Schroders
Monthly Markets Review

Overview of markets in February 2010

Highlights:

- February was another volatile period for global equities, but after a weak start, the MSCI World Index finished the month in positive territory. Concerns about sovereign debt (particularly in Greece) continued to unsettle investors, leaving European markets struggling, whereas the US put in a relatively robust performance as economic data proved reasonably upbeat overall.
- Investors continued to keep a close eye on monetary policy developments in this environment, with China's second successive 50 basis points hike in the required reserve ratio keeping attention on growth in Asia. A surprise 25 basis points hike in the US discount rate also raised expectations of an earlier-than-expected tightening in US policy, but reports from the Federal Reserve (Fed) quickly countered those expectations. Officials stressed that the move was intended to help normalise market conditions and that a hike in the US Fed Funds rate still remained a long way off.
- US manufacturing and industrial production data was robust, retail sales continued to improve and GDP for the final quarter of 2009 was confirmed as extremely strong. However, employment continued to contract and housing data was very poor, weighing on weak consumer sentiment.
- On the corporate front, news was mostly positive, with over two thirds of S&P 500 companies having now reported, and 75% having beaten earnings estimates. Encouragingly, many companies are now beginning to see revenue growth.
- Credit underperformed government bonds as risk aversion continued to dominate markets, particularly ongoing rumblings of a potential sovereign debt crisis in Europe.

US

It was a strong month for US equities. Economic data was generally upbeat, with better-than-expected readings from the jobless rate, industrial production as well retails sales, boosting confidence. The Fed's move towards withdrawing its extraordinary support measures was also a key theme over the month after Bernanke outlined the Fed's exit strategy. Expectations that the Fed would bring forward the timing of its first policy rate hike rose after the discount rate was raised by 25 basis points. However, Fed officials were quick to refute this speculation, stressing the move was aimed at normalising market conditions and that there were no plans to raise the Fed funds rate.

Eurozone

February proved another rocky month for equity markets, with mixed success for eurozone equities. Share prices slumped initially as fears over Greece's fiscal stability broadened out to include a number of other peripheral eurozone members, including Spain and Portugal. However, by mid-month, concerns about the potential for a default within the region eased somewhat and markets staged a modest rally, before uncertainty crept in once more leaving equities slightly down for the month as a whole. Consumer staples and healthcare stocks managed to nudge their way into positive territory; while consumer discretionary, financials and energy stocks posted some of the

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biggest losses. In economic news, preliminary estimates showed that eurozone growth slowed markedly in the final quarter of 2009 to just 0.1% from 0.4% in Q3 2009. In addition, the German IFO Business Climate Index was disappointing in February, falling from 95.8 to 95.2, indicating a less favourable outlook amongst companies. Manufacturing data was firmer than expected, but services data disappointed. The European Central Bank (ECB) left policy rates on hold at 1% – as the market expected – in a continued attempt to stimulate growth.

UK

Despite news that the UK has emerged from recession, investor caution on the economy continued to drive share price volatility in February. Worries about the sustainability of the recovery, along with concerns about tightening in China and the scale of fiscal deficits in Europe also weighed on sentiment. UK investors are also weighing up the prospect of a hung parliament and the likelihood of a post-election austerity budget given the 'doomsday' scenario that bond yields leap in the face of insufficient fiscal tightening. However, enthusiasm for Asia-focused firms and good results from UK banks helped the market to make progress overall. In terms of economic news, GDP growth for the final quarter of 2009 was revised higher to 0.3% quarter-on-quarter from an initial estimate of 0.1%. The main reason for the upward revision was an increase in services output data. However, concerns over the economic recovery remained, with mixed signals from the housing market during February. In addition, consumer spending and employment data were both disappointing. On a positive note, manufacturing and industrial production releases were stronger than expected. The Bank of England left interest rates on hold at 0.5% and decided not to extend quantitative easing as expected.

Japan

Economic data in Japan was largely positive. GDP expanded at a better than expected annualised 4.6% in the fourth quarter of 2009. Within this, export and industrial production growth remained robust, but consumer spending also played an important role and capex showed signs of bottoming out. An earnings recovery seemed to be underway, as cost-cutting at many companies boosted their bottom lines, although a slight strengthening of the yen weighed on exporters. Newsflow was dominated by two stock-related stories. Toyota became embroiled in a series of recalls and investigations into safety. First KDDI then Sumitomo Corp announced intentions to buy large stakes in Jupiter Telecom at a hefty premium. The rubber products sector performed strongly, helped by good profit forecasts from Bridgestone and Toyo Tire. In the oil & coal sector, some refiners saw broker upgrades as capacity reduction appeared to be stabilising the sector. Laggards included the other products sector, where Nintendo was hit by the yen appreciation. Toyota's woes dragged down the autos sector. Financials, with the exception of insurance, performed poorly – consumer finance stocks were hit by reports that the government is likely to fully implement a revised money lending law. Once again there was very little difference in the performance of the small and large cap segments of the market.

