

Investing in the N-11: *Capturing growth potential through local equity markets*

GSAM Fundamental Equity Team

The Goldman Sachs Asset Management Fundamental Equity team is comprised of five investment teams focused on US Growth, US Value, US Core, Global Developed and Growth and Emerging Markets.

In 2001, Jim O’Neill, Chairman of Goldman Sachs Asset Management, coined the acronym BRICs in reference to the opportunities presented by Brazil, Russia, India and China. In 2003, Goldman Sachs Research predicted that the BRICs could collectively rival the G7¹ by 2050. The concept became a global phenomenon, and BRIC investment opportunities have proliferated over the last 10 years. In 2005, Jim identified Bangladesh, Egypt, Indonesia, Iran, South Korea, Mexico, Nigeria, Pakistan, the Philippines, Turkey and Vietnam as the “next 11” (N-11) largest populations behind the BRICs, which collectively could have a meaningful impact on the global economy. As the BRIC countries passed key milestones and the BRIC Index subsequently outperformed the broader emerging and developed markets indexes,² the message was reinforced: Identifying drivers of sustainable growth is key to long-term economic and equity market performance.

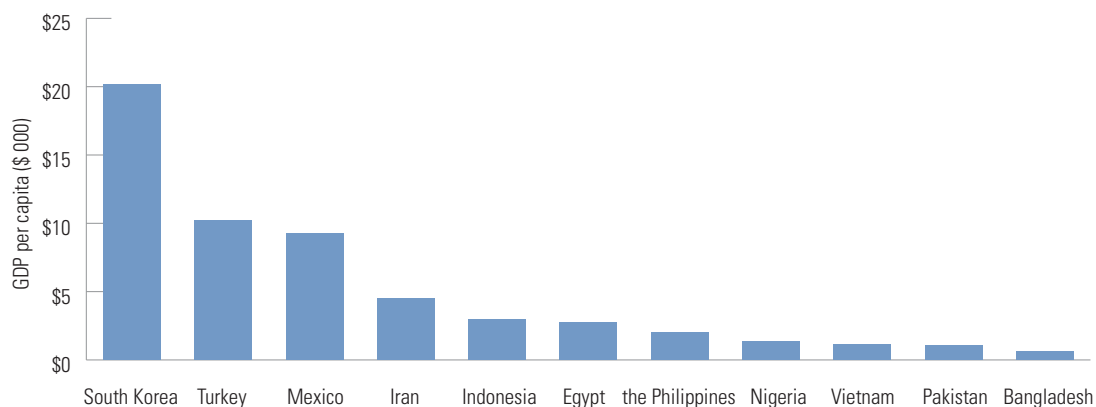
Why these 11 countries?

The N-11 represents the next 11 countries with the largest populations, after the BRICs, that could have a meaningful impact on the global economy. In our view, the N-11’s 19% share of the global population³ is significant and will contribute meaningfully to its growth, which will ultimately be reflected in its equity market capitalizations.

In addition to its population advantage, the N-11 offers a diverse opportunity set

Currently, the combination of Bangladesh, Egypt, Indonesia, Iran, South Korea, Mexico, Nigeria, Pakistan, the Philippines, Turkey and Vietnam provides an intriguingly diverse set of countries, whether measured by economic size, market capitalization, geography or economic and political conditions.⁴

Exhibit 1 – The N-11 offers exposure to diverse stages of economic development



Source: International Monetary Fund, World Economic Outlook Database, October 2010.

¹ Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.

² MSCI as at March 31, 2011.

³ Source: United Nations Data, United Nations Population Division, World Population Prospects: The 2008 Revision, using projections for 2010.

⁴ Legal and regulatory prohibitions exist with regard to investments in Iran.

