and the big shift to, as you said, the buy-side holding lots of assets, I think those are as significant a driver in the current environment as is regulation, given that banks are holding less inventory globally. I think that underpinning all of that is that when you look at the client base, regardless of how much velocity may be in their current trading activities quarter-to-quarter, the core needs in terms of their need for liquidity and our desire to provide it, that remains. So I think the core of it is the same.

James F. Mitchell - The Buckingham Research Group, Inc.

Okay. And do you see any value in trying to sort of capture more market share in the corporate-driven flow business?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

The extent to which we can – sorry, I didn't mean to ignore the last part of your question.

James F. Mitchell - The Buckingham Research Group, Inc.

Yeah.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

I think you're right to say that, obviously, the big universal banks, they're two or three times our size, they have a much bigger lending profile and a bigger retail commitment. So they will naturally participate in some flows that, given their size, we won't participate in. But the value is really in servicing the client and so the extent to which we can provide value to a client, obviously, we want to make sure we're doing that.

James F. Mitchell - The Buckingham Research Group, Inc.

Okay, that's helpful. And just maybe just one quick question on M&A activity and capital restructurings in the energy space, it's been a hot topic of whether we see some significant pickup in activity in that space as prices stabilize. Are you seeing that? Are you seeing sort of conversations and potential activity pickup there that we could see later in the year?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

So we saw, obviously, to the extent to which there were financings in the first quarter, they're obviously energy-related financing activity and we were very involved in that. I would say that, look, the space has been under extreme stress which emerged over a fairly short period of time, measured more in months than years, and so I think our expectation that there will be active dialogue across the industry. Whether or not that manifests itself immediately in the near term, we'll have to see, but obviously the industry is going through quite a bit in this price environment.

James F. Mitchell - The Buckingham Research Group, Inc.

Okay, great. Thanks for your help.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Thanks.

Operator

Your next question is from the line of Brennan Hawken with UBS. Please go ahead.

Brennan McHugh Hawken - UBS Securities LLC

Good morning. Just a couple quick ones. On trading broadly, thinking about the importance of hedge funds to your trading business, should we temper our expectations for a bounce back here in your revenues, even if we see some market improvement, given the pressure that that client base has experienced this year?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Yeah. So, look, we think of all of our clients as important, but obviously, we've had a big commitment to the hedge fund industry across equities and fixed them for a long time. We're always rooting for their performance, and so to the extent to which they have improved performance, it may be a catalyst for increased activity. Because in periods like we went through in the first quarter, obviously, they have a tendency to derisk and it reduces trading velocity over many months, although it may be, for example, an active day from time to time. But I think sentiment seems to be improving, but we're going to have to say, as I said before, it's still a little fragile.

Brennan McHugh Hawken - UBS Securities LLC

Okay, okay, thanks. And then just one more follow-up on the backlog. Could you maybe help us out a little bit on, number one, how we could see – I think you indicated in the press release that sequentially down quarter-over-quarter on the backlog. But I would have guessed that there might have been maybe some extension from 1Q into 2Q, so could you maybe help me understand that? And then also if you can give any color on some of the deal funding markets and high yield markets and whether there's been some healing and improvement in the backlogs there, given how stressed they were in 1Q? Thanks.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Sure. So, as I mentioned, the backlog was down sequentially, but it's up year-over-year. When you look across the business, the advisory portion of backlog was down versus very strong level at the end of the year, but that's up year-over-year. Versus the end of the year, as we would imagine, given what happened in the equity markets, the equity backlog is up and obviously we had a bit of an outperformance, it looks like, versus the rest of the industry on debt underwriting, and that's down sequentially. In terms of the high yield markets, over the last couple of weeks, still a bit selective, but they seem quite strong, one of the largest transactions was done just last week and so the markets are quite receptive to good solid transactions. Are you there, Brennan?

Brennan McHugh Hawken - UBS Securities LLC

Oh yeah. Yeah. Sorry. Thanks. Appreciate it.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

No problem.

Operator

Your next question is from the line of Steven Chubak with Nomura. Please go ahead.

Steven J. Chubak - Nomura Securities International, Inc.

Hi. Good morning.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Good morning, Steven.

Steven J. Chubak - Nomura Securities International, Inc.

