

Schroders

Monthly markets review

Overview of markets in May 2011

Highlights:

- Global equity markets struggled to find momentum in May amid signs that the pace of global growth was slowing – triggered by indications of weakening emerging market growth, particularly in China. Weaker economic data and renewed fears about sovereign debt loads in peripheral Europe combined to unsettle markets during the month.
- The increased risk aversion drove investors into safe haven assets, and global government bonds markets subsequently rallied – driving down bond yields in the US, UK, Germany and Japan. In currency markets, the Swiss Franc made its mark, rising to record highs against both the euro and the US dollar.
- Elsewhere, commodities markets lost momentum, with crude oil suffering one of its largest one-day declines on record. The weakness fuelled speculation that persistent high prices were beginning to take their toll on demand.

US

The S&P 500 Index delivered a dollar total return of -1.1%, with concerns about slowing economic growth weighing on risk appetite. A slew of economic indicators including US manufacturing data – the main engine driving the economy this year – showed a slow down in the second quarter, on the back of high gas prices and supply disruptions in Japan. US employment data was mixed. The third consecutive rise in headline non-farm payrolls was encouraging, but this was accompanied by a rise in the unemployment rate. Worries about peripheral European government debt also added to concerns about a wider global economic slowdown.

Eurozone

A number of factors conspired to unsettle markets in May. Sovereign debt woes took centre stage once again, as concerns about Greece's ability, or lack thereof, to meet short-term debt obligations prompted speculation that a debt restructure would be forthcoming. This, in combination with weaker economic data and disappointing consumer confidence figures, dampened risk appetite and drove investors into safe haven assets during the month. The controversy surrounding the arrest, and subsequent resignation, of IMF managing director Dominique Strauss-Kahn, did little to ease concerns. In currency markets, investors sought safety in the Swiss Franc, which hit record highs against the dollar and euro. Healthcare stocks continued to outperform, along with other defensive areas such as consumer staples. Laggards included information technology and energy stocks.

UK

With the Greek sovereign debt crisis hurting confidence and the UK's Office of National Statistics confirming weak first-quarter growth, you could be forgiven for thinking we were reporting on May 2010, not May 2011. However, while first-quarter UK growth was confirmed as lacklustre, the details looked better than the headline print: the majority of the economy expanded at a respectable pace and export growth continued. Further data released in May showed the largest jump in consumer confidence in 18 years, although this was from a three year low in April.



CPI data continues to trouble the market, jumping to 4.5% in April from 4.0% in March. The Bank of England (BoE) downgraded its growth forecast but raised its inflation forecast (CPI could reach 5% by the end of the year) – the latter is particularly worrying given the BoE's record of under estimating near-term inflation. However, with the MPC minutes on the dovish side, expectations of higher inflation did not translate into suspicions of an imminent rate hike. Against this backdrop, UK equities were remarkably range bound, falling circa 0.8% in sterling terms over the month. May was, however, not so benign for other asset classes, with commodities experiencing a sharp sell-off courtesy of renewed inflation concerns in China. Unsurprisingly in this environment, commodity-related sectors were the main detractors in contribution terms. In contrast, defensive stocks performed well.

Japan

Japan suffered in the month of May, as production and consumer spending were hit by the March earthquake and tsunami. As a result, first-quarter GDP was down 0.9% quarter-on-quarter (equivalent to 3.7% annualised) and the country slid into recession. However, the Reuters Tankan survey – a monthly indicator of business sentiment – provided a measure of support for a recovery, showing the mood among manufacturers was improving. In other news, the request for additional easing measures, by Deputy Governor Kiyohiko Nishimura, was retracted at the Bank of Japan meeting. In terms of sector performance, airlines and rubber products sectors delivered strong gains, while the oil and mining sectors retreated on the back of weak demand.

Asia (ex Japan)

Asia Pacific ex Japan equities struggled to find momentum in May and ended the month in negative territory amid signs that the pace of global growth was slowing. Commodities posted their biggest monthly drop in a year as Asia's tightening cycle continued, and global concerns – including the European debt crisis and lacklustre US data – fuelled expectations of a slowdown in oil and raw material demand. India continued to be the region's main laggard as its central bank raised interest rates early in the month. Despite first-quarter GDP growth coming in lower than expected – thereby easing inflation concerns – the market faltered under the weight of continued economic and political uncertainty. The country's telecommunications sector, in particular, endured double-digit losses against a backdrop of the ongoing corruption scandal and the introduction of new regulations on the sector. Indonesian stocks delivered the index's strongest returns as the market benefited from news that inflation in the country had bucked the regional trend and slowed for a fourth consecutive month. The news is likely to ease pressure on the country's policymakers to increase rates. In terms of sectors, following the drop in commodity prices, materials were the index's worst performers, while utilities benefited from the general rise in risk aversion.

