Global Equity Outlook

Seeing Potential in the Fundamental

We believe economic indicators, corporate earnings reports and comments from public company managements point to the potential for positive equity returns in 2016 despite the rough start to the year. In this outlook for the second quarter, we discuss several macro themes influencing equity markets:

- **Oil prices have risen as production cuts reduce supply.** We have slightly increased our energy exposure by adding to positions in large, integrated oil companies (p.2).
- **Commodity-related credit issues have remained largely contained to high-yield bonds.** We believe most major banks in developed markets have adequately provided for their exposure to oil- and commodity-related loans (p.2).
- **Low and negative interest rates could benefit income-oriented equities.** Real estate and infrastructure look interesting. However, bank margins are likely to be pressured (p.3).
- **Political risks are rising in many regions.** Particularly in the UK, Europe and the US, there is more risk to investment decisions posed by unpredictability of elections and other events (p.3).

We also explain why fundamentals suggest equities could generate positive returns this year. While we believe European and Japanese equities have more upside potential given recent underperformance, there are areas of each major market we want to own as well as avoid. In our view, active management is the only way to achieve this selective exposure.

- **US:** The consumer-related economy is healthy, in our view, and equity market performance is broadening from last year's narrow group of winners. We emphasize stock selection to avoid companies more exposed to late-cycle economic challenges including revenue growth, earnings quality and valuation (p.5).
- **Europe:** We continue to believe that European earnings growth could catch up to that of the US with just modest economic growth. We see a number of signs of economic recovery and highlight the central bank's support. However, we note that political risks have increased (p.6).
- **Japan:** Corporate reforms, high levels of cash and domestic consumption could drive equities higher. Skepticism on the economy and reforms remains but we believe low valuations reflect the uncertainty (p.7).
- **Emerging Markets (EM):** The recent market rebound is stronger than fundamentals in many markets but we find some attractive investments across EM. We highlight e-commerce (p.8).

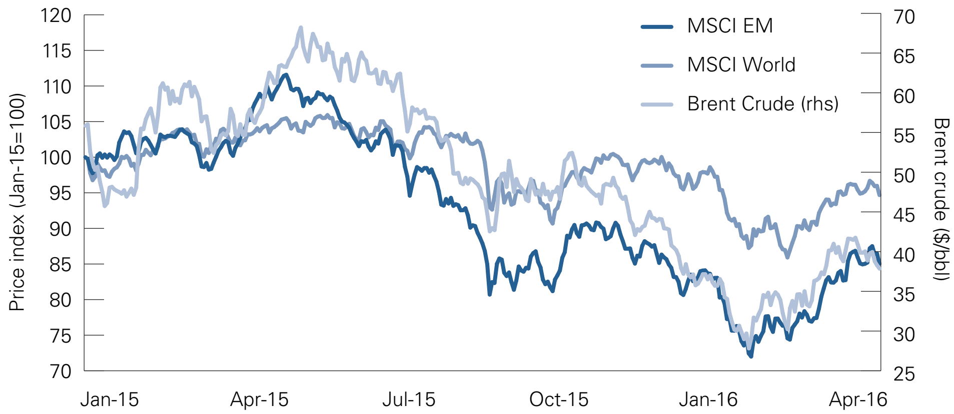
Exiting the negative macro feedback loop

As the New Year began, fears of recession and deflation generated a negative feedback loop in financial markets. Oil prices sank on fears of reduced demand, credit spreads widened on worries about defaults and equity investors lost confidence.

Markets began to recover mid-quarter, driven primarily by rising oil prices, but investors continue to lack conviction given a barrage of mixed signals. As we move into the second quarter, we see potential for change in sentiment as we believe many macro factors are improving or will at least prove manageable.

Signs of stabilization in oil markets and prices
We continue to believe that oil prices had collapsed because of oversupply rather than weak demand. Production volumes are declining and prices appear to be stabilizing in the high $30s and low $40s. If prices rise and stay above $40-45 per barrel, we believe producers may begin bringing supply back on line.

Equity markets have been highly correlated with oil prices



Source: Datastream, as of April 5, 2016.

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In our view, stable oil prices around current levels should be positive for most economies and financial markets. We have been broadly underweight energy across our portfolios but started to increase our exposure selectively during the quarter. In the US, we trimmed our exposure to US exploration and production (E&P) stocks that hit our price targets. We added to large integrated oil companies, where we see more upside potential. We have also shifted toward oil and away from heavy exposure to natural gas.

