Schroders
Monthly Markets Review

Overview of markets in September 2008

Highlights:

- The turmoil in the global financial system intensified with a number of banking failures on both sides of the Atlantic.
- Economic growth continued to deteriorate – negative US unemployment data.
- Inflationary pressures continued to fall – oil price fell sharply.
- Weak economic data and financial crisis led to a rally in global government bonds.

US

September was a very difficult month for stockmarkets around the world as the credit crunch tightened its grip on the financial system. The financial sector was heavily in the news after a number of bail-outs hit the headlines. The first of these was the nationalisation of mortgage lenders Fannie Mae and Freddie Mac. This was followed by the collapse of Lehman Brothers and the bail-out of AIG by the Federal Reserve. Other major investment banks in the US (for example Morgan Stanley, Goldman Sachs and Merrill Lynch, which was taken over by Bank of America) also saw their share prices dip, as there were concerns about whether stand-alone investment banks could survive in the current climate.

The response to this crisis was for the US Treasury to announce a $700 billion bail-out package for financial markets. The Fed also doubled the amount it lends to other central banks to over $600 billion. The House of Representatives rejected the Treasury's proposed bail-out package, which sent markets tumbling, with the S&P 500 posting in worst daily return since 1987 on 29 September.

Data from the US was again negative on consumption and unemployment, and there were signs that weaker earnings and tighter credit conditions were starting to impact corporate spending, which had to date been relatively resilient.

Eurozone

In September, European equities fell to their lowest level since January 2005 as turmoil in the global financial markets took hold. In Europe, Belgo-Dutch bank Fortis and Belgian bank Dexia required government support, and Germany's Hypo Real Estate was furnished with a government-organised emergency credit-line.

Eurozone inflation figures again indicated a downward trend with inflation rates falling from 3.8% to 3.6% in September. However, despite indications of a more pronounced global slowdown, the regional deflation trend was not enough to dispel the widespread view that the ECB will keep interest rates on hold (in October, after originally voting to keep interest rates on hold, the ECB subsequently cuts rates to 3.75%).

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UK

September was an extremely turbulent and difficult month for UK equities as the credit crisis radically re-shaped the global financial sector. Indeed, as investors worried about the fate of banks on both sides of the Atlantic, confidence became extremely fragile and UK share prices dropped back to their lowest point since 2005. Significantly, however, it was commodities rather than the banks that weighed heaviest on the market as the financial crisis prompted the further unwinding of leverage positions and growing fears about a major global slowdown.

Japan

Along with stockmarkets around the globe, Japan experienced steep falls in September. The credit crisis stepped up a gear, resulting in the failure or takeover of several high-profile financial institutions, both in the US and Europe. This, coupled with mounting signs of a global economic slowdown exerted downward pressure on Japanese equities.

The direction of the Japanese market was largely dictated by sentiment surrounding global events. Macroeconomic data in Japan pointed to the economy turning down. Real GDP has fallen, business and domestic confidence are low, the labour market is softening and exports are being affected by the global slowdown. While the recent slide in commodity prices should be positive for the real purchasing power of households and for corporate profit margins, the recent shock in the international financial markets most likely will negatively affect the spending of both corporations and households.

Seen as a safe haven in the turmoil, defensive sectors tended to outperform (pharmaceuticals, electric power & gas and foods). Among the top performers were also sectors where lower oil prices mean lower costs (rubber products, pulp & paper, air transport). Some of the poor performers were those where falling commodity prices have the opposite effect (wholesale trade, mining, oil & coal).

Asia (ex Japan)

Asian equity markets were highly volatile over the month as heightened fears about the health of world's financial system against a backdrop of slowing global growth shook investors' confidence globally. September marked a dramatic month in the credit crisis so far, culminating in the spectacular collapse of Lehman Brothers, which was followed quickly by Merrill Lynch's surprise-sale to Bank of America and the rescue of AIG by the US Federal Reserve. While the US government's announcement of a proposed USD 700 billion bailout package for the financial industry and implementation of restrictions on short selling provided some relief to the market turmoil, sentiment remained jittery as uncertainties remained on the approval of the package and more generally, the extent of the fallout from the credit crisis. Against this negative backdrop, the MSCI AC Asia Pacific ex Japan Index slumped, and underperformed the MSCI World Index.

