

2017

# INVESTMENT OUTLOOK

Chartbook

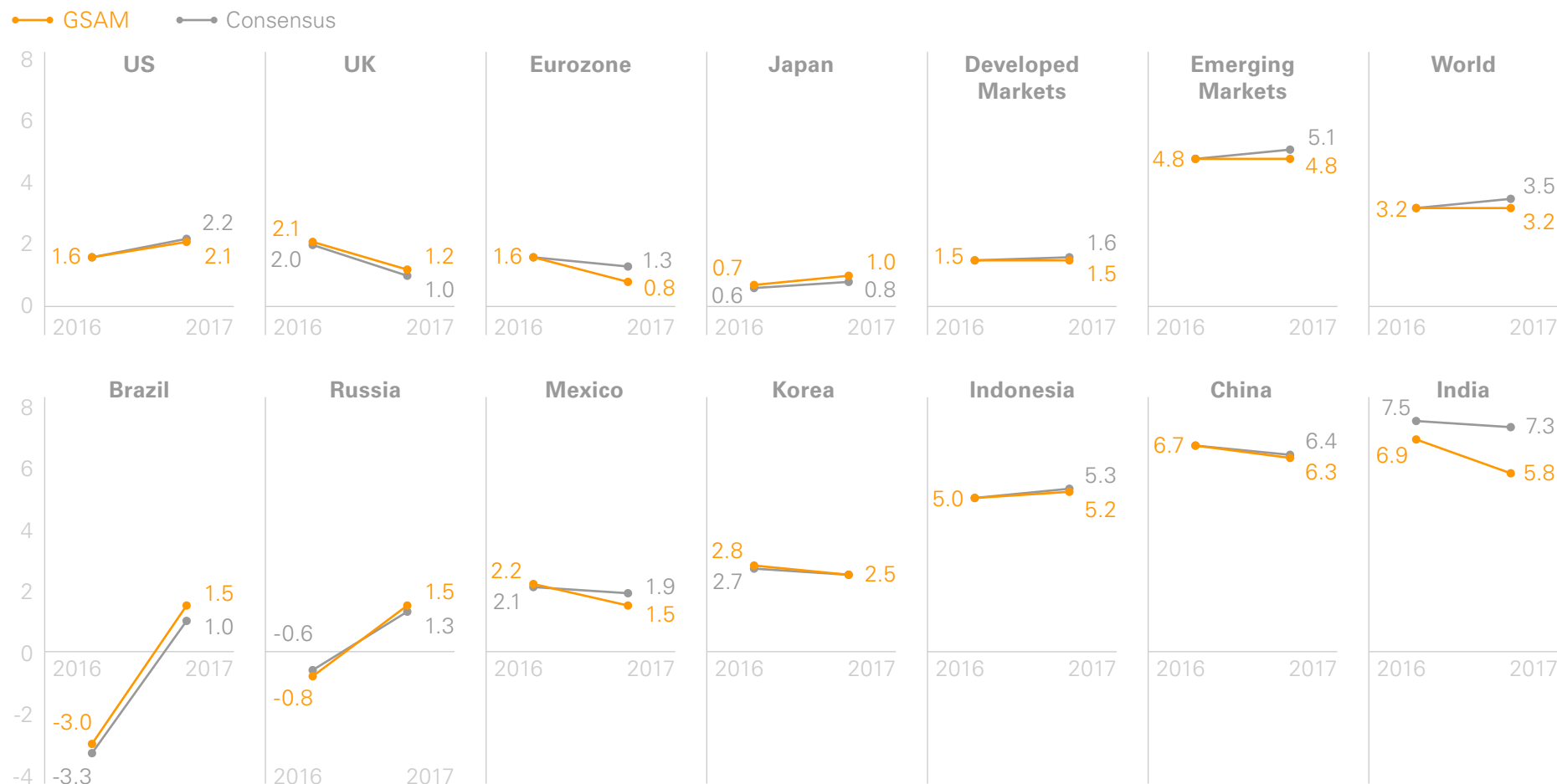
# The Long Cycle Continues

We expect the prolonged expansion phase of the growth cycle to continue in 2017



Asset  
Management

GSAM 2017 GDP Forecasts by Country, Region and Market (%)



Source: GSAM. As of December 2016. The economic and market forecasts presented herein are 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.

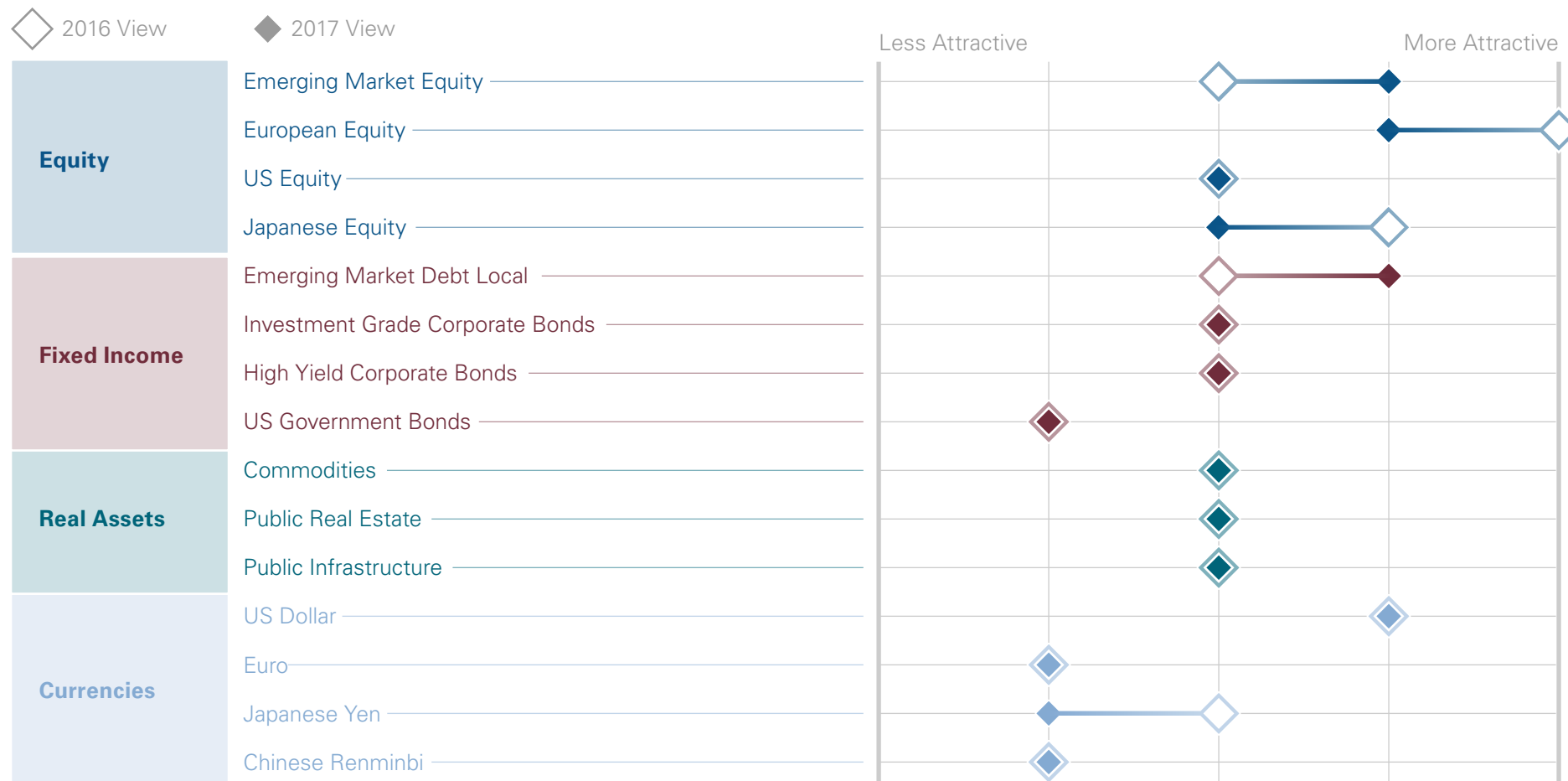
# We Believe Equities and Emerging Markets are Attractive

We favor equities and emerging market assets over corporate credit and government bonds



**Asset  
Management**

## Our 12-Month Cross-Asset Views Compared to 2016



Source: GSAM Global Portfolio Solutions (GPS) as of December 2016 and are subject to change. Chart reflects GPS relative asset allocation views and may not be representative of each GSAM portfolio team's view on opportunities within individual markets.

# The Cycle is Moving into a Period of Transition

We are watching key developments across four areas of transition that could drive market risk and investment opportunity in 2017



Asset  
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## Globalism to Populism

### Trump's First 100 Days

The first 100 days of the Trump administration will be critical for assessing policy priorities, from tax rates to trade agreements.

### Europe's Election Calendar

A Eurozone break-up scenario is unlikely in 2017 but populist gains in upcoming elections will be an important indicator of Eurozone cohesion.

### Trade (Dis)agreements

The US is likely to become more protectionist in 2017. How other countries respond will be critical to assessing the economic and market impact.

## Stagnation to Inflation

### How much is too much?

With inflation trending higher, market expectations will be as important to the outlook as the actual data.

### Earnings up, costs up, equities up?

Reflation should be positive for equities broadly, but those that cannot pass cost pressures on to consumers may see margin pressure.

### Could rates become the risk asset?

Reflation is likely to be negative for government bonds, which could become a source of volatility to other markets, such as credit.

## Monetary to Fiscal Policy

### Taper Tantrum 2.0?

A material change in the pace of European Central Bank or Bank of Japan asset purchases may drive volatility and a pullback in risk appetite.

### Trump's First Fed Picks

Trump can reshape the Federal Reserve ("Fed") and his first nominations will provide important insights into the central bank's policy direction.

### A Global Fiscal Big Bang?

Fiscal stimulus expectations have benefitted growth-oriented assets and weighed on government bonds. Long-term implications are more nuanced.

## Regulation to De-Regulation

### Divergence in Financial Sector Regulation

How far the US pendulum swings from regulation to de-regulation will hold important implications for UK and European financial regulation.

### China's Regulatory Agenda

China is likely to focus on stability rather than reform ahead of the twice-a-decade National Congress in the fall of 2017.