All together now: oil prices, credit, equities and banks
Energy-related defaults have so far remained in line with our expectations and have been largely contained within the high yield sector. Spreads have widened for some investment grade bonds, but we believe the issues in the energy and credit markets will likely prove manageable. This is largely because we believe most major banks have adequately provided for energy- and commodity-related loans and want to work with their customers to find a solution.

US banks are far ahead on excess capital and asset quality, as demonstrated by their ability to pay dividends and buy back stock and we reiterate our view that the credit environment could stay benign for a long time.

European banks in aggregate have raised nearly €800 billion since the beginning of the financial crisis[1] and we believe the majority are in good shape. In our view, a small percentage of the banking system in Europe needs to be recapitalized, mostly in Italy. We continue to be more concerned about banks in emerging markets with exposure to oil- and commodity-related loans, especially those that have been slow to write down bad debts.

Interest rates and financials stocks
We believe interest rates will be the prime driver of the performance of financials stocks. The trajectory of rate hikes in the US is now less certain. The market is pricing in two hikes this year and our fixed income team views this as a reasonable estimate. In our view, US banks could outperform if rate hikes meet or exceed expectations but otherwise the sector could struggle, given low net interest margins.

We are interested in income-oriented equities, including real estate and infrastructure.

European and Japanese rates are in uncharted negative territory. Negative rates are intended to entice companies to borrow and banks to lend but the policies could backfire, squeezing bank margins and earnings. We remain cautious on large Japanese banks in the near term, while in Europe we are more exposed to regional and retail-oriented banks.

We are interested in income-oriented equities, including real estate and infrastructure. In our view, real estate looks attractive in economies with supportive monetary policies, strong real estate fundamentals from a supply/demand perspective and low growth. Japan is a good example, and we favor exposure to real estate there over banks, particularly given the attractive valuations of many property companies. In the US, we like parts of the market with more growth and prudent balance sheet management.

Rising political risks
Complex geopolitical issues and an increasingly divisive political landscape have contributed to the recent market uncertainty and volatility. In Europe, growing far-right and far-left influences could chip away at the ability of mainstream parties to work together across borders for pan-European solutions. Polls suggest that the outcomes of the UK referendum on EU membership and the US presidential election remain uncertain.

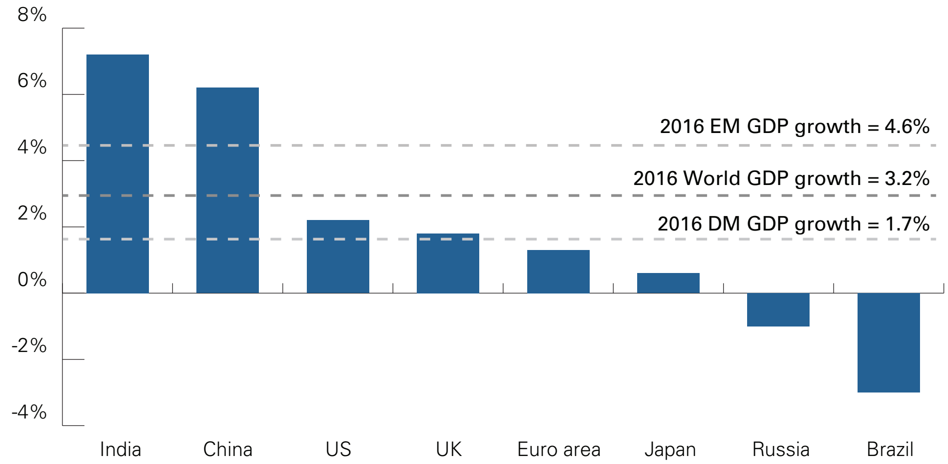
Risk to investment decisions increases as predictability decreases. Political noise can at times drown out the low undertone of economic and corporate fundamentals and we believe the effect on markets to be temporary. More concerning would be a high level of political uncertainty that paralyzes corporate decision-making and consumer spending, which could have genuine economic implications.

Fundamentals point to potential for positive equity returns

Negative headlines and market signals gave investors plenty to worry about in the last few months and overshadowed awareness that many economic and corporate fundamentals were strong or improving. Fourth quarter corporate earnings across developed markets came in mostly in line or ahead of consensus expectations. GSAM's growth forecasts remain modest but should be enough to support continued earnings growth.

