# Press release

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## Investment outlook from Neil Dwane, CIO Europe at RCM

### State of the Nations

- Recent political unrest has meant a sell-off of Russian equities, however, valuations in Russia looking very attractive and long term growth story still in play
- 2009 should bring renewed efforts by the Russian Government to encourage investment in its economy
- US defence stocks remain well supported for the time being given upheaval in Georgia, Pakistan and Middle East

### Emerging Markets

- China's economic developments set to grow post-Olympics with continued investment in infrastructure expected
- India continues to struggle with inflation, but longer-term economic growth remains
- Emerging markets well placed to sustain and grow economies as industrialisation and urbanisation trends continue
- Positive long term outlook for oil as consumption continues to grow

### Europe and the UK

- UK slowdown exacerbated by the difficulties at major banks, weakening housing market and over-leveraged consumers
- Outlook for the UK should become more positive as interest rates and tax cuts expected in 2009 as Labour seeks re-election
- Europe slowed down faster than expected, but strong Euro will keep the economic fundamentals on a strong footing
- Europe currently too reliant on US economic recovery, which isn't likely in the short term

### The State of the Nations

Recent political unrest between Russia and Georgia has highlighted the high risk nature of these sorts of conflict, when you consider the many oil pipelines in the region.

The Russians,for their part, are seeking to protect both their Soviet past of a giant empire, but also to enhance their new empire of metals and energy. Politically, Russia resents US and European involvement through NATO in Poland, Turkey, Ukraine and Georgia. In RCM's view Russia is now executing a strategy to control, or exert significant influence over, oil, gas and many metals markets, possibly creating many new OPECs. This would be assisted by closer influence over the Baku-Tbilisi-Ceyhan pipeline in Georgia.

In November we will learn who the new US President will be, however, at the moment it appears to be a close race. A McCain win may be viewed as the US remaining hard on diplomacy and a willingness to use force in all spheres of operations.  From an investment perspective, RCM would conclude that defence stocks will remain well supported, particularly if a new Cold War surfaces.

The task for the new US President is not be made any easier by the exit of Musharraf in Pakistan, where it is now unclear who holds the key to the nuclear weapons and how the political scene of Pakistan, Afghanistan, Iran and the Middle East will unfold.

For investors, it's clear that the first conclusion reached has been to sell out of Russian equities, which was probably already underway as risk was reduced and given the fall-out from the recent BP-TNK crisis. Valuations in Russia are discounting returns on equity of over 15%, historically a very attractive level, and many corporate results continue to show the attractiveness and growth rates of the booming Russian consumer economy. Sentiment is now very low towards Russia and will remain cautious. It is therefore likely that during 2009, the Russian Government will make moves to enhance its appeal to investors as the massive rebuilding of their economy accelerates, behind which confidence may grow.

**Have Emerging Markets finished emerging and what about the 'super-cycle'?**

China topped the Olympic Gold tally but will it be able to keep economic growth strong enough to keep its citizens happy? With oil and food inflation now falling away for the time being, the pressure felt in the last six months for Chinese policy to curb monetary growth, has eased. RCM believes that China will reaccelerate its economic growth back to 10% plus, as its secular longer term objectives remain - namely to widen the economic success from the coastal regions to the inland parts. This is as well given the urgent rebuilding of the Sichuan province, which was recently hit by an earthquake. Whilst we expect the Chinese to focus on infrastructure investments as the precursor to broader economic growth, RCM also expects the broadening of the economy towards domestic consumption to be successful.

India currently has difficulties with inflation, because of its larger agricultural sector and weaker balance of payments position. Nevertheless, monetary policy has been tightened strongly and longer economic development plans remain in place. This is also the case in Brazil, where the economy continues to move from agriculture and mining to include oil and bio-energy as well.

Whilst increasingly becoming part of the global economy, most emerging markets are well placed to sustain and grow their economic development. Whilst growth prospects for the US and Europe remain bright, this is only on a secular basis. Feedback from the markets suggests that the de-leveraging we have seen in Financials has forced many investors to take profits in these markets. RCM has no doubt that the industrialisation and urbanisation trends in emerging markets will continue.

Thus where does the 'super-cycle' go? For many commodities, there is a supply response coming through, albeit slower and at a higher cost of production than expected, which should support current levels of commodity pricing. Therefore, whilst we would not expect to see 100% increases in many commodity prices, we remain positive on overall global volume consumption and current valuations suggest the near collapse of many of these commodity prices. On oil, we are fundamentally more positive as marginal oil is both more expensive to extract and in more politically difficult countries. Oil still powers 85% of our transportation needs, with no credible alternatives. Therefore, even a stabilisation in global economic growth will put a floor under the oil price. RCM also believes that economies and investors will continue to review the energy efficiency of other energy sources like coal and gas and align upwards towards the oil price.

Corporately, there is clear evidence that BHP Billiton/Rio Tinto/Xstrata are now investing for a period of longer term demand as Asia, in particular, industrialises. Importantly, like OPEC in oil, much of the swing production, excluding Russia, now lies in the hands of these multi-national companies, which should seek to maximise profits not volumes. Cynics would argue that the potential combination of BHP Billiton and Rio Tinto reflects the top of the market like AOL/Time Warner did for the dot-coms, but RCM believes these are real assets with managements grounded in engineering, and not wishful thinking.

**Where are we in Europe and the UK?**

The slowdown in the UK has accelerated since the spring and exacerbated by the difficulties at many major UK banks, the weakening UK housing market and the over-leveraged UK consumer. The 'UK sensitive' sectors of the UK equity market are already anticipating a dire period and whilst it will be painful, we believe that interest rates and tax cuts will follow in 2009 as Labour seeks re-election.

Europe has slowed down faster than expected with even Germany seeing some contraction. However, the German consumer remains very well capitalised. Problems are likely to increasingly emerge in the smaller economic countries of the Eurozone where financial excesses and vulnerabilities are highest. Many Eurobanks are being kept alive by the efficient European Central Bank (ECB) liquidity support operations in some economies. Policy will be needed to find a solution to the property excesses.

The strength of the Euro has meant that until recently, the fundamentals of the EU have been on a strong footing. This will probably remain so as the ECB is not expected to compromise on this. However, we believe that the markets have run ahead of themselves by expecting the USA to avoid recession, whilst the rest of the world gets it in the neck. The US optimism is only possible if you review the manipulated and hedonistically adjusted data. Without it the US will be seen to be in a major mess with bust Financials, excessive debt levels and low growth prospects until the end of the next President's term in office.

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## Notes to Editors:



## About RCM

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