### Sector Specific Announcements

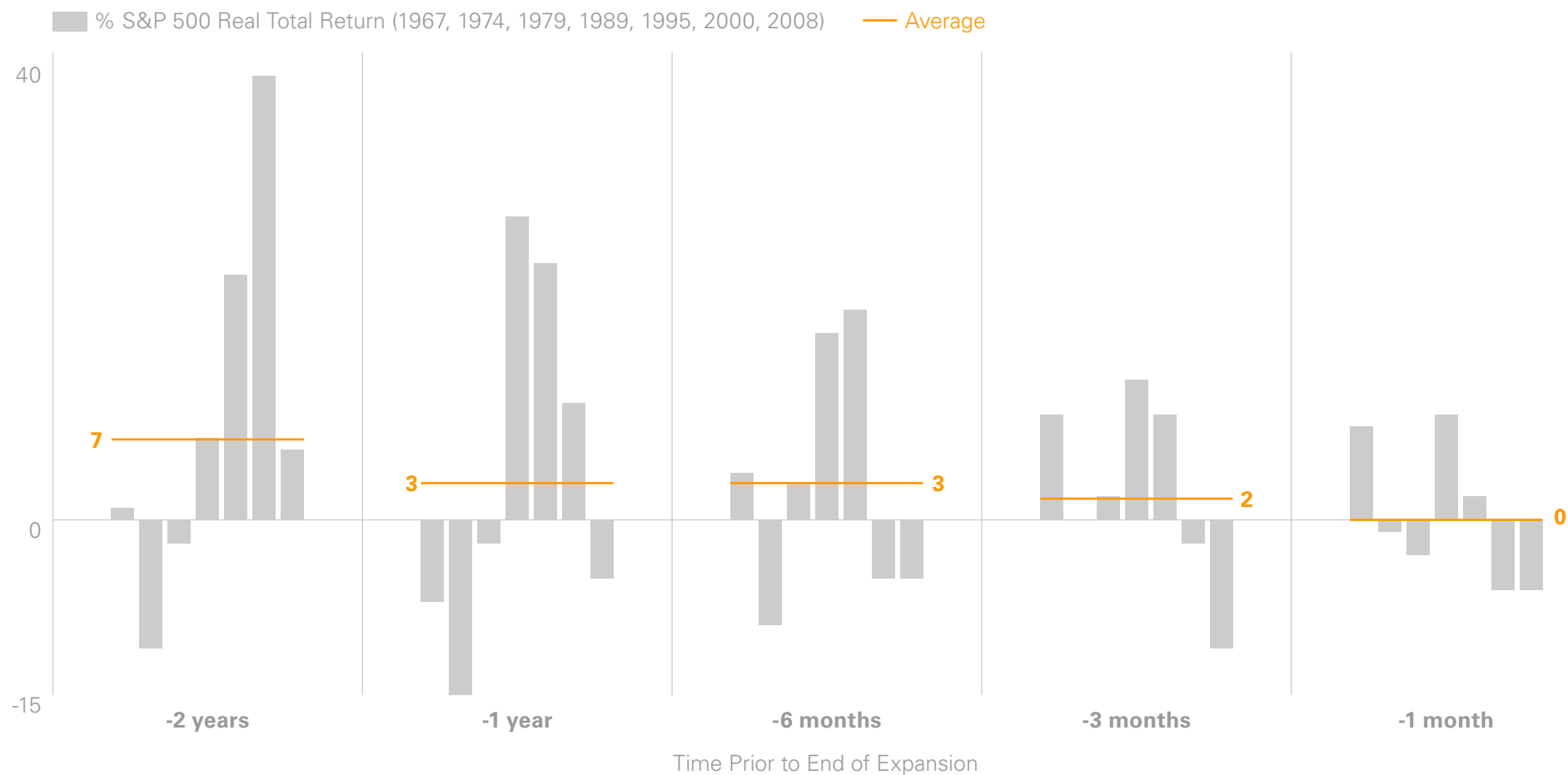
Changes in energy and healthcare regulation could create divergence among companies and sectors, creating security selection opportunities.

# Is it Time to De-risk?

We think the risk/reward potential of equities remains attractive, even in the later stages of the growth cycle



Asset  
Management



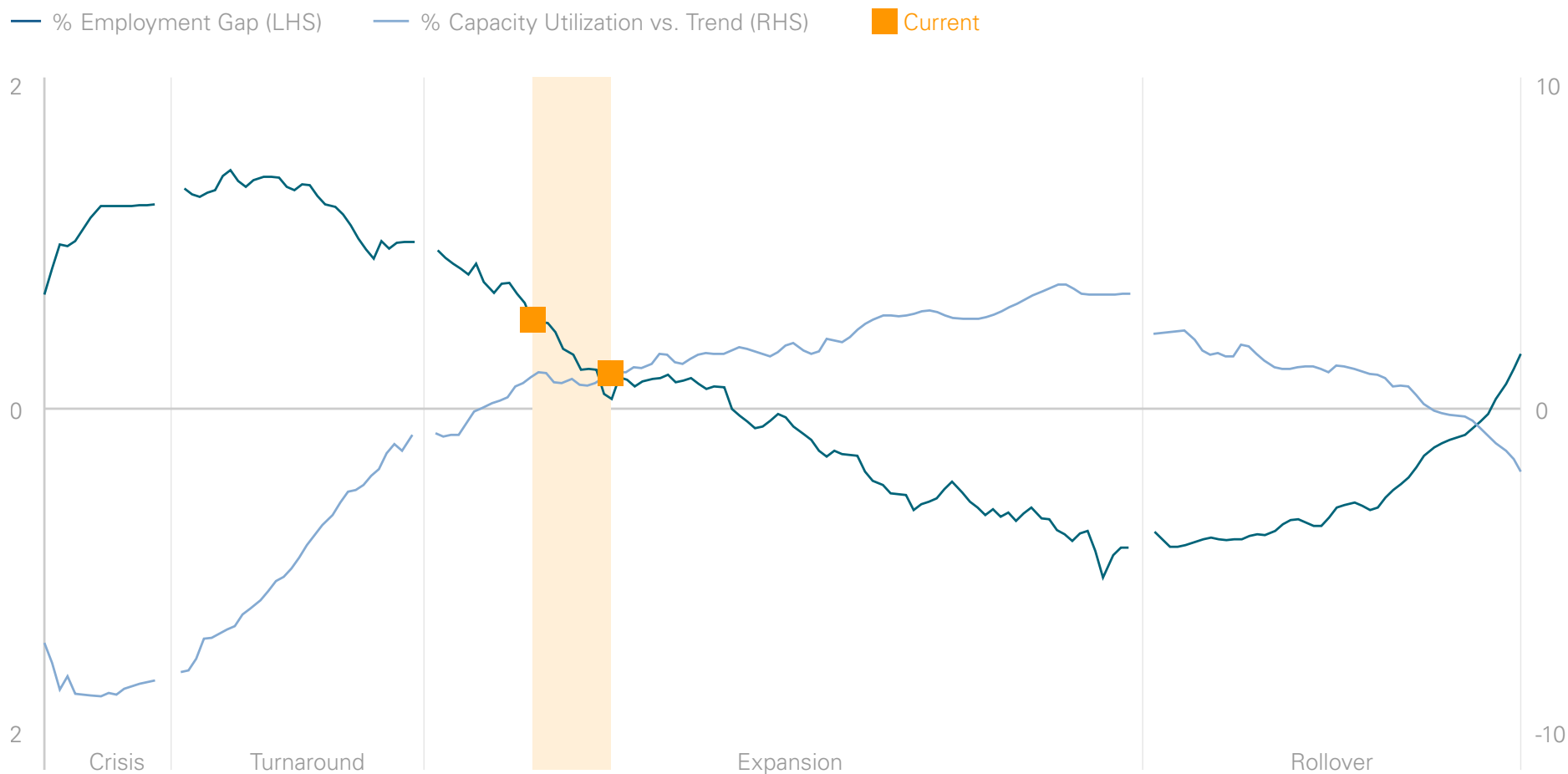
Source: Haver Analytics, GSAM Global Portfolio Solutions. Real return is the return after adjusting for inflation. As of December 2016. Shows returns for economic expansions ending Jan. 1967, Feb. 1974, May 1979, July 1989, June 1995, Sept. 2000 and Jan. 2008. **Past performance does not guarantee future results, which may vary.**

# Is it Time to De-risk?

US employment and capacity utilization in manufacturing suggest the current expansion has room to run



