

# Schroders

## Monthly markets review

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### Overview of markets in January 2011

#### Highlights:

- In January, global equity markets extended fourth-quarter 2010 gains, supported by generally better-than-expected company earnings and well-received peripheral European government bond auctions. The debut bond issue from the European Financial Stability Facility (EFSF) was also met with strong demand.
- However, mounting geopolitical tension in the Middle East, notably Egypt, prompted a pull-back in risk appetite towards the end of the month, in favour of safe-haven assets such as the yen and US treasuries. The turmoil also sparked oil-supply concerns, propelling the Brent Crude oil price to \$100 per barrel for the first time since October 2008.
- In Asia, the Chinese economy grew more rapidly than expected in the fourth quarter of 2010 pushing domestic equities to a four-month low, as investors anticipated further anti-inflation action by authorities.

#### US

US equities made good progress in January when measured in local currency terms, with the S&P 500 benefiting from news that the US economy grew at an annualised rate of 3.2% in the fourth quarter of 2010. Growth in consumer spending was a key contributor to the expansion in the economy, helping to raise hopes that 2011 could see an improvement in consumer activity. On the monetary policy front, the Federal Reserve left interest rates in their 0-0.25% range, as widely expected. Large cap stocks outperformed small caps over the month, as the fourth-quarter earnings season began with large caps delivering better earnings growth than small-cap names. In terms of sector performance, energy stocks continued to benefit from high oil prices, reflecting expectations that the combination of quantitative easing and unrest in the Middle East could drive West Texas Intermediate crude oil above \$100 a barrel. Industrials and information technology also outperformed, benefiting from encouraging earnings announcements and the pick up in GDP growth. Lower-risk sectors, most notably telecoms and consumer staples, retreated over the month. Consumer discretionary names also lagged as the sector continued to face a difficult short-term outlook.

#### Eurozone

Eurozone equities posted solid gains in January, ahead of wider European returns over the month. The good performance came as peripheral European countries such as Greece, Spain and Italy benefited from improved sentiment, following successful government bond auctions. At a sector level, financials staged a decisive comeback, with some of the riskier banks posting the strongest returns. Paradoxically, the core European economies continue to drive growth in the region, creating what some commentators have dubbed a 'two-speed' Europe. Growth continued apace in Germany, and business confidence reached its highest level since reunification. Elsewhere, Spain's attempts to tackle concerns about domestic financial sector stability by increasing core capital ratio requirements and part-nationalising savings banks provided further cause for optimism. The European Central Bank kept rates unchanged at 1.0%. However, The ECB adopted a more hawkish tone, suggesting that inflation concerns may be creeping in.



## UK

UK equities reached two-and-a-half year highs in January as the robust Christmas rally spilled over into the New Year. Markets were supported by continued upbeat company trading announcements and strong UK manufacturing data. However, during a financial crisis, the month of January has often spelt volatility for equities, and this year was no different. Again it was macro-economic events that were responsible for investor jitters. Strong growth in China sparked fears of overheating and inflation, causing a sharp sell-off in stocks, while unrest in Egypt drove markets lower towards the end of the month. Although UK data was mixed, the initial GDP estimate for fourth-quarter 2010 delivered a negative surprise, showing a 0.5% contraction. Poor weather was deemed partly responsible for the contraction, but the figure was enough to quash market fears of an imminent rate hike from the Bank of England (which had been mooted after higher-than-expected inflation data was revealed earlier in the month). Amid the ups and downs, UK equities recorded a marginal decline over the month.

## Japan

Japanese equities were off to a good start in January due to broadly positive US macro data and improved economic sentiment. The Bank of Japan upgraded its economic outlook and predicted faster inflation as the yen weakened, strengthening demand for exports. In addition, industrial production rose to its highest rate in a year. However, negative newsflow dampened sentiment later in the month, amid growing fears of global inflation, escalating tensions in Egypt, and following Standard & Poor's downgrading of Japan's sovereign debt rating from AA (with a negative outlook) to AA-; although the ratings downgrade had minimal impact on the market.

## Asia (ex Japan)

Asia Pacific ex Japan equities began 2011 weighed down by the same concerns that plagued the markets throughout much of 2010. With news that China's economy accelerated faster than expected in the fourth quarter – amid rising industrial production and retail sales – Asian markets lost ground in January, as investors anticipated further anti-inflation action across the region. With the reserve requirement ratio on Chinese banks raised mid-month, investors shied away from risk assets on expectations that other governments, such as Hong Kong and Korea, were poised to unleash more aggressive measures to cool inflation in their respective economies. Towards the end of the month, Asian stocks were further dragged down by concerns about the political unrest in Egypt, where anti-government demonstrations intensified later in the month. India proved the worst performing country in the region, with its Sensex Index enduring the biggest monthly fall since 2008. The decline came as lower-than-estimated corporate earnings fuelled concerns that the continued rise in raw material prices would dampen company profits.

## Emerging Markets

Emerging markets retreated in January, reflecting political unrest in the Middle East and poor performance from Latin America. However, markets such as Taiwan and Korea posted gains, benefiting from expectations that 2011 could see stronger global demand for Asian exports. In emerging Europe, Hungary and the Czech Republic rallied on hopes of a more benign global economic environment this year, although Turkey retreated as the central bank continued to cut rates in order to deter excessive inflows of foreign capital. Russia continued to perform strongly, driven by further strength in oil prices. In the Middle East, Egypt was the main laggard as widespread political unrest led to the closure of the stock market. In Asia, Chinese equities were flat (in local currency terms). The country's economic growth remained strong in the fourth quarter, with real GDP growth of 9.8%. India was the weakest market, suffering double-digit falls as the central bank continued to raise rates in a bid to control inflation. Indonesia also fell heavily, with inflation rising above the central bank's target range. Thailand registered a loss as January's rate rise led to fears that a strong baht could affect export growth. All Latin markets fell in January with Peru and Chile producing the weakest returns. Peru's market sold off after the central bank raised rates, while Chile's equity market suffered after copper prices fell from record highs.



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