Press release

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RCM voices concerns over increased regulation - but points to the positives of a hung parliament

Andreas Utermann, Global Chief Investment Officer at RCM, a company of Allianz Global Investors, presents his outlook on regulation, prospects for the UK under a hung parliament, and current valuations of emerging markets:

Regulatory and capital restrictions on the financial sector could be a major issue for financial stocks

"Regulators across the world, but especially in the US, are picking up the pace of reform. In particular they are proposing regulatory and capital restrictions to be imposed on the financial sector, which could potentially be a major issue for financial stocks.

"If all the proposed measures are put through, then returns in the banking sector would come under very significant pressure, and could end up being in the single-digit range. If that were to be the case and all these measures were passed, they would justify price-to-book values which would be significantly lower than historical averages and would mean that price-to-book values over 1 would not be justified.

"The furore around Goldman Sachs, which is currently brewing, is exemplifying this point. The current structure of the investment banking model and the way they have been run for the past 20 years is going to have to be reviewed. As the business model comes under very severe strain and scrutiny, this will inevitably pose a threat to some businesses.

"Clearly, with the current steepness of the yield curve these banks are continuing to make a lot of money which is helping governments to reduce their budget deficits. But ultimately, whether or not this proves to be sustainable, creates a big question mark. For the regulators and some of the more aggressive commentators, this short-term, strong performance from the investment banks could actually make regulatory action even harsher and ultimately more likely to be passed.

A hung parliament could result in positive market rebound and a strengthening of sterling

"Many commentators believe that a hung parliament or coalition government would be bad for the UK economy and bad for the stock market. Hence, after the first debate, the sell-off of the UK stock market.

"However I take a different view. I think that we will need some very tough measures to put the UK economy back on a proper growth path – a path of fiscal discipline. A coalition government could make the resolution of these issues much more likely, because parties in the coalition can 'blame' each other for the necessity of compromise. Therefore they are less likely to alienate their core voters. I think the measures that need to be taken are more easily taken in a coalition government than if you have just one party in charge.

"If we do get a coalition government and the right policies were introduced fairly quickly, there could be a substantial rebound in the market as a result of that positive surprise effect. There is also the possibility of a strengthening of sterling.

Current valuations of emerging markets

"We have seen all emerging markets re-accelerate over the last few months as they continue to de-couple in terms of their growth and their growth prospects. Of particular interest is the very strong rise in intra-emerging market trade which now accounts for the majority of the growth profile of emerging markets. We believe that this will continue and ultimately, over the next several years contribute significantly to the rebalancing of the global economy.

"Relative to history emerging markets are trading around fair value, if you look at PEs. We think to really understand what's going on we need to look at the price-to-book ratio relative to the return on equity. What we can see there is much more promising than if you just look at PEs. Overall, what we would say is that BRICs, and other emerging markets, are trading around average price-to-book values, but they have above average returns on equity; hence, above average prospects for earnings growth and that is obviously supported by the very benign macroeconomic environment. So one should say, probably, emerging markets are not expensive.

"Clearly a portfolio that can afford it from a diversification perspective, should have a fair degree of emerging market exposure, in particular if one considers that currencies over time should drift upward.

"The issue is a tactical one. Emerging markets have somewhat underperformed in relative terms over the past six months.

"That is really owing to the fact that there is an expectation or a fear in market participants' minds that as we move through 2010 there will ultimately have to be some tightening. The removal of quantitative easing mechanisms and then secondly, perhaps towards the latter part of the year, a tightening of not only emerging market economies but also perhaps by the Fed, and moving into 2011 markets are obviously discounting that.

"When that happens, historically, emerging markets have underperformed as the marginal buyer in most emerging markets is still the foreign buyer and, therefore, that has usually led to some setback. So tactically there may well be a continued period of relative underperformance of emerging markets, but clearly these are buying opportunities given the valuation and the strong long-term prospects for the economies, the earnings and also the currencies of all of these markets."

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Photographs
High-resolution photographs of our investment professionals are available to download here:
http://www.rcm.com/london/press_professionals.php

Awards

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- RCM named winner of Active North American Equity at Pensions & Investment Provider awards 2009. RCM US Large Cap Select Growth is managed by Scott Migliori, Co-CIO for US Equities, RCM.

- RCM named No.1 leading fund management firm for SRI Research by Thomson Reuters Extel 2009.

- Global CIO of RCM, Andreas Utermann, named CIO of the Year by Funds Europe magazine 2008.

- Winner of European Investment Trust of the Year by Investment Week magazine, 2008, for the RCM-managed Charter European Trust.

- Allianz RCM Global EcoTrends Fund named winner Best Climate Change Investment fund 2008, by Holden & Partners/ Incisive Media.

About RCM (all data source: RCM as at 31/12/09)
RCM is a global asset manager operating from six international offices - San Francisco, London, Frankfurt, Hong Kong, Tokyo and Sydney – with assets under management of over $140 billion worldwide. The firm provides a range of investment management solutions to institutions and individual clients. At RCM we believe that by generating and exploiting an information advantage, we will be able to deliver superior and consistent investment results for the benefit of our clients - a philosophy we call RCM informed. RCM is a company of Allianz Global Investors, a pre-eminent global asset management group committed to helping clients achieve sustainable success. As a company of Allianz Global Investors, RCM offers a distinctive investment philosophy and culture, while benefiting from the scale and substantial resources of our parent; including business support, industry best-practices and financial investment. This enhances our ability to attract and retain talent, and provide superior insight and investment performance.