

Mark Lovett, Co-CIO European Equities, RCM, comments on the outlook for European Equities. RCM is the global equity company within Allianz Global Investors.

- Equities continue to look an attractive asset class due to valuations and current earnings environment
- The shape of the economic recovery will be a gently upward sloping 'L'
- Over the next few months there will be a broadening out of the market, due to a recognition that there are attractive valuations in areas which have not participated strongly in the recent rally

Macro economic environment

"Europe, along with the rest of the world, is experiencing a substantially moderated pace of economic contraction compared to the beginning of this year and the end of last year. While this does vary at a country level, overall Europe is very much mirroring the global stabilisation. Countries such as Germany and France, which have strong export components to their GDP growth, have benefited from the growth in emerging markets, and in particular China. While it may be an upturn that does not feel like a strong recovery, (and there will be elements such as employment that lag), we believe that there will be a decent environment for equity investment for two reasons. One is the solid earnings environment, and the second is the valuation of equities. Equities continue to look an attractive asset class for investment.

Earnings environment and valuations

"In terms of earnings there is no doubt that one of the most positive features of this year has been how well, outside of the financial sector, profitability and cash flow has held up across Europe. The aggressive response by most company managements to the events at the end of last year, ensured that European companies got on top of their cost base and looked closely at the business structure they needed to put in place for this challenging economic cycle.

"The consequence of this aggressive cost-cutting is that profits and cash flow have held up surprisingly well. This has been a feature of the recent results season where a number of companies, while witnessing strong top-line falls, have managed to maintain decent levels of profitability and cash flow. Certainly when looking outside of financials, return on invested capital and margins have been surprisingly resilient.

"In terms of valuation, equities look good value relative to history and other asset classes. In particular metrics such as free cash flow yield provide a very powerful base for equity investors – such metrics supports investment in businesses with good quality management teams and good quality franchises. As Europe is still 'un-fashionable', investors can find global-leading companies on attractive valuations.

Shape of economic recovery

“Instead of an extended V shaped recovery, which would usually be expected after a substantial GDP contradiction, there is going to be a period of perhaps two to three years of, at best, trend-like growth from global economies. This will be replicated in European economies, and our view is the shape of the economic cycle will be a gently upward sloping ‘L’. For the management teams that have a good track record of managing their businesses tightly and with a strong business franchise, it will be an environment in which decent earnings and cash flow growth will be seen. Under these conditions equities can deliver good capital returns.

2010 stock selection

“Over the last few months, we have been heavily geared around cyclicals and the mid cap areas of the market, which have achieved and delivered quite spectacular returns, even though these were from very depressed valuations at the beginning of the year. We see the market environment altering and over the next few months we believe there will be a broadening out of the market, driven by valuations across different segments of the stock market. This is recognition within the market that there are attractive valuations in areas which have not participated strongly in this particular rally.

“In terms of sectors, we are finding the best opportunities in oil and gas, technology, consumer staples, and increasingly - after the massive de-rating - areas of healthcare. In Europe, companies in both the large and mid cap space look very attractive. But we remain underweight in financials and are certainly underweight in consumer spending in Europe, where we see rising interest rates and tax pressures squeezing consumers’ disposable incomes.”

- Ends -

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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.

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- 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 30/06/09)

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 \$89 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.

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