[1] Goldman Sachs Global Investment Research: Ample Liquidity, more capital reduce "crisis re-run" risk; P&L trends soften, February 9, 2016.

2016 GDP growth forecasts are modest but enough to support earnings growth, in our view



Source: GSAM, as of April 7, 2016.

We also note that most developed market global purchasing managers' indices (PMIs) remain above 50, indicating economic expansion, and unemployment has fallen to pre-financial crisis levels in the US and Japan. Both bode well for consumers.

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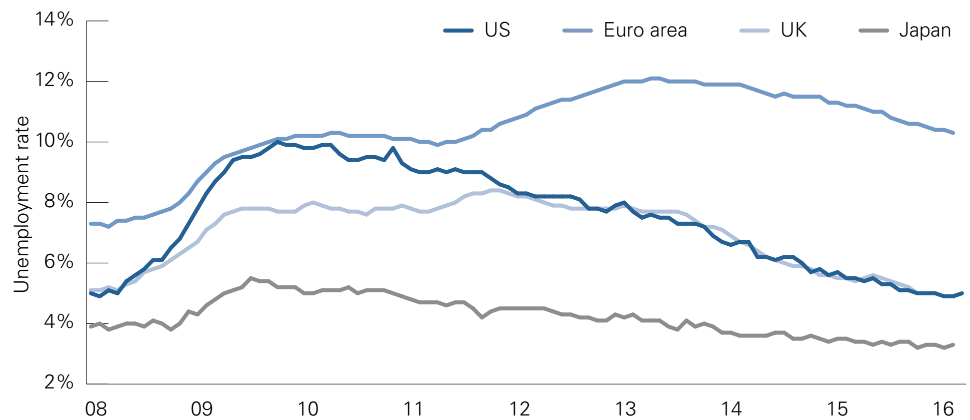


Source: BLS, Eurostat, MHLW via Haver, as of April 6, 2016.

While we believe European and Japanese equities have more upside potential given recent underperformance, there are elements of each major market we want to own and want to avoid. In our view, active management is the only way to achieve that selective exposure.

We find that many comments and anecdotes from company management teams reflect pockets of health and optimism across industries and geographies.

We continue to believe that global equities can return in the mid-single digits this year, predominantly driven by earnings growth. In our view, positive returns in a low (and potentially negative) return environment make equities attractive, particularly relative to other asset classes such as bonds, commodities and cash.

While we believe European and Japanese equities have more upside potential given recent underperformance, there are elements of each major equity market we want to own and want to avoid. In our view, active management is the only way to achieve that selective exposure. In this section we discuss what we believe is most compelling and most challenging about each major region.

US: Still going strong

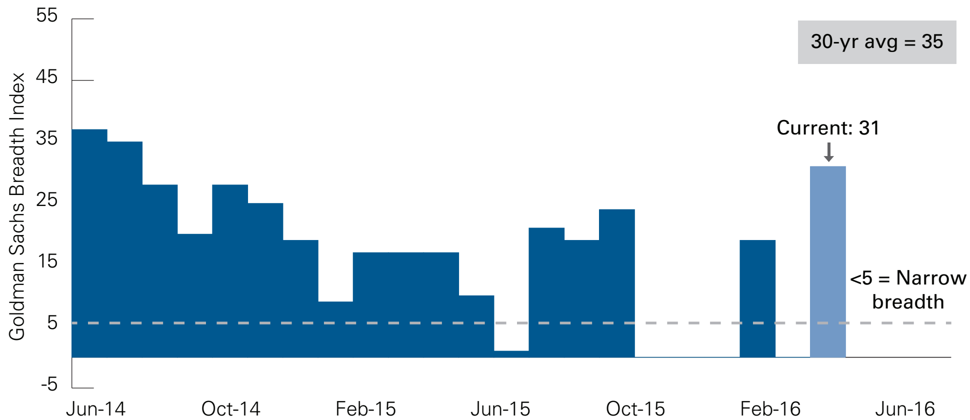
The US consumer-related economy is healthy, in our view. Low unemployment, recovering housing prices and low energy prices have supported consumption and we believe consumer spending can broaden from areas that have already benefitted such as autos, home improvement and restaurants.

The US equity market is likely to outperform other regions if sentiment on the global economy is soft.

The US equity market is likely to outperform other regions if sentiment on the global economy is soft. We like the US equity market's industry disruptors. They are often long-term secular growth winners as well as asset-light companies. We find many examples in the technology and healthcare sectors.