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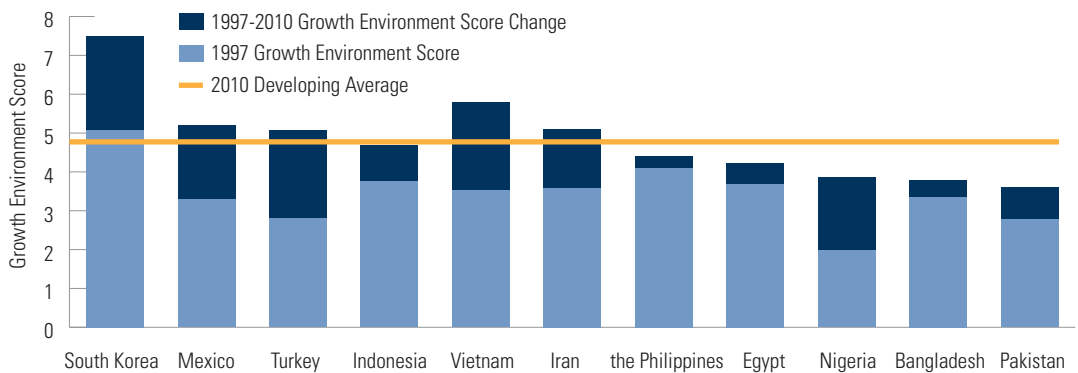
What is the N-11 growth story?

Strong or improving growth conditions, combined with favorable demographics, form the foundation of the N-11 growth story. We believe that accommodating economic and political conditions will promote economic growth, leading to a measurable increase in the N-11's share of global GDP, from roughly 12% in the current decade to 17% in 2040-2049.⁵ In addition, the N-11 countries have large populations and a majority have a median age of under 30,⁶ creating the potential to become a massive consumer base, as well as provide scale to other growth trends.

Strong and/or improving macroeconomic conditions should lead to GDP growth

Goldman Sachs Economics, Commodities and Strategy Research compiles and monitors a Growth Environment Score (GES) each year for over 180 countries. The GES monitors productivity and sustainability of growth based on 13 distinct criteria that fall into five main categories: macroeconomic stability, macroeconomic conditions, technological capabilities, human capital and political conditions. The most recent report illustrates the positive momentum in the N-11 countries. In our view, this is an important qualifier for GDP growth projections over the next several decades, as the GES seeks to gauge an economy's ability to support its own growth potential.

Exhibit 2 – Macroeconomic conditions in the N-11 countries have been improving



Source: Goldman Sachs Global Economic, Commodities and Strategic Research, Global Economics Paper No: 206, December 15, 2010.

Large and young populations could become a massive consumer base and give scale to growth trends

The defining criterion for the N-11 is population size. This is important because it gives scale to the key underlying growth trends noted above. In addition, many of the N-11 populations are compelling as they are relatively young, with more people at, or entering, the working age. This translates into more people with earning and spending power, but with fewer dependents, driving more productive societies and fueling growth.

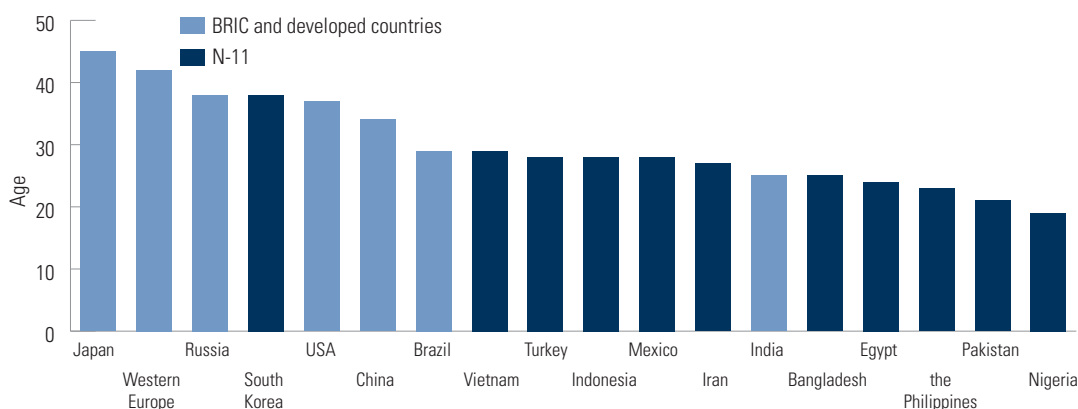
⁵ Source: GSAM, "It is Time to Re-define Emerging Markets", January 31, 2011.