Emerging Markets

Emerging markets underperformed global equities in May, reflecting a decline in global risk appetite. Asian emerging markets fell over the period but they outperformed broader emerging markets. Indonesia was the best-performing Asian emerging market in dollar terms. Annual headline inflation eased to 6.2% in April while the central bank kept rates on hold. Chinese markets were broadly flat but outperformed the MSCI Emerging Markets Index. Annual headline CPI inflation remained above 5% in April although it fell slightly from March's level. India was the main laggard as the central bank raised interest rates by half a percentage point in response to concerns over inflation. Meanwhile, Latin markets performed broadly in line with wider emerging markets. Colombia was the best performer, up over 2% in dollar terms. Brazil underperformed, with local currency weakness weighing on returns. Inflation data continued to provide a headwind, with annual inflation breaching 6.5% for the first time since mid-2005. Mexico was the weakest Latin market as the softer tone of US economic data weighed. In aggregate, emerging markets in Europe, the Middle East and Africa fell and underperformed wider emerging markets. However, Egypt's market rebounded strongly, having been very weak earlier in the year due to political upheaval. Russian equities sold off, reflecting lower-than-expected GDP growth and a fall in crude oil prices. Turkey was the weakest market as a larger-than-expected current account deficit and local currency weakness weighed on sentiment.

Global Bonds

The rally in global government bonds continued in May, as uninspiring economic prospects combined with lingering fears over the eurozone's debt crisis, caused bond yields in the US, UK, Germany and Japan to continue their declines. At the same time, inflation expectations in these countries fell sharply. The prospect of the current round of US quantitative easing (QE2) coming to an end in the next month also looms large on the horizon for investors. Concerns over the impact of QE2's termination on economic growth have contributed to investor uncertainty, along with falling yields of government bonds.

Other factors which have had an impact on bond yields in May include the continued correction in commodity prices in the first half of the month, which eased pressure on central banks to raise rates. Investors continued to favour the perceived safe havens of the fixed income spectrum, with core markets such as the UK, US and Germany outperforming. Similarly, in the credit space, higher-rated bonds outperformed. The Bank of England and the US Federal Reserve kept their interest rates stable in May, while the European Central Bank (ECB) also made no change following its first rate rise in three years in April. However, many observers expect ECB chief Jean-Claude Trichet to raise rates to 1.5% in July.

Overview: total returns (%) – to end of May 2011

	1 month			YTD		
	EUR	USD	GBP	EUR	USD	GBP
Equities (MSCI)						
World Index	1.16	-1.97	-0.66	0.10	7.28	2.04
World Value Index	0.69	-2.42	-1.12	0.64	7.85	2.59
World Growth Index	1.62	-1.53	-0.21	-0.42	6.72	1.51
World Smaller Companies Index	1.13	-2.00	-0.69	0.92	8.15	2.88
US	2.07	-1.08	0.24	0.79	8.02	2.75
Eurozone	-1.90	-4.94	-3.67	5.75	13.33	7.80
UK	0.95	-2.17	-0.86	1.45	8.72	3.42
Japan	1.52	-1.63	-0.31	-12.34	-6.06	-10.64
Emerging Markets	0.53	-2.58	-1.28	-4.29	2.57	-2.44
Asia ex Japan	1.83	-1.32	0.00	-3.27	3.66	-1.40
	1 month			YTD		
Government bonds (JP Morgan)	EUR	USD	GBP	EUR	USD	GBP
US	4.85	1.60	2.96	-4.21	2.65	-2.36
UK	3.12	-0.08	1.26	0.44	7.64	2.39
Japan	3.56	0.35	1.69	-6.64	0.05	-4.83
Germany	1.67	-1.48	-0.16	-0.05	7.11	1.88
Corporate bonds (Merrill Lynch)	4.69	1.45	2.80	-2.81	4.16	-0.92

Source: Datastream

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