

# Schroders

## Monthly Market Review

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### Overview of markets in May 2008

#### Highlights:

- Global equity markets saw some semblance of order return in May as investors came to the view that the worst of the credit crisis may now be behind us.
- With oil rising above \$135/barrel, inflation became the focus of the world's main central banks, meaning that the rate-cutting cycle is almost certainly on pause.

#### US

Following a rebound in April, the S&P 500 continued to make respectable gains in May. A rally towards the end of the period followed an easing in oil prices, which had earlier reached \$135/barrel. Economic data was generally disappointing, however. Weakening business and job conditions coupled with growing pessimism about the short-term future have further depleted consumers' confidence in the overall state of the economy. The Consumer Confidence Index now stands at a 16-year low. High oil prices have also hit consumer spending. Despite these developments, the Commerce Department announced that the US economy grew more than previously estimated during the first quarter as consumers bought fewer goods from abroad, helping the trade deficit shrink to a five-year low. The dollar did begin to rebound towards the end of the month following hawkish comments from the Fed and a late dip in the price of oil.

#### Eurozone

European equities were relatively flat in May as the previous month's investor exuberance waned somewhat. Oil and gas stocks were among the winners as the oil price continued to hover around all-time highs, while utility companies also performed strongly as investors sought out more defensive positions. Meanwhile, the financial sector was beset by rights issues, seemingly every other day. That raised further questions about the quality of bank balance sheets and the sector languished over the month.

The European economy surprised pundits with its apparent resilience after annualised GDP came in at a higher-than-expected 2.2%. Business confidence also surprised on the upside, rebounding from the previous month's lows. However, inflation continues to be a significant blight on Europe's economic landscape. Against that backdrop, market commentators began to seriously consider the prospect of an interest rate increase before the end of the year.

#### UK

UK equities failed to make any progress during May as the rally seen since the end of March appeared to run out of steam. The first half of the month was relatively strong, with the heavyweight oil and mining sectors leading the charge and a palpable sense right across the market that the credit crisis might be waning. However, the continued oil price and equity market strength seemed an unlikely combination and the market hit the buffers mid-month as oil sailed over \$135 a barrel. Amid profit-taking, further capital raisings and concerns about escalating inflationary pressures, the returns of the previous few weeks subsequently evaporated and the FTSE All-Share finished the month marginally down.

#### Japan

The Topix closed up 3.6% in yen terms. Despite broadly weak domestic and overseas economic data, positive impetus came from strong Japanese GDP growth in the first quarter, supported by solid exports to Asia and emerging markets elsewhere. Some of the best performing sectors were those that benefit from high commodity prices (oil & coal, mining and wholesale trade) alongside



cyclicals more generally. Shares in steel makers made solid gains after the announcement of price hikes agreed with Japanese auto makers. On the flip side, the worst performing sectors tended to be those adversely affected by the high price of oil (air transport, electric power & gas and rubber products). Financial sectors performed poorly following their strong recent rally, as fears over sub-prime fall-out resurfaced periodically and the US Federal Reserve warned that the crisis in financial markets would not be over for some time. Small cap outperformed as, in aggregate, the recent guidance for sales and profits over the coming year is a good deal more optimistic than for large caps, probably as a reflection of the more limited exposure of smaller companies to the exchange rate and slowing economies abroad.

### **Asia (ex Japan)**

Growing inflationary concerns and slowing economic growth provided an uncertain backdrop for Asian equities in May, with most regional indices retreating after the previous month's relief rally. Indonesia, Australia and Singapore were the best performing markets in the region. In Indonesia, the energy, utilities and industrial sectors boosted the overall performance of the market. Australia was also buoyed by the strong showing in the energy and utilities sectors while the industrial and consumer staples sectors underpinned positive performance in Singapore, despite weakness in the healthcare and technology sectors.