So, Harvey, I appreciated the color that you've given on some of the factors that were impacting market liquidity, and I know that one of the Fed Governors had recently spoken on the topic and suggested that that reduction in liquidity is a cost worth paying for to help the overall financial system. And given the regulators' willingness to sacrifice that liquidity to ensure improved safety and soundness, I'm just wondering how that informs your strategy on balance sheet and inventory management? Have you considered the fact that there might not be any relief on the regulatory side in the context of your longer-term strategy for the business?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

So I think – look, you have to give the regulators a lot of credit over the last several years for making – and I'll focus more on the U.S. financial system, including things like CCAR. I think that the safety and soundness of the large U.S. banks and the whole system, they deserve a lot of credit for driving some of that. Obviously, we made a lot of changes to our balance sheet even prior to the regulations, but I think you have to give them a lot of credit for it. I think that all these good benefits which we all benefit from, they come at some marginal cost. It's very hard to measure that marginal cost.

I don't know. I have yet to see a very good analysis that breaks down in great detail the impact of negative rates, the fact that we had declining spreads for multiple years that increased asset holdings for mutual funds compared to the shrinkage of bank balance sheets and come up with something that really does a great cost-benefit analysis. I don't think we've seen that. But I think we have to argue the benefits are pretty clear.

Now, as it informs our strategy, look, we have an obligation to deliver to our clients and we have an obligation to make sure that we comply with the rules in the way that we can most thoughtfully. And so that's how we approach our strategy. To the extent to which there was demand for the balance sheet and client activity picked up and that demand was accretive to returns, we'd be happy to grow the balance sheet, given the strength of our capital ratios. But we just haven't seen that, so you're not seeing us do this. But over time, the system is going to have to balance liquidity needs and I think that will happen. It just may take a while.

Steven J. Chubak - Nomura Securities International, Inc.

Got it. And I know you touched on some of the emergence of some of the electronic trading platforms. I'm just wondering has that in fact translated into improved liquidity in certain product areas.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Well, I think if you go back to history, even ignoring the recent regulatory changes that both clients and market providers participated in, if you go back to some of the formation of Tradeweb back into the early 2000s, I think all of those vehicles, and there may have always been challenges at the start, whether it's TRACE reporting or Tradeweb or things like that. I think over time, those generally have been at the margin, maybe not in all cases, they've contributed to increased liquidity. I think so far the markets have adjusted to things, as I said before, very well and the regulators have done a very good job of introducing swap execution facilities and gradually implementing these things.

So I think the extent to which those things have occurred has been helpful. I think where most people talk about liquidity in the marketplace really relates to transacting corporate credit and high yield credit and I don't know of a technological solution that is sort of a cure-all for that. It's all very bespoke and that may be an area that for a while the market struggles with, but not just because of regulation, it's because of all the factors I talked about before.

Steven J. Chubak - Nomura Securities International, Inc.

Thanks, Harvey. And one more just follow-up from me. I was hoping you could actually provide some color, just given the focus in the press on Brexit in terms of how you're thinking about the possible impact on your UK operations and maybe more specifically what strategies you're considering to maybe help mitigate the potential impact.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

So, obviously, we're paying very close attention to it, whether we're monitoring it from a market and credit risk perspective or from a strategy perspective. As you know, under the framework, as we understand it, it's a multiyear transition to the extent to which Brexit goes under it. But we feel when we look at it, again I want to caveat this given there's a lot of uncertainty – when we look at it, we feel like in terms of our physical commitment to the region that we're well prepared. But again, there'll be a lot that all of us will learn to the extent to which the referendum goes through on June 23. But that'll be a multiyear process.

Steven J. Chubak - Nomura Securities International, Inc.

Understood, Harvey. Well, thank you for taking my questions.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Sure. Thank you.

Operator

Your next question is from the line of Matt Burnell with Wells Fargo Securities. Please go ahead.

Matthew Hart Burnell - Wells Fargo Securities LLC

Good morning, Harvey. Thanks for taking my question. First, I want to focus a little bit on Investment Management. Revenue was obviously a bit weaker, as you've described. Guess I'm curious as to how you're thinking about the pre-tax margin in that business over the relatively near-term, say the next 12 to 18 months? By my calculation, it's been running in the low 20% range. Do you have designs even in a not so supportive market environment to be able to improve that?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

So we're obviously always focused on running the business efficiently. We don't target a pre-tax margin for the business. So over time, you may see that move as we're investing in the business, as we're taking on different types of asset pools, but we look at it across the whole business, but we don't target it.