Emerging Markets

Emerging equity markets fell sharply in September in what was a very difficult month for stockmarkets globally. Investor confidence was hit by severe difficulties at several large financial institutions in the US and Europe (including the collapse of Lehman Brothers) associated with the ongoing problems in global credit markets. Uncertainties over a proposed bail-out of the US banking sector also weighed on sentiment, while commodity price weakness was a negative for several emerging markets. Although the credit crunch has impacted confidence in emerging markets, up until now it has largely been a developed world phenomenon. However, liquidity issues are starting to emerge in some countries, even if, broadly speaking, emerging markets have low levels of debt and high savings ratios.

Russia and Argentina were the weakest performing emerging markets in September. The sharp fall in oil prices over the month was a negative for the Russian market as were concerns about tightening liquidity conditions and domestic inflation, while risk premia in Russia have increased, given investor concerns about the political and corporate governance environment. Sharp market falls prompted temporary suspensions of trading in the Russian stockmarket during the month. In Argentina, oil services and equipment company Tenaris, the largest stock in the local index, fell sharply against a background of falling oil prices. The Chinese and Indonesian markets also fell sharply. The MSCI China index underperformed despite an unexpected easing of monetary policy from the central bank, while the Chinese authorities also announced a number of measures aimed at supporting the local equity market, including the removal of stamp duty on equity purchases. In Indonesia, the central bank continued its policy of monetary tightening, raising rates by 25 basis points to 9.25%.

The Korean and Philippines markets fared relatively well. The Philippines continued to benefit from declining oil prices, while Korea held up well following previous underperformance. In other developments, the Korean central bank left interest rates on hold at 5.25% while the government announced a US$20bn package of tax cuts over the next five years. In Latin America, the Colombian, Chilean and Mexican markets outperformed.

Global Bonds

During September, the credit crisis deepened with a series of banking difficulties on both sides of the Atlantic. Governments, globally, were forced to intervene as financial institutions struggled to access liquidity. In this environment, investors became increasingly risk averse, shunning all but the safest of securities. The announcement of a US$700billion rescue plan by the US Federal Reserve, the so called TARP (Troubled Asset Relief Program) briefly helped calm markets - its rejection at the end of the month sent risk markets once again into freefall. The bill has subsequently been passed; however, concerns remain, with levels of volatility remaining high and risk aversion continuing to dominate.

Coupled with the concerns of the global financial system, economic data continues to show worrying signs of fragility. For example, US data was again negative on consumption and unemployment, and there were further signs that weaker earnings and tighter credit conditions were starting to impact corporate spending. In addition, economic growth continued to deteriorate across Europe, with the EU commission downgrading its growth forecasts for the region in 2009. Against this backdrop, risk assets including corporate bonds predictably sold off as investors fled to the relative safe haven of government bonds.

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

	1 month			YTD		
Equities (MSCI)	**EUR**	**USD**	**GBP**	**EUR**	**USD**	**GBP**
World Index	-7.60	-11.85	-9.80	-20.73	-23.85	-14.95
World Value Index	-5.60	-9.94	-7.85	-21.26	-24.35	-15.52
World Growth Index	-9.52	-13.69	-11.68	-20.30	-23.43	-14.48
World Smaller Companies Index	-9.07	-13.25	-11.24	-19.10	-22.28	-13.20
US	-4.79	-9.17	-7.06	-15.87	-19.17	-9.74
Eurozone	-11.33	-15.41	-13.44	-29.49	-32.26	-24.35
UK	-10.74	-14.85	-12.87	-26.97	-29.84	-21.65
Japan	-6.87	-11.16	-9.09	-18.92	-22.10	-13.00
Emerging Markets	-13.51	-17.49	-15.57	-32.73	-35.37	-27.82
Asia ex Japan	-12.52	-16.55	-14.60	-36.67	-39.16	-32.05

	1 month			YTD		
Government bonds (JP Morgan)	**EUR**	**USD**	**GBP**	**EUR**	**USD**	**GBP**
US	5.45	0.60	2.94	8.97	4.69	16.92
UK	2.50	-2.22	0.06	-4.27	-8.03	2.71
Japan	6.88	1.96	4.34	10.70	6.35	18.77
Germany	1.14	-3.51	-1.27	4.25	0.16	11.85

Source: Datastream to 30 September 2008

Important Information:

For professional investors and advisers only. This document is not suitable for retail clients.