

# Schroders

## Monthly Market Review

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### Overview of markets in February 2008

#### Highlights:

- Western equity markets finished the month generally lower, while emerging markets rebounded strongly on the back of ever-higher commodity prices.
- Central banks, especially the European Central Bank, are again focusing on the threat of inflation. Crude oil hit a record \$103/barrel during the month, while food and metal prices continued to surge.
- Against the background of uncertainty, bonds benefited from the continued flight-to-quality, with year-to-date returns outpacing those of equities.

#### US

The volatile start to 2008 continued into February with the release of more negative economic data adding to worries about a US recession. Sales of existing homes fell in January to the lowest level in around nine years, indicating that the housing slump is still weighing heavily on growth. The current inventory of unsold homes represents 10.3 months supply – up from 9.7 months in December. These elevated inventories are driving prices down and potential buyers are waiting to see if prices will go down any further. On a more positive note, there is some data which indicates that demand for new home sales may be near the bottom, while large numbers of Americans believe that lower house prices are making buying conditions favourable.

#### Eurozone

Volatility remained a constant theme in eurozone stockmarkets during the month. While a rally seemed on the cards at various points, markets ultimately failed to claw back the losses suffered after January's dismal performance, and finished down. While investors were still mindful of deteriorating economic conditions, they were not in a hurry to pile into defensive stocks, instead focusing on the stream of annual results released during the month. Good results were well rewarded, while companies that even slightly missed expectations were heavily punished.

Sky-high commodity prices – oil rose above the \$100 mark, while gold edged closer to \$1,000 – boosted fortunes in the metal and mining sectors, with these stocks by far the best performers. Elsewhere, the European Central Bank's interest rate setting committee unanimously chose to keep interest rates on hold. The bank is beginning to sound more wary of downside risks to growth than in previous months; however, its hands remained somewhat tied by persistently high inflation.

#### UK

The FTSE All-Share staged a slight recovery during February, within which there appeared to be a minor rotation back into some of the hardest hit areas, including industrials. There was also an element of support provided by wide-ranging takeover speculation. The mining sector was one area of interest in this regard, but attention also appeared to home in on some of the beleaguered UK lenders. The banking sector was in the spotlight regardless of this, however, as the annual results season kicked off. Well-received announcements from Barclays and Standard Chartered had a particularly key impact, helping to drive the market upwards. The Bank of England highlighted that it would not be forced into dramatic cuts in UK interest rates given that inflationary pressures remained



a concern. As a result, UK base rates came down by a generally anticipated 25 basis points as the oil price hit a record \$103 per barrel.

## Japan

The Japanese market ended February marginally lower, with continued concerns over US growth, sub-prime exposure and lower company earnings setting the tone for the month. Banks and insurers trended down due to problems in the US and European financial sectors. Weakness was not, however, confined just to financials. Any companies missing forecasts or lowering earnings expectations saw their share prices fall sharply. Sony, which revised down its full year forecast, suffered its biggest single-day fall in five years, while Olympus and Yamaha Motors also slumped.

Commodity price strength also contributed to equity market weakness, as higher prices raised concerns about rising input costs and falling margins and raised questions about the impact this would have on future earnings growth. Commodity and related sectors consequently outperformed, led by mining, wholesale trade and oil & gas. Machinery also performed strongly alongside the equally cyclical maritime transport sector. Negatives came from the real estate and construction sectors which fell on concerns over tightening liquidity and an assumption that companies in these sectors would need to issue more share capital in order to fund future growth.

## Asia (ex Japan) Markets

Asian markets remained volatile in February, as risk aversion continued to be high on the back of increasing evidence of a US slowdown and negative news from the fallout of the US sub-prime woes. Rising fuel prices, which saw crude oil closing above US\$100 for the first time, also stoked inflationary fears. Despite the negative backdrop, Asian markets managed to recover slightly from the previous month's rout to post a gain over the month.

Taiwan, Thailand and China were amongst the region's outperformers. Taiwan led the gains in February, with the consumer sectors holding up relatively well. In Thailand, the market was buoyed on the back of improved market sentiment with the easing of domestic political risks. Following the massive sell-off in the China market last month, the market bounced back in February, supported by the strong performance in the materials sector. In contrast, the Philippines, India and Hong Kong were the region's main laggards. In the Philippines, political risk was on the rise as protesters called for President Arroyo's resignation over a corruption scandal. Poor performance of industrials and consumer staples also weighed on the market. In India and Hong Kong, the markets were dogged by weak market sentiment, particularly in the financial sector.

