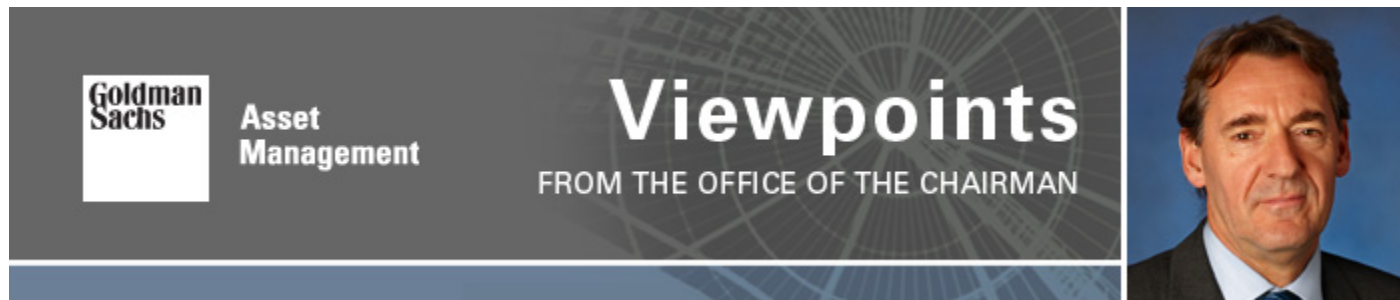


**From:** O'Neill, Jim [IMD]  
**Sent:** Friday, September 16, 2011 4:12 PM  
**Subject:** GROWTH MARKETS, BULLET TRAINS AND GREECE



### GROWTH MARKETS, BULLET TRAINS AND GREECE.

You might be pleased to read that this week's Viewpoint is shorter than usual.

I had a rather intense 3-day return trip to Japan this past week, the purpose of which was to support a new Growth Market equity fund to be distributed by a major Japanese investment company. I was actually in Japan for less than two days, but with the assistance of their marvelous bullet trains, I spent time in Tokyo as well as two other major cities while I was there.

What an interesting trip it was, coming on the back of the August mayhem and the volatility that continues in global markets. Judging by the questions I received, as I joked to a colleague on my return to London, I hadn't realized that Greece was regarded as Growth Market. The number of questions about Greece and Europe issues in general, along with the fact that US Treasury Secretary Geithner is participating in the ECOFIN meeting, shows just how much everyone thinks the EMU factor is the number one issue for any and everything. (I look forward to certain fans using this excuse after this weekend's football matches.)

Influenced by these two observations, I thought I would outline some basic observations, some of which I have mentioned before;

1. In this decade, it is likely that world GDP will be positively boosted by something in the vicinity of \$16 trillion dollars by the combined nominal GDP increase of those countries we call Growth Markets. These eight countries are; Brazil, Russia, India and China, along with Indonesia, Korea, Mexico and Turkey.
2. This increase will represent about 4 times that of the US and around double that of the US and the Euro Area put together.
3. China alone will probably be responsible for around one half of the growth generated by the Growth Markets. So, studying events in China is rather important. More specifically, what happens to Chinese cyclical developments – especially inflation – in the coming months is considerably more important than whether Greece defaults or not.
4. While some people respond to this last comment that this will not be true as all markets are correlated in terms of "risk on, risk off" these days, I am far from convinced. For instance, year-to-date, the so-called (inappropriate and out-of-date) Emerging Markets underperformed the US and other developed markets, such as Germany. This is probably because of rising inflation in China, Brazil, India and other Growth Markets. Therefore, unless the absolute worst 2008-type of outcomes occur from any possible Greek default (and /or other EMU problems), it is likely that declining inflation in China and elsewhere will sow the seeds for an outperformance of these markets.
5. As I discussed last week, if one of the consequences of the US credit downgrade by S&P is to encourage investors to search for alternative benchmarks, it is also likely that it is encouraging some countries to stand more on their own two feet. In this regard, the continued evidence that China might be accelerating steps to move towards greater openness of the use of the RMB is highly important. This will mean that alternatives to the US, Japan and Euro Area will grow. It is interesting to observe this week that now Korea has added itself to the growing list of countries that has stated a public plan to diversify into the RMB.
6. While many seem to think that the EMU mess can derail even the Growth Market story, not many are considering that developments in the Growth Market economies can help stop the derailing or "re-rail" the European economies and EMU. In this regard, it is interesting to see the BRIC countries talking about their forthcoming meeting in DC with a view to possibly diversifying more reserves into European markets. I suspect this would be a tough act to coordinate. But more importantly, it would seem to me, as GSAM's Sam Finkelstein

has suggested to me, that if China is allowing faster opening of the RMB, this will remove one of the major strategic sources of Euro strength and, along with a more dovish stance from the ECB, the case for a material decline in the overvaluation of the Euro is starting to become clearer. A weaker Euro would be amongst the things that the beleaguered countries could benefit from.

7. While it is tough to believe that the BRIC countries can coordinate any additional EMU bond purchases between them, it is not difficult to see how they and other wealthy reserve countries would want to buy more bonds from a region where policy is clearer. So, the ultimate path of greater fiscal unity and a Eurobond (which seems to be rising in Germany behind the scenes) would naturally see enormous demand from those investors. Presumably, this should help motivate those that are pushing in this direction.
8. Over the remainder of the month, as always, we are expecting various key events around the world, especially for the European crisis – including the dispersal or not of the next loan to Greece and the approval or not of the expanded EFSF. What happens surrounding these event risks might be as important as any economic data coming out of the US or Europe.
9. However, the release of the ISM and PMI numbers around the world at the start of October will remain as important as ever to inform us whether there are any valid comparisons to 2008, which so many people seem to be eager to pursue. For now, this seems unwarranted, especially after the actions of central banks to ease the availability of US\$ liquidity this week.
10. I know “Sell in May and Go Away, Come Back on St. Legers Day” doesn’t really make a huge amount of sense, but it sure seems to work quite often. GSAM’s own Steve Warren has analyzed the seasonal pattern for lots of other markets also, and surprise surprise, there is a pattern to those also. And whisper it, we have had a week following the 2011 St. Legers and equity markets have rallied. If the S&P futures rise above the 1230 area, it will get rather interesting in terms of all the momentum guys out there. And a few people might get more interested in horse racing...

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