28 August 2008

European News In Brief

Expect excellence

F&C Investments

Energy stocks provide spice to Indian market, says F&C's Mahtani

Sam Mahtani, manager of the F&C Global Emerging Markets Portfolio fund, continues to be overweight India and one of the key themes he is playing is the 'seismic shift' in the country's energy position.

"India's need for energy is well documented driven by its rapid expansion combined with the fact that most oil and gas (75%) has to be imported", he commented. "Estimates suggest this will cost $84bn in 2009". But of equal familiarity amongst investors, he reckons, is the success of Cairn India and Reliance Industries in finding oil and gas deposits in India. In addition, both companies still have extensive and promising acreage that remains unexplored. Mahtani has an overweight position in both Cairn India and Reliance Industries in his portfolio.

Over the next two years a generational shift in India's macro economic backdrop is expected as the energy discoveries of both Cairn and Reliance come on stream. Over this period both companies are set to increase output by 0.7 million barrels of oil and oil equivalent each day. This accounts for 0.5% of global oil production. It is also estimated that this will replace up to 36% percent of imports, the equivalent of $38bn.

"The new supplies of gas will enable a number of manufacturing plants and power stations to operate at optimal capacity thereby aiding India's economic expansion", he continued. India currently has amongst the most heavily subsidised oil price in the world with the costs borne by the Government and producers and suppliers. So what does the future hold for energy demand in India? "The sub-continent is only going to go one way which is good news for Cairn India and Reliance Industries, which have good records of oil discovery. Overall India has 26 sedimentary basins covering 3.14m sq km, which could contain oil and so far only 20% have been properly explored", he added. "This potential is boosted by the fact that in terms of new oil exploration India displays relatively low operational and exploratory risk for countries with deep-sea reserves".

Investors play a waiting game on Russia

The recent deterioration in relations between Russia and the West following the military action in Georgia has unnerved foreign investors, impacting the positive sentiment that has been built up over a number of years. According to fund manager Gareth Morgan, a specialist in the Russian market at F&C, the company has moved from overweight to neutral in its position on Russia and is eyeing developments closely.

"For investors, Russian is currently at a cross roads. Many Russian stocks are now at extremely attractive valuations, companies across a variety of sectors including retail, mobile telecommunications, steel and oil are reporting strong numbers and the economy is one of the most resilient in the emerging market universe," said Morgan.

"However, these tensions with Russia's neighbours and the West, combined with ongoing investigations by Russian authorities into high profile companies in the metals and mining sectors have significantly raised the risk profile for investors in recent weeks. As investors return from the holiday season, there is a real risk of further capital outflows from the Russian market unless relations normalised rapidly. At this stage it is too early to aggressively buy into the Russian market despite strong attractions at the corporate level" he added.

Euro down but not out

The abrupt reversal in the fortunes of the European single currency, particularly against the US dollar, has dominated recent headlines.

Yesterday's release of a widely-regarded measure of the business climate in Germany took the Euro to its lowest level against the dollar for six months, 8.5% down since hitting a peak of near $1.60 in mid-July. Crispin Longden, Head of Continental European Small Cap Equities at F&C, says "For all the alarmist sentiment, it is easy to over-exaggerate the apparent weakness of the Euro. Against the yen, the Euro has fallen by a much slighter 4.2% over the same period, against sterling, the Euro is essentially flat".

Longden continues "It's all about growth prospects, or rather perceived relative growth prospects, to the currency traders. Recent economic indicators across Europe have taken a resolute downturn with Denmark already in technical recession and most of the core Eurozone countries recording negative year-on-year GDP in the second quarter. Whilst far from healthy, the US economy is seen as being relatively better off. The Euro's composure versus Sterling highlights that traders regard the UK in a similar way to the rest of Europe, while Japan's prospects are considered to be aligned somewhere between the UK and the US".

This basic argument ignores other factors which suggest that the case for a weaker Euro is not nearly as straightforward as it appears. Companies across Europe are well accustomed to shifts in exchange rates and have reduced the risk to such an extent that a weaker Euro is no longer a pre-requisite for stimulating exports and boosting economic growth.

Longden argues that European policymakers now have a vested interest in defending a stronger Euro "as a means to kick-start domestic consumption, which has long been the Achilles heel of the European economies, and to combat inflation". He continues "The next interest rate move by the ECB could easily be up as down. Paradoxically, this might well leave private individuals feeling better off. With one or two notable exceptions – France and Spain – savings ratios among consumers remain relatively high across Europe with the result that, should higher interest rates be passed on by the banks, private individuals would have more money in their pockets. As for currency traders, inflation-adjusted interest rate differentials would move firmly in favour of the Euro. In my opinion, it is still too early to give up on the Euro".

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