

Schroders

Monthly Markets Review

Overview of markets in December 2008

Highlights:

- Global equity markets showed some improvement in December as investors welcomed further plans of fiscal stimulus and big cuts in interest rates.
- Economic data pointed to a continued slowdown in global manufacturing output and consumer spending as well as rising unemployment.
- Inflation continued to fall with oil and other commodity prices heading lower.
- In the bond markets, global government bonds continued to rally while corporate bonds showed tentative signs of recovery.

US

US stockmarkets had another volatile month, hampered by yet more disappointing economic data. However, markets ended the year on a note of optimism as investors scooped up bargains, with a rally in the final week of the year putting the S&P 500 just inside positive territory for the month in dollar terms. While the US government bailout of the auto sector provided some support to the market, energy stocks had a particularly difficult month as the price of oil fell to below \$36 per barrel for the first time since July 2004. On the economic front, disappointing new home sales and the weakness in consumer spending continued to provide cause for concern. Worryingly for policymakers, US unemployment also appeared to be rising rapidly. The Federal Reserve reacted by cutting interest rates to between 0 and 0.25%, while promising to use 'all available tools' to combat the global financial crisis and the threat of a prolonged recession.

Eurozone

European equities were broadly flat in euro terms during the month. At the beginning of December, equity markets rallied following the European Central Bank's decision to cut interest rates by 75 basis points. However, the slowdown in the global economy continued to subdue sentiment, driving investors into the relative 'safe haven' asset classes. Energy-related stocks were the worst hit as the oil price dipped to below \$36 a barrel before the Israeli attacks on Gaza began to raise supply-side concerns. Interest rates across Europe were slashed during the month, as the deteriorating economic outlook prompted central banks to take a more aggressive approach to combating the slowdown. The EU also proposed a €200bn fiscal stimulus package to cushion the effects of the credit crisis.

UK

UK equities performed well in December, in contrast to the dismal performance of the autumn months. While there was a continuing stream of disappointing economic news, the global authorities attempted to tackle the crisis head on with monetary easing and increases in fiscal spending. With policymakers now more concerned about the prospect of deflation rather than inflation, the Bank of England cut UK interest rates by 100 basis points to just 2%. During the month, new data indicated a relatively sharp contraction in UK manufacturing and industrial production, although UK retail sales figures held up better than expected. Given the challenging economic outlook, the financials and



resources sectors (oil and mining) continued to struggle. Defensive sectors such as pharmaceuticals, food, and tobacco outperformed.

Japan

Japanese equities made up some ground in December, after the Japanese authorities announced a raft of measures aimed at kick starting the economy. Economic news was particularly poor with exports registering their largest year-on-year decline in 50 years, while consumer confidence hit a fresh low and capital expenditure fell faster than expected. The Tankan business survey showed that sentiment among big manufacturers had fallen at the fastest rate in over 30 years and Toyota issued its second profit warning in two months. However, the government and the Bank of Japan announced a range of measures aimed at restarting lending and boosting the economy, including an interest rate cut from 0.3% to 0.1%. The yen once again strengthened considerably over the month, although a modest easing in the closing stages provided a boost to export stocks.

Asia (ex Japan)

Asian equities rebounded in December, as governments across the world introduced fresh measures to combat the recession while central banks continued to aggressively cut interest rates. India was among the best performing Asian markets, helped by its government's plans to increase spending and cut taxes, as well as the country's rapidly falling interest rates. Chinese equities also performed well with the Bank of China announcing interest rate cuts in an effort to tackle the pronounced slowdown in the country's economic growth. In China, falling manufacturing output and the associated rise in unemployment has brought fears of social unrest. However, economists expect the Chinese authorities' significant interest rate cuts and fiscal stimulus package will begin to bear fruit by the second quarter of 2009.

Emerging Markets

Global emerging markets performed well in December, following the very disappointing performance of the preceding months. Central banks across the developed and emerging world continued to ease monetary policy, in response to the deteriorating economic outlook. This included the US Federal Reserve reducing interest rates to a target range of 0-0.25%. Indonesia and Korea were the strongest performing emerging markets over the month in US dollar terms. The Indonesian central bank unexpectedly reduced interest rates by 25 basis points, while the Korean central bank cut rates by a larger than expected 100 basis points. The energy-dominated Russian market was among the weakest performers, as oil prices continued to fall.

Global Bonds

The global economic downturn has shown little evidence of respite. Several key economic indicators, such as unemployment, consumer and business confidence have all continued to show signs of weakness. The current weakness in consumer spending is likely to exert further downward pressure on ailing economic growth. Global interest rates were slashed further, as the deteriorating economic outlook prompted central banks to take a more aggressive approach to combating the slowdown. Against this backdrop, global government bonds continued to rally over the past month. While corporate bonds have shown tentative signs of recovery, posting positive returns during December, credit spreads are still at elevated levels. Furthermore, risk aversion and volatility remain historically high.

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

| Equities (MSCI) | 1 month | | | YTD | | |
|-------------------------------|----------------|------------|------------|------------|------------|------------|
| | EUR | USD | GBP | EUR | USD | GBP |
| World Index | -5.74 | 3.26 | 10.21 | -37.25 | -40.33 | -17.39 |
| World Value Index | -6.05 | 2.93 | 9.85 | -36.74 | -39.85 | -16.72 |
| World Growth Index | -5.44 | 3.59 | 10.56 | -37.85 | -40.90 | -18.18 |
| World Smaller Companies Index | -3.16 | 6.09 | 13.22 | -38.58 | -41.60 | -19.15 |
| US | -7.53 | 1.30 | 8.11 | -33.88 | -37.14 | -12.96 |
| Eurozone | 0.22 | 9.79 | 17.18 | -44.35 | -47.09 | -26.74 |
| UK | -11.34 | -2.87 | 3.66 | -45.65 | -48.33 | -28.46 |
| Japan | -1.29 | 8.13 | 15.41 | -25.44 | -29.11 | -1.85 |
| Emerging Markets | -1.57 | 7.83 | 15.08 | -50.76 | -53.18 | -35.18 |
| Asia ex Japan | 0.32 | 9.90 | 17.29 | -49.76 | -52.23 | -33.86 |

| Government bonds (JP Morgan) | 1 month | | | YTD | | |
|-------------------------------------|----------------|------------|------------|------------|------------|------------|
| | EUR | USD | GBP | EUR | USD | GBP |
| US | -5.46 | 3.57 | 10.53 | 20.17 | 14.26 | 58.20 |
| UK | -9.82 | -1.20 | 5.44 | -13.70 | -17.95 | 13.60 |
| Japan | -2.28 | 7.05 | 14.25 | 34.63 | 28.01 | 77.23 |
| Germany | 1.77 | 11.49 | 18.99 | 12.36 | 6.83 | 47.91 |

Source: Datastream to 31 December 2008

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