Matthew Hart Burnell - Wells Fargo Securities LLC

Okay. And then just moving on to capital returns, I notice that you issued some preferreds this quarter. I think in the last CCAR test, your constraining factor, in terms of the stress test at least, was the Tier 1 ratio. The preferred issuance should help you with that. Does that help you in terms of thinking about future capital returns?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

The preferred that you saw us do this quarter was the exchange of preferreds. So we were net neutral on the preferreds this quarter.

Matthew Hart Burnell - Wells Fargo Securities LLC

Okay.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

But you're right to point out that last year – all the things you point out about last year are accurate. Look, we utilize preferreds to the extent to which they are consistent with our capital plan and our objectives. Generally speaking, as you've heard me say before, we view them as reasonably expensive securities, and so we're not desirous to use them beyond where we think they sort of fit optimally in the capital structure.

Matthew Hart Burnell - Wells Fargo Securities LLC

Okay. That's helpful. And then just quickly, lastly on energy. It sounded like the vast majority of the increase in the noninvestment grade side was from downgrades. Were there any net draws on the exposure this quarter?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

There were during the quarter. They weren't material, but I don't have that number off the top of my head.

Matthew Hart Burnell - Wells Fargo Securities LLC

Okay. Thanks, Harvey.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Thank you.

Operator

Your next question is from the line of Eric Wasserstrom with Guggenheim Securities. Please go ahead.

Eric Wasserstrom - Guggenheim Securities LLC

Thanks. Harvey, I just wanted to follow up just a bit on the pipeline issue. Was there any – particularly on M&A, has there been any pipeline fallout because of change in political circumstances globally or here domestically because of the change in the Treasury's stance on inversion transactions?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Well, there was one large transaction in the marketplace which looks like in part in response to Treasury actions. It's no longer in the marketplace. We were a participant in that. But I would say that's a minimal factor in the status of the backlog. And so, no, I'd say these are small impacts.

Eric Wasserstrom - Guggenheim Securities LLC

Okay. And so to the extent that macro conditions seem, let's say, broadly unchanged over the past several months, does that continue to support what is generally a very high level of M&A? Or is the tide turning in some way in your view?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

So it feels like the fundamental conditions for I'd say an elevated level of M&A activity, they all feel like they're still in place. And those things are challenged top line growth, slow to very moderate GDP growth globally, and so it all feels like it's still in place.

Eric Wasserstrom - Guggenheim Securities LLC

Great. Thanks very much.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Thank you.

Operator

Your next question is from the line of Devin Ryan with JMP Securities. Please go ahead.

Devin P. Ryan - JMP Securities LLC

Thanks. Good morning, Harvey.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Devin.

Devin P. Ryan - JMP Securities LLC

Just want to ask the revenue question maybe another way and maybe from the top down. Just when you think about asset productivity at the firm level or revenues per asset, is it really all about increasing velocity here as client activity hopefully improves? Or are there some things that you can point to around maybe remixing how the balance sheet is weighted over time? I know it's fluid, but just trying to think about the size of really proactive opportunities to improve asset productivity by changing the balance sheet mix outside of just a pickup in client activity?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

So we really try never to drive balance sheet to different parts of the firm in a top-down way. It really comes bottom-up, and it comes bottom-up because it's in response to exactly what you're describing. It's client activity. If our bankers need more capital and more liquidity for their clients because they're financing M&A transactions, but we can't – obviously, from the top, we can't control that from the leadership of the firm. And so it's really in response. So I would say velocity broadly, whether it's in M&A, debt, financing, the ICS businesses, that really is the driving motor for the firm. Obviously, we look to be as thoughtful and efficient about our balance sheet as capital as we can in the context of that, but it really is about velocity and activity levels.

Devin P. Ryan - JMP Securities LLC

Okay. That's helpful. And then just a follow-up on expenses. As you guys think about just further steps that could be taken from here to reduce expenses if the backdrop remains challenging, I know you're always evaluating those, but are we at a point where the focus is really on reducing costs or maybe the footprint in low return areas that would reduce revenues but they'd still have a positive net impact? Or are there still some costs in the system that can be removed that don't touch revenues? I ask just because you guys have already done so much on this front.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Well, thanks for acknowledging what we've done over the last couple of years. Look, we're net ROE focused. And net ROE, as I just talked to you about, that's going to be driven in part by client levels of activity. And so, for example, as you know, at the beginning of the year, we go through a firm-wide review of resources, and when you look at that over historical time periods, that's resulted in about a 5% adjustment to resources in the firm. This year as we went through that exercise, parts of the businesses that were more challenged, like fixed income, they elected to take more significant action. And so they would have been greater than 5% during this period. But they're just responding to the market environment and there has been demand for their services in the short run.