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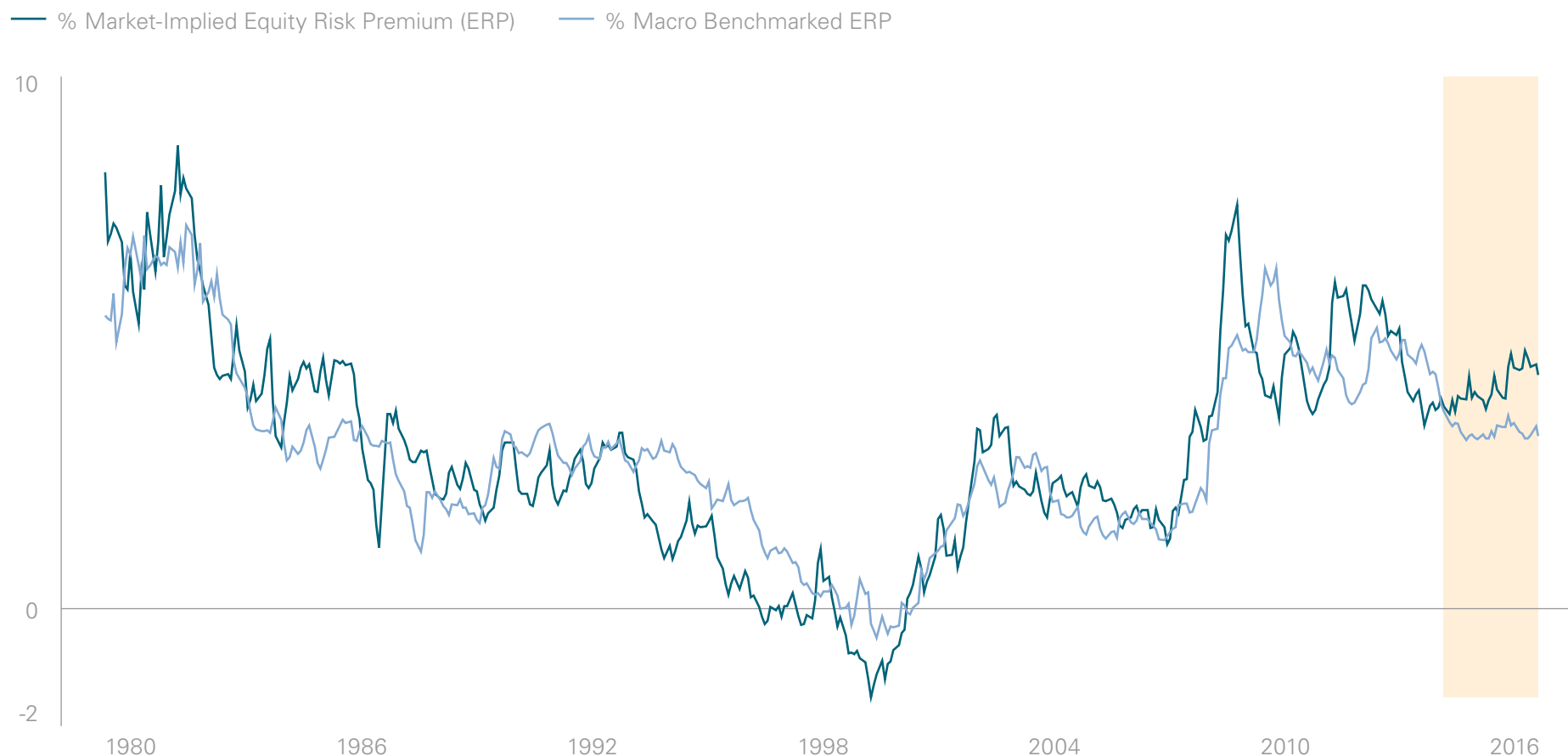
Source: Haver Analytics, GSAM Global Portfolio Solutions. As of December 2016.

# Is it Time to De-risk?

While equity valuations are elevated on an absolute basis, we believe they are reasonable considering the macro environment and interest rate levels



**Asset  
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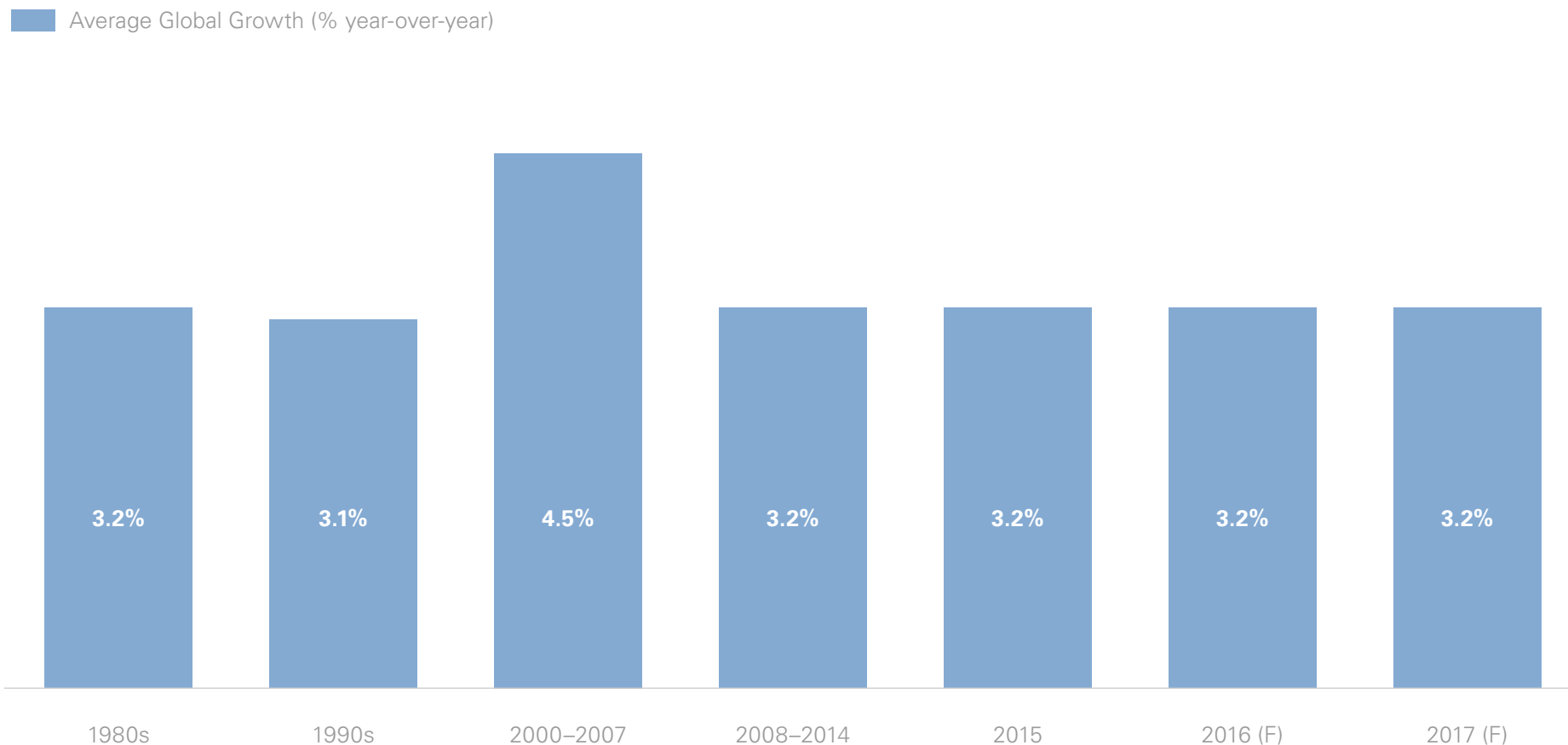
Source: Haver Analytics, Robert Shiller data, GSAM Global Portfolio Solutions. As of December 2016. The market implied ERP is based on a 1-stage dividend discount model and cyclically adjusted earnings. The macro benchmarked ERP is GSAM's estimate of the fair level of the ERP given prevailing macro conditions. There can be no assurance that these estimates can be realized. Actual ERP is likely to vary. The equity risk premium measures the market-implied return expectations for owning stocks versus a "risk-free" asset.

# Global Growth: A Prolonged Cycle or Secular Stagnation?

Global growth since the financial crisis has been remarkably steady, suggesting a prolonged cycle rather than a structural shift to secular stagnation



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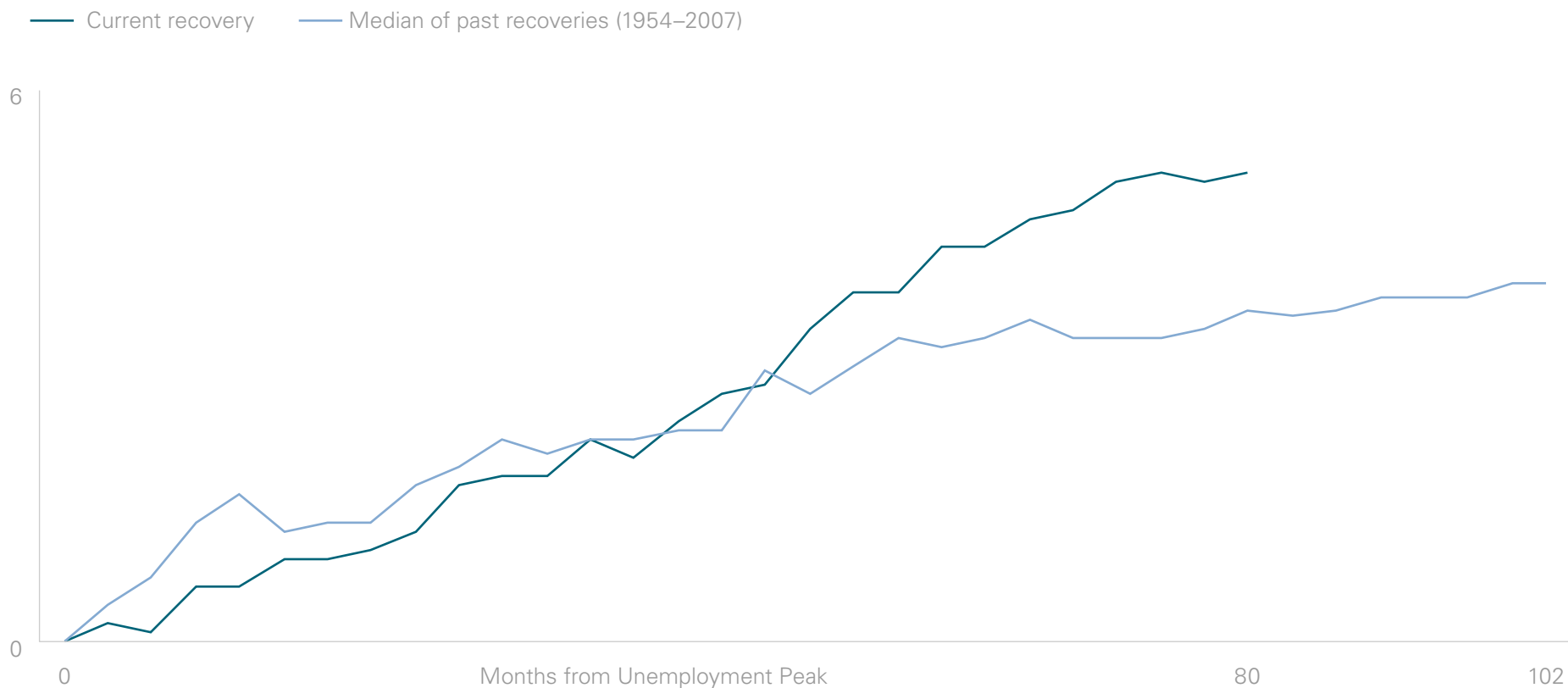
# Global Growth: A Prolonged Cycle or Secular Stagnation?