Last year's unusually narrow market has set up potential for many stocks that lagged to outperform. We also note earnings headwinds for some sectors, such as an appreciating dollar and declining oil prices, are subsiding. As a result, aggregate earnings for the US equity market could improve in 2016.

More stocks are participating in US market gains so far this year



Source: Goldman Sachs Global Investment Research, as of March 31, 2016.
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The US economy and equity market have moved to late-cycle, as we discussed in our last outlook. In the latter part of the economic cycle, companies find it harder to generate revenue growth, which makes growing earnings more challenging. Valuations also tend to be higher.

Currently, the gap between the operating earnings per share (EPS) and adjusted EPS in 2015 was 18%, the highest in 25 years.[2] Mounting non-cash costs, such as impairment for some energy companies and options for many technology companies, account for most of the difference, because they are excluded in adjusted EPS but reduce operating EPS. In our view, more scrutiny on earnings could increase the dispersion of share price returns and potentially benefit stock-picking strategies.

[2] Goldman Sachs Global Investment Research: Operating and adjusted EPS both indicate high S&P 500 valuation, March 14, 2016. GSAM leverages the resources of Goldman, Sachs & Co. subject to legal, internal and regulatory restrictions.

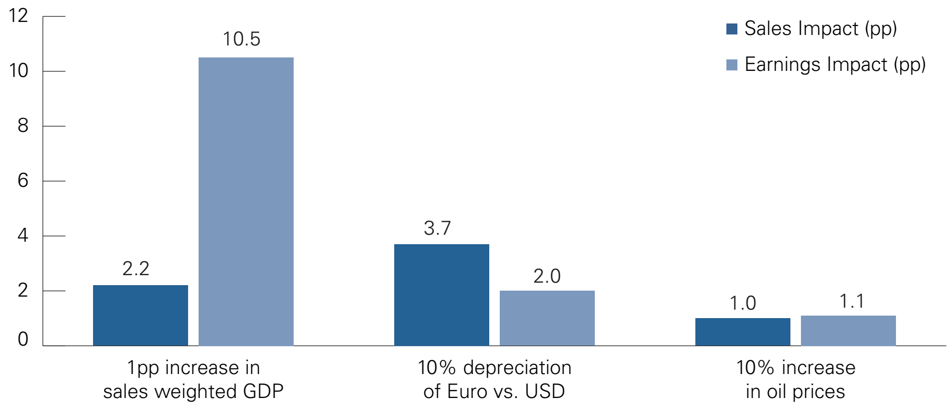
One reason we remain optimistic is because European companies, on average, have higher operating leverage—a higher proportion of fixed-to-variable costs—so their earnings benefit more from increases in sales.

Europe: Earnings growth potential intact

We continue to believe the primary driver for European equities is the potential for an earnings growth catch-up with the US. One reason we remain optimistic is because European companies, on average, have higher operating leverage—a higher proportion of fixed-to-variable costs—so their earnings benefit more from increases in sales.

We believe that economic recovery will drive an increase in revenues and note that European earnings could be particularly sensitive to an increase in GDP growth. An analysis from GS Global Investment Research shows that each percentage point increase in sales-weighted GDP (end-market GDP growth weighted by the revenue exposure of STOXX 600 to each end-market) increases earnings by 10.5 percentage points, by far the most significant macro factor driving earnings.[3]

On average, higher operating leverage allows European company earnings to benefit more from small improvements in GDP growth



Source: Goldman Sachs Global Investment Research, April 4, 2014.

Consensus expectations for Eurozone and UK growth this year are 1.50% and 2.00%, respectively. We believe this could be enough to kick-off enough revenue growth to further boost earnings growth and stock prices. We note a number of positive indicators of economic growth in the Eurozone: rising auto and retail sales and positive credit growth; toll road usage was up in France and Germany in the fourth quarter.

In addition, the ECB remains highly focused on growth. In March, the central bank announced a broad set of easing measures that exceeded market expectations.

While we are optimistic about the prospect of the domestic recovery in Europe, we acknowledge continued weakness in the emerging markets, which are an important end market for Europe. As such, we continue to favor companies more exposed to the domestic recovery and less exposed to EM end markets.

The whole scenario of operating leverage-driven earnings growth gets called into question if economic growth looks at risk. Political risks have increased, even since last quarter, and are likely to be dominating headlines over the next quarter.