⁶ Source: United Nations Data, United Nations Population Division, World Population Prospects: The 2008 Revision, using projections for 2010.

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The economic and market forecasts presented herein have been generated by GSAM for informational purposes as of the date of this presentation. There can be no assurance that the forecasts will be achieved. Please see additional disclosures at the end of this presentation.

Exhibit 3 – N-11 populations are among the youngest in the world



Source: United Nations Data, United Nations Population Division, World Population Prospects: The 2008 Revision, using projections for 2010.

Economic growth and rising income levels should lift more people into both the middle and upper classes, creating significant consumer demand. Importantly, we believe this migration into the middle and upper classes should support a vast array of consumption opportunities, from basic goods and services to discretionary items and eventually to luxury purchases. As an example, growth in demand for autos typically accelerates at an income level of about \$9,000 per capita (in 2007 purchasing price parity (PPP) terms).⁷ This implies that there would be a significant increase in demand for autos and other consumer durables, such as televisions, refrigerators and washing machines. Furthermore, this acceleration in demand is likely to occur at various points in time across the N-11 group, given the diversity of the income per capita levels and growth rates.

The impact of the rising high income class (over \$30,000 per capita income, in 2007 PPP terms) in the N-11 could be even more dramatic, largely driven by South Korea, Mexico and Turkey. By 2025, more than 60 million people from the N-11 may cross that income threshold, which is more than from the US.⁸

Can investors capture the growth through the equity markets?

Our conviction in the N-11 as a compelling equity opportunity is underpinned by our anticipation of a convergence between the N-11's share of the global population (19%),⁹ global GDP (8%)¹⁰ and global equity market capitalization (3%).¹¹ We believe that N-11 economic growth will lead to more publically listed ways to tap into these growth themes, ultimately reflected in greater market capitalizations.¹²

N-11 can offer meaningful exposure to the consumer growth story and balanced sector diversification

To measure performance of the N-11, we have constructed the MSCI GDP-weighted N-11 ex-Iran Index,¹³ (in partnership with MSCI) to reflect key areas of future growth. We believe the balanced sector allocation of the MSCI GDP-weighted N-11 ex-Iran Index¹³ offers equity investors good diversification, yet with more potential to capture the domestic consumption opportunity and less exposure to the more volatile commodity industries associated with emerging markets growth in the past.¹⁴

⁷ Source: Goldman Sachs Economics, Commodities and Strategy Research.

⁸ Source: GSAM, The Rise of the BRICs and N-11 Consumer, Jim O'Neill, December 3, 2010.

⁹ Source: United Nations Data, United Nations Population Division, World Population Prospects: The 2008 Revision, using projections for 2010.

¹⁰ Source: International Monetary Fund, World Economic Outlook Database, October 2010.

¹¹ Source: Goldman Sachs Global Economics, Commodities and Strategy Research, Global Economics Paper No. 204, 2010 share of MSCI ACWI.

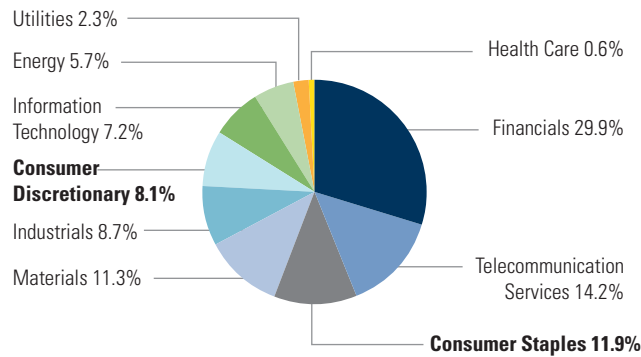
¹² Legal and regulatory prohibitions exist with regard to investments in Iran.

¹³ This is the MSCI custom index which is intended to be named the MSCI GDP-weighted N-11 ex-Iran Index.

