

Goldman Sachs Asset Management Fundamental Equity The Case for Brazil – Emerging Opportunities

1010

GSAM Brasil Equity Team

The Goldman Sachs Asset Management Brasil Equity team is comprised of local sector experts and leverages the broader GSAM global platform.

Two decades after the Latin American debt crisis, Brazil's impressive macroeconomic stability has earned its debt investment grade status and made its economy more resilient during the recent global financial crisis. Furthermore, it has laid the foundation for above average economic growth that is being fueled by rapidly increasing consumer demand from a growing middle class, significant infrastructure spending and a generous endowment of natural resources, including oil, metals, wood and land for agricultural production.

As a result, the Brazilian equity market is rapidly growing and evolving, driven by double-digit corporate earnings growth, robust capital raising and increasing mergers and acquisitions (M&A) activity. Importantly, these factors are significantly increasing investment opportunities, encouraging better corporate governance and improving liquidity. We believe Brazil equities are trading at attractive valuations relative to global markets and present investors with exciting opportunities to participate in Brazil's transformational economic journey.

Brazil's impressive macroeconomic stability is supporting above average economic growth...

Following Brazil's hyperinflation and debt default during the 1980 Latin American debt crisis, Brazil put in place critical macroeconomic stabilisation measures in the 1990s that still guide the country today. This macroeconomic stability earned its debt investment grade status, and made Brazil's economy more resilient during the recent global financial crisis, laying the foundation for above average GDP growth.

Current macroeconomic environment

The three pillars of the macroeconomic model—*inflation control*, *fiscal responsibility* and a *flexible exchange rate*—are a powerful combination that have already yielded important results. Inflation control has been the primary contributor to an increase in real income and consumption growth, both important drivers of Brazil's growth today. Fiscal responsibility has helped Brazil lower its interest rates over the past few decades. Although the central bank has raised rates recently to control inflation, and Brazil's nominal interest rates remain high relative to the rest of the world, we believe continued fiscal responsibility will ultimately allow for Brazil's interest rates to continue to decline over time, converging toward the global average. This will further encourage investments and consumption growth through continued credit expansion. Finally, in contrast to the sovereign debt issues from the 1980s where USD-denominated debt and a devaluing Real created a downward spiral, the current combination of Brazil's flexible exchange rate and more locally-denominated debt allow Brazil much more control in managing its debt payments. Brazil has seen its external debt decline from over

Goldman
Sachs

Asset
Management

This material is provided for educational purposes only and should not be construed as investment advice or an offer or solicitation to buy or sell securities in any jurisdiction except as otherwise permitted under relevant laws and regulations. Please note that Goldman Sachs Asset Management does not maintain any licenses, authorisations or registrations in Asia ex Japan, except that it conducts businesses (subject to applicable local regulations) in and from the following jurisdictions: Hong Kong, Singapore, Korea, and India.

For Professional Investors and Third Party Distributors Use Only – Not For Distribution to the General Public.

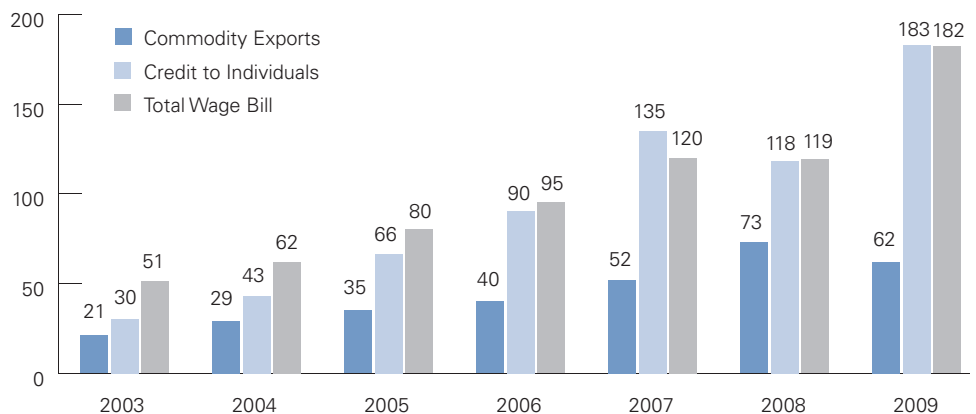
40% of GDP in 2002 to under 15% in 2009, while net external debt to GDP has declined from 33% in 2002 to -3% in 2010.¹ The success of the model resulted in an upgrade for Brazil's debt to investment grade status by S&P in 2008, an important milestone for both debt and equity investors. The country also weathered the recent global financial crisis relatively well, owing to strong financial regulation, capital requirements above Basel standards and low levels of debt, both at the individual and corporate levels, all of which have created a very healthy financial system.

