Schroders
Monthly Markets Review

Overview of markets in August 2008

Highlights:

- The opposing forces of weakening economic growth and inflation continued to weigh on markets.
- Inflationary pressures fell – oil price declined from their recent record highs.
- Some US data was better than expected, leading to strengthening of US dollar.
- Weak economic data releases led to a rally in global government bonds.

US

US stockmarkets rallied in August and the dollar recovered from the record low it reached against the euro in July. The S&P 500 index had its best month since April. Oil prices came down from their record highs of recent months, which gave some relief to US consumers. There was also positive news for the wider economy as much of the economic data being released was not as negative as originally feared. For example, US GDP in the second quarter increased 3.3% on an annualised basis, which was higher than estimated, and US non-farm payroll data was marginally better than expected.

Eurozone

European equities were up during the month, as the retreating oil price buoyed equity markets. Fears of oil supply constraints eased following reports that Hurricane Gustav had spared the major oil facilities in the Gulf of Mexico, boosting returns in the second half of August. Newsflow was mixed during the month. Weak economic data from the UK and Germany, and reports of a slump in German business confidence heightened speculation that the region was heading towards a recession. However, better-than-expected data from the US helped to offset the negative newsflow, with US consumer confidence data exceeding forecasts and home sales rebounding, taking some steps to ease concerns of a more pronounced slowdown in the European economies in the near term. The strengthening US dollar hit commodity prices, and in a reversal of trend we saw a deterioration in the share price of materials and energy stocks, with investors looking more favourably on banks, construction companies, airlines and autos by the end of the month.

UK

August was a strong month for UK equities, with the FTSE All-Share posting its first monthly gain since April. The trends within the market were somewhat unchanged, however, with the battered consumer, financial and cyclical sectors continuing to rebound following the market's whipsaw rotation in July. A rally amongst dollar earners boosted the index even further as weakness in the European economy and the stalling of the UK economy caused sterling to fall heavily against the dollar. These factors more than offset the continued weakness within the mining sector.

Japan

Market volatility continued to weigh on the Japanese equity market. Concerns over the health of the US economy continued as inflation increased further, jobs were lost for the seventh month running and consumer spending disappointed.

Once again, concerns about the US economy weighed on the Japanese market for most of the month, although a modest weakening of the yen and lower crude prices limited declines. Both the Bank of Japan (BoJ) and the government made downbeat statements about the outlook for the Japanese economy and domestic macro data was disappointing: in Q2 2008 real GDP fell 2.4% quarter-on-quarter, real wages were eroded again, consumer sentiment hit a new low and business sentiment also slipped. The mining sector made gains as investors reacted positively to two major oil development companies raising their full-year earnings projections. Defensive sectors tended to outperform against the backdrop of pessimistic sentiment (electric power & gas, pharmaceuticals, foods), as did beneficiaries of lower oil prices (air transport, land transport, rubber products). On a more negative note, financial sectors performed poorly amid a tough operating environment.

Asia (ex Japan)

August proved another dismal month for Asian equities, as concerns about the health of the global economy and the finanical sector weighed on investor confidence, eroding the gains from a decline in oil prices and a rally in the US dollar. The US Federal Reserve's signal that it was in no hurry to raise rates did little to lift sentiment either, though a big upward revision to second-quarter US GDP growth boosted the outlook for demand at the end of the month. However, Asian equities still posted their fourth consecutive month of declines.

Emerging Markets

Global emerging market equities were hit in August by concerns that the economic slowdown in the US and increasingly in Europe will negatively impact exporting countries, while the recent sharp pull-back in oil and other commodity prices also weighed on resource-rich countries. In addition, concerns grew about the degree of weakness in the Chinese economy following weaker figures. Oil net importers such as India fared much better. However, India's GDP moderated in the second quarter, to 7.9% year-on-year compared to 8.8% reported in the previous quarter, which was marginally worse than consensus expectations.

All Latin American countries, apart from Colombia, finished the month in negative territory. In Mexico, which held up reasonably well, Banco de Mexico's governor said that inflation pressures appear to be receding due to lower commodity prices. The central bank in Chile, by contrast, was more hawkish, citing continued inflationary pressures. The bank raised rates by 50 basis points to 7.75% in the month, and the market is factoring in the possibility for further increases.

Pakistan was the biggest faller among global emerging markets, with politics weighing on sentiment, culminating with the resignation of the country's president and the freezing of the stock market. The energy-dominated Russian market was the only other emerging market to come close to Pakistan in terms of performance, with sentiment souring not only due to falling oil prices but also on account of mounting tensions with the West. Investors fear that another Cold War is developing.

Global Bonds

Global economic data released during August showed further signs of weakness, all leading to strong government bond performance. Further signs that the global economy is slowing, coupled with the continuing fallout from the credit crisis suppressed risk appetite, leading investors to flee to the safe haven of government bonds. Despite some respite in economic news – US GDP in the second quarter increased 3.3% on an annualised basis, which was higher than estimated, and US non-farm payroll data was marginally better-than-expected – the global economic environment continued to display a troublesome combination of falling expectations and rising prices. For example, consumer and business sentiment remains weak. In particular, consumers are becoming more negative as their personal balance sheets feel the strain of persistently high oil, energy and food prices and more difficult mortgage conditions.

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

	1 month			YTD		
Equities (MSCI)	**EUR**	**USD**	**GBP**	**EUR**	**USD**	**GBP**
World Index	4.53	-1.36	7.13	-14.21	-13.61	-5.71
World Value Index	4.98	-0.94	7.58	-16.59	-16.00	-8.32
World Growth Index	4.11	-1.76	6.69	-11.91	-11.28	-3.18
World Smaller Companies Index	5.93	-0.04	8.56	-11.03	-10.40	-2.22
US	7.43	1.37	10.09	-11.63	-11.01	-2.88
Eurozone	1.23	-4.48	3.74	-20.49	-19.93	-12.61
UK	2.57	-3.22	5.11	-18.18	-17.61	-10.08
Japan	1.76	-3.98	4.29	-12.93	-12.32	-4.31
Emerging Markets	-2.46	-7.96	-0.03	-22.22	-21.67	-14.51
Asia ex Japan	-1.29	-6.86	1.16	-27.60	-27.09	-20.43

	1 month			YTD		
Government bonds (JP Morgan)	**EUR**	**USD**	**GBP**	**EUR**	**USD**	**GBP**
US	7.42	1.36	10.08	3.34	4.06	13.57
UK	-0.29	-5.91	2.19	-6.60	-5.94	2.65
Japan	6.54	0.53	9.18	3.58	4.31	13.84
Germany	1.28	-4.43	3.79	3.08	3.80	13.29

Source: Datastream to 31 August 2008