¹⁴ Diversification does not protect an investor from market risk and does not ensure a profit.

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Exhibit 4 – N-11 can offer good exposure to the consumer and balanced sector diversification

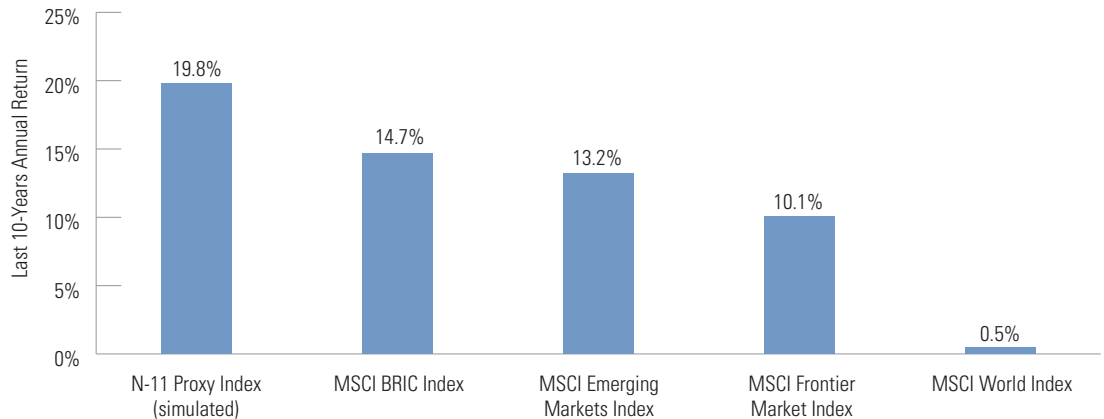


Source: MSCI GDP-weighted N-11 ex-Iran Index. January 31, 2011. (This is the MSCI custom index which is intended to be named the MSCI GDP-weighted N-11 ex-Iran Index.)

Markets driving future growth have performed well over the long term

Importantly, markets driving future economic growth have generally performed well over the long term, from an equity perspective. As such, we believe the N-11 has the potential for strong performance over time. The N-11 growth story has translated into strong equity returns, as shown below through simulated performance data since 2003.

Exhibit 5 – The N-11 equity markets (simulated) have outperformed over time



Source: Bloomberg, price return indexes through December 31, 2010. Simulated GDP weighted index return calculated by weighting local country indices from Bloomberg with annual GDP from international Monetary Fund, World Economic Outlook Database, 31-Dec-10. Excludes Iran. This is a simulated index and does not represent the performance for any Goldman Sachs product. Past performance is not indicative of future results, which may vary.

Despite strong returns, we believe that many of the N-11 countries are still trading at reasonable or attractive valuations, particularly when considering the high return on equity and growth expectations. As of the end of March 2011, the N-11 traded at a price-to-earnings ratio of 13.3X last twelve months earnings (LTM), at a discount to the developed markets average of 14.2X. However, return on equity is 23% for the N-11, compared with 17.3% for the developed markets.¹⁵

¹⁵ FactSet, Worldscope as at March 31, 2011.

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How do the N-11 compare with BRIC, Frontier and Emerging Markets?

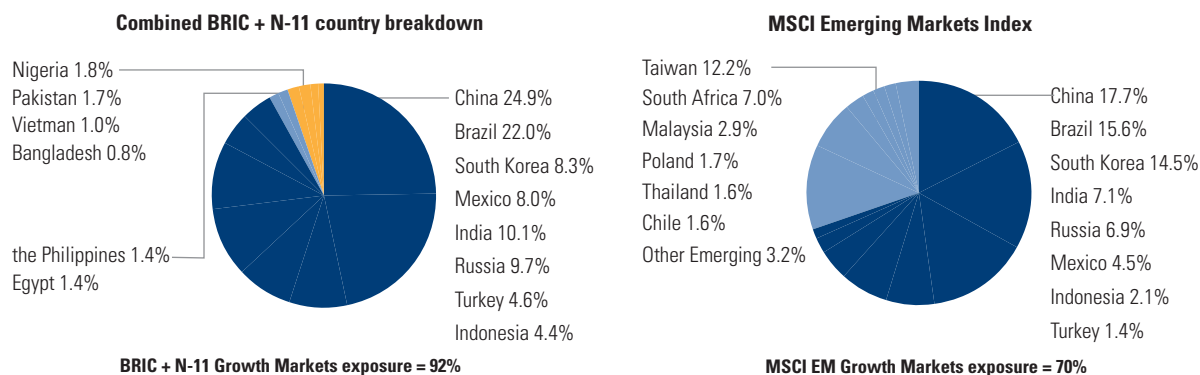
The N-11 represents the next 11 most populous countries, which we believe have the potential over time to collectively impact the global economy. That said, we do not expect this will be to the same extent as the BRICs.