Economic growth

Brazil's above average economic growth is driven primarily by favourable demographics fueling consumer demand and significant infrastructure spending. A popular misconception is that Brazil's economic growth is led by commodities. While commodities do account for 40% of Brazil's exports, exports only contribute 10% to Brazil's GDP, translating into less than 5% of GDP. Instead, consumer demand is one of the leading drivers of Brazil's growth, as purchasing power is increasing due to rising wages and an expansion of credit. In fact, as shown in *Exhibit 1*, from 2003 to 2009, the growth in total wage bill and credit to individuals has been 6X the growth of commodity exports.

Exhibit 1 – Individual wage bill and credit growth combined has exceeded commodity export growth by six fold

US\$ billions



Source: Brazil Central Bank, as of Mar-2010.

Consumer facts (from '04 to '09):⁵

- More than 3.1 million vehicles sold (an increase of 100%)
- More than 11 million computers sold (an increase of 2.4X)
- Approximately 173.9 million mobile phone subscribers (an increase of 2.7X)

Rising incomes

In addition, over half of the population is now middle class, defined as families earning an income between US\$600 to US\$2600 per month,² while poverty levels have halved since 1990.³ Finally, a large portion of the population is entering the most productive years and is more educated and urbanised than previous generations. Rising incomes and urbanisation are leading to increased consumer demand, and, in turn, an expansion of the retail sector. For example, shopping mall penetration as a share of retail sales in Brazil is only 18%, compared with 58% in the US,⁴ but is growing each year.

Infrastructure spending

Significant infrastructure spending, estimated to be over US\$860 bn from 2007 to 2014, will further drive economic growth (*Exhibit 2*). While preparations to host the World Cup in 2014 and the Olympics in 2016 are expected to total about US\$30 bn, the vast majority of the infrastructure spending comes from Brazil's PAC: Multi-Year Government Growth Acceleration Plan (in place from 2007 through 2014). Over 70% of the spending goals for the first plan, PAC I, have been completed and, in total, the next Plan is expected to account for almost US\$550 bn of the infrastructure spending in the next five years.⁶

¹ Brazil Central Bank, www4.bcb.gov.br/Pec/Gci/Ingl/Economic_Chart_Pack_mar_10.pdf

² CPS/FGV from microdata of PNAD/IBGE.

³ South America's Giant Comes of Age, Financial Times, 28-Jun-2010.

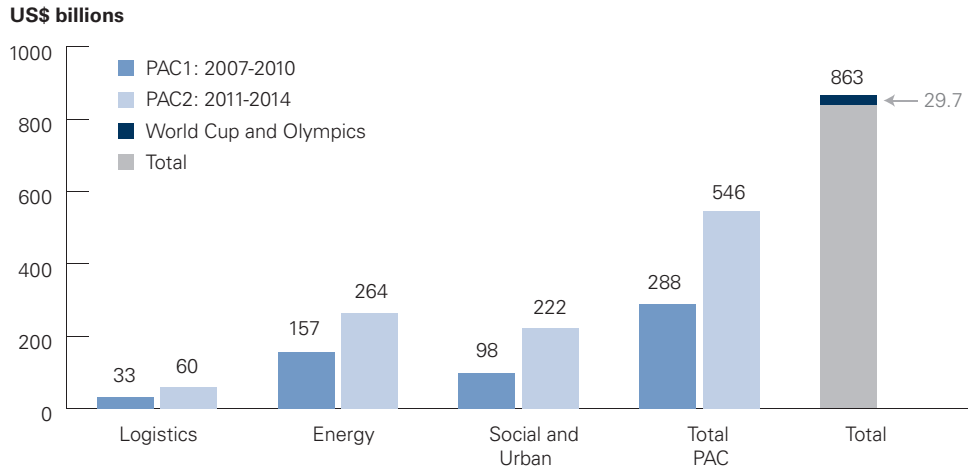
⁴ ICSC, ABRASCE.