Even in the US, where growth has been weak relative to previous recoveries, the improvement in the labor market has been in line with past recoveries



Asset  
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Improvement in Unemployment from Peak (Percentage Points)



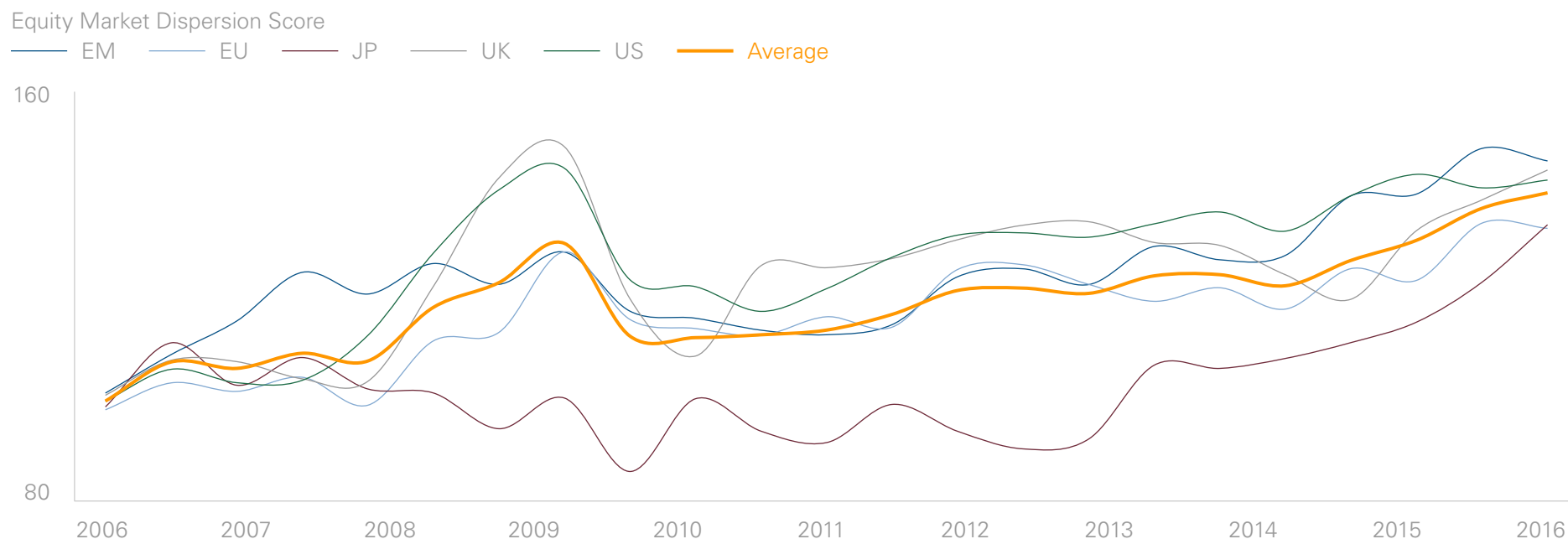
Source: Haver Analytics, GSAM Global Portfolio Solutions. Represents the median (the middle value in a consecutive series) improvement from peak during past recoveries from 1954–2007.

# Periods of Transition Can Create Investment Opportunity

Return prospects at the asset class level may be lower due to elevated valuations, but high equity market dispersion suggests security selection opportunities



Asset  
Management



“After years of relatively predictable economic policymaking, 2016 has been a steep inflection point. Given uncertain political dynamics around the globe, we believe staying nimble in industry allocations and responsive to changing market dynamics will be critical in the coming years.”

—Dennis Walsh, Portfolio Manager, Quantitative Investment Strategies

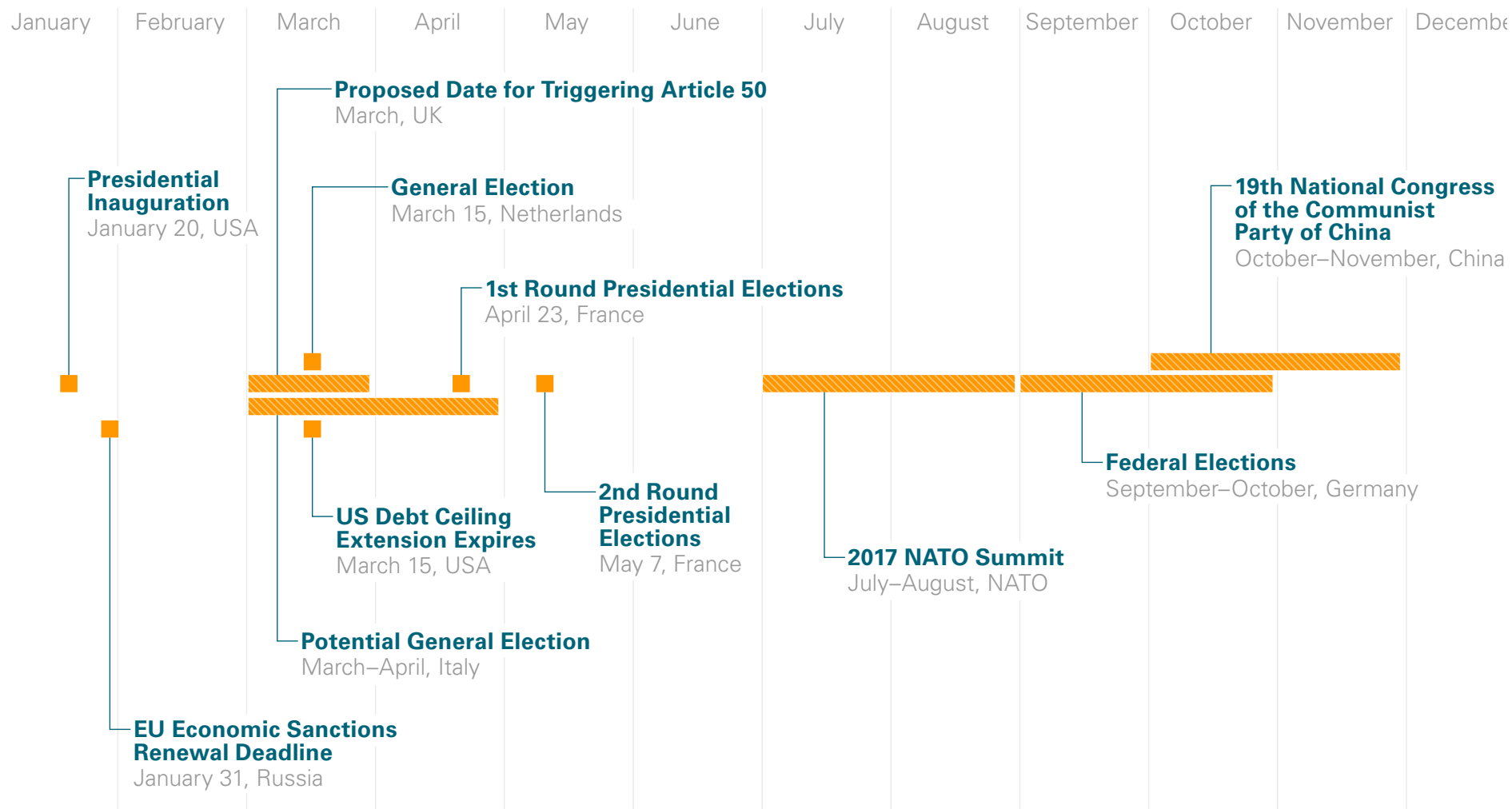
Source: GSAM. Quarterly data through September 2016. Dispersion score is a measure of the difference between the price of the top 25% and bottom 75% of equities in each market.

# A Busy Political Calendar Raises Potential Risks in 2017

As the trend toward increased globalization transitions toward rising populism, we will be watching political developments as a potential source of market volatility



Asset  
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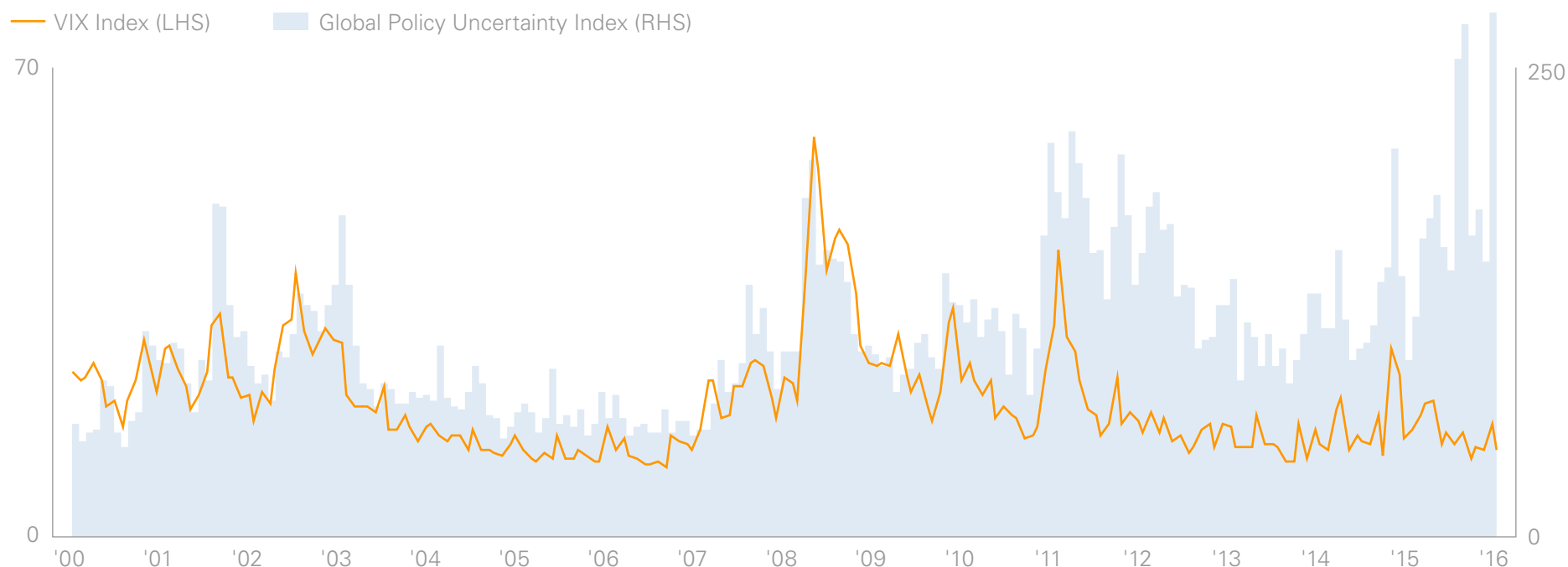
Source: GSAM.

