

Schroders

Quarterly Markets Review

Overview of markets in Q4 2009

Highlights:

- Despite volatility picking up and momentum beginning to wane, equities provided positive returns in the fourth quarter. Economic news supported sentiment overall, with a positive growth rate from the euro area (for the first time since Q1 2008), good Q3 GDP growth in the US, and most other countries (with the notable exception of the UK) officially out of recession. However, concerns about a potential debt default in Dubai unsettled investors at the end of November, and worries about sovereign risk associated with Greece and Spain dampened the mood later in the month.
- The strongest returns were generated by emerging markets, the UK and the Asia (ex Japan) region. The only market in negative territory over the quarter was Japan as concerns over reduced export competitiveness due to the strong yen impacted market sentiment.
- In terms of sectors, materials provided double digit returns on continued evidence of strong demand in emerging markets. Consumer staples, healthcare and energy also did well. The weakest returns came from financials, partly due to financial problems in Dubai, and some profit taking on the previous quarter.
- Credit outperformed government bonds and cash as investors continued to purchase high quality corporate bonds relatively cheaply during the quarter.

US

US equities continued to rise over the fourth quarter as a result of better-than-expected earnings results. Macroeconomic data also showed signs of the recovery theme, with notable highlights including the release of third quarter GDP data showing that the US had exited recession, the moderate strength in consumer spending and an improvement in labour market conditions. However, concerns about the fragility of the recovery punctured the gains towards the latter part of the quarter. Signals from the US housing market remained mixed while worries about Dubai's credit status at the end of November also undermined confidence, although Abu Dhabi's quick resolve to back state-owned Dubai World eased concerns. As the quarter came to an end, markets regained their optimism and helped cap off a strong year for US equities.

Eurozone

Following the tremendous eurozone equity market gains over the summer that continued into the third quarter, returns in the fourth quarter were comparably subdued but managed to remain in positive territory before the year drew to a close. The European Central Bank kept interest rates on hold, and this low interest rate environment along with aggressive government fiscal stimuli initiatives continued to buoy sentiment and prop up the markets. Miners led the share price gains once again, but financials stocks stumbled under renewed concerns about banks' debt exposure follow the Dubai debt concerns. Encouragingly, we saw evidence of markets broadening out as some of the more defensive healthcare, utilities and consumer-related stocks gained ground in December.



UK

Whilst equities became increasingly volatile during the quarter, the UK market was able to post a solid positive return for the final three months of 2009. This resilient performance was all the more significant given that it followed the best ever quarter for the FTSE 100 in Q3 2009, and given that investors were clearly unsettled during November and December by the threat of default in Dubai and Greece. Reasonable economic data continued to underpin market sentiment, but there was also further support as corporate announcements generally came in ahead of expectations. Confidence in the Asian growth story also helped, with basic materials the best performing industry by far. In terms of economic news, the UK economy remained in recession, although third quarter GDP was revised upward to -0.3% quarter-on-quarter, from -0.4% on its preliminary estimate. Economic data generally improved, suggesting the UK should exit recession in 2010. For example, consumer spending remained resilient and there were further signs of recovery in the UK housing market. The Bank of England (BoE) maintained interest rates at a record low of 0.5%, as expected, and in November, it extended quantitative easing by £25 billion to £200 billion. However, recent statements from the BoE were more upbeat, noting the continuing improvement in the economy.

Japan

The Japanese market lagged global equity markets and finished the period in negative territory. Sentiment in Japan remained downbeat on concerns over reduced export competitiveness due to the strong yen. The yen appreciated, hitting a 14-year high against the dollar as investors moved to diversify out of the US currency in November, although the strengthening trend of the yen reversed somewhat in December. In addition, dilution worries impacted market sentiment – several companies announced equity offerings in November, including Mitsubishi UFJ, Hitachi and T&D Holdings and many more are expected to do so. Although the quarter started with some positive economic news, towards the end of the period data was generally weak. Recent figures indicated that the recovery was faltering in some areas: industrial production advanced at the slowest pace in eight months in October and consumer prices fell a near-record 2.2%. A number of November business sentiment surveys moved lower, although the Bank of Japan's Tankan report registered an increase in corporate sentiment in the fourth quarter, especially among large manufacturers. A large downward revision to the investment spending component lowered the estimate of the Q3 GDP gain from 4.8% to 1.3%. However, the sustained growth of manufacturing output, machinery orders and exports suggests that there remains solid momentum. In December, the Bank of Japan injected further liquidity into the financial system, aimed at countering deflation and the strong yen.