⁵ ANFAVEA 2010 Yearbook, IDC Brasil, Anatel.

⁶ www.brasil.gov.br/pac/relatorios/nacionais/10o-balanco.

Significant infrastructure spending, estimated to be over US\$860 bn from 2007 to 2014, will further drive economic growth.

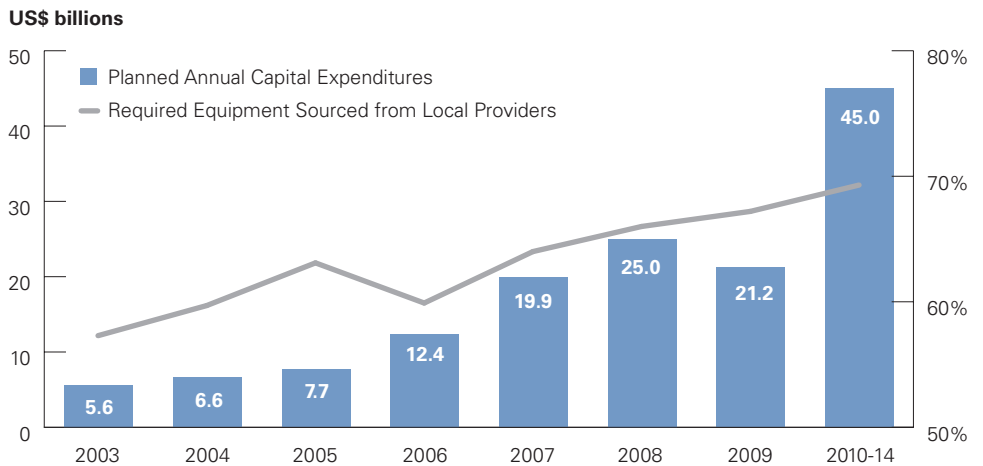
Exhibit 2 – Brazil spending over US\$860 bn in infrastructure



Source: www.brasil.gov.br/pac/relatorios/nacionais/10o-balanco.

Furthermore, we are seeing record levels of capital expenditure (capex) spending from companies. Petrobras, for example, will be investing US\$45 bn from 2010 through 2014 annually, more than double what they have invested in the last five years⁷ (Exhibit 3). Currently the 4th largest energy company,⁸ Petrobras is working to determine if recently discovered oil reserves can be economically extracted, which would turn Brazil into one of the top three oil producing countries in the world.

Exhibit 3 – New oil reserves exploration will double Petrobras’s capex investments from 2010 through 2014



Source: Petrobras (www.petrobras.com.br/en/).

Export facts:

- Largest exporter and lowest cost producer of pulp.
- Second largest exporter of iron ore (33% of the export market).⁹
- Largest producer and exporter of orange juice (86%), sugar (39%), soybeans (36%), and poultry (46%).¹⁰
- Approximately 90 million hectares of arable land available; 62 million already in use.¹¹

Natural resources

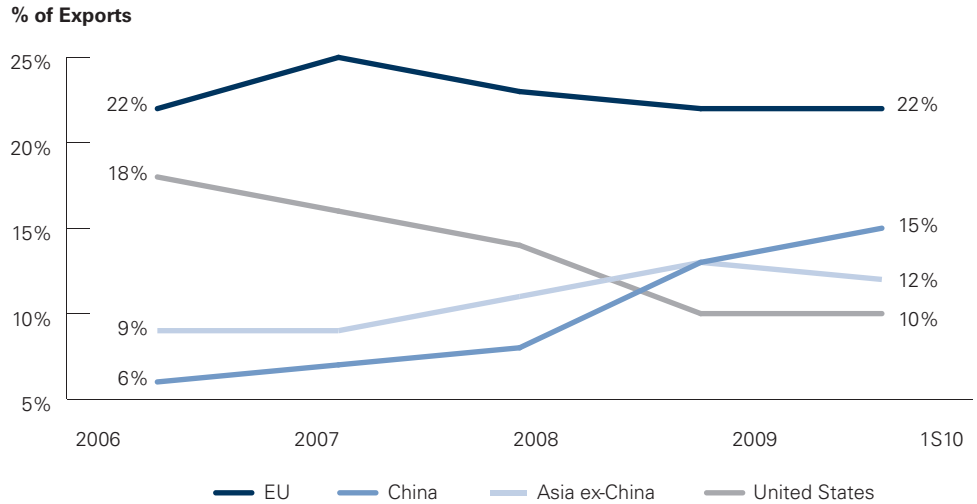
Brazil’s generous endowment of natural resources will continue to have a beneficial impact on the country’s economy as global growth resumes. As previously noted, commodity exports currently represent less than 5% of Brazil’s GDP. However, the combination of Brazil’s strong position in many commodity exports, available land for agriculture production and growing trading relationship with China may further contribute to Brazil’s growth and importance in the world economy.

