Schroders
Quarterly Markets Review

Overview of markets in Q1 2010

Highlights:

- Although global equities endured a volatile quarter, the MSCI World Index finished the period in positive territory due to generally improving macroeconomic data and mostly positive corporate earnings results. Encouragingly, many companies are now beginning to see revenue growth.
- A whole host of countries released positive growth data, showing that they exited recession in the final quarter of 2009. In particular, the US reported stronger-than-expected 5.7% annualised fourth quarter GDP growth. However, other economic releases were mixed, with US employment continuing to lag and housing data weak.
- Volatility in equity markets, worldwide, persisted as investors digested contagion risks arising from a potential sovereign debt crisis in Europe, the announcement of President Obama's bank regulation proposals and worries over the impact of further monetary tightening in China. China made a second successive 50 basis points hike in the required reserve ratio, which many believe to be the start of significant monetary tightening.
- Credit outperformed government bonds as corporate bonds continued to experience an excess of buyers over sellers.

US

US equities generated strong returns during the quarter against a backdrop of improving economic data. The period saw a continuation of strong corporate and economic news flow – generally better-than-expected manufacturing, retail sales, industrial production and corporate earnings results were released. However, this was marred slightly by some disappointing housing-related reports and mixed signals from the labour market, weighing on weak consumer sentiment. The US equity market was supported by the Federal Reserve (Fed) pledging to keep rates close to zero for the foreseeable future – although the Fed caught markets off guard by raising the discount rate, officials were quick to reassure markets that the move contained little monetary policy implications for 2010. The Fed also released more optimistic comments on the recovery. However, worries that Chinese inflation and surging property prices would increase pressure for additional tightening weighed on markets somewhat.

Eurozone

Despite losing ground in January and February, eurozone equities staged a modest rally in March to round out the quarter with positive gains as fears of sovereign default began to subside following the agreement of a support plan involving the EU and the IMF by the end of the period. In addition, weak demand for the European Central Bank's final six-month long-term refinancing operations (LTRO) suggested that banks' liquidity needs have lessened and should ease concerns regarding any liquidity squeeze following the expiration of the 12-month LTRO in July. Technology stocks were the star performers during the quarter, with better-than-expected results announcements bolstering sector performance. Towards the end of the period, positive economic news came out of the eurozone, in the form of a very strong rise in industrial production and a survey pointing to the

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highest level of confidence in the economy in nearly two years. In addition, the weakening euro boosted manufacturing growth in Germany. Indeed, the competitive exchange rate combined with rising demand in key export markets saw output expanding at its fastest pace since the mid-1990s. Improved business confidence also proved encouraging; however, the services sector remained weak under sluggish domestic demand. The European Central Bank (ECB) left policy rates on hold at 1% – as the market expected – in a continued attempt to stimulate growth.

UK

The first quarter was another volatile period for equities, with continued caution on the economy and sovereign debt worries initially taking hold in the absence of corporate news. In January, the market fell amidst fears that emerging market growth might not live up to expectations and that the worldwide economic recovery might consequently be more tepid than markets had previously hoped. Despite news that the UK has emerged from recession, investor caution on the economy continued to drive share price volatility in February. With worries about a double-dip recession consequently on investors' minds, risk aversion kept a number of consumer names, particularly retailers, under pressure. In addition, concerns about sovereign debt issues, particularly in Greece, also weighed on sentiment, but enthusiasm for Asia-focused firms and good results from UK banks helped the market to make progress overall. Towards the end of the period, sentiment improved notably as the results season kicked off, and the impressive resilience of many companies helped to drive stockmarket gains. In terms of economic news, GDP growth for the final quarter of 2009 was revised upwards to 0.4%. However, there was mixed housing, consumer spending and employment data during the quarter. The Bank of England left interest rates on hold at 0.5% and decided not to extend quantitative easing as expected.

Japan

Investor sentiment in Japan improved during the quarter, helped by better-than-expected economic activity in the US and by positive domestic data. For example, Japanese 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. Export growth continued its strong trend, but towards the end of the period, there were increasing signs that the externally-driven recovery was broadening out and beginning to lay a foundation for domestic activity. The labour market showed a modest improvement in February and consumer spending surprised on the upside for the second consecutive month. In addition, markets were encouraged as the Bank of Japan kept interest rates at 0.1% and announced additional monetary easing, contributing to a significant weakening of the yen. There was very little difference in the performance of the small and large cap segments of the market during the quarter.

