Goldman Sachs Asset Management

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FROM THE OFFICE OF THE CHAIRMAN

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Abstract

Linking GDP Growth and Equity Returns: the Role of Valuation

In this month's issue of *Monthly Insights*, the second article of our two-part series, we focus on the constituents of total equity returns and on valuation. Splitting total real equity returns into individual components shows that the outperformance of Growth and Emerging Markets (EM) equities over the past decade has been mainly driven by earnings growth and currency appreciation, rather than by a value re-rating. This means that—contrary to a skeptical view—the Growth and EM equity outperformance relative to the developed world could indeed be sustainable in the medium-to-long term.

Valuation, however, remains of key importance. This can be demonstrated by a quantitative exercise linking equity returns, growth expectations and valuation. Historically, markets with high valuations (relative to trend) have not benefited as much from growth revisions as those with low valuations. This link is particularly strong for Growth Markets. To take advantage of growth stories, investors should be looking for markets where growth expectations are still underpriced and valuations are below trend.

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Jim O'Neill's **Viewpoints** and **Strategy Series** abstracts are also available on our website.