7 Petrobras(www.petrobras.com.br/en).
 8 Source: PFC Energy (Jan-2010).
 9 Citigroup Metals & Mining, Latam Iron Ore Monitor.
 10 Banco do Brasil (Bank of America Merrill Lynch, 30-Mar-2009).
 11 USDA and Credit Suisse Report “Brazilian agribusiness” May-2007.

Brazil's trading relationship with China has been growing rapidly, and China is now Brazil's largest trading partner, accounting for 15% of total exports.

Brazil's trading relationship with China has been growing rapidly, and China is now Brazil's largest trading partner, accounting for 15% of total exports. While this relationship currently accounts for less than 2% of GDP,¹² we believe that Brazil will benefit both directly and indirectly from China's growth, largely as a result of higher commodity prices (*Exhibit 4*). Brazil's Ibovespa, the main indicator of the stock market's average performance, offers an example of the indirect benefit of higher commodity prices as over 40% of the index is comprised of Energy and Materials stocks and tends to benefit disproportionately in light of the actual economic impact to GDP.

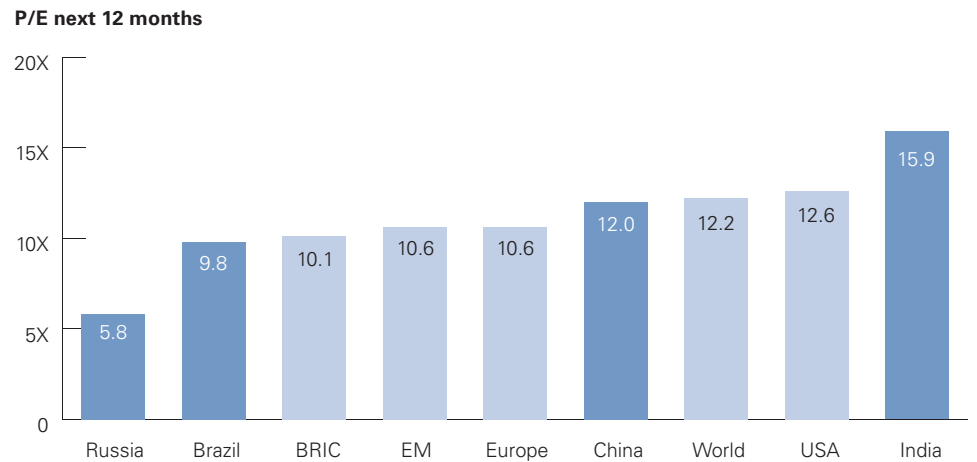
Exhibit 4 – Brazil also benefits from growth in China



...and this economic growth is driving a rapidly evolving and expanding equity market.

We believe Brazilian equities will be driven by: 1) sustainable macroeconomic growth at attractive valuations and 2) a strong capital raising and an M&A environment that is increasing the investment opportunities of the equity market and encouraging better corporate governance. In our view sustainable macroeconomic growth of around 5% should lead to corporate earnings growth of at least 10% and likely higher, supporting continued equity market appreciation (*Exhibit 5*). We believe Brazil's valuation is attractive relative to global markets and earnings growth potential.

