June 2010

Capital Markets Monthly

Allianz Global Investors

"Ke Nako"

Two important questions are likely to be on investors' minds in the coming month: Can the markets cope with the setbacks of the past weeks? And who will win the Football World Cup? The World Cup slogan is "Ke Nako", which can be translated as "It is time". And, considering the turbulent weeks on the stock exchanges, it seems that it is also time for investors to check the composition of their portfolios.

A glance at possible through-balls and threatening offside traps in the capital markets should help:

Through-ball no. 1: The economic recovery seems to be spreading. Both macroeconomic data and corporate figures have recently turned out to be better than expected in almost all regions.

Through-ball no. 2: Active fiscal and monetary policy. The measures agreed by the Euro countries together with the European Central Bank (ECB) and the International Monetary Fund (IMF) will help to minimise the refinancing risks of these countries for the next 2-3 years.

These two through-balls, however, also harbour the latent risk of falling into off-side traps:

- Although the economic motor could continue to run for a while, it is likely to lose some of its power. This means that the structural problem of high indebtedness will remain in many industrialised countries and therefore burden their growth prospects.

- The fact that the ECB has agreed to political measures by purchasing government bonds has caused a loss of confidence in the Euro's stability. Consequently, the Euro continued to lose in value compared to all other leading currencies.

One can only hope that this loss of confidence in the markets does not transfer to the real economy. Given the growth potential in the emerging markets, the recent surprisingly good US retail figures and the weak Euro (which will at least help European exporters), the risk of contagion should be kept in check.

However, markets are likely to remain nervous, and thus volatile, for weeks to come. The time of "catenaccio" has returned, meaning that defensive playing tactics also seem advisable with regard to capital investments, although the offensive aspect should not be neglected.

Wishing you attractive football and attractive yields,

Dennis Nacken

31.05.10

Equity Indices	Status
FTSE 100	5,087
DAX	5,964
DJ Euro Stoxx 50	2,552
S&P 500	1,089
Nasdaq	2,257
Nikkei 225	9,712
Hang Seng	19,497
KOSPI	1,630
Bovespa	63,047

Interest Rates %		
USA	3 Months	0.54
	2 Years	0.77
	10 Years	3.29
Euroland	3 Months	0.70
	2 Years	0.44
	10 Years	2.61
Japan	3 Months	0.39
	2 Years	0.15
	10 Years	1.26

FX	Status
USD/EUR	1.231

Raw Materials	
Oil (Brent. USD/Barrel)	73.1

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Markets in Detail

Tactical Allocation, Shares & Bonds

- Good economic and corporate data, mostly moderate valuations in the equity markets as well as yield-seeking liquidity are likely to provide the markets with more good through-balls yet.
- However, potential offside traps must not be overlooked. These include growth-inhibiting factors, such as the structural deficits of many industrialised countries, a move away from pure monetary policy and tighter regulation of the financial system.
- On balance, given the volatile markets, it might be advisable to take some accumulated profits and strengthen the team defensive.

The arrows are indicating the advised weighting of segments inside the individual asset classes (Regions, Sectors, Bonds).

Germany ↗

- For the most part unimpressed by the "debt crisis" in Europe, German real economic data, such as industrial production and order receipts for example, has continued to rise.
- The German economy with its strong focus on exports mainly benefits from two factors in this regard: the high economic growth outside Europe and the recent weakness of the Euro, which provides companies with additional windfall profits.
- The overweighting of German versus British equities should be maintained.

Europe ↘

- While Germany boasts comparably stable fundamental data, the "debt crisis" is becoming noticeable mainly in Greece, Ireland, Portugal, Spain and also the United Kingdom.
- The savings measures implemented by governments should slow down growth in these regions.
- The expected profits of European companies with a high domestic market share might fall, causing valuations to suffer.

USA ↗

- Surprisingly, order receipts, industrial production and consumer confidence have continued to rise.
- These are signs of a strong recovery following a deep crisis.
- Given the moderate valuations and the sector profile of the US equity market, which is rather defensive, a slight overweighting of the region appears advisable.