The N-11 offers an opportunity to increase exposure to the Growth Markets

The group offers exposure to some of the Growth Markets, as well as some markets that are still truly emerging.¹⁶ The country weightings carefully consider market liquidity, with greater allocations to the larger and more liquid markets. The N-11 offers significantly more exposure to some of the Growth Markets, such as South Korea, Mexico, Turkey and Indonesia, than the traditional emerging markets.

Exhibit 6 – N-11 + BRIC markets overweights the Growth Markets

- Growth Markets
- Traditional Emerging Markets captured in MSCI EM Index
- Traditional Emerging Markets not captured in MSCI EM Index



Source: The combined BRIC + N-11 country breakdown shown represents a 50% MSCI BRIC Index and 50% MSCI GDP N-11 ex Iran Index allocation, as of January 31, 2011.

Source: MSCI EM weightings as of January 31, 2011. Others include Columbia, Peru, Philippines, Egypt, Hungary, Czech Republic and Morocco.

The N-11 offers more diversification than the Frontier Markets

Despite containing less than half the number of countries, we believe the N-11 offers better portfolio diversification than the Frontier Markets,¹⁷ which offer no exposure to the Growth Markets. The N-11 can offer significantly more diversification by sector, particularly a much greater weight to what we believe will be fast-growing consumer sectors, and a more balanced allocation to Financials. From a regional perspective, the MSCI GDP-weighted N-11 ex-Iran Index¹⁸ reflects more balance, particularly with regard to exposure in the Middle East and Gulf Cooperation Council (GCC) regions.¹⁹

What are the key risks?

The key risks for the N-11 countries are similar to those for most emerging markets. As with most high growth economies, inflationary pressures are a risk. From a global perspective, both rising protectionism and increasing regulation could negatively impact growth scenarios. At the company level, earnings disappointment may result in strong reactions from typically more volatile markets. Finally, should geopolitical or global economic factors cause a general decline in investors' risk appetite, we believe this would negatively impact the N-11 markets.

¹⁶ We define Growth Markets as those countries that today account for at least 1% of global GDP. This includes the BRICs, as well as the four largest of the N-11, namely Mexico, South Korea, Turkey and Indonesia. See GSAM Strategy Series "It is Time to Re-define Emerging Markets", 31 January 2011, for more detail.

¹⁷ The non-developed countries after the traditional emerging markets, which typically have less established capital markets.

¹⁸ This is the MSCI custom index which is intended to be named the MSCI GDP-weighted N-11 ex-Iran Index.

¹⁹ Comparison of MSCI GDP-weighted N-11 ex-Iran Index with MSCI Frontier Markets Index and S&P Extended Frontier Index, as of January 31, 2011.

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Conclusion

We believe that the demographic advantage of the N-11 countries, combined with improving growth conditions, could lead to a convergence of its high share of global population with its relatively low share of global equity market capitalization, as it increases its contribution to global GDP. This diverse set of countries offers exposure to a wide range of economic development, including the four Growth Markets outside of the BRICs, as well as the six thought-provoking emerging markets. An N-11 investment also offers good geographic and sector diversification. Finally, as equity markets driving future economic growth have generally performed well over the long term, we believe the N-11 has the potential to produce strong returns over time.

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