Exhibit 5 – Brazil is trading at attractive valuations

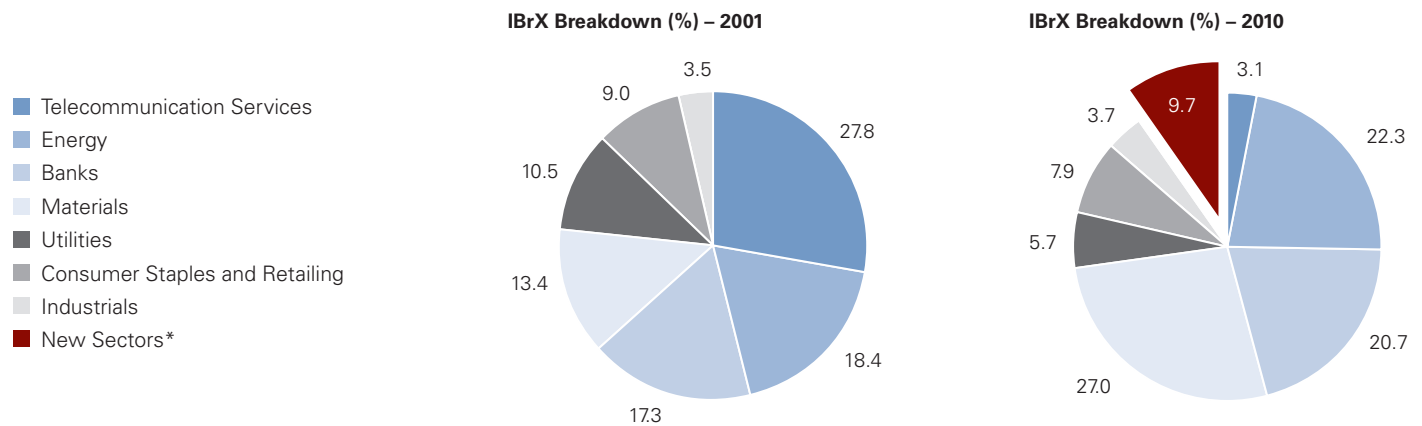


12 Morgan Stanley Research Latin America, Brazil Economics, What is the China Link, 27-Jul-2009.

Capital Markets revolution

Since 2004, Brazil has been undergoing a capital markets revolution marked by a buoyant equity capital raising environment, which was shortly interrupted during the 2008 crisis, but is back in full force. Due to high interest rates, Brazil is one of the few countries in the world where raising capital through equity is cheaper than debt. From 2004 to September 2010, there have been 134 initial public offerings (IPOs), raising over US\$67.2 bn, with another 70 follow-on offerings, raising US\$121.1 bn.¹³ The most immediate effect of this equity boom has been to broaden Brazil's equity market. As shown in *Exhibit 6*, in 2001, Telecommunication Services and Utilities stocks represented almost 40% of the equity market. Today's IBrX Index¹⁴ clearly highlights Brazil's participation in the past decade's commodity boom, as the Materials and Energy sectors have grown from a combined 32% to 49%. The Financials sector has also grown commensurately with economic development, from 17% to 21%, while the weightings of Telecommunication Services and Utilities have dropped to a combined 9%, closer to developed market index weightings.

Exhibit 6 – New sectors have gained significance in Brazil's capital markets over the past decade



Source: BMFBovespa Aug-2010.

*New Sectors are composed by: Consumer Durables and Apparel, Diversified Financials, Software and Services, Household and Personal Products.

Real Estate, Insurance, Health Care Equipment and Services, Automobiles and Components.

As capital markets have evolved, many new industries, such as Consumer Durables and Apparel, Diversified Financials, Software and Services, Household and Personal Products, Real Estate, Insurance, Health Care Equipment and Services and Automobiles and Components, which were not represented in the stock market are now part of Brazil's investable universe and account for almost 10% of the IBrX Index. These industries, many of which present both organic and acquisition growth opportunities are where we find compelling investment opportunities in Brazil.

Improving corporate governance

The development of Brazil's equity market has had a revolutionary impact on corporate governance and minority shareholder rights, even without any changes in the securities laws. The Brazilian stock exchange created the new market (Novo Mercado) where most companies have issued stock in the last 5 years. In contrast to the existing securities laws, which require a company to have only one third of their capital in voting stock, allowing control with only a 17% share, the new exchange mandates that companies must have 100% voting stock. This has also led to minority shareholder representation on company boards, and the inclusion of stock as a portion of total compensation. Accounting standards have also improved markedly and all companies listed in Brazil are required to publish their 2010 statements in accordance with the International Financial Reporting Standards.

¹³ Credit Suisse Equity Capital Markets – Brazil Database (Sep-2010).