Political uncertainty could negatively impact economic growth and corporate earnings by stalling corporate decisions on items including capital expenditure. We have not yet seen evidence of this happening. We continue to factor rising political risk into our analysis. We also believe valuations are currently incorporating some of this increased risk, as the discount to the US has once again widened.

[3] Goldman Sachs global Investment Research: Profit Pathology: A macro investor's guide to the European profit cycle, April 4, 2014.

Despite strong earnings growth, Japan is the only developed equity market where valuations have fallen over the last several years. Approximately 50% of companies in the TOPIX are still trading below book value, although aggregate ROE has risen back toward the developed market average.

Japan: Corporate reforms, cash and domestic consumption
Corporate reforms introduced as part of Prime Minister Abe's Three Arrows plan are having a meaningful impact on profitability and shareholder returns and continued progress could be a significant driver of equity returns.

Japanese companies have often lagged their peers in other developed markets when it comes to measures of profitability including return on equity (ROE) but are catching up to the developed market average. Many companies have also made progress on corporate governance, with more independent directors and further unwinding of cross shareholdings. An improvement in shareholder orientation has boosted share buybacks and dividends to multi-year highs.

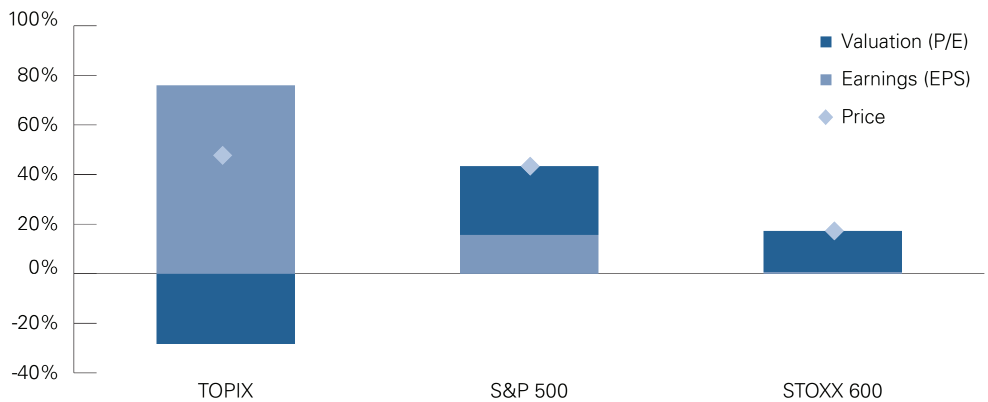
A high level of cash on corporate balance sheets, particularly in an environment of negative interest rates, means plenty of potential for more buybacks and dividends. The total value of buybacks as a percentage of total TOPIX market capitalization remains low, at just 0.93%, compared to 2.80% for the S&P500 Index.[4] Similarly, extra cash could be used for dividend payments. Some estimates suggest payments could rise to the level of about a 2.00% yield for the TOPIX in aggregate.[5] Japanese companies might also use excess cash for mergers and acquisitions (M&A), which could be positive for equities, provided companies pay appropriate prices.

Japanese households may find equities that pay dividends more attractive than cash and they are cash rich, with roughly 50% of assets in cash, compared to 35% in Europe and 13% in the US.[6] Pension plans are also likely to continue their re-allocation into equities.

Negative interest rates combined with record low unemployment and expectations of rising wage growth means consumer spending could increase. Furthermore, inbound tourism to Japan remains high and tourist spending is helping to boost domestic consumption. We maintain a favorable view on domestically-oriented companies.

The Japanese equity market also looks attractive on valuation. Despite strong earnings growth, Japan is the only developed equity market where valuations have fallen over the last several years. Approximately 50% of companies in the TOPIX are still trading below book value, although aggregate ROE has risen back toward the developed market average.[7]

Japanese equity market valuations have actually come down, despite improving earnings growth
January 1, 2013 to April 5, 2016



Source: I/B/E/S, Datastream, as of April 5, 2016. Calculated using consensus calendarized FY1 period earnings per share (EPS) and price-to-earnings (P/E).

[4] Goldman Sachs Global Investment Research report - Share buybacks at a new high driven by governance reforms, February 24, 2016.
[5] Goldman Sachs Global Investment Research report - Sub-Zero: Opportunities & Obstacles of Negative Rates, March 2, 2016.
[6] Household financial assets from Nomura, Bank of Japan, as of September 2015.
[7] Datastream, MSCI as of April 11, 2016.