Devin P. Ryan - JMP Securities LLC

Great. Thanks, Harvey.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Thank you.

Operator

Your next question is from the line of Brian Kleinhanzl with KBW. Please go ahead.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Hey, Brian.

Brian Kleinhanzl - Keefe, Bruyette & Woods, Inc.

Good morning. Just a quick question on energy or the commodities overall within FICC. I mean, you mentioned during your comments that the client activity was low due to the low energy prices, but I think you then clarified that as saying it was really the drop in energy. I just want to make sure I got that straight and that you can still grow the business even at a low level of energy prices, or was it really just because energy prices are low, revenue is going to be low?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Yeah. It's great question. It's less the absolute price level; it was more the shock and the nature of the decline. And so when you think about the precipitous nature of the decline and you go through the various client segments, so think about producers responding to that decline in prices and, for example, certainly you didn't see much incremental addition to hedge portfolio activity. On the consumer side, when you get those moves down so quickly, they tend to be a delay until you find some price stability. And for investors, I think the move was so volatile that it was difficult for investors to participate. We've certainly seen some stabilizing in those flows and increased market participation over the last several weeks. But what we saw in the first quarter, really not surprising in terms of client behavior.

Brian Kleinhanzl - Keefe, Bruyette & Woods, Inc.

Okay. Thanks. And then just one question. I know before we get into the next quarter's earnings, we'll have the CCAR results, and over the last couple of years you've been, I guess, not shy about using amalgam with regards to CCAR. Can you kind of outlay how you think about capital return as well as whether or not you're going to always be aggressive in your capital ask within the CCAR process? Thanks.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

So I wouldn't – just to get a little ticky-tacky on language, I wouldn't that there's a shyness or lack of shyness or aggression or anything like that. We very specifically and carefully go through our capital plan and we ask for what we think is appropriate. And so that's the way I would describe it.

Brian Kleinhanzl - Keefe, Bruyette & Woods, Inc.

Okay. Thank you.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Thank you.

Operator

Your next question comes from the line of Richard Bove with Rafferty Capital Markets. Please go ahead.

Richard Bove - Rafferty Capital Markets, LLC

Good morning. I was wondering, if we take as a given that your balance sheet is in pristine condition and that you're the very best, or among the very best in each one of the businesses in which you operate, we run up against a situation that the world has changed dramatically so that we are now nine years into Goldman Sachs not being able to come close to what it did in 2007. Its revenues have been flat-lining for, let's say, five years. Its earnings, pre-tax earnings this year, certainly last year, are half of what you did in 2007. When does Goldman say the time has come for transformational change, that we must do something radically different because we are getting nowhere? We're just treading water for nine years now. The stock is going nowhere. Earnings are going nowhere. Revenues are going nowhere, and yet we are the very best at what we do. When do you start saying we've got to do something radically different? We've got to change?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

So, I guess, I would say a couple of things. First, Dick, over the last several years, as you pointed out, we've been a $34 billion firm. However, we have changed. During that time period, we sold off $2.5 billion-plus worth of businesses, and we replaced those revenues. You've seen us grow our Asset Management business. Over the time period, when you look at our performance versus the peer group, and I thank you for acknowledging we're the best, we've continued to outperform the peers. We've grown book value. We've returned $25 billion to shareholders over the past four years, and so we have done many things.

We can't control what happens in terms of the environment. We don't believe negative interest rates are going to be here forever. We don't believe the client activity is going to be low forever. And you really have to look at this over long periods of time. Look, I will go back to book value, Dick. If you look at it over the past decade, we've grown it by threefold. I think that's contributing value.

Richard Bove - Rafferty Capital Markets, LLC

No. I totally agree with you. I don't see anything wrong with Goldman Sachs. I see things wrong with the world and that Goldman Sachs' position in the world is where things are wrong. And what I'm wondering is, when do you think about doing a massive merger of equals? When do you start thinking about entering new business lines which are radically different from the ones that you're in now under the understanding that you can't get anything more from what you're doing other than waiting for the tide to come in? In other words, when do you get control of your destiny as opposed to sitting here for nine years, letting the world control where you are and what you're doing?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Yeah. So, again, it's all about language, Dick. I would agree with some of the things you're saying. I certainly wouldn't agree with your statement that we are sitting here, waiting for the world to do what it does. If we felt like there was a client segment or a transaction we could do that would benefit our shareholders, and we could deliver to those clients, we would do it. We're open-minded. There is a reason why we're the leading advisory firm in the world. We would take our own advice, Dick.

