

Schroders

Monthly Market Review

Overview of markets in December 2007

Highlights:

- The key themes of 2007 – the credit crunch and the ensuing financial turmoil – continued to impact sentiment in December, and stockmarkets in most regions ended the month lower.
- In local currency terms, UK and emerging market stock ended the month higher, while the US, Eurozone and Asia slipped. Economic data from the US, the world's largest economy, continued to be mixed, though the underlying trend indicates a gradual cooling.
- In terms of central bank action, the Federal Reserve cut rates by 25 basis points to 4.25%, disappointing some investors who had been looking for a half-point cut. The Bank of England also cut rates, while the European Central Bank and the Bank of Japan left rates unchanged.

US

The US stockmarket has been volatile for the past few weeks. Signs of further weakness in the economy, combined with geopolitical concerns following the murder of Benazir Bhutto, caused US stocks to drop towards the end of December. There was also speculation about further earnings writedowns from US banks as the fallout from the sub-prime crisis continued.

New home sales dropped to their lowest rate for more than 12 years and the backlog of unsold homes in the US now amounts to a nine-month supply. Oil prices increased amid concerns over US supplies while geopolitical tension in Nigeria caused a reduction in output. These factors were part of an overall spike in commodity prices, which benefited companies in the materials sector.

US retailers benefited from an increase in consumer sentiment according to the conference board's December index; investors are keeping a close eye on early indications for the Christmas shopping period. The Fed announced a further decrease in interest rates at its meeting on 11 December, but this did little to comfort investors who had hoped for a bigger cut than the 0.25% that the Fed delivered.

Eurozone

Eurozone stockmarkets were considerably calmer in December than during the previous month, yet most indices ended the period flat or slightly down. The fallout from the summer's sub-prime mortgage sector crisis showed no signs of waning, with liquidity in interbank lending markets still a cause for concern. The European Central Bank again intervened to alleviate money-market tensions, providing unlimited liquidity in the lead up to year-end.

With regards to the economy, a slowdown seemed increasingly certain, even as inflation in the region continued to accelerate, creating a quandary for the European Central Bank. Against that backdrop investors took a cautious approach to markets, favouring defensive sectors above those whose fortunes are linked to the economy. The chemicals, aerospace and steel sectors provided some support for European markets while support services, IT hardware and construction were among the weakest performers.



UK

UK equities held up relatively well in December given that sentiment was clearly hanging on whether the US economy and, increasingly, the UK, would be forced into a recession in 2008. Significantly for the UK market, there was a change in tack by the Bank of England as it acknowledged that the downside risks had increased enough to warrant the first cut in UK interest rates since August 2005. This helped to drive up UK shares during the first part of the month, before a drop in confidence about the ability of the central banks to manage the financial crisis sent the market straight back down again mid-month. Sentiment then picked up sufficiently towards the end of December to take the FTSE All-Share back into positive territory for the month, but the underlying mood remained distinctly cautious.

Japan

Disappointing returns through December rounded off a miserable six-month period for Japan's equity market. The index fell in December by almost 4% in local currency terms and in doing so concluded the market's first calendar year decline in five years. The market fluctuated throughout December as sentiment, which in aggregate remained negative for much of the month, was once again dominated by events in the US.

Investors remained sensitive to fluctuations in the yen through the month, which ended the period marginally weaker relative to the US dollar. Exporters mirrored this volatility, although their plight this month was more a result of aggregate demand and expectations for global growth, than Japan's competitive position within the global economy or the value of its overseas earnings.

Despite arguably encouraging newsflow, the financials sector languished yet again, with real estate, miscellaneous finance and banks amongst the poorest performers. Mining, communication and retail were the only three sectors to deliver positive absolute returns over the month which, combined with foods, another strong relative outperformer over the month, illustrated a general absence of sector theme or style contribution over the month.

Asia (ex Japan) Markets

It was another difficult month for Asian equity markets in December, as investors continued to fret about the prospect of a US recession. This was despite the rate cut by the US Fed and a concerted effort by global central banks to inject additional liquidity into the financial system to alleviate the credit crunch.

