

# Schroders

## Monthly Market Review

### Overview of markets in January 2008

#### Highlights:

- Recession fears gripped global equity markets in January - markets sold off particularly sharply on Monday, 21 January, with some indices recording the biggest one-day falls since the 2001 New York terrorist attacks.
- In emergency measures, the US Federal Reserve slashed interest rates by a total of 125 basis points in two separate statements. The first cut, of 75 basis points, was made outside of the Fed's scheduled meetings and was the largest reduction in 25 years.
- There were also further write-downs from a number of leading banks, while so-called monoline insurers (companies that insure corporate bonds in order that they benefit from higher credit ratings and lower borrowing costs) faced the threat of losing their essential top quality AAA credit ratings and throwing the credit market into further turmoil.
- Bonds generally had a very good month, enjoying a strong start to the year as investors headed for the relative safety of government securities.

#### US

2008 got off to an eventful start with global stockmarket volatility hitting equity investors. There was a widespread sell-off as investors looked to bonds as a safe haven from the problems in the equity markets. The Federal Reserve responded by making an emergency interest rate cut of 75 basis points, but this did little to ease investors' concerns. When the Fed met on 30 January and announced a further 50 basis point reduction in interest rates, the markets had started to recover slightly. There were some positive signs as M&A activity started back up, with one of the biggest being the Bank of America and Countrywide Financial merger. Financial firms and homebuilders also rallied as the Fed's rate cuts meant that traders began to price in cheaper financing. However, poor jobs data towards the end of the month, with US employment falling for the first time since 2003, has supported the Fed's decision to cut rates as the economic slowdown in the US continues. On a more positive note, the ISM manufacturing index was up despite expectations that it would decline with US exports looking set to continue to benefit from the weakness in the dollar.

#### Eurozone

Along with other major global indices, European stockmarkets had their worst start to a year in decades. Recession fears gripped investors and the tide of bad news from the financial sector continued unabated. Investors abandoned equities across the board, although cyclical stocks suffered in particular. The frenzied sell-off peaked on Monday January 21, when European markets recorded their biggest one-day falls since 11 September, 2001. The Federal Reserve responded swiftly with an emergency 0.75% cut in interest rates. Despite that temporary salve, equities fluctuated markedly throughout the month and ended well into negative territory.

Société Générale later found itself in the spotlight when it turned out its unwinding of close to €50 billion worth of long positions from a 'rogue trader' – which cost the bank almost €5 billion – was at least partly to blame for the commotion in markets.

The European Central Bank said it remains relatively confident that the credit turmoil will have only a limited impact on eurozone growth in 2008, although there are clear downside risks. The ECB's primary preoccupation remains inflation, and the bank made it clear it is still prepared to hike rates to combat it, despite evidence of weakening economic growth.



## UK

While the end of 2007 was characterised by de-leveraging and a stampede out of consumer, cyclical and mid/small cap names, 2008 kicked off a new phase in the equity sell-off. In line with other markets, UK stocks experienced a significant and broad-based decline, with large caps and defensive names dropping back to meet those that had been hit in the previous few months. The only respite came late in the month as, in an unscheduled move, the US Federal Reserve slashed interest rates by a considerable 75 basis points. With a further 50 basis points cut from the Fed on the 30 January, the US central bank highlighted its willingness to act swiftly and firmly to stem the slowdown in the world's largest economy. This was sufficient to prompt a slight recovery in markets towards the end of January, but the FTSE All-Share still finished the month 8.7% down. Within this, large caps underperformed at -8.9%, while mid caps came off best with a fall of 7.3%.

## Japan

The Japanese equity market fell sharply over the month against a background of weakness in global stockmarkets due to concerns about the prospects for the world's largest economy, the US. The yen, having started the month at 109/\$, strengthened in tandem with weak economic data and the decline in investor risk tolerance due to a drop in Asian and European share prices. Having touched 104/\$, it ended the month stronger, at 106.5/\$. Inevitably, exporters were hard hit, with machinery, electrical appliances and precision instruments among those sectors underperforming over the month. Resource-related plays, for example oil and coal, pulp and paper, and mining, also suffered as the outlook for commodity prices weakened in the expectation of easing demand. The best performing sectors were the domestic defensive areas of the market, notably electric power and gas, land transport, foods and pharmaceuticals.

## Asia (ex Japan) Markets

Asian equities came under significant pressure, as fears about the flagging US economy gripped global financial markets. This was despite aggressive attempts by the Fed to ward off a recession with two interest rate cuts and Bush's plans for a fiscal stimulus package, all of which failed to lift sentiment as investors interpreted the moves as signs of weakness. China was the worst performing market, with many stocks coming off over 50% from their recent highs after being hit from several fronts. During the month, the government increased the required reserve ratio of banks to 15% and froze regulated prices of basic necessities, highlighting its intent to curb mounting inflation. Concerns over new equity supply coming on stream added to the gloom. In this environment, the material, utility and financial sectors dragged on the market. India and Korea were also amongst the region's relative underperformers, weighed down by a weak run in the material and energy sectors, respectively.