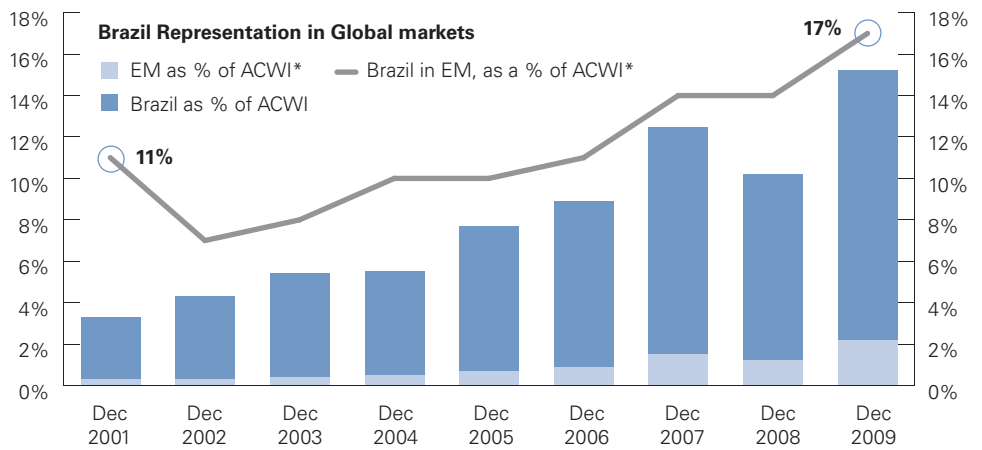
¹⁴ The IBrX is composed of the 100-best classified stocks according to their negotiability index, measured over the last twelve months.

Projections for equity market capitalisations suggest the current representation of Brazil in EM is sustainable and poised to increase further.

Drivers for increasing domestic and foreign Brazilian equity ownership

All of these important developments should facilitate the expected domestic and foreign inflows, which we believe will occur as investors recalibrate their emerging market allocations that are, on average, significantly underweight. In the past decade, the market weight of emerging market (EM) equities in the MSCI ACWI, when measured by market capitalisation, has grown from roughly 3% to 13%, while Brazil's weight alone has increased from less than half of a percent to over 2%. Brazil has outgrown the emerging markets by more than 1.5X, leading Brazil's allocation in EM, as a percentage of ACWI, from 11% to 17% over the last 10 years. Projections for equity market capitalisations suggest the current representation of Brazil in EM is sustainable and poised to increase further. The collective GDP for the emerging markets has been increasing faster than its market cap,¹⁵ suggesting a potential catch-up may be coming. The reverse has already been proven true for Japan, where a significant drop in GDP preceded an eventual corresponding drop in market capitalisation. However, despite current and projected EM market capitalisation, institutional investors continue to maintain significant structural underweights to emerging markets, with an average 6% allocation to EM equities from US defined benefit pension plans.¹⁶ While some European plans have progressively edged toward 25% allocations, many are not even at 10%.¹⁷

Exhibit 7 – Expanding emerging market opportunity set



Source: MSCI All Country World Index, De-2009.

Lower rates will prompt fund flows from Brazilian bonds to equities

Finally, we believe that over the longer term, interest rates in Brazil will decline, which could spark additional domestic investment in equities once the yield on bonds is less attractive. Today, the domestic mutual fund industry has a 12% allocation to equities, which we believe will significantly increase in the next 5 years. In addition, the allocation to equities from Brazilian pension funds in 2009, excluding the Banco do Brasil Pension Fund, Previ, which holds strategic equity stakes in large companies, was 20% of assets and is likely to rise as interest rates decline over time. Furthermore, only about 5% of Brazil's population hold investment fund accounts, compared with about 60% in the US, and of that only 14% are invested in equities, compared with a world average of almost 40%.¹⁸

15 Morgan Stanley, EM Equities – Looking Ahead Ten Years, 25-Mar-2010.

16 Source: Pensions & Investments, Jan-2010, 200 largest defined benefit (DB) pension plans as defined by total plan assets. Allocation to EM equities is the percentage of emerging market equities out of total equities.

17 Source: MSCI Barra Research, A Fresh Look at the Strategic Equity Allocation of European Institutional Investors, Jan-2010, data as of 2008 showing a sample UK, Dutch and Danish pension plan.