A weak yen has boosted corporate profitability but so has years of restructuring. Japanese companies are now less sensitive to currency movement than in the past because of their higher margins, something we don't think the market fully appreciates.

We believe valuations reflect some skepticism over whether economic recovery and reforms are taking hold. With respect to structural reforms, the process of cultural change is slow, and it can take time for investors to gain confidence in corporate reforms. Negative rates should theoretically increase spending, but could dampen consumer and business sentiment, causing companies to delay investments.

EM: Underweight inefficiency, overweight innovation

The rally underscores why we continue to invest in companies across EM, regardless of our view on a particular country's economic outlook.

Many EM markets rallied in the first quarter on rising oil prices and the expectation that China may re-boot investment to spur flagging economic growth. The rally underscores why we continue to invest in companies across EM, regardless of our view on a country's economic outlook. Fundamentals in many countries are not improving in the way that they are in some developed markets. We believe Brazil, Russia and South Africa face further challenges as continued low oil and commodity prices are beginning to affect consumption, but we continue to believe India has the best macroeconomic outlook.

We remain cautious on state-owned enterprises (SOEs) across most of EM as they have objectives other than maximizing shareholder returns. Having significantly less exposure to some of these large benchmark weightings allows us extra capital to invest in more innovative parts of the market.

We find many interesting opportunities related to the evolving EM consumer, especially with regard to e-commerce. India has one billion mobile users and will likely have 800 million smartphones users by 2020. Currently, only 1.00% of retail sales in India are online,[8] compared to 14% in South Korea[9] and 12% in China.[10]

One of the key questions we continue to consider is how local and global competitors will share the EM retail marketplace, both on the ground and online. Already, several Indian companies are racing to dominate internet retailing in the way that Amazon and Alibaba have done in the US and China, respectively. We believe a growing e-commerce ecosystem is likely to spawn development in financial technology and other internet-related development.

Other EM consumer markets are continuing to change in ways that will create new winners and losers in the retail market. In China, customer traffic has shifted away from hyper-markets to e-commerce within the last decade. Many companies we speak with have also noted an increasing focus on value for money from Chinese consumers, some of which can be attributed to being able to easily compare prices on the internet. Tourism, which is booming in China, is also increasingly moving online. We continue to favor companies exposed to the growth of e-commerce as well as other areas of consumer growth such as travel, tourism, wellness and leisure activities.

[8] Morgan Stanley India Internet Primer, February 2016.

[9] KOSIS and BAML Equity Research, as of February 2016.

[10] iResearch, as of December 2015.

Return to fundamentals

Equity markets seem to be exiting the macro feedback loop. The second quarter has thus far offered a chance to look at the fundamentals and see that opportunities for positive gains remain. As fundamental equity investors, we take some comfort in the ability to ground our views and portfolio decisions in objective and detailed analysis from a wide variety of primary sources. While markets will undoubtedly go through periods where fundamentals are ignored or discounted, we believe stocks will ultimately trade on their earnings growth potential. While each major regional market has its challenges, we believe they all offer plenty of companies with strong fundamentals and stocks with upside potential.

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5. Order Execution: Goldman Sachs AG has put in place arrangements that enable Goldman Sachs AG to comply with applicable requirements in relation to best execution as they apply to investment firms providing services of reception and transmission including an execution policy (the "Execution Policy") information on which is set out below.

5.1 Scope of the Execution Policy: Goldman Sachs AG's Execution Policy applies to clients of Goldman Sachs AG when Goldman Sachs AG receives and transmits orders on behalf of clients and places them with Goldman Sachs AG affiliates or third parties, in each case in respect of financial instruments covered by MiFID and the German Securities Trading Act (Wertpapierhandelsgesetz or "WpHG").

5.2 The Relevant Obligation: When Goldman Sachs AG receives and transmits an order on behalf of a client or places an order with another entity (including affiliates of Goldman Sachs AG) for execution Goldman Sachs AG will, subject to any specific client instructions, take all reasonable steps to obtain the best possible result taking into account the factors identified in accordance with Goldman Sachs AG's Execution Policy. In such circumstances, Goldman Sachs AG will either determine the ultimate execution venue and give the other broker or dealer a specific instruction to that effect, or Goldman Sachs AG will have satisfied itself that the other broker or dealer has arrangements in place to enable Goldman Sachs AG to comply with its best execution obligation.