Asia (ex Japan)

Following the strong performance in the year to date, the rally in Asian equities slowed but still managed to register positive gains before the year end. Macroeconomic data remained supportive of an improving global economy, with investors reacting particularly favourably to positive economic news from China, which was one of the outperformers amongst the major markets. Taiwan was also amongst the strongest performers, led by the technology sector amid rising hopes for a recovery in global demand. However, the Thai market lagged as rumours about the health of the King of Thailand at the start of the quarter weighed on market sentiment. Concerns about Dubai's credit status and news that global banks would need to raise capital quality by 2010, also took the edge off gains towards the end of the quarter; however, the positive trend resumed in the final weeks of 2009 on signs of growing demand and rising commodity prices, capping off the strongest year for Asian equities since 2003.

Emerging Markets

Emerging markets outperformed global equity markets, benefiting from commodity price strength and rounding off a year of excellent performance in which they were well ahead of developed markets. Latin American markets were among the strongest performers, particularly Chile, Mexico and Brazil, with local currency appreciation boosting US dollar returns from each market. Mexico outperformed (despite rating agencies Fitch and Standard & Poor's downgrading its sovereign debt) buoyed by evidence of domestic economic recovery. Brazil benefited from higher commodity prices. Colombia was one of the weakest performing emerging markets, with US dollar returns impacted by local currency weakness. In Asia, China outperformed with data releases showing the domestic economy continuing to grow strongly. Taiwan was also among the strongest performers in Asia, with data released showing a 31.5% year-on-year increase in industrial production in November. Israel was the best performing EMEA market, buoyed by strong performance from pharmaceuticals company Teva, the dominant stock in the local index. The Czech Republic (local currency weakness impacted returns in US dollar terms) and Egypt (impacted by Dubai-related concerns) were among the weakest performing EMEA markets.

Global Bonds

Global macroeconomic news continued to improve during the quarter. Many countries (with the notable exception of the UK) exited recession – US GDP growth expanded at an annualised pace of 2.8% in the third quarter of 2009. The eurozone also generated positive growth for the first time since the first quarter of 2008. Other economic news was generally encouraging – towards the end of the period stronger-than-expected US employment data was released. Furthermore, housing and business and consumer confidence data on the whole showed resilience.

Global investment grade corporate bonds posted positive returns during the fourth quarter of 2009, outperforming government bonds and cash, as investors risk appetite remained high. Confidence was fuelled by improving economic data and some positive corporate earnings announcements. Despite initial concerns, the Dubai debt crisis did not directly impact on the credit market.

Overview – Total Returns (%) – to end of December 2009

	3 months			2009		
	EUR	USD	GBP	EUR	USD	GBP
Equities (MSCI)						
World Index	6.14	4.18	3.18	26.72	30.79	16.45
World Value Index	4.29	2.37	1.38	23.73	27.71	13.70
World Growth Index	8.05	6.05	5.03	29.68	33.85	19.17
World Smaller Companies Index	4.84	2.91	1.92	40.25	44.75	28.88
US	8.03	6.04	5.02	23.19	27.14	13.20
Eurozone	2.73	0.84	-0.13	28.66	32.79	18.23
UK	8.99	6.98	5.95	38.92	43.38	27.66
Japan	-0.93	-2.76	-3.69	3.08	6.39	-5.28
Emerging Markets	10.62	8.58	7.53	73.45	79.02	59.39
Asia ex Japan	8.60	6.59	5.57	67.17	72.54	53.61
	3 months			2009		
Government bonds (JP Morgan)	EUR	USD	GBP	EUR	USD	GBP
US	0.55	-1.31	-2.25	-6.76	-3.77	-14.32
UK	0.79	-1.08	-2.03	7.76	11.22	-0.98
Japan	-1.54	-3.36	-4.28	-4.81	-1.75	-12.53
Germany	-0.01	-1.85	-2.80	1.84	5.11	-6.41
Corporate bonds (Merrill Lynch)	3.12	1.22	0.25	16.04	19.76	6.63

Source: Datastream to 31 December 2009

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