Issued in February 2010

Schroders
Monthly Markets Review

Overview of markets in January 2010

Highlights:

- Global equities had a volatile start to 2010, with initial gains reversed by the end of January. Favourable economic data from the US and China in the first half of the month brightened the prospects for global economic recovery. However, optimism receded in the second half thanks to less positive US data including mixed earnings releases, disappointing employment figures and a setback in the nascent housing recovery.
- The MSCI World Index finished lower overall, with sentiment shifting on the back of continued concerns about sovereign risk in the euro area, the prospect of monetary tightening in China and the announcement of President Obama's bank regulation proposals.
- With the US dollar rising, commodity-names suffered in particular, but most sectors proved weaker as investors questioned the pace of the worldwide economic recovery.
- Credit outperformed government bonds and cash as corporate bonds continued to experience an excess of buyers over sellers

US

US equities got off to a strong start in January, boosted by better-than-expected ISM manufacturing data and corporate earnings results. The second half of the month also saw a continuation of strong corporate and economic news flow, and, at month end, the US reported stronger-than-expected 5.7% annualised fourth quarter GDP growth. However, markets looked through the strong flow of data and paid greater attention to the potential implications of monetary tightening in China, sovereign risk in the Euro area and President Obama's banking reform plans, resulting in a sharp sell-off in the second half of the month.

Eurozone

Eurozone equities lost momentum in January and share prices in aggregate retreated. The risk aversion was triggered by renewed concerns about the fiscal stability of European peripheral countries, particularly Greece. Fears escalated as the European Central Bank (ECB) took an unusually firm stance. Although the central bank remains supportive, ECB President Trichet signalled that Greece would receive no special assistance. Greek Prime Minister George Papandreou announced plans to cut spending and raise revenue by €10 billion this year as part of a 3 year stability plan, but the news did little to reassure investors. Resource-related stocks came under pressure amid fears of monetary tightening in China and after sovereign debt concerns triggered a flight to safety (boosting US dollar strength during the month). Reports of Australian government plans to hit the mining industry with a new tax further unsettled markets. Financials also lost ground following US President Obama's tough stance on banks' risk-taking practises. Technology stocks were the clear leaders after better-than-expected results announcements boosted sector performance, and some more defensive consumer stocks also posted gains in January.

UK

UK equities started 2010 in volatile fashion, with strong gains in the first part of January being eradicated by the end. Sentiment continued to fluctuate on economic news, but investors shifted from feeling reassured about a recovery to worrying about the risks of monetary tightening. Indeed, whilst the US reiterated its stance to keep interest rates exceptionally low for an extended period, China spooked markets by taking clear steps to tighten liquidity. In terms of economic news, the UK economy emerged from the recession in the fourth quarter, rising 0.1% quarter-on-quarter (qoq), which was much less than most forecasts. Unemployment continued to show signs of improvement, and better-than-expected manufacturing and industrial production data was released. However, the housing market showed mixed signals. The Bank of England left interest rates on hold at 0.5%.

Japan

The Japanese market outperformed global equity markets in local currency terms. Economic data from Japan had an upbeat tone – December export volume advanced strongly, as did industrial production, with manufacturers anticipating additional output increases in the current quarter. The labour market continued to bottom out and early indications on the earnings season were encouraging. In a renewed blow for exporters, the yen saw fresh strength versus the US dollar and particularly versus the euro. This depressed sentiment along with global concerns, but essentially Japan's gradual recovery remained on track. After lagging sharply in the second half of 2009, the shipping sector was the strongest performer in January. Contributing factors included broker upgrades, a positive profit preview in a national newspaper and booming global manufacturing output, pointing to recovering demand. Banks were also strong, reflecting relief that SMFG's capital raising during the month may signal an end to equity financing in the sector (with the possible exception of Mizuho). Air transport was the weakest sector by some margin as JAL finally fell into bankruptcy and a government-sponsored restructuring plan. There was very little difference this month in the performance of the small and large cap segments of the market.

