

Schroders

Monthly markets review

Overview of markets in October 2010

Highlights:

- Expectations of further quantitative easing led markets higher in October, with the eurozone leading equity market gains. Corporate bonds generally outperformed government bonds, while the search for yield continued apace.
- On balance, macroeconomic data proved encouraging. In particular, signs of improvement in US housing, consumer confidence and manufacturing data cheered investors, as did evidence of growth in Europe. In Asia, Chinese manufacturing data accelerated; while in the UK, preliminary GDP growth surprised to the upside.
- The macroeconomic momentum, combined with strength in the corporate sector, provided a fertile environment for ongoing risk trading during the month – albeit at a more subdued pace.
- Risk appetite further strengthened commodity prices in October, while the US dollar continued to decline against most major currencies, in anticipation of another round of quantitative easing.

US

US equities extended their recent gains in October, with the Dow Jones Industrials, S&P 500 and NASDAQ 100 all registering gains over the month. US stock markets were boosted by further improvements in risk appetite and continued signs that corporate America remains in good health. However, economic data was mixed, with the unemployment rate remaining stuck at 9.6%. By contrast, data at the month end showed that the economy grew at an annualised rate of 2% between July and September, in line with Wall Street's expectations, helping to ease fears of a 'double-dip' recession. The dollar lost value against most major currencies over the month, reflecting the US's large trade deficit and fears that any re-commencement of quantitative easing by the US Federal Reserve could deal a further blow to the currency. International political tensions were also evident over the month, with Treasury Secretary Tim Geithner suggesting that the G20 nations should cap their trade surpluses in order to promote a more balanced global economy.

Eurozone

On a regional basis, eurozone equities led the modest equity market gains in October. Following an initial 'knee-jerk' sell-off at the beginning of the month as markets digested news of a second round of stimulus by the Fed, investors subsequently embraced the news and markets extended September's share-price gains. Manufacturing data showed improvement and growth in industrial production exceeded expectations, while consumer sentiment remained buoyant. Auto stocks found strong support, as did telecom services and utilities names. Elsewhere, the industrials and materials sectors enjoyed modest gains, while banks proved the laggards amid concerns about how companies would fare with the more stringent tier one capital ratio requirements (in the wake of Basel III) and uncertainty about how European regulators would deal with any future bailouts. Moody's review of Ireland's credit rating and downgrading of Spanish debt (albeit still on a stable outlook) did little to ease concerns; however, sentiment remained positive for the most part. The European Central Bank held interest rates at 1% and adopted a constructive tone – expecting the recovery to proceed at a moderate pace during the second half of 2010.



UK

The upward momentum that began in September, sparked by the increasing likelihood of further quantitative easing in the US and a firmer positive consensus on the UK economic growth outlook, continued into October. The war of attrition between upbeat company announcements and macro-economic headwinds continues, keeping volatility elevated, though the positives ultimately came out on top in October, with UK equities recording solid gains by the month-end. Global events including the emergence of so-called currency wars and evidence of protectionism in emerging markets weighed on sentiment. However, UK specific events were largely positive. Indeed, the Comprehensive Spending Review (CSR) was well received by the market. Since the Emergency Budget in June, investors have been nervous about the impact of the CSR on outsourcing and infrastructure companies given the risk that the spending squeeze may hit new capital expenditure and, in turn, earnings. In fact, the cuts revealed were not as bad as the market expected, which should be good news for companies exposed to these areas. Preliminary estimates of GDP growth for between July and September 2010 showed the economy grew by 0.8% – twice as fast as the consensus estimates of 0.4% – adding another boost to investor sentiment.

Japan

Japanese markets lagged other global indices in October, as the majority of newsflow reflected slightly more negative sentiment. Early in the month the market was boosted by an unexpected loosening of monetary policy by the Bank of Japan. Target interest rates were cut to a range of 0 to 0.1% from around 0.1%, and the Bank also created a new fund to purchase a variety of Japanese financial assets. Despite these measures the market was hit by further signs of a slowing of Japan's economic recovery – consumer confidence, bank lending, export and production levels all broadly ticked lower. Positives came in the form of a sharp upswing in machinery orders and a fall in September's unemployment figures (the third consecutive monthly drop). The yen once again strengthened significantly, but the effect on share prices was not as marked as in recent months – several exporters showed themselves able to maintain full-year profit forecasts despite incorporating more realistic exchange rate assumptions in their predictions.