Asia (ex Japan)

Asian equities generated a positive return in US dollar terms over a volatile first quarter against a backdrop of continuing positive macro data. This was despite increasing concerns about the impact of pre-emptive efforts to cool economic growth across the region, with both China and India catching investors off guard. In January and February, Beijing hiked the reserve requirement ratio of its banks while the Reserve Bank of India unexpectedly raised its key interest rates in March. Further afield, worries over sovereign default in the eurozone added to the caution; however, these concerns faded towards the latter part of the quarter after the European Union stepped in to support the Greek economy. Against this backdrop, Thailand was the best performing market, buoyed by the strong showing in the banking sector. In addition, macro news was positive, with the economy reporting fourth quarter growth of 5.8% year-on-year, helping to offset ongoing political uncertainties. On the other hand, Taiwan and China ended the quarter in negative territory and were the worse performing markets on the aforementioned China-related concerns.

Emerging Markets

Emerging Markets delivered a positive return during the quarter, and outperformed developed markets in February and March, following returns that lagged in January. Thailand was the best performing emerging market, despite domestic political uncertainties, boosted by strong performance in the banking sector. In addition, economic news was positive – fourth quarter GDP growth for 2009 came in at 5.8% year-on-year (yoy) and data in February showed exports growing by 23.1% yoy. Egypt generated strong returns, as it continued to rebound following the easing of the Dubai-related concerns that had weighed on the market in late 2009. Hungary also performed well, as the central bank continued its policy of monetary easing. Russia outperformed as data was released showing the economy continuing to recover, while rating agency Fitch upgraded its sovereign credit outlook to stable from negative in January. China generated negative returns. The Chinese authorities increased the reserve requirement ratio for banks, and concerns over monetary tightening continued to weigh on the market during the period. Taiwan also underperformed on China-related concerns. The Czech Republic struggled as it is viewed as a relatively defensive market.

Global Bonds

Global corporate bonds outperformed government bonds as credit continued to experience an excess of buyers over sellers. However, government bonds generated stronger returns during the middle of the period as risk aversion came to the fore, due to continued concerns over sovereign debt in the eurozone, the prospect of monetary tightening in China and the announcement of President Obama’s bank regulation proposals. China raised the required reserve ratio on two occasions by 50 basis points. In addition, a surprise 25 basis points hike in the US discount rate, in February, raised expectations of an earlier-than-expected tightening in US policy, but reports from the 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.

Global economic data proved reasonably upbeat overall. For example, 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.

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

	1 month			Q1 2010		
Equities (MSCI)	**EUR**	**USD**	**GBP**	**EUR**	**USD**	**GBP**
World Index	7.16	6.25	6.63	9.58	3.35	10.03
World Value Index	7.22	6.31	6.70	9.72	3.48	10.17
World Growth Index	7.10	6.19	6.57	9.45	3.23	9.89
World Smaller Companies Index	8.69	7.76	8.16	14.14	7.65	14.60
US	6.90	5.99	6.37	11.78	5.43	12.23
Eurozone	7.88	6.97	7.36	0.97	-4.77	1.38
UK	6.88	5.97	6.35	5.40	-0.59	5.83
Japan	5.96	5.06	5.44	14.78	8.25	15.24
Emerging Markets	9.01	8.08	8.47	8.63	2.45	9.07
Asia ex Japan	8.17	7.25	7.64	7.43	1.33	7.87
	1 month			Q1 2010		
Government bonds (JP Morgan)	**EUR**	**USD**	**GBP**	**EUR**	**USD**	**GBP**
US	0.00	-0.85	-0.49	7.24	1.15	7.68
UK	1.38	0.52	0.89	0.73	-4.99	1.14
Japan	-4.27	-5.09	-4.74	5.49	-0.51	5.92
Germany	0.34	-0.52	-0.16	2.84	-3.01	3.25
Corporate bonds (Merrill Lynch)	1.27	0.41	0.77	8.94	2.75	9.38

Source: Datastream to 31 March 2010

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