Asia (ex Japan)

Concerns over monetary tightening in China, worries over sovereign risk in the Euro area as well as US President Barack Obama's proposals to restrict the activities of US banks saw global risk assets retreating in January. After a strong start to the year, Asian markets succumbed to the same concerns after Beijing hiked the reserve requirement ratio of its banks in the second week of January in a bid to rein in bank lending following a surge in credit growth. Chinese financials were hardest hit, but the impact was felt across the region as investors considered the implications of lending curbs on infrastructure spending and commodities demand. As a result, the financial, material and energy sectors were the weakest performers over the month while the more defensive telecom and healthcare names delivered the best returns.

Emerging Markets

Emerging markets underperformed developed markets, giving back some ground following the excellent returns delivered in 2009, with commodity price weakness having a negative impact. Brazil and Peru were the weakest performing emerging markets over the month, with the underperformance of commodity-related stocks weighing on both markets. The MSCI China index underperformed. The Chinese authorities increased the reserve requirement ratio for banks, aggravating investor concerns that more policy tightening is to come. Data releases over the month showed the Chinese economy continuing to grow strongly, with fourth quarter GDP coming in at 10.7% year-on-year, while consumer price inflation accelerated to 1.9% year-on-year in December. Egypt was the strongest performing emerging market over the period as it continued to rebound following the easing of the Dubai-related concerns that had weighed on the market in late 2009. Russia outperformed despite a fall in oil prices over the month. Data was released showing the

Russian economy continuing to recover, with industrial output growing by 2.7% year-on-year in December, while rating agency Fitch upgraded Russia's sovereign credit outlook to stable from negative (following a similar move by fellow rating agency Standard & Poor's in December).

Global Bonds

Despite a relatively buoyant start to 2010, risk aversion returned to the market in the second half of the month, amidst negative news flow over China's monetary tightening, President Obama's proposed banking reforms and the risk of default in Greece.

The global economy continued its recovery, with US GDP, for the fourth quarter of 2009, surging at a better-than-expected annualised pace of 5.7% quarter-on-quarter. However, other economic news was mixed. Disappointing US employment, retail sales and housing data left investors somewhat unsettled during the month, contributing to the overall drop in risk appetite. Nevertheless, corporate bonds still generated strong returns and outperformed government bonds, which also rallied during the month.

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

	1 month			YTD		
Equities (MSCI)	**EUR**	**USD**	**GBP**	**EUR**	**USD**	**GBP**
World Index	-1.02	-4.11	-3.37	-1.02	-4.11	-3.37
World Value Index	-0.36	-3.47	-2.72	-0.36	-3.47	-2.72
World Growth Index	-1.68	-4.75	-4.01	-1.68	-4.75	-4.01
World Smaller Companies Index	0.75	-2.39	-1.64	0.75	-2.39	-1.64
US	-0.40	-3.51	-2.76	-0.40	-3.51	-2.76
Eurozone	-4.67	-7.65	-6.93	-4.67	-7.65	-6.93
UK	-1.75	-4.81	-4.07	-1.75	-4.81	-4.07
Japan	5.18	1.90	2.69	5.18	1.90	2.69
Emerging Markets	-2.52	-5.56	-4.83	-2.52	-5.56	-4.83
Asia ex Japan	-2.99	-6.02	-5.29	-2.99	-6.02	-5.29
	1 month			YTD		
Government bonds (JP Morgan)	**EUR**	**USD**	**GBP**	**EUR**	**USD**	**GBP**
US	4.88	1.61	2.40	4.88	1.61	2.40
UK	3.09	-0.13	0.64	3.09	-0.13	0.64
Japan	5.96	2.65	3.45	5.96	2.65	3.45
Germany	1.53	-1.64	-0.87	1.53	-1.64	-0.87
Corporate bonds (Merrill Lynch)	5.28	1.99	2.79	5.28	1.99	2.79

Source: Datastream to 31 January 2010

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