Schroders
Monthly markets review

Overview of markets in August 2010

Highlights:

- Global equity markets lost ground during August amid renewed indications that the worldwide economic recovery could be losing steam. The deteriorating health of the US economy and a cooling Chinese economy weighed heavily on global equities.
- Eurozone equities lost momentum as the prospect of a double-dip recession weighed on sentiment, following another round of weak economic data out of the US. The Federal Reserve's comments that monetary policy would remain accommodative and the European Central Bank's efforts to play down the risks did little to alleviate investor concerns.
- The US financial markets ended the month in negative territory as weak home sales, high unemployment, and disappointing manufacturing orders weighed on equity markets in the US, with the Dow, S&P 500 and Nasdaq all registering negative returns.
- Japanese equities lost ground on signs that the US economic recovery was deteriorating and on a cooling Chinese economy. Investors were also disappointed with the Central Bank of Japan's decision not to intervene in currency markets, with the yen's recent appreciation potentially leading to declining exports and a slowdown in economic growth.
- Save haven commodities like gold and silver outperformed as concerns about the sustainability of the global recovery were reaffirmed by weak economic indicators. Oil traded somewhat lower this month as on predictions of sluggish lower global demand.

US

The US financial markets ended August in negative territory after further evidence of the deteriorating health of the US economy dampened investor sentiment, sparking a flight-to-safety away from risky assets, which in turn negatively affected equity performance. Weak home sales, high unemployment and disappointing manufacturing orders weighed on equity markets in the US, with all major indices ending the month down. August saw the largest US trade deficit in 21 months, disappointing import figures from China and the Federal Reserve's downgrade of its economic outlook, which led investors to buy safer assets such as gilts, long-dated bonds, gold and major currencies like the dollar and yen.

Eurozone

Eurozone equities lost momentum in August, as the prospect of a double-dip recession weighed on sentiment, following another round of weak economic data out of the US. Comments from the Federal Reserve that monetary policy would remain accommodative, to support the fragile US economy, did little to dispel the fears. The European Central Bank played down concerns over the US slowdown, and eurozone economic data proved slightly more resilient during the month. As expected, interest rates remained unchanged at 1.0%. Business confidence indicators rose, consumer demand was robust and retail sales were up. The eurozone economy also expanded beyond forecasts in the second quarter – led by strong growth from Germany. Unemployment remained steady, although the headline figure belied the disparity between the more robust German-led 'core' economies and the 'peripheral' nations, such as Spain and Greece. Manufacturing and industrials data slightly disappointed during the month. The mixed news prompted a flight to quality; with healthcare, telecom services and consumer staples the only sectors to register overall gains

Issued by Schroder Investment Management Limited.
31 Gresham Street, London EC2V 7QA. Registered No. 1893220 England.
Authorised and regulated by the Financial Services Authority.
Schroders

UK

The UK equity market continued the pattern of whipsaw volatility evident in recent months, with investors reacting against most of what they had committed to the month before. As attention turned from July's reports of strong company profits, investors tended to react to macro-economic newsflow, wherever possible emphasising the negative. Key concerns included the uncertain global outlook, weak growth prospects at home and the looming impact of government spending cuts in most of the developed economies. The Bank of England helped to confirm the pessimistic mood, predicting a choppy recovery. Company news remained largely positive, though the impact on the market was limited, while volatility was exacerbated by thin summer trading volumes. Results announcements remained encouraging and bid activity continued. Industries perceived as dependent on consumer spending were marked down, including travel and leisure, media and general retail. Companies with exposure to the public sector were also broadly negative, while poor returns among resource and material stocks suggested doubts about ongoing capital investment in Asia. There were some exceptions. Automotives and household goods were positive, but for the most part investors favoured sectors seen as recession-proof were favoured, such as water and electricity suppliers and food retailers.