On the other hand, India, China and Taiwan were the weakest performers in the region. In India, all sectors performed poorly, with the exception of healthcare and technology, on negative cues from other Asian markets, as well as rising concerns about consumer spending and corporate profits. In China, the stockmarket was hurt by persistent concerns about rising inflation, exacerbated by the Sichuan earthquake, undermining already fragile sentiment further. Across the strait, profit-taking pressure pulled down several sectors in the Taiwanese market, with financials bearing the brunt of the consolidation. Across the region, the best performance was seen in the materials sector, while telecoms and financial were the key laggards.

### **Emerging Markets**

The energy-dominated Russian market was the best performer, with higher oil prices a key positive. The Russian government also approved a reduction in the mineral extraction tax on oil (starting from next year) and introduced a tax holiday for capital intensive oil fields. Argentina performed well, boosted by strong returns from oil services and equipment company Tenaris, the largest stock in the local index. The Brazilian market maintained the rally initiated when rating agency Standard & Poor's upgraded the country to investment grade at the end of April. Fellow rating agency Fitch moved Brazil up to investment grade during May, while the Brazilian market also benefited from the strong performance of energy stock Petrobras against a background of rising oil prices. The Czech market also performed well, gaining from the strong performance of electricity company CEZ (one of the largest local index constituents), while data was released showing Czech GDP growing by 5.4% year-on-year in the first quarter. The relatively small Pakistani market was by far the weakest performer over the month. It fell sharply after the country's central bank raised interest rates by 150 basis points to 12% to combat inflationary pressures, while political uncertainties also weighed on the market.

### **Global Bonds**

Escalating inflation concerns due to rising oil prices overshadowed the global fixed income market in May. With oil hitting \$135 a barrel, speculation was rife that the Federal Reserve, as well as other central banks, will reverse recent policy and actually increase interest rates. Yields on bonds of all maturities rose, but those at the short-end rose the most. In Germany, two-year yields increased dramatically – up 56 basis points, the biggest one-month move since at least 1990. Eurozone inflation came in higher than expected, prompting policymakers from the European Central Bank to voice their concerns. In credit, the picture was more mixed. While spreads narrowed, a reflection of investors' increased appetite for risk, returns generally ended the month in negative territory, the pace of spread compression was unable to offset the overall fall in bond markets.

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

<b>Equities (MSCI)</b>	<b>1 month</b>			<b>YTD</b>		
	<b>EUR</b>	<b>USD</b>	<b>GBP</b>	<b>EUR</b>	<b>USD</b>	<b>GBP</b>
World Index	1.84	1.65	1.87	-8.28	-2.50	-1.79
World Value Index	0.07	-0.12	0.10	-10.35	-4.71	-4.01
World Growth Index	3.52	3.33	3.56	-6.29	-0.39	0.33
World Smaller Companies Index	3.86	3.66	3.89	-6.65	-0.78	-0.06
US	1.79	1.60	1.82	-9.04	-3.32	-2.61
Eurozone	1.34	1.15	1.37	-9.72	-4.04	-3.34
UK	-0.40	-0.59	-0.37	-10.90	-5.29	-4.60
Japan	2.71	2.52	2.74	-4.56	1.45	2.19
Emerging Markets	2.08	1.88	2.11	-7.68	-1.87	-1.15
Asia ex Japan	-3.14	-3.33	-3.11	-15.75	-10.45	-9.80

<b>Government bonds (JP Morgan)</b>	<b>1 month</b>			<b>YTD</b>		
	<b>EUR</b>	<b>USD</b>	<b>GBP</b>	<b>EUR</b>	<b>USD</b>	<b>GBP</b>
US	-1.04	-1.23	-1.01	-4.61	1.40	2.14
Germany	-1.52	-1.71	-1.49	-7.78	-1.97	-1.26
Japan	-1.62	-1.80	-1.59	-1.50	4.70	5.46
UK	-1.24	-1.43	-1.21	0.68	7.02	7.80

Source: Datastream to 31 May 20083

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