# US: The Trump Administration's First 100 Days

Markets appear to be priced for benign scenarios despite policy uncertainty



Asset  
Management



“The balance and composition of Trump's policy agenda between stimulus, trade, immigration and foreign policy is still largely unknown and hard to generalize, and therefore leads to a wide range of macroeconomic and market outcomes.”

—Neill Nuttall, Co-CIO, Global Portfolio Solutions

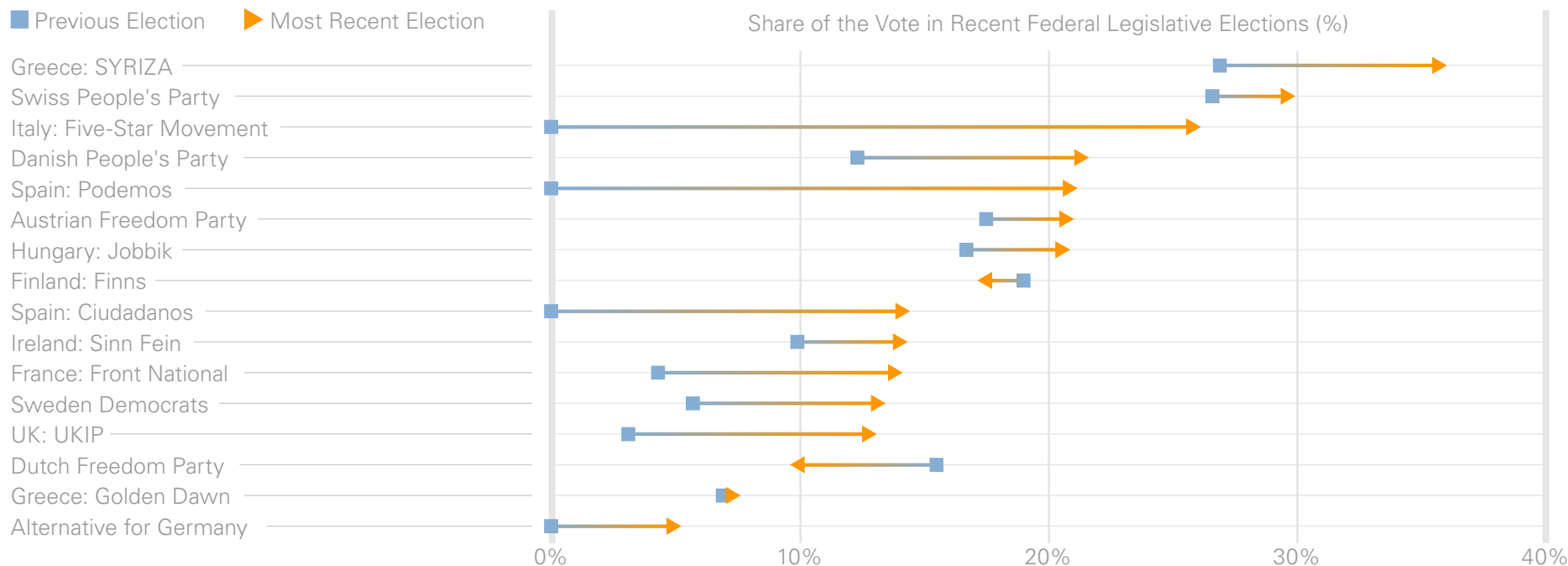
Source: Bloomberg. Baker, Bloom & Davis. As of Dec. 6, 2016. The Global Economic Policy Uncertainty Index is a GDP-weighted measure of news references to policy uncertainty. The VIX Index is a measure of S&P 500 implied volatility.

# Europe's Non-traditional Parties are Gaining Power

Populist gains in key elections may add to market concerns about Europe's cohesion



Asset  
Management



“The populist push is forcing mainstream parties to listen to people’s concerns about globalization, immigration and austerity. We think a Eurozone break-up scenario is unlikely in 2017, but we do see the potential for Trump-like policies in terms of trade, taxes and infrastructure spending.”

—Alexis Deladerrière, Portfolio Manager, International and Global Equity

Source: <http://www.parties-and-elections.eu/>, and GSAM. As of November 2016.

# Trade Tariffs Could Affect Key Business Sectors

The shift from globalism to populism is likely to lead to more protectionist trade measures, which could be a source of broad market risk or sector differentiation



Asset  
Management

\$bn in US Exports   \$bn in US Imports

	Mexico	China	All Countries <sup>1</sup>
Agriculture	-3.0	17.8	29.5
Oil, Gas, Minerals	-20.8	1.9	-149.7
Food	4.9	0.7	9.5
Beverages, Tobacco	-3.3	1.3	-10.6
Textile	2.8	-12.3	-14.7
Apparel	-4.2	-56.3	-69.9
Paper	4.3	-2.7	-5.8
Petroleum	16.6	0.6	32.9
Chemical	19.1	-3.9	-4.7
Plastics	5.7	-15.7	-15.0
Non-metallic Minerals	-1.2	-6.1	-8.9
Primary Metals	1.0	-3.1	-19.1
Fabricated Metals	2.8	-17.9	-18.5
Machinery	3.9	-19.9	-22.4
Computer	-11.0	-151.9	-155.0
Electrical Equipment	-8.5	-35.9	-40.4
Transportation	-59.5	10.9	-106.3
Furniture	-1.5	-18.3	-22.6
Misc. Manufacturing	-2.8	-35.3	-25.8
<b>All Goods</b>	<b>-54.9</b>	<b>-346.1</b>	

Source: Data as of 2014. Department of Commerce, Goldman Sachs Global Investment Research.

<sup>1</sup>Sample limited to 30 Trading Partners.

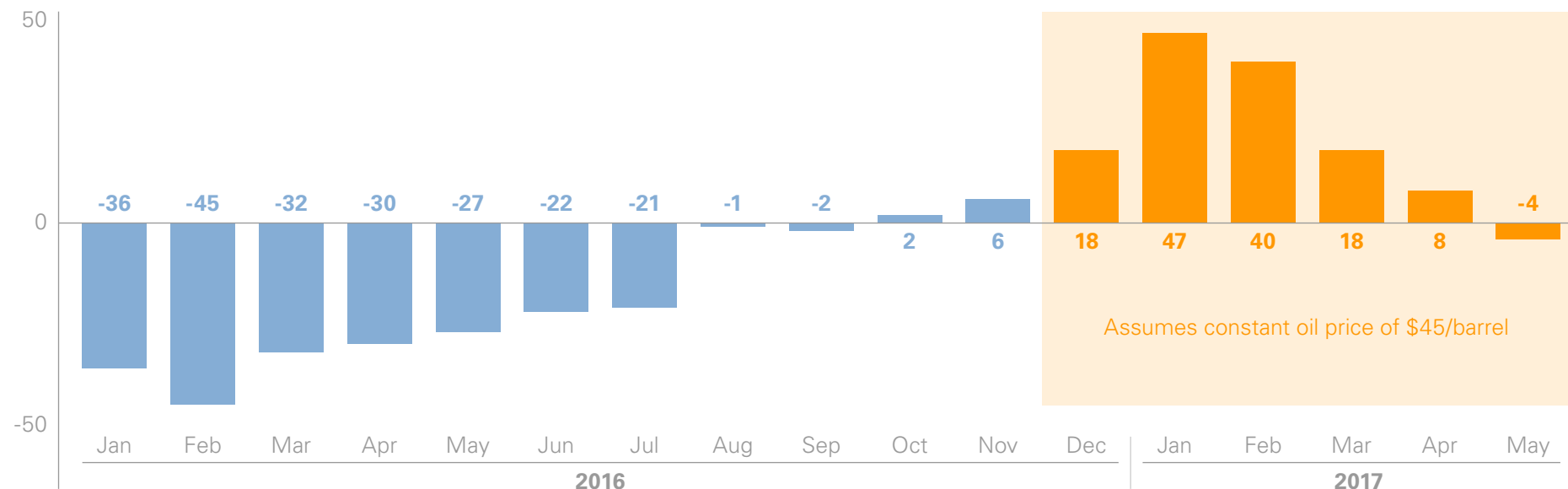
# From Stagnation to Inflation: How Much Inflation is Too Much?

Oil prices are higher on a year-over-year basis and could contribute significantly to inflation in 2017, adding to existing price pressures and inflation expectations in the US



Asset  
Management

Brent Oil Price Change (% Year-over-Year)



"The shift in investor focus from deflation to inflation likely reflects a healthy evolution of this economic cycle. However, uncertainty with respect to the level and volatility of real yields and inflation expectations will generate investment opportunities."