Asia (ex Japan)

Asian stocks touched their highest level in more than two years as confidence in the region's recovery was boosted by news that Chinese manufacturing activity continued to accelerate in October. Expectations of further quantitative easing by the US Federal Reserve also boosted Asian equities; however, fears of overheating continued to linger over the region's major economies. Hong Kong's authorities intensified efforts to cool its property market by cracking down on foreign buyers, while, amid similar concerns, Taiwan raised its benchmark interest rate for the second time this year. India's central bank also said inflation remained above a 'comfortable level', triggering expectations that it was poised to raise interest rates for the sixth time this year.

Emerging Markets

The MSCI Emerging Markets index rose in value in October although it lagged developed world markets. Peru, Mexico and Turkey ranked among the strongest performing emerging markets over the month. Peru benefited from an improving global outlook for metals and minerals as China reported third-quarter GDP growth of 9.6% year-on-year. Mexico left its interest rates on hold during the month and was lifted by hopes that further quantitative easing could help to support the US, its main trading partner. Turkey gained support from a favourable liquidity environment and strong economic data. Chinese equities also rose in value, despite an unexpected rise in interest rates, while the Russian equity market benefited from a robust oil price.

Brazil, the Philippines and the Czech Republic were among the markets that lagged over the month. Brazil increased its IOF tax on foreign investments into fixed income to 6% from 4%, raising fears of further capital controls. Stocks in the Philippines struggled to make headway after very strong performance in September. The Czech Republic is viewed as a relatively low-risk emerging market due to the dominance of electricity producer CEZ and, consequently, it underperformed the rise in the broader index.

Global Bonds

Quantitative easing remained the focus for bond markets during October as investors continued to speculate on the likelihood, potential magnitude and probable method for a second attempt by the Fed. This speculation initially caused core government bond yields to edge even lower, but US treasuries, UK gilts and German bunds ultimately finished weaker. The shift began mid-month as markets seemed to find an excuse (a surprise increase in US retail sales) to book profits in the increasingly crowded safe haven trade. Further positive US data (notably on consumer confidence, durable goods orders and initial jobless claims) contributed later in the month and accompanied an increase in treasury yields in advance of the Fed's 3 November meeting and the US mid-term elections.

Corporate bonds generally outperformed government bonds against this backdrop, with high yield demand remaining strong. The prospect of interest rates remaining lower for longer continued to encourage a search for yield, based on increasingly explicit statements from global central banks. Japan made a particularly noteworthy move in October, symbolically cutting interest rates from 0.1% to a range of between 0 and 0.1%.

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

	1 month			YTD		
	EUR	USD	GBP	EUR	USD	GBP
Equities (MSCI)						
World Index	1.90	3.75	2.26	10.31	6.87	7.94
World Value Index	1.41	3.24	1.76	8.39	5.01	6.06
World Growth Index	2.39	4.25	2.75	12.24	8.73	9.83
World Smaller Companies Index	2.12	3.97	2.47	18.76	15.06	16.21
US	2.09	3.94	2.44	11.57	8.09	9.18
Eurozone	3.71	5.59	4.07	3.03	-0.19	0.82
UK	2.10	3.95	2.45	10.08	6.64	7.71
Japan	0.23	2.04	0.57	8.58	5.19	6.25
Emerging Markets	1.08	2.91	1.43	17.94	14.26	15.40
Asia ex Japan	0.80	2.63	1.15	19.05	15.34	16.49
	1 month			YTD		
Government bonds (JP Morgan)	EUR	USD	GBP	EUR	USD	GBP
US	-1.93	-0.16	-1.59	12.34	8.83	9.92
UK	-1.75	0.03	-1.41	10.71	7.25	8.33
Japan	1.46	3.30	1.82	22.86	19.02	20.22
Germany	-1.15	0.64	-0.81	7.98	4.61	5.66
Corporate bonds (Merrill Lynch)	-1.59	0.20	-1.25	15.10	11.51	12.63

Source: Datastream

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