

Schroders

Monthly Markets Review

Overview of markets in October 2008

Highlights:

- Fears over a worldwide economic recession strengthened following deteriorating US manufacturing, unemployment data and falling corporate profits
- The financial crisis deepened – global central banks cut interest rates and injected further liquidity into the banking system
- Inflationary pressures continued to recede – commodity prices fell sharply
- Weak economic data led to global government bonds to rally further

US

October was another volatile month for the US stockmarket, as it was for stockmarkets around the world. At the beginning of the month, Congress passed the revised Troubled Asset Relief Plan (TARP), which provided relief to financial markets. Central banks were also forced into measures in an attempt to calm volatility in global markets, with coordinated interest rate cuts from the Federal Reserve, European Central Bank and Bank of England, which initially caused a slight rally in markets, before investors became nervous again amid mounting evidence of recession. The Fed responded by making a further interest rate cut at the end of the month, taking interest rates in the US to 1%.

Eurozone

In October, European equities continued to take a battering as companies struggled to cope with the credit squeeze, investor confidence plummeted and lending fears continued to suffocate the financial system. To combat the crisis, the European Central Bank cut interest rates by 0.50% to 3.75%, and governments across Europe took co-ordinated action and made sizeable commitments (guaranteeing to safeguard bank deposits and debts and outlining capital investment plans) in an effort to free up the 'banking paralysis' and re-ignite confidence in the markets. The measures succeeded in restoring some confidence, with European equities rallying on the back of initial announcements, and the co-ordinated bail-out ensured that the immediate panic gripping markets subsided. However, investors still remained concerned about the take-up of individual government bail-out offers and the ability of banks to raise capital if required.

UK

October was another extremely punishing month for UK and global equities. A rally in the last few days managed to marginally lessen the blow, but the FTSE All-Share still suffered huge losses. Sentiment was initially weak on continued fears about systemic collapse despite the passing of the US rescue package. As a result, the authorities intervened with co-ordinated global interest rate cuts, whilst the UK announced its own £50 billion banking rescue plan. A seemingly clever and sensible solution, this plan was then emulated across Europe and, to some extent, in the US as well.

In the meantime, however, worries were escalating about a deeper and more global economic slowdown and markets were then forced to face some potentially very significant second-round



effects as the emerging economies came under increasing pressure. This, together with the impact of much lower oil prices, caused a sharp jump in the value of the US dollar, which, in turn, prompted a further wave of de-leveraging. It was only in the final days of October that markets started to recover some ground as interest rates looked set to come down materially around the world.

Japan

Global markets crashed in October and the TOPIX suffered heavy losses. With the financial crisis worsening, central banks and governments around the world scrambled to address the issues facing the global system. They slashed interest rates, rescued more financial institutions, injected capital into the banking system and made other bold moves aimed at resolving the crisis, but the actions failed to assuage investors' worries. Concerns over a global economic recession continued to strengthen in response to developments including falling corporate profits and a deterioration in US statistics on industrial production, retail sales and consumer confidence. The downward spiral of share prices was reinforced by forced redemptions and a lack of liquidity. Commodity prices tumbled over the month – oil fell from nearly \$100 per barrel to around \$60 – and inflation figures eased.

Sentiment in Japan was impacted by concerns about the global economy, but also by a strengthening yen (seen as a safe haven currency) and by further domestic data which seemed to confirm that the economy was on the way to a fully-fledged downturn. For example, machinery orders plummeted, export growth figures fell far short of expectations and department store sales were down year-on-year for a seventh consecutive month. Many firms lowered earnings guidance; exporters Sony and Canon were among those making deep cuts. Late in the month, the government unveiled its second stimulus package, larger than the first, and also cut interest rates by 20 basis points to 0.3%.