During the month, India, Malaysia and the Philippines were amongst the region's best performers. In India, the market continued to be buoyed by robust foreign investment inflows, while domestically, the government's plan to introduce further relief measures for exporters affected by strong appreciation of the rupee provided additional support. Malaysia was the next best performing market, boosted by the strong performance of the industrial and utility sectors. In the Philippines, the good showing from the utility sector also bolstered returns, buoyed further by a 25 basis point cut in interest rates.

In contrast, China, Australia and Korea were the region's weakest performers. In China, Beijing's ongoing tightening programme continued to undermine confidence in the market, dragged lower by the weak performance in the IT sector. In Australia, industrials and materials contributed to weak performance amid increased nervousness about the state of the global economy. The energy sector dragged the equity market down in Korea. In the region as a whole, the healthcare sector was the outperformer over the month, while industrials were the main laggards.

Emerging Markets

Global emerging markets made solid progress over the month following the negative return delivered in November. However, market conditions were volatile against a background of ongoing concerns about problems in global credit markets and the prospects for global growth, while the assassination of Benazir Bhutto at the end of the month also unsettled investors.

Egypt and India were the best performing emerging markets over the month. In India, favourable developments included the release of data showing industrial production growing by 11.8% year-on-year in October and exports growing by 35.6%. The Malaysian and Philippine markets also made good progress. Local currency strength boosted US dollar returns from these markets, while in the Philippines, the central bank reduced interest rates by 25 basis points.

The energy-dominated Russian market also performed well in December, with oil prices rising strongly over the month. In other developments, the pro-Kremlin United Russia party won a landslide victory in the parliamentary elections. Argentina was one of the weakest performers over the month, despite the release of data showing the country's economy growing by 8.7% year-on-year in the third quarter. The South African market also underperformed, with the country's central bank raising interest rates by 50 basis points to 11% in a bid to combat inflationary pressures.

Global Bond Markets

December was characterised by rising yields in both the US and Eurozone, as bond investors scaled back their bets that the Federal Reserve and European Central Bank would cut rates in coming months. Despite the Fed cutting rates by a quarter point at the beginning of the month, which disappointed some investors, other news pointed to a less pessimistic outcome for the economy. The Fed, along with other major central banks, provided money markets with massive cash injections, while the US government announced plans to help certain categories of sub-prime homeowners with rate freezes on their borrowings.

In Europe, yields rose as the European Central Bank steadfastly kept rates unchanged for a sixth month. The central bank remains concerned about inflation, as though officials revised down the region's growth forecast to 2% year-on-year in 2008, it expects inflation to average 2.5%, above its objective. The Bank of England, by contrast, voted unanimously to cut rates, further supporting the ongoing rally in UK bond markets and rounding out a very good year for Gilts.

Overview – Total Returns (%) – to end of December 2007

Equities (MSCI)	1 Month			YTD		
	Local	USD	EUR	Local	USD	EUR
World Index	-0.78	-1.26	-0.87	5.20	9.57	-1.18
World Value Index	-1.32	-1.82	-1.43	-0.03	4.09	-6.12
World Growth Index	-0.25	-0.72	-0.33	10.50	15.12	3.83
World Smaller Companies Index	-1.39	-1.79	-1.40	-3.75	1.12	-8.79
US	-0.57	-0.57	-0.18	6.03	6.03	-4.37
Eurozone	-0.45	-0.84	-0.45	8.54	20.35	8.54
UK	0.51	-2.69	-2.31	6.57	8.39	-2.24
Japan	-3.27	-3.95	-3.57	-10.13	-4.14	-13.54
Asia ex Japan	-0.09	-0.39	0.01	38.03	40.52	26.74
Emerging Markets	0.62	0.36	0.75	33.55	39.78	26.07

Source: Datastream to 31 December 2007

Government bonds (JPMorgan)	1 Month			YTD		
	Local	USD	EUR	Local	USD	EUR
US	0.05	0.05	0.44	9.20	9.20	-1.51
Germany	-0.43	-0.83	-0.43	1.98	13.07	1.98
Japan	0.19	-0.51	-0.12	2.66	9.50	-1.24
UK	1.30	-1.93	-1.54	5.10	6.90	-3.59

Source: Datastream to 31 December 2007

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