Japan

The Japanese market posted negative returns in August. Japanese markets retreated on signs that the US economic recovery was deteriorating and on a cooling Chinese economy. The yen traded near a 15-year high against the dollar and strengthened against a basket of major currencies this month, while the Nikkei 225 experienced its biggest monthly drop since May, leading the Asian markets lower. With China's imports declining month-on-month and the yen strengthening to record levels, investors have shown concern that Japan's exports will be hurt, slowing economic growth in the region. The Central Bank of Japan's decision to refrain from tackling the yen's surge was not well received by the market, with investors demanding more steps to curb the currency's advance and stimulate economic growth.

Asia (ex Japan)

Despite becoming the world's second largest economy, China was the key laggard of the region's markets in August. Jitters over the progress of the global recovery overshadowed positive economic data emerging from the region and tipped Asia Pacific's equities into the red. Despite indications of rising inflation, China's economy slowed in July as efforts to cool the property market and limit energy consumption began to bite. While risk appetite waned over the period, Hong Kong bucked the regional downward trend as stocks touched their highest level in three months following strong corporate earnings and an upbeat outlook for the local property market. Other regions that succeeded in shrugging off global recovery concerns included Thailand, where markets delivered the region's strongest returns – reaching their highest level since 1996 – on the back of easing political tensions and better-than-expected Q2 economic data.

Emerging Markets

The MSCI Emerging Markets index delivered negative returns in August as commodity prices declined and concern deepened that the global economic recovery will falter given relatively weak data from the US. However, these markets outperformed developed markets. China was the key laggard of the region's markets in August. Jitters over the progress of the global recovery overshadowed positive economic data emerging from the region and tipped Asia Pacific's equities into the red. A stronger US dollar and weakness in commodities, such as oil and copper, led emerging markets lower. However, gold rose to near $1,250 an ounce, as the precious metal recorded its biggest monthly gain since April, on speculation of a slowdown in the global economy. South Korea was one of the worst performing markets over the period, as US concerns triggered foreign selloffs in domestic shares, especially technology plays on concerns that demand for such products will not be sustainable. Russia, a key component of the MSCI Emerging Markets index, also posted negative returns in August as weaker oil prices dimmed the outlook for energy producers.

Global Bonds

Macro news dictated financial market performance yet again in August as central bank rhetoric became increasingly dovish and economic releases fuelled fears about a double-dip. The Federal Reserve's response to weaker data in the US was a second wave of quantitative easing, whereby the central bank will be reinvesting MBS income into US treasuries. News of the so-called 'QE2' helped to drive US treasury yields to their lowest point this year – a trend that was mirrored amongst German bunds and UK gilts as faltering risk appetite perpetuated the search for safe havens.

Overview – Total Returns (%) – to end of August 2010

		1 month			YTD	
Equities (MSCI)	**EUR**	**USD**	**GBP**	**EUR**	**USD**	**GBP**
World Index	-1.29	-3.69	-1.86	6.32	-5.81	-1.04
World Value Index	-1.46	-3.86	-2.03	6.12	-5.98	-1.22
World Growth Index	-1.12	-3.53	-1.70	6.51	-5.64	-0.85
World Smaller Companies Index	-2.19	-4.58	-2.76	11.98	-0.8	4.24
US	-2.06	-4.44	-2.63	7.61	-4.67	0.16
Eurozone	-3.77	-6.12	-4.33	-5.66	-16.42	-12.18
UK	0.47	-1.98	-0.11	6.27	-5.85	-1.08
Japan	0.16	-2.28	-0.43	11.21	-1.48	3.52
Emerging Markets	0.54	-1.91	-0.05	12.77	-0.09	4.97
Asia ex Japan	1.37	-1.11	-0.77	13.94	0.94	6.06
		1 month			YTD	
Government bonds (JP Morgan)	**EUR**	**USD**	**GBP**	**EUR**	**USD**	**GBP**
US	4.62	2.07	4.01	23.01	8.97	14.50
UK	5.18	2.62	4.57	18.72	5.17	10.51
Japan	6.51	3.91	5.89	29.29	14.54	20.34
Germany	3.87	1.34	3.27	10.55	-2.07	3.90
Corporate bonds (Merrill Lynch)	4.74	2.19	4.13	24.88	10.64	16.25

Source: Datastream to 31 August 2010

Important Information:

Schroders