Asia (ex Japan)

The rout in global stockmarkets continued in October, with Asia proving no exception. With the financial crisis deepening, concerted efforts by central banks and governments around the world, including co-ordinated interest rate cuts and the injection of further capital into the banking system, did little to stem the panic engulfing the markets. Against this gloomy backdrop, the MSCI AC Asia Pacific ex Japan Index suffered heavy losses and underperforming the MSCI World Index.

Emerging Markets

Global emerging equity markets fell sharply in October in local currency terms against a background of heightened concerns about global financial and economic conditions and a sharp sell-off in equity markets across the world. Globally, governments and central banks intervened with bank rescue packages and interest rate cuts. This included a coordinated 50 basis point rate cut by major central banks such as the US Federal Reserve, European Central Bank and Bank of England. Commodity prices also weakened further as the global growth outlook deteriorated, a negative for several emerging markets. However, emerging markets rallied towards the end of October in the wake of a second US interest rate cut for the month and the Federal Reserve's announcement of temporary reciprocal currency arrangements (swap lines) with Brazil, Mexico, South Korea and Singapore. The International Monetary Fund (IMF) also announced the creation of a new facility that can be drawn on by emerging market countries with a track record of sound macro-economic policies.

Global Bonds

The global economy continued to show further signs of weakness during October. Fears over a worldwide economic recession strengthened following deteriorating US manufacturing, retail sales, unemployment data and falling corporate profits. In addition, sharp falls in employment data, business and consumer confidence were reported across continental Europe. This suggests that the

region is facing prolonged recession-like conditions, and indeed the European Commission dramatically downgraded its growth forecast for the region in 2009. Commodity prices plummeted during the month due to concerns over demand in the wake of the economic downturn. For example, oil fell from nearly \$100 per barrel to around \$60. Against this backdrop inflation statistics eased, and are expected to fall further in the coming months.

During the month, global central banks and governments implemented a series of measures in an attempt to address the issues facing the worldwide economic and financial system. In a concerted effort, the Federal Reserve, Bank of England and European Central Bank all slashed interest rates early in October. Global policy easing continued unabated over the month, with other countries such as China, Australia, Norway, Hong Kong, Taiwan and Japan all cutting interest rates. In addition, central banks and governments, across the globe, injected further capital to provide stimulus to the banking system, and rescued more financial institutions.

Against this macroeconomic background, global government bonds ended the month in positive territory as the flight to quality rally continued. In direct contrast, corporate bonds fell during October (although not to the same extent as the previous month), as investors shunned all but the safest of securities. Continuing fears over both the solvency of a number of financial institutions and recessionary growth led to a further widening of credit spreads.

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

Equities (MSCI)	1 month			YTD		
	EUR	USD	GBP	EUR	USD	GBP
World Index	-10.21	-18.93	-10.57	-28.82	-38.26	-23.94
World Value Index	-9.72	-18.50	-10.09	-28.91	-38.35	-24.04
World Growth Index	-10.69	-19.37	-11.05	-28.81	-38.26	-23.93
World Smaller Companies Index	-14.29	-22.62	-14.63	-30.66	-39.86	-25.90
US	-8.18	-17.10	-8.55	-22.75	-33.00	-17.45
Eurozone	-15.74	-23.93	-16.09	-40.59	-48.48	-36.52
UK	-10.24	-18.96	-10.60	-34.45	-43.14	-29.95
Japan	-5.61	-14.78	-5.99	-23.46	-33.62	-18.22
Emerging Markets	-19.53	-27.35	-19.86	-45.87	-53.05	-42.16
Asia ex Japan	-15.88	-24.06	-16.22	-46.73	-53.79	-43.07

Government bonds (JP Morgan)	1 month			YTD		
	EUR	USD	GBP	EUR	USD	GBP
US	10.51	-0.23	10.06	20.43	4.45	28.68
UK	0.70	-9.09	0.29	-3.60	-16.39	3.01
Japan	20.21	8.52	19.72	33.07	15.41	42.19
Germany	1.87	-8.03	1.46	6.21	-7.88	13.49

Source: Datastream to 31 October 2008

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