

Schroders

Monthly Markets Review

Overview of markets in July 2008

Highlights:

- The opposing forces of inflation and weak economic growth continued to weigh on markets.
- Weak economic data releases prompted government bonds to rally across several markets.
- Fears over the collapse of US mortgage giants, Freddie Mac and Fannie Mae, rattled markets before the government announced measures to support both corporations.

US

US stockmarkets remained volatile as the fall-out from the credit crisis and financial services write-offs continued to weigh on the market. The stockmarket received some relief in the second half of the month as oil prices retreated from their \$147/barrel highs, but this was offset by more negative news from the US housing market as several surveys pointed to increasing foreclosure levels and continued deterioration in home values. There was also negative data from the Labour Department as unemployment rose to its highest level for four years.

Eurozone

European equities started July on a weak note as deteriorating news on the economy plus a spate of profit warnings discouraged investors. However, the second-quarter reporting season kicked off mid month with results that were generally not as grim as many feared and, at the same time, oil prices came off their highs, relieving some of the inflationary pressures that had prompted the European Central Bank to raise rates by a quarter percent at the beginning of the month. The combination of these factors helped to draw back the early losses, and in a reversal of the recent trend, financials found support, whilst materials & mining and energy stocks fell as commodity prices slipped back from record highs. European markets ended the month almost flat.

UK

July was another very interesting month for UK equities, not least because of a reversal of fortunes within the market itself. Indeed, having dropped off sharply in the first part of the month (on rising fears of stagflation and moves to shore up US mortgage agencies Freddie Mac and Fannie Mae), UK equities then clawed back a reasonable proportion of these losses following better-than-expected corporate earnings and a quickly retreating oil price. This turnaround in the oil price caused the momentum-driven resources sectors to surrender a fairly solid portion of their recent gains, whilst the beleaguered financial and consumer names received a much needed boost.

Japan

As world stockmarkets continued to decline in July, the TOPIX was no exception. Investor concerns included global inflation, the lengthening US slowdown and growing signs of a downturn in Europe and elsewhere. There were fresh fall-outs from the credit crunch in the shape of further write-downs by large financial firms, the failure of three US regional banks and panic over possible insolvency of Fannie Mae and Freddie Mac, which required aggressive (and possibly costly) action from the US government to shore up confidence.



Sentiment in Japan was once again highly influenced by newsflow from the US, including steadily worsening macro data. The news from within Japan was hardly more encouraging: the Tankan survey showed business confidence deteriorated again, exports contracted unexpectedly in June, and the combination of inflation and declining real wages had a marked impact on consumer spending. One bright spot was that strong machinery orders in May indicated that some resilience remains in domestic capex. As the earnings season got underway, volatility in individual stocks was high, with some stocks, particularly cyclicals, falling despite decent results.

Asia (ex Japan)

Asian equities finished July slightly lower, but remained relatively resilient following the previous month's sell-off. Fears about the slowing global economy and rising inflationary pressures continued to weigh on investors' minds. With financials featuring prominently in many regional markets, coupled with the energy-intensive nature of many developing Asian economies, the unwinding of the long energy/short financials trade with the fall in crude oil prices meant that Asian markets fared better relative to global peers.

Hong Kong-listed China stocks stabilised from a large sell-off in May and June and turned in modest performance in July. Despite the uncertainty of the global economy, the market was driven by the retreat in global oil prices, earning surprises from the Chinese banks, the US' continued efforts to help the ailing financial sector and anticipation of selective relief in monetary policies from the Chinese government. Airlines and oil refiners posted strong gains on lower crude oil prices. Mainland property developers surged following expectations that the government may loosen policies to support the property market. Despite the 1H08 warning of losses by independent power producers (IPPs), their share prices gained as investors priced in profit declines and expect possible electricity pricing reform post the Olympics. The shipping sector underperformed following market expectations of an over-supply of dry bulk vessels which will lower dry bulk rates in 2009.

Emerging Markets

Global emerging equity markets were weak overall in July. Uncertainties about the outlook for global growth had a particularly negative impact on oil and materials prices in the month, to which emerging markets have a higher sensitivity than global markets. Argentina was the weakest performer following the strong returns delivered in June. The relatively small Pakistani market also fell sharply, as did Peru, which was impacted by weaker copper prices. The energy-dominated Russian market underperformed by a wide margin against a background of weaker oil prices. Thailand and Brazil were also among the weakest performers. In Thailand, the central bank raised interest rates by 25 basis points to 3.50% in a bid to combat rising inflation, while political uncertainties also weighed on sentiment. In Brazil, pressure on commodity-related stocks impacted market performance. The Brazilian central bank continued with its policy of monetary tightening, raising interest rates by 75 basis points to 13% in a bid to curb inflation.

Turkey was by far the best performing emerging market over the month, rallying sharply following recent weakness. It benefited particularly from the Turkish Constitutional Court's decision to reject a motion to ban the ruling AK Party, with uncertainties over this case having weighed on sentiment for several months. The Hungarian, Polish, Indian and Philippines markets also outperformed in July, rebounding from previous weakness.

Global Bonds

Economic data releases deteriorated in several economies over the month, leading to a strong rally in government bonds in several markets. Fears over the collapse of US mortgage giants, Freddie Mac and Fannie Mae, rattled markets. However, sentiment turned more positive following the announcement of government measures to support both corporations. In Europe, investors reduced expectations of further rate rises from the European Central Bank, leading to a rally in short-dated bonds.

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

	1 month			YTD		
	EUR	USD	GBP	EUR	USD	GBP
Equities (MSCI)						
World Index	-1.46	-2.42	-1.96	-17.93	-12.42	-11.99
World Value Index	-0.76	-1.72	-1.26	-20.54	-15.20	-14.79
World Growth Index	-2.13	-3.08	-2.63	-15.38	-9.70	-9.25
World Smaller Companies Index	-0.81	-1.77	-1.31	-16.01	-10.37	-9.93
US	-0.18	-1.14	-0.68	-17.74	-12.21	-11.78
Eurozone	-1.50	-2.46	-2.00	-21.45	-16.17	-15.76
UK	-3.16	-4.10	-3.65	-20.23	-14.86	-14.45
Japan	-2.46	-3.41	-2.96	-14.44	-8.69	-8.24
Emerging Markets	-2.75	-3.69	-1.96	-20.26	-14.90	-14.48
Asia ex Japan	0.17	-0.80	-0.34	-26.66	-21.73	-21.34

	1 month			YTD		
	EUR	USD	GBP	EUR	USD	GBP
Government bonds (JP Morgan)						
US	1.39	0.41	0.88	-3.80	2.67	3.17
UK	3.02	2.02	2.49	-6.33	-0.03	0.45
Japan	-0.62	-1.59	-1.13	-2.78	3.76	4.26
Germany	1.87	0.89	1.36	1.78	8.62	9.15

Source: Datastream to 31 July 2008

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