When Goldman Sachs AG quotes or negotiates with a client the terms of a transaction in which an affiliate is willing to deal with such client as principal for its account, therefore the Execution Policy will not apply, unless a client requests otherwise and Goldman Sachs AG agrees to such request

5.3 Executing Firms: Goldman Sachs AG includes in its Execution Policy details of the various executing firms which it accesses for each of the financial instruments covered by MiFID or WpHG in respect of which Goldman Sachs AG places or transmits orders to other entities for execution. Goldman Sachs AG includes those execution firms in its Execution Policy that it believes enable Goldman Sachs AG to obtain on a consistent basis the best possible result when placing client orders.

Goldman Sachs AG will usually transmit the orders received for execution to an executing firm for all financial instruments (including equities and fixed income instruments) to a third party or to one of Goldman Sachs AG's affiliates such as Goldman Sachs International, London, to Goldman, Sachs & Co., New York, and to Goldman Sachs Bank AG, Zurich.

5.4 Relevant Factors: In circumstances where a client has been classified as a professional client, subject to any specific instructions that Goldman Sachs AG accepts from clients, Goldman Sachs AG takes into account a range of factors that allow Goldman Sachs AG to comply with its requirements in relation to best execution as they apply to investment firms providing services of reception and transmission of orders. These may include price, costs, speed, likelihood of execution and settlement, together with any other consideration relevant to the order.

In determining what is the best possible result for a client, Goldman Sachs AG does not compare the results that can be achieved for a client on the basis of its Execution Policy and fees with results that might be achieved for a client by another investment firm on the basis of that firm's execution policy or a different structure of commission or fees, nor does Goldman Sachs AG compare the differences in its own commissions or fees which are attributable to the nature of the services that Goldman Sachs AG provides to clients.

5.5 Monitoring and Review: Goldman Sachs AG monitors the effectiveness of its order execution arrangements and Execution Policy on an ongoing basis to identify and implement any appropriate enhancements. In addition, Goldman Sachs AG regularly reviews whether the brokers and dealers to whom it transmits orders for execution and with whom Goldman Sachs AG may place orders provide for the best possible result for its clients on a consistent basis and whether Goldman Sachs AG needs to make changes to its execution arrangements.

Goldman Sachs AG will notify its clients of any material changes of its Execution Policy.

6. Conflicts of Interest and Inducements: Goldman Sachs AG and its European affiliates ("Goldman Sachs") offer a wide range of financial services to many clients. The broad range of services, such as investment research, investment advice, trading, asset management, corporate finance business including underwriting or selling in an offering of securities and advising on mergers and acquisitions, and the diverse group of clients and products may give rise to a number of competing interests. Goldman Sachs has established, implemented and maintains a written conflicts of interest policy which reflects its approach to managing such competing interests.

Goldman Sachs has identified circumstances with reference to specific services and activities, which may give rise to a conflict of interest entailing a material risk of damage to the interests of one or more of its clients.

To manage such conflicts Goldman Sachs has principles, procedures and measures that are designed to ensure that the services provided or activities conducted are carried out with integrity and an appropriate degree of independence to protect the interests of clients.

These principles, procedures and measures include the prevention or control of information exchange, appropriate organisational structures and supervisory roles (to prevent inappropriate influence of one person over another, or the involvement of a person where such involvement could impair the proper management of conflicts of interest), and avoiding any direct link between the remuneration of employees and revenues generated by them.

The policy provides that in certain circumstances it may be appropriate for Goldman Sachs to disclose the general nature of a conflict of interest to a client.

Goldman Sachs AG does not provide investment advice as a fee based investment adviser. Goldman Sachs AG may accept and retain fees received from third parties in connection with investment advice. Further details of Goldman Sachs' conflicts of interest policy are available on request.

7. Statement of Risks and Nature of Financial Instruments: A client should not deal in a financial instrument unless such client understands the nature and associated risk. A client should also be satisfied that the product is suitable in light of the client's investment objectives, risk affinity, other personal circumstances and the client's financial position. Goldman Sachs AG holds available the information on risks and nature of financial instruments.

8. Cost and Associated Charges: The actual amounts will depend on the service provided to a client. Each client will be provided with information on applicable fees and their method of calculation in writing prior to the provision of an investment service.

If you would like additional information on Goldman Sachs AG or any of its affiliates contact your usual Goldman Sachs representative.

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