Richard Bove - Rafferty Capital Markets, LLC

Okay. Thank you very much.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Thank you.

Operator

Your next question is from the line of Marty Mosby with Vining Sparks. Please go ahead.

Marty Mosby - Vining Sparks IBG LP

Thanks. Harvey, we'll go from the strategic to the very tactical of my questions here. We've harped on this in the past on kind of the timing of the comp ratio. Year-over-year the expenses were right in line with revenues. But if you look from sequential, you had a 13% reduction in revenues and a 29% increase in your overall compensation. So that combination really created a squeeze on your returns, which if you would have adjusted for that, would have raised your return on tangible common equity by 1.5 percentage points, 2 percentage points in this particular quarter. So just was curious, in the past, it's worked in your favor. This quarter, it really didn't.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

So, look, at this stage, it's our best estimate, Marty, in terms of where we think the year will go. Obviously, the performance was challenged in the first quarter and you saw competition of benefit expense come down 40%. It's pretty meaningful.

Marty Mosby - Vining Sparks IBG LP

No, it was. I am just saying, sequentially the pattern, it just throws you off, and it creates the pressure on returns in a first quarter that's not strong, but weak. Whereas if you were on the average for the year and kept it kind of constant for the average, then you would have a much more kind of just leveled out playing field that we'd just have a dramatic shift between fourth and first quarter. So that's the way...

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Yeah. I understand your point. It really is our best estimate. We're going to have to see how the year progresses.

Marty Mosby - Vining Sparks IBG LP

Fair. The other thing which I know is a hard question to be able to answer, but it's kind of important when you start thinking about just what are the core earnings and trying to take out some of the volatility that happens from quarter to quarter. The I&L business gives you increased tangible book value, it has been a contributor, so there's nothing wrong with it, but the volatility does create pressures and then also advantages in certain quarters. What is your just range? And just kind of you're not think out the recession, but just kind of think about it in general, what would be the range of outcomes given that you do have some NII in there and you would typically have some flow of deals? And it could be a broad range. I was just kind of thinking when you budget or plan for some normality, what's your kind of aspect to what you think about there?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

So, when we budget and plan for it, it really is a process through which, because of the nature, again, this is a long-term business, where we're committing long-term capital, it really is done under a very controlled process where the businesses request that capital. As you pointed out, we had roughly $240 million of NII in there. And now the majority of the balance sheet, and this has been in transition over several years, the balance sheet has transitioned more to debt and lending activities, but that is not something, again, that we drove top-down. That was driven by the client demand and the opportunity set. As I said, look, you have to look at this over the long term. As I said earlier, including our first quarter, it's driven $11 billion of revenue over the last eight quarters.

Marty Mosby - Vining Sparks IBG LP

Right.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

But you have to look at this at the long term because it's going to be – it's pro-cyclical and there's going to be volatility quarter to quarter.

Marty Mosby - Vining Sparks IBG LP

And then the recent history of zero this quarter to $1 billion would be kind of the range we've been seeing. Is that kind of what you would see?

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Well, I would say that this has been a pretty extreme quarter. You have to go back to the third quarter of 2011 or back to other periods where markets have been extremely volatile to see this kind of performance. But, again, it reinforces what we've told you already, which is, it's price sensitive, it's pro-cyclical and quarter to quarter, you really have to look at it over the long term.

Marty Mosby - Vining Sparks IBG LP

I got you. And you adjust for those two pieces, you put it to an average in I&L and kind of the average compensation ratio for the year and you're really at 9.5% kind of returns. So that's the benefit you'd have as you kind of roll forward. So, thanks.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Well, that's your job.

Marty Mosby - Vining Sparks IBG LP

That's right.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

Thanks, Marty.

Operator

And at this time, there are no further questions. Please continue with any closing remarks.

Harvey Mitchell Schwartz - Chief Financial Officer & Executive Vice President

So, hey, everybody, since there are no more questions, I'd like to take a moment to thank all of you for joining the call. Hopefully, I and other members of senior management will see many of you in the coming months. If you have any questions come up, please don't hesitate to reach out to Dane. Otherwise, enjoy the rest of your day. Thanks, everyone.

Operator

Ladies and gentlemen, this does conclude the Goldman Sachs first quarter 2016 earnings conference call. Thank you for your participation. You may now disconnect.

Comments (0)