

Schroders

Monthly Market Review

Overview of markets in March 2008

Highlights:

- Global stockmarkets in March continued to be hurt by concerns affecting the financial system as well as the slowdown in the US economy. Another 0.75% cut in US interest rates helped ease some of the pressure.
- Some of the better performances came from stocks that are seen as being particularly resilient to a weaker economic environment, such as consumer staple and utility companies.
- In commodities, oil prices were volatile, setting a new high of \$111.80 a barrel. Gold also traded above \$1,000 an ounce as investors hedged dollar weakness and inflation fears.

US

There was further volatility in the market during March, with investor confidence being hit by rumours surrounding some of the larger financial institutions in the US. The most high profile of these cases was Bear Stearns, which lost 84% of its share value in one day before being the subject of a takeover bid from JP Morgan orchestrated by the Federal Reserve (Fed). It was not all bad news however, as markets rallied on the back of some rare positive news from the housing market. Existing home sales posted their first increase for seven months and mortgage lenders received a boost on the back of measures to add liquidity to mortgage markets. The Fed made a further interest rate cut of 0.75% on 18 March, to leave its main interest rate at 2.25% prompting a rally in the S&P 500 index. This rally was also a reaction to the announcement of 2007 earnings by Goldman Sachs and Lehman Brothers, which allayed fears that investment banks are seriously wounded.

Eurozone

Negative newsflow relating to the US economy and the financial sector clouded European equity markets in March, resulting in high volatility and a failure to claw back losses sustained since the start of the year. The worsening US economic outlook and a widening interest rate differential pushed the euro to new record highs against the dollar. The stronger euro is a source of concern for European equities because it hurts export competitiveness and reduces value of dollar earnings.

Meanwhile, the financial sector remained in focus with the near failure and subsequent takeover of US investment bank, Bear Stearns, validating market fears about the sector and increasing suspicions about similar problems at other institutions. The Bear Stearns news led to particularly heavy selling on 17 March, with European markets hitting year-to-date closing and intraday lows on this date. Positively, subsequent days saw a recovery from this low point, helped by the 75 basis point interest rate cut in the Federal Funds rate and an increase in JP Morgan's offer for Bear Stearns.

UK

The FTSE All-Share ended the month down by just over 2%, wiping out the gains made in February. The market's behaviour has been counter-intuitive with cyclical companies doing better than, or at least not as bad as, non-cyclical companies. There was a reversal of fortunes in the mining sector as Vale pulled out of takeover talks with Xstrata sending the target company's shares falling. With Rio Tinto and BHP Billiton also markedly down, the resources sector fell by more than 5.5%. The finance sector managed to hold up, although there was a mixed bag of results. The sector experienced a



flight to quality with solid performances from well-capitalised banks that are well managed and are geographically diverse, such as HSBC Holdings. Lloyds TSB, which ticks all the boxes except geographical positioning, also did well.

Persistent interbank failure continued to cast a dark shadow over the market and with no growth forecast in the US for the next quarter, we may be following the US into recession. The vigorous action taken by the Fed in the collapse and takeover of Bear Stearns will be seen as a seminal event and the Bank of England will feel the necessity of matching such actions here if banks are going to start lending to each other again.

Japan

A recurrence of the themes that have blighted global markets over the past six months ensured that Japanese equities registered a negative return in March, capping the worst first quarter for Japanese equities in 18 years. All sectors apart from air transport delivered negative returns over the month. Defensive sectors outperformed, with notable contributions coming from foods, land transportation and electric power & gas. Somewhat counter-intuitively, small caps outperformed, reflecting perhaps a focus on more domestically-orientated names but also, perhaps, a recognition that valuations had fallen too far. At the other end of the spectrum a mixture of cyclical and financial sectors lagged. Banks inevitably struggled due to both external factors, which continued to undermine the mega-banks, notably Mizuho, and Chuo Mitsui Trust, which cut earnings forecasts due to weak mutual fund sales. Real estate also underperformed on reports that the housing market remained difficult and office rent growth may slow. Transport equipment and electrical appliances were among those sectors which struggled in the face of currency strength, while wholesale trade suffered as commodity prices fell back towards the end of the period.

Asia (ex Japan) Markets

Asian markets declined over the month on the back of protracted weakness in the US economy. The collapse of Bear Stearns added to the uncertainty and led to a sharp sell-off of risky assets. Still, global equity markets managed a slight rebound after the Fed cut rates by 75 basis points on 18 March to 2.25% and implemented policy measures to ease the credit crunch. Against this volatile backdrop, Asian equities underperformed global markets.

During the month, Taiwan, Singapore and Thailand were amongst the region's outperformers. In Taiwan, the market rallied strongly on the back of the Kuomintang's (KMT) landslide victory in the presidential elections amid expectations that the new government will promote policies to stimulate economic growth through increasing tourism, trade and investment with China. Singapore was another outperformer, supported by the positive performance in the financial, technology and healthcare sectors. In Thailand, market sentiment improved with the easing of domestic political risk.

