

# Schroders

## Monthly Markets Review

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### Overview of markets in May 2009

#### Highlights:

- The global equity market rally continued as investors focused on indications that the global economy is stabilising. In particular, financial stocks, worldwide, reacted positively to the long-awaited release of the Federal Reserve's stress test results, indicating that 10 of the US banks needed to raise a total of \$75 billion to have sufficient capital, an amount that was seen as manageable. In addition, several of the tested banks were deemed to not require any further capital.
- The global macroeconomic backdrop remained weak and US data, in particular, was mixed. Encouraging signs included a larger-than-expected rise in a closely watched index of leading economic indicators in April and a significant increase in consumer confidence. However, unemployment continued to worsen and retail sales fell again in April.
- Global government bonds underperformed credit. Risk appetite increased as conditions in the corporate bond market improved significantly.
- The oil price climbed steadily, buoyed by signs of the global economy bottoming out, and in particular by hopes of recovering Chinese demand.

#### US

US stockmarkets continued to rally as we saw the third successive monthly gain in May, leading to the largest three-month percentage gain for 10 years. Growth in Chinese manufacturing has boosted confidence in the global economy and further signs of this have come from commodity markets, where we have seen the biggest monthly rally since 1974. It has not all been good news, however, as latest figures have shown that consumer spending has dropped for a second straight month as concerns over rising unemployment and record wealth destruction prompted households to boost savings rates to the highest level in 14 years. In addition, hopes of a recovery in the property market were dampened when housing starts fell to a record low in April, and mortgage delinquencies and foreclosures continued to rise. The auto industry has also continued to struggle. Amongst the big three automakers, Chrysler filed for bankruptcy protection and GM, after announcing a \$6 billion loss in Q1 2009, looked to be heading the same way.

#### Eurozone

Eurozone equities also continued to rally, with improved sentiment driving the gains before markets lost momentum, falling slightly, following the weaker outlook for the US economy and expected rise in US unemployment figures. The European Central Bank cut interest rates by a further 0.25% to 1% and announced plans to purchase €60 billion of euro-denominated covered bonds as part of its ongoing credit easing policy. The more cyclical areas of the market benefited from the improved risk appetite during May. The rally saw energy and materials leading the advance and, once again, the financials sector outperformed.



## UK

The rally in UK equities continued in May, although the pace of recovery slowed towards the end of the month. The overall economic outlook remains bleak, and S&P revised down the UK's outlook to negative from stable during May. Nevertheless, investors are more optimistic that the current downturn is unlikely to deepen into a 1930s-style depression. The huge stimulus of quantitative easing (QE) and the effective 'insurance' of the banking sector continued to yield positive results in May with LIBOR spreads normalising, corporate bond spreads narrowing, and equity markets continuing to creep back up. Investors focused on better-than-expected economic news, such as retail sales, which were better than expected, increasing by 0.9% month-on-month, and also housing data. The Bank of England took the bold move of expanding its QE programme, announcing plans to inject an extra £50 billion into the UK economy.

## Japan

The Japanese market made strong progress in May. Investors focused on positive signs, shrugging off negatives such as nuclear tests by North Korea and renewed fears of swine flu. GDP fell by an unprecedented 15.2% year-on-year, while the labour market continued to deteriorate, which fed through to weak domestic demand. However, other reports pointed to a recovery in the Japanese economy. As inventory adjustments wound down, industrial production improved by 5.2% in April compared to the month before and the pace of decline in exports slowed for the second consecutive month in April (to -39.1% year-on-year), indicating that the cycle may have bottomed in February. Investors were cheered by the first improvement in the Bank of Japan's economic outlook for nearly three years, albeit only to 'economic conditions have been deteriorating, but exports and production are beginning to level out'.

## Asia (ex Japan)

Developed Asian stockmarkets had another month of very strong gains in May, as investors continued to focus on positive newsflow. This included the results of the US government's 'stress tests' of the country's leading financial institutions, which coupled with the upward trend in oil and other commodity prices added to investor confidence that the worst of the global downturn is over. Within the region, continued signs of a recovery in China's economy, together with an additional stimulus package coming out of Hong Kong, added to the optimism. Over the month Singapore and Hong Kong saw the best relative performance in the region while Australia was the key laggard. Across sectors, cyclicals, particularly energy and financials, continued to benefit from the return in risk appetite while the more defensive sectors such as healthcare and utilities were the weakest in the region.

## Emerging Markets

Global emerging markets delivered strong returns in May, against the background of improved risk appetite and confidence among some investors that we may be seeing signs of an economic recovery. In particular, the Indian market posted very strong returns, rising sharply on news of the Congress party's unexpectedly decisive victory in the country's parliamentary elections, which is set to give the party a freer hand in pursuing its pro-growth/pro-reform policies. Russia, Hungary and Brazil also outperformed. The energy-dominated Russian market benefited from a sharp rise in the oil price over the month, while the central bank continued to reduce interest rates, cutting rates by 0.5%. The Korean market underperformed, with concerns over rising tensions with North Korea weighing on sentiment.

## Global Bonds

Economic data in May showed further signs of stabilizing, although leading indicators just deteriorated less rather than registering any meaningful improvement. Risk assets have continued to perform well, as investors focused on generally better-than-expected data, despite the fact that the overall global economy remains weak. Indeed, May was one of the best performing months ever for global credit (following strong returns in April), with corporate bonds easily outperforming both government bonds and cash. Risk appetite increased as conditions in the corporate bond market improved significantly – a combination of government fiscal and financial support programs, very attractive yield spreads and better-than-expected corporate earnings announcements have resulted in a narrowing in yield spreads.

### Overview – Total Returns (%) – to end of May 2009

	1 month			YTD		
	EUR	USD	GBP	EUR	USD	GBP
<b>Equities (MSCI)</b>						
World Index	2.22	9.19	0.33	5.31	7.23	-4.40
World Value Index	2.69	9.69	0.79	3.35	5.23	-6.18
World Growth Index	1.78	8.72	-0.10	7.23	9.18	-2.65
World Smaller Companies Index	1.83	8.77	-0.05	11.64	13.67	1.35
US	-1.23	5.50	-3.05	1.64	3.50	-7.72
Eurozone	5.06	12.22	3.12	5.51	7.43	-4.21
UK	6.61	13.87	4.64	12.49	14.54	2.12
Japan	3.27	10.31	1.36	-0.92	0.89	-10.05
Emerging Markets	9.67	17.15	7.65	35.59	38.06	23.09
Asia ex Japan	8.71	16.12	6.70	34.04	36.48	21.68
	1 month			YTD		
<b>Government bonds (JP Morgan)</b>	EUR	USD	GBP	EUR	USD	GBP
US	-7.39	-1.08	-9.10	-6.11	-4.40	-14.76
UK	0.81	7.68	-1.05	6.81	8.75	-3.04
Japan	-3.79	2.77	-5.57	-7.90	-6.22	-16.39
Germany	-1.52	5.20	-3.33	-1.40	0.40	-10.48
<b>Corporate bonds (Merrill Lynch)</b>	-2.32	4.34	-4.13	4.11	6.01	-5.48

Source: Datastream to 31 May 2009

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