Japan →

- Japan continues to benefit from the growth momentum of its Asian neighbours.
- For instance, order receipts and industrial production have continued to develop well. Private consumption and consumer confidence have also increased slightly.
- Thanks to the momentum of positive profits revisions, valuations have rallied further, even though the P/E ratios are higher than those for European or US equities.

Emerging Markets →

- The emerging markets remain the world's growth motor. This is impressively confirmed by Singapore's industrial production, which was 51% higher in April than in the previous year.
- However, attention should be paid to money supply growth and the Chinese property market, which is fuelled by low key interest rates and capital inflows from abroad. They harbour a latent risk of overheating.
- Talk of a "bubble" seems premature however. On the one hand, monetary policies are already having a more restrictive effect (e.g. in China and India), and on the other, valuations do not yet appear to point in that direction.

Sectors

- In terms of sectors, we continue to favour both interesting cyclical sectors (industry, technology) as well as defensive sectors such as health and telecommunications.
- However, as a result of a more defensive composition, we recommend taking profits on well established cyclicals such as raw materials.
- In 2010 however, better performance yields should be attained not so much through sector-driven investment decisions, but rather through "stock-picking", i. e. a targeted selection of individual securities.

Investment Theme: Active Management

- Where inefficient markets are concerned, active management is surely the order of the day; this appears to apply to an even greater degree in volatile sideways markets.
- The index developed by our equities fund manager RCM, which examines stock-picking versus sector-picking. based on volatilities, is currently showing a stock-picker market.
- Even if the selection of individual securities were to boost performance, this can be supplemented by the above-described "barbell" strategy in relation to sector allocation.

Euro Bonds

- The flight to safety caused yields on highly-rated European government bonds to fall further.
- The announced emergency parachute is causing a "creditworthiness transfer" from the stronger countries (mainly Germany) to the remaining Eurozone countries. This should contribute in the medium term to a spread convergence of Eurozone government bonds.
- Although growth in Europe is expected to remain subdued against the background of the planned budget consolidation processes, thus supporting the ECB's expansive strategy, real yields are already at a very low level historically, so that in terms of perspective, an easing of the debt problem and lowered risk aversion might put pressure on yields.

Imprint

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Capital Market Analysis
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International Bonds

- Despite surprisingly positive economic data, US government bonds showed substantial yield declines against the backdrop of a global rise in risk aversion, reassuring central bank comments and a continuing relaxed inflationary environment.
- The key interest rates of leading central banks are likely to remain low for the foreseeable future. The threatened move away from pure monetary policy towards the start of 2011, however, might cause yields to rise as early as 2010.
- An overweighting of medium maturities should continue to dominate against the background of overall steep yield curves.

Emerging Market Bonds

- Given the rise in risk aversion, risk premiums on emerging markets bonds have increased slightly.
- While many industrialised countries are battling increasing government debt, many emerging markets are managing to reduce their debts in relation to GDP.
- On balance, the segment continues to appear attractive even compared to corporate bonds because it has a higher narrowing and thus price gains potential.

Corporate Bonds

- Following the significant spread tightening since the beginning of the year, risk premiums on corporate bonds have increased against the background of the "debt crisis" in the Eurozone and the simultaneous rise in risk aversion.
- In terms of valuations however, corporate bonds remain well placed in the medium run. Implicit default rates continue to move at above-average levels.
- The attractive carry should provide a sufficient risk buffer for the months ahead. However, little can now be expected from converging risk premiums (and/or additional price gains).

Currencies

- In the coming months, we can expect a more stable US dollar, even though a counter-movement of the EUR is likely in the short term.
- The main stress factors affecting the common currency are the loss of confidence in fiscal discipline, growth capacity and the independence of the ECB in the Eurozone.
- While the yen appears overvalued, the Chinese renminbi might figure prominently on the watch list of internationally allocating investors, as it is likely to be revalued.

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