Schroders
Monthly Markets Review

Overview of markets in August 2009

Highlights:

- Global markets closed slightly up after a muted month, which seemed to lack conviction in any particular direction. There was a growing sense among investors that the rally in global equity markets since March has pushed prices to such levels that a correction of some kind, or at least a slowdown in their ascent, is overdue.
- US economic data showed signs of improvement, with the unemployment rate moving lower, easing from 9.5% in June to 9.4% in July. In addition, manufacturing data, durable goods orders and industrial production figures all strengthened from previous lows. However, on the negative side, retail sales remained disappointingly weak. News from China was mixed. A solid gain in manufacturing, driven by domestic demand, and record imports of oil and iron ore seemed to bode well for economic recovery. However, overall imports and exports continued to decline, and market falls and talk of the authorities curbing loan growth caused investor jitters.
- Global government and corporate bonds generated positive returns, with credit marginally outperforming government bonds and cash.
- There was wide variation in the price movements of various commodities; oil closed marginally down for the month, whereas prices for sugar and many metals rose strongly.

US

On the positive side, sentiment on US economic recovery improved. This was helped by comments from the Federal Reserve that the worst of the downturn had passed after it acknowledged that activity is levelling off (as opposed to a slowing pace of contraction in previous statements). Bright spots included a sharp slowing in the rate of decline of GDP growth and a pick-up in housing sales, boosted by low interest rates and bargain prices (thanks to record foreclosures). However, not even the Obama administration's CARS programme (designed to kick start the automobile industry) could lift July retail sales growth into positive territory - although consumer confidence measures improved, actual spending remained anaemic.

Eurozone

European equities extended their July rally as risk appetite drove further market gains during August. Better-than-expected economic data continued to buoy investors' spirits during the month. Notably, evidence of economic growth during the second quarter, for both France and Germany, surprised economists and investors alike. In addition, business and consumer confidence improved and government incentive plans, such as the car scrappage scheme adopted by Germany and France, boosted industrial orders (which surprised to the upside, rising 3.1% month on month) and consumer spending. The European Central Bank left interest rates on hold at 1.0%, as the markets expected. Strong performance in the financials, utilities, industrials and energy sectors led the share price gains.

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UK

Despite growing cries of ‘too far, too fast’, the UK stockmarket continued to ratchet its way up during August. The support came from both encouraging economic data (with further signs of stabilisation globally and even some suggestions of improvement in relation to the UK housing market) along with a busy and generally positive results season. The UK banks played a key role in this sentiment upswing as reports from Lloyds that loan losses may have peaked provided a very positive surprise for the market. The Bank of England (BoE) kept interest rates on hold in August, as the market expected. However, the BoE decided to extend its quantitative easing programme by a further £50bn. Consumer spending remained resilient in July and retail sales data was better than the market expected in June, up 0.4% month on month.

Japan

The Japanese market showed a lack of clear direction, with investors rotating rapidly between cyclicals and defensives and tending to focus on short-term earnings-driven stock ideas. Some investors remained on the sidelines or acted cautiously, waiting for the outcome of the general election at the end of the month. Economic data showed some improvements, such as better than expected machine orders. Thanks to government stimulus spending and an increase in exports due to re-stocking, Q2 GDP growth was positive for the first time in five quarters, jumping from -11.7% year-on-year (yoy) to +3.7%. However, figures on unemployment, labour earnings and household spending were not encouraging and concern over deflation worsened after the fall in core CPI accelerated in July.

Asia (ex Japan)

After a strong July rally, which was underpinned by stronger-than-expected interim earnings announcements and a recovery in key leading indicators, global equity markets slowed down noticeably in August. It should not come as a surprise that emerging market equities have fared the worst during such periods of investor pull-backs. With China leading the sell-off, Asian equities posted negative returns over the month in the wake of the ongoing volatility in Chinese stocks, which were shaken by continuing fears of government curbs on lending. Asian bank stocks were hit hard, as were the Taiwan and Hong Kong markets. However, credit-sensitive markets and markets that benefit from stronger US growth, such as Korea, advanced. Across sectors, information technology and healthcare were the best performing areas, while telecoms and financials were the weakest.

Emerging Markets

Emerging markets underperformed global equities during the month following strong recent returns, with investor concerns about the potential for policy tightening in China weighing on sentiment. China was the weakest performing emerging market in August with investors concerned about the impact of government measures to curb investment and credit growth, given the strength of the domestic economy. Data was released showing new loan creation slowing to -6.8% yoy in July following recent strong growth. Taiwan, Chile and Israel also underperformed. In Taiwan, the weakness of the Chinese market weighed on sentiment, as did the severe damage caused by Typhoon Morakot (although the overall impact on the economy is expected to be relatively limited). Hungary, Turkey and South Africa outperformed, with the central banks in each country cutting interest rates by 50 basis points. Mexico also outperformed, buoyed by investor confidence about the prospects for economic recovery in the US.

Global Bonds

Global economic data showed signs of improvement. For example, US existing home sales rose to 7.2% and an employment report for July beat expectations. As a result, some economists raised US GDP growth forecasts for the second half of 2009 and into 2010. However, on a negative note, consumer spending and retail sales data remained weak. In Europe, GDP data released in mid-August showed that both the French and German economies had officially emerged from recession in the second quarter of 2009, with both economies reporting flattish growth of 0.3% for the period. Against this background, global government bond prices rose in August, despite continuing concerns over increasing levels of supply. In addition, corporate bonds generated positive returns, due to surprisingly strong economic data, although performance was more muted than recent months. Credit marginally outperformed government bonds and cash.

Overview – Total Returns (%) – to end of August 2009

	1 month			YTD		
Equities (MSCI)	**EUR**	**USD**	**GBP**	**EUR**	**USD**	**GBP**
World Index	2.92	4.17	5.96	16.92	20.70	6.47
World Value Index	4.75	6.03	7.85	16.75	20.53	6.33
World Growth Index	1.06	2.29	4.05	16.93	20.71	6.49
World Smaller Companies Index	4.85	6.13	7.95	28.64	32.80	17.15
US	2.23	3.48	5.26	11.81	15.43	1.83
Eurozone	5.61	6.89	8.73	20.00	23.88	9.28
UK	4.27	5.54	7.35	26.31	30.40	15.03
Japan	2.69	3.94	5.73	7.79	11.28	-1.84
Emerging Markets	-1.53	-0.33	1.38	46.40	51.14	33.33
Asia ex Japan	-4.39	-3.23	-1.57	44.04	48.70	31.17

	1 month			YTD		
Government bonds (JP Morgan)	**EUR**	**USD**	**GBP**	**EUR**	**USD**	**GBP**
US	-0.26	0.96	2.69	-6.30	-3.27	-14.66
UK	0.85	2.08	3.83	10.77	14.35	0.88
Japan	2.03	3.27	5.04	-5.25	-2.18	-13.71
Germany	0.35	1.57	3.32	1.26	4.53	-7.78
Corporate bonds (Merrill Lynch)	0.94	2.16	3.92	12.36	16.00	2.33

Source: Datastream to 31 August 2009

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