Across sectors, soaring commodity prices boosted the materials sector while financials were the key laggards on the back of further bad news in the credit markets.

## Emerging Markets

Global emerging equity markets performed well in February, rebounding from the sharp falls suffered in the previous month. Peru delivered the best returns, with strong metal prices benefiting this commodity-driven market. The country's economy continues to grow at a rapid pace, with data released over the month showing Peruvian GDP increasing by 9.9% year-on-year in December. The Taiwanese and Thai markets also outperformed by a wide margin. Taiwan's fourth quarter GDP grew at a 6.4% rate year-on-year, above consensus expectations. In Thailand, the central bank announced that the capital controls it had imposed on foreign inflows since December 2006 would be lifted on 3 March, as the new government took measures to improve confidence and growth. The Brazilian market also outperformed against a background of strong commodity prices. Over the month, data was released showing industrial production increasing by 6.4% year-on-year in December, which was above market expectations.

The Philippines and India were the weakest performing emerging markets in February. The Indian market continued its run of underperformance from the previous month, following the excellent returns delivered in 2007. Economic news included fourth quarter GDP growth decelerating to 8.4%

year-on-year. In the Philippines, consumer price inflation in January was higher than consensus expectations, at 4.9% year-on-year. The Malaysian and Hungarian markets also underperformed by a wide margin. Malaysia lagged despite fourth quarter GDP growth coming in ahead of consensus expectations at 7.3% year-on-year, while in Hungary data was released showing an increase in inflation in January and sluggish fourth quarter GDP growth.

## Global Bond Markets

Risk aversion remained strong across most markets in February. Stresses in the financial system persisted as de-levering by banks continued and investors generally avoided adding risk exposure. Credit standards have explicitly tightened as banks reduce their own loan holdings and as investors demand prohibitively high compensation for taking incremental risks. Economic data also weakened during the month, led by further declines in the housing market and consumer spending.

Bond prices in the US and elsewhere rose. Short maturity Treasuries led the way, supported by flight-to-quality buying and anticipation of more assertive action from the Fed at their next meeting on March 18th. Even after reducing rates by 1.25% during January, markets are expecting another 0.75% reduction in March. Two-year Treasury yields ended February at 1.62%, a decline of 0.48% on top of the 0.95% drop in January. Credit spreads continued to rise, leading returns to lag those of Treasuries. Conversely, commodity prices rose and inflation concerns caused the 30-year Treasury yield to rise eight basis points, resulting in the yield curve to steepen to new highs.

## Overview – Total Returns (%) – to end of February 2008

Equities (MSCI)	1 month			YTD		
	GBP	USD	EUR	GBP	USD	EUR
World Index	-0.59	-0.53	-2.99	-8.05	-8.11	-11.50
World Value Index	-2.16	-2.10	-4.51	-8.57	-8.61	-12.01
World Growth Index	0.95	1.01	-1.48	-7.54	-7.60	-11.01
World Smaller Companies Index	0.77	0.83	-1.66	-7.09	-7.15	-10.58
US	-3.17	-3.11	-5.50	-8.93	-8.99	-12.35
Eurozone	1.30	1.36	-1.14	-10.52	-10.58	-13.88
UK	0.36	0.42	-2.06	-8.49	-8.55	-11.93
Japan	0.63	0.69	-1.80	-3.84	-3.91	-7.46
Asia ex Japan	5.79	5.86	3.24	-8.71	-8.77	-12.14
Emerging Markets	7.35	7.42	4.76	-5.89	-5.96	-9.43

Government bonds (JP Morgan)	1 month			YTD		
	GBP	USD	EUR	GBP	USD	EUR
US	1.07	1.13	-1.37	3.84	3.77	-0.06
Germany	3.19	3.25	0.70	7.28	7.20	3.25
Japan	2.60	2.66	0.12	8.43	8.36	4.36
UK	0.28	0.34	-2.14	1.11	1.04	-2.69

Source: Datastream to 29 February 2008

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