—Raymond Chan, Head of Markets Team, Global Portfolio Solutions

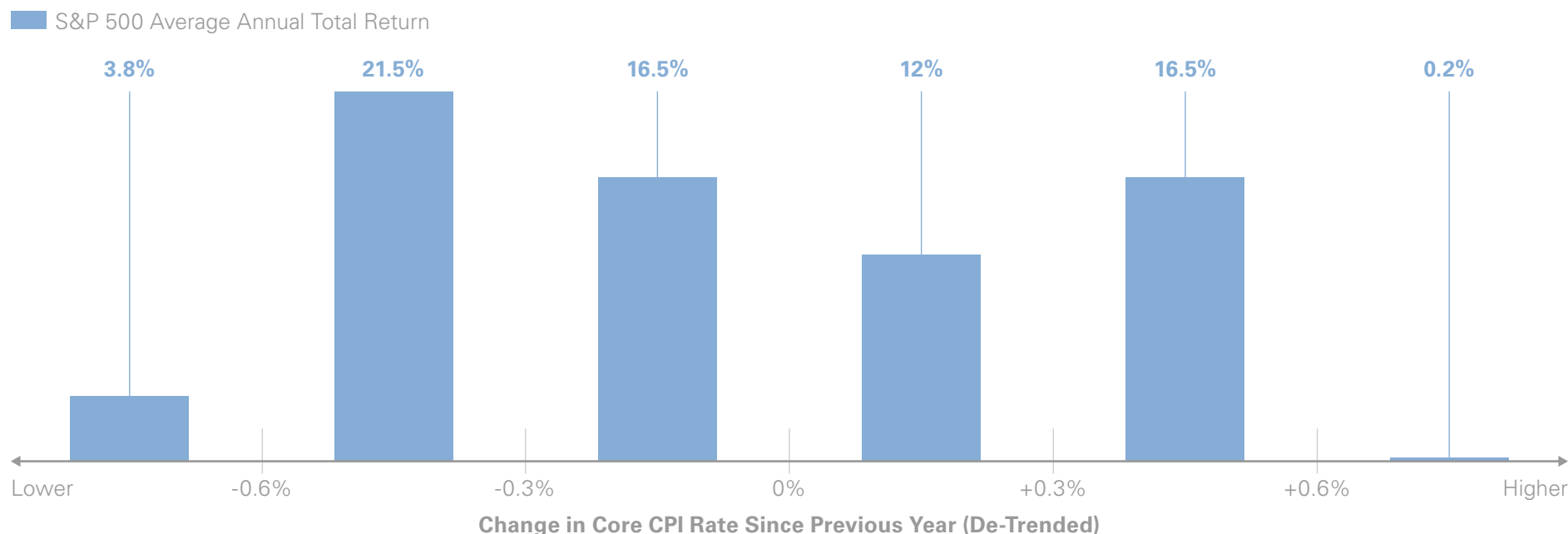
Source: Haver analytics and GSAM calculations. December 2016 to May 2017 assumes oil price remains unchanged at \$45/barrel. These examples are for illustrative purposes only and are not actual results. If any assumptions used do not prove to be true, results may vary substantially.

# Can Equities Weather Rising Wages and Input Costs?

Historically, equities have performed well as long as changes in inflation remain relatively modest



Asset  
Management



“A tighter labor market has resulted in steady wage growth, which is weighing on corporate profitability. We are observing this trend across a number of private companies. Private equity managers are finding it increasingly difficult to fill the skill gap in industries such as software and engineering services.”

—Michael Brandmeyer, Co-CIO, Alternative Investments and Manager Selection (AIMS)

Source: Bloomberg, Haver analytics and GSAM Calculations. Represents time period from 1982 to 2015. These examples are for illustrative purposes only and are not actual results. If any assumptions used do not prove to be true, results may vary substantially. The Core Consumer Price Index (CPI) represents the CPI minus energy and food prices and is used to measure core inflation. **Past performance does not guarantee future results, which may vary.**



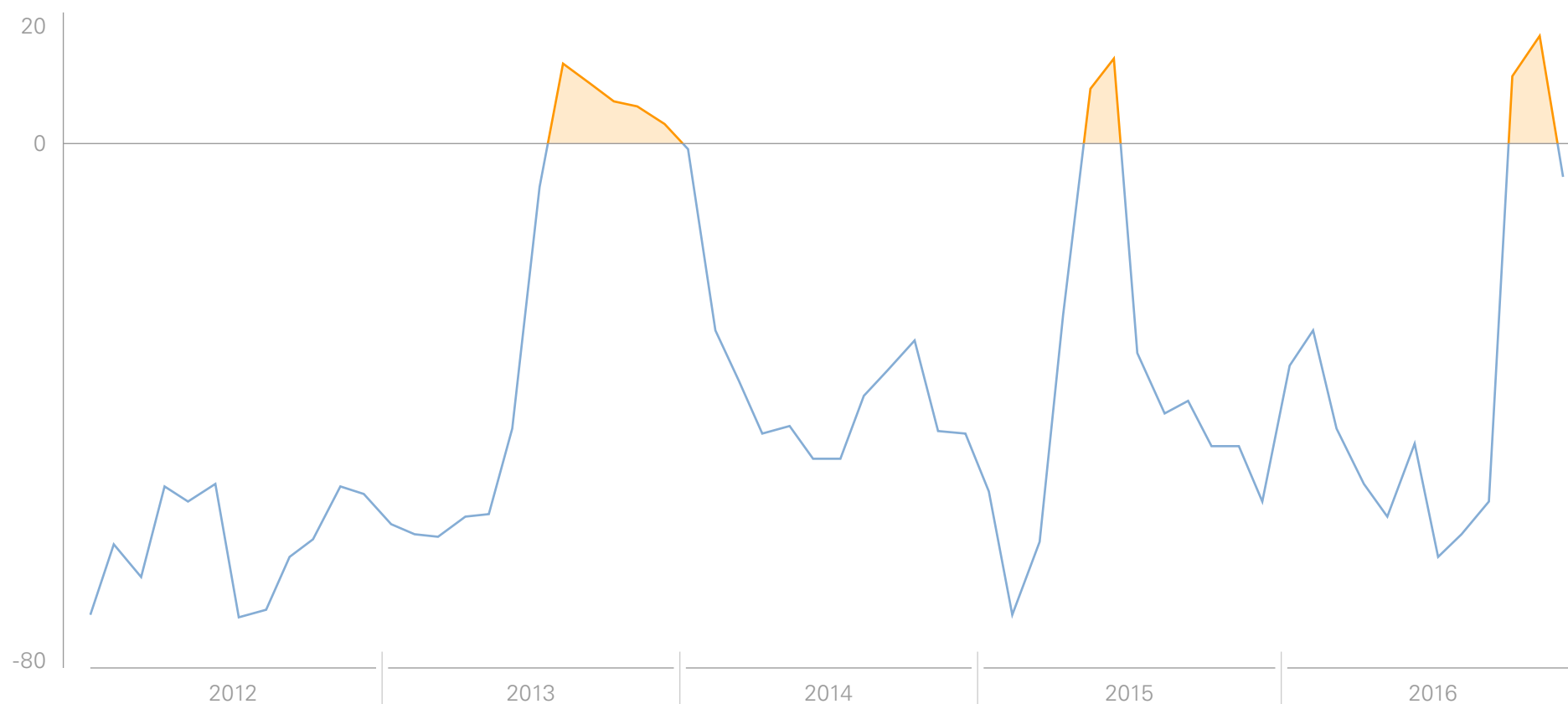
# Could Interest Rates Become the Risk Asset?

We expect interest rates to rise in 2017 and will be watching for signs that rate risk is spilling over into equity and credit markets



Asset  
Management

% Correlation of Bond Returns to Equity Returns



Source: Bloomberg and GSAM calculations. Bonds is the Barclays US Government Index, Equities is the S&P 500. As of Nov. 30, 2016. Past correlations are not indicative of future correlations, which may vary. Diversification does not protect an investor from market risk and does not ensure a profit. Correlation describes the extent to which two or more variables fluctuate together.

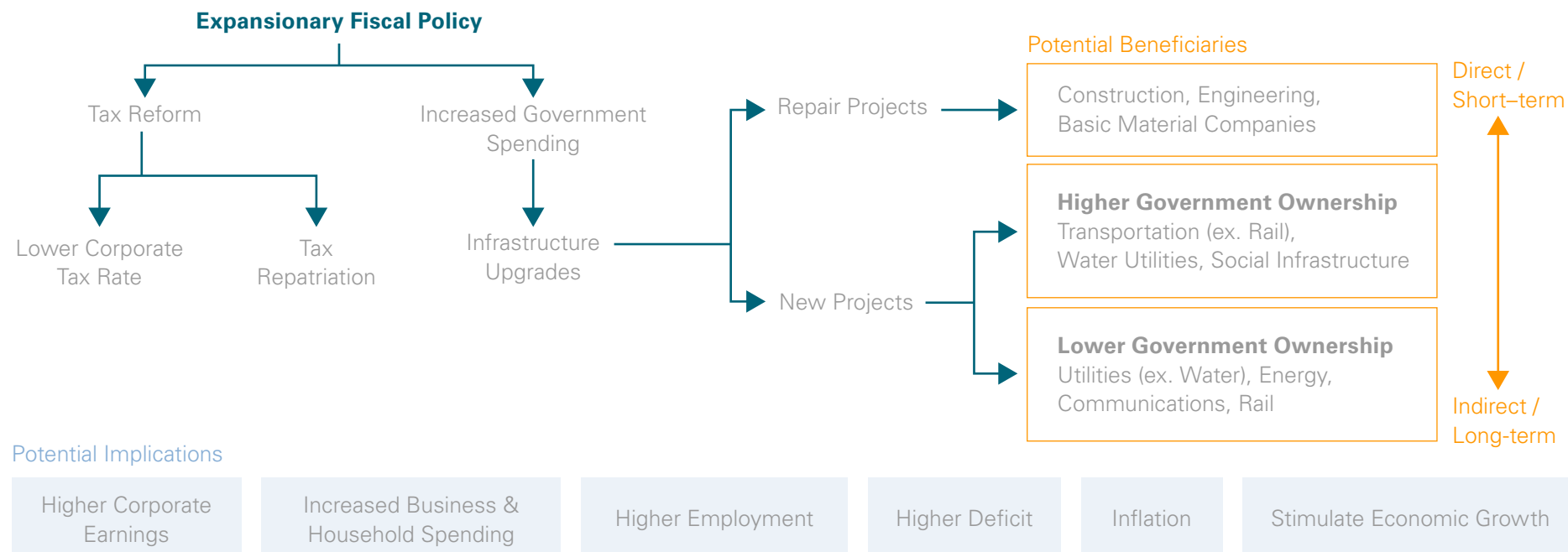
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# Implications of a Transition from Monetary to Fiscal Policy

While monetary policy easing benefitted many asset classes, the effects of fiscal policy could be more gradual and differentiated across economic and business sectors



Asset  
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“The economic impact of infrastructure spending will manifest years down the road and will not be as significant as one might expect. We think it’s positive, but not transformational.”

