JAPANESE EQUITY

Time to take contrarian investment approach and reconsider Japan

Despite fears of a recession, Japanese corporate fundamentals are robust and Japanese equities provide a compelling developed-market investment, writes Matt Mack

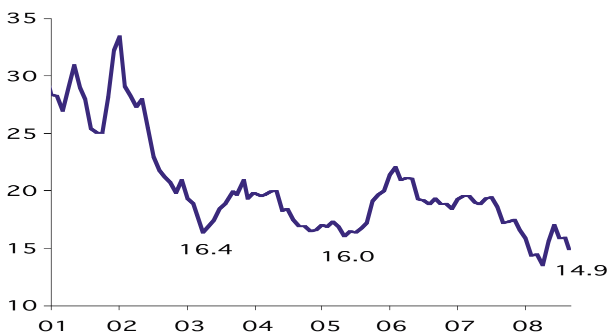
Since its rally in 2005, the Topix has underperformed most markets. That run was driven by investors' decision to increase their exposure to Japan in hope that the re-election of Prime Minister Koizumi in September 2005 would lead to significant economic reform. The subsequent sell-off, in 2006, reflected investors' intolerance to delay of those reforms and fear of the impact that a slowdown would have on Japan.

Despite this backdrop, we believe Japan is attractive relative to other developed markets. Political and regulatory problems persist, and there is the threat of economic recession, which looks increasingly likely as exports to Europe have recently slowed considerably. However, in our view, equity prices reflect these issues and Japan should be better positioned to weather the economic challenges than either the US or Europe. We believe that value exists, Japanese corporate fundamentals appear robust, and the Japanese consumer appears to be best positioned to weather an economic downturn.

"JAPAN SHOULD BE BETTER POSITIONED TO WEATHER THE ECONOMIC CHALLENGES THAN EITHER THE US OR EUROPE"

Though Japanese PE multiples are currently higher than those of other developed markets, they are currently at long-term lows. Also, more than half of Japanese companies now trade below book value and dividend yields of listed companies exceed bond yields, as they did in 2005.

Figure 1: Japan's forward P/E multiple



Notes: 12-month forward P/E, estimates based on Toyo Keizai consensus earnings estimates. Monthly basis. As of August 22, 2008
Source: Toyo Keizai, Goldman Sachs Research calculations

DOMESTIC INVESTORS

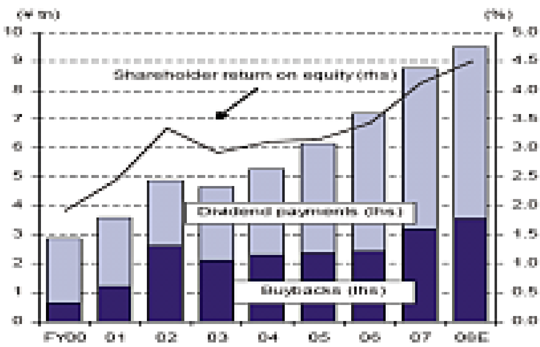
International yields should also be supportive of Japanese equities because the alternatives available to domestic retail investors have deteriorated. Japanese households typically hold more cash than their western counterparts and for most of the past decade, Japanese retail investors have sold domestic equity and bought foreign securities.

However, the 3 per cent yield of US 5-year treasuries, down from 5 per cent just over a year ago, coupled with recent appreciation of the yen, render foreign bonds less exciting and domestic equity has become an attractive option. Furthermore, as inflation continues to rise, investors may be incentivised to shift cash from bank deposits to equities in an effort to keep pace with inflation.

Additionally, the popular carry trade, borrowing in yen to buy higher yielding currencies such as the Australian and New Zealand dollars, looks less attractive with the sharp depreciation of those commodity driven currencies.

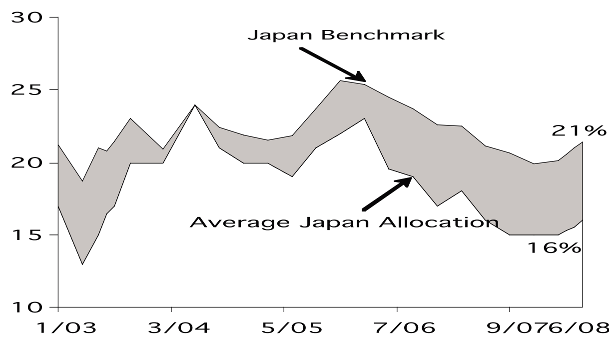
With regard to company fundamentals, corporate balance sheets have been rebuilt over the past 20 years, and leverage is close to 20-year lows. Dividend payout ratios are low compared to those in the west and Japanese companies

Figure 2: Companies returning 45% of net income to shareholders



Notes: Based on 1,147 TSE 1 non-financials with consolidated data available since March 2000. For periods prior to March 2000, calculations are based on available data. Goldman Sachs Research estimates for FY2008
Source: Company data, Goldman Sachs Research estimates

Figure 3: EAFE Fund Estimated Japan Allocations – Average 15.81%



Note: Japan benchmark weighting within the MSCI-EAFE index and estimated allocation as of June 2008

have less exposure to exotic products that caused the recent credit crunch- a rare benefit from Japan's recession and subsequent risk aversion.

Japanese companies, have the ability to raise dividends or increase share buybacks despite a slowing global economy. Improved corporate management has also unlocked value through margin expansion, increasing dividends, and historically high levels of share buybacks in recent years. These shareholder-oriented uses of capital have been some important trends in the current results season.

Importantly, the Japanese consumer is relatively unleveraged, with over 50 per cent of his or her financial assets in cash, versus the American consumer with typically under 20 per cent in cash. Additionally, Japan has not endured a real estate bubble - property prices have fallen significantly since 1992 - and Japan has a historically higher rate of long term employment and much lower job mobility than in other developed markets.

JOB SECURITY

One would envisage that this cultural pattern will endure for some time yet which makes it less likely for Japanese citizens to lose their job in an economic downturn. This provides some comfort for the consumer in comparison with other economies.

Currently, the average EAFE (Europe, Australasia and Far East) investor is as much as 5 per cent underweight Japanese equities.

Despite Japan's well-known problems, we believe a potential risk is that the equity market will be squeezed up as underweight investors try to reduce that position given the relatively better economic, corporate and consumer fundamentals versus those underpinning other markets.

Furthermore, investors needing to raise cash are more likely to be sellers of equities other than Japanese equities (due to the lack of ownership) putting additional pressure on those markets relative to Japan. For reasons cited above, in our view, Japan is one of the more compelling developed-market investments and investors should seriously consider how an allocation to Japanese equity fits within their overall portfolio.

Matt Mack is head of GSAM's European Sub-Advisory business

CORPORATE STATEMENT

Goldman Sachs **Asset Management**

Contacts:
- Matt Mack,
  Head of Sub-Advisory,
  44 (20)7552-3234
- Daniel Riggs,
  UK and Ireland Discretionary Sales,
  44 (20)7552-3465

Since its establishment, Goldman Sachs Asset Management (GSAM) has swiftly established itself as an industry leader in the provision of forward-thinking investment solutions for clients. Our 14 independent investment teams offer over 80 different investment strategies across asset classes, regions and the risk spectrum and manage $780.5bn in assets (AUM as at March 31st 2008)