

Greek tragedy will pave the way for ‘managed austerity’

Neil Dwane, Chief Investment Officer Europe at RCM, a company of Allianz Global Investors, provides insight into recent events and the implications for markets.

Sovereign risk

“As markets look ahead to closure around the Greek episode, we will be left with the ongoing spectre of sovereign risk, which looks more likely to rise than disappear in the coming years. We believe that the issue for the EU, particularly France and Germany, is that neither the Euro nor the EU has any official mechanism in place to help bail out any country which falls into difficulty. Therefore, as a consequence of the Greek crisis, we expect to see official tools being put in place within the EU to manage this challenge and other potential crises going forward. Greece is not alone. We believe many developed countries currently have unsustainably high levels of debt and will need a period of fiscal consolidation and support from their stronger friends over the next three to five years.

Markets call for ‘managed austerity’

“Clearly, any country that is currently overspending its income, which includes Japan, the US, the UK and many parts of Europe, is likely to see a period of what we are now calling ‘austerity’ over the short to medium term. It is plausible that markets would prefer ‘managed austerity’ to ‘market-imposed austerity’. This means in practice, that countries will have to manage their economic situation more effectively, before the external market is driven to impose lower levels of spending, as the shock to an economic system from market-imposed austerity is not in the best interest of the economy or policymakers.

“Austerity, however, means lower growth. It means living within our means: saving and deleveraging. Therefore, in the medium-term, we believe investors will probably see more attractive relative growth available in emerging markets. In the developed world there should also be corporate growth from companies that have exposure to franchises in emerging markets, or in companies and countries where there is an under-representation of their industry in that area.

The Euro and inflation

“In terms of inflation the strength of the Euro in the last couple of years has mitigated inflation threats. We believe that a weaker Euro could potentially contribute to a higher level of inflation in Europe than has been the case to date. Whilst this shouldn't overplayed, when you look at the emerging markets there is clear evidence, even today, that China and other Asian countries are now beginning to feel the inflationary threats of rising food, commodity and fuel prices. Inflation is definitely something that is beginning to develop in the background. Still we believe a weaker Euro is definitely what

Europe needs to help maintain growth and we have seen solid export numbers out of Germany in the last couple of months, which has clearly been supported by the recent weakness in the Euro.

The state of the economic recovery and continuing risks

“We believe there is clear evidence in Europe that the economic recovery has been stalling. European economic data has been disappointing, with industrial production and other signals showing a pause in growth due in part, particularly in Germany, Italy and France, to the winding down of the scrappage tax on cars. Markets have possibly underestimated just how powerful this incentive to that a industry in those countries has been and, as that now dissipates, it is unclear what the real level of underlying economic demand is going to be.

“So we are seeing stalling momentum in Europe and the UK and, we would argue, in the US too. The housing market is clearly 'double dipping' at present, car manufacturing – following its own scrappage incentive – has definitely stalled as well. However, what we have seen in the US is that figures from the service sector were much stronger than we expected. This is important considering that services represent 65% to 70% of the US economy. At present, the US economy appears to be ahead of Europe in terms of its economic prognosis.”

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http://www.rcm.co.uk/press/04_fundmanagers.html

Awards

- 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 30/09/09)

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