—Collin Bell, Client Portfolio Manager, Fundamental Equity

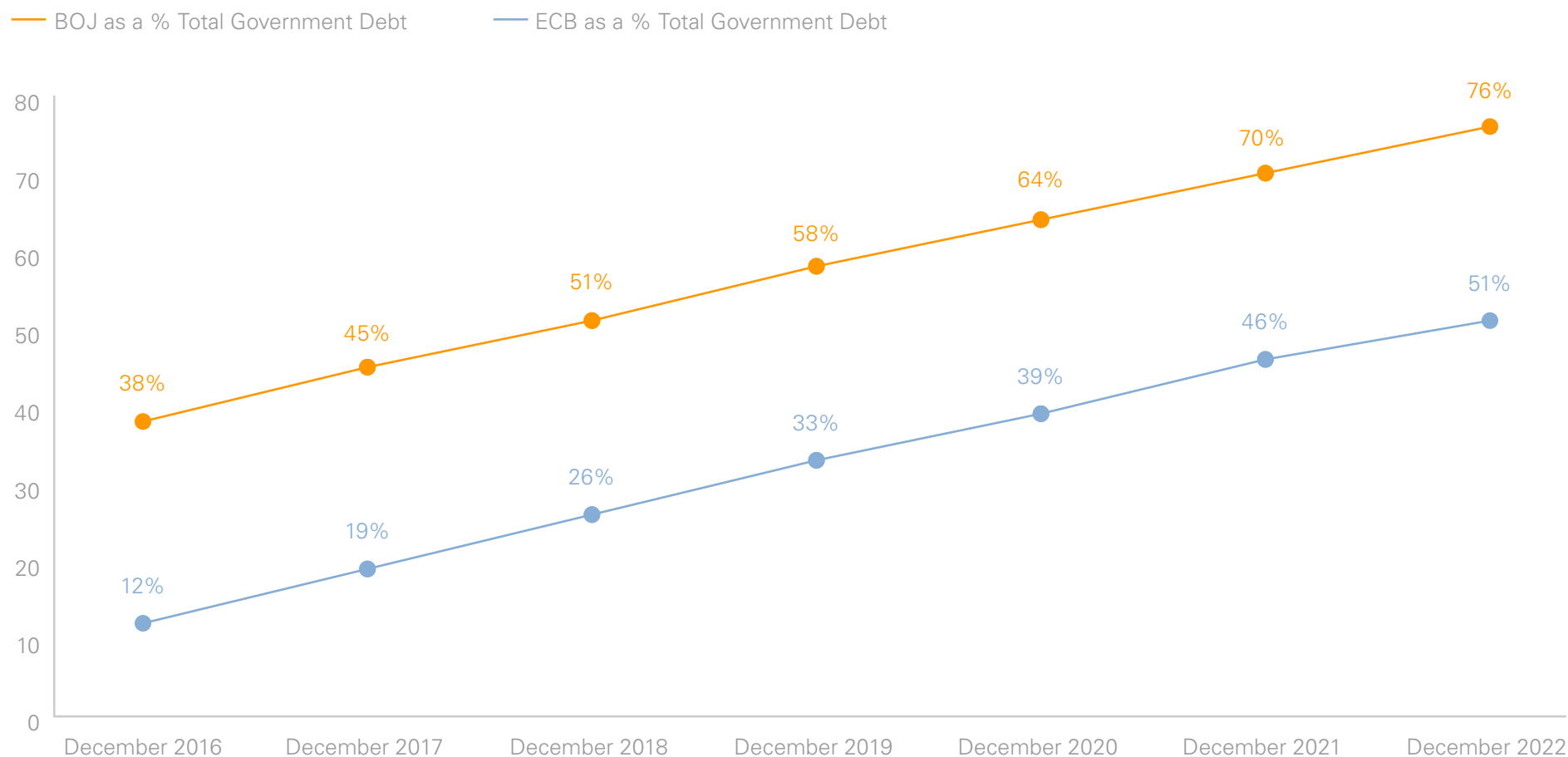
Source: GSAM. As of December 2016. For illustrative purposes. Goldman Sachs does not provide accounting, tax or legal advice. Please see additional disclosures at the end of this presentation.

# Taper Tantrum 2.0?

The path of ECB and BoJ bond buying is unsustainable long-term, but we believe central bankers can manage market perceptions of their asset purchase programs for now



Asset  
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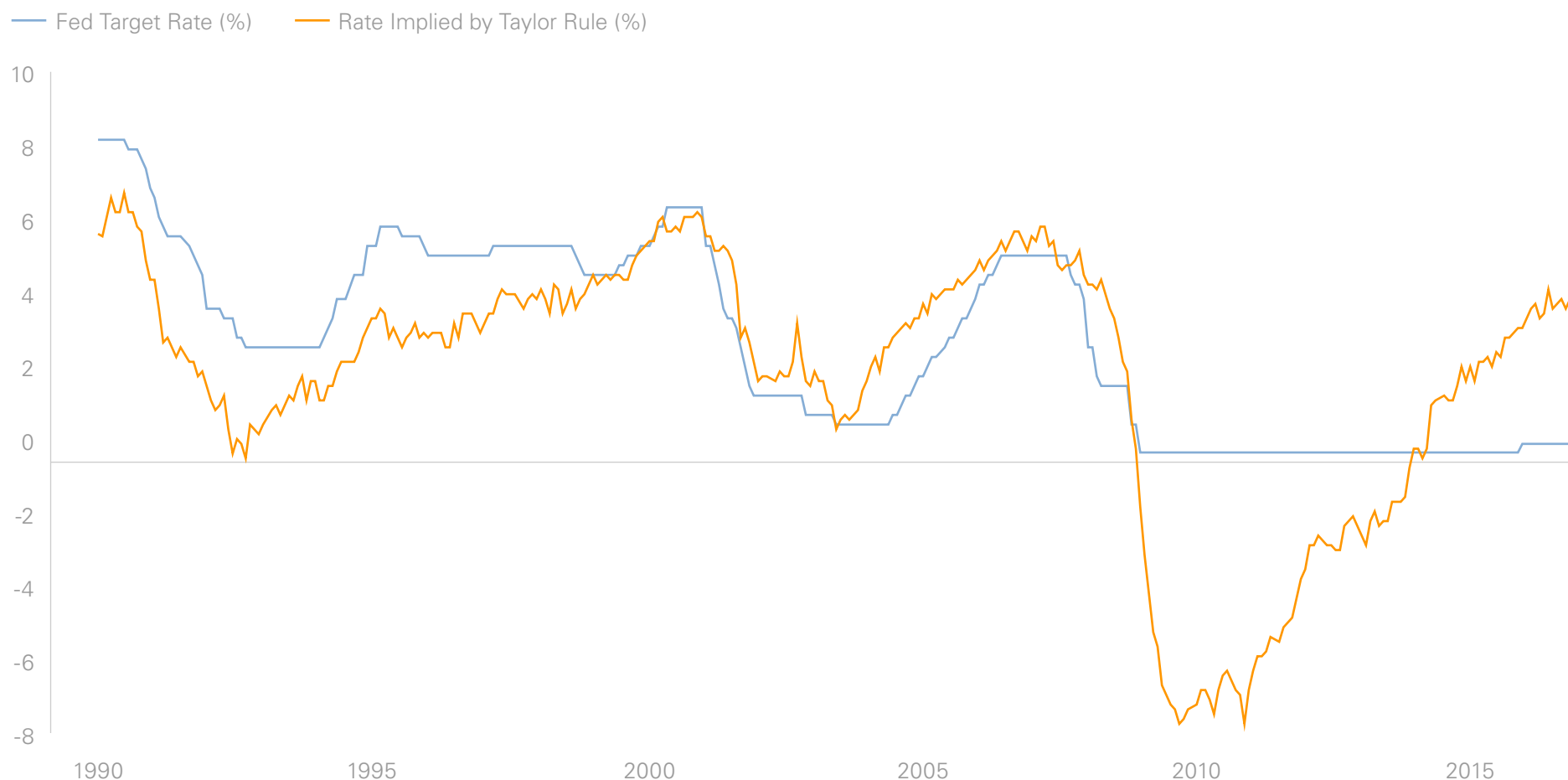
Source: Autonomous Research. As of Dec. 9, 2016.

# Could Markets Price a More Aggressive Path of Fed Policy?

The Trump administration's first picks to fill open Fed seats could lead markets to expect a more aggressive hiking path



Asset  
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Source: Bloomberg. As of Nov. 30, 2016. The Taylor Rule is a model for adjusting policy rates based on actual inflation relative to the central bank's target, actual employment versus an estimate of full employment and an estimate of the "neutral" policy rate consistent with full employment.

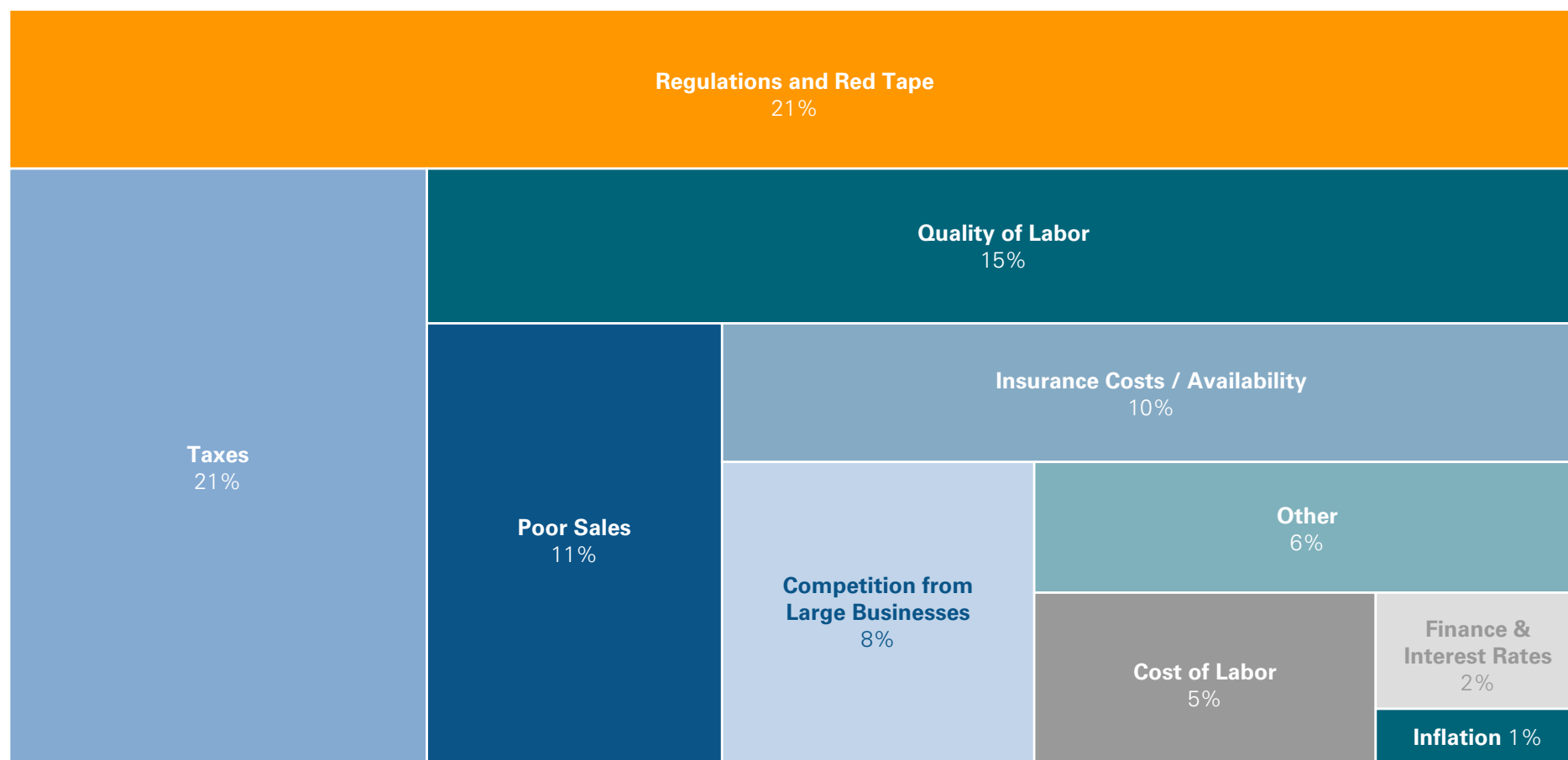
# A Shift to De-regulation Could Support Growth

