

# Schroders

## Monthly markets review

### Overview of markets in October 2011

#### Highlights:

- October proved a positive month for global markets, with investors regaining their risk appetite and markets managing to claw back some of the losses sustained in the previous month.
- Equities rallied ahead of the European summit on the back of hopes that greater political urgency would translate into a deal capable of containing the region's debt crisis. Despite the lack of detail and little guidance around implementation, the deal was initially greeted with optimism before scepticism began to creep back as the month drew to a close.
- Encouraging data from the US, including the non-farm payrolls, generally strong quarterly earnings results, and September's retail sales figures also helped, reviving hopes that the world's largest economy may avoid heading back into recession.

#### US

The US market finished October in positive territory. Moderately positive economic data points signalling that the US was not slipping back into recession, coupled with some good corporate earnings, improved investor sentiment over the month. Consumer spending remained strong over the month and October nonfarm payrolls were revised to 57,000 from flat. The perception that European political leaders were taking more determined action to address the sovereign debt crisis, created a positive backdrop and acted as a tailwind for US equities; although, it may take many months before we see how the plan will be delivered and implemented.

#### Eurozone

Following September's tumultuous market conditions, an element of political leadership, and crucial decision-making around the financial support mechanisms to be implemented to tackle the sovereign debt crisis, brought some relief to markets in October. Cyclical sectors typically led the rally while more defensive names lagged. Investors took comfort in the decision to boost the powers of the European Financial Stability Facility, while European leaders' agreement on a coordinated recapitalisation of the banking sector added to the air of optimism – which saw equity markets claw back a good portion of the losses sustained in the previous month.

Economic data remained subdued, with weakness in both the manufacturing and services sectors. German business confidence also softened, while euro area consumer confidence fell to a new two-year low in October. The European Central Bank chose to keep interest rates on hold at the final meeting for outgoing president Jean-Claude Trichet. The bank did, however, offer alternative supportive measures in the form of a covered bond purchase programme and extended liquidity (announcing the return of one year long-term refinancing operations).



## UK

A stellar performance from the FTSE All Share in October produced the fourth best monthly return of the last ten years. Over the month, three quarters of the index constituents were up in absolute terms (including one quarter up in double digits – in percentage terms). The rally was largely driven by growing expectations of a comprehensive solution to the sovereign debt crisis in Europe, while stocks were also helped by better macroeconomic data from the US. The corporate reporting season was supportive with a number of companies beating their earnings expectations. The Bank of England (BoE) voted unanimously in favour of a £75 billion extension to its asset purchase programme at the October meeting. Given that September CPI rose from 4.5% to 5.2% year on year, matching the record high from September 2008, the move by the BoE clearly shows that they view the downside risks to growth as a greater threat than above target inflation. Despite the strong rally, at the end of the month UK equities were 4% below their starting level this year.

## Japan

Japanese equities struggled to find momentum in October, finishing the month in negative territory. The yen hit record high levels which invited the Japanese government to intervene. The Bank of Japan expanded its credit and asset purchase programme by five trillion yen, bringing the total programme up to 55 trillion yen. The market reaction was initially positive; however, the impact of the intervention was short lived. In addition, the severity of the floods in Thailand weighed on share prices, with Japanese automobile and electronics makers having established production bases in the country in order to escape the effect of the strong yen on exports from Japan.

## Asia (ex Japan)

After the turmoil of the third quarter, Asia ex Japan equities bounced back from a low base to post double-digit gains over the month. On signs that European leaders were taking action to contain the region's debt crisis, stocks across Asia rallied in spite of headwinds closer to home. China's PMI manufacturing index dropped to its lowest level since February 2009 while economic activity in the country also slowed. Expectations that this would spur a loosening of monetary policy overrode fears of a general economic slowdown to help Chinese equities deliver some of the region's strongest gains. Australian equities also outperformed as investors were encouraged by signs that manufacturing activity in the country had declined at a slower pace in October. From a sector-specific point of view, financials registered the strongest returns, largely on the back of a rebound in the Chinese banking sector. Shares in the country's largest banks rallied on expectations that they were in line to report record annual profits, after third-quarter earnings rose and bad-debt ratios declined. Across the rest of the index, reduced risk aversion left defensive sectors – including telecommunication and utilities – lagging the index.