On the positive side, Malaysia, Indonesia and Thailand were amongst the region's outperformers. Malaysia was the best performing market in January, with the telecom sector holding up relatively well. Indonesia was helped by the strong showing in the industrials sector while losses in Thailand were mitigated by the performance of consumer staples. Across markets, the healthcare sector was the outperformer over the month, while the energy and industrial sectors were the key laggards.

## Emerging Markets

Emerging equity markets fell sharply in January against a background of overall weakness in global stockmarkets, due to investor concerns about the outlook for the US economy. Turkey delivered the weakest returns, despite the Turkish central bank continuing with its policy of monetary easing, cutting interest rates by 25 basis points to 15.5% and the latest data revealed that industrial production grew 7.7% year-on-year in November.

In China, the MSCI China index underperformed the broader market by a wide margin. The People's Bank of China continued with its policy of monetary tightening, while data was released showing GDP growth slowing marginally (to a still impressive rate) of 11.2% year-on-year in the fourth quarter. The energy-dominated Russian market was also among the weakest performers. Over the

period, oil prices fell back, while data was released showing continuing consumer price inflation in Russia.

India also underperformed, following the strong performance delivered in previous months. Over the period, data was released showing industrial production growth decelerating to 5.3% year-on-year in November, while the Reserve Bank of India left interest rates unchanged. In other developments, the Indian government announced a liberalisation of the foreign direct investment rules for seven sectors of the economy including construction, civil aviation and petroleum/natural gas. Elsewhere in Asia, the markets of Malaysia, Pakistan, Indonesia and Thailand held up relatively well. Local currency appreciation boosted the performance of the Malaysian, Indonesian and Thai markets in sterling terms, while in Thailand, political uncertainties eased with the country's Supreme Court affirming the pro-Thaksin PPP party's victory in December's elections, following legal challenges.

Latin American markets also performed relatively well, particularly Mexico and Chile. Mexican equities held up well, following their underperformance in previous months. In terms of economic news, industrial production increased by 0.8% year-on-year in November, which was below consensus expectations while the central bank left interest rates on hold at 7.5%. In Chile, local currency appreciation had a large positive impact on sterling returns from the market, while the central bank raised interest rates by 25 basis points to 6.25%, in a bid to combat inflationary pressures.

### **Global Bond Markets**

Data releases and market sentiment were very supportive for bonds during January, with US and eurozone bond markets experiencing a particularly strong start to the year. Increasing evidence of a slowdown in the US, including higher unemployment and weaker consumer confidence data spooked investors globally. As equity markets tumbled around the world, the Federal Reserve cut rates by an unprecedented 125 basis points in two announcements made days apart from each other.

Still, with equity markets tumbling, government bond markets rallied. Eurozone government bonds enjoyed the best month for returns in more than four years, while US bonds also had a good month. Credit markets had a tougher month, tracking equities lower. The continued fall-out from US sub-prime woes led to further banking writedowns (Citigroup, one of the first banks to announce dented earnings from the sub-prime mortgage crisis, reported a record fourth quarter loss and had its credit rating cut from AA to AA- by S&P). Concerns about the sustainability of US bond insurance companies affected by exposures to sub-prime related structured obligations shook market sentiment further. Spreads widened, especially on lower-rated investment grade credits and high yield.

**Overview – Total Returns (%) – to end of January 2008**

	1 month			YTD		
	Local	USD	EUR	Local	USD	EUR
<b>Equities (MSCI)</b>						
World Index	-8.38	-7.62	-8.78	-8.38	-7.62	-8.78
World Value Index	-7.42	-6.68	-7.85	-7.42	-6.68	-7.85
World Growth Index	-9.31	-8.52	-9.67	-9.31	-8.52	-9.67
World Smaller Companies Index	-8.68	-7.92	-9.07	-8.68	-7.92	-9.07
US	-6.07	-6.07	-7.25	-6.07	-6.07	-7.25
Eurozone	-12.89	-11.78	-12.89	-12.89	-11.78	-12.89
UK	-8.81	-8.93	-10.07	-8.81	-8.93	-10.07
Japan	-9.17	-4.57	-5.77	-9.17	-4.57	-5.77
Asia ex Japan	-14.02	-13.82	-14.90	-14.02	-13.82	-14.90
Emerging Markets	-12.41	-12.45	-13.55	-12.41	-12.45	-13.55

	1 month			YTD		
	Local	USD	EUR	Local	USD	EUR
<b>Government bonds (JPMorgan)</b>						
US	2.61	2.61	1.32	2.61	2.61	1.32
Germany	2.53	3.83	2.53	2.53	3.83	2.53
Japan	0.46	5.55	4.23	0.46	5.55	4.23
UK	0.83	0.70	-0.56	0.83	0.70	-0.56

Source: Datastream to 31 January 2008

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