Regulation is among the top concerns of US small businesses



Asset  
Management

% Single Most Important Business Problem



Source: Bloomberg, National Federation of Independent Business. As of November 2016.

# Could US De-regulation Drive Divergence with Europe?

The Trump administration has suggested easing US financial regulations, which could lead Europe toward reduced financial regulation given Europe's historical reliance on bank credit



**Asset  
Management**

## Euro Area

Reliance on Bank Lending

Reliance on Market Lending



## US

Reliance on Bank Lending

Reliance on Market Lending



0% 10% 20% 30% 40% 50% 60% 70% 80% 90% 100%

Source: Haver Analytics, Federal Reserve, European Central Bank. Based on 2014 data.

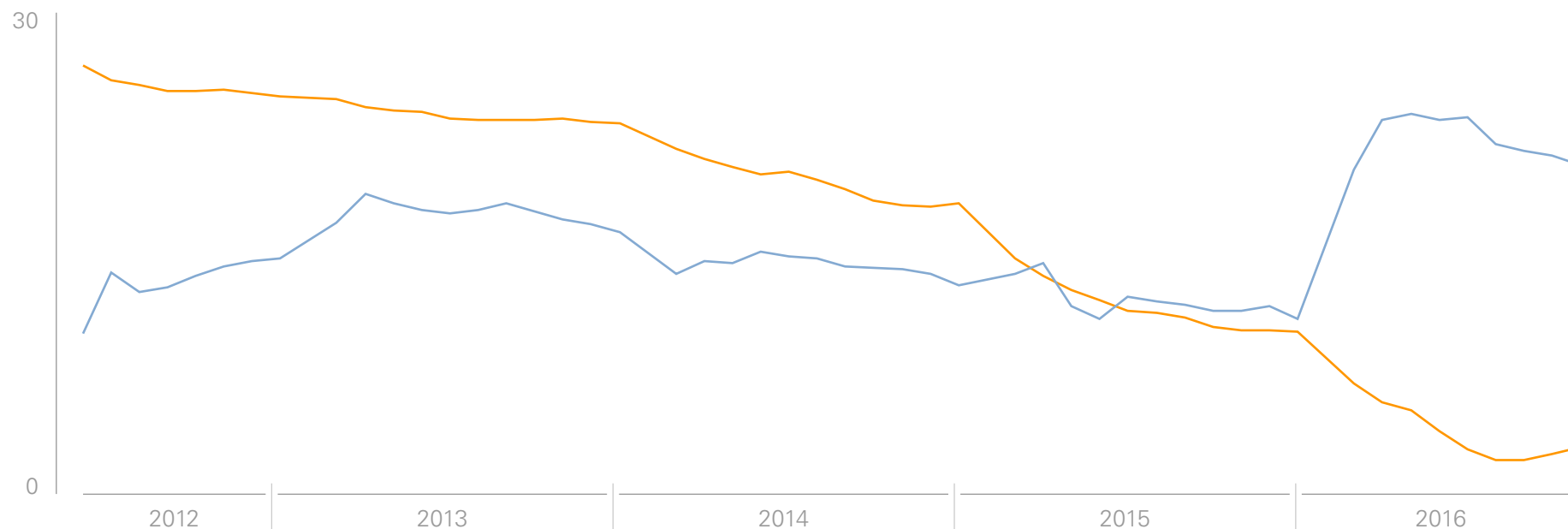
# China: Focus on Stability Ahead of Communist Party Congress

We are cautious on the outlook for China and expect policymakers to focus on fiscal stimulus and stability ahead of the fall 2017 Communist Party Congress



Asset  
Management

China Fixed Asset Investment (% Year-over-Year)      Private      State or State-Owned



“Trade protectionism poses a downside risk to China’s growth, mainly via indirect effects on investment and the labor market. A strong desire for stability ahead of the upcoming political transition suggests the government will respond, leading to worsening imbalances.”

—Prakriti Sofat, Emerging Markets Economist, Global Fixed Income

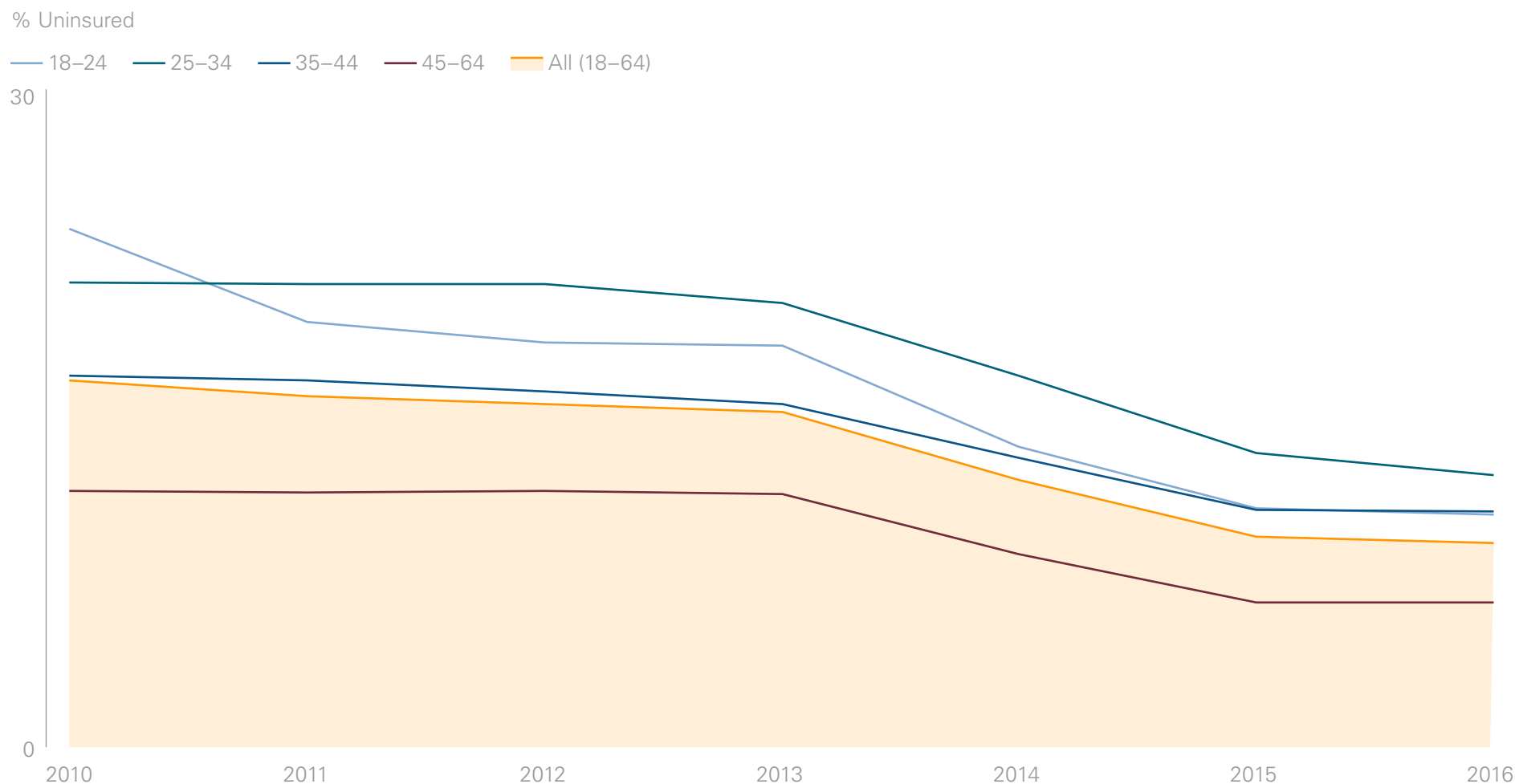
Source: Bloomberg. As of October 2016.

# Sector Specific Regulatory Changes Can Create Opportunity

Repeal or changes to the US Affordable Care Act could weigh on demand for health care services, but could create security selection opportunities in other health sectors



Asset  
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Source: US National Center for Health Statistics. 2016 as of Q2 2016.



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Although **Treasury Inflation-Protected Securities (TIPS)** are considered free from credit risk, they are subject to other types of risks. These risks include interest rate risk, which may cause the underlying value of the bond to fluctuate, and deflation risk, which may cause the principal to decline and the securities to underperform traditional Treasury securities. TIPS have special tax consequences, generating phantom income on the "inflation compensation" component of the principal. A holder of TIPS may be required to report this income annually although no income related to "inflation compensation" is received until maturity.

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