18 Source: BM&F Bovespa presentation Jul-2010, data from ICI – Investment Companies Institute and Anbima.

Brazil's economic prosperity continues to have a transformational impact on its equity markets. Equity markets are continuing to meaningfully develop, driving significant investment opportunities, improved corporate governance and liquidity.

We believe most of the key risks are short term in nature and unlikely to derail the virtuous cycle of sustainable growth in Brazil.

First, in the very short term, the upcoming presidential elections can create uncertainty, but we believe the next government will uphold the three pillars of the macroeconomic model, namely inflation control, fiscal responsibility and a free floating exchange rate regime, as the cornerstones of the macroeconomic framework, which will allow Brazil's economy to continue to prosper. In our view, the biggest risk lies on the worsening of the fiscal behavior which we have seen in the last few years, partly as a result of the global crisis, which has in turn led to a growing gross government debt. It will be important to see this short term phenomenon proving to be temporary rather than permanent. Second, Brazil's high interest rates may rise in the near term to control inflation, however that will only happen if growth is higher than expected which will in turn lead to higher earnings. Overtime, interest rates are likely to converge closer to global levels, ultimately benefiting equities. Third, while it is true that in the short term volatility in commodity prices may lead to a disproportionate impact in Brazilian equities due to the strong representation of commodities in the Ibovespa index, the actual impact on GDP is significantly smaller and as the equity market broadens we expect that impact to fade overtime. Additionally, over the long term, we expect global growth, particularly in the Emerging Markets, to fuel significant demand for commodities, which should be a tailwind for Brazilian equities.

Conclusion

Brazil is hitting its stride and beginning to realise its long-awaited potential. Having learned from previous boom and bust cycles, its sound macroeconomic policy of the last 15 years has set the stage for above average growth over the foreseeable future. Importantly, this growth is being driven not just by the country's wealth of natural resources, but by steady and significant growth in real income and personal consumption, as well as a massive infrastructure spending program.

Brazil's economic prosperity continues to have a transformational impact on its equity markets. Strong GDP growth is leading to above average corporate earnings growth and a boom in equity capital markets activity. Equity markets are continuing to meaningfully develop, driving significant investment opportunities, improved corporate governance and liquidity. Importantly, this expansion comes at a time when investors are reassessing underweights to emerging market countries, particularly in light of their rising economic importance and investibility. The case for owning Brazil equities is strong— their market valuation looks attractive relative to global markets and earnings growth, and the long-term trend of lower interest rates should continue to support even further equity ownership.

If you would like more information please contact your Goldman Sachs Asset Management Relationship Manager

Disclosures

This material has been prepared by GSAM and is not a product of the Goldman Sachs Global Investment Research (GIR) Department. The views and opinions expressed may differ from the views and opinions expressed by the GIR Department or other departments or divisions of Goldman Sachs and its affiliates. Investors are urged to consult with their financial advisors before buying or selling any securities. This information should not be relied upon in making an investment decision. GSAM has no obligation to provide any updates or changes.

THIS MATERIAL DOES NOT CONSTITUTE AN OFFER OR SOLICITATION IN ANY JURISDICTION WHERE OR TO ANY PERSON TO WHOM IT WOULD BE UNAUTHORISED OR UNLAWFUL TO DO SO.

References to indices, benchmarks or other measures of relative market performance over a specified period of time are provided for your information only and do not imply that the portfolio will achieve similar results. The index composition may not reflect the manner in which a portfolio is constructed. While an adviser seeks to design a portfolio which reflects appropriate risk and return features, portfolio characteristics may deviate from those of the benchmark.

Although certain information has been obtained from sources believed to be reliable, we do not guarantee its accuracy, completeness or fairness. We have relied upon and assumed without independent verification, the accuracy and completeness of all information available from public sources.

This information discusses general market activity, industry or sector trends, or other broad-based economic, market or political conditions and should not be construed as research or investment advice.

Opinions expressed are current opinions as of the date appearing in this material only. No part of this material may, without GSAM's prior written consent, be (i) copied, photocopied or duplicated in any form, by any means, or (ii) distributed to any person that is not an employee, officer, director, or authorised agent of the recipient.

This material is provided for informational purposes only and should not be construed as investment advice or an offer or solicitation to buy or sell securities.