Asia (ex Japan)

Asian equities finished a volatile month little changed in February, as investors remained cautious about the impact of sovereign risk in the eurozone as well as the withdrawal of stimulus measures around the world. That said, the market was able to regain its balance after the initial shock of the Fed raising its discount rate, which led to worries about tightening in the policy rate. However, Fed Chairman Ben Bernanke was quick to reassure investors that interest rates would not be increasing. The Chinese authorities also hiked banks' reserve requirement ratio for a second time in as many months. However, better macro data helped buoy the Chinese market, although Taiwan and Korea suffered as technology stocks slumped on uncertainty over the sustainability of the global recovery.

Healthcare and industrials were among the best performing sectors while technology and telecoms trailed during the month.

Emerging Markets

World equities finished the month in positive territory, following the negative returns of the previous month, although market conditions were volatile. Concerns about fiscal problems in Greece and in some other eurozone countries weighed on sentiment, as did ongoing concerns about policy tightening in China. Emerging Markets delivered a positive return against this background although it lagged developed markets, despite commodity price strength. Latin American markets were among the best performers, in particular Peru, Brazil, Mexico and Colombia. Generally strong performance from commodity-related and financials stocks boosted the performance of these markets, while in Mexico, data was released showing industrial production continuing to recover, coming in at 1.6% year-on-year in December. In Asia, the Philippines and Thailand were the best performing markets, as they rebounded from weakness in the previous month. In the Philippines, strong export data was released, showing growth of 23.6% year-on-year in December. In Thailand, economic news included fourth quarter GDP growth coming in at 5.8% year-on-year. Emerging European markets were the weakest performers over the month. Turkey, Poland, Hungary and the Czech Republic underperformed against the background of concerns about fiscal problems within the eurozone, while domestic political tensions also weighed on the Turkish market. The energy-dominated Russian market also underperformed despite a rise in oil prices over the month.

Global Bonds

Global government bonds outperformed corporate bonds in February as investors digested contagion risks arising from a potential sovereign debt crisis in Europe, mixed global economic releases and worries over the impact of further monetary tightening in China. China made a second increase in the reserve requirement ratio, which many believe to be the start of significant monetary tightening. The Fed also caught markets off guard by raising the discount rate, although officials were quick to reassure markets that the move contained little monetary policy implications for 2010.

Global economic data was mixed in February, with US consumer sentiment and unemployment data still lagging. However, on a positive note, statistics showing a strong expansion in factory output in Europe, Asia and the US have helped allay fears of a double-dip recession.

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

	1 month			YTD		
Equities (MSCI)	**EUR**	**USD**	**GBP**	**EUR**	**USD**	**GBP**
World Index	3.32	1.45	6.78	2.26	-2.72	3.18
World Value Index	2.70	0.84	6.14	2.33	-2.66	3.25
World Growth Index	3.94	2.06	7.43	2.20	-2.79	3.12
World Smaller Companies Index	4.23	2.34	7.72	5.01	-0.11	5.96
US	4.99	3.09	8.50	4.57	-0.53	5.51
Eurozone	-1.82	-3.60	1.47	-6.41	-10.97	-5.57
UK	0.37	-1.45	3.73	-1.38	-6.19	-0.49
Japan	2.99	1.12	6.44	8.32	3.04	9.30
Emerging Markets	2.22	0.37	5.65	-0.35	-5.21	0.55
Asia ex Japan	2.38	0.53	5.81	-0.68	-5.52	0.22
	1 month			YTD		
Government bonds (JP Morgan)	**EUR**	**USD**	**GBP**	**EUR**	**USD**	**GBP**
US	2.26	0.40	5.68	7.25	2.02	8.21
UK	-3.62	-5.36	-0.39	-0.64	-5.49	0.25
Japan	4.00	2.11	7.48	10.20	4.82	11.19
Germany	0.95	-0.88	4.33	2.49	-2.51	3.42
Corporate bonds (Merrill Lynch)	2.18	0.33	5.60	7.57	2.33	8.54

Source: Datastream to 28 February 2010

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