In contrast, India, China and Indonesia underperformed the region significantly. In India, rising inflationary pressures and sustained volatility in global markets continued to weigh on the market. Rising inflationary concerns, heightened by central bank's decision to hike the required reserve ratio of banks for the second time this year in a bid to tighten monetary policies and to cool the economy, also dampened market sentiment in China. In Indonesia, the poor performance of materials and energy counters pulled the market down. Across sectors, strong performance was seen in the technology sector while the energy sector was the key laggard.

Emerging Markets

Emerging equity markets delivered a negative return in March, in contrast to the good performance seen in the previous month. This occurred against a background of ongoing concerns about problems in global credit markets (with the difficulties at US investment bank Bear Stearns impacting investor risk appetite) and continuing uncertainties about the prospects for the global economy.

Turkey delivered the weakest returns by a wide margin, with local currency depreciation having a large negative impact on performance in US dollar terms. The Turkish market is particularly sensitive to changes in risk appetite, while increased domestic political tensions were also a negative. The Chinese, Indian and Indonesian markets also fell sharply, with local currency weakness impacting US dollar returns from Indonesia. In China, consumer price inflation hit 8.7% year-on-year (driven to a large extent by severe weather-related supply disruptions) – the highest level in over a decade, which raised investor concerns about further monetary policy tightening. The Indian market continued its run of underperformance seen this year (following the strong returns delivered in 2007) despite the continuing strength of the domestic economy, with data released showing GDP growing by 8.4% year-on-year in the final quarter of 2007.

Poland was among the best performing emerging markets in March, with local currency appreciation having a large positive impact on US dollar returns. The country's economy continues to show a strong rate of growth, with data released showing real GDP growing by 6.1% year-on-year in the fourth quarter. Poland's central bank also raised interest rates by 25 basis points to 5.75% in a bid to combat inflationary pressures. The Chilean, Argentine and Mexican markets also performed relatively well. In Chile, local currency appreciation had a large positive impact on US dollar returns, driven by the significant interest rate differential with the US and the country's strong fiscal and trade accounts. The market also benefited from the strong performance of electricity companies, which account for a large portion of the Chilean market. The Mexican market was boosted by expectations of inflows from domestic pension funds, while data was released showing industrial production growth coming in ahead of consensus expectations at 3.1% year-on-year in January.

Global Bond Markets

Global bond markets were mixed in March as while negative corporate news continued to weigh on riskier assets, which typically can favour the safer havens of government bonds, inflation kept creeping upwards. This fuelled fears of a slowing or halt to further rate cuts from the Fed. In the US, markets ended the month higher, with yet more banking woes – this time Bear Stearns being bailed out by the Fed and subsequently sold to JP Morgan – sending investors into the safer haven of Treasuries. The Fed cut interest rates by 0.75% to 2.25%, less than some in the market were expecting, and warned that rate cuts could stoke inflation. In the eurozone, bonds failed to end the month higher. While they began the month by tracking Treasuries higher, by mid-month the tide was turning. Several inflation measures were indicating that prices were rising faster than the European Central Bank (ECB)'s target. The ECB did not cut rates during the month, preferring to leave them on hold and remind the market that their focus is on inflation. ECB officials' stance meant that the market pared back, at least for now, its forecast for rate cuts.

Overview – Total Returns (%) – to end of March 2008

Equities (MSCI)	1 month			YTD		
	GBP	USD	EUR	GBP	USD	EUR
World Index	-0.83	-0.91	-5.07	-8.80	-8.95	-15.99
World Value Index	-0.52	-0.60	-4.77	-9.04	-9.19	-16.21
World Growth Index	-1.12	-1.20	-5.35	-8.57	-8.71	-15.77
World Smaller Companies Index	-0.87	-0.96	-5.11	-7.90	-8.04	-15.15
US	-0.28	-0.37	-4.55	-9.18	-9.32	-16.34
Eurozone	1.72	1.63	-2.63	-8.98	-9.12	-16.15
UK	-2.07	-2.15	-6.26	-10.38	-10.52	-17.44
Japan	-3.91	-4.00	-8.02	-7.61	-7.75	-14.88
Emerging Markets	-5.20	-5.28	-9.26	-10.79	-10.92	-17.81
Asia ex Japan	-6.03	-6.11	-10.05	-14.21	-14.35	-20.97

Government bonds (JP Morgan)	1 month			YTD		
	GBP	USD	EUR	GBP	USD	EUR
US	0.82	0.73	-3.49	4.69	4.53	-3.56
Germany	3.88	3.79	-0.56	11.44	11.27	2.67
Japan	2.60	5.01	0.61	13.97	13.79	4.99
UK	0.76	0.68	-3.55	1.89	1.73	-6.14

Source: Datastream to 31 March 2008

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