This material has been issued or approved for use in or from Hong Kong by Goldman Sachs (Asia) L.L.C. This material has been communicated in the United Kingdom by Goldman Sachs Asset Management International which is authorised and regulated by the Financial Services Authority (FSA). This material has been issued or approved for use in or from Singapore by Goldman Sachs (Singapore) Pte. (Company Number: 198602165W). Please note that neither Goldman Sachs (Asia) LLC nor any other entities involved in the Goldman Sachs Asset Management (GSAM) business maintain any licenses, authorisations or registrations in the People's Republic of China ("PRC") nor are any of the GSAM funds registered in the PRC.

Please note that neither Goldman Sachs (Asia) LLC nor any other entities involved in the Goldman Sachs Asset Management (GSAM) business maintain any licenses, authorisations or registrations in the Republic of Indonesia nor are any of the GSAM funds registered in the Republic of Indonesia. No Goldman Sachs entity, other than Goldman Sachs (Asia) L.L.C, Goldman Sachs Asset Management International and Goldman Sachs Asset Management Korea Co., Ltd., is currently licensed to provide discretionary investment management services and advisory services to clients in Korea and nothing in this material should be construed as an offer to provide such services except as otherwise permitted under relevant laws and regulations. Goldman Sachs (Asia) L.L.C. is registered as a Cross-Border Discretionary Investment Management Company and a Cross-Border Investment Advisory Company with the Korean Financial Supervisory Commission, and as a licensed corporation for, amongst other regulated activities, advising on securities and asset management with the Hong Kong Securities and Futures Commission. Goldman Sachs Asset Management International is licensed as a Cross-Border Discretionary Investment Management Company and a Cross-Border Investment Advisory Company with the Korean Financial Supervisory Commission, as an investment adviser with the Securities and Exchange Commission of the United States and for Managing Investments with the Financial Services Authority of the United Kingdom. Goldman Sachs Asset Management Korea Co., Ltd. is licensed as an Asset Management Company in Korea and is also registered as an Investment Advisory Company and Discretionary Investment Management Company with the Korean Financial Supervisory Commission. Details of their respective officers and major shareholders can be provided upon request. Please note that neither Goldman Sachs (Asia) LLC nor any other entities involved in the Goldman Sachs Asset Management (GSAM) business maintain any licenses, authorisations or registrations in Malaysia nor are any of the GSAM funds registered in Malaysia. The securities may not be offered or sold within Malaysia.

These materials are provided solely for your information and consideration, and are not intended as a solicitation in respect of the purchase or sale of instruments or securities, or the provision of services. Please note that neither Goldman Sachs (Asia) LLC nor any other entities involved in the Goldman Sachs Asset Management (GSAM) business maintain any licenses, authorisations or registrations in the Philippines nor are any of the GSAM funds registered with the Securities and Exchange Commission of the Philippines under the Securities Regulation Code. Not all services or products can be made available in Taiwan. Any particular offer of securities may not have been and may not be registered with the Securities and Futures Bureau, Financial Supervisory Commission of Taiwan pursuant to relevant securities laws and regulations and may therefore not be capable of being sold or publicly offered in Taiwan. The Goldman Sachs companies involved in any such promotion may not maintain any licenses, authorisations or registrations in Taiwan. Please note that neither Goldman Sachs (Asia) LLC nor any other entities involved in the Goldman Sachs Asset Management (GSAM) maintains any licenses, authorisations or registrations in Thailand nor are any of the GSAM funds registered in Thailand. The offer and sale of securities within Thailand and the provision of investment management services in Thailand or to Thai entities may not be possible or may be subject to legal restrictions or conditions. This presentation has been communicated in Canada by GSAM LP, which is registered as a portfolio manager under securities legislation in certain provinces of Canada and as a non-resident commodity trading manager under the commodity futures legislation of Ontario. In other provinces, GSAM LP conducts its activities under exemptions from the adviser registration requirements. In certain provinces, GSAM LP is not registered to provide investment advisory or portfolio management services in respect of exchange-traded futures or options contracts and is not offering to provide such investment advisory or portfolio management services in such provinces by delivery of this material.

Copyright © 2010, Goldman, Sachs & Co. All rights reserved, Compliance Code: 42662.OTHER.TMPL.



**Asset
Management**