

Schroders

Monthly Market Review

Overview of markets in June 2008

Highlights:

- Mounting inflationary pressures and weak economic growth served to re-inject uncertainty into the markets in June.
- Global equities experienced a sharp sell-off as record oil prices fuelled fears of spiralling inflation and re-ignited concerns over the health of the financial services sector.
- Banks were amongst the worst hit as investors speculated about further write-downs. Auto-makers also bore the brunt of the fallout as input costs increased and consumer demand began to wane. Encouragingly, the more defensive areas of the market found support in their 'safe haven' status.

US

June saw the S&P 500 index suffer its worst month since September 2002, with the relentless rise in oil prices continuing to weigh on consumer-facing US companies. The exception to this has, of course, been oil producers who have benefited from oil recently reaching \$143 a barrel. Consumers have been forced to cut back due to these high oil prices and sales of expensive items, such as cars, sales of which have also been affected by high fuel costs, have been hit the hardest. Tax rebate cheques from the government have, however, helped US consumers to deal with the jump in fuel costs for the time being.

Eurozone

Stockmarkets fell heavily in June on a combination of persistently high inflation and strong evidence of a slowing economy. The eurozone MSCI EMU index ended June down almost 12% in local currency terms. Capital raisings continued to dominate financial industry headlines in June. Shares in Fortis plunged after it unveiled plans to bolster its finances by more than €8 billion. However, it was not all doom and gloom in the banking sector. Lloyds TSB made a tentative approach to buy Germany's Dresdner Bank from Allianz during the month. In economic news, soaring inflation continued to vex the European Central Bank (ECB) as figures showed that prices were 4% higher in June than a year earlier. That is twice as high as the ECB's inflation target and the highest reading since the eurozone's formation in 1999. In addition, German investor confidence plunged to its lowest for almost 16 years in June, according to the ZEW index, highlighting nervousness about the outlook for Europe's largest economy.

UK

Sentiment has turned unremittingly gloomy in recent weeks due to a rising oil price, poor economic news and persistent issues amongst the banks. With surging fuel prices (\$140+ a barrel) pushing up inflation, any relief for the deteriorating UK economy in the form of further interest rate cuts was effectively ruled out. The market subsequently surrendered the gains it had made since the middle of March. While the overall market was down, there have been areas of outperformance, notably companies exposed to the oil and mining industries, as well as emerging markets. This has opened up a considerable divide between the cheapest and the most expensive names in the market.



Japan

The Japanese market struggled in June, reversing gains that had been made earlier in the quarter. Inflation and slowing global growth emerged as the main concerns for investors, although the weakness of global financial institutions also played its part in dampening sentiment. Food and commodity prices continued to pose the biggest risk to global inflation, although core inflation remained relatively benign. While there was some evidence suggesting food inflation may well have peaked, oil trended higher, and in so doing frequently hit new all-time highs. Brent crude ended the quarter at US\$140 a barrel, having started the quarter at US\$97.50.

The yen continued to weaken relative to the US dollar, touching ¥108/US\$ before closing at ¥106/US\$ by the end of the month. Shares in exporters, notably automakers and electronics producers, initially prospered in this environment before mounting US job losses combined with falling consumer confidence and house prices to suggest that US demand for Japanese goods had further to fall. Inevitably, the market rotated as sentiment turned. Names in defensive sectors such as electric power and gas, land transport and foods outperformed, having lagged through April and May. At the other end of the spectrum, financials and cyclicals, which had driven the market rally through April and May, were sold off as investors unloaded shares with the greatest exposure to rising energy costs and the continuing fall-out from the credit crisis, which saw no sign of abating.

Asia (ex Japan)

Asian markets fell sharply in June on concerns about the slowing global economy, rising energy prices and fears of more write-downs. India, the Philippines and Korea were the weakest performers in the region. Indian inflation jumped to a 13-year high of 11.1%, prompting the Reserve Bank of India to tighten monetary policy twice in an effort to contain price rises. Philippine markets saw negative performance across several sectors, particularly consumer discretionary and utilities, which dragged heavily on the performance of its equity market. In Korea, the market was dragged down most heavily by the technology and industrials sectors. Indonesia, Australia and Singapore fell the least in the Asian region.

Emerging Markets

Emerging equity markets fell sharply in June against a background of weakness in broader global stockmarkets. Investors' risk appetite declined due to factors including growing concerns about inflationary pressures across the world (with strongly rising oil prices having a significant impact) and the potential for monetary tightening. India was the weakest performing emerging market over the month. The market was impacted by concerns about domestic inflation (data was released over the period showing wholesale price inflation coming in at over 11% year-on-year, which was above market expectations) with the central bank twice raising interest rates over the month. The Philippines market also fell sharply, with the central bank raising rates to combat rising inflation, which reached a nine-year high of 9.6% in May. The Chinese and Turkish markets were also among the weakest performers over the month. In Turkey, the central bank raised interest rates by 50 basis points to 16.25%, while domestic political uncertainties continued to weigh on investor sentiment. Argentina was the best performing emerging market in June, boosted by strong returns from oil services and equipment company Tenaris, the largest stock in the local index.

Global Bonds

Inflation concerns were ever-present in June but the impact was more mixed than in previous months. In the US, yields recovered a little as the Federal Reserve sought to reassure the market that it wasn't planning a series of interest rate hikes. Officials made it clear that they are watching economic data, and as things stand at the moment they are expecting a weaker economic outlook to moderate inflation. With Treasury investors scaling back their interest rate expectations, the market managed to end the month in positive territory. However, it was a very different story for the eurozone market, which was badly hit, as the ECB indicated early in the month that it would raise interest rates as soon as July (which it indeed did). In credit, risk-aversion returned mid-month, and lower-rated credits, especially high yield, underperformed government bonds.

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

	1 month			YTD		
	EUR	USD	GBP	EUR	USD	GBP
Equities (MSCI)						
World Index	-9.20	-7.94	-8.59	-16.71	-10.25	-10.23
World Value Index	-10.70	-9.46	-10.09	-19.94	-13.72	-13.70
World Growth Index	-7.74	-6.46	-7.12	-13.54	-6.83	-6.81
World Smaller Companies Index	-9.29	-8.03	-8.68	-15.32	-8.75	-8.73
US	-9.41	-8.15	-8.79	-17.60	-11.20	-11.18
Eurozone	-11.67	-10.44	-11.07	-20.25	-14.06	-14.04
UK	-7.55	-6.27	-6.92	-17.62	-11.23	-11.21
Japan	-8.09	-6.81	-7.47	-12.28	-5.47	-5.44
Emerging Markets	-11.19	-9.96	-10.59	-18.00	-11.64	-11.62
Asia ex Japan	-13.09	-11.89	-12.50	-26.78	-21.10	-21.08

	1 month			YTD		
	EUR	USD	GBP	EUR	USD	GBP
Government bonds (JP Morgan)						
US	-0.54	0.84	0.13	-5.12	2.25	2.27
Germany	-0.77	0.61	-0.10	-0.09	7.67	7.69
Japan	-0.68	0.70	-0.01	-2.17	5.43	5.45
UK	-1.40	-0.04	-0.74	-9.07	-2.01	-1.99

Source: Datastream to 30 June 2008

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