## Emerging Markets

The MSCI Emerging Markets index posted a positive return (in dollar terms) in October and outperformed the MSCI World index, reflecting an improvement in risk appetite. The Latin markets outperformed broader emerging markets. Brazil outperformed, aided by strength in the Real. Chile outperformed, with sentiment supported by a rally in copper prices. Peru outperformed, aided by a rebound in commodity prices. Mexico outperformed modestly. The central bank left rates unchanged but sentiment was supported by hopes of rate cuts later in 2011. Colombia underperformed, reflecting the market's relatively defensive status.

Asian emerging markets underperformed the wider emerging bloc. However, China outperformed, aided by hopes of policy easing. Korea outperformed, supported by resilience in exports and local currency strength. Thailand underperformed, with sentiment hit by heavy flooding in Bangkok and elsewhere. Malaysia underperformed, reflecting the relatively defensive nature of the market. The Philippines underperformed. The central bank left rates on hold in order to support growth, while a fiscal stimulus package received a mixed response. Indonesia underperformed. The central bank unexpectedly cut its key policy rate in order to mitigate the financial uncertainties in the developed world. Indian equities underperformed; inflation concerns resulted in another increase in the repo rate. Taiwan underperformed, amid concerns over the outlook for global GDP growth.

The EMEA markets underperformed their emerging peers. Russia outperformed, aided by a recovery in oil prices. Poland and Hungary outperformed, supported by hopes of a resolution to the EU debt crisis. Egypt underperformed; political and sectarian risks weighed on the market. South Africa underperformed; inflation concerns provided a headwind in October. The Czech Republic underperformed, reflecting the defensive composition of the local index. Morocco, another defensive market, also underperformed. Turkey underperformed, reversing some of the outperformance seen in September. The central bank surprised the market by increasing lending rates.

### Global Bonds

The trends of recent months were reversed in October, as risk appetite made a comeback. Risk markets rose due to optimism about the outcome of the European summit on Greece and on the back of the stabilisation of global economic data which allayed fears of a US double dip recession.

After a dismal quarter for credit markets, improved sentiment in October led to a month of outperformance versus aggregate sovereign bond returns. Lower rated credit and high yield performed particularly strongly as their yields fell and clawed back some of the losses made in recent months. Indeed, the BofA Merrill Lynch Global High Yield index rose almost 7% (in dollar terms) over the month.

Emerging market debt on both the government and corporate front delivered positive returns over the month and Asian currencies performed well, led by the Korean won. In developed market government bonds, yields rose on core sovereigns such as US treasuries, UK gilts and German bunds but they still outperformed bonds from the troubled eurozone countries such as Greece, Italy and Spain which continued to perform poorly.

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

	1 month			YTD		
	EUR	USD	GBP	EUR	USD	GBP
<b>Equities (MSCI)</b>						
World Index	6.17	10.37	6.52	-6.40	-2.68	-5.60
World Value Index	5.43	9.61	5.78	-6.99	-3.29	-6.19
World Growth Index	6.89	11.12	7.25	-5.83	-2.08	-5.02
World Smaller Companies Index	7.58	11.84	7.94	-9.34	-5.74	-8.57
US	6.76	10.99	7.12	-2.56	1.31	-1.73
Eurozone	8.59	12.90	8.96	-11.81	-8.31	-11.06
UK	7.78	12.06	8.15	-3.71	0.12	-2.89
Japan	-4.05	-0.25	-3.73	-14.38	-10.97	-13.65
Emerging Markets	8.94	13.26	9.31	-14.67	-11.28	-13.94
Asia ex Japan	7.74	12.01	8.10	-13.52	-10.08	-12.78
	1 month			YTD		
<b>Government bonds (JP Morgan)</b>	EUR	USD	GBP	EUR	USD	GBP
US	-4.59	-0.81	-4.27	3.94	8.07	4.83
UK	0.88	4.88	1.22	11.12	15.53	12.06
Japan	-5.08	-1.32	-4.76	1.63	5.67	2.50
Germany	-0.70	3.24	-0.37	7.01	11.26	7.92
Corporate bonds (Merrill Lynch)	-2.12	1.75	-1.80	3.38	7.48	4.26

Source: Datastream

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